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VAT aspects of cross border E-Commerce in Kenya

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VAT Aspects Of Cross Border E-Commerce In Kenya

Bilha Wanjiru Mwangi

Submitted in partial fulfillment of the requirements of the Degree of Master of Laws, at

Strathmore University



Strathmore Law School

Strathmore University

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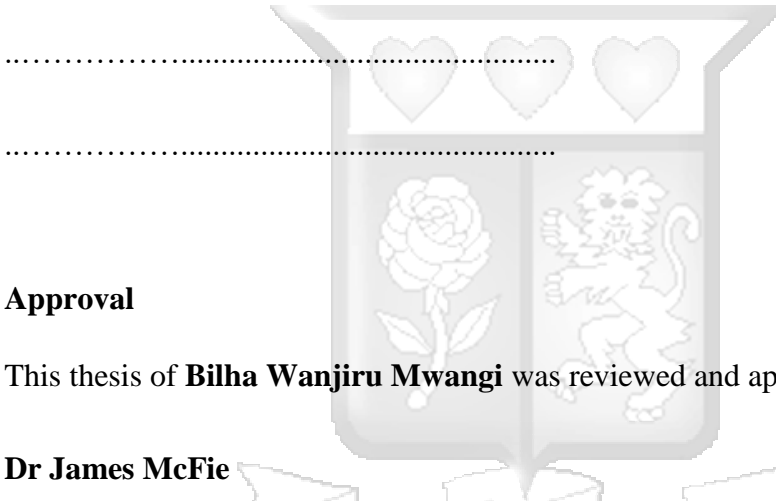
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ABSTRACT

Digital commerce has become part and parcel of the economy and businesses are able to transact in various jurisdictions without establishing a physical presence in the market jurisdiction. Countries have for a long time relied on maxims of territory and jurisdiction to levy taxes which have been hinged on physical presence. The shift of commerce from brick and mortar has therefore presented challenges to jurisdictions on how to deal with the VAT aspects of cross-border digital transactions.

This study observed that the OECD has taken measures towards building global consensus on the tax treatment of cross-border electronic commerce. As a result, the OECD issued the International VAT/GST Guidelines which were closely followed by the Mechanisms for the Effective Collection of VAT/GST to guide countries in the levying and collection of VAT/GST in cross-border transactions in services and intangibles. This study has demonstrated that Kenya has adopted some of the measures recommended in the Guidelines but it has also noted that some gaps exist in its legislation. The Kenyan legal framework has been found deficient with regard to the definition of electronic services, adoption of a simplified registration and compliance regime for foreign suppliers of services and intangibles and the failure to include intermediaries in the scope of the VAT law.

This study undertook two comparative case studies and analysed the legal frameworks of South Africa and Australia relating to the levying of VAT/GST on cross-border digital transactions. It established that South Africa has successfully adopted the simplified registration and compliance regime and also broadened the definition of electronic services in its VAT law. It noted that, Australia had also broadened its definition of electronic services and included the activities of intermediaries in the scope of its VAT laws. The study has identified these legislative actions as constituting key lessons that Kenya that can draw from these two case studies.

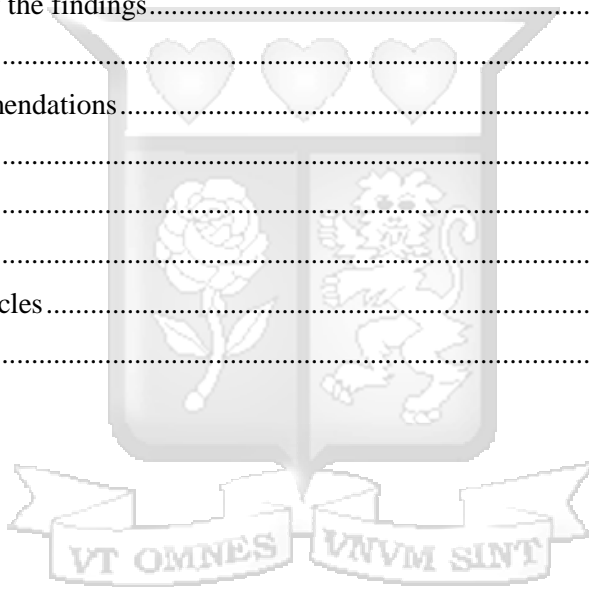
This study concluded that Kenya is currently not adequately collecting VAT on cross border digital supplies of services and intangibles. The country needs to borrow from South Africa and Australia and reform its VAT laws.



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LIST OF DEFINITIONS

BEPS

Base Erosion and Profit Shifting

BEPS Action 1 Report

The 2015 Final Report on Action 1 "Addressing the Tax Challenges of the Digital Economy" of the OECD/G20 Base Erosion and Profit Shifting Project.

Destination principle

Tax is ultimately levied only on the final consumption that occurs within a taxing jurisdiction.

Digital economy

The digital economy is comprised of markets based on digital technologies that facilitate the trade of goods and services through e-commerce on the Internet.

E-commerce

E-commerce is the practice of buying and selling goods and services through online consumer services on the internet.

Foreign supplier

A supplier who is not located in the jurisdiction of taxation.

Intangibles

An intangible is something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred between independent parties in comparable circumstances. It includes but is not limited to intellectual property.

Intermediary

An intermediary is an entity that facilitates transactions on their website, internet portal, gateway, store or market place by allowing third parties to make supplies electronically to end-users.

Origin principle

Tax is imposed in the country where goods are produced and services are rendered – where the value is added to those goods and services.

Remote supplies

The delivery of services and intangibles by a business from a remote location to consumers around the world without any direct or indirect physical presence of the supplier in the consumer's jurisdiction.



LIST OF STATUTES

KENYA

National

1. Constitution of Kenya, 2010
2. Value Added Tax, Act No. 35 of 2013
3. Tax Procedures Act, Act No. 29 of 2015
4. Kenya Revenue Authority Act, Act No. 2 of 1995

SOUTH AFRICA

National

1. Value Added Tax Act, Act No 89 of 1991.
2. The Revenue Services Act 34 of 1997.
3. Electronic Communication and Transaction Act, No. 25 of 2002.

Subsidiary

1. Electronic Services Regulations published by Government Notice No. R 221 of 28 March 2014.
2. Electronic Services Regulations published by Government Notice No. 42316 of 18 March 2019.
3. SARS, External Guide, VAT Registration Guide for Foreign Suppliers of Electronic Services, 2019.

AUSTRALIA

National

1. A New Tax System (Goods and Services Tax) Act 1999.

International Legal Instruments

1. WTO Agreement on Subsidies and Countervailing Measures

LIST OF ABBREVIATIONS

ATO	Australian Tax Office
B2B	Business-to-Business
B2C	Business-to-Consumer
BEPS	Base Erosion and Profit Shifting
EU	European Union
KRA	Kenya Revenue Authority
ICT	Information and Communications Technology
SARS	South Africa Revenue Services
OECD	Organization of Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
VAT/GST	Value Added Tax/ Goods and Services Taxes
WTO	World Trade Organization



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DEDICATION

To my husband Charles Kinyanjui for your love and support through this LLM journey and doing the double shifts as I trudged along. To my children Thami, Njau and Mwangi you are a constant source of joy, fulfilment and inspiration. To the rest of my family, thank you for your support and encouragement.



CHAPTER 1: INTRODUCTION

1.1 Background to the problem

The primary purpose of taxation is to raise revenue for government expenditure. Other purposes of taxation are the redistribution of wealth and income, control of the economy, social control and also as a means of ensuring people pay the full price of something, for example pollution tax.¹

Some countries tax their citizens or residents on their worldwide income, others tax income sourced in their state only. Most countries adopt a combination of both approaches.² The residence jurisdiction and source jurisdiction of taxation form the fundamental platforms of a country's international tax law.

The digital economy is comprised of markets based on digital technologies that facilitate the trade of goods and services through e-commerce on the Internet.³ A study conducted in the year 2017 established that 17% of Kenyans who are connected to the internet shop online; this is a sharp rise from a mere 3% in the year 2014.⁴ The spread and evolution of ICT has expanded the scale of cross-border business activity undertaken without substantial physical operations in the market countries.⁵

This rise in e-commerce has presented unique challenges to tax collection and administration. For instance, the purchase of an e-book on an internet platform from a non-resident supplier will in most instances be done without the payment of Value Added Tax (VAT) which would ordinarily be payable if a similar transaction was conducted at a physical bookstore in Kenya, or if the book was sold in a physical format. The delivery of the e-book is done remotely on the internet without passing through the traditional ports

¹ Morse G and Williams D, *Davies: Principles of Tax Law*, Sweet & Maxwell, London, 2012, 7ed, 3-5.

² Holmes K, *International tax policy and double taxation treaties, an introduction to principles and application*, IBFD, Amsterdam, 2014, 2ed, 19

³ The digital economy, OECD, 2012 <http://www.oecd.org/daf/competition/The-Digital-Economy-2012.pdf> on January 25, 2018

⁴ Connected Consumer Study, Kantar TNS Research Group, 2017 (Google backed) <https://www.thinkwithgoogle.com/intl/en-145/perspectives/local-articles/connected-consumer-survey-2017/>

⁵ Olbert M and Spengel C *International Taxation in the Digital Economy: Challenge Accepted? World Tax Journal February 2017 p.8*

of entry, that would provide the tax authorities with an opportunity to levy the appropriate taxes. With the e-book sale transaction, the taxman would be none-the wiser and the tax payer is unlikely to voluntarily declare this import and pay the attendant taxes.

Disruptive technologies have further complicated matters as they have changed the manner in which business is traditionally conducted. Cockfield notes that global digital transactions involving digital goods and services as well as intangible assets are characterized in part by their intangible nature and ease of crossing national borders.⁶ This is well illustrated by service platforms such as Uber in the transport industry and AirBnB in the hospitality industry. These two companies are among the largest players in their respective industries. In spite of this, Uber does not own any vehicles and simply provides a ride hailing service while AirBnB does not own any hotels or accommodation facilities and on its part, provides an online marketplace and hospitality service.

These companies are also able to transact in various jurisdictions without establishing a physical presence there. The services offered by these platforms are obtained and mostly paid for through the internet or electronically. Further, the business models used by these companies are largely not captured in the current taxation law framework. This implies that the applicable taxes are subjective as they apply only to mainstream taxi, hotel service providers and book vendors operating in brick and mortar establishments that have known physical locations and are therefore within easy reach of the taxman. This goes against the principle of tax effectiveness and fairness which requires that taxes should be designed such that the opportunity for evasion or avoidance is minimised. Goolsbee and Zittrain highlight that the most important presumed cost of not enforcing taxes on internet commerce is the potential revenue loss.⁷

As national barriers to cross-border trade and investment broke down from the 1980s, with the resultant explosion in globalization of international business and capital flows, the tax spotlight has been shining brightly on the appropriate tax policy tools which a

⁶ Cockfield A, *Taxing Global Digital Income in a Post-BEPS World*, Queens Law, Research Paper Series February 2018

⁷ Goolsbee A and Zittrain J, *Evaluating the Costs and Benefits of Taxing Internet Commerce*, 52 Nat'l Tax J. 413, 199

government might implement to collect revenue from an increasing number of entities (both natural and legal persons), which do not fall within its jurisdiction because they are located in another country, but nevertheless derive income from the country over which the government has jurisdiction.⁸

The question in the taxation of e-commerce is how to reconcile national fiscal boundaries with the borderless world of the internet.⁹ A government's authority to tax had always been based on territory and jurisdiction.¹⁰ E-commerce has made it difficult for a country to determine what is its jurisdiction to tax. E-commerce effectively obliterates any footprints leading to the buyers' and sellers' locations.¹¹ It therefore follows that taxation of the digital economy needs to be assessed from an international tax law perspective.

The Kenya Revenue Authority (KRA) has admitted that the digital economy is growing fast but the tax code has not kept up.¹² The Organisation for Economic Co-operation and Development (OECD) identified the challenges of the digitalisation of the economy as one of the main focuses of the Base Erosion and Profit Shifting (BEPS) Action Plan leading to the 2015 BEPS Action 1 Report.¹³ The OECD has taken a significant step forward in reaching an international consensus on the tax treatment of electronic commerce.¹⁴ The OECD in its BEPS Action 1 Report¹⁵ outlined measures, which although not directly recommended, potentially encouraged countries to adopt these measures in the short term to address the challenges of the taxation of the digital economy. The measures discussed included introduction of withholding tax on digital payments,

⁸ Holmes K, *International tax policy and double taxation treaties, an introduction to principles and application*, Second Revised Edition, p.1

⁹ Basu, S, "International Taxation of E-Commerce: Persistent Problems and Possible Developments", JILT 2008(1)

¹⁰ Basu S, *International Taxation of E-Commerce: Persistent Problems and Possible Developments*, JILT 2008(1)

¹¹ Basu S, *International Taxation of E-Commerce: Persistent Problems and Possible Developments*, JILT 2008(1)

¹² Global tech giants give KRA income tax avoidance headache, Business Daily, February 1, 2016

¹³ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris p.102-103

¹⁴ Taxation and Electronic Commerce, Implementing the Ottawa Taxation Framework Conditions, OECD, 2001

¹⁵ OECD (2015) *Addressing the Tax Challenges of the Digital Economy*, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

equalization levy and the use of the nexus rule and the attendant digital permanent establishment. Countries could implement these measures subject to their existing treaty obligations. However, the OECD also indicated that it was generally not in favour of any unilateral actions by countries. It is noteworthy that Kenya has not implemented any of these proposed measures.

Neither the OECD's Final Report on Action 1 nor the academic literature produce a clear and unanimous answer to the question of how to address the tax challenges of the digital economy.¹⁶ The determination of the allocation of taxing rights in the digital economy requires global consensus as it would require revision of profit allocation rules, nexus rules as well as anti-BEPS rules. The OECD is expected to issue a final report on Taxation of the Digital economy in the year 2020.¹⁷ Even as the OECD continues to work on a framework for global action, some countries have proceeded to take up unilateral measures to counter the challenges and capture additional tax revenues. Italy has for instance introduced a digital services tax that applies to digital services supplied by businesses exceeding a set threshold of revenues and levied at a rate of 3% of the taxable base.¹⁸ India has on its part introduced an equalisation levy on online advertising revenue earned by non-resident e-commerce companies in India.¹⁹

The 2015 BEPS Action 1 Report outlined how highly digitalised businesses could structure their affairs so that little or no VAT is paid on remotely delivered services and intangibles.²⁰ In line with the destination principle, it was agreed in the report that, where services and intangibles are supplied cross-border by foreign suppliers to a final consumer (business-to-consumer or B2C), VAT would be collected in the jurisdiction where the

¹⁶ Olbert M and Spengel C *International Taxation in the Digital Economy: Challenge Accepted?* World Tax Journal February 2017 p. 21

¹⁷ OECD Taxation of the Digital Economy Final Report is due in the year 2020

¹⁸ Italian Budget Law 2019 (Law no.145/2018), published in the Official Gazette (G.U.) on January 1, 2019. The Ministry of Finance was required to issue an implementing decree within the following four months (i.e., by April 30, 2019) and the Digital Services Tax would apply as from the 60th day after its publication in the Official Gazette. However, this decree yet to be issued.

¹⁹ <https://www.pwc.com/us/en/services/tax/library/insights/india-introduces-new-equalization-levy-on-online-advertising-rev.html>

²⁰ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, p.102

consumer is located. It was further recommended that the registration of foreign suppliers should be done under a simplified registration and compliance regime. These measures were subsequently incorporated into the OECD VAT/GST Guidelines²¹. The OECD has also provided further guidance to governments on the best practice in the design and operation of the collection mechanisms recommended by the OECD VAT/GST Guidelines.²²

For most countries with VAT, international trade is a significant component of their economies. A country with a VAT must define the jurisdictional reach of the tax; that is, the tax may be imposed on production within the country (an origin principle VAT), on domestic consumption (a destination principle VAT), or some combination of the two. Almost every country with a VAT relies on the destination principle to define the jurisdictional limits of the tax. Under a pure destination principle, imports are taxed and exports are completely free of tax (zero rated).²³

Kenya has in its VAT Act²⁴ adopted the rules for the VAT treatment of B2C supplies of intangibles and services by foreign suppliers in accordance with the OECD VAT/GST Guidelines. It has further attempted to adopt a simplified registration regime for foreign suppliers.²⁵ However, there are no clear guidelines provided to operationalise this regime. Millar notes that many developing countries also formally impose VAT on B2C digital commerce, yet practically may lack the ability to enforce the tax.²⁶ This study will be restricted to the analysis of the levying of VAT on cross-border transactions in electronic services and intangibles conducted between businesses and consumers (B2C).

²¹ OECD International VAT/GST Guidelines 2017, p.71

²² OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017

²³ Schnek A, Oldman O, *Value Added Tax, A Comparative Approach*, Cambridge University Press 2007 p.180

²⁴ Section 8(2) *Value Added Tax Act*, Act No. 35 of 2013

²⁵ Section 15A, *Tax Procedures Act*, Act No. 29 of 2015

²⁶ Millar R, *VAT/GST in a Global Digital Economy – Looking Ahead: Potential Solutions and the Framework to make them work*, Legal Studies Research Paper No. 16/30

Bird and Gendon assert that VAT generates the largest share of tax revenue in many developing countries.²⁷ Having this in mind, and with there being no consensus globally on how to address the profit attribution for cross border transaction of services and intangibles, the Government of Kenya should concentrate its efforts in further reforming the VAT regime and fully implementing the OECD VAT/GST Guidelines with a view of increasing its collection of tax revenue from the digital economy. The OECD reported that “the early data on the impact of these measures is very promising. This is the case, for example, in South Africa where the revenue collected through the application of the recommended principles and collection mechanisms amounted to South African Rands 585 million for 2016/2017”.²⁸ Deloitte observed that “the EU, as the earliest adopter of these principles, has identified the total VAT revenue declared via its simplified compliance regime in 2015 (the EU regime’s first year of operation) was in excess of EUR 3 billion”. The simplified measures are also reported to have resulted in lower compliance costs for businesses, lowering the costs by as much as 95%.²⁹

According to the United Nations Conference on Trade and Development (UNCTAD) estimates,³⁰ the number of shoppers who rely on the Internet to buy goods in Kenya hit the 2.61 million mark in 2017 compared with 1.2 million in 2014. These numbers are a reflection of transactions of both physical goods and electronic goods, all the same they provide a view of the scope of online trading. The UNCTAD report also highlighted that the uptake of e-commerce in Africa has seen online shoppers surge at an annual rate of 18% which is way above the global rate of 12%. With a rapidly digitalising economy, if measures are not put in place to effectively levy VAT on cross-border e-commerce transactions, Kenya will lose a significant amount of tax revenues. This will in turn lead to the government being unable to meet its fiscal obligations.

²⁷ Bird R and Gendron P, *VAT in Developing and Transitional Countries* (Cambridge University Press, 2007)

²⁸ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris

²⁹ Deloitte, *VAT Aspects of cross-border e-commerce - Options for modernization* November, 2016

³⁰ UNCTAD B2C E-commerce Index 2018 Focus on Africa

1.2 Research Problem

The move of commerce from the traditional brick and mortar establishments into the digital space has come with unprecedented challenges in the sphere of tax collection and administration. The ability of businesses to remotely supply services and intangibles to consumers in jurisdictions where such businesses have not established any physical presence greatly contributes to these challenges. The research problem addressed in this study is an analysis of the legislative framework that Kenya has in place to levy VAT on cross-border e-commerce transactions and its effectiveness. This study seeks to identify the gaps that exist in Kenya's VAT legislation relating to the levying and collection of VAT on these transactions.

1.3 Hypothesis

This study is premised on the hypothesis that Kenya's VAT legislation is inadequate for the levying of VAT on cross border e-commerce transactions. The study also hypothesises that reforming Kenya's VAT legislation will result in an increase in the amount of VAT collected from cross border e-commerce transactions.

1.4 Research Objectives

The objectives of this study were:

1. To analyse the current VAT legislation and regulations addressing the taxation of the cross-border e-commerce transactions in Kenya.
2. To identify the gaps that exist in Kenya's VAT legislation relating to the levying and collection of VAT on cross-border e-commerce transactions.
3. To draw lessons from South Africa's and Australia's VAT/GST treatment of cross-border e-commerce transactions.
4. To identify the legislative reforms that should be undertaken to address the gaps identified in Kenya's VAT treatment of cross-border e-commerce transactions.
5. To assess whether reforming Kenya's VAT legislation will result in an increase in the amount of VAT collected from cross border e-commerce transactions..

1.5 Research Questions

1. What is the current VAT legislation and regulations addressing the taxation of the cross-border e-commerce transactions in Kenya?
2. What gaps exist in Kenya's VAT legislation in the levying and collection of VAT on cross-border e-commerce transactions?
3. What lessons can Kenya draw from South Africa and Australia in their VAT/GST treatment of cross-border e-commerce transactions?
4. What legislative reforms should be undertaken to address the challenges identified in the levying and collection of VAT on cross-border e-commerce transactions in Kenya?
5. Will reforming Kenya's VAT legislation result in an increase in the amount of VAT collected from cross border e-commerce transactions?

1.6 Literature Review

1.6.1 Value Added Tax on E-commerce

German business man Wilhelm Von Siemens is credited with coming up with the idea of a VAT in the 1920s.³¹ The popularity of VAT has risen since then with 165 countries operating a VAT by the year 2017.³² Buydens notes that VAT raises revenue in a neutral and transparent manner.³³ The overarching purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households.³⁴ In Kenya, the power to impose VAT is vested in the national government.³⁵

The collection of Value Added Tax/Goods and Services Tax (VAT/GST) on cross-border transactions is an important issue. Countries are thus recommended to apply the principles

³¹ Ebril L, Keen M, Bodin J and Summers V, *The Modern VAT*, IMF 2001, p. 4

³² OECD International VAT/GST Guidelines, 2017, p. 3

³³ Buydens S, *Consumption Tax Trends 2008*, OECD Publishing, p. 23

³⁴ OECD (2017) VAT/GST Guidelines, p. 16

³⁵ Article 209(1), *Constitution of Kenya*

of the International VAT/GST Guidelines and consider the introduction of the collection mechanisms included therein.³⁶

The International VAT/GST Guidelines set forth internationally agreed principles and standards for the value added tax (VAT) treatment of the most common types of international transactions, with a particular focus on trade in services and intangibles.³⁷ The Ottawa Framework Taxation Conditions are broadly applicable to VAT in both domestic and international trade. Neutrality is noted as a core principle of VAT design.³⁸

There are several well accepted broad considerations that go into the development of tax policies globally. These are neutrality, efficiency, certainty and simplicity, effectiveness and fairness, as well as flexibility. Taxation policy frameworks also take into account equity. Abrams and Doernberg posited that perhaps the most significant implication of the growth of electronic commerce for tax policy may be that technology rather than policy will determine the tax rules of the [21st] century.³⁹

In Kenya, the national government exercise its power to levy VAT through the Kenya Revenue Authority (KRA). KRA is empowered to collect and receive all government revenue.⁴⁰ This authority includes the collection of taxes. In meeting its mandate KRA is faced with a myriad of challenges, one being the taxation of the digital economy. Currently, data, digitised goods and services can be generated and monetised without physical or territorial limitations.⁴¹ According to Li, the digital economy threatens the tax base of corporate income tax and VAT by facilitating BEPS and potentially causing the tax base to disappear (base cyberization).⁴²

³⁶ OECD (2015) *Addressing the Tax Challenges of the Digital Economy*, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris

³⁷ OECD (2017) *International VAT/GST Guidelines*, Preface, p. 3

³⁸ OECD *International VAT/GST Guidelines*, 2017, p. 20

³⁹ Abrams H and Doernberg, *How Electronic Commerce Works*, *Tax Notes International*, May 12, 1997, p.1573, 1589.

⁴⁰ Section 5(1), *Kenya Revenue Authority Act* (Act No. 2 of 1995)

⁴¹ Li J, *Protecting the tax base in a digital economy*, Tax base protection for developing countries, New York, 4 June 2014 http://www.un.org/esa/ffd/tax/2014TBP/Paper9_Li.pdf on 25 January 2018

⁴² Li J, *Protecting the tax base in a digital economy*

E-commerce is the practice of “buying and selling goods and services through online consumer services on the internet”.⁴³ E-commerce is the key element of the digital economy. The digital economy has become an integral part of a number of businesses and the global economy as a whole. Businesses have gone online in order to broaden their customer reach as well as strategically reduce their costs. It has been estimated that e-commerce globally was worth around \$22.1 trillion in 2015, up by 38 per cent from 2013.⁴⁴

It is noteworthy that the 2018 United Nations Conference on Trade and Development (UNCTAD) Business to Consumer E-commerce Index ranked Kenya in position seven in e-commerce uptake in Africa and position eighty-five globally. In the report, UNCTAD estimates that the e-commerce market in Africa was worth about \$5.7 billion in 2017. With the previously highlighted growth of e-commerce in Africa, notably at a pace faster than the rest of the world, African governments must not only impose VAT on B2C e-commerce transactions but must also devise ways of enforcing the tax.

The G20 leaders acknowledged that International tax rules, which date back to the 1920’s, have not kept pace with the changing business environment, including the growing importance of intangibles and the digital economy.”⁴⁵ Web technological development and related networking technologies stand in stark contrast to the slow jurisprudential change. International tax legislation is best regarded as the body of legal provisions of different countries that covers the tax aspects of cross-border transactions. International tax, in this sense, is concerned with direct taxes (i.e. income taxes, estate taxes, gift taxes, wealth taxes and social security contributions) and indirect taxes (i.e. value added – or goods and services – taxes, sales taxes and customs duties).⁴⁶

⁴³ Black’s Law Dictionary

⁴⁴ United Nations Conference on Trade and Development

https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1281&Sitemap_x0020_Taxonomy=Information%20and%20Communication%20%20on%2030%20January%202018

⁴⁵ G20, Tax Annex to the Saint Petersburg G20 leaders’ declaration, Saint Petersburg, 2013

⁴⁶ Holmes, *International tax policy and double taxation treaties, an introduction to principles and application*, Second Revised Edition, IBFD 2014 p. 1

Digital products have been the focus of discussions of taxation of e-commerce as almost all aspects of sourcing a product and supplying to a customer can be carried out electronically. Miller and Oats observe that emerging business models in the world are doing away with the need for physical presence in a customer's state as a result threatening the very basis of the international tax system and resulting in the erosion of the tax base in many countries.⁴⁷ The consumer's experience in cyberspace blurs the distinction between physical presence and the virtual presence available in cyberspace. E-commerce allows vendors to create a virtual presence in a taxing jurisdiction in which they are otherwise physically absent.⁴⁸ According to Holmes, "if a government wishes to tax transactions and economic events that occur across its borders, it needs to have some underlying policy rationale to substantiate its impost".⁴⁹

1.6.2 Destination Principle of VAT

There are two broad approaches to VAT, the destination principle and the origin principle. Under the destination principle tax is ultimately levied only on the final consumption that occurs within a taxing jurisdiction.⁵⁰ Schnek and Oldman state that under the origin principle tax is imposed in the country where goods are produced and services are rendered – where the value is added to those goods and services.⁵¹ Tax is levied in the various jurisdictions where value is added. The OECD also highlights that:

“under the origin principle tax paid on a supply would then reflect the pattern of its origins and the aggregate revenue would be distributed in that pattern. This would run counter to the core features of VAT: as a tax on consumption; the revenue should accrue to the jurisdiction where the final consumption takes place.

⁴⁷ Miller A and Oats L, *Principles of International Taxation*, Bloomsbury Professional, West Sussex, 2014, 229

⁴⁸ Armstrong GT, *Physical Presence vs. Virtual Presence: The Cyberspace Challenge to Quill and the streamlined the sales and Use Tax Act*, *The State and Local Tax Lawyer*, Vol. 9 (2004), 59-86

⁴⁹ Holmes, *International tax policy and double taxation treaties, an introduction to principles and application*, 1

⁵⁰ *International VAT/GST Guidelines* OECD 2017 p. 15

⁵¹ Schnek A & Oldman O, *Value Added Tax, A Comparative Approach*, Cambridge University Press 2007, p.22

Under the origin principle, these revenues are shared amongst jurisdictions where value is added.”⁵²

Therefore, by imposing tax at the various rates applicable in the jurisdictions where value is added, the origin principle could influence the economic or geographical structure of the value chain and undermine neutrality in international trade.⁵³

The OECD notes that:

“the fundamental issue of economic policy in relation to the international application of the VAT is whether the levy should be imposed by the jurisdiction of origin or destination. As previously illustrated under the destination principle, tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction, while under the origin principle, the tax is levied in the various jurisdictions where the value was added. The key economic difference between the two principles is that the destination principle places all firms competing in a given jurisdiction on an even footing whereas the origin principle places consumers in different jurisdictions on an even footing.”⁵⁴

The application of the destination principle in VAT achieves neutrality in international trade and there is widespread consensus that it is preferable to the origin principle both theoretically and practically.⁵⁵ The destination principle is the international norm and is sanctioned by World Trade Organization (“WTO”) rules.⁵⁶ Kenya, like most countries has modelled its VAT Act⁵⁷ on the destination principle which provides that the place of taxation is the place of consumption.

A country’s right to collect VAT in cross border transactions is based on the destination principle.⁵⁸ In international trade the use of the destination principle is generally straight

⁵² *International VAT/GST Guidelines* OECD 2017 p.16

⁵³ *International VAT/GST Guidelines* OECD 2017 p.16

⁵⁴ OECD *International VAT/GST Guidelines*, 2017, p. 17

⁵⁵ OECD *International VAT/GST Guidelines*, 2017, p. 18

⁵⁶ WTO Agreement on Subsidies and Countervailing Measures, Foot Note 1

⁵⁷ *Value Added Tax Act*, Act No. 35 of 2013

⁵⁸ OECD *VAT/GST Guidelines*, Paris OECD 2014

forward with regard to goods but challenges arise when dealing with trade in services and intangibles. The challenge in transactions relating to services and intangibles is that these transactions will not be subject to a country's customs controls and the related imposition of VAT and other taxes.

For a registration-based collection regime for B2C supplies of services and intangibles by non-resident suppliers, the VAT/GST Guidelines provide that the regime should be a simplified registration and compliance regime. The VAT/GST Guidelines recommend the use of the reverse charge mechanism for cross-border business-to-business (B2B) supplies of services and intangibles that are taxable in the jurisdiction where the customer is located. The Guidelines define the reverse charge mechanism as “a tax mechanism that switches the liability to pay VAT from the supplier to the customer”. The reverse charge mechanism eases the burden for foreign suppliers that are not established in the jurisdiction where they supply services and intangibles to the customer, as they are spared from having to register and account for VAT in this jurisdiction. This mechanism also ensures that VAT is accounted for by requiring the customer that is the recipient of the supplies and that is registered for VAT to account for the attendant VAT.⁵⁹

1.6.3 Challenges of taxation of the digital economy

Arnold analyses and concludes that the digital economy presents three major challenges to the current international tax system. First, the digital economy is borderless; it permits businesses to be conducted globally and remotely. Secondly, the digital economy presents many difficult issues of characterisation with respect to new sources of revenue. Thirdly although data has become an important source of value in the digital economy, it is difficult for tax systems to capture the income from such data.⁶⁰

With businesses adopting a range of new digital business models, the challenge remains in the design of taxation mechanisms that will match these diverse models. The OECD

⁵⁹ International VAT/GST Guidelines OECD 2017 pg. 17

⁶⁰ Arnold B, *International Tax Primer*, Kluwer Law International, Alphen aan den Rijn, 2016, 3ed, 205

undertook a project to analyse the tax challenges of the digital economy.⁶¹ The OECD assessed whether the digital economy should be ring fenced and concluded that it should not be; in essence it advocated for the treatment of the digital economy in a manner similar to the rest of the economy.

According to Millar, the non-VAT-taxation of inbound B2C commerce, whether digital or not, is inconsistent with fundamental principles of VAT. It lacks neutrality in the sense that consumers choosing between like products face different tax outcomes, which might contribute to their choice of which product to consume. Local suppliers are also clearly disadvantaged by the non-taxation of inbound goods and services.⁶² As previously highlighted this is likely to be the case for inbound digital goods and services as physical goods will be subjected to VAT at the ports of entry. The problems of taxation of the digital economy are quite pervasive and governments all over the world are putting in place measures to combat these challenges.

The fact that some people and companies may be able to avoid taxes because of their international mobility might mean that the burden is in some respects now borne more unequally, and inefficiently, than before. In addition, if there is a sense that some individuals or companies can avoid paying tax because of their domicile or ability to shift profits around, then acceptance of the system and belief in its equity may be damaged.⁶³

The BEPS debate on the digital economy started with concerns about distorted competition.⁶⁴ Multinational enterprises engaged in the digitalized economy – it was said – are able to benefit not only from lack of substantial taxation in the market country but, due to the mobile character of their business, also from no or low taxation elsewhere as they successfully stash away their assets and profits in tax havens or employ other

⁶¹ OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy, 2015

⁶² Millar R, *VAT/GST in a Global Digital Economy – Looking Ahead: Potential Solutions and the Framework to make them work*, Legal Studies Research Paper No. 16/30 p.6

⁶³ The Institute for Fiscal Studies & Mirrlees J, *The Mirrlees Review, Tax by Design*, Oxford University Press, Oxford, 2017, 16

⁶⁴ OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy, 2015 at para. 180

preferential tax regimes.⁶⁵ Baez and Brauner highlighted that efficiency and neutrality seem to require that income generated by the digital economy be taxed in the same manner as income generated by more traditional means.⁶⁶ It is fair to say that in the first place these claims are built on the economic concept of neutrality of the tax regime.⁶⁷

The OECD's final report in 2015 identified collection of VAT as a challenge of the digital economy on cross border B2C transactions. Lin notes that the Corporate Income Tax (CIT) base of these jurisdictions is eroded or lost primarily because the rules that determine a country's source based taxing rights are outdated and ineffective for the digital economy. The VAT base is eroded due to difficulties in enforcing and collecting tax.⁶⁸

With the digital revolution the role of the tax collector has become all the more challenging as businesses have evolved and will keep evolving and taking up new models. These changes make it imperative for KRA to quickly adapt to the changes, stay abreast with the ever-changing digital economy and most importantly seek legislative reforms to empower it to collect taxes in the digital economy. With the gaps identified KRA must put in place safeguards to ensure that revenue leakage is minimised and that it collects what is due from the businesses and consumers utilising a digital platform to trade in digital goods, services and intangibles. A robust understanding of how digitalisation is changing the way businesses operate and how they create value is fundamental to ensuring that the tax system responds to these challenges.⁶⁹

There has been a differing view by some players in the digital economy advocating against introduction by states of special tax measures targeting highly digitalised business models.

⁶⁵ European Commission, A Fair and Efficient Tax System in the European Union for the Digital Single Market, 21 Sept. 2017

⁶⁶ Baez A, Brauer Y, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, WU International Taxation Research Paper Series No. 2015-14, p. 1

⁶⁷ OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy, 2015

⁶⁸ Lin, J *Protecting the Tax Base in a Digital Economy*, Osgoode Hall Law School, Research Paper Number 78, Volume 13, Issue 17, 2018

⁶⁹ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris

Some stakeholders argue that adoption of such measures “would create additional complexity, foster uncertainty and lead to economic distortion”.⁷⁰ It is said that the establishment of a specific tax regime for digital services and other digitalised business models would drive an inefficient wedge between the digital and the non-digital sectors of the overall economy.⁷¹ There is a general consensus that the digital economy cannot be “ringfenced” for tax purposes.⁷² Tax authorities must tread carefully before deploying tax rules for specific elements of the Internet, including reforms to address BEPS. The better approach lies in developing broad tax rules that can be directed at substantively similar economic activities generated by both digital and traditional businesses.⁷³

Given these conflicting positions the government must strike a balance and adopt tax legislation on e-commerce that neither stifles innovation nor inequitably provides an unfair advantage to entities operating in the digital economy while placing a bigger burden of taxation on the entities operating outside the digital platform.

1.7 Theoretical Framework

Adam Smith propounded the four canons of taxation which he identified as equity, certainty, convenience and economy in tax collection.⁷⁴ With regard to equity, Smith reasoned that taxes should be levied on tax payers in proportion to their abilities which are determined by the benefits they derive from the state. He further argued that taxes should be certain and not arbitrary. He opined that taxes should be levied in a manner that is most convenient to the tax payer to make compliance easy. Lastly, he was of the view that there should be economy in tax collection. Taxes should be efficient to administer and should not be accompanied by high compliance costs for the tax payer and high administrative costs for the tax administrator. Taxes should not alter the decision making of tax payers to participate in one form of industry. These four canons have provided

⁷⁰ KPMG International letter of October 2017 to OECD taskforce on the digital economy

⁷¹ European Commission, *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, 21 Sept. 2017

⁷² OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report*, 16

⁷³ Cockfield A, *BEPS and Global Digital Taxation*, Tax Notes International, September 5, 2014, p. 938

⁷⁴ Smith A, *An Inquiry into the Nature and Causes of the Wealth of Nations* (selected ed, 1993) 450

guidance to countries in the formulation of their tax policies. This study is hinged on canons of equity in taxation, convenience and economy in tax collection.

Neutrality is another important principle in taxation and provides another lens through which this study will be undertaken. Neutrality is defined as the impartiality of treatment.⁷⁵ Groves highlights that one of the perspectives of partiality that is of concern is the unequal treatment of essentially similar taxpayers. Neutrality is therefore concerned with the even application of taxation rules and standards. Groves further opines that taxes should only deviate from neutrality for adequate public purposes.⁷⁶

Neutrality requires the treatment of similar activities in a similar way. A neutral tax system minimizes distortions over people's choices and behaviour. These distortions create complexity, encourage avoidance, and add costs of both taxpayers and governments.⁷⁷ The impact of tax laws on a taxpayer's decision to change the form or substance of their activities in order to reduce their tax payments should be kept to a minimum.

The OECD in the Ottawa Taxation Framework identified five widely accepted general tax principles that should apply to e-commerce and should guide governments in their approach to taxation of e-commerce.⁷⁸ The first principle is neutrality which requires taxation should be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Efficiency is also a key principle which states that compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible. Certainty and simplicity is yet another principle requiring that tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction. Effectiveness and fairness is the fourth principle and highlights that taxation should produce the right amount of tax at the right time with the potential for tax evasion and avoidance being minimised. The fifth principle is flexibility of the systems for taxation to ensure that they keep pace with technological and commercial developments. This study also relies on two

⁷⁵ Groves H.M, *Neutrality in Taxation*, National Tax Journal Vol.1 no. 1, 1948 pg. 18

⁷⁶ Groves H.M, *Neutrality in Taxation*, National Tax Journal Vol.1 no. 1, 1948 pg. 18

⁷⁷ The Institute for Fiscal Studies & Mirrlees J, *The Mirrlees Review, Tax by Design*, 40-41

⁷⁸ Electronic Commerce: Taxation Framework Principles, (OECD Ottawa Taxation Principles) 2001

of these principles; the principle of neutrality and the principle of effectiveness and fairness.

Governments also take into account international tax rules due to the nature of e-commerce. E-commerce transactions are in many instances conducted across borders and therefore interact with several national legislations. Holmes highlights that countries incorporate international tax rules into their tax legislation for five primary reasons. The first reason is national wealth maximisation which means a country ensures it gets a fair share of revenue for cross-border transactions thereby maintaining its domestic tax base. The second reason is tax equity, which requires imposing equal taxes on taxpayers with equal income or equal ability to pay. The third is economic efficiency which focuses on developing the competitiveness of a country's economy and ensuring taxation does not discourage optimal investment decision making. The fourth is administrative efficiency, which targets minimisation of costs related to tax compliance and administration. The fifth reason is that countries aim to achieve international compatibility in their international tax rules. These objectives of international tax policy may conflict in which event a country will decide on the objective that carries the day keeping in mind the social and economic well-being of its citizens.⁷⁹

1.8 Approach and Methodology

This study is qualitative and will rely on desk research which will entail a review of legislation, case law, books, journal articles, newspaper articles, publications and studies conducted by international bodies such as OECD, United Nations and the European Union and other international publications.

Comparative case studies will be undertaken of South Africa and Australia. These two jurisdictions' respective legal frameworks are analysed with a view of identifying the legislative measures they have adopted to address the challenges of levying VAT on cross-border e-commerce and establishing the lessons Kenya can draw from them.

⁷⁹ Holmes, *International tax policy and double taxation treaties, an introduction to principles and application*, Second Revised Edition, IBFD 2014 p.4-6

South Africa has enacted legislation targeting the levying of VAT on cross-border e-commerce transactions. South Africa is an appropriate jurisdiction for a comparative case study as it has been “identified as one of the jurisdictions that has experienced a great level of success in the application of VAT on cross border e-commerce transactions”.⁸⁰ Like Kenya, South Africa is a non-OECD country and also a developing country making this success all the more significant. It is therefore ideal for drawing comparisons as the two countries have similarities in their economies and face comparable challenges in enforcement and compliance of VAT.

Australia is also among the nations that have taken up measures for the levying of GST on cross-border transactions in services and intangibles. Australia is an OECD member country⁸¹ and it was selected for the case study as it is also noted to have made great strides in the VAT taxation of cross-border supplies of electronic services and intangibles. The OECD identified Australia as one of the jurisdictions that had adopted rules for the VAT treatment of B2C supplies of services and intangibles by foreign suppliers in accordance with the OECD International VAT/GST Guidelines.⁸² The country had also implemented a simplified registration and compliance regime. As a developed country and OECD member it provides a different perspective to this study.

1.9 Chapter Breakdown

Chapter one will cover the introduction of the study, the background to the problem and the statement of the problem. It will analyse the theoretical framework of the study. It will also define the key terms and concepts relating to taxation, its basis, tenets, tax policy and international taxation. It will conclude with the approach and methodology employed in the study.

Chapter two will discuss the current VAT legislative framework in Kenya that addresses the cross-border transactions in services and intangibles and its effectiveness. The chapter

⁸⁰ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris pg.

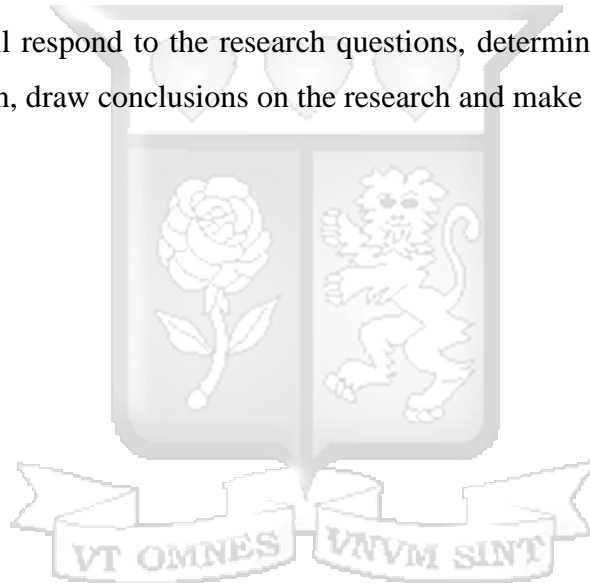
⁸¹ OECD International VAT/GST Guidelines 2017, p. 115

⁸² OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy, 2015, pg. 102

will also review the related international legal frameworks. It will identify and highlight the gaps that exist in Kenya's VAT legislation relating to the levying and collection of VAT on these transactions.

Chapter three will be a comparative case study analysis of the legislation and regulations relating to levying of VAT in e-commerce transactions in South Africa and Australia. In particular the chapter will analyse the VAT/GST regime that is in place in the two countries emphasizing on the provisions relating to cross-border trade in services and intangibles. It will also identify the lessons that Kenya can draw from these two jurisdictions.

Chapter four will respond to the research questions, determine whether the hypotheses have been proven, draw conclusions on the research and make recommendations.



CHAPTER 2: KENYA'S LEGISLATIVE FRAMEWORK ON THE LEVYING OF VAT ON CROSS-BORDER E-COMMERCE TRANSACTIONS

2.1 Introduction

This chapter discusses the efficacy of the Kenyan legislative and policy framework on VAT with respect to cross-border e-commerce transactions. The chapter features an analysis of Kenyan Acts of Parliament and the international best practice that has been adopted by countries globally.

2.2 Kenyan Legislative Framework

2.2.1 National Legislation

The Constitution of Kenya vests the right to levy VAT on the national government.⁸³ The VAT Act 2013⁸⁴ governs the administration of VAT in Kenya and the Tax Procedures Act⁸⁵ provides for the procedural rules for administering tax laws. These two Acts are identified as the relevant legislations in the analysis of the VAT aspects of cross-border e-commerce transactions in Kenya.

VAT is an indirect tax and is levied on the value added in the different stages of production and collected through a staged collection process. VAT was introduced in Kenya in the year 1990 through the enactment of the VAT Act.⁸⁶ The government did away with sales tax and introduced VAT in order to broaden the tax base and increase its revenues. VAT was perceived as the tax of the future in line with the country's objective of reducing reliance on direct taxes as well as diminishing the role of trade taxes.⁸⁷ This Act was repealed by the current Value Added Tax Act which came into effect in the year 2013.⁸⁸

⁸³ Article 209(1), *Constitution of Kenya*

⁸⁴ *Value Added Tax Act*, Act No. 35 of 2013

⁸⁵ *Tax Procedures Act* No. 29 of 2015

⁸⁶ *Value Added Tax Act*, CAP 476 Laws of Kenya

⁸⁷ Kenya Institute of Public Policy Research and Analysis (KIPPRA) *Tax Compliance Study: Tax Policy Unit in Macroeconomics Division* (2004)

⁸⁸ *Value Added Tax Act*, Act 35 of 2013, Commencement date of 2nd September 2013

The overhaul of the VAT Act was occasioned by the inadequacies of the legislation. The key objectives of the new legislation were to increase government revenues and simplify the VAT system in order to improve tax compliance.⁸⁹ The increase of revenue was expected to be achieved through the reclassification of many goods that were previously zero-rated as taxable at the standard rate and the reclassification of a variety of exempt goods as taxable goods. The Act also made provisions for the use of information technology for various tax procedures in a bid to improve the compliance process.

According to the 2019 Kenya National Bureau of Statistics Economic Survey, VAT contributed 23.26% of the total tax revenue in Kenya in the financial year 2017/2018.⁹⁰ The Economic Survey further reveals that of this contribution, VAT from imports amounted to 9.81% of the total revenue, while VAT from domestic consumption accounted for 13.44% of the total revenue. VAT comes second only to income tax in terms of contribution to the government's revenue. This underscores the importance of VAT and the need to protect its base from erosion.

The preamble to the VAT Act 2013 sets its objective as being to review and update the law relating to value added tax and to provide for the imposition of value added tax on supplies made in, or imported into Kenya, and for connected purposes.⁹¹ The Act provides that value added tax is chargeable on taxable supplies made by registered persons in Kenya, on the importation of taxable goods or supply of imported taxable services.⁹² Kenya has two applicable tax rates: 16% which applies to all taxable supplies, imported goods and services and a rate of zero percent which applies to a specific category of goods and services that are listed in the Second Schedule of the Act.⁹³

⁸⁹ Mutua J, A Citizen's Handbook on Taxation in Kenya, 2012 pg. 6

⁹⁰ Kenya National Bureau of Statistics, Economic Survey 2019 pg. 76

⁹¹ *Value Added Tax Act*, Act No. 35 of 2013

⁹² Section 5(1) *Value Added Tax Act*, Act No. 35 of 2013

⁹³ Section 5(2) *Value Added Tax Act*, Act No. 35 of 2013

The overhaul of Kenya's Value Added Tax Act⁹⁴ in the year 2013 saw the introduction of provisions that took into account the digital economy. The VAT Act⁹⁵ defines the place of supply of services as being in Kenya:

“if the place of business of the supplier is not in Kenya, the supply of services shall be deemed to be made in Kenya if the recipient of the supply is not a registered person and;

- a) the services are physically performed in Kenya by a person who is in Kenya at the time of supply;*
- b) the services are directly related to immovable property in Kenya;*
- c) the services are radio or television broadcasting services received at an address in Kenya;*
- d) the services are electronic services delivered to a person in Kenya at the time of supply; or*
- e) the supply is a transfer or assignment of, or grant of a right to use, a copyright, patent, trademark, or similar right in Kenya.”*

The VAT Act⁹⁶ further defined electronic services to mean *“any of the following services, when provided or delivered on or through a telecommunications network:*

- a) websites, web-hosting, or remote maintenance of programs and equipment;*
- b) software and the updating of software;*
- c) images, text, and information;*
- d) access to databases;*
- e) self-education packages;*
- f) music, films, and games, including games of chance; or*
- g) political, cultural, artistic, sporting, scientific and other broadcasts and events including broadcast television.”*

The Kenyan VAT design model conforms to the destination principle whereby the place of taxation is the place of consumption and exports are zero-rated. In the imposition of VAT on cross-border electronic services and intangibles the focus is therefore on determining the place where the final consumption of the services or intangibles takes place. The most basic question in the assessment of VAT is whether a supply exists or not.⁹⁷ The subject matter of this study is primarily the cross-border supply of electronic services and intangibles and their VAT treatment. The word supply is defined in the VAT

⁹⁴ Value Added Tax Act, Act No. 35 of 2013

⁹⁵ Section 8 (2), Value Added Tax Act, Act No. 35 of 2013

⁹⁶ Section 8(3), Value Added Tax Act, Act No. 35 of 2013

⁹⁷ Kollmann J, *Taxable Supplies and their Consideration in European VAT*, February 2019, IBFD pg. 1

Act 2013 as “the supply of goods and services”.⁹⁸ This meaning calls for the definition of goods and services, to determine whether the cross-border supply of services and intangibles that is being investigated is indeed subject to the VAT Act 2013.

Services are defined as “anything that is not goods or money”.⁹⁹ This in turn leads to the query of what are goods and money. Goods are defined as tangible movable and immovable property and includes electrical or thermal energy, gas and water, but does not include money. Money is defined as “any coin or paper currency that is legal tender in Kenya, bill of exchange, promissory note, bank draft, or postal or money order, any amount provided by way of payment using a debit or credit card or electronic payment system”.¹⁰⁰

Thuronyi observes that it is not possible to have a supply that is not either a supply of goods or a supply of services, except for supplies of land or money. From this, it is clear that "services" has an extended meaning. It covers the use of all forms of property and also transfers of the right to dispose of intangible property.¹⁰¹ Similarly, upon an examination of these definitions it is observed that although the VAT Act 2013 does not expressly define intangibles, it can be inferred that intangibles fall within the definition of services as they are neither goods nor money.

A taxable supply is defined by the VAT Act 2013 as “a supply other than an exempt supply made in Kenya by a person in the course or furtherance of a business carried on by the person”.¹⁰² Although the definition refers to a supply made in Kenya it should be read broadly together with the provisions of Section 8(2) of the Act that provides the instances when services emanating from foreign suppliers are deemed to be made in Kenya. This appraisal highlights that the definition of taxable supply does indeed encompass the cross-border supply of electronic services and intangibles.

⁹⁸ Section 2 (1), *Value Added Tax Act*, Act No. 35 of 2013

⁹⁹ Section 2 (1), *Value Added Tax Act*, Act No. 35 of 2013

¹⁰⁰ Section 2 (1), *Value Added Tax Act*, Act No. 35 of 2013

¹⁰¹ Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; Victor Thuronyi, ed.) Chapter 6, Value-Added Tax pg. 25

¹⁰² Section 2(1) *Value Added Tax Act*, Act No. 35 of 2013

The Tax Procedures Act was enacted on 15th December 2015 and in its preamble identifies its objectives as the harmonization and consolidation of procedural rules for the administration of tax laws in Kenya.¹⁰³ Prior to the enactment of this Act the procedural rules relating to the various tax laws were addressed separately by the respective laws. This was a disjointed approach that presented immense compliance challenges to tax payers as each tax statute had its own procedural rules.

The Tax Procedures Act¹⁰⁴ provides for the appointment of a tax representative by a non-resident person in cases where the non-resident person with no fixed place of business in Kenya is required to register under a tax law; the non-resident person shall appoint a tax representative in Kenya in writing. These provisions therefore apply to non-resident persons VAT obligations set out in the VAT Act. However, these provisions were not accompanied by any rules or guidelines for use by non-resident persons. The ability of a non-resident supplier to appoint a tax representative addresses only one aspect of the simplified registration and compliance regime envisioned by the International VAT/GST Guidelines.

A search through Kenyan case law did not reveal any cases that could contribute to the subject matter of this study. It was noted that there is currently no settled case law in Kenya on the application of VAT on the cross-border transactions in services and intangibles.

2.2.2 International Best Practice

The OECD Action 1 Plan had identified two main tax challenges relating to VAT in the digital economy which were listed as VAT exemptions for imports of low valued goods and remote digital supplies to consumers.¹⁰⁵ This thesis addresses the levying of VAT on cross-border e-commerce transactions which are characterized by the remote supply of electronic services and intangibles. It has been noted that such remote digital supplies are

¹⁰³ *Tax Procedures Act No. 29 of 2015*

¹⁰⁴ Section 15A, *Tax Procedures Act No. 29 of 2015*

¹⁰⁵ This study restricts itself to the examination of the second aspect relating to the remote digital supplies to consumers.

in most instances not charged the attendant VAT and consequently present unfair competition to local suppliers. As illustrated earlier, the business models in the digital economy allow for the supply of services and intangibles remotely bypassing the border controls that were traditionally used to levy VAT on imports.

With the rapid expansion of international trade there is more interaction between VAT systems of various jurisdictions which also exacerbates the risk of double taxation and unintended non-taxation.¹⁰⁶ As a response to this challenges, the OECD developed the International VAT/GST Guidelines (the Guidelines) which are a set of internationally agreed principles and approaches for the application of VAT in cross-border transactions, with a particular focus on trade in services and intangibles. The Guidelines highlight that “their aim is to minimise inconsistencies in the application of VAT in cross-border trade with a view to reducing uncertainty, risks of double taxation and unintended non-taxation in international trade”.¹⁰⁷

The Guidelines are not legally binding as they were adopted as OECD Council recommendations, however they are internationally accepted as best practice in the handling of international trade in services and intangibles. Notably the Guidelines were endorsed by more than one hundred jurisdictions comprising both OECD and non-OECD members at the third meeting of the OECD Global Forum on VAT, held in Paris in November 2015. The OECD encourages jurisdictions to adhere to the Guidelines when designing and implementing VAT legislations. The Guidelines are however not prescriptive and acknowledge the sovereignty of countries in the formulation of their legislation and therefore call for their application while keeping in mind the respective jurisdictions domestic context.¹⁰⁸

It is noted that the Guidelines approach cross-border trade from two perspectives: business to consumer (B2C) transactions and business to business (B2B) transactions. For B2B supplies the aim is to prevent businesses incurring irrecoverable VAT. The Guidelines

¹⁰⁶ <https://www.oecd.org/ctp/international-vat-gst-guidelines-9789264271401-en.htm> Accessed on 16th April 2019

¹⁰⁷ International VAT/GST Guidelines OECD 2017 pg. 3

¹⁰⁸ International VAT/GST Guidelines OECD 2017 pg. 11

therefore indicate that the general rule is that the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles.¹⁰⁹ The Guidelines further recommend the use of a reverse charge mechanism in such transactions for the collection of VAT where the supplier is not located in the jurisdiction of taxation.

With regard to the levying of VAT on cross-border B2C transactions in services and intangibles, the aim is to tax final consumption in the right jurisdiction. The Guidelines provide two general rules in this respect: the first rule relates to on-the-spot supplies and provides that the place of taxation is the jurisdiction in which the supply is physically performed, the second rule applies to other kinds of supplies and provides that the jurisdiction in which the customer has its usual residence has the taxing rights.¹¹⁰ The Guidelines also provide a specific rule relating to internationally traded supplies of services and intangibles directly connected with immovable property. They provide that in such cases the taxing rights may be allocated to the jurisdiction where the immovable property is located.¹¹¹

James and Ecker highlight that the OECD Guidelines were developed as a response to the fact that the place of taxation rules for most jurisdictions VATs were designed in an era when trade was conventional and involved tangible goods that crossed customs borders and most services were performed on the spot.¹¹² Having due regard to the evolution of international trade and the growing instances of remote supplies of services and intangible goods, a global harmonized approach is necessary to address these cross-border transactions to prevent double taxation and non-taxation.

The Guidelines featured recommendations on the options available to jurisdictions in dealing with B2C transactions. In line with the destination principle which has been adopted by most countries globally, the first recommendation stated that “the jurisdiction in which a customer has its usual residence has the right to collect VAT on remote supplies

¹⁰⁹ International VAT/GST Guidelines OECD 2017, Guideline 3.2, pg. 41

¹¹⁰ International VAT/GST Guidelines OECD 2017, Guideline 3.5 and 3.6, pg. 67-68

¹¹¹ International VAT/GST Guidelines OECD 2017, Guideline 3.5 and 3.8, pg. 84

¹¹² James K & Ecker T, *Relevance of the OECD International VAT/GST guidelines for non-OECD countries*, Australian Tax Forum, 2017

of services and intangibles”.¹¹³ The second recommendation was that jurisdictions should require non-resident suppliers to register for VAT in the jurisdiction where the consumer is located. The non-resident supplier would be required to levy and collect VAT on supplies in the same rate and manner as a local supplier. This model was noted to be the most effective means of collection of VAT on cross-border B2C supplies as collection by customers would be problematic. The third recommendation was that a jurisdiction’s requirement for the registration of non-resident suppliers should be coupled with establishment of a simplified registration and compliance regime for the non-resident suppliers. The simplified regime would ease the compliance process for the non-resident suppliers.¹¹⁴

For the application of the simplified registration and compliance regime, the Guidelines provided jurisdictions with guidance on its salient features. These characteristics include simple registration procedures, filing of simplified returns, use of electronic payment methods, use of electronic record keeping systems, elimination of invoicing requirements for business to consumer supplies covered by the regime and appointment of third-party providers to act on behalf of the non-resident supplier.¹¹⁵

The OECD also developed the Mechanisms for the Effective Collection of VAT/GST (the Mechanisms) which are to provide guidance to countries on the best practice in the design and operation of the collection mechanisms recommended by the OECD VAT/GST Guidelines.¹¹⁶ The Mechanisms recognize the main challenge presented by cross-border trade in services and intangibles as being “the jurisdictional break in the chain of the staged tax collection process” which forms the core of VAT. They also highlight the importance of exchange of information and administrative cooperation in dealing with this jurisdictional break.

¹¹³ International VAT/GST Guidelines OECD 2017, Guideline 3.6, pg. 69

¹¹⁴ International VAT/GST Guidelines OECD 2017, Guideline 3.135 pg. 72

¹¹⁵ Guidelines, paragraphs. 3.135 – 3.151

¹¹⁶ OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017

Traditionally the levying, collection, remittance and compliance of reporting requirements have been obligations of suppliers. With the growth in international trade and the remote supply of services and intangibles, jurisdictions face challenges in enforcing this requirement on suppliers who are not located in the jurisdiction of taxation. The Mechanisms identify four VAT collection methods that are available to countries to use in cross-border transactions in services and intangibles. The first method is the supplier collection which the OECD advises should be coupled with a simplified registration and compliance mechanism in order for it to be effective. The second method is the intermediary collection method while the third is customer collection method. Lastly there is the automated systems method which is currently viewed more as a means to assist in the operation of the other three methods. Countries can opt to apply any or a combination of these collection methods.¹¹⁷

The recommendations of the Guidelines are however not without challenges, for instance, the supplier collection regime may be particularly burdensome to foreign suppliers as it imposes obligations to register for VAT and comply with VAT regulations in a jurisdiction whose laws they may not be conversant with. Such suppliers may be faced with high costs of compliance which brings inefficiency into the tax system. However, the Guidelines provide that this can be redressed by ensuring that the supplier collection regime is implemented in conjunction with a simplified registration and compliance regime.¹¹⁸

It is noted that queries arise on the use of the Guidelines as the benchmark given that they were developed by OECD member countries with some minimal input from non-OECD members. The OECD member countries notably have different levels of development and administrative capabilities compared to countries such as Kenya which is a developing country. James and Ecker are of the view that “although the guidelines are a significant step in the efforts to encourage global coordination on the taxation of cross-border supplies of services and intangibles, a number of technical normative and administrative

¹¹⁷ OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017 pg. 17-27

¹¹⁸ OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017 pg. 19

issues will require further review so that the guidelines are not merely relevant, but achievable for all countries with VAT”.¹¹⁹

This study observes that, despite the Guidelines being formulated by countries that have social economic circumstances that differ from those of Kenya, they can still be applied in Kenya. It was previously observed in section 1.1 of Chapter One, that application of the Guidelines’ proposals has been successful in non-OECD countries such as South Africa which points to the fact that they can also work in Kenya and other developing countries.

2.3 Positive attributes of the legal framework

An assessment of the Kenyan legislation in the levying of VAT on cross-border supply of services and intangibles reveals some positive attributes of the legal framework. One of the key positive attributes of Kenya’s VAT legislation is that it is compatible with the destination principle which is a widely accepted international norm. As indicated earlier VAT is generally levied in the place of consumption.¹²⁰ In keeping with the destination principle the VAT Act 2013 also provides for the tax-free treatment of exports and they are therefore zero-rated.¹²¹

Another positive attribute is that while enacting the VAT Act 2013¹²² Kenya also adopted the recommended treatment of cross-border B2C transactions in services and intangibles more so with regard to the place of supply rules. The VAT laws provide for taxation in the place where the consumer is located or final consumption is undertaken with the exception of the supply of on-the-spot B2C services that are taxed in the place the service is rendered¹²³ and services relating to immovable property that are taxed where the property is located.¹²⁴

¹¹⁹ James K & Ecker T, *Relevance of the OECD International VAT/GST guidelines for non-OECD countries*, Australian Tax Forum, 2017

¹²⁰ Section 5(1) *Value Added Tax Act*, Act No. 35 of 2013

¹²¹ Section 5(2)a, Section 7(1) and Second Schedule Part A (1) *Value Added Tax Act*, Act No. 35 of 2013

¹²² *Value Added Tax Act*, Act No. 35 of 2013

¹²³ Section 8(2)b, *Value Added Tax Act*, Act No. 35 of 2013

¹²⁴ Section 8(2)c, *Value Added Tax Act*, Act No. 35 of 2013

The VAT Act 2013 also features the appropriate treatment of cross-border B2B transactions in services and intangibles in conformance with the Guidelines. The Act defines the supply of imported services as the supply of services to a registered person by non-resident persons who are not required to register for VAT in Kenya.¹²⁵ Where the registered person is entitled to either a part credit or a full credit these will be applied and where they are tax exempt they are required to account for and pay a reverse VAT.¹²⁶ The effect of these provisions is that the taxation is in the jurisdiction of the customer and VAT is collected through the customer collection regime by way of a reverse charge mechanism.

The reverse charge mechanism has several benefits for the tax authority, the first being the ease of enforcement as the customer is within their jurisdiction and it can therefore easily exercise its authority. This in turn considerably lowers the revenue risk that is associated with non-resident suppliers. The tax authority also benefits from lower administrative costs as they will be spared the aspect of seeking compliance by the non-resident supplier. There is also a reduction in compliance costs for the non-resident suppliers as the compliance is shifted to the customer whose compliance costs are relatively lower in comparison by virtue of their sharing the same jurisdiction with the tax authority.¹²⁷

2.4 Negative attributes of the legal framework

An evaluation of the Kenyan legal framework identifies some weaknesses in the application of VAT on cross-border transactions in services and intangibles. In its current state, Kenya's legislation has been unable to adequately address the levying of VAT in cross-border e-commerce transactions. As pointed out in section 1.1 of Chapter One, KRA has admitted to the fact that the law has not kept pace with the rapid changes in the digital economy.

¹²⁵ Section 2 (1), *Value Added Tax Act*, Act No. 35 of 2013

¹²⁶ Section 10 (2), *Value Added Tax Act*, Act No. 35 of 2013

¹²⁷ OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017 pg. 25

The first shortcoming is the ineffectiveness of the provision on supplier collection of VAT on cross-border B2C transactions in services and intangibles. This supplier collection regime places the onus of collection of VAT on the foreign supplier for cross-border B2C supplies of services and intangibles. This process has been ineffective due to the lack of a simplified registration and compliance mechanism for non-resident suppliers. Kenya has failed to fully adopt the recommended simplified registration and compliance regime which is designed to lessen the compliance burden on foreign suppliers. The Guidelines highlight that in the absence of a simplified mechanism, the non-resident suppliers are unlikely to comply as they may find the ordinary VAT registration and compliance process cumbersome or they may in the extreme avoid serving customers in the jurisdiction.¹²⁸

It is significant that in reality unless such foreign suppliers collect the applicable VAT on their supplies of services and intangibles, the tax authority is unlikely to collect any tax. To illustrate this, to date a purchase of an electronic book on the Amazon platform which is a taxable supply does not get levied VAT. Payments for advertising services on social media platforms such as Facebook and Twitter which are taxable supplies are also not subjected to VAT. It was reported that in the year to September 2017, Airbnb hosts in Kenya earned KSh. 390 million, and in a similar period in 2018, the amount had ballooned to KSh. 510 million.¹²⁹ Bookings for accommodation on the Airbnb platform which is a taxable supply should also attract a VAT charge but this is not currently the case. In these illustrations all the suppliers are non-resident and noting their failure to levy VAT they are unlikely to be registered for VAT and are therefore not remitting any VAT.

This shortcoming in Kenya's legislation leads to an uneven playing field for domestic suppliers of electronic services and intangibles. Foreign suppliers engaged in the same trade are able to supply at a lower price since they are not levying VAT on their supplies.

¹²⁸ International VAT/GST Guidelines OECD 2017, Guideline 3.132, pg. 71

¹²⁹ Daily Nation, Saturday 23rd March 2019 <https://www.nation.co.ke/news/Kenyans-turn-homes-into-hotels/1056-5037690-m90y41/index.html> 4th April 2019

On the other hand, the domestic suppliers' supplies are deemed more expensive by domestic customers due to the VAT element.

There is currently no data available that captures and quantifies the tax revenue lost as a result of these gaps, however based on the Airbnb example it is clear that a problem exists and it is likely to escalate as the digital economy grows and more business is conducted online. One of the key principles of taxation is flexibility which alludes to a tax system's ability to keep up with changes in technology and commercial developments. The inability of the tax system to keep up with these developments may have adverse effects on tax revenue mobilization by the government.

Kenya's definition of electronic services is very prescriptive and therefore fails to recognize that the business models in the digital economy evolve rapidly leading to the introduction of services that would not fit into the definition provided. This results in the unintended exclusion of certain electronic services from the ambit of the law. This situation leads to a loss of VAT revenue for the country as an increasing number of services are digitized and do not fit into the prescribed definition of electronic services. Kenya should adopt a broad definition of electronic services in its legislation and only make exclusions of specific services as it may deem necessary on the basis of its tax policy.

The Tax Procedures Act makes provisions for the appointment of a tax representative by a non-resident person with no fixed place of business in Kenya who is required to register under a tax law.¹³⁰ The VAT Act 2013 provides that if one has made or expects to make taxable supplies of Kenya Shillings five million and above in a twelve-month period, they should register for VAT.¹³¹ Based on this provision non-resident suppliers who meet this threshold are required to register for VAT.

The Tax Procedures Act further provides that where the non-resident person fails to appoint the tax representative the Commissioner may appoint one for that person.¹³² These

¹³⁰ Section 15A (1), *Tax Procedures Act* No. 29 of 2015

¹³¹ Section 34 *Value Added Tax Act*, Act No. 35 of 2013

¹³² Section 15A (2), *Tax Procedures Act* No. 29 of 2015

provisions are however deficient in that they are not accompanied by any rules or guidelines. Devoid of this guidance these legal provisions have not been operationalized. It is noted that the ability to appoint a representative is also one of the features of a simplified registration and compliance regime.

The VAT Act 2013 requires suppliers of taxable supplies to issue tax invoices at the time of supply.¹³³ The issuance of tax invoices upon supply is mandatory and no exceptions have been made for any transactions. Further, the invoices are required to conform to the prescribed format.¹³⁴ This is an onerous requirement for non-resident suppliers of services and intangibles. The Mechanisms provide that for B2C supplies under the simplified registration and compliance regime, invoicing should be eliminated given that the customer would not be eligible for input VAT claims. In the event that the invoices are required then they should be issued based on the rules of the jurisdiction of the supplier and should only contain basic information.

The VAT Act 2013 has no express provisions for the VAT treatment of intermediary activities. Intermediaries that participate in a digital supply chain have been identified as being capable of playing a role in the collection of VAT relating to non-resident suppliers.¹³⁵ This business model is quite pervasive in the digital economy and therefore needs to be addressed.

2.5 Conclusion

The Chapter has analysed the Kenyan legislative framework on VAT relating to cross-border e-commerce transactions. It has also reviewed the international legal framework on cross-border transactions in services and intangibles. It has identified both the positive and negative attributes of the Kenyan legal framework and its efficacy in the VAT treatment of these transactions.

¹³³ Section 42(1) *Value Added Tax Act*, Act No. 35 of 2013

¹³⁴ The Value Added Tax Regulations, 2017

¹³⁵ OECD *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*, October 2017 pg. 25

CHAPTER 3: COMPARATIVE CASE STUDIES ON THE LEVYING OF VAT ON CROSS-BORDER E-COMMERCE TRANSACTIONS IN SOUTH AFRICA AND AUSTRALIA

3.1 Introduction

This chapter undertakes two comparative case studies that feature South Africa and Australia and their VAT treatment of cross-border e-commerce transactions. The chapter examines the South African and Australian VAT legislative frameworks relating to cross-border trade in electronic services and intangibles. In particular the chapter will analyse the South African and Australian VAT legislative provisions relating to these supplies. The analysis is undertaken with a view of identifying any lessons that Kenya can draw from the two countries.

3.2 South Africa

3.2.1 Provisions of the South African VAT legislation

The South African Value Added Tax Act (SA VAT Act) was enacted in 1991 introducing VAT to the country and doing away with sales tax.¹³⁶ The South Africa Revenue Services (SARS) is the entity charged with the collection of tax in South Africa.¹³⁷ VAT is levied on the supply of goods and services, the importation of goods and supply of imported services.¹³⁸ VAT is charged at a standard rate of 15% with certain transactions being exempted or zero-rated.

VAT is levied on the supply of goods and services when the supply is in the course or furtherance of an enterprise.¹³⁹ The definition of enterprise brings electronic services under the ambit of the SA VAT Act and makes them subject to VAT.

The SA VAT Act's definition of an "enterprise" includes:

¹³⁶ Value Added Tax Act, Act no 89 of 1991, Laws of the Republic of South Africa

¹³⁷ The Revenue Services Act 34 of 1997

¹³⁸ Section 7(1) Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

¹³⁹ Section 7(1)a Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

“b(vi) The supply of electronic services by a person from an export country where two of the following criteria are met:

- a) The recipient of the electronic services is a resident of the Republic; or*
- b) The payment to the foreign electronic service entity originates from a bank registered or authorised in terms of the Banks Act 94 of 1990;*
- c) The recipient of the electronic services has a business, residential or postal address in the Republic.”¹⁴⁰*

The SA VAT Act provides that a supplier carrying on an enterprise is liable to register for VAT at the end of any month in which the total value of the supplies they have made in a rolling period of twelve months exceeds South African Rands 1 Million.¹⁴¹ Voluntary registration is allowed for suppliers with an annual turnover of over South African Rands 50,000 but less than South African Rands 1 Million.¹⁴² The registration threshold for foreign suppliers of electronic services had initially been set at South African Rands 50,000 but this was adjusted upwards in April 2019 to South African Rands 1 Million in line with the threshold applicable for all other businesses.¹⁴³ A foreign supplier of electronic services that meets the set threshold is therefore required to register for VAT.

The SA VAT Act has undergone several amendments over the years since its enactment in 1991. This study restricted itself to the analysis of the amendments that relate to and have a bearing on the levying of VAT on cross-border transactions in services and intangibles.

3.2.2 Legislative amendments targeted at the digital economy

Prior to 2014, the SA VAT Act provided for taxation of cross-border supplies of electronic services through the “imported services” provisions.¹⁴⁴

The VAT Act defines imported services as follows:

¹⁴⁰ Section 1(1) Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

¹⁴¹ Section 23, Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

¹⁴² Section 23, Value Added Tax Act, Act 89 of 1991 Laws of the Republic of South Africa

¹⁴³ Section 23(1)A, Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

¹⁴⁴ National Treasury Republic of South Africa, *Explanatory Memorandum: Regulations Prescribing Electronic Services for the purpose of the Definition of “Electronic Services” In Section 1(1) of the Value-Added Tax Act, 1991*, 24 October 2018

*“imported services means a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies.”*¹⁴⁵

On the basis of this provision, the recipient of electronic services from a foreign supplier was due to declare VAT on these services provided they were not utilizing the supplies solely for the purpose of making taxable supplies. In essence only electronic services supplied by foreign suppliers to final consumers were subjected to VAT.

Regulations for Electronic Services

South Africa’s Minister of Finance published Regulations relating to electronic commerce that took effect on 1st June 2014. The Regulations defined electronic services as follows:

*“2(1) These regulations prescribe those services that are electronic services for the purpose of the definition of “electronic services” in section 1(1) of the Act.
(2) These regulations apply to any supply of electronic services in the course or furtherance of an enterprise carried on by a person from a place in an export country –
(a) to a recipient that is a resident of the Republic; or
(b) where any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990)
(3)The services listed in regulation 3 (educational services), regulation 4 (games and games of chance), regulation 5 (internet-based auction service facilities), regulation 6 (miscellaneous services), regulation 7 (subscription services) are electronic services where such services are supplied by means of an electronic agent, electronic communication or the Internet for any consideration.”*¹⁴⁶

The Regulations were applicable only to electronic services that were supplied by foreign suppliers engaged in enterprise to either recipients resident in South Africa, or to instances where payment for the services emanated from a bank registered in South Africa. This definition of electronic services provided a prescriptive list of what services constituted electronic services. Given the evolving nature of the digital economy and the fast-paced innovation in the sector this prescriptive listing would soon become outdated. The government detected this inadequacy and acknowledged that the limited application of

¹⁴⁵ Section 1(1), Value Added Tax Act, Act 89 of 1991 Laws of the Republic of South Africa

¹⁴⁶ Electronic Services Regulations published by Government Notice No. R 221 of 28 March 2014.

the definition led to the exclusion of a large number of inbound electronic services from the tax net. This gave undue advantage to foreign suppliers and was detrimental to domestic suppliers.¹⁴⁷

It was highlighted in the first chapter that South Africa successfully collected revenue amounting to South African Rands 585 Million for 2016/2017 “through the application of some of the recommended principles and collection mechanisms set out in the OECD VAT/GST Guidelines”.¹⁴⁸ Despite this success, South Africa undertook further amendments to remedy the challenges identified in the system. The following section highlights these amendments to the VAT Act and the Regulations for electronic services.

Amendment of the Regulations for electronic services - March 2019

The South African National Treasury had in the 2018 budget review indicated its intent to amend the Regulations for electronic services. The National Treasury subsequently published the amendments to the Regulations in March 2019 which took effect on 1st April 2019. The key change effected was the definition of the term “electronic services” which was defined as follows:

*“For the purposes of the definition of “electronic services” in section 1(1) of the Act “electronic services” means any services supplied by means of an **electronic agent**, **electronic communication** or the **Internet** for any consideration, other than:*

- (a) educational services supplied from a place in an export country and regulated by an educational authority in terms of the laws of that export country; or*
- (b) telecommunications services; or*
- (c) services supplied from a place in an export country by a company that is not a resident of the Republic to a company that is a resident of the Republic if-*
 - (i) both those companies form part of the same group of companies;**and*

¹⁴⁷ Legal Tax Design, Tax and Financial Sector Policy Unit, ‘VAT on e-services South Africa’s Experience,’ 2018 available at https://www.un.org/esa/ffd/wp-content/uploads/2018/05/2018-ECOSOC-ICTM_SM_Digital_ABaig.pdf

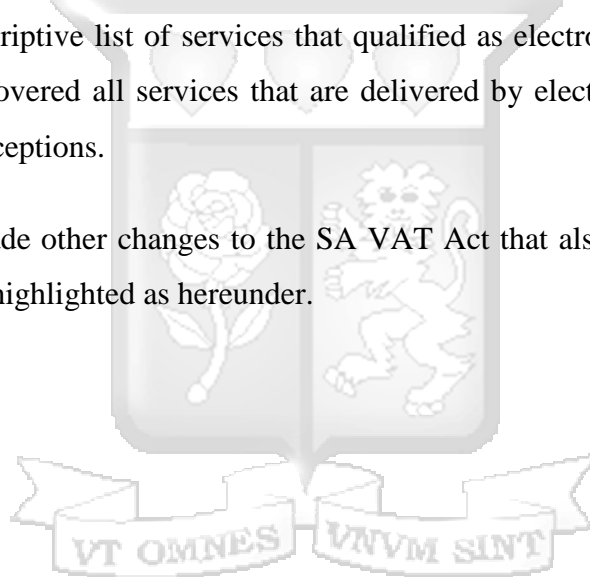
¹⁴⁸ OECD 2018- *Tax Challenges arising from digitalisation: Interim report 2018 Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris

- (ii) *the company that is not a resident of the Republic itself supplies those services exclusively for the purposes of consumption of those services by the company that is a resident of the Republic.*”¹⁴⁹

The Regulations had provided that the applicable definitions of the terms electronic agent,¹⁵⁰ electronic communication¹⁵¹ and internet¹⁵² were those provided in the Electronic Communication and Transactions Act.¹⁵³ These definitions were a necessary reference given the revised definition of the term electronic services.

Regulations 3 to 7 which contained a list of the services that qualified as electronic services were repealed in the amendment to the Regulations.¹⁵⁴ Notably, the impact of this change was that South Africa shifted from a definition of electronic services that provided a prescriptive list of services that qualified as electronic services to a broader definition that covered all services that are delivered by electronic means save for the limited listed exceptions.

South Africa made other changes to the SA VAT Act that also took effect on 1st April 2019 which are highlighted as hereunder.



¹⁴⁹ Regulations Prescribing Electronic Services for the purpose of the Definition of “Electronic Services” in Section 1 of the Value-Added Tax Act, 1999. Regulations published by Government Notice No. 42316 of 18 March 2019.

¹⁵⁰ “Electronic agent” means a computer program or an electronic or other automated means used independently to initiate an action or respond to data messages or performances in whole or in part, in an automated transaction.

¹⁵¹ “Electronic communication” means a communication by means of data messages.

¹⁵² “Internet” means the interconnected system of networks that connects computers around the world using the TCP/IP and includes future versions thereof.

¹⁵³ Section 1, Electronic Communication and Transaction Act, No. 25 of 2002

¹⁵⁴ Regulations Prescribing Electronic Services for the purpose of the Definition of “Electronic Services” in Section 1 of the Value-Added Tax Act, 1999. Regulations published by Government Notice No. 42316 of 18 March 2019.

Intermediary

The term intermediary was included in the definitions in the Act and it was defined as;

*“Intermediary means a person who facilitates the supply of electronic services supplied by the Foreign Electronic Service Entity and who is responsible for issuing the invoices and collecting payment for the supply.”*¹⁵⁵

The introduction of intermediaries into the ambit of the SA VAT Act paved way for collection of VAT through intermediaries/digital platforms.¹⁵⁶ This was a significant development since the OECD's Working Party No.9 on Consumption Taxes (WP9) had recognised that involvement of such platforms in the collection of VAT/GST had the potential to significantly enhance the effectiveness of VAT/GST collection given their important role in generating, facilitating and/or executing online sales. The platform was viewed as a form of store that provided an array of different digital supplies and in many instances was the only point of contact with the customer.¹⁵⁷

The definition of enterprise was also amended to incorporate in its meaning the activities of an intermediary through the inclusion of a new subsection b(vii).

“Enterprise means:

*b) Without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern — (vii) the activities of an intermediary.”*¹⁵⁸

The import of this provision is that where a foreign intermediary facilitates a foreign supplier of electronic services to make supplies in South Africa and is responsible for the invoicing and collection elements of the supply, the intermediary will be required to register for VAT and remit VAT for these transactions. The foreign intermediary will be

¹⁵⁵ Section 1(1), Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

¹⁵⁶ The terms intermediaries and digital platforms have been used interchangeably in the OECD (2019), The Role of Digital Platforms in the Collection of VAT/GST on Online Sales, OECD, Paris.

¹⁵⁷ OECD (2019), The Role of Digital Platforms in the Collection of VAT/GST on Online Sales, OECD, Paris. www.oecd.org/tax/consumption/the-role-of-digital-platforms-in-the-collection-of-vat-gst-on-online-sales.pdf

¹⁵⁸ Section 1(1), Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

deemed to be the supplier of the electronic services for VAT purposes. This provision does not apply to intermediaries that are purely facilitating payments.¹⁵⁹

This study observed that South Africa has a simplified registration and compliance regime in place for foreign suppliers of electronic services and SARS has provided a detailed registration guide for use by the foreign suppliers.¹⁶⁰ This conforms to the recommendations of the VAT/GST Guidelines on adoption of a simplified registration and compliance regime where a supplier VAT collection regime is used in cross-border supplies of intangibles and electronic services.

3.2.3 Conclusion

It was noted that the South African VAT legislation and Regulations do not mention intangibles, however, this study observed that the definition of electronic services highlighted earlier read together with the definition of services is broad enough to encompass intangibles. Services were defined as:

*“Services” means anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods or money.*¹⁶¹

South Africa has adjusted the registration threshold for foreign suppliers of electronic services to bring it at par with the threshold applicable for all other businesses. This demonstrates the application of the principle of neutrality in the treatment of domestic and foreign suppliers.

This study also noted that there is no distinction between B2B and B2C transactions in both the SA VAT Act and the Regulations. The consequence of this is that the B2B and B2C transactions are treated in a similar manner. This approach differs from the one

¹⁵⁹ National Treasury Republic of South Africa, *Explanatory Memorandum: Regulations Prescribing Electronic Services for the purpose of the Definition of “Electronic Services” In Section 1(1) of the Value-Added Tax Act, 1991*, 24 October 2018

¹⁶⁰ SARS, “External Guide, VAT Registration Guide for Foreign Suppliers of Electronic Services,” 2019 available at <<https://www.sars.gov.za/AllDocs/OpsDocs/Guides/VAT-REG-02-G02%20-%20VAT%20Guide%20for%20Foreign%20Suppliers%20of%20Electronic%20Services%20-%20External%20Guide.pdf>>

¹⁶¹ Section 1(1), Value Added Tax Act, Act 89 of 1991, Laws of the Republic of South Africa

adopted by Kenya; all the same the SA VAT legislation is coherent and effectively addresses cross-border transactions in services and intangibles. In any case the VAT/GST Guidelines do not provide a recommendation for countries to adopt a system that distinguishes between B2C and B2B transactions.

This study has determined that similar to other countries, the continuous amendment of the South African law has been driven by the constant need from a tax perspective to effectively address the challenges of levying VAT on cross-border digital trade. It is also fueled by the need to level the playing field for local suppliers by requiring foreign suppliers to comply with local VAT laws to prevent distortions in trade.

Kenya can draw lessons from South Africa and the measures the country has implemented to deal with the levying of VAT in cross-border e-commerce transactions. South Africa has adopted a broad definition of electronic services in its tax legislation and provided some limited exclusions. This ensures that the developments in the digital economy do not curtail the country's ability to levy VAT on electronic services. The country has included intermediaries in the scope of its tax legislation which enhances the country's ability to collect VAT on transactions conducted on online platforms. South Africa has also put in place a simplified registration and compliance regime to ease the compliance process for foreign suppliers. These measures offer valuable lessons for Kenya in its quest to adequately address the levying of VAT on cross-border e-commerce transactions.

3.3 Australia

3.3.1 Provisions of the Australian VAT legislation

Australia has a Goods and Services Tax (GST) in place which is a consumption tax levied at the point of final consumption. According to the International VAT/GST Guidelines, the term VAT “is used to refer to any national tax by whatever name or acronym it is known such as Goods and Services Tax (GST) that embodies the basic features of a value added tax”.¹⁶² The GST is therefore the same as VAT. Australia's Goods and Services Tax Act (GST Act) was enacted in the year 1999 introducing VAT to the country.¹⁶³ The

¹⁶² International VAT/GST Guidelines, OECD, 2017, OECD Publishing, Paris

¹⁶³ A New Tax System (Goods and Services Tax) Act 1999

Australian Taxation Office (ATO) is the entity charged with the collection of taxes in the country. The ATO is a non-corporate Commonwealth entity within the Australian Treasury portfolio.¹⁶⁴

The Australian GST Act defines supply as: “*A supply is any form of supply whatsoever.*”¹⁶⁵

The GST Act provides that a taxable supply is made where a supply is made for a consideration, is connected with Australia, is made in the course of an enterprise and made by a supplier who is registered or required to be registered. Supplies that are GST-free and input taxed are not taxable supplies.¹⁶⁶ The GST Act provides for the levying and payment of GST on the supply of taxable supplies.¹⁶⁷ The law further provides that the GST payable on taxable supplies is 10% of the value of the taxable supplies.¹⁶⁸

An entity that is carrying on an enterprise and its turnover meets the GST registration turnover threshold is required to register for GST.¹⁶⁹ The turnover threshold for GST registration is Australian Dollars 75,000 per annum.¹⁷⁰ Entities carrying on an enterprise with a lower turnover can also voluntarily register for GST.¹⁷¹

3.3.2 Legislative amendments targeted at the digital economy

The Australian government in its Budget 2015-2016 indicated that it intended to extend the application of GST to cross border supplies of digital products and services imported by consumers from 1st July 2017. The measure was estimated to result in a growth in GST revenue of Australian Dollars 350 Million over the forward estimates period. It noted that based on the law at the time, digital products and services imported by consumers were

¹⁶⁴ The Australia Tax Office available at <https://www.ato.gov.au/About-ATO/Who-we-are/> Accessed 5th May 2019

¹⁶⁵ Division 9-10(1), A New Tax System (Goods and Services Tax) Act 1999

¹⁶⁶ Division 9-5, A New Tax System (Goods and Services Tax) Act 1999

¹⁶⁷ Division 9-40, A New Tax System (Goods and Services Tax) Act 1999

¹⁶⁸ Division 9-70, A New Tax System (Goods and Services Tax) Act 1999

¹⁶⁹ Division 23-5, A New Tax System (Goods and Services Tax) Act 1999

¹⁷⁰ Division 23-10, A New Tax System (Goods and Services Tax) Act 1999

¹⁷¹ Division 23-15 (1), A New Tax System (Goods and Services Tax) Act 1999

not subject to GST. This resulted in a loss of GST revenue and placed domestic businesses at a tax disadvantage compared to overseas businesses.¹⁷²

An analysis by Walpole and Stiglingh highlights that although the definition of supplies includes “any form of supply whatsoever” and services are specifically included in the definition of supplies, intangible supplies lacked a “connection with” Australia’s “indirect tax zone”. To remedy this, the GST Act was amended with regard to the place-of-supply rules so as to include within them a supply to “an Australian consumer”.¹⁷³

The GST Act was amended to include sub-section 9-25(5)d which provides that:

*“(5) A supply of anything other than goods or *real property is **connected with Australia** if:*

- (a) the thing is done in Australia; or*
- (b) the supplier makes the supply through an *enterprise that the supplier *carries on in Australia; or*
- (c) all of the following apply:*
 - (i) neither paragraph (a) nor (b) applies in respect of the thing;*
 - (ii) the thing is a right or option to acquire another thing;*
 - (iii) the supply of the other thing would be connected with Australia.*
- (d) the recipient of the supply is an Australian consumer.”¹⁷⁴*

Following this amendment, a supply is determined to “be connected with Australia if the imported services or digital products are sold to an Australian consumer”. The GST Act was also amended to include a definition of the term Australian consumer. The following definition of the term was included:

“An entity is an Australian consumer of a supply made to the entity if:

- (a) the entity is an *Australian resident (other than an entity that is an Australian resident solely because the definition of Australia in the *ITAA 1997 includes external Territories); and*
- (b) the entity:*
 - (i) is not *registered; or*

¹⁷² Australian Government, *Budget measures: budget paper no 2: 2015–16* available at https://www.budget.gov.au/2015-16/content/bp2/download/BP2_consolidated.pdf accessed 9 May 2019

¹⁷³ Walpole M & Stiglingh *Untangling the World Wide VAT Web on digital supplies* Australian Tax Forum: a journal of taxation policy, law and reform, vol. 2017, pp. 429 - 463

¹⁷⁴ Division 9-25(5), A New Tax System (Goods and Services Tax) Act 1999

*(ii) if the entity is registered - the entity does not acquire the thing supplied solely or partly for the purpose of an *enterprise that the entity *carries on.*"¹⁷⁵

The import of these amendments was that the supply of intangible supplies to an Australian consumer were construed as being connected to Australia and therefore subject to GST. These provisions were only applicable to consumers who were not registered for GST or where the consumer was registered, the consumer had not acquired the supplies for use either exclusively or partly in furtherance of an enterprise it was engaged in. Walpole and Stiglingh opine that the amendments not only addressed the problem with the GST Act that supplies of intangibles by non-residents would usually fail the “connected with” test, but it also narrowed the impact of the remedy by restricting it to the private consumption of such supplies. The rules are also noted to be broad and cover all intangible services.¹⁷⁶

This study noted that the GST Act provides for a reverse charge mechanism where offshore supplies of intangibles are made to a recipient solely or partly for purposes “of an enterprise that the recipient carries on in Australia, but not solely for a creditable purpose”. The GST liability is effectively shifted from the supplier to the recipient of the supply in a B2B transaction.¹⁷⁷ The applicable GST is only payable by the recipient of such a supply if it meets the additional criteria of also being registered for GST and the supply in question is for a consideration.¹⁷⁸

Electronic Distribution Platforms

Australia introduced the concept of “an operator of an electronic distribution platform (EDP) or online marketplace” into its GST legislation on 1st July 2017. As previously highlighted, intermediaries or digital platforms play a crucial role in online sales and present an opportunity for effective collection of VAT/GST. The GST Act was amended to introduce a provision on electronic distribution platforms. The GST Act uses the term

¹⁷⁵ Division 9- 25(5)7, A New Tax System (Goods and Services Tax) Act 1999

¹⁷⁶ Walpole M & Stiglingh *Untangling the World Wide VAT Web on digital supplies* Australian Tax Forum: a journal of taxation policy, law and reform, vol. 2017, pp. 429 - 463

¹⁷⁷ Division 84-10, A New Tax System (Goods and Services Tax) Act 1999

¹⁷⁸ Division 84-5, A New Tax System (Goods and Services Tax) Act 1999

electronic distribution platform which is in effect a digital platform or intermediary as defined by the OECD.¹⁷⁹

“Meaning of electronic distribution platform:

(1) A service (including a website, internet portal, gateway, store or marketplace) is an electronic distribution platform if:

- (a) the service allows entities to make supplies available to end-users; and*
- (b) the service is delivered by means of *electronic communication; and*
- (c) the supplies are to be made by means of electronic communication.”¹⁸⁰*

The GST Act goes further to exclude entities that are engaged solely in the provision of carriage services¹⁸¹ and payment processing services from the ambit of this definition of an electronic digital platform.¹⁸² Subsection 84-55(1) of the GST Act provides that where imported intangible supplies are made to a consumer through an electronic digital platform, the operator of the platform is deemed the supplier of the supplies and becomes liable for GST.¹⁸³ The liability for GST is therefore shifted from the foreign supplier to the operator of the electronic digital platform who must levy, collect and remit the applicable GST.

This study noted that the country has a simplified GST registration mechanism for non-resident suppliers of imported services and intangibles products to Australian consumers. The registration is undertaken electronically on the ATO’s website. Non-resident suppliers that opt for this simplified registration cannot claim any input credits.¹⁸⁴

Australia provides several valuable lessons for Kenya to emulate. The first lesson is similar to the learning drawn from South Africa in the adoption of a broad definition of electronic services. Australia having noted the challenges of a narrow definition of the term amended its law to take up a broader definition. Australia’s inclusion of

¹⁷⁹ OECD (2019), The Role of Digital Platforms in the Collection of VAT/GST on Online Sales, OECD, Paris

¹⁸⁰ Division 84-10(1), A New Tax System (Goods and Services Tax) Act 1999

¹⁸¹ These are services such as those operated by internet service providers and telecommunication companies

¹⁸² Division 84-10(2), A New Tax System (Goods and Services Tax) Act 1999

¹⁸³ Division 84-55(1), A New Tax System (Goods and Services Tax) Act 1999

¹⁸⁴ Australian Tax Office website <https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Doing-business-in-Australia/Australian-GST-registration-for-non-residents/> accessed on 10 May 2019

intermediaries under the ambit of its tax legislation is also a key lesson for Kenya. With the growth in the use of intermediaries to conduct cross-border e-commerce transaction this legislative development has provided Australia with a convenient and effective platform for collection of GST on cross-border e-commerce transactions. Another lesson is Australia's adoption of a simplified GST registration regime for foreign suppliers which eases their compliance burden and encourages compliance. The country's responsiveness to the changes in the digital economy through legislative amendments is another positive attribute that Kenya should emulate having noted the latter's tax authority's complaint that the legal code has not kept up with the digital economy.

3.3.3 Conclusion

This study has observed that Australia introduced legislation that brought digital products and services into the ambit of the GST Act. It adopted a broad definition of intangible supplies which makes the law dynamic and adaptive to technological changes.

The levying of GST is on domestic consumption of imported services and intangible supplies while the reverse charge mechanism is applied to similar supplies in a B2B transaction.

It was noted that the GST registration threshold was similar for both domestic suppliers as well as foreign suppliers. This is in keeping with the neutrality principle that advocates for the equal treatment of both domestic and foreign suppliers without granting neither an unfair advantage over the other.

Australia has enacted and implemented elaborate legal provisions relating to operators of electronic digital platforms. It targets to increase its GST collections by harnessing the potential of these platforms in the effective collection of GST.

CHAPTER 4: SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

4.1 Introduction

This chapter presents a summary of the findings of the research, responds to the research questions, determines whether the hypotheses have been proven, draws conclusions on the research and makes recommendations.

4.2 Summary of the findings

This study sought to undertake an analysis of the legislative framework that Kenya has in place to levy VAT on cross-border e-commerce transactions and its effectiveness. Chapter One of this study highlighted that taxation of the digital economy has continued to present challenges to tax authorities globally. Technological developments have increased the ease with which services and intangibles can be traded across borders. This borderless economy has been a boon for businesses and a stumbling block for tax authorities. In particular the levying of VAT on cross-border e-commerce transactions has been complicated by the ability of suppliers to supply services and intangibles to customers without needing to establish a physical presence in the market jurisdiction.

Chapter One of this study highlighted that despite the challenges presented by the digital economy, tax authorities cannot adopt unilateral measures and have to continually be guided by the key principles of taxation. As tax policy is developed in the various jurisdictions it should be guided by the OECD Ottawa Taxation principles of neutrality, efficiency, certainty and simplicity, effectiveness and flexibility. Further, a balance must be maintained between a jurisdiction's need to collect tax revenue and ensuring they do not stifle cross-border trade.

It was noted that the adoption of the destination principle by most jurisdictions has been hailed as a step in the right direction in ensuring the neutrality of international trade. Neutrality was highlighted as being at the core of VAT design. In the cross-border trade in services and intangibles the well accepted practice is for VAT to be charged in the jurisdiction of consumption.

Chapter Two of this study analysed the Kenyan VAT legislative framework on the VAT treatment of cross-border trade in services and intangibles whereby it was noted to have both positive and negative attributes. It was established that Kenya's VAT legislation is guided by the destination principle which is in line with the international norms. It was noted that Kenya included the levying of VAT on the supply of electronic services by non-resident suppliers in its VAT legislation. Kenya had also conformed to some of the recommendations of the International VAT/GST Guidelines on the VAT treatment of cross-border transactions in services and intangibles. Kenya had also made an attempt at providing for a simplified registration and compliance regime by including some features of the regime in its legislation. However, some gaps which are highlighted in section 4.3 here below, were identified in the legislation which need to be addressed in order for the country to adequately address the levying of VAT on these transactions.

Chapter Two also addressed the international best practice for the VAT treatment of cross-border transactions in services and intangibles. The growth in international trade and the interaction of various countries VATs was noted to increase the risk of double taxation and unintended non-taxation. In order to address this challenge, the OECD had come up with the International VAT/GST Guidelines. Although the Guidelines are not prescriptive, the OECD advocates for countries to follow them in the design of their VAT systems while keeping in mind their respective domestic contexts. The Guidelines are internationally accepted as best practice and provide specific measures that countries can adopt in their legislation. The OECD also provided further implementation guidance through the Mechanism for the Effective Collection of VAT/GST.

In Chapter Three, an analysis of the South African legislative framework illustrated the country's success in collecting VAT in the cross-border electronic services and intangibles transactions. The adoption of a simplified registration and compliance regime was noted to have contributed greatly to this success. South Africa had also adopted several legislative reforms targeting the collection of VAT from imported electronic services. The country had amended the law to broaden its definition of "electronic services" so as to capture a wider range of services in the tax net.

A review of Australia and its GST treatment of cross-border electronic services and intangibles transactions established that the country has been in the frontline in the adoption of appropriate measures to address the challenges that have dogged the taxation of the digital economy. Australia was recognized as one of the early adopters of the measures recommended in the International VAT/GST Guidelines. It had identified the potential tax revenue growth that would result from inclusion of imported supplies of digital products and services. Australia has also continually made changes in the law in order to ensure its GST base was protected from erosion. The most significant of these changes relate to broadening the scope of the definition of electronic services and the inclusion of electronic digital platforms in the GST laws.

This study observed that the experiences of these two countries offer valuable lessons for Kenya in the levying of VAT on cross-border electronic services and intangibles.

4.3 Conclusions

The hypothesis that Kenya's VAT legislation is inadequate for the levying of VAT on cross border transactions in electronic services and intangibles has been proven. This study has been able to demonstrate that the legislative framework that Kenya has in place to levy VAT on these transactions is inadequate. The key deficiencies have been identified principally as the narrow definition of electronic services in the law, the lack of a simplified registration and compliance regime for use by non-resident suppliers and the failure to include intermediaries/digital platforms in the VAT collection process.

The supposition that reforming Kenya's VAT legislation will result in an increase in the amount of VAT collected from cross border e-commerce transactions has been exemplified by the analysis of the South African and the Australia case studies. In Australia, the government quantified the amounts it was estimating to be losing as a result of a limited definition of electronic services in its laws. This informed the Australian government's decision to undertake an amendment of the law to incorporate a wider definition of electronic services. While cognizant of the fact that changes in the law may not directly translate into an increase of VAT revenue, it has been proven that such adjustments do indeed contribute to higher tax collections. In South Africa, the data

available attested to an increase in revenue following the adoption of a simplified registration and compliance regime. It is also noted that legislative amendments are only effective when they are accompanied by the relevant administrative tax mechanisms.

4.4 Recommendations

In order to adequately collect VAT from cross-border digital transactions, Kenya needs to reform its VAT legislation by:

a) Amending the definition of electronic services

Kenya needs to expand the definition of the term “electronic services” in the VAT Act. The definition of electronic services should be amended to remove the prescriptive list of what constitutes electronic services. Instead, the law should adopt a broader definition which would be cognizant of the evolving nature of digital services and intangibles. Any exceptions necessary could be specifically provided for in the law.

b) Adoption of a simplified registration and compliance regime for non-resident suppliers of electronic services and intangibles

Kenya has adopted a supplier collection model for non-resident suppliers of business-to-consumer services and intangibles and it is recommended that it should fully establish a simplified registration and compliance mechanism to facilitate compliance for non-resident suppliers. To do this it needs to enact regulations to operationalize the simplified registration and compliance regime.

The simplified regime should be designed such that it is separate and distinct from the traditional registration regime. The regulations should among other things, provide for registration of suppliers electronically for instance through the tax authority’s website. The simplified regime should also have the capacity for the filing of the necessary returns through an online portal. In this regard, the simplified regime can be integrated into the iTax system which is Kenya’s online tax registration and filing system. The foreign suppliers that register under the simplified regime should not be eligible for input tax recovery. They should also not be required to meet all the usual reporting requirements

with the filing of returns kept at the bare minimum. Kenya can also eliminate tax invoice requirements for business-to-consumer supplies that are covered by the simplified regime, in light of the fact that the customers involved generally would not be entitled to deduct the input VAT paid on these supplies.

KRA should provide user guides on the regime on its website for use by the foreign suppliers or their tax representatives. The adoption of the simplified regime has been shown to lead to effective revenue collection without creating economic distortions and maintaining neutrality in international trade.

c) Inclusion of the Intermediaries in the ambit of the VAT Act

This study notes that the crucial role of intermediaries in the online sales infrastructure. The intermediaries provide an easy means of capturing the cross-border trade in services and intangibles in the tax net. Kenya should enact provisions in its VAT Act that bring intermediaries under the ambit of the Act. The law can provide a legal framework for the shifting of the VAT liability from the non-resident supplier to the intermediary for the effective collection of VAT.

d) Enforcement mechanisms

The enforcement of the VAT laws has been noted to be a challenge for developing countries. Kenya can embark on capacity building for its revenue authority staff to ensure they are well equipped to handle the levying of VAT on the cross-border transactions in services and intangibles. The use of technology is crucial in Kenya's efforts to capture taxes in the digital economy. As highlighted in section 4.4b, Kenya can maximize its use of the technology it has in place by customizing it cater for a simplified registration and compliance regime. This would greatly support its tax collection efforts from foreign suppliers participating in cross-border e-commerce transactions with consumers in Kenya.

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