ALLIGNING KENYA'S DIGITAL TAX TO GLOBAL CONSENSUS

The nascent digital economy has revolutionized the global order of businesses by breaking down traditional barriers of international trade and creating platforms for the seamless interaction of buyers and sellers. The growth of this economy has generated billions for multinationals who have leveraged on web-based platforms to provide services and goods in remote jurisdictions.

Last year, Alibaba generated $38 billion within twenty-four hours on its traditional Single's Day. When the clock struck midnight, it's reported that Alibaba sold $ 1 billion worth of goods within a span of 68 seconds. The record-breaking sales demonstrate the power of the internet and commerce globalization sparking a tax gold-rush for tax administrators to rope in big digital players to their jurisdictional tax.

However, taxing the digital economy has not been easy. It was noted as one of the main concerns of the Base Erosion and Profit Shifting (BEPS) Action Plan issued by the OECD which latter led to the publication of the 2015 BEPS Action 1 Report on *Addressing the Tax Challenges of Digital Economy.* The report detailed how digitalization had exacerbated the BEPS issues while explaining the challenges of allocating taxing rights on profits earned from multinational cross-border activities.

With no current solution, a number of countries have adopted unilateral tax measures to protect their tax base and sovereign right to impose and administrate tax in their jurisdiction. For example, France has implemented a 3% digital service tax on particular services provided by large tech companies whereas other countries such as India have expanded the scope of permanent establishments to include non-residents who have limited physical presence within their jurisdiction but play key roles in nation's economic life.

Through the Finance Act, 2019, Kenya aims to bridge its domestic revenue gaps by declaring income earned through a digital marketplace as chargeable income. Though the new provisions may reward KRA's revenue collection ambitions in the short-term, the new amendments may have long-term ramifications on the country's foreign direct investment and domestic economic growth. A tax on the digital economy may stifle innovation and deter traditional business models from transitioning into the digital economy.

Globally, the wave of taxing the digital economy is gaining momentum. In this article, we take a look at what's going on in different countries.

Europe: France's Digital Tax

On 11th July 2019, the French Government set precedence for other nationals when the Senate of the French Parliament passed law to impose a 3% digital service tax on certain digital services.

The digital service tax is imposed on two forms of services; the provision of digital interfaces and advertising services. Jumia, Twitter, Alibaba and Facebook are examples of digital interface providers whereas Google is an example of a company that provides advertising services based on user data.

The French digital service tax is limited to certain companies with taxable turnovers exceeding Euro 750 million on their worldwide income and Euro 25 million on income sourced from France.

Based on those parameters, its estimated that the French digital service tax will target 30 companies, with 17 of them originating from USA and only one from France.

As a result, the USA Government was quick to raise concerns on the French digital service tax amid fears of a looming tariff war between both countries. However, tension have cooled down with France agreeing to drop its digital service tax once a consensus-based solution has been tabled by the OECD.

Its estimated that the French government will collect approximately Euro 500 million from the digital service tax.

Throughout Europe, other countries including Austria, Belgium, the Czech Republic, Italy, UK and Spain have published proposals or announced to introduce a digital service tax similar to that of France.

Most countries have opted to freeze the tax pending consensus by OECD member states on a similar unified multilateral solution instead of adopting unilateral tax measures.

The OECD has purposed to come to a consensus in 2020 on the best approach to tax the digital economy.

Asia: India's Digital Tax

India is emerging as a Global powerhouse ranking sixth in the global consumer market. Its telecommunication industry on the other hand is the second largest based on the number of mobile phones, smartphones and internet users.

As a result, the Government of India has been keen on developing a digital tax for its e-commerce sector.

Through the Finance Act 2016, the Government of India introduced an equalization levy of 6% on gross revenues for foreign advertisers with annual revenues exceeding INR 100,000.

The levy is based on payments made by Indian residents or non-residents with permanent establishments to non-residents with no fixed places of businesses in India.

In April 2018, the Indian Government further expanded the definition of taxable significant economic presence to include digital permanent establishments. This ropes in digital players earning income in India but have no physical presence.

India intends to drop the two tax measures once an international consensus for taxing the digital economy has been achieved.

Africa: Zimbabwe's Digital Tax

Zimbabwe became one of the first African countries in January 2019 to impose a digital tax on e-commerce platforms and satellite broadcasting service providers.

Zimbabwe's tax laws provide that any payments received by an e-commerce platform or satellite broadcasting service provider from a resident in Zimbabwe is be deemed income derived from Zimbabwe.

Provided that the revenue exceeds USD 500,000 per annum, the tax is levied at a flat rate of 5% on the gross revenue.

Kenya

Kenya on the other hand has introduced provisions relating to taxation of the digital economy through the Finance Act 2019 as follows;

1. Including income generated through a digital market place as part of income that is accrued or derived in Kenya ergo income subject to Income Tax under the Income Tax Act CAP 470.
2. Including supplies made through a digital market place as supplies subject to VAT under the Value Added Tax Act.

3. Defining income from a digital market place as income generated through interaction between buyers and sellers through a digital platform via electronic means.
4. Providing that the Cabinet Secretary for matters Finance shall make regulations as to how the tax shall be charged for both Income Tax and Value Added Tax.

So far what Kenya has done is to state that the income from the digital economy is subject to Income Tax and VAT in Kenya. Further define what constitutes this income and that the tax shall affect buyers and sellers. Although the CS is meant to provide further guidance via regulations which will highlight how the tax will be implemented and provide further guidance, the taxpayer is in limbo as to how the tax will affect their business. A few queries that the current provisions need to be answered include;

1. How will foreign entities who provide these digital platforms be required to account for the tax. Although the Tax Procedures Act stipulates that in such a case the business needs to appoint a local representative, this may not be easy more so where these entities have no physical presence in Kenya. This will essentially affect both Income Tax and VAT.
2. The challenge of physical presence ties with the concept of a Permanent Establishment (PE). Foreign entities that are not based in Kenya can only be taxed if they operate through a PE. Further these entities need to be carrying out crucial profit making or essential activities related to the generation of this income in Kenya. This may be a challenge more so where these entities carry out their essential activities outside Kenya and have nil or auxiliary activities in Kenya.
3. How will this income be allocated to Kenya with no reference to a PE or any key activities or assets? More so in a case where such income is deemed to be taxable in another jurisdiction.
4. How will the implementation of this tax affect taxpayers in terms of relief where the income is deemed as taxable in more than one jurisdiction and as such relief is not provided in the case of Income Tax.

In interim, the Government of Kenya is yet to issue guidelines how it intends to tax its digital economy. At this juncture, it's prudent for the Government to invite ample public participation to ensure it doesn't disrupt the national business climate while protecting its sovereign right to impose tax.

The Road Ahead

The OECD secretariat is currently receiving public comments on different proposed tax measures. As it stands, the OECD is still working with different stakeholders including, governments, NGOs, international communities and scholars to achieve a national consensus.

The OECD's task to provide a unified approach to tax the digital economy within a limited timeframe may prove to be an uphill task for the intergovernmental economic organization.

Although Kenya is not explicitly a member of the OECD, Kenya could adopt from the recommendations that OECD would make on taxation of the digital economy.

Let's talk

For further information on how the proposed tax provisions will affect your business or assistance on any other matter kindly contact your regular Taxwise Africa Analyst or the contacts below;

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