

**THE NEED FOR DOUBLE TAXATION AGREEMENT LEGAL
ADOPTION PROCESS:
LIVING UP TO THE IMPERATIVES OF THE NEW
CONSTITUTION OF KENYA 2010**

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DECLARATION

I, **Jemimah Wangari Mugo**, do hereby declare that this thesis is my original work and has not been submitted to any other university or institution for any award. I hereby now submit the same for the award of Master of Laws Degree of the University of Nairobi.

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DEDICATION

I dedicate this work to my son, Don, for always keeping me on my toes; my sister, Becks, for being true; and my best friend and partner in life, Andrew Mwaniki. Thank you all for supporting me. I love you dearly.

TABLE OF CONTENTS

DECLARATION.....	I
ACKNOWLEDGMENT	II
DEDICATION.....	III
GLOSSARY OF ACRONYMS	VII
CHAPTER ONE: INTRODUCTION AND SETTING AGENDA FOR A GENERAL UNDERSTANDING OF DOUBLE TAXATION AGREEMENTS	1
1.1 INTRODUCTION	1
1.2 BACKGROUND TO THE STUDY.....	4
1.3 STATEMENT OF THE PROBLEM.....	7
1.4 RESEARCH METHODOLOGY.....	7
1.5 RESEARCH QUESTION.....	10
1.6 OBJECTIVES.....	10
1.7 HYPOTHESES.....	11
1.8 JUSTIFICATION.....	12
1.9 THEORETICAL FRAMEWORK	14
1.10 LITERATURE REVIEW	18
1.11 CHAPTER BREAKDOWN	21
CHAPTER TWO: THE NATURE OF DOUBLE TAXATION AGREEMENTS AND THEIR CONSTITUTIONAL BASIS.....	24
2.1 THE CONSTITUTIONAL BASIS OF THE JURISDICTION/POWER TO LEVY TAX	24
2.2 RATIONALE FOR DTAS.....	27
2.3 THE HISTORY OF DTAS (THE OECD MODEL)	29

2.4	THE NATURE OF DTAS	31
2.4.1	<i>Double Tax Agreements as International Agreements.....</i>	32
2.4.2	<i>DTAs as a means a of allocating the power to tax between countries.....</i>	35
2.4.3	<i>DTAs as a means to relieve the double tax burden.....</i>	39
2.4.4	<i>Conditions under which treaty reliefs may be claimed.....</i>	41
2.5	ADOPTION OF DTAS	45
2.6	CONCLUSION.....	48
CHAPTER THREE:..... KENYA’S APPROACH TO DOUBLE TAX AGREEMENTS		
	PRACTICE	49
3.1	TAXATION AND DTA ADOPTION PRACTICE UNDER KENYA’S 1969 CONSTITUTION.....	49
3.2	TAXATION AND DOUBLE TAX RELIEF UNDER KENYA’S NEW CONSTITUTIONAL DISPENSATION	54
3.3	PERTINENT LEGISLATION.....	57
3.4	CONCLUSION.....	59
CHAPTER FOUR: COMPARATIVE STUDY ON APPROACH TO DOUBLE TAX		
	AGREEMENTS (DTA) PRACTICE.....	61
4.1	THE UNITED KINGDOM.....	62
4.1.1	DTAS AND THEIR CONSTITUTIONALITY	62
4.1.2	LEGAL AUTHORITY AND PROCESS IN BILATERAL/TREATY RELIEF	63
4.2	THE REPUBLIC OF SOUTH AFRICA.....	66
4.2.1	TREATIES AND THEIR CONSTITUTIONALITY	67
4.2.2	LEGAL AUTHORITY AND PROCESS IN BILATERAL/TREATY RELIEF	69
4.3	INDIA	72
4.3.1	DTAS AND THEIR CONSTITUTIONALITY	72

4.3.2	LEGAL AUTHORITY AND PROCESS IN BILATERAL/TREATY RELIEF	73
4.4	CONCLUSION.....	75
CHAPTER FIVE:..... OVERALL CONCLUSIONS AND THE WAY FORWARD		
.....		77
5.1	A RECAP OF THE STUDY	77
5.2	SUGGESTIONS FOR THE WAY FORWARD.....	78
REFERENCES AND OTHER SOURCES.....		81

GLOSSARY OF ACRONYMS

AU	African Union
CGTA	Capital Gains Tax Act 1979, United Kingdom
CTA	Capital Transfer Act 1984, United Kingdom
CoK	the Constitution of Kenya 2010
DTAs	Double Taxation Agreements
ECOSOC	United Nation's Economic and Social Council
FDI	Foreign direct investment
IHTA	Inheritance Tax Act 1984, United Kingdom
ICTA	Income and Corporation Taxes Act 1988, United Kingdom
KRA	Kenya Revenue Authority
MNEs	Multinational Enterprises
OECD	Organisation for Economic Cooperation and Development
RSA	Republic of South Africa
UK	United Kingdom
UN	United Nations

CHAPTER ONE: INTRODUCTION AND SETTING AGENDA FOR A GENERAL UNDERSTANDING OF DOUBLE TAXATION AGREEMENTS

1.1 INTRODUCTION

Tax has been defined as a compulsory levy imposed by an organ of the government for public purposes.¹ Indeed, taxation has been said to be one form of revenue from the people (individuals and corporates) that is used to defray the necessary expenses of government.² Taxation is driven by various forces, that are advanced by various quarters; political, economic, social as well as administrative forces. Indeed, taxation, a political phenomenon, is the foundation of existence of state and has been called the ‘tie that binds the ruler and the ruled’.³ Globally, taxation has become one of the major means of raising public revenue to finance government expenditure.

However, the contribution to finance government expenditure through taxation must be based on a sound basic structure that free and rational persons concerned would accept. Raising revenue from the public must be founded on a firm constitutional authority. Such authority includes the power to impose taxes and charges, the power to collect as well as the power to levy taxes and related charges.⁴ For instance, in France, the French Declaration on the Rights of Man 1789 aptly founds the constitutional basis of tax thus:

¹ Geoffrey Morse and David Williams, *Davies: Principles of Tax Law*, 6th Ed. (London: Sweet & Maxwell, 2008), at p. 3

² Adam Smith, *An Inquiry Into The Nature And Causes Of The Wealth Of Nations*, A Pennsylvania State University, Electronic Classics Series Publication, Jim Manis, Faculty Editor, Hazleton, PA 18202, 2005 at p. 676 – 677, available at <http://www.econlib.org/library/Smith/smWN21.html#V.2.28>, (accessed on 19 October 2011)

³ Miranda Stewart, *Tax Reform and Development: Global and Local Politics*, Colloquim on Tax Policy and Public Finance, Springs 2004, at p. 1

⁴ Bruce A. Ackerman (1999) *Taxation and the Constitution*, 99 *Columbia Law Review*, at pp. 1-58. See also Fernando Estrada (2010) “A Reading Hayek on Power to Tax,” at <http://ssrn.com/abstract=1575864> (last accessed on March 20, 2011)., as well as Erik M. Jensen (2010), *The Individual Mandate and the Taxing Power*, Case Research Paper Series in Legal Studies Working Paper 2010-33.

A common contribution is essential for the maintenance of the public forces and for the cost of administration. This should be equitably distributed among all the citizens in proportion to their means. ... all the citizens have a right to decide, either personally or by their representatives, as to the necessity of the public contribution; to grant this freely; to know to what uses it is put; and to fix the proportion, the mode of assessment and of collection and the duration of the taxes.⁵

Adam Smith states that a tax system must be governed by certain basic tenets; the principles of taxation which are largely economics-based.⁶ He includes equity, equality, certainty, taxes must be levied in the most convenient way and the costs of imposing and collecting taxes should be kept minimal.⁷

Even in adhering to the above principles in raising public revenue by a State from within its jurisdiction, adherence to those tenets ought to be extended in levying taxes on those engaging in international entrepreneurship. In a globalized economy, international business profits resulting mainly from foreign trade and investment portfolio abroad are prone to the question of the jurisdictional scope of taxation.⁸ There are several traditional grounds of jurisdiction to tax that have been prescribed under international law.⁹ First, nationality-based jurisdiction, also known as residence-based, under which tax is levied on a person based on, for individuals, on their residence status and for legal persons, either the place of incorporation or the place of effective management and control of the legal person. Second, territorial, also referred to as source-based, where tax is levied in the country where the income has been derived from. Third, jurisdiction is also claimed as a combination of both residence and source.

⁵ French Republic, *Declaration of the Rights of Man and of the Citizen*, Approved by the National Assembly of France, August 26, 1789, articles 13 and 14

⁶ *supra*. n. 2, Smith, A. More canons (such as productivity) have been evolved in the quest for a just and equitable system of taxation. For a candid analysis of these canons especially in the historical context of Kenya, see also Attiya Waris, "Taxation without Principles: A Historical Analysis of the Kenyan Taxation System", Kenya Law Review 272-304

⁷ *Id.*

⁸ Sol Picciotto, *International Business Taxation*, (London: Weidenfeld and Nicolson, 1992) at p. 1

⁹ Reuven S. Avi-Yonah, *International Tax As International Law*, Public Law and Legal Theory, Research Paper No. 41, John M. Olin Center For Law & Economics Research Paper No. 04-007, available at <http://ssrn.com/abstract=516382> (Accessed On 28 February 2011), at p. 2, 3

Arising from the potential and practical conflict inherent in these bases on which tax is typically levied, (tax bases), which varies from one jurisdiction to another, the possibility for same income being subjected to tax more than once becomes real. This is particularly so where a person has businesses operations in more than one jurisdiction. For instance, a company resident in a particular country that practices residency bases of taxation may be subject to tax in that country on its global profits irrespective of where those profits are derived from geographically; and on the other hand, source where profits arising from a source in a particular country are taxed in that country. Thus, the problem of international juridical double taxation arises.

International juridical double taxation is defined as the imposition of comparable taxes in two or more jurisdictions, on the same taxpayer in respect of the same subject matter and for identical periods.¹⁰ Double taxation has been said to result in harm to the development of economic relations between countries in the exchange of goods and services as well as movement of capital and labour.¹¹ Without mechanisms or rules to ameliorate this position, a multinational enterprise (MNE) carrying on a trade in a number of countries is likely to suffer high tax cost.

One of the means that the international community has sought to alleviate problems of double taxation is through the negotiation and adoption of Double Tax Agreements (DTAs), which,

¹⁰ Organization for Economic Co-operation and Development Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital*, June 1998 Condensed Version, at p. 7

¹¹ Organisation for Economic Co-Operation and Development, *Harmful Tax Competition: An Emerging Global Issue*, 1998 at p. 13 para. 21 (available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>) accessed on 20 October 2011. *See also*, Voget, Johannes, Jenny Litghart J., & Vlachaki, Mina. *The Determinants of Double Tax Treaty Formation*, 2011, mimeo, Tilburg University, where the authors argue that that double tax agreements exhibit a positive and significant impact on foreign direct investment

among other matters, provide for the allocation of taxing rights in relation to profits from cross-border transactions.

1.2 BACKGROUND TO THE STUDY

Typically, a DTA is an agreement between two countries under which revenue authorities of each country grant tax concessions or reliefs to shield taxpayers operating within their jurisdictions from being liable for tax on the same tax base under both systems. These concessions do also make provision for lower withholding tax payable in one country on dividends, interest and royalties paid to a person in the other country.¹² Normally, a DTA creates rights and obligations between party/state territories, and binds persons who are residents of one or both of the contracting states.¹³ The agreement does not, of itself, create rights that citizens and residents of a contracting party can rely on and enforce unless the relevant jurisdiction gives it legal effect in its domestic law, usually through ratification.

Stated differently, DTAs focus on prevention of double taxation, through allocation of fiscal taxation rights among states. Consequently, DTAs aim at reducing taxes either in totality through exemption of certain incomes from taxation or partially through waivers and variation of tax rates.

DTAs are incorporated into Kenya domestic laws by statutory instruments made under article 2 (6) of the Constitution of Kenya, 2010 (hereinafter the “CoK”).¹⁴ This article provides that any treaty or convention ratified by Kenya shall form part of the laws of Kenya, a complete departure from the reign of the Constitution of Kenya, 1969. The legislation establishing the

¹² Public Law Company, *Withholding Tax*, available at www.practicallaw.com/A37215, accessed on 20 October 2011

¹³ Jonathan Cooklin and Emma Bailey, Freshfields Bruckhaus Deringer, *Double tax treaties: an introduction*, available at <http://tax.practicallaw.com/4-366-9968> (accessed on 21 April 2011)

¹⁴ Republic of Kenya, *The Constitution of Kenya 2010*, Nairobi, Kenya: Government Printer

mode of exercising jurisdiction in Kenya did not expressly recognize the place of international treaties, including DTAs as forming part of Kenya's legislation.¹⁵

Adoption of international treaties generally in Kenya was thus governed by customary public international law regime.¹⁶ As regards DTAs, the Minister for Finance played a critical role in their negotiation and formulation, whereas the Minister for Foreign Affairs undertook the role of how a DTA is adopted into law. Currently, Kenya has ratified nine DTAs, all under the 1969 constitutional dispensation with the following governments: United Kingdom, Germany, Norway, Sweden, Denmark, India, Canada, Zambia and more recently France¹⁷.

This study seeks to establish whether the above subsisting process in the adoption of DTAs in Kenya is due to change with the promulgation of the CoK. This is particularly so because, despite the good intentions behind entering into DTAs, they could facilitate the flight of tax revenue for governments, thus undermine efforts in revenue collections. In Kenya, tax has been recognized as the main source of revenue for the national government as per part 3 of Chapter Twelve (12) of the CoK. The CoK has gone to great lengths to correct various past mistakes in public finance sourcing, allocation, administration and accountability, as aforementioned. Indeed, under article 94 (5) of the CoK, only parliament has power to make provision having the force of law in Kenya subject to Article 94(6) of the CoK. The

¹⁵ Republic of Kenya, *Section 3 of the Judicature Act*, Chapter 8, Laws of Kenya, Nairobi, Kenya: Government Printer Section 3

¹⁶ See generally, *Vienna Convention on the Law of Treaties 1969*, done at Vienna on 23 May 1969 (Entered into force on 27 January 1980). United Nations, *Treaty Series*, vol. 1155, p. 331. Article 7, under which Ministers for Foreign Affairs are regarded as having full powers to represent their state under article 7, by virtue of their functions

¹⁷ Legal Notice No. 140, Income Tax Act (Cap 470, Laws of Kenya), Declaration for Special Arrangement for Relief from Double Taxation between the Government of the Republic of Kenya and the Government of the French Republic, 1st September 2009

constitutional basis of public finance is founded on the establishment and organization of a functional State.¹⁸

Following on the constitutional basis of taxation as per the French Declaration aforementioned, Kenya has not been left behind and has adopted the foregoing logic as a basis for levying taxation, first through a declaration of the sovereignty of the people under article 1 of the CoK and secondly the delegation of that exercise of sovereignty to their democratically elected representatives. Further, under the CoK, the power to impose taxes and charges has been expressly set out in article 209 (1). It specifically provides for the power to impose taxes and charges, by the national government and any other tax that may be authorised by an Act of Parliament. While under Article 201(b) (i) the burden of taxation shall be shared fairly, and additionally the CoK provides that taxes and charges can only be imposed, waived or varied if permitted by legislation.¹⁹

The revenue raising powers prescribed above ought to be governed by principles of public finance as enshrined in the CoK. They include: openness and accountability, promotion of equitable society where the burden of taxation is shared fairly, responsible financial management and prudent usage of public funds.²⁰ By putting the above mechanisms in place, the provision confers two benefits. First, by outrightly subjecting the waivers to stringent compliance conditions, it has potentially expanded the base of revenue sourcing. Secondly, instances of arbitrary or secretive waiver of taxes in undeserving circumstances would be minimized by dint of this constitutional provision.

¹⁸ William Niskansen, *A Constitutional Approach to Taxes and Transfers*, Vol., 6, No.1, *Cato Journal* (Spring/Summer 1986), at p. 347, available at <http://www.cato.org/pubs/journal/cj6n1/cj6n1-16.pdf>, accessed on 20 October 2011

¹⁹ Republic of Kenya, *The Constitution of Kenya 2010*, article 210, Nairobi, Kenya: Government Printer.

²⁰ *Id.*, Article 201

1.3 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.

In Kenya, the DTA adoption process was driven by the Executive. In this regard, the Minister for Finance played a critical role in their negotiation and formulation, whereas the Minister for Foreign Affairs undertook the role of how DTAs are adopted into law. Currently, Kenya has ratified nine DTAs, all under the 1969 constitutional dispensation with the following governments: United Kingdom, Germany, Norway, Sweden, Denmark, India, Canada, Zambia and more recently France

Consequently, the adoption of DTAs can no longer be at the sole discretion of the Executive, through the Minister or Cabinet Secretary in charge of finance. The coming into play of a new constitutional order calls for change in the adoption of DTAs so as to bring about accountability, certainty as well as equity.

1.4 RESEARCH METHODOLOGY

In undertaking this study, reliance has been placed on both primary and secondary sources. Primary sources will form the basis of the study, where interviews will be undertaken to establish the procedure in place in the adoption of DTAs. This is deemed necessary in absence of legal rules governing adoption of treaties in Kenya. Interviewees for this study are limited to several key persons drawn from government departments that drive the DTA adoption process in Kenya: the Ministry of Finance, State Law Office, Kenya Revenue

Authority (KRA), Ministry of Foreign Affairs and Kenya Investment Authority. Their contributions will be invaluable as it is based on their practical experience in absence of any legislation or government policy on the matter.

I have also relied on literary materials. This was undertaken to establish the constitutional basis of taxation, the nature of DTAs and how they interact with domestic tax legislations as well as the Constitution. The data sources will include, but not limited to the CoK, legislations, judicial precedents, texts, treaties, journal articles, dissertations, relevant studies, periodicals, policy reports, working papers, economic survey and statistical abstracts.

Further, and so as to evaluate some of the reforms that may be introduced in the DTA adoption process, a comparative study will be undertaken of certain jurisdictions. First, the United Kingdom provides the best bet in this area from which Kenya has to a great extent borrowed its legislations and practices due to its colonial ties.²¹ Secondly, the Republic of South Africa, which provides a case study from a continental perspective, as a member of Africa Union. Despite its legacy of many years of apartheid and only attaining independence fairly recent compared to Kenya, South Africa has emerged as the economic super power of Africa. Thirdly, the Republic of India, a country which shares history with Kenya, being a former British colony but one which has also rose to be the world's eleventh-largest economy. India is also making major investments into the country. The comparative study will be undertaken through review of literary materials.

²¹ Republic of Kenya, *The Judicature Act*, Chapter 8, Laws of Kenya, Nairobi, Kenya: Government Printer Section 3, under which the mode of exercise of jurisdiction shall be in conformity with inter alia “(b)...all other written laws, including the Acts of Parliament of the United Kingdom....(c).....the substance of the common law, the doctrines of equity and the statutes of general application in force in England on the 12th August, 1897, and the procedure and practice observed in courts of justice in England at that date.... “

The comparative method is the process of comparing different societies or groups within the same society to show whether and why they are similar or different in certain aspects.²² Comparison has been recommended where there is need to establish and explain both differences and similarities between societies.²³ In the context of international tax law and, particularly, the law of DTAs, comparative methods have gained significant relevance. This is true both from a domestic tax perspective, the perspective of tax treaty policy, and the application of given rules in international tax law.²⁴ The paradox of impossibility of comparative tax analysis posed by rapid legislative change, complexity of tax systems, differences in fiscal jurisdiction and heterogeneity of local tax concepts is solved by a functional approach.²⁵

The above approach has been deemed as relevant to use in the study of DTA adoption in Kenya, under which, study of other jurisdictions' adoption process shall be undertaken to establish the similarities, the differences thereof and eventually establish some of the aspects that may be incorporated into Kenya's practice.

The Internet will also form a critical and important source of information, wherefrom a number of articles have already been identified. Websites such as Social Science Research Network (SSRN), the European Union (EU) and the Organisation for Economic Cooperation and Development (OECD) will fall under the internet search.

²² Adapted from *Comparative Method In Sociological Research*, available at <http://www.oppapers.com/essays/Comparative-Method-Sociological-Research/188433> (accessed on 24 October 2011).

²³ *Ibid.*

²⁴ Abstract to Reimer, Ekkehart, "*Comparative International Tax Law - Issues and Methodology [Der Rechtsvergleich im Internationalen Steuerrecht. Fragestellungen und Methoden]*" (February 15, 2010). *Münchener Schriften zum Internationalen Steuerrecht*, Vol. 29, pp. 87-140, 2010. Available at SSRN: <http://ssrn.com/abstract=1544251> (accessed on September 18, 2011).

²⁵ Garbarino, Carlo, "*An Evolutionary Approach to Comparative Taxation: Theory, Methods and Agenda for Research*" (October 30, 2007). Bocconi Legal Studies Research Paper. Available at SSRN: <http://ssrn.com/abstract=1116686> (accessed on September 18, 2011).

1.5 RESEARCH QUESTION

What is the impact of the CoK on the adoption of DTAs and consequently, the legal reforms necessary, if any, for the regulation of the double taxation agreements regime in Kenya?

1.6 OBJECTIVES

This study examines the law in Kenya, if any, as well as the practice in the DTA adoption process to point out its legal and administrative inadequacies in light of the constitutional principles governing public finance in line with the CoK and suggest reforms.

In examining this position, this study will first, discuss some of the well settled principles of a sound taxation system and how such principles have been inculcated into the CoK chapter on public finance. Secondly, discuss the law and practice of DTA adoption in Kenya prior to the promulgation of CoK for us to appreciate the impact that the CoK does have on this practice going forward. Thirdly, the study shall demonstrate why it is imperative to introduce the principles of taxation discussed above into the DTA adoption process, as a minimum, to achieving the principles set out in article 201 of the CoK. Fourthly, this study will endeavor to demonstrate that a generic process of adopting treaties, DTAs included, would suffice. This approach is supported by the fact that, by their very nature, DTAs are minor treaties that are not only limited to taxation but primarily to income taxation. Further, a comparative study of the three jurisdictions chosen for this study depicts such a generic approach as the best practice in treaty adoption.

Further, the study discusses the legal framework and practical considerations of DTA adoption process to show how the adoption is implemented. And lastly, this study discusses

the challenges in the DTA adoption process in the light of the principles laid down to govern public finance in Kenya and suggests reforms.

This study is therefore important because the suggested reforms are intended to provide a legal framework to govern DTA adoption in Kenya. The study seeks to examine and explore the sort of tax institutions and laws that govern DTAs in Kenya and how they are impacted on under the CoK. For purposes of this study, the terminology adoption has been coined to encompass the process of treaty making from negotiations, formulation, drafting, and ratification into the implementation stage.

In discussing the Kenyan scenario, the study aims at refracting certain selected jurisdictions in DTA making to a local case study. It is also intended that an improved system would adhere to principles of transparency; accountability and public representation at the very least, for it is only such a system that will safeguard against revenue loss. An improved system would also form an example of best practice to be emulated by other countries.

1.7 HYPOTHESES

In undertaking this research, the following hypotheses are set out to be tested:

1. there is an absence of a legal framework on the process of adoption of treaties generally, and DTAs in particular, in Kenya; and
2. with the advent of the CoK, under which stringent mechanisms for imposition, variation and waiver of taxes have been introduced, there is need for legal reforms to regulate the process of adoption of DTAs.

1.8 JUSTIFICATION

This study is aimed at identifying the lack of the legal framework governing the process of DTA adoption and to put forth suggested reforms to remedy this problem. The study is important because the suggested reforms are aimed at bringing about transparency and accountability in DTA adoption as a constituent part public finance. The reforms proposed in this study will also give the people of Kenya, both directly and through their elected representatives, an opportunity to adjudge the negation, conclusion and application of the treaties against some legal yardstick as opposed to executive high handedness and secrecy.

Kenya has introduced a constitutional basis for public finance through the establishment and organization of the structures through which the sovereignty of the people may be exercised under Article (1) and (3) of the CoK. This basis is premised on the notion that a government does derive its powers from the ultimate consent of those who are governed.²⁶ The power granted to the State or other democratically elected representatives is not absolute. In taxation terms, the well settled canons of taxation²⁷ have also been enshrined in the Constitution, providing some form of restraint on the State's power to tax, where, for instance, certainty and equity have become crucial.²⁸

For purposes of this discussion, certainty entails the requirement that citizens are made aware in advance of what taxes have been imposed, waived or varied, as may be prescribed under legislation.²⁹ This therefore removes arbitrariness by the tax officials.

²⁶ Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution*, The Collected Works of James M. Buchanan, Vol. 8, 1980, Liberty Fund Indianapolis, at p. 3

²⁷ *supra* n.2, Smith, A., at pp. 676 – 677

²⁸ Republic of Kenya, *The Constitution of Kenya 2010*, Article 201, Nairobi, Kenya: Government Printer

²⁹ Republic of Kenya, *The Constitution of Kenya 2010*, Article 210, Nairobi, Kenya: Government Printer

It is appreciated that the impact of the CoK on public finance in general and taxation in particular, has attracted much debate, where many have commented on the public finance chapter.³⁰ However, little has been written on the impact of the CoK on the process of adoption of DTAs in Kenya. Thus, a need arises to conduct a study in this area with a view to put across reform proposals.

The taxation reform agenda may be influenced by both internal and external accountability. Internal accountability is to the citizens or domestic interest groups. For instance, under the CoK, enactment of any legislation ought to be undertaken in observance of national values and principles of governance.³¹ As relates to tax legislation, such legislation must not prejudice national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour³².

On the other hand, external accountability is to international aid agencies, such as the International Monetary Fund (IMF). For developing countries, the predominant force of external accountability is normally to governments of developed countries, non-governmental tax experts and international institutions. The effects of economic globalization, in particular, the constraints of mobility of international capital do also play a more significant role as external accountability.³³

³⁰ See for instance, Njeru Kirira, *Public Finance under Kenya's new Constitution*, Society for International Development, Sid Constitution Working Paper No. 5, available at <http://www.sidint.net/docs/WP5.pdf> (accessed on 21 October 2011). In this paper, the author examines the new Constitution and its implications for public finance, particularly the nature of Kenya's public finance and administration system, the short-comings of the new legal framework and its likely impact in the new Constitutional order, taking a historical and comparative approach.

³¹ *supra* n.14, CoK 2010, article 10

³² *supra* n.14, CoK 2010, article 209 (5)

³³ *supra* n.3, See, Stewart, at p. 10, 20

Whereas Kenya has in the past been driven, to a greater extent, by external accountability, CoK has put in place demand for internal accountability. The adherence to internal accountability demands can be achieved by borrowing from practices in other jurisdictions: the United Kingdom, by virtue of our past relations during colonization, as result of which, most of legislations are borrowed therefrom; India, seen as emerging market from the third world economy; and lastly South Africa, from where expertise was derived from in the drafting of CoK.

It is thus hoped that this study will make some contribution in the DTA adoption process as well as invite government interest in formulating a generic legislation on adoption of treaties that conforms to the CoK. Such a move would be informed by internal accountability to the people of Kenya, whose contribution in form of tax, accounts for approximately 90% of the total revenue³⁴. The policy also ought to be in line with principles of public finance under article 201 of CoK. Such policy need to also be live to the rights and freedoms guaranteed under chapter four of CoK, specifically right of access to information.

1.9 THEORETICAL FRAMEWORK

In international movement of labour and capital, getting it wrong from a taxation perspective can be an expensive affair. In the world where there are limited resources, it is every government's wish to attract these resources to its frontier. In so doing, governments have resorted to entering into DTAs as one way of assuring the potential investors of non-

³⁴ For instance, under the fiscal year 2010/2011, the total revenue target was Kshs 688.5 billion comprising of Kshs. 609.6 billion of ordinary revenue and KShs. 78.9 billion of appropriations-in aid. (see the *Budget Speech for the Fiscal Year 2010/2011* by Hon. Uhuru Muigai Kenyatta, E.G.H., M.P., Deputy Prime Minister and Minister for Finance. In addition, Part 7 of Kenya's current (2011/12) Budget Statement entitled 'Fiscal Projection for 2011/12' projects that out of the total revenue target of Ksh. 787.6 billion (i.e. 24.7 % of Kenya's GDP), about 70 % i.e. Ksh. 713.6 billion is to be financed through ordinary revenue, meaning taxes, while a (comparatively) paltry Ksh. 75.9 billion is expected to flow from Appropriations-in-Aid (AiA). Compare this to para. 84 of Uganda's 2011/12 Budget which confirms that out of a Resource Envelope of Ushs. 9,840 billion, Ushs. 6,170 billion is expected to flow from tax revenues.

discrimination and as a shield against double taxation. This study on the impact of the CoK on the adoption of DTAs with regard to taxation as a source of public finance in Kenya is based on the economic analysis theory of law. The economic analysis of law is an interdisciplinary subject that brings together two fields of study, i.e., law and economics. The law-economic paradigm is only one tool of assessing the impact of legal rules..³⁵ The aspect of economic analysis of law that informs this study is the one that provides a scientific and empirical framework within which to analyse the likely effects of legal rules as well as inform the application of existing laws.³⁶

One economist whose writing informs this study is Adam Smith, who to an extent may be regarded as assuming a liberalist perspective, whose key consideration is consequences. Adam Smith's studies have been reflected as that science which inquires into the general principles which ought to be the foundation of the laws of all nations or as the theory of the general principles of law and government forms the basis of this study.³⁷ According to Smith, the four great objects of law include justice, police, revenue and arms.³⁸ Of importance to this study, would be revenue where funds have to be raised so as to defray the expenses of government.³⁹ As regards revenue-raising that comes from people by way of taxes, the focus would be the proper means of levying revenue. Adam Smith has codified such proper means of raising revenue through adherence to certain basic tenets.

³⁵ Richard A Posner., *Economic Analysis of Law*, (5th Ed. Aspen, New York, 1998) at p. 179,

³⁶ Id.

³⁷ Adam Smith, *Lectures on Justice, Police, Revenue and Arms*, Delivered in the University of Glasgow, Reported by a Student in 1763 and edited with an introduction and notes by Edwin Cannan, (1986: Oxford, Clarendon Press), at p.1, available at http://library.stmarys-ca.edu/subjects/integral-liberal-arts/s-z/smith/Lectures_on_Justice_Police_Revenue_and_Arms.pdf, (accessed on 21 October 2011)

³⁸ Id.

³⁹ Id.

Taxes, the one form in which a state can raise revenue, must be premised on certain general maxims or principles.⁴⁰ These principles may be expounded as follows: first, the subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

Secondly, the tax which each person is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. The uncertainty of taxation encourages the insolence, and favours the corruption, of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. Thirdly, every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. And lastly, a tax system must be efficient in collection.

In the Kenyan context, the above principles can be gleaned from article 201 of the CoK, titled principles of public finance. The article brings about transparency, equality, equity, prudence and certainty. The CoK goes further to introduce public participation in financial matters, which may be tied up to article 210 under which tax may only be varied, imposed or waived only through a legislation.

DTA adoption, an area that impacts on ability of a country to raise public revenue must also be live to these principles. It must be clear to the public, the conditions and circumstances under which a DTA has become part of the laws of Kenya.

⁴⁰ Supra n.2 on Smith, A., at p. 676 – 677,

Under the economic analysis of law therefore, it becomes relevant to consider what economic issues such as financial markets and taxation have to do with justice, equity, efficiency and fairness. Therefore, where resources such as public revenue are not utilized properly or wasted, a good legal system can prevent this to achieve efficiency and justice. In this case, interaction between economic and normative law will advance the rules that ought to be in place as well as how legal issue, such as DTA adoption, ought to be dealt with.

This study shall therefore be undertaken by using the economic concepts as put forward as basis for a good tax system by Adam Smith, to explain the effects of the CoK on the adoption of DTAs. That is, given the need to have principles under article 201 governing public finance, how should DTAs be adopted in Kenya and is such an outcome legally acceptable. This approach will provide a methodology for analysis which rules will lead to efficient outcomes. Legal rules ought to be efficient, where efficiency means the maximization of the social willingness to pay.⁴¹

The evaluation of legal rules from an economic approach would also help answer the question whether the legal rules achieve their objectives or whether alternative rules would do any better. Certainty in the law is fundamental to the rule of law, which holds that law ‘should be clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable.’⁴²

Economic analysis of law thus provides an impetus for law reform by posing the question: what are the likely effects of legal rules. We live in a dynamic and constantly evolving society and therefore a regulatory regime such as law cannot be allowed to stagnate but rather

⁴¹ Bix, Brian, *Jurisprudence: Theory and Context*, 3rd ed. (London: Sweet & Maxwell, 2003): Chap 18, “Economic Analysis of Law”, pp. 189-216

⁴² Id.

should evolve in tandem with the changing society. In this case, what are the effects brought about by the CoK, and whether those effects are socially and legally desirable. Legal rules will be studied as a working and living system.

It is intended that this study will review, analyze and critique the debate on the future impact of CoK on the adoption of DTAs and propose a solution that is sound and upholds the economic terms in form of basic canons of taxation of equity and certainty.

1.10 LITERATURE REVIEW

In undertaking this study, various literary materials have been analyzed, which have been cited. The core materials, a combination of legislations and texts, whose information has been invaluable to this study, are as below.

Firstly, the CoK, the supreme law of the Republic of Kenya forms the basis upon which this study will be undertaken.⁴³ The CoK is the supreme law of Kenya and vests the sovereign power in the people of Kenya, providing guidance on how it may be exercised. The CoK has gone into new frontiers by providing detailed provisions on public finance, under chapter twelve. Part one of this chapter details the principles and framework of public finance that shall guide all aspects of public finance in Kenya. These principles must be adhered to on public finance in general and specifically on the revenue-raising powers, of which taxation forms part of. The CoK does also provide guidance on imposition of taxes. In this respect, article 210 provides that no tax may be imposed, waived or varied except as provided by legislation. Despite the above provisions under the CoK, nothing has been written on the impact of the CoK on the process of adoption of DTAs in Kenya. Consequently, in this study,

⁴³ See, section 1.2 of this chapter herein above

the aspects on waiver and variation of taxes that may be introduced by the DTAs will be evaluated in light of exercise of sovereignty by the people of Kenya and adherence to principles under article 201.

Secondly, Adam Smith's publications⁴⁴ laid the foundation upon which taxation system generally must be pegged upon. It will be shown in this study that these principles have actually found their way into article 201 of CoK that lays down the principles on public finance. Whereas these principles were absent in the Constitution 1969 on public finance, the same cannot be ignored in the adoption of DTAs under the CoK as the latter calls for openness, accountability and equality on matters public finance.

Brennan and Buchanan⁴⁵ write on the Government's power to tax, how this power may be used, and how it may be and should be constrained. The writers examine such issues as the nature of taxation, what is involved in the power to tax and what is implied by the government's possession of that power. The writers' basis of questioning the constitutional orientation of the particular perspective of taxation, where a "Constitution" is conceived as the set of rules, or social institutions, within which individuals operate and interact with one another, forms an important aspect of understanding how adoption of DTAs may be and ought to be brought within such orientation.

Mayson and Blake's work⁴⁶ has been offered as commentary on the existing law relating to the direct taxes of the United Kingdom. It provides detailed analysis of the history and the

⁴⁴ Adam Smith on *An Inquiry Into The Nature And Causes Of The Wealth Of Nations* (see note 2 above) and *Lectures on Justice, Police, Revenue and Arms* (see note 32 above)

⁴⁵ Geoffrey Brennan and James M. Buchanan, *The Power To Tax: Analytical Foundations of a Fiscal Constitution*, (New York: Cambridge University Press, 1980), vol. 9.

⁴⁶ Mayson, S.W and Blake, S., *Mayson on Revenue Law*, Blackstone Press Limited: London, 1990

taxation regime in the United Kingdom. This work will be reviewed to establish the DTA adoption process in the United Kingdom.

Hollis⁴⁷, introduces and advances a third, comparative perspective on treaty law and practice. In this work, the author argues that an examination of treaties from the traditional perspectives, leads to an incomplete, and at times inaccurate, account of treaty law and practice. Consequently, as treaties proliferate in both numbers and subjects, a comparative view offers alternative insights, experiences, legislative approaches and practices for dealing with treaties. The author argues that by comparing how different states negotiate, conclude and implement their treaty obligations, we necessarily respond to those concerned with a national perspective by obtaining views on how individual states relate to treaties. Further, the comparative approach can inform the international law of treaties. By analyzing a representative group of states, we can compile evidence of what state practice is, which, in turn, informs the content of the customary international law of treaties. To demonstrate how the comparative approach operates, and an aspect deemed crucial in this study, the author analyzes a representative group of nineteen states, three of which have form part of this study - India, South Africa and the United Kingdom. The author compares the surveyed states' treaty laws and practices with respect to four core questions: firstly, how the states define treaties as a matter of domestic law and practice; secondly, the scope of the executive's authority over treaty making; thirdly, the role played by the legislature in treaty making; and lastly, how are treaties incorporated into national law. In this study, this work is deemed important for purposes of understanding the issues raised under the second and third aspects of treaty making. These two literary materials will be helpful during the comparative analysis that would form the basis for reform agenda in Kenya.

⁴⁷ Hollis, Duncan B., *A Comparative Approach to Treaty Law and Practice*, NATIONAL TREATY LAW & PRACTICE, D. Hollis, M. R. Blakeslee, L. B. Ederington, eds., The American Society of International Law, Martinus Nijhoff, June 2005

Sol Picciotto's work⁴⁸ will be helpful on the description of the underlying principle of taxation and addresses the challenges posed by the twentieth (20th) century; the application of national taxes to income from international business; the co-ordination of national jurisdiction to tax international income. It also provides a meaningful conclusion on the problem of double taxation.

In my study, I have endeavored to contribute to the deliberation of DTA adoption process by focusing on the Kenyan scenario. I have examined the nature of DTAs, their constitutional basis and the adoption process in order to create a general awareness of the lacuna in the law in the treaty adoption generally I have discussed the legal and administrative challenges of DTA adoption process, particularly so in light of the CoK. My study highlights general challenges as well as difficulties that are unique to the Kenyan scenario. By suggesting reforms to improve regulation in Kenya, my study provides useful contributions in the implementation of the CoK in matters public finance and exercise of the sovereignty by the people of Kenya or their representatives.

1.11 CHAPTER BREAKDOWN

The agenda of this study has been set out in chapter one. The chapter comprises of an introduction of the legal issues and topic to be investigated, taxation in general, principles inherent in a sound tax system, the nature and role played by DTAs in the international movement of capital. The chapter also discusses how chapter twelve of the CoK on public finance has incorporated these principles of a sound taxation system in particular the principles of equity, certainty, accountability and openness. I have endeavoured to

⁴⁸ Sol Picciotto, *International Business Taxation: A Study In The Internationalization Of Business Regulation*, (London: Weidenfeld and Nicolson, 1992)

demonstrate how inclusion of such principles into the CoK, impacts on the adoption of DTAs. The objective of chapter one has been to introduce the topic on canons of taxation, the constitutional basis under CoK on taxation, the DTA regime and how the process of adoption of DTAs will have to change going forward.

In Chapter two, I have provided an overview and nature of DTAs as well as their constitutional basis of jurisdiction to tax. The first part discusses the constitutional basis for jurisdiction to levy taxes. The second part provides a discussion on DTAs – the meaning, history and their nature, in part, as a means of allocating the power to levy tax and further, as a means to relieve the burden of double taxation. The conclusion arising from this chapter is closely linked to the second part and demonstrates the consequences and impact of adoption of DTAs of the tax system and tax legislation of a country. It is deemed important to understand these aspects in order to comprehend the need for DTA adoption regulation, regulation that must be in tandem with the CoK. Therefore this chapter extrapolates on the link between the DTA regime and the provisions of the CoK which underpin and anchor the regime in the context of Kenya's current practice regarding DTAs.

In Chapter three, I have examined Kenya's approach to the process of adoption of DTAs under the 1969 Constitution. The chapter discusses the limitations in DTA adoption process in light of the CoK and will end with a conclusion on how the said process sits within the new constitutional dispensation and whether any reforms would be needed.

Chapter four presents a comparative analysis of the DTA adoption approaches that are in use in other jurisdictions, with specific reference to India, South Africa and United Kingdom. This comparative study will be undertaken to establish whether there are any lessons that can

be learnt and put into use in Kenya in compliance with the principles laid down under the CoK.

The last chapter of this study concludes with suggestions on reforms to the DTA adoption process in Kenya. The suggested reforms aim at introducing certainty, equality, and accountability in line principles set under article 201 of CoK. The chapter concludes the study by reiterating the significance of a good tax system in general and in particular the DTA adoption process, as one which is designed on the basis of an appropriate set of principles (rules). Such DTA adoption process should also aim at striking a balance between the interest of the taxpayer and that of tax authorities.

CHAPTER TWO: THE NATURE OF DOUBLE TAXATION AGREEMENTS AND THEIR CONSTITUTIONAL BASIS

International trade resulting in global profits may lead to international juridical double taxation. This arises from the fact that, at times, taxation is not territorially limited, with different States applying different basis upon which taxation is levied, that is source or residence. The effect of such non-territorial limitation would be a State's desire to levy taxes on incomes that are outside its jurisdiction. DTAs thus play a crucial role in providing certainty for the taxation regimes for foreign investors venturing into foreign countries, through the elimination of double taxation on the same income.

This chapter discusses the nature of DTAs. It also extrapolates on the nexus between the taxation system in Kenya, the DTA practice and the provisions of the CoK which underpin and anchor the taxation regime. Further, the chapter explores the nexus between taxation and key constitutional principles on one hand and cannons of taxation on the other.

2.1 THE CONSTITUTIONAL BASIS OF THE JURISDICTION/POWER TO LEVY TAX

One of the four great objects of law, according to Adam Smith is generation of revenue that must be used to defray government expenses.⁴⁹ The question of how the revenue is raised and the law governing such revenue raising powers is critical consideration in this study. To achieve the objectives of taxation, the policy governing taxation should adhere to certain principles, such as those enunciated by Adam Smith⁵⁰ and to some extent, as replicated under

⁴⁹ *supra*. n. 37 on *Lectures on Justice, Police, Revenue and Arms*. See also section 1.8 of the preceding chapter.

⁵⁰ *Supra* .n. 37 on *Lectures on Justice, Police, Revenue and Arms*

article 201 of the CoK. These principles are equity, certainty, convenience, economy, transparency and accountability.

In addition to the principles of taxation, a taxation system in general must observe certain fundamental human rights, which only become more than declarations of belief when they are clearly defined, have political backing and are legally enforced. These fundamental rights include: the right to equal protection under which every person is equal before the law and has the right to equal protection and equal benefit of the law⁵¹; and the right of access to information held by the state⁵². These principles and human rights should run through every aspect of public finance, and accordingly, the same should be reflected in the DTAs adoption process.

Normally, it is government's interest to levy as much tax as would be sufficient to cover its expenditure. On the other hand, it is the interest of the taxpayers to pay only such tax as would be justifiable and necessary expenses of good government permit.⁵³ For the ordinary citizen, the power to tax is the most familiar manifestation of the government's power to coerce. This power of the national government under article 209 to impose, vary or waive tax is however not absolute but is rather subject to the authorisation as may be granted through legislation in line with article 210 of the CoK.

⁵¹ Supra .n. 14 on CoK, article 27

⁵² Supra .n. 14 on CoK, , article 35

⁵³ John S. Mill, *Considerations on Representative Government*, in *Essays on Politics and Society*, vol. 19, *Collected Works*, p. 441. According to Lord Clyde in the case of *Ayrshire Pullman Motor Services & D.M. Ritchie v. IRC* (1920) 14 Tax Cas. 754 at 763-4, "No man in this country is under the smallest obligation, moral or otherwise, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow-and quite rightly- to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer, is in like manner, entitled to be astute to prevent, as far as he honestly can, the depletion of his assets by the Inland Revenue ,"

Kenya's taxation system seems to be a blend between power to tax and the right to tax. The power to tax involves the power to impose on every taxpayer charges that carry with them effective powers of enforcement under the very definition of the taxing power.⁵⁴ The power to tax, *per se*, does not carry with it any obligation to use the tax revenue raised in any particular way; that is, the power to tax does not logically imply the nature of spending.⁵⁵ On the other hand however, CoK contains certain provisions that govern the spending of national revenues. For instance, article 202 which provides for equitable share among the national and county governments, article 204 under which half per cent of national revenues must be paid into an equalisation fund, articles 220 to 224 on budgets and spending of revenues and articles 225 to 227 on control of public money.

The reasoning behind the requirement for approval and authorisation through legislation in imposition, waiver or varying taxes, is pegged on the basic principles of public finance enshrined under article 201. These constitutional principles are traceable to Adam Smith's principle of taxation. Similarly, the adoption of DTAs must adhere to these principles. The authority to levy taxes and legislate on taxes stems from the legitimacy of a government. The call for representation in taxation has conceptually and ideologically underpinned the provisions of article 210 of CoK.

The catchphrase "no taxation without representation" which symbolizes the beginning of United States of America (U.S.A) independence has a substantial legal, constitutional, and even economic, significance in modern times.⁵⁶ Tax would therefore seem to be a product of

⁵⁴ *Supra* .n. 21, Brennan, G and Buchanan, J. M., , *The Power to Tax*., at p.11

⁵⁵ *Ibid*

⁵⁶ See generally, Yoseph Edrey, *Constitutional Review And Tax Law: An Analytical Framework*, American University Law Review, [Vol. 56:5] at p. 1190, available at <http://www.wcl.american.edu/journal/lawrev/56/edrey.pdf?rd=1> (accessed on 23 October 2011)

consent, whether such consent is direct and personal, or indirect and collective through the legislative process that is based on the accepted attributes as detailed by Adam Smith.⁵⁷

Thus, where as taxation is an extraction applied by the governments to cause contributions to the common fund to finance common objects, that authority of the government to levy taxes, lies largely within the broader context of a government's legitimacy. In Kenya, this power has been vested in the legislature under article 1 of CoK, the democratically elected representatives of the people. Accordingly, it is only the legislature that may exercise the taxing power or the imposition, waiver and variation rights⁵⁸, within the set constitutional principles⁵⁹.

2.2 RATIONALE FOR DTAS

The worldwide introduction of direct taxes on business income, and the rise in their rates after 1914 immediately brought home to businessmen the relative incidence of such taxes as a factor in their competitive position.⁶⁰ This was particularly so for those involved in cross-border business. Cross-border trade brings with it the international movement of labour and capital, as a result of which incomes derived from a foreign country, may be subject to tax both in the foreign country and their home country, leading to international double taxation.⁶¹

International double taxation arises due to the fact that each country has its own sovereign right to levy tax on income, either derived from within its jurisdiction or where the owner of capital giving rise to that foreign-sourced income is its resident, under its own set of tax rules.

⁵⁷ *Id.*, at p.1227.

⁵⁸ *Supra* .n. 14 on CoK, article 210

⁵⁹ *Id.*, article 201

⁶⁰ *Supra* .n. 50, Picciotto, S., *International Business Taxation*, at p. 14

⁶¹ For a comprehensive and illustrative study of the purposes of tax treaties, see Ruth Mason "U.S. Tax Treaty Policy and the European Court of Justice", *59 Tax Law Review* 65 (2005).

There are various ways in which countries' tax systems could differ, that may contribute to the problem of international double taxation. They include the scope of taxation⁶², source rules for income⁶³; rules for determining the tax residence of an individual or a company⁶⁴; and measures provided for under a country's domestic laws to relieve double taxation.⁶⁵

Double taxation invariably increases the burden of tax on foreign income. This has a negative impact on cross-border movements of investment, technology and expertise. To mitigate the effects of double taxation on her residents deriving income from outside the national boundary, one measure that a country can take is to conclude a DTA on bilateral or multilateral basis with other countries.

DTAs are aimed at relieving the individuals or organisations named in those agreements, from the burden of double taxation on the same tax base.⁶⁶ One of the objectives of a DTA is to provide certainty which is one of the basic canons of taxation that were laid out by Adam Smith as aforementioned, regarding when and how tax is to be imposed in the country where the income-producing activity is conducted or payment is made.

⁶² In this regard, Giovannini *et al* have contrasted two principles i.e. 'the territorial principle', according to which taxes are levied on domestic investment irrespective of the country of residence of the beneficiary, and the 'worldwide principle', according to which taxes are levied on domestic savings irrespective of where they are invested. It is shown by the authors that the worldwide principle involves much fewer distortions than the territorial principle.

⁶³ Source rules determine whether income is sourced in the state where the income arises, or in the state where the income is received

⁶⁴ Consider, for instance, the case of *Firestone Tyre and Rubber Company v. Llewellyn* in which a subsidiary company resident in England was held liable to pay the UK tax on the basis that its directors resided in England..

⁶⁵ Supra .n. 48, Reuven S. Avi-Yonah, *International Tax As International Law*, at p. 2, 3.

⁶⁷ Ault, Hugh J., *Corporate Integration, Tax Treaties, and the Division of the International Tax Base: Principles and Practice*, (1992), Boston College Law School Faculty Papers, Paper No. 146, available at <http://lawdigitalcommons.bc.edu/lfp/146> (accessed on 21 June 2011)

2.3 THE HISTORY OF DTAs (THE OECD MODEL)

To appreciate the role played by DTAs in the international taxation systems, it is important to retrace their development, with a special focus on what informed such development. Globally, taxation systems are jurisdictional such that there is no corporate tax integration. Thus, to bring about global co-existence on matters taxation, the classical system of corporate taxation and the treaty-developed principles of non-discrimination and reciprocity define the international tax rules for corporate income.⁶⁷

The efforts for the elimination of double taxation were started off by the League of Nations⁶⁸ acting through its Financial Committee began in 1921. These efforts were in response to an appeal by the 1920 Brussels International Financial Conference for action aimed at eliminating double taxation.⁶⁹ In the course of sessions held from 1923 to 1927, the Financial Committee of the League of Nations drafted Bilateral Conventions for the Prevention of Double Taxation in the Special Matter of Direct Taxes dealing specifically with income and property taxes.⁷⁰ Within the framework of the activities of the Fiscal Committee established permanently in 1923, a Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation was formulated, but was later revised by the Fiscal Committee in June 1935.⁷¹

After the UN Fiscal Commission and its Committee on International Tax Relations stopped functioning in 1954, the focus in the field of international taxation shifted to the Organisation

⁶⁷ Ault, Hugh J., *Corporate Integration, Tax Treaties, and the Division of the International Tax Base: Principles and Practice*, (1992), Boston College Law School Faculty Papers, Paper No. 146, available at <http://lawdigitalcommons.bc.edu/lspf/146> (accessed on 21 June 2011)

⁶⁸ Precursor to the UN

⁶⁹ United Nations, *Historical Setting of the United Nations Model Convention*, available at <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan004555.pdf> (accessed on 21 June 2011).

⁷⁰ *Supra* .n. 50, Picciotto, S., *International Business Taxation*, at p. 23 - 24

⁷¹ *See*, United Nations, *Historical Setting Of The United Nations Model Convention*

for European Economic Cooperation (OEEC)⁷², with the first Model being released in 1956, titled “The Study of Questions Related to Double Taxation and Other Fiscal Questions of a Similar Technical Nature”. After the OEEC became the Organisation for Economic Cooperation and Development (OECD) in September 1961, the mandate of the Fiscal Committee was confirmed and the Committee subsequently agreed on a number of new articles which were embodied in a report entitled “Draft Double Taxation Convention on Income and on Capital” published in 1963.⁷³

As at the publication of the 1963 OECD model, a great number of former colonies were attaining political independence and efforts to extend tax treaty networks by developed states to these least-developed states were viewed with suspicion of neo-colonial domination by former colonial masters.⁷⁴ The UN thus renewed its efforts in 1967 in response to a resolution of the UN’s Economic and Social Council (ECOSOC) on the area of double taxation, in order to examine the special problems of tax treaties between developed and developing countries.⁷⁵ The efforts of the consequent *Ad Hoc* Group of Experts culminated in the publication of three (3) documents, viz: the Guidelines for Tax Treaties between Developed and Developing Countries in 1974⁷⁶, a Manual for Negotiation of Tax Treaties between Developed and Developing Countries (UN 1979)⁷⁷ and the UN Double Taxation Model Convention between Developed and Developing Countries of 1980^{78,79}. From then on, UN Member States/countries began to liberally conclude DTAs to tackle the problem of international double/multiple taxation and attract foreign investment.

⁷² Currently known as the Organisation for Economic Cooperation and Development (OECD)

⁷³ United Nations, *Historical Setting of the United Nations Model Convention*, available at <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan004555.pdf> (accessed on 21 June 2011).

⁷⁴ *Supra* .n. 50, Picciotto, S., *International Business Taxation*, . at p. 55, 56

⁷⁵ *Ibid*

⁷⁶ United Nations (1974b), Department of Economic and Social Affairs, *ST/ESA/14*

⁷⁷ United Nations (1974b), Department of Economic and Social Affairs, *ST/ESA/94*

⁷⁸ United Nations (1974b), Department of Economic and Social Affairs, *ST/ESA/101*

⁷⁹ *Supra* .n. 50, Picciotto, S., *International Business Taxation*, at p. 55, 56

These efforts, both at the OECD and UN, have continued and been informed by the desirability of promoting greater inflows of foreign investments to developing countries on acceptable and beneficial economic conditions.⁸⁰ The growth of foreign direct investment (FDI)⁸¹ from developed to developing countries has been, to a large extent, pegged on the prevailing investment climate such as the elimination of double taxation.⁸² The need to attain such an investment climate has resulted into the creation and formulation of the Model Double Taxation Conventions both at the UN and the OECD.

The above models are said to be a source of law on double taxation but, because of technical and structural limitations, they cannot be a primary source in the manner of overriding a country's constitution such as Kenya's.⁸³

2.4 THE NATURE OF DTAS

By their very nature, DTAs possess certain characteristics: the definition of the scope of taxing rights, variations, waivers, methods of eliminating double taxation and other special provisions, for instance, on anti-avoidance and limitation of benefit provisions. It is deemed necessary to review the nature of DTAs so as to understand how they sit within the current study in light of the provisions of CoK on taxation contained under article 210.

⁸⁰ *Ibid*

⁸¹ Foreign direct investment (FDI) is direct investment into one country by a company in production located in another country either by buying a company in the country or by expanding operations of an existing business in the country.

⁸² *Ibid*

⁸³ *See* Article 2(1) of CoK which boldly decrees/declares the supremacy and binding nature of the Constitution on all persons and State organs. In terms of hierarchical applicability, international law under which the OECD Model Law falls ranks at sub-article (5), way below the Constitution, hence the latter forms the focus of the present study rather than the OECD Model Law.

2.4.1 Double Tax Agreements as International Agreements

DTAs are international agreements that have been negotiated and ratified between the governments of two or more countries. The practical implication arising therefrom is that countries are not free to adopt any international tax rules they please, but rather operate within the provisions of the DTAs, which changes in the same way international law changes over time.⁸⁴ DTAs, thus, assume a higher status than domestic law on taxation and, consequently, whereas unilateral action by a member state to DTA is possible, such action is generally also restricted.⁸⁵

Generally, municipal/domestic law has been the domain of the legislature. However, as regards matters of public finance, this had been left to the domain of the executive in Kenya, in the old/repealed constitution, under which, the power to impose taxes was exclusively in the domain of the executive. Under the old constitutional dispensation, the powers of Parliament to legislate on matters involving imposition of taxes and other charges were severely restricted and presidential approval/assent was a mandatory prerequisite before Parliament could debate any Bill that involved financial measures of imposition of taxes and charges.⁸⁶ Section 48 of the repealed constitution provided that the president had to give recommendation, signified by the a Minister (usually the Minister for Finance) to proceed on any Bill or upon a motion, even an amendment to a Bill on matters making provision for *inter alia* imposition of or alteration of taxation.

⁸⁴ Reuven S. Avi-Yona, , 'Tax Competition, Tax Arbitrage and the International Tax Regime', Working Paper No. 73 January 2007, University of Michigan Law School, Public Law And Legal Theory Working Paper Series, , at p. 1, (available at <http://ssrn.com/abstract=955921>, (accessed 10 June 2011).

⁸⁵ The possibility of unilateral action resonates with the differentials/coordination approach to tax harmonization whose one form is the conclusion and operationalization of DTTs.

⁸⁶ See Section 48 of the Constitution of Kenya (1969).

The Minister for Finance assumed the role of bringing changes to the domestic legislation on taxation. Indeed, section 41 of the Income Tax Act⁸⁷ empowers the Minister to make special arrangements for relief from double taxation. Under this section, the Minister is empowered, by notice, to declare special arrangements, specified in the notice, made with the government of any country with a view to affording relief from double taxation in relation to income tax and other taxes of a similar character imposed by the laws of the Kenya. The arrangements specified in the notice have effect in relation to income tax. The Minister is obligated to table the notice before the National Assembly without delay, but curiously, after the notice is already in force.

The CoK, on the other hand, by dint of both the letter and spirit of articles 1, 201 and 210, delegates the sovereign power of the people to Parliament on matters of taxation, either in levying, waiving or varying taxes. It would thus follow that any matter regarding taxation, DTAs included, can only be legislated upon and in line with the principles laid under article 201, by the legislature. The usurpation of power by the executive, by virtue of these provisions, seems to have been fully curtailed.

Kenya's constitutional law and International tax agreements

The CoK binds all persons and all state organs at both the national and county levels of government as a result of article 2 of CoK. The validity or legality of the constitution shall under no circumstances be subject to challenge by or before any court or other state organ. Resting on this basis the CoK additionally provides that any treaty or convention ratified by Kenya shall form part of the law of Kenya.

⁸⁷ Republic of Kenya, *Income Tax Act*, Chapter 470, Laws of Kenya, Nairobi, Kenya: Government Printer

However the CoK is silent on the organ or person vested with the responsibility or the process of domesticating international agreements that form part of laws of Kenya. In other jurisdictions, such as the Republic of South Africa (RSA), the responsibility for the negotiation and signing of all international agreements is vested in the National Executive.⁸⁸

Under the Constitution of Kenya, 1969 (repealed), Kenya operated under the dualist approach established by English jurisprudence. Under this jurisprudence, a treaty signed and ratified by the executive, is binding at the international level but is not part of domestic law until it has been incorporated into domestic law by legislation. Under the dualist approach, treaties are part of a separate legal system from that of the domestic law and do not directly form part of domestic law.⁸⁹ In terms of this approach, a treaty to which a state has expressed its consent to be bound does not automatically become applicable within that state until appropriate national legislation has been enacted to give the treaty the force of law in the domestic arena.⁹⁰ Under the dualist approach, a state first expresses its consent to be bound by a treaty in the international sphere, but without involving its legislature and then subsequently involves the legislature in transforming the treaty so as to make it enforceable domestically.⁹¹

Under the monist approach on the other hand, a treaty would become directly applicable, both at the international and at the domestic level, on the date of its entry into force following ratification, acceptance, approval or accession by the state, in accordance with the relevant clause of the treaty in question.⁹² Thus, certain treaties may become domestically, directly applicable in the signatory state (self-executing treaties) and do not rely on subsequent

⁸⁸ Constitution of the Republic of South Africa, No. 108 of 1996, section 231

⁸⁹ Dr.A.O.Adede, *Domestication Of International Obligations*, 15-09-2001, available at <http://www.commonlii.org/ke/other/KECKRC/2001/14.html> (accessed on 12 Sep. 11)

⁹⁰ *Ibid*

⁹¹ *Ibid*

⁹² *Ibid*

national legislation to give them the force of law, in which case, the domestic courts and other government bodies will look to the text of the treaty itself as a source of law.⁹³

Kenya assumes the direct incorporation of the treaty rules through a drafting technique which gives the force of law to specified provisions of the treaty or indeed the whole treaty, usually scheduled to the transforming act itself. This approach was inherited by Kenya and other commonwealth countries from the British practice.

2.4.2 DTAs as a means a of allocating the power to tax between countries

International tax law, as traditionally conceived, is concerned with the international dimension of domestic fiscal laws, that is, with the interface of a given tax jurisdiction with other jurisdictions.⁹⁴ Where cross-border investment occurs, flow of funds between countries, or economic transactions are entered into between taxpayers of different fiscal jurisdictions, the interaction of the respective tax laws of the countries concerned will determine the fiscal implications for the parties involved. This is premised on the fact that income taxation is fundamentally territorial. Territorial in that, fiscal or tax jurisdiction entails the authority to impose and levy taxes and, from the perspective of public international law, the taxing right of any given State depends on its fiscal jurisdiction, an attribute of statehood and sovereignty such that without sovereignty, such fiscal jurisdiction may not exist.⁹⁵

⁹³ *Ibid*

⁹⁴ Arnold BJ and McIntyre MJ, *International Tax Primer*, The Hague: Kluwer Law International 2002, where they state that while tax laws are not international and are the creations of sovereign states, the term 'international tax' embraces the international aspects of the income tax laws of particular countries

⁹⁵ Rutsel Silvestre J. Martha Deventer, *The Jurisdiction To Tax In International Law: Theory and Practice of Legislative Fiscal Jurisdiction*, (1989). Meseen ed. 1996, at 15.

Thus, countries, as a direct result of international tax competition and by virtue of the fiscal jurisdiction, endeavour to increase their revenue collection by extending their respective tax jurisdictions as far as possible.

The other crucial characteristic of DTAs is that their primary purpose is to allocate fiscal jurisdiction⁹⁶, in circumstances that seek to avoid double taxation for individuals or organisations that operate in two or more jurisdictions. Whereas every State has the sovereign power to declare its tax base, it is constrained by the practical difficulties of enforcement and collection should it attempt to extend the tax base beyond its geographical boundaries. International law, which is recognised to a varying extent by the common law of many countries, sets no formal limitation on the extent of a state's jurisdictional power to levy tax in terms of its own legal and fiscal framework. Any restraints in this regard are self-imposed, and flow from the aforementioned practical limitations and also from a reluctance to bring its fiscal system into disrepute by imposing tax which, in practice, cannot be enforced.

On the whole, the fiscal jurisdiction determines the rights and obligations of one State toward others, takes cognisance of international agreements between States and of customary international law. State (or fiscal) sovereignty and fiscal jurisdiction are not identical concepts and produce differing schools of thought regarding the imposition of tax. The first school holds that a State's sovereign rights under international law translate to unlimited territorial fiscal jurisdiction; and that a State's right to impose tax does not require the presence of any connecting factor to the person being taxed or the transaction giving rise to

⁹⁶ See generally, Alfred Nizamiev, *The Main Characteristics of State's Jurisdiction to Tax in International Dimension*, (2003). LLM Theses and Essays. Paper No. 36, available at http://digitalcommons.law.uga.edu/stu_llm/36, (accessed on 23 October 2011), where the author defines fiscal jurisdiction generally refers to the power to make decisions regarding financial matters.

the tax liability.⁹⁷ This approach denies the existence of any principle of customary international law which, by tradition, limits fiscal jurisdiction.⁹⁸

A second school of thought maintains that fiscal jurisdiction is limited by a legally relevant connection⁹⁹ or fiscal attachment between the State and the taxpayer, which links a taxpayer to a particular fiscal jurisdiction.¹⁰⁰ According to international usage, a jurisdictional claim based on such a legally relevant connection or prescribed nexus between the State making that claim and the person being subjected to tax is referred to as residence taxation. It bestows on a State the power to tax and thereby confers legislative fiscal jurisdiction.

Some of the means that are normally adopted in this allocation include the following:¹⁰¹

First, where full rights to tax are allocated to only one country, either to the country of source or residence, the other country would in such a situation exempt entirely from taxation such income that has been taxed in the other country. Thus, this approach belies mutual agreement (mutuality) between the state parties to the particular DTA.

⁹⁷ David W. Williams, *Trends In International Taxation* (International Bureau of Fiscal Documentation (IBFD) Publications: Amsterdam, 1991), at p. 101

⁹⁸ Frederick Mann, *The Doctrine of Jurisdiction Revisited after Twenty Years*, *Recueil des Cours* 186, (1984) at p. 109

⁹⁹ Cornelis Van Raad, *Non-Discrimination In International Tax Law*, (1986), 20-1, where the author speaks about four main theories justifying the right of a state to tax aliens. Under the contractual theory, taxation is regarded as an aspect of a bilateral contract between the State and the alien taxpayer. Another theory is the ethical theory. In this theory, benefits received from the State, and the capacity to pay, determine the exercise of sovereign taxing power over aliens. The third theory is the sovereign theory, in which the right to tax aliens is considered an attribute of (territorial) statehood or sovereignty. The most important contribution to modern international taxation, however, was the theory of economic allegiance. In this concept the duty of aliens to pay taxes to the foreign State stems from their residence, economic activity, or possession of property within the boundaries of that State

¹⁰⁰ Ian Brownlie, *Principles Of Public International Law*, 4th ed. (Clarendon Press. Gloucestershire 1990), at p. 298

¹⁰¹ *supra* n. 86, Reuven S. A., on *Tax Competition, Tax Arbitrage and the International Tax Regime*, , at p. 1,

Secondly, full rights to tax may be allocated to both countries but certain limitations would be imposed, for instance, where the tax in the source country would be limited to no more than a specified level or percentage and the country of residence giving a credit for tax paid in the source country. This form of allocation normally results in a sharing of tax between the two countries. A good example of this would be withholding taxes on, for instance, management and professional fees where the source country can only levy tax at a certain, usually, reduced withholding tax rate, while the receiving country would grant a credit of such taxes paid elsewhere prior to imposing a further tax. For instance, under section 35 of the Income Tax Act¹⁰², management and professional fees are subject to withholding taxes based on the rates that are prescribed under the Third Schedule to the Income Tax Act, under which the general non-resident withholding tax rate is 20%. However, under the Kenya DTA with the United Kingdom, Kenya may levy taxes on management and professional fees but such withholding tax rate may however not exceed 12.5%.¹⁰³ Again, this aspect of allocation of taxation rights under DTAs poses the questions whether those who negotiate these treaties have got the power under the CoK to vary the taxes imposed under a statutory legislation. A tax credit is allowed in Kenya where foreign tax is paid by a Kenyan resident under section 42 of the Income Tax Act.¹⁰⁴

Thirdly, full rights to tax are granted to both state parties to the bilateral DTA without limitation on the tax that may be levied by the source country. In this case, each party to the DTA can levy any form of tax in accordance with the domestic tax law as fully mandated by

¹⁰² *supra*, n 89,, Chapter 470, Laws of Kenya,

¹⁰³ Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Kenya for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, 1973, Article 14.

¹⁰⁴ *supra*, n.83

the DTA. However, the country of residence would still be under an obligation to advance a credit for tax paid in the source country.¹⁰⁵

Although the potential fiscal sovereignty of a given State, in principle is unlimited, it is in practice limited by unilateral restraint in its domestic tax law, or by multilateral measures taken at international level, such as treaties. Thus, tax treaties establish taxing rights between two states to avoid the incidence of double taxation that may otherwise result from conflicting rules. Such rights include the allocation of taxing rights between the country where the income has its source and the country in which the recipient of the income resides. Tax treaties, when well conceived and properly implemented, remove the costs and inhibiting effect of international double taxation, thereby promoting international trade and investment.¹⁰⁶

2.4.3 DTAs as a means to relieve the double tax burden

As discussed herein above, the double taxation is normally mitigated under DTAs by allocation or apportionment of taxing rights to jurisdiction. Where however the income remains subject to tax in both countries, a DTA will normally set out the methods for elimination of double taxation, either by exemption or by credit/concession.

Exemption method may be either full exemption or exemption with progression. Under the former, the income in question is normally left out altogether, so that the State concerned is not entitled to take that income into consideration, when determining/ ascertaining the taxable

¹⁰⁵ *supra*, n. 89, *Income Tax Act*, section 39

¹⁰⁶ See *Maximov v US* 373 US 49; 10 L Ed 2d 184 at 188, where on the meaning of the purpose of tax treaties, the United States Supreme Court has held that ‘. . .the general purpose. . .[is] not to assure complete and strict equality of treatment – a virtually impossible task in light of the different tax structures of the two nations – but rather, as appears from the preamble of the convention itself, to facilitate commercial exchange through the elimination of double taxation resulting from both countries levying on the same transaction or profit; an additional purpose [is] the prevention of fiscal evasion’.

income of a taxpayer.¹⁰⁷ The latter, however, only applies where tax in the country of residence is computed using graduated rates, such that although tax is not imposed by the country of residence on the income in question, it is, however, taken into account for the purpose of determining the effective rate of tax to be applied on other income taxable in that country. This approach achieves the transparency and certainty objectives of taxation in arriving at the net taxable income.

The credit method, on the other hand, may also take two forms: ordinary and full credit. With regard to ordinary credit, the tax credit allowed by the country of residence is restricted to its own tax on the income derived from the country of source such that if the tax suffered in the source country is higher than the tax in the country of residence, complete relief is not available, the rationale being to achieve equity and proportionality in taxation. As regards full credit, the tax paid in the country of source is allowed as a credit in full. Under this form, if the tax in the country of source is higher than the tax in the country of residence, it results in the country of residence conceding its tax on other income.

The approach of eliminating double taxation adopted in a DTA normally reflects the method that is provided in the domestic tax legislation.¹⁰⁸ Kenya provides for the ordinary credit method such that a credit shall not exceed the lesser of the Kenyan tax attributable to the income or the foreign tax chargeable upon the income in respect of which the credit is to be allowed or upon each part of the income.¹⁰⁹ Article 25 of the Kenya-Denmark DTA has adopted this method and provides in part under sub-article 1:

¹⁰⁷ Before arriving at the taxable income, there is need to ascertain the statutory income of the taxpayer concerned. In this regard, an interpretation of Section 3 of the Kenyan Income Tax Act, for instance, is imperative

¹⁰⁸ Hence, still in DTA implementation, a level of municipal/national autonomy remains preserved for purposes of the smooth implementation of the resultant tax arrangements.

¹⁰⁹ *supra* n. 89, *Income Tax Act*, section 42 (4)

“Subject to the provisions of the law of Kenya regarding the allowance as a credit to a Kenyan resident against Kenyan tax of tax payable in a territory outside Kenya, Danish tax payable under the laws of Denmark and in accordance with this Convention, whether directly or by deduction, in respect of income from sources within Denmark shall be allowed as a credit against any Kenyan tax payable in respect of that income, provided that such credit shall not exceed the Kenyan tax, computed before allowing any such credit, which is appropriate to the income derived from Denmark”.¹¹⁰

Following the provisions of the above article therefore, deduction for the tax paid in Denmark is restricted to that part of its own tax which is appropriate to the income which may be taxed in Kenya. In addition to the above methods of elimination of double taxation, relief is also granted in the form of reduced rates of withholding taxes for payments that fall within the withholding tax regimes like royalties, interest, dividend, management and professional fees.

2.4.4 Conditions under which treaty reliefs may be claimed

Reduced tax collections have a deleterious impact on the financial resources of a country. Accordingly, tax avoidance is a concern of most, if not all fiscal jurisdictions. A perennial concern, therefore, is the drawing of the boundary between legitimate tax minimization and unacceptable tax avoidance. There is also an international dimension to the issue of tax avoidance.

Certain other provisions do exist in DTAs that stipulate the conditions that must be satisfied before a person can claim a relief or certain other benefits, like reduced rates of withholding taxes, under a treaty. For instance, some treaties will normally require that for an exemption or treaty relief to be claimed under such a treaty, the payment that is sought to be exempted

¹¹⁰ Convention between Denmark and Kenya for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, 1972 (effective January 1, 1972)

or the relief that ought to be availed is made to be to an entity that is established, located or effectively connected to a country that is a party to that particular treaty.

Other conditions include the provision that the treaty relief is only available to the beneficial owner of the payment, where beneficial ownership is defined as ‘the sole and unfettered right to use, enjoy or dispose of’ the asset or income in question. As regards beneficial ownership, Lord Diplock in *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd*¹¹¹, stated:

My Lords the concept of legal ownership of property, which did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit, owed its origin to the Court of Chancery. The archetype is the trust. The “legal ownership” of the trust property is in the trustee, but he holds it not for his own benefit but for the benefit of the *cestui que* trustent or beneficiaries. On the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the “legal ownership” in the trustee, and what came to be called the “beneficial ownership” in the *cestui que* trust.’ Also, in *Wood Preservation Ltd v Prior (Inspector of Taxes)* (1968) 45 TC 112, CA, at 132–133 Harman HJ held beneficial ownership to mean, ‘An ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own.’

Under the ‘beneficial ownership’ clause in some jurisdictions, the relief is not available to a person who, for purposes of the international arrangement, is a resident of the other contracting state where fifty per cent (50%) or more of the underlying ownership of that person is held by an individual(s) who are not resident(s) of that other contracting State for the purposes of the arrangement.¹¹²

Accordingly, even where the reliefs under the DTAs may have noble intentions or reasons underlying them¹¹³, the same may be open to abuse through such schemes as treaty

¹¹¹ [1975] STC 345, HL, at 349

¹¹² Republic of Ghana, *Internal Revenue Act, Cap 592* Section 111 (4)

¹¹³ Such as those envisaged by Article 210(1) and (2) of the CoK, in terms of tax waiver or variation. In the words of Article 210(2)(a), “...the reason for the waiver [which in taxation lexicon includes reliefs].”

shopping.¹¹⁴ As bilateral tax treaties apply only to persons who are residents of one or both of the Contracting States¹¹⁵, treaty shopping necessarily involves deliberate measures by individuals and entities to change their residence for treaty-benefit purposes.¹¹⁶

As international agreements, and though enacted as part of domestic law, DTAs should be read in accordance with the interpretation canons of international law. DTAs must be interpreted as any other international treaty and applied in good faith as per the cardinal treaty principle of *pacta sunt servanda*¹¹⁷ so as to give full force and not to defeat the intentions of the parties.¹¹⁸ A DTA ought to be interpreted in good faith in accordance with the ordinary meaning to be given to the words in question of the treaty in their context and in the light of its object and purpose and intent of the contracting parties.

The OECD is concerned about international capital flows as well as the matter of treaty shopping. Its commentary on Article 1 states:

7. *The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion.*
- 7.1. *Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws. Such attempts may be countered by provisions or jurisprudential rules that are part of the domestic law of the State concerned. Such a State is then unlikely to agree to [the] provisions of bilateral double taxation conventions that would have the effect of allowing abusive transactions that would otherwise be prevented by the*

¹¹⁴ H. David Rosenbloom, *Tax Treaty Abuse: Policies and Issues*, (1983), 15 *Law and Policy in International Business* 763 at 766, defining treaty shopping as “a premeditated effort to take advantage of the international tax treaty network, and careful selection of the most favourable treaty for a specific purpose”. The practice is akin to “forum shopping” whereby parties to a dispute shop for a suitable court or dispute settlement body to resolve their dispute due its procedural convenience or the availability of effective remedies.

¹¹⁵ OECD Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital* (Paris: OECD 2009), Art 1.

¹¹⁶ Marcariani, J., *Treaty Shopping*, *The Tax Specialist*, Vol. 9, No.3, February 2006 at page 170: “Treaty shopping” is thus a technique followed by persons or entities that “hop” or “shop” for a favourable treaty regime in order to structure their business and investment transactions to obtain treaty benefits in ways that were originally unintended by the bilateral treaty partners

¹¹⁷ *The Preamble to The Vienna Convention.*

¹¹⁸ *Articles 26, 31 of the Vienna Convention.*

*provisions and rules of this kind contained in its domestic law. Also, it will not wish to apply its bilateral conventions in a way that would have that effect.*¹¹⁹

From the above excerpts, it is clear that even the OECD that has been at the forefront of propagating the need by the member states and the world at large to extend DTAs, appreciates the fact that increases in such DTAs bring about the risk of tax avoidance. This is through facilitating the exploitation of the provisions of the treaties and countries' treaty network and difference between the laws of various countries in order to secure the benefits and the tax advantages available under some domestic laws and the relief from tax provided for in double taxation conventions.¹²⁰ This would be both counterproductive and regressive for defeating the intentions of DTAs and also minimizing the tax revenues of national governments who are parties to the DTAs.

The DTAs that Kenya is party do not contain elaborate anti-avoidance provisions and measures. As a matter of domestic law, Kenya inevitably has judicial anti-avoidance doctrines or statutory anti-avoidance rules designed to prevent, or at least inhibit, tax avoidance.¹²¹ These judicial formulations and legal rules apply generally to transactions and schemes, including international transactions, which cross the threshold into impropriety. The effective consequence is that the tainted transactions and schemes can be disregarded by the Kenya Revenue Authority (KRA) when issuing assessments to tax, and for the taxpayers concerned to be taxed as though the transactions in question had not been entered into.

Where the impugned transaction straddles national borders, the international aspects of anti-avoidance measures come into play. As a matter of domestic law, this raises the issue of the

¹¹⁹ Refer to paragraphs 7 and 7.1 which have been reproduced in the main text.

¹²⁰ Walter Block, *The Justification of Taxation in the Public Finance Literature: A Critique of Atkinson and Stiglitz, Due, Musgrave and Shoup*, 3 *Journal of Public Finance and Public Choice* (Fall 1989), at p. . 540.

¹²¹ Republic of Kenya, Income Tax Act, Chapter 470, Laws of Kenya at section 23

status of tax treaties under the constitutional law of the countries involved. It would thus be critical to include clauses that curb international tax avoidance tendencies such as effectively managed or beneficial ownership clauses as detailed above so that the exemptions or reliefs granted benefit those who were initially legitimately intended in the treaties. Other means of curbing tax avoidance would be the assertion of an inherent anti-abuse principle based on the *pacta sunt servanda* principle of international law.

2.5 ADOPTION OF DTAs

The adoption of DTAs brings with it the various traits referred to above as nature of DTAs, which as shown may impact on the revenues of a country. This section thus intends to show how DTAs once negotiated form part of municipal laws of the country-parties and thereby become binding laws in those countries of operation by dint of ratification¹²² or domestication. In this regard, apart from being applied as international agreements under principles of international law¹²³, DTAs may be applied as domestic law and interpreted as such.

Every legal discussion, taxation and adoption of DTAs being one of them, ought to begin with a constitutional framework. Under the constitutional law doctrine of constitutionalism, the State has the authority to do only what the Constitution allows it to do. In the new/post-2010 constitutional dispensation Kenya, the sovereign power belongs to the people and may

¹²² According to Franceschi (*Supra*. n. 36, p. 139), “*ratification means the procedure whereby the executive power of a state – traditionally the Head of State – signifies its final consent to an agreement. It also means the international procedure whereby a treaty enters into force, namely the formal exchange or deposit of the instruments of ratification, or the actual document, sealed or otherwise authenticated whereby a State expresses its willingness to be bound by the treaty*”. For the author’s views on the external and internal effects of a treaty, see p. 152 while for the inconsistency of Kenya’s treaty practice generally, see p. 290

¹²³ The window of application on international law in Kenya is allowed by Article 2(5) of the CoK which provides, verbatim and *seriatim* that (5) “The general rules of international law shall form part of the law of Kenya” and that (6) “Any treaty or convention ratified by Kenya shall form part of the law of Kenya under this Constitution.”

be exercised directly or through their democratically elected representatives.¹²⁴ However, there are limitations on the government's powers. These take two forms: the formal and substantial.¹²⁵ Formal limitation deals with authorization and seeks to interrogate the question whether the government has been granted the power to act by the law. On the other hand, substantial limitation deals with the question of what is the right and the appropriate way the government should act and exercise its power, i.e. constitutionally. The substantial dimension is crucial in that the Constitution is the supreme law of the Republic of Kenya and binds all persons, including the Legislature and State/Executive officers and institutions such as the Ministry of Finance, the State Law office and Kenya Revenue Authority (KRA), which, as is demonstrated herein after, are the charge of DTA adoption in Kenya.¹²⁶

What then is the constitutional position of the taxation regime in Kenya? As opposed to Kenya's old/repealed Constitution which proffered omnibus and skeleton provisions on taxation generally, the new Constitution adopts a two-tier differentiated taxation regime targeting both the national and county governments in the spirit of a devolved tax system. Indeed, under Article 209 of the Constitution, only the national government may impose the major taxes in Kenya's national tax profile being income tax; value-added tax; customs duties and other duties on import and export goods; and excise duty. This power of the national government to impose, vary or waive tax is however subject to the authorisation as may be granted through legislation in line with Article 210 of the Constitution of Kenya.

Several conclusions may be drawn from the foregoing glimpse of the provisions of the Constitution: first, it may be deduced that only the Legislature, the democratically elected

¹²⁴ Republic of Kenya, *The Constitution of Kenya, 2010*, Article 1

¹²⁵ Yoseph Edrey, *Constitutional Review And Tax Law: An Analytical Framework*, American University Law Review, [Vol. 56:5] at p. 1190

¹²⁶ *See*, The Constitution of Kenya, 2010, Article 2

representatives of the people of Kenya, has the power to impose, waive or vary taxes. Secondly, where the Legislature permits the waiver of any tax, a public record of each waiver as well the reasons therefore need to be maintained. The reasoning behind this second proposition is pegged on the basic principles of public finance which include openness, accountability and public participation as enshrined under the said Article 201.

In Kenya, DTAs gain their force of operation under section 41 of the Income Tax Act under which the Minister (for Finance) may from time to time by notice declare that arrangements that have been made with the government of any country with a view to affording relief from double taxation in relation to income tax and other taxes of a similar character imposed by the laws of the country to have effect. Under sub-section (2), the arrangement for such relief may be applicable prior to or after the commencement of the Act.¹²⁷

It is notable that the Legislature is only involved after the process has been concluded in line with provisions of sub-section (4) which provides that the Minister shall cause a copy of the notice made under sub-section (1) to be laid, without delay, before the National Assembly.¹²⁸

The role of the National Assembly once the notice of special arrangement is tabled before it is not clear. The aforementioned trend of dealing with DTAs under domestic law should be amended so as to comply with the constitutional requirements of Article 210 regarding the imposition, waiver and varying of taxes, a province/jurisdiction that has been vested exclusively in the Kenyan Legislature by dint of Article 210(1).

It is evident from the section 41 of the Income Tax Act that the DTA adoption process has failed in several major respects: first, the non-involvement of the legislature in the process

¹²⁷ While the Income Tax Act commenced on January 1, 1974, some DTAs like the Kenya/Zambia one was signed much earlier i.e, on August 27, 1968.

¹²⁸ *supra*, n. 89, *Income Tax Act*, Section 41.

and secondly, failure to have a public record of what DTAs have been adopted and thus, have force of law in Kenya. From a constitutional perspective, the procedure set under section 41 aforementioned fails under both the formal and substantial criteria when looked at under the CoK lens.

2.6 CONCLUSION

This chapter has delved deeper into the juridical, constitutional, historical and fiscal nature of DTAs generally. The Kenyan position on some of the issues was also evaluated, the constitutional position on taxation, the principles governing a sound taxation system and how these principles must trickle down to govern the adoption of DTAs. In particular, the supremacy of the CoK, the sovereignty of the people and how such sovereignty may be exercised under the CoK has also been discussed under this chapter. The principles of sound taxation system as enunciated by Adam Smith and how these are reflected in our CoK have also been reviewed.

CHAPTER THREE: KENYA'S APPROACH TO DOUBLE TAX AGREEMENTS PRACTICE

Chapter two has established the nature of DTAs and extrapolated the nexus between the taxation system in Kenya, the DTA practice and the provisions of the CoK which must govern DTA adoption process. The Chapter also set out the basic principles of taxation that must also be present in a DTA adoption process discussion. These principles include certainty and no arbitrariness, as well as consideration of the convenience for the contributor; efficiency; fairness and equity.¹²⁹ These principles must flow in every aspect of taxation, including the DTA adoption process.

This Chapter will evaluate the DTA adoption process prior to the promulgation of CoK and the envisaged practice thereafter.

3.1 TAXATION AND DTA ADOPTION PRACTICE UNDER KENYA'S 1969 CONSTITUTION

As mentioned elsewhere in this study, Kenya's repealed Constitution¹³⁰, which had been in place since 1969¹³¹, contained a few unconsolidated references to taxation, which vested exclusively in the domain of the Executive.¹³²

¹²⁹ *supra*. n.2, Smith A., *An Inquiry Into the Nature and Causes of the Wealth of Nations*

¹³⁰ Revised Edition 1998 (1992)

¹³¹ This old Constitution is commonly referred to as the "Independence Constitution" which has been severally amended.

¹³² In fact, even the related issue of treaties (or at least, tax treaties) was given no treatment at all by this Constitution and neither did it expressly regulate foreign affairs and treaty practice altogether, leaving the Executive to exercise sole and exclusive power and discretion over these matters. This created a "legitimacy or democracy crisis" in DTA practice. More recently, this unfortunate situation has been ameliorated in other Commonwealth countries such as the United Kingdom whose current practice is that the Crown seeks parliamentary approval for certain kinds of treaties e.g. those dealing with finance. A full comparative study between Kenya and other fiscal jurisdictions will be undertaken in Chapter Four of this research project.

Kenya, like many commonwealth countries, is a dualist state when it comes to incorporation of treaties into domestic law. This implies that dualist states require all treaties to be incorporated before they can have any domestic legal effects. Since Kenya was a dualist state, DTAs should have been presented as Bills for parliament approval. However, DTAs were never tabled before Parliament in the form of Bills or prior to their ratification and entry into force.¹³³

Even though the repealed Constitution lacked specific and clear-cut provisions on taxation, rather dealing with only one aspect of taxation, namely the authority to tax, with the prerogative power on such matters being left to the whim of the Executive, the above constitutional position seems to be the foundational basis governing DTA adoption practice.¹³⁴ DTAs are micro subject for which the Constitution cannot, understandably, go to that detail. The exercise of the prerogative was relegated to subsidiary legislation (i.e., legal notices).

Section 41 of the Income Tax Act which falls under Part VI of the Act (dealing with rates, deductions and set-off of tax and double taxation relief) has been used to regulate DTA practice in Kenya. The section empowered the Minister to enter into DTAs for relief from double taxation with the government of any country, for periods even before coming into effect of the DTA. The relief granted under the DTAs is in respect to income tax and other taxes of similar nature, notwithstanding any provisions of written law in Kenya. Once a notice specifying the arrangement entered into for DTA has been issued, the amendment or

¹³³ In this sense, it is arguable that Article 210 of the new Constitution (herein, 'CoK'), to be discussed shortly, injects some democracy into the taxation system of Kenya by subjecting all taxation, imposition of licensing fees, waivers and variations to legislation (meaning, parliamentary intervention).

¹³⁴ *Supra*, n.89, *Income Tax Act*,. The Preamble to this Act defines it as “*An Act of Parliament to make provision for the charge, assessment and collection of income tax: for the ascertainment of the income to be charged; for the administrative and general provisions relating thereto; and for matters incidental to and connected with the foregoing*”.

revocation of the contents thereof may only be made by the Minister. The Minister is only required to notify the parliament of any DTA entered into when the same is already in force.

Various points, though controversial, can be drawn from the text and wording of the above-provision. First, under this provision, the executive, through the Minister of Finance ostensibly acting on behalf of the President, could by Legal notice (L.N.) declare that arrangements had been made with governments of other countries for purposes of affording relief from double taxation in respect of incomes or similar charges, and such arrangements shall have effect in relation to income tax.¹³⁵ Secondly, the arrangement so made may be effective even on matters that happened prior to the arrangement coming into effect, that is, apply retroactively.¹³⁶

Thirdly, the Minister may at his discretion and as he may deem necessary or expedient, make any amendments or revocation of prior arrangements. Fourthly, the Minister shall lay a copy of the notice before the National Assembly without delay, which would mean that the Legislature only learnt of the DTAs after the event and after the agreement is already in force. The tabling is a mere formality under which the representatives of the people have no voice. In addition, the absence of a clear timeframe or deadline within which to table a copy of the notice before Parliament is a serious anomaly and misnomer because an interpretation of the phrase “without delay” is relative and contentious.

¹³⁵ See, for instance, the DTA between Kenya and Canada (Legal Notice No. 111 of 1987) and most recently, the DTA between the Government of the French Republic and the Government of the Republic of Kenya (Legal Notice No. 140 of 2009).

¹³⁶ The operation of the Income Tax Act commenced on January 1, 1974. The window for retroactive application of the notice is open to take cognizance of the statutes on income taxation which operated prior to the enactment of the Income Tax Act such as The East African Income Tax Management Act (then, Cap. 24). An example of such a DTA concluded under the latter Act is the DTA between Kenya/Denmark Legal Notice No. 5 of 1973 (see note 30, *infra*).

From the above statements of the provisions, it is evident that the DTA adoption process lacked in the basic principles of taxation. First, as enunciated by Adam Smith of a sound taxation system, and secondly, as contained in the public finance chapter 12 of the CoK, that is, of openness, accountability, democracy, either direct or representative. Consequently, it may be stated that parliament's role under the repealed constitutional dispensation seemed to be a rubber-stamping exercise of the Executive act of entering into special arrangements, and adoption of DTAs.¹³⁷ The Minister was simply expected to lay a copy of the DTA legal notice before the National Assembly.¹³⁸

The constitutional and legislative position outlined above was confirmed during an interview with a senior officer of the Kenya Revenue Authority (KRA).¹³⁹ As a result of the lacuna in the law as set out above, and the absence of clear written policy guidelines, the officers at the Ministry of Finance, the State Law office, the Ministry of Foreign Affairs and the revenue authority have over the years administratively developed a system governing the adoption of DTAs. The adoption process envisaged in this study entails the process of involved from the formulation, negotiation to the ratification or domestication of DTAs. The competent authority with respect to matters of finance and taxation and the one who assumes the lead role in DTA adoption process is vested in the Minister for Finance. The Minister derives his authority from section 41 of the Income Tax Act.¹⁴⁰

The team that is involved in the DTAs adoption process assumes the following roles:

¹³⁷ Some of the DTAs that have come in force in this manner include: L.N.111 of 1987 (DTA between Governments of Kenya and Canada; L.N. 20 of 1980 between the Governments of Kenya and Federal Republic of Germany; L.N. 61 of 1989 between the Governments of Kenya and India; and most recently, L.N. 140 of 2009 between the Governments of Kenya and French Republic.

¹³⁸ Interview with Moses Maina, Senior Assistant Commissioner, KRA Policy and Legal Unit on the negotiation, formulation and ratification process of DTAs in Kenya, at Nairobi, Kenya, 24th August 2011. The interview was intended to understand the process that the Government of the Republic of Kenya has adopted on DTA adoption practice prior to the promulgation of the Constitution of Kenya 2010, on August 27, 2010.

¹³⁹ Interview 1

¹⁴⁰ Interview 1 and 2

The representation from State Law Office, Department of Treaties and Agreements as the principal legal advisor to the Government under Section 26(2) of the repealed Constitution renders legal advice on all matters relating to international law. This department renders legal advice on government policy, all transactions that the government enters into, the interpretation and guidance regarding various statutes and matters arising generally from public governance which may have an international implication.¹⁴¹

The Ministry of Foreign Affairs as a facilitator, co-ordinator and a steward of the country's foreign policy, is responsible for the policy aspects of DTAs, as well as matters of form and procedure of negotiation meetings and correspondence.¹⁴² This practice by Kenya seems to be in line with the provisions of the Vienna Convention on Law of Treaties¹⁴³, which provides that Heads of State, Heads of Government and Ministers for Foreign Affairs, for the purpose of performing all acts relating to the conclusion of a treaty, need not produce full powers expressing the consent of the State to be bound by a treaty and are considered as representing their State by virtue of their functions.¹⁴⁴

The negotiations for a DTA may be initiated by any Contracting State/Party to the DTA, the substantive basis of which may be either the OECD or the UN Model. On conclusion of the negotiation process, the heads of delegation initial each page of the draft DTA. The initialled drafts are then sent to the heads of the competent authority, which, once satisfied with the contents of the DTA, sends it to the State Law Office for drafting formalities and approval.

¹⁴¹ Interview 4

¹⁴² Interview 2 and 4

¹⁴³ Done at Vienna on 23 May 1969. Entered into force on 27 January 1980, United Nations, *Treaty Series*, vol. 1155, p. 331, available at http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf, (accessed on 25th August 2011)

¹⁴⁴ *Ibid.*, Article 7 (2).

Once the State Law Office has cleared the draft, the DTA is sent to the Government Press for printing and gazettelement.¹⁴⁵

Following gazettelement of the DTA, the Ministry of Foreign Affairs is charged with the mandate of communicating to the Government of the other countries the completion of the adoption procedures from the Kenyan perspective. Indeed, the provisions of the Vienna Convention referred to above guide the process and means of expressing consent to be bound by the resultant DTAs.

The above procedural matters were confirmed in subsequent interviews, which were deemed necessary to establish the government position in absence of any policy and or legal document.¹⁴⁶

3.2 TAXATION AND DOUBLE TAX RELIEF UNDER KENYA'S NEW CONSTITUTIONAL DISPENSATION

Since the coming into force of CoK on 27th August 2010, Kenya has not adopted any DTA although one has been signed¹⁴⁷, but still in line with the provisions of section 41 of the Income Tax Act.¹⁴⁸ Despite the constitutional deficiencies in both the old Constitution and the Income Tax Act, one would expect to see elaborate provisions on taxation possibly including a mention of DTAs in the new Constitution. However, these provisions are limited to two articles with no reference to DTAs. Article 209 of the CoK only deals with taxation by the national and county governments and lists the various taxes which can be levied by these

¹⁴⁵ Interview 2 and 4

¹⁴⁶ Interviews 3, 2, and 4

¹⁴⁷ The DTA between the Kenya and United Arab Emirates signed on the 21 November 2011.

¹⁴⁸ Indeed, it is anomalous that Section 41 of the Income Tax Act is yet to be amended to incorporate the new DTA practice intended by the new Constitution which has been in operation for more than one year.

governments in order to raise their public revenue. While article 210 of CoK, states that no tax may be imposed, waived or varied except as may be provided by legislation.

An analysis of article 209 of the CoK shows that the executive still retains great power on matters of taxation; in line with the repealed Constitution, as it gives the executive, the national and county governments the power to impose taxes and charges. A contradiction however would seem to emerge under article 210 which provides that no tax or charge may be imposed except as provided by legislation. Article 210, it may be argued, as opposed to being contradictory with article 209, effectively removes the power to impose taxes from the executive vesting the same in parliament. It follows therefore that whatever tax measures, including the adoption of DTAs, the Executive proposes to impose, the final determinant is Parliament. It may be argued that the import of article 210 was aimed at remedying the shortcomings of the repealed Constitution under which the parliament, the state organ through which the people may exercise their sovereign power as their democratically elected representatives,¹⁴⁹ had been given such cosmetic and perfunctory role in the regulation and practice of taxation in general and in particular DTA practice. *Prima facie* and in practice, the executive usurped parliament's primary constitutional role of law-making, a constitutional and legal misnomer. This usurpation of the powers of the legislature by the executive effectively undermined parliament and entrenched executive domination in the arena of DTA practice.

However, the import of Article 210 may be faulted. Although the provision may have been intended for parliamentary oversight purposes, it can be a recipe for conflict between the executive and parliament. Moreover, in a polarized parliamentary set up such provision can

¹⁴⁹ supra, n. 18, CoK, article 1 (2)

inhibit the government's ability to impose new taxes and charges.¹⁵⁰ This critique suggests that a clear-cut approach which allows either the executive or the legislature exclusive authority to impose taxes and charges would bring certainty in a taxation system. The half-hearted attempt provided by Articles 209 and 210 is not ideal. The drafting of articles 209 and 210 on this subject needs to be restructured with the power to impose being vested in Parliament.

Thus conceived, article 210 is well-intended so far as it seeks to change the structure and architecture of the process of taxation generally and to a great extent adoption of DTAs in Kenya. This entrenches democracy in taxation and, by extension, DTA practice (a form of tax variation or waiver¹⁵¹) which has hitherto been under executive monopoly as was legitimized by the old constitutional dispensation. The CoK does contain, and it should not, elaborate provisions outlining the general principles which should guide all aspects of matters relating to public finance. The core principles include transparency and accountability, public participation, equity, equality and certainty both in the raising of revenue through fair sharing of the burden of taxation and in the allocation and expenditure thereof.¹⁵² This study notes that the CoK does not expressly mention DTAs yet arrangements under these treaties have serious ramifications on the domestic revenue of Kenya which necessitates democratic intervention.

¹⁵⁰ In most jurisdictions the power to impose taxes has been exclusively given to the legislature. In the United States of America the power is vested in the Congress, in India it is with the legislatures of the respective States while in Malaysia and South Africa the power is also vested in the legislature. In Uganda it is with the Executive and Parliamentary inroads are expressly excluded. A full comparative study will be undertaken in the next chapter.

¹⁵¹ *See generally*, Chapter 2: "The nature of DTAs"

¹⁵² Though, quite admittedly, Kenya has suffered serious problems with the expenditure side of taxation with inundating claims of corruption, embezzlement of funds, mis-procurements and other expenditure-side constraints.

3.3 PERTINENT LEGISLATION

Emanating from the enactment of the CoK, the government has put in place a policy to revise, amend and/or vary all pertinent legislation, including tax legislation. For purposes of DTA, key legislation that give clarity to state policy include the Finance Bills, Income Tax Act as well as possibly a law on Treaties generally.

Currently, there is a bill pending on treaties, the Ratification of Treaties Bill, 2011.¹⁵³ This Bill does not mention any specific genre of treaties (including DTAs) and is hence generic in its approach. According to the Bill's memorandum of objects and reasons, its principal object is to provide for a standardised procedure for ratification of international treaties by the Government of the Republic of Kenya. The Bill generally appreciates that this procedure has been lacking in Kenya, leading to lack of clarity as to the exact number and identity of the international instruments which have a binding effect on the citizens of Kenya. The need for a law to regulate this area has been aggravated by Article 2(6) of the CoK which requires that any treaty or convention ratified by Kenya shall form part of the laws of Kenya under the CoK.

The Bill seeks to give both the parliament and the executive distinct roles in the adoption of treaties entered into by Kenya. For instance, under section 4 (1), the relevant State Department shall be required to prepare and present a memorandum outlining the objects of the treaty for approval by the Cabinet. Upon approval of the memorandum of objects by the Cabinet, the relevant Cabinet Secretary shall in consultation with the Attorney General, publish a Bill for consideration by the Parliament. In submitting the Bill and the provisions of the treaty to the Parliament for consideration, the relevant Cabinet Secretary also would be

¹⁵³ Drafted by Hon. Millie Odhiambo Mabona, M.P., as a Private Member's Bill, dated June 16, 2011.

required to include detailed explanation on any constitutional implications and how the treaty advances or threatens Kenya's interests. With respect to DTAs, it can be implied that the relevant State Department and relevant Cabinet Secretary would be the Ministry of Finance and the Cabinet Secretary in charge of Finance, respectively.

Of more relevance to the case for parliamentary (read, democratic) intervention is Section 5 of the Bill which provides, *in toto*, that:

- “(1) A Bill published under section 4 shall, depending on its subject matter, be considered by both or the relevant House of Parliament paying due regard to Part 1 and Part 2 of Chapter Eight of the Constitution.
- (2) The relevant parliamentary committee shall, during its consideration of the Bill, ensure public participation in the ratification process in accordance with laid down parliamentary procedures.”¹⁵⁴

The section of the bill aforementioned, acknowledges the importance of democracy by specifically calling for the involvement of parliament, as its role and composition may be established under the CoK. In this regard, the Bill not only corrects a fundamental past mistake, for instance, by seeking to involve the legislature in the treaty making process as aforementioned, but it also, for the first time in the history of Kenya, gives the DTA practitioners the opportunity to adjudge the negation, conclusion and application of treaties against some legal yardstick as opposed to executive high handedness and secrecy. The Bill further appreciates that Kenya may wish to be bound by treaties covering a variety of subjects, including DTAs and accordingly, provides for the role to be played various State Departments and their respective Cabinet Secretaries, in the ratification process. In this regard, the Ministry of Finance and the Cabinet Secretary in charge of the Ministry, the

¹⁵⁴ Other pertinent sections of the Bill include Section 7 (which gives power to the relevant Cabinet Secretary to sign instruments of ratification of a treaty), Section 9 (which reinforces the legal requirement of both Cabinet and Parliamentary approval of treaties) and Section 12 (which compels the relevant Cabinet Secretary and State Department to create public awareness on concluded treaties)

technocrats in matters taxation and DTA will be required to prepared the memorandum of objects for approval by Cabinet and the Bill for parliamentary consideration, for any new DTA.

3.4 CONCLUSION

From the above discussion, the shortcomings of both the old Constitution and CoK with regard to taxation, and specifically the DTA adoption process, have been analyzed, despite the fact that CoK has established certain core principles that must govern public finance matters. Consequently, Kenya needs to re-evaluate the process of adoption of DTAs, which require a specialist and technical adopting process, to ensure compliance with provisions of both articles 201 and 210. From the latter perspective, various reliefs are granted under DTAs that would fall within the provisions of waiver from tax under the provisions of Article 210 of the CoK, which must thus be legislated or approved by Parliament. On the other hand, the process which has in the past been implemented at the instance of the Minister for Finance, a custom adopted under the old Constitution, ought to now embrace openness and accountability, equality as well as other principles of a sound taxation system.

The new constitutional provisions provide a window of opportunity for the provisions of the Income Tax Act to be amended and brought into harmony with the CoK. One way through which this can be achieved is by repealing provisions of section 41 of the Income Tax Act such that the provisions of the Treaty Ratification Bill, 2011 do take precedence, ensuring both parliamentary and public participation in the DTA, among other treaties, adoption process. To ensure compliance with the principles of governing public finance, there is need for such legal reconciliation and harmonization together with the case for an enabling clear-cut legislation. The Ratification of Treaties Bill, 2011, if legislated into law, will provide the

certainty, the transparency and accountability that has been lacking in the past, by virtue of its various provisions outlined herein above.

CHAPTER FOUR: COMPARATIVE STUDY ON APPROACH TO DOUBLE TAX AGREEMENTS (DTA) PRACTICE

Kenya's DTA practice has been presented in the preceding chapter as being largely unsatisfactory and inadequate vis-à-vis the CoK and the peoples' democratic participation. In this chapter, the study undertakes a comparative look at the issue of treaty adoption in order to reinforce the call for reforming Kenya's current adoption process. The countries selected for this purpose are the United Kingdom (UK), Republic of South Africa (RSA) and India. The reason for selection of these three states, besides being common law jurisdictions are: the UK being Kenya's former colonial master and wherefrom Kenya has borrowed most of its legislations. India, like Kenya is a former colony of the UK, has emerged to be among the world's super power from an economic perspective with over 70 DTAs. A significant number of FDI into Kenya have also come from India in the recent past. The choice of RSA has been informed by the continental ties that it has with Kenya, both being members of the African Union (AU).

In adopting a comparative approach to this study, it is hoped that Kenya can benefit from comparing the law and practice from the three states, offer alternative insights, experiences, legislative approaches and practices for dealing with treaties. These alternatives may offer us new avenues for further developing, improving, or even modifying our system of treaty law and practice. As discussed in chapter three, already an attempt, though half-hearted, has been made by the CoK. However, this requires further interrogation in a comparative perspective.

4.1 THE UNITED KINGDOM

The United Kingdom (U.K), unlike many other nations, has no single core constitutional document but rather has an uncodified and an unwritten constitution. The source of revenue law in the UK comprises of statutes, case law, principles of construction as well as official statements.¹⁵⁵ The Bill of Rights 1689 forms the basis of taxation and declares that “levying moneys for or to the use of the Crown by pretence of prerogative without grant of Parliament is illegal”.¹⁵⁶

Therefore, the law relating to taxation is derived from the unwritten constitution and actualised in Acts of Parliament: the Income and Corporation Taxes Act 1988 (ICTA), the Capital Gains Tax Act 1979 (CGTA) and the Capital Transfer Act 1984 (CTA), being the consolidating Acts for each tax together with the subsequent Finance Acts and any statutory instruments.¹⁵⁷ Official pronouncements do also form part of source of revenue laws by virtue of section 1 (1) Taxes Management Act 1970, which provides that income tax, corporation tax and capital gains tax shall be under the care and management of the Commissioners of Inland Revenue.

4.1.1 DTAs and their Constitutionality

In the UK, domestic legislation generally provides that, all income which arises in the UK, whether derived by a UK resident or not, and income derived from abroad by a UK resident, is chargeable to UK tax.¹⁵⁸ This means that the UK does acknowledge circumstances where both it and a foreign jurisdiction may seek to tax the same income or gains or transfer – one jurisdiction on the basis that the taxpayer has a personal contact with it through domicile,

¹⁵⁵ See generally, Mayson, S.W and Blake, S., *Mayson on Revenue Law*, Blackstone Press Limited: London, 1990, at p. 5 - 6.

¹⁵⁶ Mayson, S.W and Blake, S., *Mayson on Revenue Law*, Blackstone Press Limited: London, 1990, at p. 3

¹⁵⁷ *Ibid*, at p. 4

¹⁵⁸ *Ibid*, at p. 28

residence, or ordinary residence, and the other on the basis that the income, gains or transfer arise from assets sources within that jurisdiction.¹⁵⁹ In such cases, double taxation would be avoided through either unilateral or bilateral double taxation relief.¹⁶⁰

Unilateral relief refers to a situation where a jurisdiction, the UK for instance, grants relief on its own volition where no such similar relief is granted by the foreign jurisdiction on one hand while on the other hand, bilateral relief arises from a DTA between UK and the overseas jurisdiction under which each jurisdiction modifies its general tax law.¹⁶¹ This relief may be by exemption or by way of credit.¹⁶²

4.1.2 Legal authority and process in Bilateral/Treaty Relief

The power of the UK government to enter into DTAs with other jurisdictions is given by section 788 of ICTA 1988, section 10 (1) CGTA 1979 and section 158 IHTA 1984. The contents of the DTAs entered into by virtue of these provisions override the provisions of general revenue law.¹⁶³ On the contrary however, the provisions of a treaty cannot impose a tax charge in the United Kingdom in circumstances where a charge could not be levied under the UK revenue law. This is a universal practice

According to constitutional practice in the UK, parliament has no formal role in treaty-making, as the power to do so is vested in the executive, acting on behalf of the Crown.¹⁶⁴

¹⁵⁹ *Ibid.*, at p. 35

¹⁶⁰ *See*, ss. 788 to 816 Income and Corporation Taxes Acts 1988, ss. 10 and 11 of Capital Gains Tax Act, and ss. 158 and 159 Inheritance Taxes Act 1984

¹⁶¹ *See*, Mayson, at p. 35

¹⁶² *See generally*, section 2.4.3 herein above for a discussion on these reliefs.

¹⁶³ *See*, section 788 (1) and (3) of ICTA 1988, section 10 (1) of CGTA 1979 and section 158 (1) of IHTA 1984

¹⁶⁴ House of Commons Information Office, *Treaties*, Factsheet P14, Procedure Series, Revised August 2010, available at <http://www.parliament.uk/documents/commons-information-office/p14.pdf>, at p. 1 (accessed on 7 October 2011); *See also*, Hollis, Duncan B., *A Comparative Approach to Treaty Law and Practice.*, NATIONAL TREATY LAW & PRACTICE, D. Hollis, M. R. Blakeslee, L. B. Ederington, eds., The American

Where a treaty requires a change in UK legislation or the grant of public money, parliament may be involved and required to vote in the normal way to make or deny the required provision. In the circumstances it can only overcome the will of the executive to conclude a particular treaty by expressing disapproval and relying on political pressure to change the mind of ministers, or, in the extreme case, by withdrawing its confidence from them.¹⁶⁵ According to this scenario, the UK is where Kenya was under its old Constitution. It is the executive arm of State that plays a major role in treaty making.

The lack of formal parliamentary involvement in treaty-making differentiates the British parliament from most other national legislatures, whose written constitutions stipulate that parliamentary approval of treaties is required before ratification for at least some categories of treaty.¹⁶⁶ For instance, the constitution of the U.S.A provides that treaties are made by the President by and with the advice and consent of two-thirds of the senators.¹⁶⁷ The British Government, like other governments, frequently concludes treaties with other governments that are not subject to ratification; ratification was deemed necessary in treaty-making when it was necessary to ensure that the ministers or diplomats who had negotiated the treaty had not exceeded their instructions and that the government in question was prepared to be bound by the text which they had signed.¹⁶⁸ The modern view of international law is that treaties need ratification only if a specific requirement for it is written into the treaty because national legislation is needed to implement the treaty or there is a strong political content.¹⁶⁹

Society of International Law, Martinus Nijhoff, June 2005, at p. 20, available at SSRN: <http://ssrn.com/abstract=790926>

¹⁶⁵ *Ibid*

¹⁶⁶ *Id.* at p. 2

¹⁶⁷ *Id.* at p. 2

¹⁶⁸ *Id.* at p. 4

¹⁶⁹ *Id.*

Whereas the parliament may not have any formal role in treaty-making as aforementioned, treaties with direct financial implications in UK require the assent of Parliament because they affect revenue: the most common type being bilateral agreements for avoidance of double taxation, DTAs. The texts of these agreements must be laid in the form of draft Orders-in-Council, which would thus be occasionally debated in parliament.¹⁷⁰ The Order-in-Council may be made under Section 158 of the IHTA 1984, Section 2 of the Taxation (International and other Provisions) Act 2010 or Section 173 of the Finance Act 2006.

For instance, under section 2 of the Taxation (International and other Provisions) Act 2010, titled ‘giving effect to arrangements made in relation to other territories’, Her Majesty is under an obligation to table before parliament, a draft Order-in-Council of any arrangement made between the UK and another jurisdiction for purposes of relief from double taxation which relate to certain taxes amongst them income tax, corporate tax and capital gains tax. The tabling of the Order-in-Councils is deemed necessary where the intention is to give effect to the arrangements in question. This would imply that such arrangement for relief from double taxation may not be effective in the UK unless and until parliamentary approval has been granted. As regards matters of international tax enforcement arrangements, the foregoing are also required, where Her Majesty tables the draft Order-in-Council before parliament before such arrangements can have effect in the UK under section 173 of the Finance Act 2006, titled International Tax Enforcement Arrangements. An Order under this section is not to be submitted to Her Majesty in Council unless a draft of the Order has been laid before and approved by a resolution of the House of Commons.

¹⁷⁰ Id.

The fact that the executive in the UK is empowered to make treaties binding on it does not mean that they exercise such power unencumbered. Although the UK executive could consent to be bound by any treaty at anytime, in practice it would refrain from joining treaties that require implementing legislation until after its enactment.¹⁷¹ It would appear for instance, based on the provisions of the various Acts of parliament under which DTAs can be negotiated as pointed out above; parliament does play a critical role. This parliamentary role is as was envisaged in the Bill of Rights 1689 that declared levying moneys for or to the use of the Crown by pretence of prerogative without grant of Parliament as illegal. From an international tax perspective and specifically as regards the bilateral agreements for avoidance of double taxation, the adherence is by the tabling of the DTAs prior to their entering in force as draft Orders-in-Council before the House of Commons for debate. This position contrasts Kenya's position envisaged under section 41 of the ITA, where the executive would only inform parliament of any DTAs after the same was already in force. The UK's practice with respect to DTAs, if adopted in Kenya, would bring about constitutional checks and balances, such as the ones envisaged under article 210 of the CoK which is currently missing from Kenya's perspective.

4.2 THE REPUBLIC OF SOUTH AFRICA

Republic of South Africa's (RSA) form of government follows a parliamentary structure. The executive officials are elected from within the legislative body. RSA follows the common law method. The Constitution of the RSA¹⁷² has been declared as the supreme law of the RSA. That supremacy is as relevant to the tax legislation as to any other legislation, such that any

¹⁷¹ Hollis, Duncan B., *A Comparative Approach to Treaty Law and Practice.*, NATIONAL TREATY LAW & PRACTICE, D. Hollis, M. R. Blakeslee, L. B. Ederington, eds., The American Society of International Law, Martinus Nijhoff, June 2005, at p. 25, available at SSRN: <http://ssrn.com/abstract=790926>

¹⁷² Act 108 of 1996

tax legislative aspect must be live to and in line with the provisions of the Constitution as was observed by the Constitutional Court¹⁷³,

even fiscal statutory provisions, no matter how indispensable they may be for the economic well-being of the country – a legitimate governmental objective of undisputed high priority – are not immune to the discipline of the Constitution and must conform to its normative standards.

The most important source of direct taxation in RSA is normal tax levied in line with the provisions of the Income Tax Act 58 of 1962 (as amended). The Income Tax Act falls under the control of the Department of Finance of the South African Government, the Minister in control being the Minister of Finance.¹⁷⁴ The administration of the Act is vested in the Directorate: South African Revenue Service (SARS).¹⁷⁵

4.2.1 Treaties and their Constitutionality

Before 1994 RSA followed the English dualist approach to the incorporation of treaties, such that treaties do not form part of domestic law directly until an appropriate national legislation has been enacted to give the treaty the force of law domestically. Treaties were negotiated, signed, ratified and acceded to by the executive and only those treaties incorporated in an Act of Parliament became part of RSA law.¹⁷⁶ Thus, treaty-making fell exclusively within the competence of the executive. However, the 1993 Kempton Park negotiators, representative of both the governing National Party, the African National Congress, and a wide variety of other political organizations, strongly motivated by considerations of transparency and accountability - which had played little role in the Apartheid State and thus, influenced by the

¹⁷³ First National Bank of SA Ltd t/a Wesbank v C: SARS 2002 (4) SA 768 (CC) at 787B, paragraph [31].

¹⁷⁴ , David Clegg and Rob Stretch *Income Tax in South Africa*, Volume 1: December 2010 - SI 38. Product developer: Sophia Khan, Chapter 1 Introduction, 1.4 Administration, available at [http://10.65.64.30/nxt/gateway.dll?f=templates\\$fn=default.htm\\$vid=mylnb:10.1048/enu](http://10.65.64.30/nxt/gateway.dll?f=templates$fn=default.htm$vid=mylnb:10.1048/enu) (accessed on 7 October 2011)

¹⁷⁵ *ibid.*

¹⁷⁶ John Dugard, *International Law and the South African Constitution*, 1 EJIL (1997) 77-92, at p. 81 available at <http://www.ejil.org/pdfs/8/1/1426.pdf> (accessed on 7 October 2011)

Namibian Constitution, they departed radically from the pre-1993 position in respect of the treaty-making power and incorporation of treaties.¹⁷⁷ While the executive retained its power to negotiate and sign treaties under the Interim Constitution, the National Assembly and Senate were required to agree to the ratification of and accession to treaties.¹⁷⁸

The current Constitution of RSA, 1996, makes provision for the conclusion of agreements in section 231 thereof. Although the responsibility for the negotiation and signing of all international agreements vests in the National Executive, the RSA Constitution does appreciate the need for parliamentary ratification, where treaties have to be approved by resolution in both the National Assembly and the National Council of Provinces, with certain exceptions.

There are, therefore, two frameworks for the conclusion of agreements in RSA. First, the framework that applies to international agreements that require ratification or accession (parliamentary approval) in order to be brought into effect under section 231(2). Secondly, the framework that does not require parliamentary approval, but applies to international agreements of technical, administrative or executive nature that merely requires the signature of a duly authorised representative of a state party to come into effect per section 231(3).¹⁷⁹ This therefore means that, treaties in South Africa are divided up based on the procedural requirements for approval.

¹⁷⁷ Id.

¹⁷⁸ Id.

¹⁷⁹ The Republic of South Africa, *Practical Guide and Procedures for the Binding of Agreements*, 2nd Ed. Office of the Chief State Law Adviser, Department of Foreign Affairs, available at http://www.dfa.gov.za/foreign/bilateral/binding_agreement1014.pdf (accessed on 7 October 2011)

Under this parliamentary method, the Head of State, the president, retains the treaty-making power, but may exercise it only through the Government or with its concurrence.¹⁸⁰ In this instance, negotiation of agreements is undertaken by the Minister within whose portfolio the subject of the treaty falls.¹⁸¹

In summary, the procedure for the adoption of agreements involves several steps.¹⁸² Firstly, an opinion on the agreement's consistency with domestic law, international law and RSA's international obligation is obtained from the State Law Advisers at the Department of Justice and Constitutional Development. Secondly, a President's Minute is prepared by the responsible government department for signature by both the responsible line function Cabinet Minister and the President. Thirdly, the President's Minute, a short Explanatory Memorandum together with two copies of the agreement are forwarded to the Office for certification in accordance with the prescribed procedures in a coversheet, before it can be presented to the Presidency for approval.

4.2.2 Legal authority and process in Bilateral/Treaty Relief

The decision on whether or not a treaty falls within one of the exceptions to the parliamentary approval requirement, that is, within the technical, administrative or executive nature, is taken by the executive, without consultation with parliament.¹⁸³ Although the executive can conclude these treaties without legislative pre-approval, that does not mean that executives always keep the legislature in the dark on their intentions. The practice is that the executive

¹⁸⁰ Hollis, Duncan B., *A Comparative Approach to Treaty Law and Practice*, NATIONAL TREATY LAW & PRACTICE, D. Hollis, M. R. Blakeslee, L. B. Ederington, eds., The American Society of International Law, Martinus Nijhoff, June 2005, at p. 20, available at SSRN: <http://ssrn.com/abstract=790926> (accessed on 9 October 2011)

¹⁸¹ *Id.* at p. 22

¹⁸² The Republic of South Africa, *Practical Guide and Procedures for the Conclusion of Agreements*, 2nd Ed. Office of the Chief State Law Adviser, Department of Foreign Affairs, at p. 7, available at http://www.dfa.gov.za/foreign/bilateral/conclusion_agreement1014.pdf (accessed on 7 October 2011)

¹⁸³ *Id.* at p. 26

gives the legislature advance notice of its intention to bring a treaty into force for the state, in which case even for agreements not subject to Parliamentary approval, RSA requires they be tabled before both houses of parliament for debate.¹⁸⁴ This seems to reflect the notion of a political check, assessing when to allow or check unfettered executive authority based on whether the treaty has any policy significance.

Technical, administrative and executive agreements are not specifically defined. It is usually the department responsible for processing the agreement to determine, in conjunction with the Law Advisors of Justice and Foreign Affairs, whether an agreement falls within this category.¹⁸⁵ These include agreements which are: departmentally specific, of major political or other significance, have no financial consequences, and do not affect domestic law.¹⁸⁶

In the case of agreements which are of an administrative, executive or technical nature or which do not require ratification or accession, the mere signing of the agreement by a person authorised by the National Executive will be sufficient to bring the agreement into effect, provided the signature is intended to indicate consent to be bound.¹⁸⁷ The prior approval of the signing of the agreement by the National Executive will constitute the necessary formal authority to bind the RSA to the agreement, although the agreement will still need to be tabled in the Assembly and the Council within a reasonable time of its signing in line with section 231(3) of the 1996 Constitution.¹⁸⁸

¹⁸⁴ *Id.* at p. 27

¹⁸⁵ The Republic of South Africa, *2006 Manual on Executive Acts of the Office of the President of South Africa*, Chapter 5, at p. 45 available at http://www.ndi.org/files/1614_za_constPDF.pdf (accessed on 9 October 2011)

¹⁸⁶ *Id.* at p. 44 - 45

¹⁸⁷ *Id.* at p. 45

¹⁸⁸ *Id.* at p. 45

The National Executive ‘assumes responsibility’ for such agreements and such responsibility includes determining the arrangements by which negotiation and signing takes place.¹⁸⁹ Line function Ministers must ensure that international agreements do not conflict with the domestic law or government policy and that it will not have adverse financial consequences.¹⁹⁰ Where the international agreement does not deal with a routine departmental matter, for example where it impacts on RSA’s domestic law or involves financial expenditure, the matter cannot be dealt with by a single Minister and should be remitted to the Cabinet by way of a cabinet memorandum for the approval of the agreement and for the authorisation of a particular person to represent the Republic in concluding the necessary formalities.¹⁹¹

DTAs in RSA seem to fall within the legal framework which does not require ratification or accession by parliament prior to their coming into force. This is so as they seem to fall under technical, administrative or executive nature, with the Minister in charge of Finance (the National Executive) undertaking the role of ensuring their coming into effect. This practice in RSA mirrors the Kenya’s practice pre-CoK under which the executive assumed the adoption process without the involvement of the parliament. Although the classification of DTAs as technical, administrative or executive treaties which do not thus require parliamentary approval works to fast track their adoption process, there is need to bring democracy in this process. Democracy and adherence to the principles of public finance under the Kenya’s CoK could be achieved through the involvement of parliament in line with article 210 of the CoK.

¹⁸⁹ Id. at p. 45

¹⁹⁰ Id. at p. 45

¹⁹¹ Id. at p. 45

4.3 INDIA

India is a Union of States , a Sovereign Socialist Secular Democratic Republic with a parliamentary system of government , which is federal in structure and with certain unitary features.¹⁹² The Republic is governed in line with the terms of the Constitution of India which was adopted by the Constituent Assembly on 26th November 1949 and came into force on 26th January 1950 .¹⁹³ As per Article 79 of the Constitution of India, the council of the Parliament of the Union consists of the President as the constitutional head of the Executive of the Union and two Houses known as the Council of States and the House of the People. ¹⁹⁴ Article 74(1) of the Constitution provides that there shall be a Council of Ministers with the Prime Minister as its head to aid and advise the President . The President is thus under an obligation to exercise his/her functions in accordance to the advice of the Council of Ministers. Thus, the real executive power is vested in the Council of Ministers.¹⁹⁵

4.3.1 DTAs and their Constitutionality

With respect to taxation, the Indian Constitution specifically provides that taxes can be imposed only by the force of law under Article 265, Chapter XII. In line with the foregoing provisions, section 4 of the India Income Tax Act (ITA), 1961 provides for a charge of income tax¹⁹⁶, on the total income that is both accrued in and out of India in line with the provisions of section 5 of the ITA. Such tax law is required to provide for a taxable event upon the occurrence of which the subject-matter of taxation is obliged to defray the tax imposed to the government coffers. In such events, the only legally available way to avoid

¹⁹² Republic of India, *Constitution of India*, National Portal of the Government of India, available at http://india.gov.in/govt/constitutions_india.php (accessed on 10 October 2011)

¹⁹³ Id.

¹⁹⁴ Id.

¹⁹⁵ Id.

¹⁹⁶ *CIT v. K. Srinivasan* [1972] 83 ITR 346 (SC), where the expression income-tax' as used in the Finance Act and the Income-tax Act was said to include surcharge and additional surcharge wherever provided in the Act. The surcharge, the special surcharge and the additional surcharge form part of the income-tax and super tax and are not separate taxes by themselves

taxation is to challenge the levy itself or to invoke the benefit of an exemption in terms of which the otherwise taxable subject-matter is exonerated from the liability to pay the tax.¹⁹⁷

The evolution of rules of international taxation as a distinct branch of fiscal laws governing the tax treatment of entities and transactions upon which two or more sovereign states can claim their right to tax has not been without its fair share of influence on the India fiscal regime, where the intent to avoid international double taxation of income and taxation is embraced.¹⁹⁸ Under article 253 of the Indian Constitution, Parliament has power to make any law for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.

4.3.2 Legal authority and process in Bilateral/Treaty Relief

Effectively, provisions of article 253 aforementioned, and as regards double taxation relief, Section 90 of the Indian ITA¹⁹⁹ which statutorily governs the process of adoption of DTAs empowers the Central Government to enter into an agreement with the government of any country for granting relief from double taxation both in India and that other country. Being a developing country, India has consistently argued that a provision such as section 90 (2) has leads to considerable erosion of tax-base of India. This is particularly so since India has been a party to numerous tax treaties and particularly with jurisdictions which are characterized as tax-havens.²⁰⁰

¹⁹⁷ Jain, Tarun, *Tweaking with Treaty Provisions: A Lawyer's Perspective on the Direct Taxes Code Bill, 2009* (October 1, 2010). At p. 3 Available at SSRN: <http://ssrn.com/abstract=1865040> (accessed on 10 October 2011)

¹⁹⁸ *Id.* at p. 4

¹⁹⁹ This section is the equivalent of Section 41 of the Kenyan Income Tax Act already analyzed under Chapter Three.

²⁰⁰ *Supra*. note 63, at p. 7

In this regard, the Supreme Court of India in *Union of India v. Azadi Bachao Andolan*²⁰¹ has observed that the very object of grafting section 90 of Indian ITA is to enable the Central Government to issue a notification for implementation of the terms of the DTAs which would automatically override the provisions of the ITA.²⁰² The court went ahead to state that the validity and the *vires* of the legislation, primary or delegated, has to be tested on the anvil of the law making power, holding that the Central Government has the requisite power to enter into arrangements for relief of double taxation as DTAs in line with section 90 of ITA.

From the above dictum of the court, the power to legislate under section 90 of the ITA 1961 may only be exercised, and rightly so, by the Parliament as stipulated under sections 265 and 253 of the Indian Constitution. The role of parliament in the formulation and ratification of DTAs is further backed by the fact that that India is a dualist approach, in which case no international treaty can be implemented in India unless a domestic law provides to such effect. This has been judicially backed by the High Court in *Karan Dileep Nevatia v. Union of India*²⁰³. In analyzing the constitutional and legal parameters of article 253 of the Indian Constitution on international treaties summarized the court summed up the position as follows:

First, the stipulations of a treaty duly ratified by the Central Government do not by virtue of the treaty alone have the force of law. Secondly, though the executive has power to enter into international treaties under article 73 (read with Entries 10 and 14 of List I of the VII Schedule to the Constitution of India) the power to legislate in respect of such treaties, lies with parliament which may refuse to perform such treaties leaving India in default. Thirdly, though the applications under such treaties are binding upon India, these treaties are not of

²⁰¹ [2003] 263 ITR 706 (SC)

²⁰² *Supra*, note 63 at p. 8

²⁰³ 2010 (112) Bom LR 127

their own force binding upon Indian nationals, until such times as they will have been domesticated as part of Indian domestic law. Fourthly, the making of law by parliament in respect of such treaties is necessary when the treaty restricts or affects the rights of citizens or others or modifies the law of India. Lastly, if the rights of citizens or others are not affected or the laws of India are not modified then no legislative measure is needed to give effect to such treaties.²⁰⁴

Pursuant to Section 90 foregoing, India adopts a two-tier DTA practice, which calls for parliamentary approval of all international treaties even where mandate is vested on the executive.

I am persuaded that, like India and RSA, and considering the need for Kenya to be a favorable investment destination, Kenya should adopt a two tier system in its approach to DTA admission. This not only tallies with the relevant provisions of the CoK which import democracy in the approach but also ensures that there is due consideration of the fundamental rights of the citizens of Kenya through equal and fair treatment.

4.4 CONCLUSION

The existence of the nexus between income and the taxing country is a prerequisite for the right by the country to levy tax to arise. The jurisdictions analyzed above share a number of similarities amongst them: the right to tax incomes of their residents derived both from within and outside their territories as well as the incomes of non-residents that are derived from within their jurisdictions. Despite these fiscal rights that these jurisdictions do have, they do provide relief from double taxation, either bilateral or unilateral. Bilateral relief is effected

²⁰⁴ Jain, Tarun, *Tweaking with Treaty Provisions: A Lawyer's Perspective on the Direct Taxes Code Bill, 2009* (October 1, 2010), at p. 15 Available at SSRN: <http://ssrn.com/abstract=1865040> (accessed on 10 October 2011)

through DTAs while the latter is through domestic tax legislation. This chapter has also established that whereas the right to negotiate and conclude the DTAs is vested in their respective executives, the executive powers are not unencumbered. The legislatures have the right to oversee the admission of treaties in general, as may be exercised by the executive. This right of the legislature to apply checks and balances on the executive is granted either by their respective constitutions or other domestic legislations.

In the UK for instance, parliament has been granted the power to oversee the executive power in the admission of DTAs by the provisions of the various Acts of Parliament under which DTAs can be negotiated. This parliamentary oversight is as was envisaged in the Bill of Rights 1689 which declared that the levying moneys for or to the use of the Crown by pretence of prerogative without grant of Parliament as illegal. Adherence to this declaration is by the tabling of the DTAs, prior to their entering in force, as draft Orders-in-Council before the House of Commons for debate.

On the other hand, the constitution of the RSA, though terming the DTAs as technical in nature and which may accordingly come into force by the sole action of the Minister, cabinet approval is deemed critical. The Indian constitution vests the authority for DTA adoption on the central government. However, the High Court in India has interpreted their constitution with regard to DTA adoption by stating that the parliament plays a critical role in legislating such DTAs, thus giving them force of law in India.

CHAPTER FIVE: OVERALL CONCLUSIONS AND THE WAY FORWARD

5.1 A RECAP OF THE STUDY

This study has dealt with a number of tax issues: generally ranging from the sources of government revenue for which taxation forms part, reasons behind taxation and tax administration; the constitutional basis of taxation on; and particularly on the concept of international taxation, double taxation of incomes that may arise from cross-border trade and initiatives undertaken to create certainty in taxation that is critical for international movement of capital and labour, through DTAs.

In chapter one, it emerged that methodology is very important to any tax study including an analysis of DTA adoption process and practices such as the present one. This chapter defined and delimited the problem investigated in the project. It was observed that DTAs perform an important role in providing certainty for the taxation of the state parties thereto and their economic investors. This certainty is through alleviation of the problem of double taxation on the same income by inclusion of tax waiver, concessions as well as reduced withholding tax rates. However, such means of alleviating double taxation must now, in Kenya, be governed and regulated in accordance with the CoK. The CoK, in particular, article 210 vests the legislature with the power to legislate on taxation including matters of tax imposition, waivers and variations.

Chapter two looked deeper into the juridical, constitutional and fiscal nature of DTAs generally and in the Kenyan context. The nexus between principles of sound taxation and constitutional set-ups was also examined leading to the finding that for any tax or DTA regime to be viable, it must be sensitive to the principles of certainty, openness and

accountability and equity and must be re-aligned to the constitutional requirements on taxation or fiscal arrangement.

For its part, Chapter three looked into the central question of the study by focusing Kenya's DTA practice under both the old and new constitutional dispensations. The old constitutional order was overly executive-driven, with parliament playing a rubber-stamping role. Though the CoK has given parliament an oversight role on taxation matters, the provisions of section 41 of the Income Tax Act that provided the executive with its mandate for exercise of jurisdiction in DTA adoption process still subsists. It was concluded here that Kenya, through article 210 in the CoK, has made a significant stride in injecting democracy and constitutionalism in DTA practice by introducing parliamentary oversight over the process. This remarkable fiscal-legal stride is very positive considering the fact that this process had hitherto been an exclusive domain of the Kenyan Executive through the Ministry of Finance.

Chapter four of the study comprised comparison between Kenya's DTA practice, on the one hand, and the DTA practices of the UK, India and RSA, jurisdictions that have been chosen based on their very special ties to Kenya. It emerged that Kenya has, indeed, a lot to learn from these, more progressive, economic and political partner, jurisdictions in terms of expanding the scope of parliamentary oversight over DTA practice.

5.2 SUGGESTIONS FOR THE WAY FORWARD

The overall study did establish that Kenya has no legal framework governing the process of adoption of treaties and such a lacuna in law is no longer sustainable in view of the CoK. The practices observed in the jurisdictions which were studied, together with the principles of a

sound taxation system and constitutional principles make me to suggest, as my academic contribution to the study of this enormous issue that:

First, Kenya needs to enact an Act of Parliament that will govern the process of adoption of treaties. It is recommended that a generic approach to adoption of treaties in general be implemented as is commonly the case in the three jurisdictions already studied. As DTAs by their nature, may impact on the total revenue of a country through allocation of taxing rights and provisions of waivers, the legislation that is enacted to govern the process of adoption of treaties ought to place strong emphasis on parliamentary oversight.

Secondly, the treaty adoption Bill proposed above ought to be constitutionally-anchored. In particular, the Bill ought to adhere to article 1 that deals with the sovereignty of the people and how that sovereignty may be exercised; article 2 on the supremacy of the Constitution and its interface with other regimes like rules of international law and treaties. As regards representation of the people, the Bill must also be premised on article 201 and 210 of the CoK which lay a constitutional base for principles governing public finance and taxing authority, respectively.

Thirdly, the already-published *Ratification of Treaties Bill, 2011* that provides a general framework for adoption of treaties ought to be amended to establish the various classification of treaties. For instance, and borrowing from the RSA, the Bill could provide classification into technical, administrative or executive treaties and the mechanism that needs to be adopted for such treaties. Such a mechanism would borrow heavily from the provisions of article 231 of the Constitution of RSA, which despite the two frameworks, parliamentary oversight is still brought into the DTA adoption process.

Lastly, the operational capacity of the offices of the Attorney General, Ministry of Foreign Affairs, KRA and Ministry of Finance (Treasury) should be strengthened in order to effectively handle the entire corpus of Kenya's DTA practice along the lines of the conceptual parameters discussed in this study. The operational capacity would take the form of tax and DTA education. This, it is hoped would equip them with the relevant skills to appreciate and incorporate democracy in the adoption process.

Ultimately, it is opined that it is imperative for Kenya, like, every other state, to decide for itself, who will have authority to negotiate treaties on its behalf, whose approval is required before the state can consent to a treaty, and how to incorporate such treaties into its national law.

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