

SUBMISSION ON THE PROPOSED INCOME TAX (DIGITAL SERVICE TAX) REGULATIONS, 2020

About the Lawyers Hub Kenya

The Lawyers Hub is a Legal-Tech organization incorporated within the Republic of Kenya serving the global south. It exists to provide innovative and technology-driven solutions to policy, legal practice and access to justice with a particular focus on technology-driven enterprises and policy alternatives. In the year 2020 alone, the Lawyers Hub has convened policy makers, academia and legal-tech organizations from 20+ countries within the African Continent, curated rapid tech solutions under the Global Legal Hackathon and developed key policy briefs for the African Continent on Artificial Intelligence, Data Privacy & Digital Identity, Tech and Migration, and Taxing the Digital Economy. In this regard, we offer our submissions on the proposed regulations.

1. Introduction

Changes in legislation to facilitate the taxation of the Digitalized economy in Kenya began in June 2019 through amendments made by the Finance Act 2019.

Finance Act 2019

a) The Act amended Section 3(2) of the Income Tax Act to include income earned from a digital marketplace as a taxable income subject to payment of Income Tax.

b) The Act Amended Section 5 of the Value Added Tax Act to include supplies made through digital market supplies as taxable supplies subject to VAT.

c) A digital Marketplace was defined to mean “a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means”.

d) The Act also empowered the Cabinet Secretary, responsible for matters relating to finance, to make regulations that provide the mechanism for implementing both the Income Tax and VAT to be charged above.

Finance Act 2020

Pursuant to this, the 2020 Finance Act introduced the following changes:

a) The Act provided for the Digital Service Tax (DST) payable by a person whose income from the provision of services is derived from or accrues from a digital marketplace.

b) The rate of DST shall be 1.5% of the gross transaction value and shall be due at the time of paying for the service to the service provider.

Regulations

To enable the implementation of these taxes, the Cabinet Secretary released the Draft Value Added Tax (Digital Market Supply) 2020 in May 2020 and the Proposed Income Tax (Digital Service Tax) Regulations 2020. The Latter is the focus of this Memorandum.

2. Issues

Pending global consensus

The question of taxing digital service providers is receiving attention and participation across the world with countries grappling with the multi-national nature of digital service providers and taking into account their tax incidence across multiple countries. With discussion and negotiations still under way, countries have resorted to developing their own mechanisms which risk significant disruption depending on the direction that the global agreements take.

Unilateral action

As such, Kenya's action is considered a unilateral approach to the cross border, cross jurisdictional and cross fiscal policy nature of environments being faced by digital survival providers. The approach Kenya is taking with both resident and non-resident, VAT and ITA obligations is likely to be disrupted once the OECD begins implementation of pillar 1 on profit allocation and new taxing rights in market jurisdictions.

Tax incidence

There is concern that since the DST is payable at the time of paying for the service to the service provider and this may present the service or platform provider an opportunity to raise cost and shift the tax incidence to the user. Threshold

Countries like the UK and other EU countries have set thresholds for the purpose of DST with minimum turnover, focusing their efforts on taxing multinational corporations. The DST regulations as currently have no threshold and thus exposes small entrepreneurs. In the UK for example, the threshold is 25 million pounds. This creates a distinction between small and local against multinational companies.

Regulation forum and tax nexus rules

Currently the regulations do not provide rules on how to address non-resident services for whom there is no nexus with Kenya for the purpose of taxation. These rules give authority to tax income. The concept of permanent establishment is a complex one as it does not account for the digital marketplace.

In 2017 the OECD changed the definition of permanent establishment in its Tax Model Convention and in its Multilateral Instruments (MLI) under articles 12-15. Kenya has signed the MLI but has not brought it into force. Without this, the question of definition and nexus is amorphous and without clear definition on a global level, which is indispensably crucial due to the nature of the digital marketplace.

Definition of digital service taxes

The African Tax Administration Forum (ATAF) released a policy brief on digital services tax essentially discouraging the levy of DST as an income tax or something similar to an income tax, instead referring to it as a levy charged on a specifically defined service that is not creditable. Regulation 4 of the current DST regulations is precisely the opposite of this recommendation in referring to DST as an advance tax to be off-set against income at the end of the year. The ATAF recommendation allows Kenya to avoid the issue of double taxation down the line. As of now, a double taxation issue is likely to exist in Kenya's future.

Increase of prices for services

Non-resident persons offering digital services within Kenya on whom digital tax will fall are likely to transfer this cost to consumers in order to maintain their margins and thus not bear the cost. This is because their non-resident status denies them the opportunity to claim this tax at year's end while filing annual returns like their resident competitors. Eventually, this transfer of cost fails to achieve the objective of having such persons pay for profits accruing in Kenya.

Practicalities of tax remittance and agency

The tax point for DST is the point of remittance and thus services providers working in remittance such as banks, payments and mobile money service and platform providers. It can thus be expected that these will make up the tax agents for non-resident persons. Currently, the practical aspects of how this tax will be collected remains unclear.

Multiple tax obligations

The current obligations under the income tax stand even as DST is introduced. It will be levied among other taxes under the ITA such as withholding, installment and minimum taxes. With this multiplicity of obligations, the DST being levied against income further serves to reduce the profits being made in Kenya, which is an undesirable outcome as far as commerce is concerned, creating a need for opportunities to offset and reliefs for businesses.

Effect on US FTA negotiations

Kenya is currently in negotiations with the US to enter into a bilateral trade agreement. The US has made its trade policy known with countries that have attempted to levy taxes against American digital service providers, responding with investigations and sanctions against France and India for example. It is likely and expected that Kenya will be asked to in some way exclude American companies from this tax obligation which will provide an unfair competitive advantage to local and non-American counterparts in the impact the tax will have on cost of product to the consumer.

Effect on the AfCFTA

Further, Kenya is a signatory of the AfCFTA. At the outset of the above-mentioned negotiations there was public concern that Kenya was acting alone and isolating itself from the regional efforts. Under the AfCFTA is the principle of equal treatment which essentially provides that as African countries enter individual bilateral trade agreements, similar favour and benefit should be available for other African countries. The impact of this will be that Kenya may have to forego its taxes on other African digital service providers, eventually rendering its treatment of local companies unfair.

3. Discussion outcomes

The move to tax digital service providers is a legitimate and well-intentioned one by the Kenyan government. However, the manner in which this action is being taken exposes Kenya to potential future complications in proceeding in a manner that is likely to experience significant disruption as global consensus emerges. The haste with which this tax is being approached reveals many gaps in concept, execution and overall alignment with crucial principles of tax administration such as certainty and fairness.

It is possible for Kenya to proceed but while paying keen attention to the recommendations of the regional and global efforts, in order to set up a system that is future cognizant and steady even as global positions and practices emerge. Further, there remains a great need to provide protection for local businesses, given the digital services economy and the Government's efforts to nurture the sector to growth. The Regulations as they are offer indiscriminate and insensitive treatment of local businesses, particularly those in early and growth stages where income is still low.

4. Recommendations

Public education: a key and recurring issue across the discussion was questions on taxable persons, with members of the public struggling to clearly identify persons eligible for this tax. We recommend that KRA endeavors to educate the public to offer clarity and certainty for Kenyans on the DST.

Clarity and certainty in definition

The definitions can be more specific and provide a criterion to provide certainty in determining persons eligible for tax. Particularly, for entities that are considered intermediaries in platformed environments

Adopting definition as levy or charge instead of tax

Kenya should adopt the guidance given by ATAF on how to define the DST without associating it with income and in order to remain aligned with the developing global position on defining digital service providers in a manner that also avoids the incidence of double taxation, given that non-resident parries under the current definition are unable to reclaim this tax.

Turnover tax

An exemption for resident persons whose turnover is less than Ksh 1 million as there will be no way of reclaiming taxes which would benefit service providers such as those in the transport hailing sector, which are a significant group in the digital service providers.

Threshold rules

The failure to include a fiscal bare minimum as the cut off for eligibility for DST generalizes the fiscal powers of all manner of businesses to withstand the impact of tax on their profit making and business growth. It is recommended that Kenya takes cue from other countries to set a minimum and protect enterprises and entrepreneurs against additional tax burdens.

Alignment with global standing

Due to the nature of the digital environment as a multi-user, multi-platform, multinational one with discussions taking place in different regional and global bodies, Kenya should seek to align itself with the manner of defining digital services. This is in view of the likely situation where the discussions referred to have been fruitful and the global or regional direction is set.

PUBLIC POLICY DISCUSSION

The Income Tax (Digital Service Tax) Regulations, 2020

Registered



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Attendees

Attendance Rate



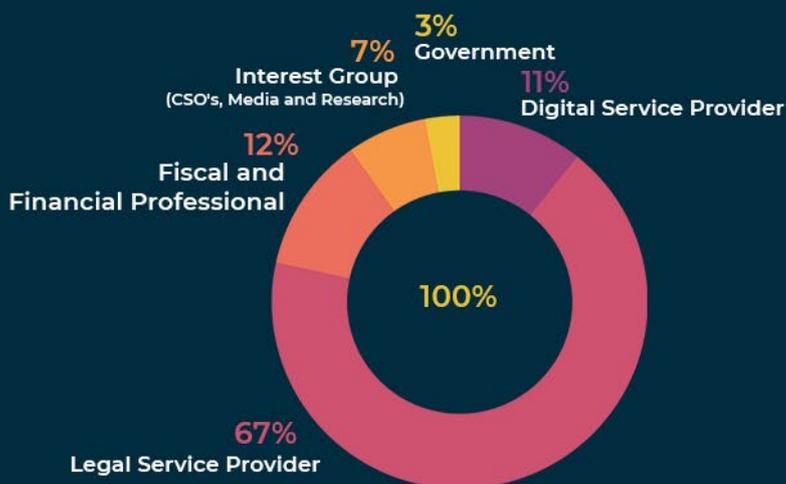
61%

Attendance

142

minutes

Duration



Questions Asked

72



Participants Demographic

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