DOUBLE TAXATION AGREEMENTS IN KENYA: A COMPARATIVE ANALYSIS OF THE EFFECTIVENESS OF THE OECD AND UN TAX TREATY MODELS.

Submitted in partial fulfilment of the requirements of the Bachelor of Laws Degree, Strathmore University Law School

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Declaration

I, SOPHIE DIANA GAI, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed: .....

Date: .....

This dissertation has been submitted for examination with my approval as University Supervisor.

Signed:.....

MS. MERCY MBOVI MBITHI

DEDICATION

I would like to dedicate this dissertation to my loving family members who have been with me through the journey, offering support and encouragement when the road was not easy and to all students who work effortlessly so that they may graduate. Most of all, I dedicate this work to the Almighty who provided me with the spirit to keep going.

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ABSTRACT

As a developing country that is wallowing in immense debt, Kenya has no option but to rely on all the revenue it can generate to drive development. Tax revenue plays a great deal in this since it is a major source of revenue for the country. About 90% of Kenya's total revenue is derived from tax.[1] According to a report, Kenya's revenue portfolio is significantly driven by tax revenue.[2] On July 2018, Kenya's tax revenue was reported at $952.895 million.[3] Kenya has adopted the provisions of the OECD and UN Tax Treaty Models to protect itself from tax abuse when entering DTAs. However, Kenya loses some rights to tax foreign investors because of incorporating certain Models' provisions in its DTAs leading to loss of revenue.

This study has examined the OECD and UN Treaty Models and how their various Articles are incorporated into selected Double Taxation Agreements ratified by Kenya. Kenya's taxation rights vary in different DTAs with some DTAs being adopted based on the OECD Model, some on the UN Model and some on both Models. This shows that DTA provisions are all dependent on how they are negotiated, meaning that in some instances, Kenya intentionally gives up its double taxation rights. By drawing lessons from the application of these Articles in DTAs, this study gives recommendations on measures that can be taken to more effectively secure Kenya's tax base.

[1]Smith A, *An Inquiry into The Nature and Causes of The Wealth of Nations*, Pennsylvania State University, Electronic Classics Series Publication, Hazleton, 2005, 676 – 677.

[2] ICPAK, *Annual Budget Implementation Review Report 2016/2017,* April 2018,2.

[3] https://www.ceicdata.com/en/indicator/kenya/tax-revenue on 28 February 2019.

LIST OF ABBREVIATIONS

OECD- Organization for Economic Co-operation and Development

PE- Permanent Establishment

UN- United Nations

BO- Beneficial Ownership

ATAF- Africa Tax Administration Forum

MNO- Multi-National Organisation

DTA- Double Taxation Agreement

FDI- Foreign Direct Investment

UAE- United Arab Emirates

CHAPTER 1

INTRODUCTION

According to Adam Smith, the key taxation principles include equality, equity, and certainty.[4] Taxation must be imposed in the most expedient means and the expenses of levying and amassing taxes should be nominal.[5]Adherence to these principles ought to be extended to levying of taxes on those engaging in international entrepreneurship.[6] The Kenya Income Tax Act Chapter 470 does not define what double taxation is. However, double taxation results when equivalent taxes are levied in a State by sovereign tax jurisdictions of equivalent status.[7] When similar taxes are levied in two or more States on one taxpayer with regard to the same taxable earnings or profits, for example, where income is taxed in the Source Country and in the residence country double taxation arises. Double taxation is juridical if taxes are levied on a person twice on the same revenue by two or more States. It is cost-effective when two or more persons are taxed on an equivalent thing.[8] It discourages foreign investors from trading in the country. To rectify this, States adopt Double Taxation Agreements (DTAs) to provide an incentive to investors hence encouraging Foreign Direct Investment (FDI).

DTAs are agreements between countries that set down different rules which specify a country's taxing rights over a resident to ensure that tax is not imposed on the same type of income twice.[9] They are meant to promote trade across the border and foreign investment by distinguishing the taxation rights of different States. However, double taxation has been said to harm the advancement of economic dealings among some States in the trading of goods and services as well as the transfer of resources and labor.[10] This is because they may be more inclined to further one Contracting party's rights over the other's.

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[4] Smith A and Cannan E, *Wealth of Nations*,18ed, Bantam Classic, New York, 2003, 639.
[5] Waris A, *"Taxation without Principles: A Historical Analysis of the Kenyan Taxation System*", Kenya Law Review, Nairobi, 2007, 272-304.
[6] Mugo J, *The Need for Double Taxation Agreement Legal Adoption Process: Living up to the Imperatives of the New Constitution of Kenya 2010*, Published LLM Thesis, University of Nairobi, 2010, 2.
[7] https://www.oecd-ilibrary.org/docserver/9789264218789-5 en.pdf?expires=1578550832&id=id&accname=guest&checksum=CF2DCF88645CD709AEABC9DBC9A9E070 on 7 January 2020.
[8] http://www.oecd.org/ctp/glossaryoftaxterms.htm on 28 November 2019.
[9] http://www.oecd.org/dataoecd/33/0/1904176 pdf on 26 on 26 November 2019.
[10] http://www.oecd.org/dataoecd/33/0/1904176 pdf on 26 on 26 November 2019.

BACKGROUND OF THE STUDY

Typically, to eliminate double taxation, States enter into DTAs amongst themselves. The Organization for Economic Co-operation and Development (OECD) plays an important role in shaping these DTAs because it produces a Model Convention that is frequently updated and serves as a template for many bilateral treaties. However, the OECD Model has been a subject of debate in developing countries because it favors rich Nations by emphasizing the rights of the investor's resident State (usually a rich Nation) to levy the taxes.[11] A variant of this Model known as the United Nations(UN) Model which is more amenable to developing countries' interests has been produced. It is a more preferable Model because it prioritizes the taxing rights of the State where the economic activity is actually undertaken.[12]

Nonetheless, both Tax Treaty Models only offer a Model for the bilateral trade of data among tax authorities of States. These Models have some similar Articles. This will be witnessed in Chapter 3 of this paper. For instance, Article 26 of the OECD provides for the exchange of information which is `foreseeably relevant' for the `administration or enforcement of taxes of every kind', and it now requires each party to use its powers to obtain and provide such information even if it is not needed for its own tax purposes.

Moreover, States may maintain or introduce other restrictions on the procedures for obtaining or supplying information. For example, some States consider that before any information is supplied, the person concerned must be notified of the request, and be given an opportunity to object. This could give tax evaders ample opportunity to cover their tracks.

Kenya largely relies on tax revenue as a driving force for development. In fact, taxes are the greatest source of revenue to the government with the contributions of Multinational Organizations (MNOs) hosted by Kenya and Gross Domestic Product generally being considered the most significant.[13]

[11] Rixen T, *The Political Economy of International Tax Governance*, Palgrave Macmillan, Basingstoke,2008, 101-104.
[12] Rixen T, *The Political Economy of International Tax Governance*, 101-104.
[13] European Commission, *Transfer Pricing and Developing Countries***,** 2011, 9.

Approximately 20% of taxpayers in Kenya contribute 80% of domestic tax revenue with the remaining 20% category being foreign investors.[14] Kenya has, therefore, entered into Double Taxation Agreements (DTAs) with other countries, especially developed countries, in order to attract foreign direct investment(FDI) by subsequently dealing with the issue of double taxation giving foreign investors surety.[15]

STATEMENT OF THE PROBLEM

DTAs play a crucial role in providing certainty for the taxation regimes for foreign investors in foreign countries, through alleviation of the problem of double taxation on the same income. They may nonetheless constrain a government's effort and ability to raise public revenue to finance its expenditure since they may limit taxation rights placing a heavy financial burden on citiens.[16]

As a country largely relying on tax revenue, Kenya may be disadvantaged by the provisions of certain DTAs since they leave room for treaty abuse and even take away taxation rights. An example of such a DTA is the Mauritius-Kenya DTA which the Court recently rendered void. Further, the OECD Model moves further taxing powers to capital exporting countries while the UN treaty reserves more for capital importing countries.[17]This leads to developing countries like Kenya signing away their taxation rights since adopting some provisions of these tax Models limits their taxation rights over international investment.

OBJECTIVES

This study examines the effects of adopting certain provisions of the OECD and UN Treaty Models in selected DTAs signed by Kenya.

It proves that Kenya signs away some of its taxation rights by being party to the OECD and UN Treaty Models placing a heavy financial burden on taxpayers.

It is, therefore, important because it suggests reforms that can be made on some of the provisions of the OECD and UN Models so that parties adopting those provisions in DTAs may not be

[14] European Commission, *Transfer Pricing and Developing Countries***,** 2011, 10**.**
[15] Ahmed S and Giafri R, The Role of Double Taxation Treaties on Attracting Foreign Direct Investment: A Review of Literature, *6 Research Journal of Finance and Accounting 12*, 2015, 1.
[16] Mugo J, *The Need for Double Taxation Agreement Legal Adoption Process: Living up to the Imperatives of the New Constitution of Kenya 2010*, 7.
[17] Daurer V and Krever R, Choosing between the UN and OECD Tax Policy Models: An African v Study, European University Institute, Global Governance Programme Working Paper Number 31,2012, 1.

disadvantaged. This thereby spearheads foreign investment and good relations among DTA Contracting countries while promoting global economic development.

RESEARCH QUESTIONS

1) What are the effects of adopting certain provisions of the OECD and UN Treaty Models in DTAs that Kenya is party to?
2) Do these provisions effectively secure Kenya's taxation rights?
3) Does Kenya sign away its taxation rights by being party to the UN and OECD Treaty Models?

HYPOTHESES

While undertaking this research, the following hypotheses are set to be tested;

1. Kenya signs away its taxation rights by adopting certain provisions of the OECD and UN Tax Treaty Models in its DTAs.
2. The OECD and UN Models attempt but do not effectively secure Kenya's taxation rights in DTAs.
3. By signing away its taxation rights through adopting certain provisions in its DTAs, Kenya loses a substantial amount of tax revenue from FDI.

JUSTIFICATION

This study has proven that Kenya signs away its taxation rights by being party to the OECD and UN Tax Treaty Models. By signing away its taxation rights, Kenya is unable to impose certain taxes on MNOs and this leads to the loss of a substantial amount of tax revenue from FDI. It proposes reforms that may be undertaken to prevent such losses. The proposed reforms will allow Kenya to enter DTAs while adopting the provisions of these Models and benefit without losing tax revenue.

THEORETICAL FRAMEWORK

Cross-national border transactions raise a lot of questions when it comes to taxation. For instance, which country's tax policies should apply, at what rates and why would a country allow for preference for another country's policy over its own. This paper utilizes the game theory to enable understanding of why Kenya has an incentive to enter DTAs with other countries.

Many a times, the law is faced with situations in which there are few decision makers and in which the optimal action for one person to take depends on what another actor chooses. These situations are like games in that people must decide upon a strategy. A strategy is a plan for acting that responds to the reactions of others. Game theory deals with any situation in which strategy is important. It enhances the legal understanding of rules and institutions. For each player in a game to choose a strategy, the game must be characterized by players, strategies of each player, and payoffs to each player for each strategy.[18]

The study further applies the domino theory of regionalism. This theory alleges that countries are eager to liberalize regionally but are reluctant to regionalize multilaterally. This study uses this theory to show how Kenya may be influenced by other developing countries to enter DTAs.[19]

LITERATURE REVIEW

Article 2(6) of the 2010 Constitution of Kenya provides that any treaty or convention ratified by Kenya shall form part of the law of Kenya under the Constitution. This, therefore, means the OECD and UN Models bind Kenya as law and Kenya must be ready to deal with whatever negative implications that come with them.

Michael Lennard in his study comprehensively compared the OECD and UN Tax Treaty Models and the developments in their application. This study has largely relied on his paper to identify which aspects of the Models to compare and how they are applicable in the Kenyan context.**[20]**

The **Tax Justice Network** has a paper summarizing and explaining the nature of existing arrangements and standards in taxation. It attempts to evaluate whether they can effectively tackle the prevalent problems that DTAs present to Contracting countries. The paper also briefly outlines instances in which developing countries sign away their taxation rights by being party to the OECD and UN Tax Treaty Models.[21]This study has borrowed on some of the findings of that paper but dives into depth with the Treaty Models as the main focus point.

[18] Cooter R and Ulen T, *Law and Economics*, 6 ed, *Berkeley Law* Books, Berkley, 2016, 33.
[19] Baldwin R, 'A domino theory of regionalism' National Bureau of Economic Research, NBER Working Paper 4465, 1993.
[20] Lennard M, The UN Model Tax Convention as Compared with the OECD Model Tax Convention-Current Points of Difference and Recent Developments, Asia-Pacific Tax Bulletin, 2009.
[21] Tax Justice Network, Trick or Treaty? Kenya's Tax Treaty Giveaways to Tax Havens.

Hearson also conducted another study on the measurement of tax negotiation outcomes. In the study, he compared the wide discrepancies between the content of treaties signed by Zambia and Kenya during the 1970s with the finding that the latter concluded treaties that have a higher source index. However, the study provides that in the 1980s, a convergence began between the two countries because Zambia became more source based. He concluded by establishing that compared to other developing countries like Zambia, Kenya was found on the source-based end because it is a large economy.[22]This study has relied on the evidence presented by Hearson when showing instances Kenya is a resident-based or source-based country.

Klaus Vogel, in his study, considered the challenges and major concerns that arise when interpreting Double Taxation Agreements. He alleged that double taxation has become rampant because a large majority of States, in addition to imposing taxes on domestic property and economic dealings, impose taxes on property located and dealings carried out in other countries to the extent that they benefit residents. Additionally, he proposed that the OECD Model Treaty and parallel tax treaties are necessary because they provide a basis for a real mutual understanding of particular tax provisions by different States. [23] This study has used the latter notion to show instances in which the Tax Treaty Models being discussed in this paper have proven rather useful.

Sohail Bin Saghir and Rabie Najmiddin wrote on the need for double taxation to attract FDI. They emphasized that treaties can assist in extenuating ambiguity for foreign investors on the tax burdens placed on their profits and income earned in foreign countries.[24] This study has relied on this information to show how DTAs aid in providing surety to foreign investors being hosted by Kenya.

Veronika Daurer and Richard Krever have a working paper that contains an African case study on choosing between UN and OECD Tax Policy Models. The paper provides numerical data on Kenya as one of the countries included in the study. The paper establishes that Kenya has ratified eight treaties with OECD members in line with the OECD Model and lacks any services permanent

[22]Hearson M, 'Measuring Tax Treaty Negotiation Outcomes' The International Centre for Tax and Development, Working Paper Number 47, 2016, https://www.ictd.ac/publication/measuring-tax-treaty-negotiation-outcomes-the-actionaid-tax-treaties-dataset/ on 8 November 2019.
[23] Vogel K, Double Tax Treaties and Their Interpretation, 4 *Berkeley Journal of International Law 1,* 1986.
[24] Ahmed S and Giafri R, The Role of Double Taxation Treaties on Attracting Foreign Direct Investment: A Review of Literature, *6 Research Journal of Finance and Accounting 12*, 2015.

establishment recognition, making it weak as a treaty negotiator in respect to this issue.[25]This study heavily relied on the data provided by the working paper to support its findings on Kenya.

Thomas Rixen analyzed the functional scheme of international double taxation avoidance. He argued that double taxation avoidance displayed the strategic structure of a coordination game with a distributive conflict. The allocation of tax revenue is dependent on the asymmetry of investment flows between treaty partners. Since investment flows are defined dually, bilateral negotiating can best suit countries' concerns for the distribution of tax revenues and other economic benefits connected to the tax base.[26] This study has relied on this information to establish its theoretical framework.

Richard Baldwin writes on the domino theory of regionalism. He explains why countries are eager to liberalize regionally but are reluctant to regionalize multilaterally. This study has used this theory to explain how Kenya may be influenced by other developing countries to sign DTAs and why most tax treaties are bilateral rather than multilateral.[27]

This paper proves that Kenya signs away some of its taxation rights when adopting certain provisions of the OECD and UN Treaty Models in DTA thus leading to loss of tax revenue. This in turn shifts investors' financial burden to Kenyan citizens. Additionally, it gives a critical analysis and comparison of these two Treaty Models. By suggesting reforms to improve the effectiveness of these Models' provisions, this study provides useful contributions in preventing the loss of a significant amount of tax revenue in Kenya through signing away of taxation rights.

RESEARCH DESIGN AND METHODOLOGY

This paper has majorly relied on secondary sources since most of the information needed during research was found in already published works.

[25] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019.
[26] Rixen T, The institutional Design of international double Taxation Avoidance, Social Science Research Center Berlin Paper Number 8322, 2008, iii http://mpra.ub.uni-muenchen.de/8322/ on 28 February 2019.
[27] Baldwin R, 'A Domino Theory of Regionalism' National Bureau of Economic Research, Working Paper Number 4465, 1993, https://www.nber.org/papers/w4465 on 8 November 2019.

The secondary sources used were literary materials and include; legislation, judicial precedents, texts, treaties, journal articles, dissertations, relevant studies, periodicals, policy reports, working papers, economic survey, and statistical abstracts.

LIMITATIONS

Lack of access to information is the major limitation this study faced. For instance, some articles and books are costly to acquire or purchase online.

CHAPTER BREAKDOWN

Chapter one of this paper establishes the agenda of this study. It introduces the legal issues and the topic being investigated, the objectives and justification of the paper, theoretical frameworks that have been be applied, research methodology used and literature review available on the issues. Chapter two discusses the theoretical framework in detail. Chapter three constitutes of a comparative analysis of the OECD and UN Treaty Models and other alternatives to these Treaty Models. Chapter four analytically expounds on the research questions. It gives a detailed analysis of some of the DTAs Kenya is party to and how specific provisions of the OECD and UN Models incorporated in them that may lead to loss of taxation rights. It mainly focuses on the treaties between Kenya and tax havens such as Mauritius, Netherlands and United Arab Emirates. Lastly, Chapter five concisely gives a conclusion and provides recommendations on how to deal with the issues highlighted in the paper.

CHAPTER 2

THEORETICAL FRAMEWORK

INTRODUCTION TO CHAPTER 2

In this Chapter, the game theory and domino theory of regionalism are analyzed in relation to the topic of study. The game theory is relied on to show the incentives Kenya has to enter DTAs with other countries. The domino theory of regionalism shows the influence countries in the East African region have over each other when entering DTAs.

GAME THEORY

The game theory is a theory that stipulates that where a decision is to be made and there are multiple parties involved, each party will make their decision based on what the other party decides. Analogically, it is like a game of chess. Each player has to know where to move a particular piece to keep the game going and avoid being on checkmate. In a game, the parties involved are known as players, the chess moves are the strategies and the action of taking a piece from or checkmating the opponent player is the payoff.[28]

In a game of chess, the game may end either because of a checkmate or a stalemate. When it ends with a checkmate, it means that one player has won and another has lost. If the game ends with a stalemate, it means that neither player has lost or won hence resulting to an equilibrium between players. A game is in equilibrium when no player can increase his or her payoff by changing strategy, so long as the other players do not change their strategies.[29] This equilibrium is known as a Nash equilibrium. In such an equilibrium, no individual player can do any better by changing his or her behavior so long as the other players do not change theirs.[30] However, it is important to note that some games do not have a Nash equilibrium while some have several equilibria. If the equilibrium makes a player better off without making another player worse off, it is Pareto efficient.

When it comes to double taxation, the two Countries party to the treaty are the players. The provisions of the treaty and negotiations are the strategies and the benefit derived from the treaty for instance, exemption of residents from double taxation is the payoff. Double taxation lowers the

[28] Cooter R and Ulen T, Law and Economics, 6ed, Berkeley Law Books, Berkley, 2016, 33.
[29] Cooter R and Ulen T, Law and Economics, 6ed, Berkeley Law Books, Berkley, 2016, 208.
[30] Cooter R and Ulen T, Law and Economics, 6ed, Berkeley Law Books, Berkley, 2016, 36

income of Corporations and this discourages them from investing in a particular Country. As had earlier been mentioned, Kenya relies on FDI for revenue. Allowing double taxation in Kenya would thus discourage foreign investors from investing and carrying out business in the country. Hence, Kenya has an incentive to enter DTAs so as to encourage FDI. This incentive is not only for Kenya, but also for other countries.

When players to a treaty both have a good payoff from the treaty, there is a Nash equilibrium making the treaty Pareto efficient.

The terms of the treaty must be favorable to all players for this equilibrium to exist. However, Corporations may disrupt this equilibrium by engaging in treaty shopping leading other players to being worse consequently being Pareto inefficient.

Additionally, Resident countries have an incentive to limit a Source Country's taxation rights in a DTA. This is because, limiting source taxes will lower tax burden of its investors abroad.

DOMINO THEORY OF REGIONALISM

The domino theory of regionalism was established by Baldwin. It is an economic archetype that implies that an individual characteristic occurrence in a developing country causes a domino effect on other developing countries.[31] A good example of a this domino effect is when Kenya initiated the LAPSSET Corridor Program, other developing countries such as South Sudan and Ethiopia joined in to support the initiative. However, despite having support from neighboring countries, opposition was also encountered. For instance, Tanzania withdrew its support from the Program and this led to Uganda following suit. With this pattern, it may be possible that other countries party to the project may also withdraw from the Program. There are countless reasons as to why countries may be joining or withdrawing from the Program for instance, financial incapacity, lack of interest or a show of political dominance.

Firstly, examining the East African region, Kenya seems to be the most economically developed country and thus attracts a lot of foreign investors.[32]This may mean that Kenya has a very huge influence on other developing countries which are seeking to develop to its level economically.

[31] https://www.bilaterals.org/spip.php?page=print&id_article=25653 on 24 December 2019.
[32] Nyamwange M, Foreign direct investment in Kenya, University of Nairobi, MPRA Paper Number 341552, 2009, 4 https://mpra.ub.uni-muenchen.de/34155/ on 17 December 2019.

Similarly, this same logic may seem to be applicable when it comes to signing of DTAs. Let us say, for instance, Tanzania seeks to reach the same level of economic development as Kenya, Tanzania may ratify a DTA upon influence by Kenya and this in term may lead to other countries especially in the East African region ratifying the same treaty with the hope of attaining economic enlightenment and thus causing a domino effect of regionalism.

The problem with such a trend is that countries may ratify treaties that are detrimental to them out of 'peer influence' with a bid to fit in or advance economically. It is thus crucial for countries to take time and keenly examine treaties in relation to their needs before ratifying anything. Countries need understand that factors such as resources and even politics come to play when entering such arrangements. In some countries, economic development may be spearheaded by natural resource exploitation, in others, by favorable legislation that attracts investors or even by both natural resource exploitation and favorable legislation working hand-in-hand.[33]

Secondly, according to Baldwin, when a threat to profits by competing outsiders is presented, countries may be more inclined to join existing integration schemes or initiate new ones.[34] In this case, it is all a matter of competition. Analogically, there may be two brilliant students in a class competing for the top position- say student X and student Y. When X tops the class after putting in a lot of time into his studies by doing things like not going out to play during recess, Y may be inclined to start missing recess too so that they may also study and get the top position when the next results are released. In the East African region for example, Kenya's current competitors economically may be Ethiopia and Rwanda. Once Kenya realizes that either of these two countries seem to be threatening its title as 'East Africa's Economic Giant', it may decide to go through thick and thin to defend its title. This may mean even ratifying similar legislation just to stay ahead of the game.

Nonetheless, not all countries seek to reach the same level of economic development since different countries may have different strategies aiming towards economic development. For instance, Kenya is the only country in the East Africa region that has signed a DTA with United

[33] https://www.bilaterals.org/spip.php?page=print&id_article=25653 on 24 December 2019.
[34] https://www.bilaterals.org/spip.php?page=print&id_article=25653. on 24 December 2019.

Arab Emirates. Kenya has set herself strategically to attract investments from the UAE more than the other counties. [35]

According to Baldwin, countries are more driven towards avoiding losses rather than securing gains.[36] He proposes that international investment agreements may be used to explain why countries in which trade is diverted do not conclude these agreements in seclusion. Agreements concluded between two countries: a Host country and FDI Source Country increase competing countries' incentives to negotiate agreements to prevent diversion of FDI.[37]

Developing countries end up contesting amongst themselves concluding strict investment agreements despite not wanting to sign an agreement in which their capacity to impose certain requirements on foreign investors are limited by certain national provisions.

Moreover, they are expected to be more apprehensive about other countries signing agreements with key FDI source countries because of the threat of FDI diversion. As a result, pressure to prevent FDI diversion among developing countries only leads to more losses than gains with developed countries FDI source countries as the only ones enjoying gains.

[35] https://www.standardmedia.co.ke/article/2001246524/kenya-woos-uae-investors-with-new-tax-agreement on 2 January 2020.
[36] Baldwin R, 'A domino theory of regionalism' National Bureau of Economic Research, NBER Working Paper 4465, 1993,4.
[37] https://www.bilaterals.org/spip.php?page=print&id_article=25653 on 20 December 2019.

CHAPTER 3

A COMPARATIVE ANALYSIS OF THE UN AND OECD TREATY MODEL

INTRODUCTION TO CHAPTER 3

This Chapter defines what DTAs are, gives a brief history of the OECD and UN Treaty Models. Thereafter, specific Articles of the Models are critically compared, highlighting their similarities and differences. The intention of the comparison is to show how certain Articles in either Models may be more advantageous or detrimental in contrast to each other. It also aims to present how both Models have been developed over time and instances in which they still fall short. Additionally, this Chapter touches on the ATAF Model in relation to the Articles of the OECD and UN discussed herein.

DOUBLE TAXATION AGREEMENTS (DTAs)

As earlier defined, DTAs are agreements between countries that set down different rules which specify a country's taxing rights over a resident to ensure that tax is not imposed on the same type of income twice.[38] There are two major forms of double taxation: economic and juridical. Economic double taxation occurs when the same income, in the hands of different taxpayers is taxed by multiple countries. For example, if an individual runs a company in Kenya and it has a branch in Uganda, economic double taxation occurs when both Kenya and Uganda tax that same company. Juridical double taxation occurs when the same income, in the hands of the same taxpayer, is taxed in multiple countries. For instance, a Kenyan citizen working in Uganda is taxed in both Kenya and Uganda.

According to Eric Neumayer, double taxation discourages international trade, FDI and slows down economic growth. Adopting DTAs helps to promote foreign direct investment by distinguishing the taxation rights of different States, eliminate double taxation and enable exchange of tax information among tax authorities. So far Kenya has entered into about 14 DTAs.

[38] http://www.oecd.org/dataoecd/33/0/1904176 pdf on 26 on 26 November 2019.

ESTABLISHMENT OF THE OECD AND UN TREATY MODELS

The OECD Treaty Model was 'first drafted in 1963 when only a few dozen tax agreements were in force. It was aimed at facilitating bilateral negotiations between countries and harmonize bilateral conventions for the benefit of both taxpayers and national administrations. More than 3000 tax treaties in force around the world are based on the OECD Model. Kenya was the 94th country worldwide and 12th country in Africa to join the OECD Model Convention.[39]

The UN Treaty Model was developed to provide guidance to countries in designing DTAs, as well as in applying and interpreting them. It was developed in 2011.

Tax treaties vary a lot from country to country. This means that the definition of certain terms in DTAs depend on the countries party to the treaty. There have been instances where parties to a treaty have conflicted on the definition of terms.[40] However, the adoption of the UN and OECD treaty Models has helped bring clarity on such issues. These Models basically provide a standard reference point during times of such conflict.[41] Not only do these Models deal with definition matters, they also deal with many other meticulous matters. For instance, certain types of taxes may be imposed in one treaty party and not in the other. Nonetheless, like any other law formulated by man, they are not perfect and have their shortcomings.

For the basis of this chapter, specific Articles have been selected based on past authorship on the topic. This is mainly because analyzing all the Models' Articles would be bulky and some Articles may not be relevant to this paper. The chapter will be largely based on selected Articles of both Models which have been considered by scholars to be problematic. Additionally, it is important to note the concurrence of the Article sub-headings in both Models. This may have come about because the UN Model is to a great extent based on the OECD Model due to the experience inherent in the application of the OECD Model and also because the OECD Model was already familiar to and used by many States when the UN issued its Model convention.[42]

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[39] https://www.oecd.org/tax/treaties/tax-treaties-2017-update-to-oecd-Model-tax-convention-released.htm on 23 December 2019.

[40] Vogel K, 'Double Tax Treaties and Their Interpretation' 4, International Tax and Business Lawyer, 1986, 29.

[41] Tax Justice Network, Trick or Treaty? Kenya's Tax Treaty Giveaways to Tax Havens, 3.

[42] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 9.

ARTICLE 5-PERMANENT ESTABLISHMENT

In both Models, this Article deals with Permanent Establishments. It seeks to preserve the taxation rights of Source countries. However, the UN Model does a better job at this than the OECD Model. The former deals with the economic ties deemed necessary before a Source Country may exercise its taxation rights under the Treaty while the latter does not.

In the UN Model, the duration test for building sites is six months while in the OECD it is twelve months.[43] The UN Model proves more advantageous in this case because countries do not have to stay long periods before taxation of MNOs commence. Kenya, in a majority of its DTAs, seems to stick to the duration stipulated by the UN Model rather than that of the OECD.[44] However, this may sometimes disincentive investors from setting up PE and they may be more inclined towards the provisions of the OECD over the UN during treaty negotiations. Something interesting to note with the OECD practice, however, is that 12 month duration is only applicable for building sites and in most instances, a 6 month period has been applied where only a place of business exists.[45]

The UN Model also provides for PEs for services, something that is not provided for under the OECD. It states that, "The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period."[46] Kenya has incorporated the provisions of the UN Model in only about 6 out of 16 DTAs. This shows that it is more inclined towards the provisions of the OECD Model.[47]

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[43] Article 5(3)(a), UN Tax Model Convention.
[44] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019, 8 .
[45] Lennard M, 'The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments' Asia-Pacific Tax Bulletin, 2009, 4.
[46] Article 5(3)(b), UN Tax Model Convention.
[47] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019, 10 .

The OECD does not have any specific stipulations on provision of services but rather treats services similar to provision of goods.[48] Conversely, this is not applicable to shipping, air transportation, artists and sportspersons. This is questionable since some performers are usually paid a lot of money for a single performance that can sustain a full economic cycle while for other service providers this may take a while.[49]

The UN Model is more favorable to developing countries in this case since it recognizes that presence is not enough for taxation of services by the host country. The UN Model aims to promote inter-nation equity to Source countries.

Developing countries are disadvantaged by the OECD provision since they are unable to easily determine gross revenues of foreign investors during certain periods of activity. The provision is disadvantageous and difficult to administer efficiently. Determining gross revenues is relevant for the host country to know whether more than 50% of business' revenue is resultant from the services offered by the non-resident within the country.

Further, the UN Model provides that delivery activities are enough to constitute economic activity in a Host Country and enable taxation by the Source Country. This is not the same position in the OECD. The existence of a supply of goods due for delivery allows for their sale leading to profits and provides an incessant link with the Source Country may be subject to taxation in the Source Country and may be deemed to establish a PE. In practice, however, this provision may be difficult to implement since it is necessary to determine the total income ascribed to the PE and this may not in most cases generate copious taxable income. Additionally, PEs which only deal with delivery are most of the times apportioned trivial amounts of income.[50]

[48] Lennard M, 'The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments' Asia-Pacific Tax Bulletin, 2009, 5.
[49] Lennard M, 'The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments' Asia-Pacific Tax Bulletin, 2009, 4.
[50] Article 5, UN and OECD Tax Treaty Models.

ARTICLE 7-BUSINESS PROFITS

The UN Model has a provision for the 'force of attraction rule'. The provision states that, "If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment;
(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment."[51]
This rule differs in the OECD Model. The UN Model allows for particular profits that are not attributable to the PE but are related to the sale of comparable goods in the Source Country to be taxed. This rule only applies to business profits. Sale of goods through independent commissioned agents and purchase activities are not taxable under this rule. Most treaties, for instance, the Netherlands-Kenya treaty as has been discussed in the subsequent chapter, do not usually incorporate this rule since they do not wish to tax income from activities unrelated to an establishment that cannot be deemed to amount to a PE. This is because adopting such a provision would create uncertainty and disincentivize investors.

Treaties, such as the Mauritius-Kenya treaty, that implement this rule may benefit administratively since it would not be mandatory for Source Country taxation to conclude whether certain activities or incomes derived are related to the PE. There is usually preference for this rule because it allows the exercise of acceptable and moderately conservative taxation rights despite difficulty in attribution of income. Moreover, this provision makes the UN Model favorable because it gives some clarification on how deductions are to be treated when determining profits of a PE.[52]

[51] Article 7(1), UN Tax Treaty Model.
[52] Article 7, UN and OECD Tax Treaty Models.

ARTICLE 10-DIVIDENDS

The UN Model does not specify the maximum withholding tax that may be imposed on dividends in a Source Country but allows for room for negotiations amongst parties to a treaty. The OECD provides that a 5% maximum tax rate will apply to FDI dividends and a 15% maximum to portfolio investment dividends. Countries that go by the UN Model usually have higher maximum dividend tax rates compared to those that follow the OECD. The limit required to qualify for FDI and thus lower withholding tax rates under the UN Model is lower than the OECD by about 15%. This is so because in some developing countries, non-residents cannot have more than 50% share ownership and therefore, 10% is seen as reasonable for FDI classification. This 50% share ownership is a mandatory requirement in Kenya except where there is a treaty exemption.[53]

Kenya has proven successful at negotiating withholding tax rates higher than 15 % in more than half of their treaties. However, the higher rates are found in the treaties signed with OECD countries. The only DTA with a withholding rate lower than 10% is the India-Kenya DTA.[54]

ARTICLE 12-ROYALTIES

Under this Article, the UN Model provides that taxation of royalties will be done in the Source Country if the income arises from there. The OECD provides contrary to this; that royalties should be taxed in the Resident Country. However, almost half of the countries party to the OECD ascribe to the UN Model approach.[55] The taxing of royalties is based on the inkling that the country in which intellectual property is being used should tax profits derived by the owner from such utility. Both Models, however, do not define what entail royalties leading to obscurity in interpretation.[56] However, the commentaries on both Models come to the rescue by complimenting this Article and giving more clarity on the matter.

[53] Article 10, UN and OECD Tax Treaty Models.
[54] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019 ,13 .
[55] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019, 15.
[56] Article 12, UN and OECD Tax Treaty Models.

ARTICLE 13-CAPITAL GAINS

The OECD provides that capital gains should be taxed upon isolation of shares that accrue more than 50% of their direct value or derived indirectly from the disposal of immovable property found in the other Contracting State and may be taxed there. The UN Model is more clear on this as it indicates who and how the 50% provision is to be applied. It also provides that gains may be taxed after the isolation of shares of a company which is a resident in another State based on an agreement of shareholding whether directly or indirectly.[57]

ARTICLE 21-OTHER INCOME

The UN Model under this Article provides that other incomes will be taxed in the Source Country where they arise. This adds to the provisions of the OECD to allow the country in which the income is generated to tax it but only if domestic law allows for the country to do so. Only allowing the Resident Country to tax other incomes would be unfair in terms of inter-nation equity since it would disadvantage the Source Country if the incomes arise from there. Also, this is more convenient since it helps minimize any instances of double taxation.[58]It is interesting to note that Kenya has given away its source taxing rights in a majority of its treaties with OECD countries, but retained them in its treaties with most African and non-OECD countries.[59]

ARTICLE 27-ASSISTANCE IN THE COLLECTION OF TAXES

Both the OECD and UN Model concur in terms of mutual assistance. They both provide that parties to the Model Conventions will aid each other in the collection of revenue claims. This is agreeable because it promotes mutual cooperation among party States. Previously, the UN Model had no such provision. However, now it even recognizes that developing countries should not be burdened with the implementation if this provision when they lack financial capacity to do so.[60]

[57] Article 13, UN and OECD Tax Treaty Models.
[58] Article 21, UN and OECD Tax Treaty Models.
[59] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019 ,17.
[60] Article 27, UN and OECD Tax Treaty Models.

OTHER EXISTING TAXATION MODEL CONVENTIONS

AFRICA TAX ADMINISTRATION FORUM TAX MODEL CONVENTION

The ATAF Model was drafted by the Africa Tax Administration Forum based in Pretoria, South Africa. Its intended objectives were to provide an approach to African States for the avoidance of double taxation and prevention fiscal evasion with respect to the taxes on incomes. For the ATAF, taxation is essentially about people and their relationship with the State. The way taxes are raised has an impact on the economically active–the employed, corporations, small business, traders and consumers. Tax administrations have the potential to be a force for development, state-building and social cohesion, making a difference to the lives of millions of Africans across the length and breadth of the continent. This is why the establishment of ATAF is a cause for hope for Africa as it wrestles with the social, economic and political challenges of the 21st century. There are about 25 African countries that are party to the ATAF Model, Kenya included.

It generally follows the UN and OECD Models so it is almost similar to them in multiple ways. However, in some instances, it has proven more efficient that the OECD and UN Models. This paper will give a few instances in which the ATAF Model has proven more efficient based on the DTAs earlier discussed. Effective, efficient and capable tax authorities able to mobilize domestic fiscal resources are essential if they are to provide governments with sustainable, domestically-generated revenue, thereby reducing the reliance on foreign investment and development aid. This will give African states the fiscal space to determine spending priorities in line with their own national objectives and socio-economic needs.[61]

Firstly, its provisions on building sites are similar to those of the OECD Model. It also provides that where services have been carried out in a Contracting State for 6 months and within a 12 month timeframe, a service PE will be created. Secondly, for business profits, it has been drafted in accordance to the OECD Model.

Thirdly, its provision on taxation of dividends stipulates that for there to be Beneficial Ownership (BO), an individual has to have a shareholding of at least 10% of the share capital.[62] Beneficial Ownership is the unconstrained right to use and enjoy the dividends, interest or royalties of a

[61] https://oecdobserver.org/news/archivestory.php/aid/3133/African_tax_administration:_A_new_era.html
[62] Article 10(2), Africa Tax Administration Forum Tax Treaty Convention.

company. However, it does not specify the maximum rates that ought to be applied. These rates are thus left to the determination of the States party to the DTA.

Fourthly, the ATAF Model has a provision on technical fees which is not encompassed in the OECD and UN Model. It defines what technical fees entails and this makes it advantageous over the Models. Fifth, it contains the same provisions for the taxation of royalties as those in the UN Model. Additionally, it is more favorable because unlike the other Models, it is more comprehensive. It gives details on what royalties are and what they entail. Sixth, it takes a credit method approach for the elimination of double taxation. This approach requires that foreign-sourced income be taxed where it is sourced with the tax paid being deducted abroad.

Based on observation, most of the provisions of the ATAF Model seem to be in concurrence with those of the UN Model.

CHAPTER 4

APPLICATION OF FINDINGS

INTRODUCTION TO CHAPTER 4

In this Chapter, the incorporation of the Models' Articles analyzed in Chapter 3 in three main treaties; Mauritius-Kenya(which was nullified by the Court), Netherlands-Kenya and United Arab Emirates treaties is examined. According to the Financial Secrecy Index (FSI) 2018, UAE and Netherlands are scored highly on their levels of secrecy hence the basis of their use in this study. UAE has been ranked number nine with a secrecy score of 84% while Netherlands has been ranked 14 with a secrecy score of 66%. Further, the taxation regime of the two countries has been characterized with low tax rates subsequently being classified as tax havens. Tax havens will usually negotiate for low tax rates which may be like the existing domestic rates while the country with higher tax rates will be pushed towards the low tax rates hence affecting revenue collection for the high rate state. DTAs with tax havens present the challenge of the harmful practices relating treaty shopping, round tripping and other forms of treaty abuse.[63]

[63] Tax Justice Network, Trick or Treaty? Kenya's Tax Treaty Giveaways to Tax Havens, 7.

The Mauritius-Kenya treaty is used to show the shortcomings that may lead to the nullification of a DTA. However, it is important to note that the DTA between Kenya and Mauritius was deemed unconstitutional in 2019. The treaty was invalidated because the government had failed to follow the right ratification processes. It had been signed in 2012 to avoid double taxation of companies set up in Mauritius but instead ended up reducing tax rates and leading to loss of revenue. The DTA encouraged formation of shell companies in Mauritius leading to treaty shopping. Treaty shopping is the scrutiny of tax treaty provisions to shape an international business deal or operation so as to manipulate a certain tax treaty. The phrase is normally applied in instances where an individual who is not a resident of the Contracting countries establishes an entity in one of the treaty countries in order to benefit from the treaty.[64] It also cut taxes on interests, royalties and administrative fees.

MAURITIUS-KENYA DTA

This treaty provided that a building site will be considered a PE after 12 months as prescribed by the OECD Model.

When determining business profits, this treaty adopted the provisions of Article 7(3) of the UN Model which provides more clarity on how deductions are to be dealt with when ascertaining what amounts to PE profits.

This treaty was based on the UN Model when it came to taxation of dividends. The BO was set at 10%. Residents with BO are subject to a maximum withholding tax of 5% on gross dividends while non-residents are subject to a maximum of 10%.

As concerns management, technical and professional fees, the OECD and UN Models are silent on taxation to be imposed. Only the African Tax Administration Forum (ATAF) Tax Model Convention provides on these. However, it is very vague since it only defines what constitutes technical fees. Neither the Netherlands nor the UAE treaties discussed below have included a provision for this either.

Taxation of royalties under this treaty was done based on the UN Model. Royalties were to be taxed based on the Source Country's domestic laws on royalty taxation.

[64] http://www.oecd.org/ctp/glossaryoftaxterms.htm on 28 February 2019.

On matters capital gains, this treaty did not espouse to the provisions of the UN or OECD Models. This means that there is no means of disposal of shares where entities are linked directly or indirectly by association.

Other incomes under this treaty were taxed based on the UN Model which provides that these incomes will be taxed in the Source Country based on its domestic laws.

To eliminate double taxation, this treaty proposed that foreign residents be spared from paying taxes. This means that Kenya should not tax income and that the foreign residents should only be taxed in their initial countries of residence. This approach is unsuitable since it causes Kenya to lose a lot of income in terms of tax revenue.

NETHERLANDS-KENYA DTA

This treaty provides that a building site will be considered a PE upon the lapse of 9 months. This is less than the 12 months prescribed by the OECD Model and 3 months more than what is prescribed in the UN Model.

In terms of business profits, this treaty has adopted the provisions of the OECD Model. However, this presents a challenge. There is no clarity on how deductions should be handled when determining what amounts to PE profits since the provision is ambiguous.

This treaty embraces the OECD provision on taxation of dividends. The OECD Model provides that residents with BO will pay a maximum withholding tax of 5% where they hold at least 25% of shares and a maximum of 15% withholding tax in all other cases. In instances where BO holds at least 10% of the capital of the parent company, no tax will be imposed on dividends.

Royalties are taxed based on the Source Country's domestic laws. This is the same approach provided for in the UN Model.

This treaty has no provision for the taxation of capital gains.

Other incomes in this treaty are taxed based on the provisions of the OECD Model. The Model provides for taxation of these incomes based on the domestic laws of the Resident Country.

To eliminate double taxation, this treaty takes a similar approach as the Mauritius treaty.

UNITED ARAB EMIRATES-KENYA DTA

This treaty prescribes that a building site will be deemed to be a PE upon the lapse of 6 months within 12 months. This treaty attempts to consolidate the prescribed durations in the UN and OECD Models respectively.

This treaty has more clarity when it comes to dealing with business profits since it also takes up the UN Model provisions on the subject just like the Mauritius treaty.

In terms of taxation of dividends, this treaty assumes the OECD Model approach but fails to provide a basis on which BO may be determined.

Taxation of royalties is in line with the provisions of the UN Model that taxation of royalties will be subject to the Source Country's domestic laws.

Similarly, just like the Mauritius and Netherlands DTAs being discussed, this treaty has no provision for capital gains tax.

Other incomes under this treaty just like in the Mauritius treaty are taxed based on the UN Model.

To eradicate double taxation, this treaty proposes the adoption of the credit method. This method entails a country exempting its residents from paying taxes on foreign source income or by including foreign source income on the tax base of its residents while allowing a credit for taxes paid to other countries.[65]

In terms of professional fees, management fees and technical fees, Kenya imposes a withholding tax of 20% while the UAE does not impose any. This is good for Kenya when it comes to securing of taxation rights. However, it might disincentivize foreign investors.[66]

[65] Lokken L and Kitamura Y, 'Credit vs. Exemption: A Comparative Study of Double Tax Relief in the United States and Japan' 30 Northwestern Journal of International Law & Business 3, 2010, 622.

[66] https://www.grantthornton.co.ke/globalassets/1.-member-firms/kenya/insights/pdf/grant-thornton-alert---kenya--uae-double-tax-agreement-1009.pdf. on 9 January 2020.

CHAPTER 5

RECOMMENDATIONS AND CONCLUSION

RECOMMENDATIONS

It is evident that Kenya has in many occasions evidenced itself as a Source Country.[67] From the analysis of the Mauritius, Netherlands and UAE treaties in the previous chapter, it can be established that Kenya relinquishes its taxing rights in respect to income taxation since investors are only taxed in their countries of residence despite operating from elsewhere. Additionally, Kenya has in some instances, such as in its treaties with Mauritius and Netherlands, agreed to bear the burden of eradicating double taxation experienced by its outward bound investors by assenting to them.

Examining the aforementioned treaties in relation to the Articles OECD and UN Models, some measures may be taken to secure Kenya's taxation rights.

Firstly, on the matter of PE, as had earlier been highlighted, there is need to consolidate the time frames under which PEs may arise in different circumstances. Since a provision for temporary absences, for instance, due to weather do not exist, a PE may still arise, leading to unfair taxation standards which seems to be against the spirit of the tax treaties. Also, anti-fragmentation rules should be introduced under Article 5 so that abuse through splitting of contracts may be deterred. A Force of Attraction rule should also be included to encompass other activities that are connected to the PE. Integration of technology in construction activities may reduce the time required for construction hence it is important to consider shorter time periods such as 3 months. Adopting the provisions of the UN Model would be more appropriate in this case since Kenya lacks services PE recognition in its treaties with OECD members making it a weak negotiator.[68]

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[67] Hearson M, 'Measuring Tax Treaty Negotiation Outcomes' The International Centre for Tax and Development, Working Paper Number 47, 2016, https://www.ictd.ac/publication/measuring-tax-treaty-negotiation-outcomes-the-actionaid-tax-treaties-dataset/. on 22 December 2019, 24.

[68] Daurer V and Krever R , Choosing between the UN and OECD Tax Policy Models: An African Case Study, Wein Universität, International Taxation Research Paper Number 16, 2014, https://epub.wu.ac.at/4356/1/SSRN-id2499980.pdf on 8 November 2019, 13.

Secondly, the provisions of taxation of business profits in treaties should adopt the Force of Attraction rule to avoid ambiguity arising from any limitations. Additionally, aside from the attempts of the UN Model to bring clarity on the treatment of deductions when determining PE profits, the OECD Model should also make such endeavors.

Thirdly, in taxation of dividends the withholding tax imposed on foreign investors should be parallel to prevent any form of prejudice and ensure the least oustering when benefitting from lowered tax rates. There should be specific yardsticks that define what amounts to BO. This can be done by clearly indicating the limitations of BO in the Company's Act. This will also prevent discretionary application of treaty provisions thus promoting fairness. However, the challenge with this is that it may take a lot of lobbying and resources to incorporate such measures. Fourthly, the treaties and UN and OECD Models should embrace the definition of what constitutes royalties as provided for in the ATAF Model to prevent obscurity in interpretation during taxation of royalties.

If renegotiation of the existing treaties is not feasible, one tool for reducing the abuse associated with royalties, dividends and interest, is to simply check whether the entity (to whom the payment is being made) meets the definition of 'beneficial owner' as required by the treaty. If the definition is not found in the treaty, it may be attained through;

i. Reference to the UN or OECD Model commentaries,
ii. Reference to the domestic tax law definition via the employment of Article 3 (2) (if available), or
iii. Through Article 25 (3) found in both the OECD and UN Models which provides for the mutual agreement procedure to be used in situations where doubts arise as to the interpretation or application of the treaty.

This analysis of the various Article 12 provisions in the OECD and UN Models, should allow Kenya to make an informed decision about which text fits best for their situation.[69]

Fifthly, just as the ATAF Model provides for what is and what constitutes technical fees, the treaties and UN and OECD Models should purpose to incorporate a similar provision. This

[69] https://www.ciat.org/taxing-service-payments-and-royalties-under-the-oecd-and-un-Model-tax-conventions/?lang=en

purposes to prevent ambiguity and ensure taxation rights on incomes in future is distributed more fairly. Domestic laws should be applicable as agreed upon by parties in case of ambiguities.

Sixth, the UN Model seems to be more detailed when it comes to matters of capital gains. Article 13(4) and 13(5) should be adopted in the treaties to limit possible abuse. This will also give Kenya an opportunity to tax gains from the disposal of immovable property and disposal of shares originating from Contracting States.

Seventh, sometimes other income arises from the Contracting States but ends up being taxed elsewhere. Such incomes should be taxed in accordance to the domestic laws of the State in which the income arises to prevent incidents of double taxation. This can be implemented by incorporating Article 21(1) and 21(3) of the UN Model into the Netherlands-Kenya treaty since the others have already done this.

Lastly, to eliminate double taxation, countries should consider the taxes paid to the other States of operation. This means the implementation of a unilateral tax relief regime. Relief from the effects of double taxation should be granted on the basis of domestic legislation rather than treaty provisions.

Some steps taken in countries like the United States of America (USA) to do away with double taxation include allowing credit for taxes paid overseas and discharging foreign source income from being taxed domestically.[70]USA also has its own Tax Treaty Model.

Largely, Kenya should consider renegotiating provisions deemed unfavorable in its DTAs with other countries. However, this recommendation may be limited by financial constraints. Additionally, a lot of time and expertise will be required because of the treaty making and ratification process.

CONCLUSION

In conclusion, it can be found that despite having their own shortcomings, the OECD and UN Models are proving to be good causes in securing Kenya's taxation rights. Kenya has incorporated most of the provisions of both Models in its DTAs with other States. However, more can be done to improve the provisions of these DTAs and prevent Kenya from eroding its tax base or

[70] https://tax.kpmg.us/content/dam/tax/en/pdfs/2019/2019-us-taxation-of-americans-abroad.pdf on 23 December 2019.

negotiating away its taxation rights. A balance should be struck between protecting taxing rights and incentivizing foreign investors to promote FDI and it is thus up to tax administrators to ensure this. However, there is hope for developing countries such as Kenya with the establishment of Models such as ATAF. The ATAF Model proves that developing countries such as Kenya have the capability to deal with complex tax issues without relying much on legislation established by developed countries. This Model aims to effectively mobilize domestic resources and improve the accountability of States to its citizens.

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