A commentary on the proposed digital services tax in Kenya: a case of premature legislation?

By:

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It is without a doubt that the mode of doing business is changing with the preferred means being via the digital platform. The digital marketplace is complicated and has posed challenges to many nations including Kenya in getting its share of tax from any income that is derived from the Nation's jurisdiction. It is this realization that led to the amendment of the Income Tax Act through the Finance Act 2020 that introduced the Digital Services Tax (DST).

The process of taxing e-commerce began in 2018 through the amendment to the Value Added Tax Act in 2018 as it acknowledged a lot of revenue was being lost on business conducted on the digital platforms and the easiest option was the imposition of an indirect tax which is difficult to avoid. It would however appear that this was not enough hence the recent amendments to the Income Tax Act. the DST shall commence on 1st January 2021 and all Digital Service

Providers shall pay this tax on income from the provision of services is derived from or accrues in Kenya through a digital market place. If the Digital Service provider is a resident or a non-resident with a permanent establishment in Kenya they shall be entitled to offset this DST against the tax payable for that year of income.

The approach taken by Kenya is the imposition of a tax of 1.5% of the gross value of the transaction. The owner of the platform has the obligation to remit this amount and the case of those who are non-resident with no permanent establishment then this is a final tax. The challenge in my view is the enforcement in terms of cost and time. Some transactions have such little value that one might wonder whether a cost benefit analysis was done to come up with this proposition. The amendments propose the appointment of an agent to exclusively deal with DST. The Draft DST regulations for the digital service collection service that will identify, deduct and remit digital service tax to the commissioner, in order to assess this, it would be interesting to see how much the Kenya Revenue Authority would be amended and the DST be based on a threshold that makes economic sense.

While the desire to tax digital platforms is legitimate, the strategy taken by the country may be too costly. It is likely that this law may face future amendments to include factors such as thresholds so that the tax administration aspect is cost effective. For example, the law provides that this amount shall be due at the time the amount is paid to the service provider for the service, it is unclear how this is supposed to be remitted. If you compare this to rental income tax which is due by the 20th of each month, one is able to consolidate the income and make the necessary payments without incurring any unnecessary transaction charges from the intermediary financial institutions. However, if a Digital Service provider makes a sale of a dollar per transaction per day, this person is expected to remit what is due to the revenue authority immediately.

This cost predicament also leads to the next issue of threshold to qualify for this tax. Since no threshold is given, it means it is applicable to all digital service providers. This will work against startups which will find it difficult to comply and will have the undesirable consequence of locking out local innovators who would like to take advantage of the digital space to grow their

business in favour of those multinationals who have no cashflow concerns.

If we compare the amendments to the current United Kingdom DST laws in its Finance Act where it has a broader scope of digital services that extend beyond the traditional digital market place that link buyers and sellers. The delve into detail of the digital services platforms and acknowledge that other than linking buyers to sellers, they do offer services such as advertising and that payment for these services can be made both within and without its borders. To be entitled to tax, first they define the scope that looks at both the users, the item for sale and well as a financial threshold for a digital service provider to qualify to pay this tax.

They acknowledge that a UK user may purchase accommodation outside the UK to be enjoyed outside the UK, therefore this income should not be subjected to the UK DST. The Kenyan approach is that provided the user is from Kenya as per the proposed Draft DST regulations then such a purchase should be subject to the proposed digital services tax which results in an unjust tax. Thirdly, it does not address the issue of what happens when all payments are made abroad yet the services are to be offered in Kenya. An illustration would be in the instance of a multinational paying a social media entity for advertising targeted to the Kenyan user, as per these draft regulations, provided that the money does not come from an entity in Kenya then it is exempt from this DST. Effectively multinationals and the big tech will not be affected. Similar to UK, Austria through its Digital Tax Act 2020, takes an approach similar to the UK where it looks at the threshold and goes into looking at the targets of advertising as well market in determining whether an entity should remit tax to its government.

In conclusion, Kenya should be commended for making this step, however it is premature and will effectively affect the small players in the digital service marketplace who will probably be local entrepreneurs therefore effectively leaving the digital marketplace to the Big Tech companies. In order to ensure fairness, it is proposed that they reconsider the approach taken and introduce a threshold to qualify for this tax which should be high enough to make economic sense. Secondly, the law should give the digital service providers reasonable time to remit this tax, preferably and monthly basis and last but not least,

expand the definition of the user to capture the different ways digital services providers use to create income from the users in a particular country.

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