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Tax Alert
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The Income Tax (Digital Service Tax) Regulations 2020

Walking the journey with you

The Government of Kenya (GoK) introduced the Digital Service Tax (DST) with effect from 1 January 2021 vide the Finance Act 2020. In a bid to clarify and provide more detail on the persons affected and the scope of services covered, the Cabinet Secretary for National Treasury and Planning ("the CS") issued the Draft Income Tax (Digital Service Tax) Regulations, 2020 in August 2020 and invited the public to submit their views on the draft regulations.

Following the submissions of the views by the members of the public, the CS has now published, vide Legal Notice No 207, the Income Tax (Digital Service Tax) Regulations, 2020 ("the Regulations"). The Regulations seek to provide the clarity and details of how DST will be administered. Although not all the recommendations advanced during the submissions by stakeholders were adopted, it is worth noting that some of the recommendations were considered and are now reflected in the Regulations. The notable changes include: affording taxpayers the opportunity to register through a simplified registration framework as opposed to the use of DST agents; providing clarity on some key definitions such as licensed financial service providers and review of applicable penalties to eliminate the option of restricting access.

In this alert, we summarise the Regulations and provide our point of view on the key provisions.

Who will be affected?

DST will apply to both residents and non-residents who fall into either of the categories below:

- **Digital marketplace providers** – A person who provides a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.
- **Digital service providers** – A person who provides digital services through a digital marketplace. Digital services have been listed under Regulation 3. They include downloadable digital content, streaming of digital content, any form of monetizing data about Kenyan users, subscription-based media, data management using electronic means, online sale of tickets, search engine related services, e-learning among other services.

DST shall not apply to;

- Income that is subject to withholding tax in Kenya;
- Income of a non-resident person who carries on the business of transmitting messages by cable or radio communication, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet, or any other similar communication;
- Income arising from online services that facilitate payments, lending or trading of financial instruments, commodities, or foreign exchange carried out by financial institutions specified under the Fourth schedule to the Income Tax Act (ITA) and financial service providers approved or authorized by the Central Bank of Kenya; and
- Online services provided by Government institutions.

Digital marketplace providers and digital service providers will be subject to DST in Kenya, if they provide or facilitate the provision of services to a user who is deemed to be located in Kenya. A user is considered to be located in Kenya, if one of the following parameters are met:

- The user accesses the digital interface from a terminal, for instance a computer, tablet, or mobile phone, located in Kenya;
- Payment for digital services is made using a credit or debit facility provided by any financial institution or company located in Kenya;
- Digital services are acquired using an internet protocol address registered in Kenya or an international mobile phone country code assigned to Kenya; or
- The user has a business, residential, or billing address in Kenya.

DST paid by a resident or non-resident, with a permanent establishment in Kenya, will be offset against their income tax liability for the applicable year of income. On the other hand, DST paid by a non-resident without a permanent establishment in Kenya will be final tax.

Our view

The final Regulations provide better clarity on the person affected by the DST in Kenya, as well as the option for registration of non-residents which will ease compliance.

Our view is that the GoK should have considered setting a minimum threshold for applicability of DST and exempting some businesses with low margins. Imposing DST on all digital services irrespective of the threshold is likely to result in undesirable implications especially for persons under the Turnover Tax Regime and minimum tax, and whose primary income is derived from provision of digital services.

In the UK, for example, only large businesses are liable to DST, that is businesses with in-scope annual global revenue of more than £500m, of which more than £25m are attributable to sales from the UK. For France, the thresholds are €750m and €25m for global and local sales, respectively while for Italy the threshold is €750m and €5.5m for global and local sales, respectively. In Kenya, the threshold could be aligned to the turnover tax threshold or other reasonable threshold.

How will DST be computed?

DST shall be imposed at a rate of 1.5% of the Gross Transaction Value (GTV). Under the Regulations, GTV is defined as:

- The consideration received in respect of the service provided in the case of a digital service provider; and
- The commission or fee paid for the use of the platform in the case of a digital marketplace provider.

Excluding value-added tax (VAT) charged for the service.

Our view

The clarification as to what constitutes GTV is a welcome move, especially for digital marketplace providers whose revenue may only be a small proportion of the transaction value. It will go a long way in simplifying compliance with these Regulations.

That said, the definition may not have dealt with all the complexities that may arise from digital transactions. One such complexity is the apportionment of GTV where a particular digital service is offered to users located both in and outside Kenya. In other jurisdictions such as France, the law provides for a specific formula to deal with apportionment of income in the case of users in mixed jurisdictions.

We hope that this will be addressed sooner rather than later to ease implementation for affected taxpayers.

Accounting for DST

Digital marketplace providers and digital service providers in Kenya, whether resident or non-resident, are required to register for DST obligation. Non-resident persons without a Permanent Establishment (PE) in Kenya have the option of appointing a tax representative who will account for the tax on their behalf and to register through the simplified form of registration.

Registration for the DST obligation shall be done through an online form prescribed by the Commissioner and will culminate to issuance of a Personal Identification Number. For registration, the information below will be required;

- **Details of the applicant's business** – This includes: the name of the applicant's business, certificate of incorporation, national tax identification number, the postal and registered address, the website or uniform resource locator, and any other information that the Commissioner may require.
- **Person responsible for tax** – Name, the postal and registered address, electronic address and telephone number, and any other information that the Commissioner may require.

In addition to the above information, the Commissioner may request for documentation in support of the information supplied.

Taxpayers or their tax representatives, are required to submit a monthly return using a prescribed form and remit the DST by the 20th day of the month following the end of the month that the digital service was offered.

The return may be amended in accordance with the provisions of the Tax Procedures Act, 2015. However, where an amendment results in a tax overpayment, the amount overpaid shall be retained as a credit and offset against the DST payable in the subsequent tax period in the case of a non-resident person without a PE. In the case of a resident or a non-resident person with a PE in Kenya, the amount overpaid is refundable.

A person liable to DST is required to keep records in line with the provisions of the Tax Procedures Act, 2015. Kenya has a five year statute of limitation rule implying that such records should be kept for a minimum of five years.

Any person who fails to pay DST or comply with the DST compliance provisions will be subject to penalties prescribed by Kenyan tax laws.

Our view

The move to provide room for a simplified registration is welcome especially for non-resident persons who may struggle to secure a tax representative in Kenya. We believe that it will go a long way in enhancing compliance

In addition, allowing taxpayers to file amended returns is a good measure.

However, we are of the view that the restriction of how the overpayment arising from an amendment will be dealt with is unnecessary and amounts to deprivation of taxpayers' rights. Taxpayers who would like to apply the tax overpayment to offset against future DST payable should be allowed to do so whether or not they are resident persons and similarly non-resident persons should be granted the opportunity to choose whether to claim a refund or utilise the tax overpayment against future tax liabilities.

Conclusion

The introduction of DST is not unique to Kenya. In the last two years, a number of European and Asian countries have introduced DST into their taxation regime. The countries include France, India, Singapore, United Kingdom, among others. Most, if not all of these countries, have mature digital economies.

The Kenyan Treasury has identified the digital economy as one of the focus areas for taxation in order to grow tax revenue amidst the increasing budgetary pressures. There are those who may argue that Kenya's, and indeed Africa's digital economy is still at an infant stage and may question the timing of the introduction of DST in Kenya, especially considering that discussions on DST are still ongoing at the OECD. The country will also need to contend with the reaction by some of the developed economies such as the US to the introduction of DST. On the other hand, there is the view that given the growth of the digital economy, which has been further propelled by the current pandemic, the time is ripe to put in place measures to effectively tax digital transactions.

Being a new form of taxation in Kenya and, indeed, in many parts of the world, it is expected that the implementation and enforcement of DST is likely to face some challenges but with continuous refinement and aligning to best practices, the hurdles should be overcome in the long run.

Should you wish to discuss this further, kindly feel free to contact any of the contacts below or your usual Deloitte contact who will be more than glad to offer you guidance and assistance.

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