



IMPOSITION OF TAX ON THE E-COMMERCE INDUSTRY IN KENYA

Background

Taxation of the digital economy has been an area of debate in the international arena. For instance, the tax challenges of the digitalisation of the economy was identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan and culminated in the 2015 BEPS Action 1 Report (2015 Final Report). According to the 2015 Final Report, features of the digital economy such as mobility of the intangible assets and the mobility of the users has further complicated tax collection and created substantial opportunities for profit shifting.

The Organisation for Economic Co-operation and Development (OECD) has placed emphasis on the need for the establishment of an international framework for the taxation regime of the digital economy towards ensuring the proper allocation of taxing rights with a view of ensuring transparency, certainty, stability and mitigating the risks of double taxation. Till date, this remains an important part of the international agenda.

Regionally, the Africa Tax Administrative Forum (ATAF) published a policy document in June 2020 announcing that it is in the process of developing a “Suggested Approach to Drafting Digital Services Tax Legislation” (Suggested Approach), with an aim of providing African countries with a structure and framework for introducing Digital Service Tax (DST).

DST has been introduced against the background of the acceleration in technology and evolving business models that has enabled persons to conduct their businesses through digital platforms in Kenya. DST will apply on income from such platforms which has previously proven difficult to tax due to the nature of the transactions. In addition to DST, we expect that soon there will be clear guidelines on the indirect taxation of taxable supplies through the digital marketplace which will reinforce the existing provisions within the Value Added Tax (VAT) Act.

The purpose of this article is to discuss the imposition of taxes on the digital economy in Kenya, important considerations and practical nuances of the taxes as imposed.

Digital Services Tax

The efforts to impose tax on income derived from or accrued in the digital marketplace may be traced back to the Finance Act, 2019 which amended various provisions of the Income Tax Act (ITA) to include the definition of a digital marketplace and to further include income accruing through a digital marketplace as income which is subject to tax under the ITA. According to

Section 3(3)(ba) of the ITA, a digital marketplace refers to a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.

The Finance Act, 2020 added Section 12E to the ITA which effectively imposes the tax known as Digital Service Tax. According to Section 12E(1) of the ITA, Digital Service Tax shall be payable by a person whose income from the provision of services is derived from or accrues in Kenya through a digital marketplace (as defined under Section 3(3)(ba) of the ITA). Accordingly, this tax will be payable by resident persons or non-resident persons with a permanent establishment (PE) who generate income from the provision of services in Kenya through a digital marketplace.

The features of the DST may be summarised as follows: -

- i) DST is tax that is chargeable on business income that accrues through the digital marketplace.
- ii) It is chargeable at the rate of 1.5% on the gross transaction value of the services.
- iii) It is due and payable at the time of the transfer of the payment for the service to the service provider.
- iv) The obligation to make payment will be on the service provider.
- v) Resident and non-resident persons with a PE in Kenya, shall offset DST paid against the tax payable for that year of income. For this reason, it is a form of advance tax for taxpayers within these categories.

Noting that DST is chargeable on business income, we believe that foreign persons who are subject to this tax may where and if applicable, rely on treaty provisions relating to business profits.

In comparison to the amendment under the Finance Act, 2019, which defined the digital marketplace and regarded income accruing from this source as chargeable income, the amendments under the Finance Act, 2020 have now detailed the persons to whom this tax will be applicable to, the specific income which will be chargeable, the rate of tax and the time of payment. Therefore, it is evident that DST is not an additional tax. It is, however, an administrative measure targeted at increasing compliance as regards business income that is generated through electronic means which would otherwise, be subject to the corporation tax rate but for the complexities in tax collection.

To further implement this tax, the Finance Act, 2020 amended the Tax Procedures Act empowering the Kenya Revenue Authority (KRA) to appoint DST agents who will collect and remit DST to the KRA. A practical nuance arises, however, considering that with the advancement in technology, there is increased use of the digital marketplace such that there are numerous transactions being undertaken by different persons every minute of the day. Given this, the stipulated time of payment for DST, which is the time of the transfer of the payment for the service to the service provider, may pose a compliance challenge for persons operating digital platforms. In many cases, payments are made every day and at different intervals throughout the day. It is therefore too onerous to require payment of tax every day and in some cases several times a day depending on the frequency of payment to the service providers.

The ITA empowers the Cabinet Secretary for National Treasury (Cabinet Secretary) to make regulations to provide mechanisms for implementing the provisions of the digital marketplace. This has led to the recent publication of the draft Income Tax (Digital Service Tax) Regulations, 2020 (Digital Service Tax Regulations) for public comment. We highlight the features of the draft Digital Service Tax Regulations below.

Features of the Draft Income Tax (Digital Service Tax) Regulations, 2020

i) Taxable Services

The draft Digital Service Tax Regulations list digital services which fall within the scope of taxable services subject to DST. These include streaming and downloadable services of digital content including videos and movies, provision of a digital marketplace, website or online applications that link buyers and sellers, online ticketing services, online distance teaching and electronic data management such as cloud storage services.

It is important to note that the draft Digital Service Tax Regulations expressly exclude online services conducted by a licensed financial service provider which facilitate activities including payments, from the scope of digital services for purposes of this tax. In this regard, services provided by licensed financial institutions such as internet banking which have become popular in Kenya will not be subject to DST. In addition to this, services which although provided or delivered through an electronic or digital platform will not be subject to DST where the payments for these services are already subject to withholding tax under the ITA.

ii) Taxable Persons

According to the ITA, DST is payable by persons whose income from the provision of services accrues in Kenya through a digital marketplace. The draft Digital Service Tax Regulations further expound on this, stating that the tax is chargeable on the income of both resident and non-resident persons who derive the income from the provision of services through a digital marketplace. It should be noted that the tax is applicable on the income from the provision of a digital marketplace itself, that is, the platform as well as, the income from the provision of services through a digital marketplace. Income from these services will be deemed to have accrued in Kenya where a user of the services is located in Kenya.

iii) Gross Transaction Value

The draft Digital Service Tax Regulations also expound on the term 'gross transaction value' and provides a distinction of the term in relation to payment made to a digital service provider vis a vis payment made to a digital marketplace provider. For a digital service provider, gross transaction value on which DST will be levied is the payment received as consideration for the services excluding the VAT chargeable for this service. In the case of a digital marketplace provider, the gross transaction value on which DST will be levied is the commission or fee paid for the use of the platform excluding the VAT chargeable on the supply.

iv) *Administration and Compliance*

According to the draft Digital Service Tax Regulations, the payment of the tax shall be the liability of the digital service provider or any person that collects the payments for digital services.

A non-resident person without a PE may appoint a tax representative to account for the DST on their behalf, in which case, the tax representative will be required to remit the tax due by the 20th day of the month following the end of the month when the service was provided.

The KRA may appoint a DST agent who shall deduct, account and remit the DST to the Commissioner through a DST collection service in the case of a resident or a non-resident person with a PE in Kenya and a non-resident person who has not appointed a tax representative.

It should also be noted that persons subject to this tax will be required to submit returns in the prescribed form and remit the tax by the 20th day of the month following the end of the month that the digital service was offered.

We note that the draft Digital Service Tax Regulations offer guidance that may address some of the practical nuances in the remittance of DST towards ensuring that persons to whom the tax applies remain compliant.

Value Added Tax on Electronic Services

In addition to the DST, we note that electronic services are subject to VAT in Kenya.

The taxation of taxable supplies made electronically is not a new concept in Kenya. According to Section 8 of the VAT Act, a supply of services will be deemed to have been made in Kenya if the recipient of the supply is not a registered person and the services are electronic services delivered to a person in Kenya at the time of supply. The statute defines electronic services as any of the following services, when provided or delivered on or through a telecommunications network: -

- (a) websites, web-hosting, or remote maintenance of programs and equipment,
- (b) software and the updating of software,
- (c) images, text, and information,
- (d) access to databases,
- (e) self-education packages,
- (f) music, films, and games, including games of chance, or
- (g) political, cultural, artistic, sporting, scientific and other broadcasts and events including broadcast television.

We note that this provision formed part of the VAT Act which came into force in 2013. In addition to this, the Finance Act, 2019 further inserted various provisions within the VAT Act such as the definition of a digital marketplace. It is important to note that both the ITA and VAT Act adopted the same definition of a digital marketplace. Following this amendment, the provisions of Section 5(1) of the VAT Act, which imposes VAT on various supplies, are applicable to supplies made through a digital marketplace.

The amendments under the Finance Act, 2019 further empowered the Cabinet Secretary to make regulations that enable the implementation of the VAT on supplies made through the digital marketplace. Ideally, the supply of electronic services to a person in Kenya is subject to the standard rate of VAT. However, given the practicalities and the fast-growing digital economy, the application of the same on actual electronic services has been difficult. This therefore led to the drafting of the draft Value Added Tax (Digital Marketplace Supply) Regulations, 2020 (Digital Marketplace Supply Regulations) which are also yet to be passed into law.

According to the draft Digital Marketplace Supply Regulations, VAT is chargeable on taxable services supplied through the digital marketplace and within the context of a Business to Consumer (B2C) transaction where the business is registered for VAT whereas the consumer is a person not registered for VAT. The draft Digital Marketplace Supply Regulations further widen the scope of supplies made through the digital marketplace which will be regarded as taxable and subject to VAT.

A key provision of the draft Digital Marketplace Supply Regulations is the proposed introduction of a simplified VAT registration framework which will be applicable to suppliers from an export country or foreign jurisdiction. Accordingly, a digital marketplace supplier who is from an export country/foreign jurisdiction will be required to register under this framework and will upon successful registration be issued with a Personal Identification Number (PIN) for purposes of filing the VAT returns and payment of the VAT due. Alternatively, the supplier may appoint a tax representative in Kenya if they are unable to register for VAT in Kenya. It should also be noted that a deduction of input tax shall not be allowed under the simplified VAT registration framework.

The provisions of the VAT Act will apply to resident digital marketplace suppliers who will be required to register under the VAT Act where the value of their taxable supplies meets the annual threshold of KShs.5 Million (approximately USD 47,000).

The proposed levy of VAT on the services supplied through the digital marketplace has stirred public debate given the looming increase in tax liabilities that will inevitably increase the cost of services acquired through the digital marketplace. We, however, note that different jurisdictions all over the world are rolling out indirect taxes on foreign suppliers undertaking businesses through digital platforms. This is in line with the destination principle according to which, internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption. We have provided in the table below examples of jurisdictions which have implemented VAT on digital services.

Table 1: Examples of Jurisdictions

European Union (EU)	The levy of VAT on digital services within the EU is dependent on the place of supply of the digital services. For example, for B2C supplies, the supplies will be subject to VAT in the country where the customer is located (as is the case with most if not all the jurisdictions). For EU member states, the Mini One Stop Shop (MOSS) scheme applies, according to which, member states of EU supplying digital services to other EU member states need not register with the tax authorities of those states. They need only register, file returns and make payments through the MOSS scheme which is a centralised system.
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There are two types of MOSS schemes – Union VAT MOSS scheme (applicable to business in the United Kingdom (UK) and EU member states) and non – Union VAT MOSS scheme (applicable to businesses outside the UK and EU).

It should be noted that the standard rate of VAT applied varies amongst different EU member states.

India India levies goods and services tax (GST) at the rate of 18% on electronic services which are referred to as Online Information Data Base Access and Retrieval (OIDAR) services within their legal regime. This was introduced in 2017.

South Africa South Africa introduced VAT on e-services which is chargeable at the rate of 15% in 2014. The regulations providing for the same were further amended in 2019 to provide clarity on what constitutes electronic services as supplied by foreigners. Accordingly, foreign suppliers of electronic services who meet the requisite threshold are required to register as vendors in South Africa with respect to the supplies made to South African customers.

Uganda Uganda introduced the levy of VAT on electronic services provided by non-resident suppliers in 2018. Accordingly, a person is required to register for and charge VAT of 18% on their supplies where the amount of supplies exceeds the registration threshold. Uganda (contrary to Kenya as per the draft regulations) permits the deduction of input tax incurred with respect to the supply of electronic services in Uganda by a non-resident person.

The direct taxation of income accruing from the digital economy is slowly being implemented in different jurisdictions, with France being the first jurisdiction to impose DST on gross revenues accruing from the provision of digital interface services and targeted advertising services. Prior to this, the EU proposed a harmonised set of rules with a view of imposing direct taxes on revenue from services provided in the EU. The EU members, however, failed to reach an agreement and the same is yet to be implemented although individual member states such as France have proceeded to implement DST in their jurisdictions. In the African continent, countries such as Tunisia, Zimbabwe and Nigeria have implemented or are in the process of implementing DST.

We have provided a brief analysis of the potential impact of both DST and VAT on certain business activities in Kenya.

Implications on the E-Commerce Industry in Kenya

The taxation of the e-commerce industry in Kenya will have far-reaching implications on business activities that fall within the scope of taxable services as set out under the draft Digital Service Tax Regulations and the draft Digital Marketplace Supply Regulations once they come into force. As previously mentioned, DST will apply to services including online marketplaces, streaming and downloadable services of digital content, electronic data management and ultimately services that are provided through an online or electronic platform to the exclusion of services which

would otherwise be subject to withholding tax. On the other hand, VAT will be applicable to the supply of electronic services and other taxable supplies made through the digital marketplace.

From the above, it is clear that the taxation of the e-commerce industry places additional obligations on suppliers of digital and electronic services that fall within the scope of taxable services. Inevitably, the imposition of the two taxes will result in an increase in the cost of supply which will be passed on to the end user of the services. We have provided below instances when the two taxes will be applicable on certain supplies.

Example 1 – Supply of a digital marketplace and electronic tickets

Company R (R Co) provides an online application for the automated sale of electronic tickets (e-tickets) to events and vacation packages. This online application is a platform for sellers such as Company T (T Co), which is an event organiser, to sell e-tickets for its events to its target consumers.

Under the draft Digital Service Tax Regulations, DST will be chargeable on the payment received by a digital service provider as consideration for the services as well as the payment received by a digital marketplace provider as commission or fee paid for the use of the platform. DST in this case, will be chargeable at the rate of 1.5% on the cost of the e-ticket and will become due at the time of the payment for the e-ticket by a third party user provided the user is located in Kenya. Noting that R Co will receive a commission or fee for hosting T Co on its platform and enabling the sale of the e-tickets, DST will also be chargeable at 1.5% on the amount of the commission paid by T Co to R Co for use of the digital platform. If the business income of T Co and R Co is subject to corporation tax in Kenya for reason that they are resident persons or non-resident persons with a PE in Kenya, the DST deducted and remitted on the payments received will be offset against the total corporation tax payable by them. It should be noted that the DST will be applicable to the income earned by the digital marketplace provider should the draft Digital Service Tax Regulations, which define the gross transaction value with respect to both the digital service provider and digital marketplace provider, become effective.

From an indirect tax perspective, VAT will be chargeable on the cost of the e-ticket bought through the platform as well as the cost of providing the platform (which qualifies as an electronic service). It should be noted that the DST will be levied on the cost of the e-ticket and the use of the platform excluding the amount of VAT chargeable.

Example 2 – Supply of digital content

Company A (A Co) is a non-resident company that supplies streaming and downloading services worldwide providing access to media such as movies and music in exchange for a monthly subscription fee. Some of the content hosted on A Co's platform is generated by itself. It also provides opportunities to third party content creators to host their content on its platform on commission basis. Some of the end consumers of A Co's services as well as the third-party content creators are located in Kenya.

In this scenario, DST will be chargeable in Kenya on the monthly subscription fee payable by the users. Based on the draft Digital Service Tax Regulations, DST will also be chargeable on the commission paid by the third-party content creators located in Kenya. In addition, the monthly subscription fee and the commission will be subject to VAT in Kenya given that the services are provided to Kenyan consumers and to the extent that they are consumed in Kenya.

Conclusion

Given the increasing digitalisation of the economy and the shift of businesses around the world to the digital marketplace due to its efficiency, it is evident that the digital marketplace will continue to be a source of taxable income in Kenya and across the world and increasingly an area of focus for mobilization of tax revenues. The law and practice must therefore not only ensure certainty and clarity on the taxation of such income domestically, but also ensure congruence and equity where the liability to tax arises in more than one jurisdiction.

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