



ORARO & COMPANY  
ADVOCATES

## LEGAL ALERT

UNDERSTANDING DIGITAL SERVICE TAX AND ITS  
IMPLEMENTATION IN KENYA

## DIGITAL SERVICE TAX

### THE GENESIS OF THE DIGITAL SERVICE TAX

Following the recent and rapid expansion of digitisation and digitised aspects of the economic and societal space, numerous global debates have been sparked in many legal and regulatory tax statutes. The tax implications of digitisation range from direct and indirect taxation, tax policies and tax administration. With the emergence of new digital streams of income, the allocation of profit and the nexus rules to distribute taxing rights on income generated from cross-border activities has given rise to ambiguities as to the manner these tax issues may be resolved.

The Organization for Economic Co-operation and Development (the “OECD”) recognized these emerging tax challenges. Consequently, the OECD and G20 formulated the Inclusive Framework on the Base Erosion and Profit Shifting (the “BEPS Framework”) to resolve them. The Framework contains fifteen (15) actionable measures that may be implemented by member states.

Action 1 relates to the tax challenges arising from digitisation. This action sought to address the fact that the emergence of new and often intangible value drivers has eroded the need for physically proximate markets, hence, the nexus rules to distribute taxing rights on income accrued digitally is difficult to determine. Member states have since dedicated and pledged to co-operate to secure the integrity of the global tax system.

### THE FINANCE ACT, 2019

Kenya, in conformity with the BEPS Framework, made first mention of the taxation of the digital economy when it enacted the Finance Act, 2019. The 2019 Act introduced and defined a digital marketplace as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means. Goods and services supplied in digital marketplace will now be subject to Income Tax and VAT.

As a result, the Act amended the Income Tax Act (the “ITA”) at section 3 to recognize income that was accruing through a digital marketplace as being subject to income tax. Additionally, the Finance Act, 2019 amended the Value Added Tax Act. It recognized that the provision of supplies through a digital marketplace was also subject to VAT.

### THE FINANCE ACT, 2020

In 2020, the Finance Act went ahead to cement the enforceability of the collection of digital service tax by inserting Section 12 E. The Finance Act, 2020 provides that digital service tax is payable by a person whose income comes from the provision of goods or services through a digital marketplace and is derived from or accrues in Kenya.

The tax is payable in the instance that a resident or a non-resident person with a permanent establishment in Kenya shall offset the digital service

tax paid against the tax payable for that year of income. The tax is payable at the time of the transfer of the payment for the service to the service provider. The 2020 Act also makes provision for the payment of digital service tax at the rate of 1.5% of the gross transaction value.

### THE INCOME TAX (DIGITAL SERVICE TAX) REGULATIONS, 2020 (the “DST Regulations”)

Pursuant to the changes enacted in the Income Tax Act through both Finance Acts, the Cabinet Secretary gazetted Legal Notice No. 207 of 2020 to operationalize the Regulations which will guide the taxation of the digital marketplace. The Income Tax (Digital Service Tax) Regulations, will take effect from January 2021, will encompass the following provisions:

#### Definitions

“digital marketplace” has the meaning assigned to it in section 3 (3) (ba) Section 3(3) (ba) of the Income Tax Act defines a digital marketplace as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means

“digital marketplace provider” means a person who provides a digital marketplace platform;

“digital service” means any service that is delivered or provided over a digital marketplace;

“digital service provider” means a person who provides digital services through a digital marketplace; and

“platform” means any electronic application that allows digital service providers to be connected to users of the services, directly or indirectly, and includes a website and mobile application.

#### The Scope of Chargeable Service

The digital services upon which the Digital Service Tax (the “DST”) shall be applicable include:

- 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 held desk services including supply of customised 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.

The DST Regulations shall not apply to income taxed under Section 9(2) or Section 35 of the Income Tax Act. As well as services of licensed financial institution specified under the Fourth Schedule to the Income Tax Act of financial service provider authorised or approved by Central Bank of Kenya and online services provided by Government institutions.

### **Application of digital service tax**

- Digital service tax shall apply to the income of a resident or non-resident person derived from or accrued in Kenya from the provision of services through a digital marketplace.
- Digital service tax paid by a resident or non-resident person with a permanent establishment in Kenya shall be offset against the tax payable by that person for that year of income.
- Digital service tax paid by a non-resident person without a permanent establishment in Kenya shall be a final tax.

### **User Location**

The DST Regulations provide that if a person/entity who provides or facilitates provision of digital service to a person located in Kenya, they shall be subject to DST. Such persons/entities are deemed to be in Kenya if:

- a) the user receives the digital services from a terminal located in Kenya, where terminal includes a computer, tablet and mobile phone;
- b) payment for digital services is made using a debit or a credit facility provided by financial institutions or company located in Kenya;
- c) if an IP address is registered in Kenya or international mobile phone country code assigned to Kenya; or
- d) if the user has a business, residential or billing address in Kenya.

### **Gross Transaction Value**

The Regulations also provide that DST shall be imposed on the gross transaction value of digital services and on digital marketplace the of the platform. This gross value shall not include value added tax.

### **Appointment of a tax representative**

Where a non-resident person without a permanent establishment in Kenya elects not to register under the simplified tax registration framework, the non-resident shall be required to appoint a tax

representative in accordance with Section 15A of the Tax Procedures Act, 2015.

### **Simplified tax registration**

A person who applies for registration under the simplified tax registration framework, shall go through an online registration form as provided for on the i-Tax platform and provide all requisite information as required in the application form. Upon registration, the Commissioner shall issue an applicant with a Personal Identification Number (PIN). Where a person ceases to provide digital services in Kenya they shall be required to apply for registration in the prescribed form.

### **Accounting and Payment**

The payment of DST shall be paid by the digital service provider or digital marketplace provider or the tax representative appointed as stated above. They shall be required to submit a return and remit tax due by the 20th day of the month following end of the month that the digital service was offered.

### **Amendment of returns**

A taxpayer is permitted to file amended returns as provided for under section 31 of the Tax Procedures Act, 2015. Where such an amendment results in overpayment of tax, in the case of a non-resident person without a permanent establishment in Kenya, the overpaid amount will be retained as a credit and offset against the digital service tax payable in the

subsequent tax period.

In the case of a resident or a non-resident with a permanent establishment in Kenya, the amount overpaid shall be refunded as provided for under section 47 of the Tax Procedures Act, 2015.

### **Maintenance, Filing and Record Keeping**

The Taxpayer shall be required to maintain and keep records as provided for in section 23 of the Tax Procedures Act, 2015.

### **Offences and Penalties**

A person who fails to comply with the provisions of these Regulations shall be liable to penalties prescribed under the Tax Procedures Act, 2015

### **NOTEABLE CHALLENGES**

- a) The Concept of Permanent Establishment is normally linked to the place where all or part of the business activities of an entity/organization are conducted. It may be difficult to tax entities as governments will face the challenge of establishing a physical presence of some entities since most digital companies operate a business model that allow for business transactions with minimal physical presences in the country or tax jurisdiction.
- b) There is a need to create awareness about digital tax and how it will be effected. Many SMEs and business operating on online digital platforms are largely unaware of the introduction of digital tax in



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Kenya. The Kenya Revenue Authority needs to ensure that adequate information is available to those business that will be affected by the digital tax set to be implemented in January 2021.

### CHALLENGES THAT FACE THE IMPLIMENTATION OF THE DIGITAL SERVICE TAX

- a) The digital tax will apply to large cross border digital companies which will be taxed where they do not have any physical presence.
- b) 1.5% of the digital service tax will apply to both domestic and foreign entities which creates an unfair disadvantage to the local small medium enterprises.
- c) Lack of coherent and uniform digital tax policies that apply to most countries.
- d) Levying tax on gross revenues instead of profits may be problematic.
- e) Small business in Kenya may face significant challenges with an additional digital tax.
- f) Service providers may pass the cost to the consumer thereby making e-commerce expensive.

### THE VALUE ADDED TAX REGULATIONS (DIGITAL MARKET SUPPLY REGULATIONS, 2020)

The above regulations apply to income derived from transactions carried out across a digital marketplace which will be subject to VAT.

### SCOPE OF THE REGULATIONS

The digital services will include the supply of downloadable digital content, subscription-based media, distance teaching, software programs, digital content for listening and viewing supplies on online marketplaces, digital media content, data management services, search engine services, tickets for live events.

#### **Business-to-Business (“B2B”) Transactions**

B2B Transactions is defined under the Regulations as a transaction between a supplier from an export country to a tax registered or non-registered business entity in Kenya that is required to account for a tax on imported services under Section 10.

#### **Business-to-Consumer (“B2C”) Transactions**

B2C Transactions are defined under the Regulations to mean:

*“a transaction between a supplier from an export country and a consumer in Kenya.”*

B2C relates to a transaction in which the supplier is based outside Kenya whilst the recipient is Kenya. It may also be that the supplier either conducts business in Kenya, is registered in Kenya, supplies goods and services in Kenya and the recipients are in Kenya and the payment made to the supplier by the customer originates from Kenya.

### Requirements for registration

What should be Regulation 6 (indicated as Regulation 18 in the Regulations) mandates that persons supplying goods and/or services through a digital marketplace are required to register for tax in Kenya where:

- (a) the supplies are made by a person from an export country to a recipient in Kenya in a business-to-customer transaction; and
- (b) the person is conducting business in Kenya in accordance with section 8(2) and any of the following circumstances apply –
  - i. the recipient of the supply is in Kenya;
  - ii. the payment for the services is made to the supplier in the export country from a bank registered under the Banking Act; or
  - iii. the payment for the services that is made to the supplier in the export country is authorised in Kenya.

This Regulation also states that persons from export countries who make business-to-customer supply of services to recipients in Kenya shall register for tax through a simplified registration framework in accordance with Regulation 7.

Regulation 7 (cited as Regulation 20 in the in the Regulations) elaborates the procedure for registration to the simplified tax registration framework (the “Framework”) for suppliers from export countries who

make supplies on a digital marketplace. An application for the registration under the Framework shall be done through an online registration form prescribed by the Commissioner.

The information required upon registration shall include –

- a) the name of the business including the business’s trading name;
- b) the name of the contact person responsible for tax matters;
- c) the postal address or registered address for the business and its contact person;
- d) the telephone number of the contact person;
- e) the email address of the contact person;
- f) the websites or uniform resource locators (URLs) of the supplier through which business is conducted;
- g) the national tax identification number issued to the supplier in the supplier’s jurisdiction;
- h) the certificate of incorporation or registration issued to the business in the country where the business is incorporated; and
- i) any other information as required by the Commissioner.

Applicants may be required to provide further documentation to substantiate any of the information provided in (a) – (h) above.

Upon successful registration under the Framework, the Commissioner shall issue the applicant with a

PIN for the purpose of payment of taxes and filing of returns thereof.

A service provider duly registered under this regulation (Regulation 7) who ceases to make taxable supplies on a digital marketplace shall make an application to the Commissioner for their deregistration from the Framework in accordance with Section 36 of the Value Added Tax Act (No. 35 of 2013) (the "VAT Act"). Section 36 of the VAT Act mandates such persons to make an application in writing to the Commissioner within thirty (30) days of the date the said persons cease to make taxable supplies.

Regulation 15 (indicated as Regulation 28 in the Regulations) mandates supplies on a digital marketplace who are required to register under the Regulations to make an application to the Commissioner to effect the said registration within six (6) months from the publication of the Regulations.

### **Offenses and Penalties**

Regulation 14 (indicated as Regulation 27) provides that a person who fails to comply with the provisions of the Regulations shall be liable to the penalties under the Act or the Tax Procedures Act, 2015.

### **Value Added Tax Act**

Section 37 of the VAT Act prescribes - the scope for offences relating to registration and prescribes their

punishment therein.

Offences relating to registration occur where a person –

- a) fails to apply for registration as required under the VAT Act;
- b) applies for cancellation of registration when still required to be registered;
- c) fails to apply for cancellation of registration as required under the VAT Act; or
- d) fails to comply with section 35 or 36 (7) of the VAT Act.

Such persons would be deemed to have committed an offence under the VAT Act and shall be liable upon conviction to a fine not exceeding KES 200,000 or to imprisonment for a term not exceeding two (2) years, or to both.

Section 63 of the VAT Act goes further to impose a general penalty by stating that persons convicted for offences for which no penalty is prescribed shall be liable to a fine not exceeding KES 1,000,000 or to imprisonment for a term not exceeding three (3) years, or to both.



## Conclusion

The Legal Notices having been gazetted shall be effective 1st January 2021. Digital Service Tax shall be applicable, and it is important to familiarize with all the requirements and consequences for non-compliance. Compliance shall therefore not be optional but a mandatory requirement for all those providing any digital service expressly referred in the Regulations.

## Disclaimer

*This alert is for informational purposes only and is not intended to constitute legal advice.*

## Contact Details

If you have any queries or need clarifications, please do not hesitate to contact;



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