What amendments to Kenya's digital tax law mean for SMEs

By John Syekei, Nikhil Hira, Denis Magonga and Angela Mukora

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Digital traders would likely have heard of the recent changes to the Income Tax and VAT Acts introduced by the Finance Act, 2019 (the Act). With effect from 7 November 2019, goods and services supplied in the digital marketplace will now be subject to income and VAT tax.

Image source: Getty Images

The taxes hardly come as a surprise to Kenyans as the Kenya Revenue Authority (KRA) made a clear declaration in the 2018 KRA Annual Summit of its intention to broaden its tax base by introducing taxes on the emerging digital economy. Even before then, there were signals of future tax changes, with the VAT Act, 2013 envisaging VAT on downloaded electronic services.

All this comes after the large-scale technological and digital developments Kenya has experienced in the past two decades, ranking third among African countries with the highest Bitcoin usage in 2019 and with a population that has a remarkably high appetite for online betting, borrowing and purchases.

The ins and outs of the new taxes

Section 4 of the Finance Act amends the Income Tax Act to include ‘income accruing through a digital marketplace’ as taxable income. Likewise, section 18 of the Act expands the VAT Act to be ‘applicable to supplies made through a digital marketplace’.

The Act broadly defines a digital marketplace as 'a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.' This broad catch-all provision seeks to ensure that entities generating income through a digital platform are captured. The most obvious targets of the provision are expected to be e-hailing platforms and online selling marketplaces such as Uber and Jumia.

How the new provisions will be implemented?

While the Act indicates that the measure to tax income from digital transactions entered into force on 7 November 2019, it also states that the Cabinet Secretary of National Treasury and Planning shall make regulations to provide for the mechanisms of implementation. There is no clear timeline as to when these regulations shall be published, posing a practical challenge to implementation of the provisions. This means that enforcement of this tax will be delayed.

It would be beneficial to stakeholders in the digital and technological sector if the regulations were to clearly set out:

- the specific income that is subject to the tax provisions;
- the applicable rates of tax to be applied (particularly in the case of non-resident persons without a permanent establishment in Kenya); and
- the party responsible for accounting for the taxes.

As of February 2020, it remains unclear whether these taxes are operational, given the absence of clear guidelines on how these would operate.

Across the border

Taxation of the digital economy is not a novel concept in the world, with countries such as India and France jumping on the bandwagon in recent times. Globally, the introduction of digital taxes is fast becoming infamous for setting off retaliatory trade wars between countries.

In 2016, India imposed digital taxes (commonly dubbed the ‘Google Tax’) on tech companies involved in digital advertising. The tax seemed to target Over-the-Top (OTT) service providers such as Google, Twitter and Facebook. In 2018, the country went further, introducing a provision requiring companies to pay tax on domestic income accrued from a digital platform. The implication of this provision is that non-resident big tech companies would now be required to pay direct taxes on income generated in India. In retaliation, the USA introduced immigration restrictions that adversely affect Indians resident in the USA.

Similarly, the French government last year proposed a digital tax where tech companies would be mandated to pay a 3% tax 'on the gross revenues derived from digital activities of which French “users” are deemed to play a major role in value creation'. The laws also introduced a threshold for annual revenue generated (EUR750-million for taxable digital services supplied worldwide and EUR25-million for taxable digital services supplied in France). These thresholds were seen as a move to capture big tech companies such as Amazon, Google and Facebook.

As expected, the proposed tax sparked threats of retaliatory tariffs on imported wines and cheeses from France in the USA. At the moment, the rivalry between France and the USA has seemingly been quelled through a quasi ceasefire agreement to suspend the digital tax in exchange for a postponement of the threatened retaliatory tariffs until the Organisation for Economic Cooperation and Development (OECD) provides a harmonised position on digital taxes. The OECD is best placed to ensure that there is uniformity of digital taxes around the world, as it has done for other taxes in the past – VAT being one such example.

These trade wars have in the past caused global stock markets to stumble. A similar crippling effect to the digital economy is imminent if the two superpowers cannot find common ground on the subject of digital tax.

What is the OECD’s take on digital taxes?

The OECD is an intergovernmental economic organisation mandated to foster world trade and economic progress. In the past few years, the OECD has been working on a model for taxation of the digital economy, set to be part of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). Primarily, the model proposes to allocate the primary right to tax to the country from which the digital revenue generates (where the transaction takes place) rather than the country in which the investment is made (where the platform is hosted).

Under BEPS, the first pillar is intended to focus on profit allocation rules among states, including necessary modifications to traditional transfer-pricing rules, nexus rules and the arm’s length principle, to take into account the changes that digitisation has introduced to the world economy.

BEPS is also set to examine concepts of marketing intangibles, user contribution and significant economic presence, and how they can be used to address the resultant tax challenges of the digital economy.

Anticipated effects of the tax in Kenya

The new amendments introduced by the Act have been negatively received by digital platform operators and consumers in Kenya. The move has been viewed as tantamount to double taxation for digital platform operators and burdensome to consumers, particularly where VAT on supplies is concerned.

This is because without clear guidelines on how this tax will be applied, ascertaining who bears the cost of this new tax is largely speculative. In the event that the VAT provision intends to place incidence on the consumer, the new tax may inevitably end up stifling innovation by taking away the very incentive for digital marketplaces - which have for a long time, been regarded as a more cost-efficient means of conducting business compared with traditional brick and mortar businesses.

This particular point was raised during the public participation in the Finance Bill, where it was pointed out that a huge portion of the Kenyan youth population, because of lack of jobs and capital, have turned to innovation in the digital space to reduce operational costs of doing business. Members of the public were therefore concerned that this move would encourage flight from the sector and hamper growth of start-ups and small and mid-size enterprises (SMEs).

What is more worrying is that national digital taxes (without a corresponding international tax regime) could endanger cross-border trade and investment. This is because any investor attempting to do business across borders would face the risk of being taxed repeatedly on the same portion of income.

Carefully thought-out international tax agreements may be the key to minimising the risk of endangering cross-border trade. A huge challenge for the drafters of such agreements, however, is that digital creatures lack defined territorial boundaries and are always evolving faster than the law. This is the challenge that plagues any attempt to regulate cyberspace.

What next for Kenya?

The regulations for the new tax provisions will be key in understanding how the tax will be imposed on digital marketplaces in Kenya, its operational workings and its effect. Our view is that these regulations should align with the broader government policy on the digital economy, international best practice and data protection laws to ensure a smooth implementation.

Perhaps it would be prudent for industry players to lobby to ensure that a favourable environment for innovation is central to the efforts of the National Treasury in formulating these regulations, so that Kenya does not lose its position as an innovation and tech hub in Africa.

ABOUT THE AUTHOR

John Syekei (Partner), Nikhil Hira (Director) , Denis Magonga (Associate) and Angela Mukora (Associate) - Bowmans Kenya