TAXING THE DIGITALIZING ECONOMY

Presentation by:

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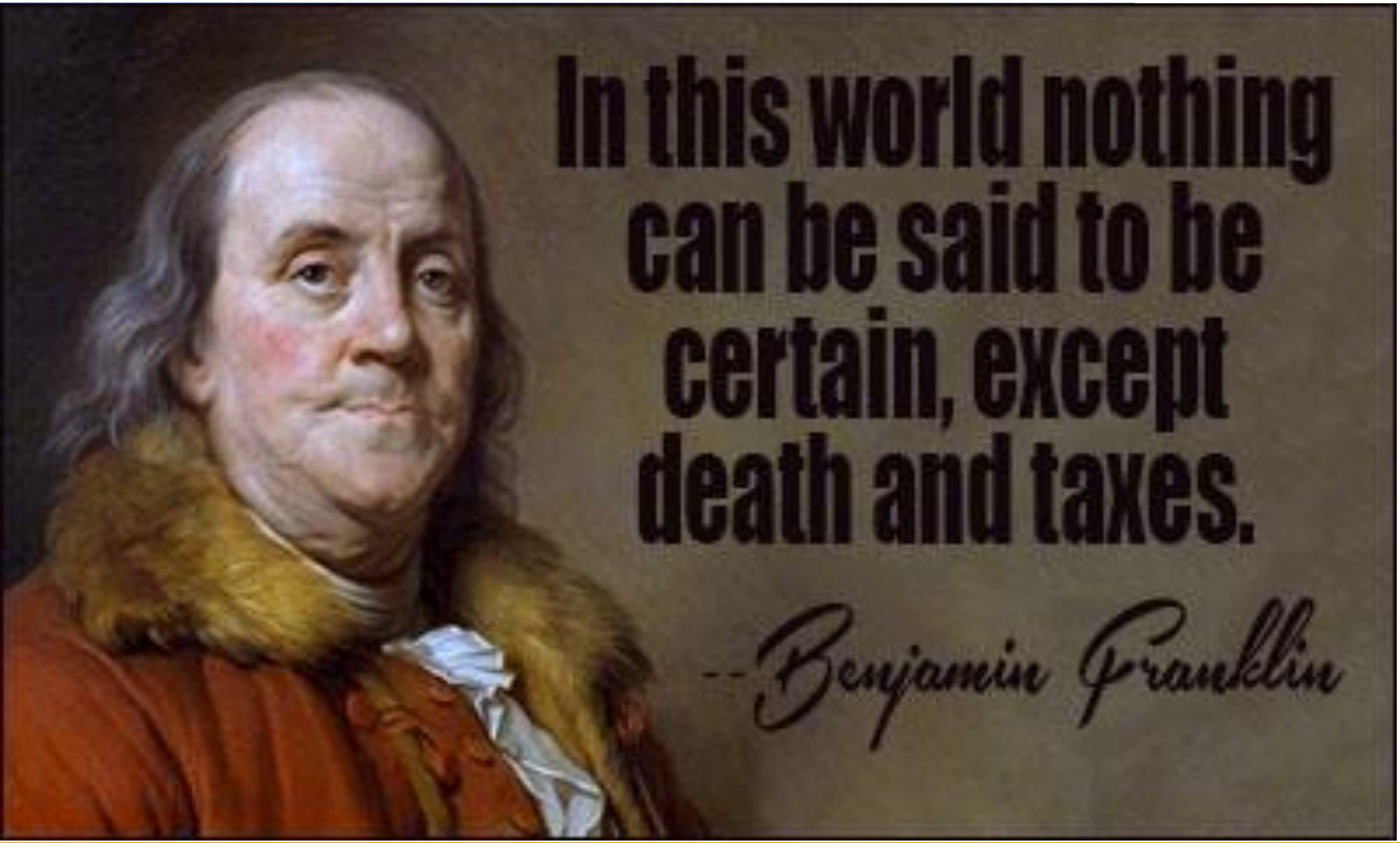
Thursday 10th September 2020

Agenda

1. Definition of the digital economy
2. Models from other countries
3. Applicability in Kenya.
4. Conclusion

Perspective



Digital Economy

- Conducting business through markets based on the world wide web
- Digital disruption / advances have generated enormous wealth in record time
- However, the wealth has been concentrated around a small number of individuals, companies and countries
- Consumers have more choices when they shop for products and services as they are not only restricted to the local brick and mortar shops

Digital Economy Drivers

- **Digital Data:** arise from the digital footprints of personal, social and business activities taking place on various digital platforms

Year	Global Internet Protocol traffic (IP)
1992	100 gigabytes (GB) per day
2007	2,000 GB per second
2017	45,000 GB per second
2022	150,700 GB per second (projected)

- **Digital platforms:** provide the mechanisms for bringing together a set of parties to interact online
- **Transaction platform** such as Amazon, Alibaba, Facebook, eBay, Uber, Airbnb
- **Innovation platforms** create environments for code and content producers e,g Android and Linux

Highly Digitized Business Models

- **Cross-jurisdiction scale without mass:** Digitalization allows some businesses to be heavily involved in the economic life of a jurisdiction without any, or any significant, physical presence, thus achieving operational local scale without mass;

- **Reliance on intangible assets**: For many digitalized enterprises, the intense use of IP assets such as software and algorithms are crucial; and

- **Data, user participation and synergies with IP:** E.g user generated content as seen in the case of social networks

Value in the digital Economy

- Digital data can be used for development purposes and for solving societal problem
- Platforms facilitate transactions and networking as well as information exchange
- foster the production of higher quality goods and services at reduced costs.
- New Employment opportunities for special skills
- Tax revenue stream for Government in the digital economy
- Enhanced productivity

Downside in the digital Economy

- Digital data can be used for development purposes and for solving societal problem
- Platforms facilitate transactions and networking as well as information exchange
- Foster the production of higher quality goods and services at reduced costs
- Loss of customs revenue from digitization of products
- Increased competition for SMEs in from, digital firms
- Lost employment opportunities due to digitization

Challenges in taxing the Digital Economy

- Under taxation of major digital platform
- Who has the taxing rights?
- No unified policy on taxation of the digital economy
- Lack of proper information about the size of the digital economy

Base Erosion Profit Shifting (BEPS)

- Digitalization has given rise to fundamental challenges for policymakers in all countries
- In 2015, the OECD released a report on taxation of the digital economy
- Possibility of “ring-fencing” the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalization
- The destination principle is key in determining the ultimate bearer of tax

BEPS...continued

- The OECD proposes the concept of **significant economic presence**
- Non- residents are liable to tax in the country of sales even without a fixed place of business within the geographic boundary of the country of sales

Europe

1. Taxable Revenues

- Include revenues resulting from supply of digital services characterized by **user value creation**
- The targeted businesses would not exist without user involvement
- The massive traffic is not driven by the platform provider but by the users themselves.
- DST targets the income generated from digital revenue without taxing user participation.

2. Taxable Person

The Directive proposes that an entity with the following thresholds qualifies as a taxable person :

- Worldwide revenues in excess of ***EUR 750 Million*** in the latest financial year
- Taxable profit exceeding ***EUR 50 Million*** obtained by all related entities within the European Union

Europe...continued

3. Place of Taxation

- The European Union is comprised of independent states.

- The proposal is that the DST is due in the Member state where the users are located.

- Advertisements on a digital interface: the number of times an advertisement has appeared on user's devices used to determining the proportion to revenues to be allocated

Europe...continued

4. Rate of Tax

- The rate for the Digital Services Tax has been set at 3% across the European Union

5. Obligation to Pay

- The person providing taxable services is liable for the payment of the tax and fulfilment of the obligations

India

- **Equalization levy** introduced in February 2016
- Aim: taxing business-to- business transactions in the digital advertising space i.e: the income relating to foreign e-commerce companies from within India

1. Rate of Tax

- The rate of equalization levy is 6%

2. Tax Base

- The Equalisation levy is levied on **non-resident digital advertising companies** offering:
  - online advertisements,
  - provision for digital advertising space
  - online business facilities received from a person resident in India

India...continued

Exceptions

- The non-resident providing the specified service has a PE in India and the specified service is effectively connected with the PE;
- The annual accrued payments made to one single service provider do not exceed ***Rs 100,000*** in one financial year; or
- The service is not for business purposes

Obligation to Pay

- Obligation falls on the company resident in India
- In the form of WHT upon making payment to the non-resident
- Remitted to the India Revenue Authority by the 7th day of the next month

In your opinion, What is the ideal way of taxing the digital economy in Kenya?

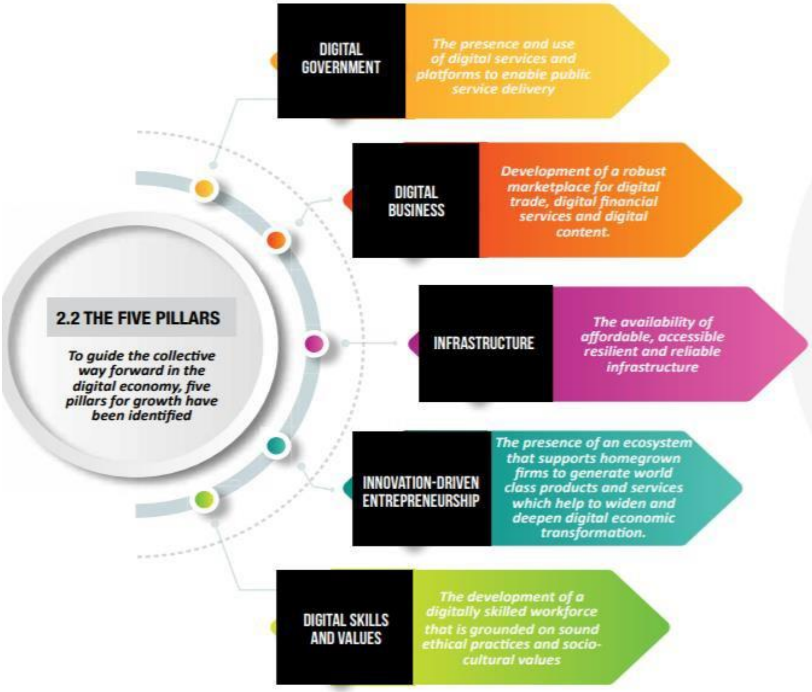
Kenya

- According to CBK, total funds transferred through mobile platforms was **KES 3.64 trillion** in 2017, jumping to **KES 3.98 trillion** in 2018
- Value can be created by people and companies on different continents, generating divergent views about what constitutes a PE for tax purposes

1. Where is the **profit** generated?
2. Where is the **value** added?
3. Who is the ultimate **customer**?

Digital Economy Blue Print

- In 2019, the Ministry of Information, Communications and Technology launched the Digital Economy Blue Print
- Aim: Find value in the adaptation of the Digital Economy within the economic ecosystem and to realize the potential of digital transformation that will propel the economy
- Practical examples include: buyers and sellers; riders and drivers; and content producers and subscribers (Waabeh, Mdundo)



Why Different Regime?

- Article 210 - Constitution of Kenya

“No tax or licensing fee may be imposed, waived or varied except as provided by legislation.”

Finance Act, 2019

- The Finance Act, 2019 defined the digital market place to mean ***a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means***

- Brings to charge income earned from the digital market place and subjects the same to VAT

- The National Treasury has issued draft Regulations on the taxation procedures and collection of tax

Finance Act, 2020

- The Finance Act, 2020: w.e.f 1 January 2021 income derived or accrued in Kenya ***from the provision of services in the digital marketplace***.

- DST rate is 1.5% of the ***gross transaction value***.

- Accounted for as WHT, payable to the KRA when paying the service provider. KRA empowered through Tax Procedures Act, 2015 to appoint agents for the collection and remittance of DST – Banks?

Income Tax Implications

- Income tax is primarily based on the physical presence of a company in Kenya.
- Majority of the digital economic activities do not establish a taxable presence in Kenya.
- Under Pillar one of BEPS Action Plan 1, the OECD recommend the use of revenue threshold in levying income tax on the digital economy.

Regulations

- Further assessment is required on the amount of income generated by the entity in the specific country under consideration.

- The CS, National Treasury issued draft:

1. Income Tax (Digital Services Tax) Regulations, 2020 (Digital Income Tax Regulations); and

2. Value Added Tax (VAT) (Digital Marketplace Supply) Regulations, 2020 (Digital VAT Regulations).

Scope of Regulations

- The Regulations have been published for public commentary/opinion prior to submission to the National Assembly for approval
- Seek to provide further specific guidelines on the application of collection of income tax and VAT on transaction conducted through the digital market place
- The guidelines specify the scope of services falling within the ambit of the respective tax regimes, registration requirements and guidelines on place & time of supply

Scope of Regulations…continued

- The Regulations cover both Business to Business (B2B) transactions as well as Business to Consumer (B2C) transactions
- Applicable to a wide array of activities
- Services include: website hosting, warehousing, file-sharing and cloud storage services, supply of music, films and games and downloadable digital content such as mobile applications, e-books and movies

VAT Implications

- Majority of the digital services providers are non-resident therefore a simplified registration process provided

- Registration under two circumstances:

1. Where the digital marketplace supplies are supplied by a person from a place of an export country to a recipient in Kenya in a B2C transaction

2. Where the person is conducting business in Kenya as provided under Section 8(2) of the VAT Act, 2013 and the recipient of the supply is in Kenya.

VAT Implications…continued

- The simplified VAT registration will be completed through an online form to be provided by the Commissioner
- A Personal Identification Number (PIN) for VAT purposes will be issued to the applicant upon registration
- May register through a local tax representative
- Subject to other provisions of VAT Act, 2013 in relation to rates and remittance, however, no input deduction is allowed under the simplified VAT registration framework

Questions on taxpayers' mind

- What is the definition of the digital marketplace?
- Is there a clear demarcation of who is affected by this legislation?
- If am under the TOT or below the VAT threshold does this legislation apply to me?
- I am tax resident in Kenya and I already pay my taxes is this regime necessary for tax resident persons?
- What is the government policy objective? Economic growth vs revenue mobilization?
- Who will be the appointed DST agents?

Implications - Key Concerns

- Pushback from some countries such as US and China following the introduction of similar measures in France, Nigeria, South Africa and Zambia.

- Therefore, will the imposition of this tax create trade wars between Kenya and other countries?

- Will the KRA be able to monitor the digital space and enforce compliance?

Lessons on Implementation

- UK and France have applied minimum revenue thresholds to net the bigger players in the sector while ensuring the tax regime does not stifle the smaller ones
- Minimal threshold may be appropriate for the Kenyan digital marketplace to ensure that while the Government gets its revenue, the tax does not stifle the growth of the infant Kenyan digital economy

Questions?

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