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THE DIGITAL SERVICE TAX OVERVIEW

DIGITAL SERVICE TAX

Digital Service Tax ("DST") was introduced in Kenya through the Finance Act, 2019 and enacted through the Finance Act, 2020 with an effective date of 1st January 2021. It was introduced to both the Income Tax Act ("ITA") and the Value Added Tax Act ("VAT Act").

Both Acts prescribe that DST shall be payable by a person whose income is earned in Kenya from the provision of services through a digital marketplace. Further, both the ITA and VAT Acts define a digital marketplace as **"a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means"**.

Below we highlight the salient features of this new tax from an Income Tax and VAT perspective

INCOME TAX APPLICABILITY

The Cabinet Secretary for the National Treasury and Planning published The Income Tax (Digital Service Tax) Regulations which came in to force on 2nd January 2021 to guide on the application of DST.

WHO IS LIABLE TO PAY DST?

DST will be paid by the digital service provider or the digital marketplace provider or the tax representative of a non-resident person.

Any non-resident persons providing digital services or digital marketplace to a user in Kenya shall need to appoint a tax representative in Kenya who shall be responsible for remitting the DST to Kenya Revenue Authority ("KRA").

WHICH CATEGORIES OF INCOME SHALL BE SUBJECT TO DST?

DST is applicable on the provision of digital services and digital marketplace. Digital services provided by residents and non-residents on which DST will apply are as follows:

- downloadable digital content including downloadable mobile applications, e-books and films;
- over-the-top services including streaming television shows, films, music, podcasts and any form of digital content;
- sale of, licensing of, or any other form of monetizing data collected about Kenyan users which has been generated from the users' activities on a digital marketplace;
- provision of a digital marketplace;
- subscription-based media including news, magazines and journals;
- electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services;
- electronic booking or electronic ticketing services including the online sale of tickets;
- provision of search engine and automated help desk services including supply of customized search engine services;
- online distance training through pre-recorded media or e-learning including online courses and training; and
- any other service provided through a digital marketplace.

A non-resident company providing a digital service to a user located in Kenya shall be subject to DST where:

- the user receives the digital service from a terminal (computer, tablet or mobile phone) located in Kenya;
- the payment for the service is made using a debit or credit facility provided by a Kenyan financial institution or Kenyan company;
- the digital service is acquired through 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.



WHICH CATEGORIES OF INCOME SHALL BE EXEMPT FROM DST?

- Income already subject to withholding tax
- Income of a non-resident person carrying on business of transmitting messages by cable, radio, optical fibre, television broadcasting, Very Small Aperture Terminal (VSAT), internet, satellite or by any other similar method of communication.
- Online services which facilitate payments, lending or trading of financial instruments, commodities or foreign exchange carried out by:
 - (i) A financial institution specified under Fourth Schedule of the ITA.
 - (ii) A financial service provider authorized or approved by the Central Bank of Kenya.
- Online services provided by Government institutions.



HOW WILL DST BE COMPUTED?

DST shall be computed at **1.5%** of the gross transaction value of the digital service.

This shall be the payment received as consideration for services in the case of provision of digital services or the commission or fee paid to the digital marketplace provider for the use of the platform in the case of a digital marketplace.

The gross transaction value shall be exclusive of VAT.

WHEN IS DST DUE?

According to Section 12E(2) of the ITA, DST shall be payable at the time of transfer of payment for the service to the service provider.

However, for remittance purposes, the Regulations have clarified that a DST return and tax payable shall be due by the twentieth day of the month following the end of the month that the digital service was offered.

IS THERE A TURNOVER THRESHOLD FOR DST?

There is no turnover threshold for DST purposes in Kenya as is the case with some tax jurisdictions around the world.

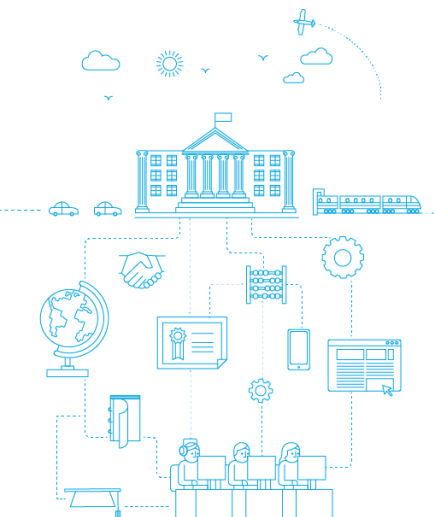
CAN DST PAID BE SET OFF AGAINST INCOME TAX PAYABLE?

DST paid by a resident or non-resident person with a permanent establishment in Kenya can be offset against tax payable by the person for that year of income.

DST paid by a non-resident person without a permanent establishment in Kenya shall be final tax.

A non-resident company without any permanent establishment in Kenya may be able to claim tax paid in Kenya under a special arrangement as a credit against tax chargeable on that income in their resident country.

CAN I AMEND DST RETURNS?



Any amendment of the DST return shall be made within 5 years from the date the DST return was submitted.

Any DST overpaid through any amendment of a DST return by a resident person or non-resident with a permanent establishment in Kenya shall need to apply for refund within 5 years of the date on which the tax was paid.

Any DST overpaid through any amendment of a DST return by a non-resident without a permanent establishment in Kenya shall be retained as a credit and offset against DST payable in a subsequent tax period.

HOW WILL A TAXPAYER REGISTER FOR DST?

DST registration will be done online on the iTax platform. A taxpayer will only be able to make payments and file DST returns after registering for DST on iTax.

A non-resident person without a permanent establishment in Kenya may register under the simplified tax registration through an online registration form on iTax through their appointed tax representative.

The simplified tax registration shall include the following information:

- Name of applicant's business including trading name
- Name of contact person responsible for tax matters
- Postal and registered address of the business and contact person
- Telephone number of the contact person
- Electronic address of the contact person
- Websites or uniform resource locator of the applicant through which the business is conducted
- **National tax identification number issued to the applicant in their country of residence**
- **Certificate of incorporation issued to the applicant's business**
- Any other information that the Commissioner may require

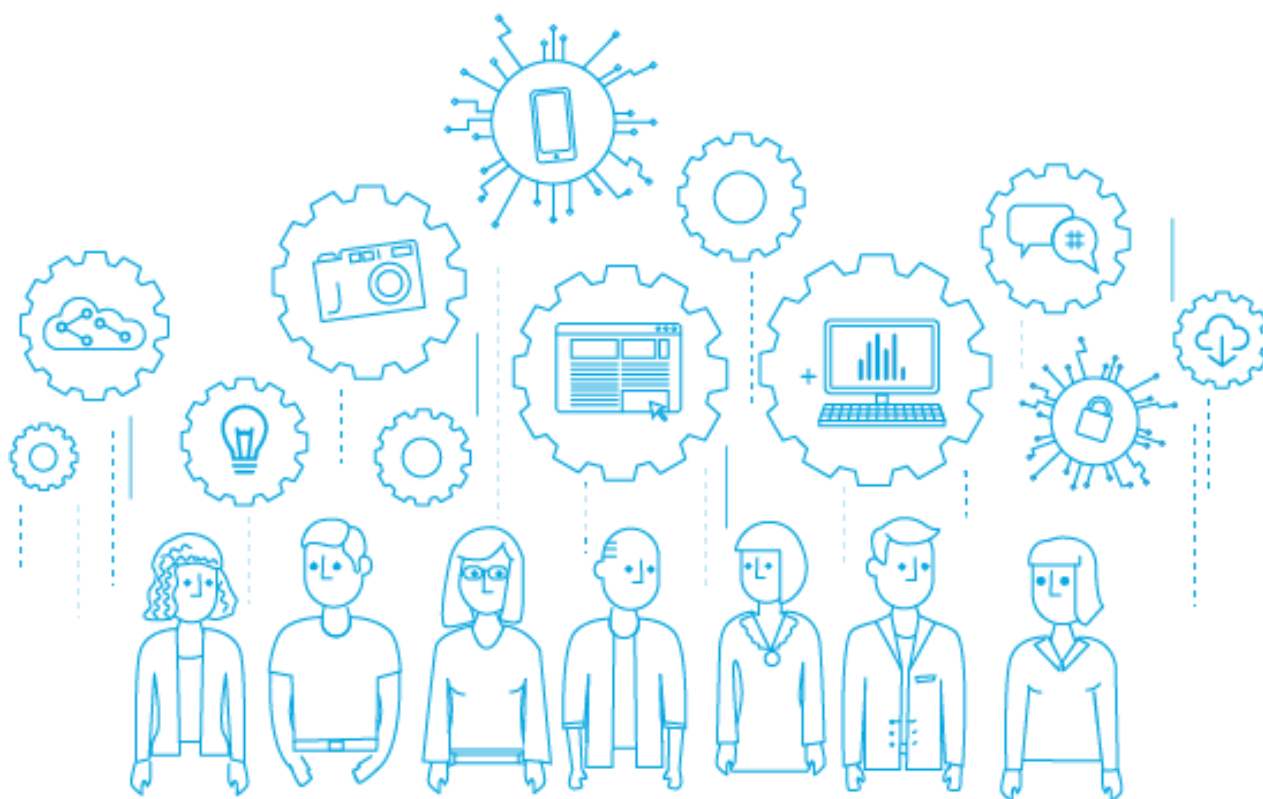
Upon registration, the Commissioner shall issue the applicant with a PIN for the purpose of filing returns and payment of DST.

If no tax representative is appointed, the Commissioner may appoint a digital service tax agent for the purpose of collecting and remitting the DST to the Commissioner.

PENALTIES AND INTEREST ON DST

Failure to submit DST return by the due date – 5% of the tax due.

Failure to pay DST by the due date – 5% of the unpaid tax.



Interest charged at 1% per month or any part thereof on any unpaid tax.

VAT APPLICABILITY TO THE DIGITAL SERVICE WORLD IN KENYA

The Finance Act, 2020 brought under the ambit of Value Added Tax ("VAT") supplies undertaken in the digital marketplace. It is important to note the VAT Act also adopted the same definition of a digital marketplace as the Income Tax Act. VAT will be applicable on supplies undertaken in the digital marketplace at the standard rate when supplied in Kenya.

On 25th September 2020 via Legal Notice No. 190 of 2020, the Value Added Tax (Digital Marketplace Supply) Regulations, 2020 were gazetted which sought to clarify how DST would work and the mechanics around the same.

Below, we highlight the features of VAT and the digital service.

WHAT IS A TAXABLE SUPPLY IN THE CONTEXT OF A DIGITAL MARKETPLACE?

In sum, a taxable supply will include what can be termed as a digital service provided by **non-residents without a permanent establishment** which are as follows:

- downloadable digital content including downloadable mobile applications, e-books and films;
- subscription-based media including news, magazines and journals;
- over-the-top services including streaming television shows, films, music, podcasts and any form of digital content;
- software programs including software, drivers, website filters and firewalls;
- electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services;
- music and games;
- search engine and automated helpdesk services including customizable search engine services;
- tickets for live events, theatres or restaurants;
- distance teaching through pre-recorded media or e-learning including online courses and training;
- digital content for listening, viewing or playing on any audio visual or digital media;
- services that links the supplier to the recipient including transport hailing services or platforms;
- electronic services under Section 8 (3); and
- any other service provided through a digital marketplace that is not exempt under the Act.

WHO IS LIABLE TO PAY VAT?

VAT will be payable by the digital service provider or the digital marketplace provider (vendors in this case) or the tax representative of a non-resident digital service provider or marketplace provider. In the context of the e-commerce industry, it would be applicable to a Business to Consumer (B2C) transaction where:

- the consumption of this supply has been done in Kenya which will be determined via:
 - whether the payment proxy including credit card or debit card information and bank account details of the recipient of the digital supplies is in Kenya; or
 - whether the residence proxy including the billing or home address or access proxy including internet address, mobile country code of the SIM card of the recipient is in Kenya.
- the payment of the services is made to the supplier from a bank registered under the Banking Act; and
- the payment for the services that is made to the supplier is authorized in Kenya.

Where the supply of digital services is made by a non-resident provider to a registered business user (B2B) in Kenya, VAT on imported services regime shall apply on these transactions and will not be subject to VAT on the digital services regime. The regulations require the registered business entity in Kenya to notify the non-resident supplier that the supplier will not be required to account for VAT in Kenya on the supply.

Under B2B, clarification will be needed by KRA on who will be accounting for VAT where the non-resident supplier is registered in Kenya and is supplying to both registered and non-registered consumers in Kenya.

IS THERE INCOME THAT WILL BE EXEMPT?

Sale of tangible goods via an online platform by either resident or non-resident persons. The principle behind this is that any goods sold by non-residents through an online platform to a resident will be captured through a physical border entry such as a port where taxes will be applicable on the goods upon clearance. DST is aimed towards online borderless transactions which escape the tax nets globally.

IS THERE A TURNOVER THRESHOLD FOR VAT TO BE APPLICABLE TO DIGITAL SERVICES?

There is no turnover threshold for VAT to be applicable. The principle behind this is that any VAT on imported services needs to be accounted for without any threshold applicable. Similarly, VAT on digital services by a non-resident to a consumer in Kenya also needs to be accounted for by the supplier of the digital service.

HOW DO I REMIT VAT ARISING FROM DIGITAL SERVICES?

The regulations provide that a non-resident supplier without a permanent establishment who makes supplies on a digital marketplace shall register under a simplified tax registration framework which will be done online via the iTax platform.

To register the supplier will be required to furnish the following information:

- the name of the business including the business's trading name;
- the name of the contact person responsible for tax matters;
- the postal address or registered address of the business; and
- the telephone number of the contact person;
- the email address of the contact person;
- the websites or uniform resource locators (URLs) of the supplier through which business is conducted;
- the national tax identification number issued to the supplier in the supplier's jurisdiction;
- the certificate of incorporation or registration issued to the business in the country where the business is incorporated; and
- any other information that the Commissioner may require.

Upon registration, the Commissioner shall issue the applicant with a PIN for the purpose of filing returns and payment of VAT. **The non-resident supplier without a permanent establishment is required to apply for registration within six (6) months from the date of publication of the regulations.**

A non-resident person without a permanent establishment or presence in Kenya may also elect not to register under the simplified tax registration framework. In this case they **should appoint a tax representative** who will account and remit the VAT to the KRA.

If no tax representative is appointed, the Commissioner may appoint a digital service tax agent for the purpose of collecting and remitting the VAT on DST to the Commissioner.

WHEN IS VAT DUE?

It will be due on or before the 20th day of the succeeding month in which the digital service was offered through a return indicating the value of transactions and the tax remitted.

CAN I AMEND MY VAT RETURNS?

An amended return can be done to rectify a position in line with the provisions of the Tax Procedures Act ("TPA").

Where an amendment results in an overpayment of tax, the overpaid amount shall be retained as a credit in favour of the person who overpaid and offset against the tax payable in the subsequent tax period.

DO I NEED TO ISSUE AN ELECTRONIC TAX INVOICE?

No. The supplier is however required to issue an invoice or receipt showing the value of the supply and the tax deducted.

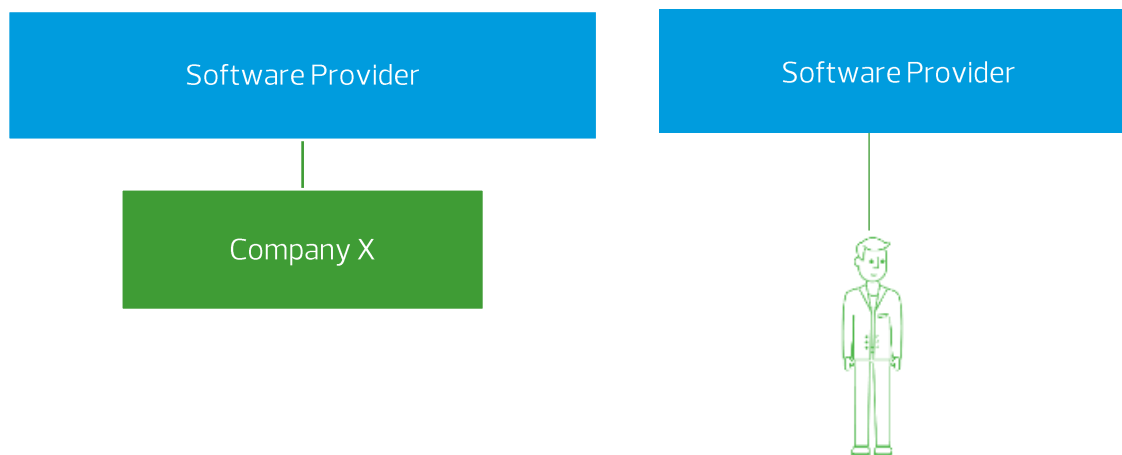
CAN I CLAIM INPUT VAT?

The regulations prohibit the non-resident supplier from claiming any deduction for input tax for business to consumer transactions for a supply of a digital marketplace.

PENALTIES AND INTEREST ON NON-COMPLIANCE

A person who fails to comply with the provisions provided under the regulations is liable to the penalties under the Tax Procedures Act ("TPA"). The TPA provides that non-compliance attracts penalties at the rate of 5% of the tax payable and monthly accrual of interest at the rate of 1% of the tax payable.

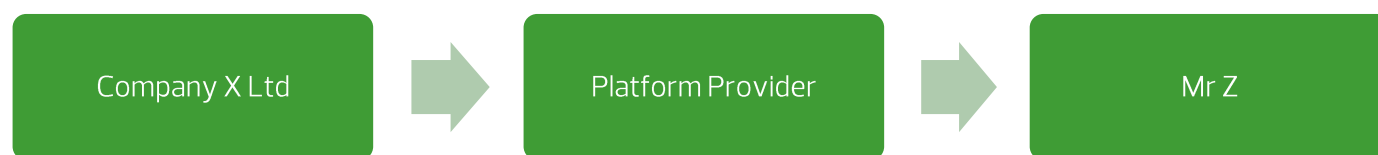
ILLUSTRATION 1



In the illustration above, where a non-resident software provider provides the digital service to Company X and charges a subscription or licence fee for the provision for the service, in this case, the software provider is liable to account for DST on the fees earned and VAT on this imported service shall need to be accounted for by Company X under the VAT on imported services regime. Output VAT on the subscriptions shall need to be paid and input VAT can be claimed on the same supply by Company X if relating to provision of taxable supply.

The other scenario is where a non-resident software provider provides the same service to an individual person, then the software provider still needs to account for DST on the fees received from the individual, and also VAT needs to be accounted for the provision of this service by the software provider. In both cases, the obligation to pay DST lies on the software provider.

ILLUSTRATION 2



In illustration 2, Company X advertises and sells its **goods** using Platform Provider to Mr Z, a buyer on the platform. In this scenario, DST would be payable by the Platform Provider on the commission it earns from Company X for the use of the platform. DST is not applicable on the sale of goods through an online platform.

However, if Company X were providing any online or digital service through Platform Provider, then DST will need to be paid by Company X on the provision of the online service to Mr Z on the amount it earns on the provision of that online service and DST will also need to be paid by Platform Provider on the commission income earned by Platform Provider on the sale of the service by Company X.

VAT on digital services shall be accounted by the supplier of the platform (Platform Provider on the commission earned) and service (by Company X on the goods sold or online service).

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