

Sagamore Hill.

TAX NEWSLETTER.



Understanding Tax Implications for International Employees: Compliance Essentials for Global Teams.

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Every month, we make a [publication](#) of the most downloaded tax case law from our [database](#) where we provide more analysis, on the issues of determination and further providing our insights for your further reading. Our goal is to keep you updated on this very dynamic tax landscape.

In this month's newsletter, we offer discussion and insights on employment taxes from international taxation perspective

Back ground of the case.

The case was between GTZ international and commissioner of domestic taxes where the appellant was assessed for PAYE for employees in Kenya and Sudan. The appellant appealed on the assessment on the taxes on non-residents employees in Sudan and those working in GTZ international services in Nairobi of 20M together with the associated interest and penalties.

The appeal stemmed from two points in the respondent's decision.

1. That the appellant had the obligation to deduct, remit and account for PAYE in respect of non-resident employee working in Sudan and all employees working in Nairobi as per Section 5(1)(b) of the Income Tax Act.
2. The appellants' office in Nairobi is a permanent Establishment of GTZ in Germany and also of South Sudan operations and such liable to PAYE taxes.

Grounds of the appeal were as follows.

The principal grounds of appeal were as follows.

1. That the appellant was a Permanent establishment of GTZ in Germany.
2. That the appellant was office in Nairobi had existed since 2004 for sole purpose of the business carried by itself
3. That the appellant's South Africa was an independent set up that did not report to the Nairobi office but reported directly to the GTZ head office in Eschborn Germany.
4. That the appellant had remitted income tax for more than 250 Kenyan Staff in South Sudan.

The appellant argued that the office in South Sudan was independent and did not report to the office in Nairobi but reported directly to GTZ head office in Germany. As such, the appellant refuted the claim that Nairobi office controlled activities of GTZ international service in

Sudan.

The appellant, however, had to rely on the office in Nairobi for logistical support by channelling funds to the office in South Sudan, due to the sanctions by USA.

The appellant submitted these services were of auxiliary nature and the Nairobi office was merely providing assistance. Further, the contracts of GTZ international services employees were concluded in Germany or South Sudan. Further the location of all employees was in South Sudan save for one employee.

The appellant refuted the respondents' interpretation of a permanent establishment.

Respondents case.

The respondent argued that the GTZ international services office in Nairobi is a permanent establishment of GTZ in Germany and also of Sudan operations as without the facilitation of the money transfer, the South Sudan business would literally come to an end.

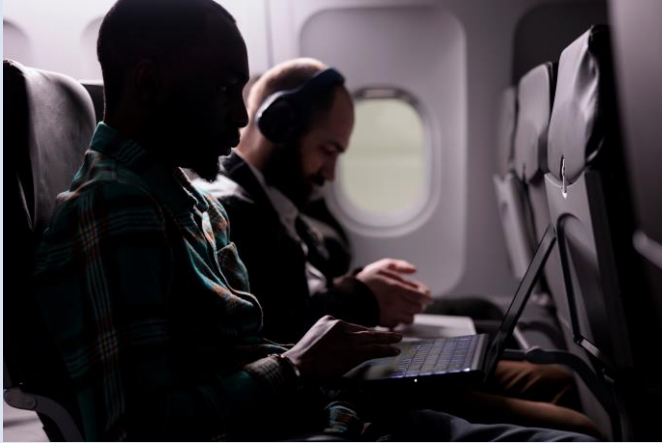
The respondent further stated that the income tax act placed an obligation on the GTZ international to deduct, remit and account for PAYE in respect of the non-resident employees working in South Sudan and all employees working in the Nairobi office of GTZ international services.



Courts' determination.

The court observed that the respondent dropped assessment on the South Sudan employees who were Nationals or citizens of the country while the parties pursued the Alternative Dispute Resolution mechanism. This was as observed in **Civicon Vs KRA**, where the court ruled that the tax demanded by KRA on salaries paid to South Sudan nationals was unreasonable as the employees were foreign nationals who rendered services in a foreign nations using money sourced from another foreign country and paid in a foreign country. The court further observed that the appellant is a foreign company that has its office in Nairobi and further most of its activities in South Sudan are carried out from the Nairobi office. This made it evident enough that the Nairobi office was a permanent establishment

as defined in the Income Tax Act. The appellant allegations that the office was merely used for **auxiliary** purposes without furnishing any evidence to support that the controls and approvals were done in Germany did not stand. There simply was never independence of South Sudan office in its operations.



The income tax act defines a permanent establishment to include;

a fixed place of business through which business is wholly or partly carried on and includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources, a warehouse in relation to a person whose business is providing storage facilities to others, a farm, plantation or other place where agricultural, forestry plantation or related activities are carried on and a sales outlet;

The Kenya-Germany Double Taxation treaty further gives an exhaustive and inclusive meaning.

As for the Kenyan Nationals in South Sudan, the appellant conceded to the tax assessed on some of them, but the appellant further requested the respondent to drop the tax demand made on the other expatriates.

- The court made the decision that the disputed PAYE for the Kenyan nationals who worked in South Sudan during the period of the project is payable however, under strict compliance with the provision of the income Tax Act Section 3(2)(ii) that states as follows.

3(2) Subject to this Act, income upon which tax is chargeable under this Act is income in respect of—

- a. gains or profits from—
 - I. any business, for whatever period of time carried on;

II. any employment or services rendered;

- The tax assessed on the German Nationals was not payable as their labour contracts were signed in Germany and their place of work was South Sudan and not Kenya.

Further reading and analysis.

Further to the discussion above, the increased ease of labour mobility has brought with it a lot of tax challenges as regards the taxation of cross border provisions of labour. We aim to provide further discussion on this issue in the next few pages so as to enhance your compliance.

In Kenya, a Service Permanent Establishment starts to exist if the employee is in the country for an aggregate of 91 days or more.

On double taxation treaties.

It is incredibly important to understand that Double taxation treaties do not confer taxing rights, but rather they provide; **relief to a qualifying person, sharing of information between countries, resolving of unfair complex areas of taxation and promote cross border trade.**

Double taxation treaties do have in one of their articles, the definition of terms, for their interpretation and applicability. In the case above, the issue of Permanent establishment was well defined in the double taxation treaty.

However, in some unique cases, double taxation treaties definition of terms may not cover all aspects of the dynamic of the recent business trends, mainly because of the changing nature of business transactions, as majority of these treaties entered into force many years ago.

Double taxation treaties, do however, provide that where any term not otherwise defined in the treaties, shall unless the context otherwise require, have the meaning which it has under the laws in the contracting state, where the income has been derived. This is in line with the Article 3(2) of the OECD Model Tax Convention. As relates the discussion in this newsletter, the Commentary further proceeds to note that domestic tax law may expand the concept of employment, making it important to make reference to the domestic tax laws of a country.

To help take this point home, a UK case of ***Flower Vs***

HMRC, a diver who was working in the North Sea was formally an employee, but he was taxed as though he was carrying on a trade, since what he was engaging in was not defined in the treaty in the definition of terms and yet, the UK laws had a distinct provision in its domestic laws. In this regards, if the diver was taxed using the business profits article in the OECD model tax convention, he was not taxable in the UK due to a lack of a permanent establishment, where as if the employment article applied, the UK could tax.

Netherlands offers visiting employee, who has a specific know-how not available in their country, who has specific education, professional qualifications and at least two and half years of experience and are highly paid, a tax advantage where 30% of their salary is considered tax free in Netherlands and further deductions such as expenses on school fees are also added into their package as allowable expenses.

We must, however, note that there's a limit to what domestic tax law may deem to be employment that is acceptable for tax treaty purposes. In identifying this limit, it is important to determine whether the **services** that the individual renders, constitute an integral part of the business enterprise. In most countries, the emphasis is given to who or which enterprise bears the **responsibility or risk** for the results produced by that person's work. This is in line with the **result-test** used in many

countries domestic tax laws that helps determine the substance of the relationship and whether the relationship is an employment or not. We covered these difference in our [August 2021 issue](#) that differentiate between a contract of service and contract for service. There are further guidelines that one may consider so as to determine the true economic employer, where the employee has been seconded to a different entity both in different tax jurisdiction. These tier breakers will help allocate the taxing rights between the two contracting states. They are;

- Who gets to determine the worker's holidays and work schedules?

- Which between the two companies bears the risk, or enjoys the benefit in relation to the work done by the employee?
- Whose authority it is to instruct the employee as to how the work is supposed to be done?
- Who has the responsibility and controls of the place where the work is performed?
- Who provides the tools of work?
- Who determined the qualifications needed of the individual to do the work?
- Who has the authority to impose disciplinary action on the individual?

The case discussed above, that of Flower, is an exceptional example of a potential mismatch of earning activities as defined in the domestic tax laws, that gives rise to a potential mis-match of income characterisation. This instant case buttresses the importance of referencing domestic tax laws to help define terms where the definition in the Double Taxation Treaty is not comprehensive enough. The domestic tax laws in the UK defined anyone engaging in the kind of diving activities that the south African diver was engaging in, to be considered to be engaging in business.



On international mobile employees

Multi-national entities will in most cases second their employees who are specialists to offices or location in other countries, making it important for the employer and employee to understand the tax implication of such kind of arrangements. Generally, these employees will be taxed on the income they received while in assignments in the country that they earned the income. But this is not always the case.

Article 15 (2) of the OECD Model Tax Convention provides the following three provisions to handle the

circumstances of each individual case that give the home country, or the country of tax residence of the employee the taxing rights.

1. The recipient was in that other country for a period not exceeding an aggregation of 183 days in any twelve months.
2. The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State.
3. The remuneration is not borne by a permanent establishment which the employer has in the other State.

Key things to note from this is that, the number of days is aggregated to less than 183 days for a period of 12 months. This means that if the employee takes break in a continuous assignment to go back to the home country, but the employee goes back to the country of assignment days or months later, the latter days will be added to the former days in the prior assignment if they within a twelve months' period. This is to avoid abuse through short period secondments. Again, the important things to note here is the twelve-month period that does not necessarily mean from January to February. This is to avoid an employer assigning an employee assignment in that other country at the turn of the year for example for 180 days, therefore resetting the days to zero, immediately reassigning them immediately for the next 180 days. The employee will have worked an aggregate of close to a year should the reference was other than a 12 months' period.

What about the day of arrival and departure, one may ask? The general practise is that these days are included in the calculation of the number of the days.

The other two direct provisions, imply that the employer must not have a permanent establishment in that other country, and the person paying must not be a resident of the other state.

The employees who are seconded for these assignments are therefore exposed to two scenarios.

1. They stop to be tax residents in their home countries if the assignment is of more than an aggregate of 183 days as per the OECD MTC or as the number of days as may be defined in their double taxation treaties or domestic tax laws. In Kenya, a Service Permanent Establishment would start to exist if the employee is in the country for an aggregate of 91 days or more.
2. The employee not only remains a taxable in their home country, but also becomes a tax

resident in the other country that they have been seconded to. This is largely because, most countries, including Kenya, use the **Source Based Principle** where the country taxes any income which has a source in the country. Kenyan courts have recently ruled that where a non-resident company has employees working here in Kenya, the said company should register for the respective tax obligations.

For the case of Kenya, an individual will be regarded to be a resident, and therefore taxable in Kenya as a resident if;

- I. He has a permanent home in Kenya and was present in Kenya for any period in any particular year of income under consideration; or
- II. He has no permanent home in Kenya but—
 - a. Was present in Kenya for a period or periods amounting in the aggregate to 183 days or more in that year of income; or
 - b. Was present in Kenya in that year of income and in each of the two preceding years of income for periods averaging more than 122 days in each year of income;

A permanent home, is defined by the Income Tax Act to mean a place where an individual resides or which is available to that individual for residential purposes in Kenya, or where in the opinion of the Commissioner the individual's personal or economic interests are closest. It is incredibly important take note of the conjunction "and" making it mandatory that an individual person must have a permanent home, in addition to being present in Kenya. The courts have recently upheld this fact.

A body of persons will be taken to be a tax resident in Kenya, if;

- I. The body is a company incorporated under a law of Kenya; or
- II. The management and control of the affairs of the body was exercised in Kenya in a particular year of income under consideration; or
- III. The body has been declared by the Minister, by notice in the Gazette, to be resident in Kenya for any year of income

In passing, there has been increased audits by Kenya Revenue Authority on corporate residency based on the



second pointer, that is based in the place of effective management, we issued publication discussing the issue [comprehensively here](#).

Tax equalisation arrangements.

Due to the exposure the international employees face, whereby, they may become tax resident in countries that might tax their income at higher rates, and even become liable to make contribution to foreign government social security programs, employers do offer tax equalisation arrangements, whereby the employer ensures that the net pay received by an individual is the same, in spite of where they have been posted by grossing up the amount payable to them. Surprisingly, in some cases, the employer may benefit, where the employee is seconded in low tax jurisdictions.

Due to the complex nature of these internationally mobile employee type of arrangements, some countries, as they strive to encourage MNEs to come into their countries and in most cases to bring specialists with them, these countries offer favourable tax regimes to such kind of specialists. For example, Netherlands offers visiting employees, who has a specific know-how not available in their country, who has specific education, professional qualifications and at least two and half years of experience and are highly paid, a tax advantage where 30% of their salary is considered tax free in Netherlands and further deductions such as expenses on school fees are also added into their package as allowable expenses.

Kenya has taken similar direction so as not to impede international mobility of labour and to invite highly experience personnel in high technical fields. For instance, the Finance Act 2023 introduced an amendment in the First schedule of Income Tax Act which exempts certain incomes from tax. The newly inserted section 71, states that

“Income earned by a non-resident contractor, sub-contractor, consultant or employee involved in the implementation of a project financed through a one hundred percent grant under an agreement between the Government and the development partner, to the extent provided for in the Agreement: Provided that the non-resident is s in Kenya solely for the implementation of the project financed by the one hundred percent grant”

Like Netherlands, there’s a limit to the extent such a person is required to meet to enjoy the benefit which again the Tax Law Amendment Bill 2024 seeks to further extend so that only income received from the engagement in the project will be exempted from tax. The proviso states that “any other income not directly related to the project earned by that non-resident contractor, sub-contractor, consultant or employee shall be subject to tax”.

Director fees.

As regards the directors’ fees and other similar payments received by an individual director acting in his capacity as a member of the board of the company in another state, Article 16 of the OECD MTC provides that such payments may be taxed in that other state of the resident of the company in which he is a director.

The commentaries of this article provides that the director fees received by the directors in his capacity as a director will in most countries be taxed in the country of resident of the company, but if the same director receives other similar payments acting as an employee, consultant or advisor of the company, where such clear distinction exists, then such payments will be taxed differently. In practise, and in most countries, the director will be taxed in the two countries, and where the country of residence of the director has a double taxation treaty with that other state, then the home country of the director will apply the treaty provision, either provide a credit, or apply an exemption on that income. Most countries adopt the credit method.

We hope that you have found the above discussion valuable. Should have any question for us, do not hesitate to reach out to us.

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