

# **Strathmore University**

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## **Law School**

### **ADDRESSING THE AMBIGUITY IN TAXING BUNDLED DIGITAL SERVICES: A CRITICAL ANALYSIS OF KENYA'S DIGITAL SERVICE TAX FRAMEWORK.**

Submitted in partial fulfillment of the requirements of the Bachelor of Laws Degree,  
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By

**Lisa Ntabo Moraa**

**146066**

Prepared under the supervision of

**Mr. Allan Mukuki**

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## **TABLE OF CONTENTS**

<b>ACKNOWLEDGEMENT</b> .....	iv
<b>DECLARATION</b> .....	v
<b>LIST OF CASES</b> .....	vi
<b>LEGAL INSTRUMENTS</b> .....	vii
<b>LIST OF ABBREVIATIONS</b> .....	ix
<b>ABSTRACT</b> .....	x
<b>CHAPTER 1</b> .....	1
<b>1.0 INTRODUCTION TO DIGITAL SERVICE TAXATION</b> .....	1
<b>1.1 BACKGROUND TO THE PROBLEM</b> .....	2
1.1.0 The Origin of Digital Service Tax.....	2
1.1.1 Digital Service Tax in Kenya and Proposed Transformations.....	3
<b>1.2 STATEMENT OF THE PROBLEM</b> .....	4
<b>1.3 PURPOSE OF STUDY</b> .....	4
<b>1.4 HYPOTHESIS</b> .....	4
<b>1.5 RESEARCH QUESTIONS</b> .....	5
<b>1.6 RESEARCH OBJECTIVE</b> .....	5
<b>1.7 JUSTIFICATION OF STUDY</b> .....	5
<b>1.8 METHODOLOGY</b> .....	6
<b>1.9 SCOPE AND LIMITATION OF STUDY</b> .....	6
<b>1.10 THEORETICAL FRAMEWORK</b> .....	7
1.10.1 Introduction.....	7
1.10.2 Tax Theories.....	7
i) Ability to Pay Theory.....	7
ii) Benefit Principle.....	8
iii) Tax Neutrality.....	9
1.10.3 Conclusion.....	11
<b>1.11 LITERATURE REVIEW</b> .....	11
1.11.1 Introduction.....	11
1.11.2 Understanding Digital Service Bundling and Consumer Behaviour.....	12

1.11.3 Policy and Economic Implications of Bundling Mechanism and Digital Services.	14
1.11.4 Bundling in the Context of Agricultural Digital Services.....	16
1.11.5 Challenges in Taxing Bundled Digital Services.....	18
1.11.6 Conclusion.....	19
<b>1.12 CHAPTER BREAKDOWN.....</b>	<b>20</b>
<b>1.13 CONCLUSION.....</b>	<b>20</b>
<b>CHAPTER 2.....</b>	<b>21</b>
<b>2.0 ANALYSIS OF KENYA’S DIGITAL SERVICE TAX FRAMEWORK.....</b>	<b>21</b>
2.1 Introduction.....	21
2.2 Legal Basis of Kenya’s DST Framework.....	21
2.3 Scope of Digital Service Tax Framework.....	23
VAT and Its Interaction with DST.....	25
2.4 Implementation and Enforcement Mechanism of DST and its Impact.....	26
Registration.....	26
Compliance.....	27
Impacts.....	27
2.5 Digital Service Tax in Bundled Services.....	28
2.6 Appreciation and Limitation of the Digital Services Tax.....	29
2.7 International View on Digital Service Tax.....	30
2.8 Conclusion.....	31
<b>CHAPTER 3.....</b>	<b>32</b>
<b>3.0 GAPS IN KENYA’S DIGITAL SERVICE TAX FRAMEWORK.....</b>	<b>32</b>
3.1 Introduction.....	32
3.2 Gaps in Digital Taxation.....	33
Definition of a Tax Gap.....	33
3.3 Legal Gaps in the DST Framework.....	34
3.4 Administrative and Implementation Challenges.....	35
3.5 Policy and Economic Gaps.....	38
Economic Gaps.....	38
3.8 Conclusion.....	39

<b>CHAPTER 4.....</b>	<b>39</b>
<b>4.0 COMPARATIVE ANALYSIS OF DIGITAL SERVICE TAX FRAMEWORK: INDIA AND AUSTRALIA’S VIEW ON TAXING BUNDLED SERVICES.....</b>	<b>39</b>
4.1 Introduction.....	39
4.2 Conceptual Framework.....	40
4.3 An Overview of India’s Goods and Service Tax.....	41
4.4 Treatment of Bundled Digital Services.....	43
4.5 Strengths and Weaknesses of India’s GST framework.....	46
4.6 An Overview of Australia’s Goods and Service Tax.....	46
4.7 Treatment of Bundled Services in Australia's GST.....	48
4.8 Positive and Negative Impacts of Australia’s GST.....	49
4.9 Lessons Drawn in the Analysis of Kenya’s DST, India, and Australia’s GST concerning Bundled Digital Services.....	50
4.10 Conclusion.....	51
<b>CHAPTER 5.....</b>	<b>52</b>
<b>5.0 RECOMMENDATIONS AND CONCLUSION.....</b>	<b>52</b>
5.1 Introduction.....	52
5.2 Key Findings in Taxation of Bundled Digital Services in Kenya.....	52
5.3 Policy Recommendations for Kenya's DST Framework.....	53
5.4 Conclusion.....	56

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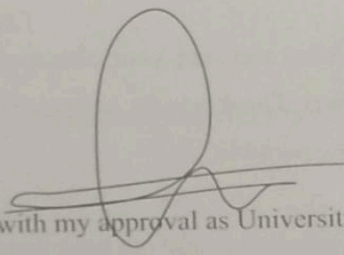
**DECLARATION**

I, NTABO LISA MORAA, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed: .....

20 January 2025

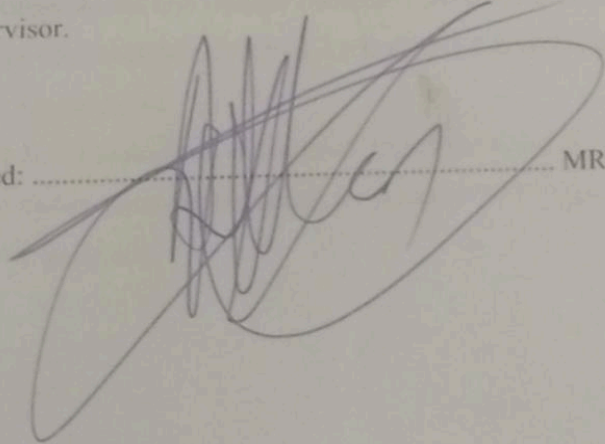
Date: .....



This dissertation has been submitted for examination with my approval as University Supervisor.

Signed: .....

MR. ALLAN MUKUKI



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1. Clause 8, Finance Bill (2024)
2. Proposed amendment) Section 12E, Income Tax Act(1974)
3. Article 209, Constitution of Kenya (2010)
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5. Section 4, Finance Act (2020)
6. Section 9, Finance Act (2020)
7. Regulation 2, The Income Tax (Digital Service Tax) Regulations (2020)
8. Section 12E, Income Tax Act, 1974
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26. Regulation 9, The Income Tax (Digital Service Tax) Regulations (2020)
27. Section 15A, The Tax Procedures Act (2015)
28. Section 19, Finance Act (2020)
29. Section 5(1), Kenya Revenue Authority Act (1995)

30. Section 10, The Income Tax (Digital Service Tax) Regulations (2020)
31. Section 35, Income Tax Act (1974)
32. Section 12E, Income Tax Act (1974)
33. Regulation 6, The Income Tax (Digital Service Tax) Regulations (2020)
34. Section 43, Income Tax Act (1974)
35. Section 3(1) (ca), Income Tax Act (1974)
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### **India Legislation**

1. Section 2(102), Central Goods and Services Tax (CGST) Act, 2017
2. Section 8, Central Goods and Services Tax (CGST) Act, 2017
3. Section 2(17), Integrated Goods and Services Tax (IGST) Act, 2017
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6. Section 15, Central Goods and Services Tax (CGST) Act, 2017
7. Rule 27-31, Central Goods and Service Tax (CGST) Rules,2017
8. Section 14, Central Goods and Services Tax (CGST) Act, 2017

### **Australia Legislation**

1. Section 5(9), New Tax System (Goods and Services Tax) Act, (1999)
2. Section 38, New Tax System (Goods and Services Tax) Act, (1999)
3. Section 23(15), New Tax System (Goods and Services Tax) Act, (1999)
4. Section 84(5), New Tax System (Goods and Services Tax) Act, (1999)
5. Section 9(80), New Tax System (Goods and Services Tax) Act, (1999)

## **LIST OF ABBREVIATIONS**

1. DST -Digital Service Tax
2. BEPS -Base Erosion and Profit Shifting
3. MNCs-Multinational companies
4. OECD-Organization for Economic Cooperation and Development's
5. KRA-Kenya Revenue Authority
6. SEPT-Significant Economic Presence Tax
7. LMICs-Low- and middle-income countries
8. DAISI-Digital Agricultural Innovations and Services Initiative
9. IMF- International Monetary Fund
10. GATT- General Agreement on Tariffs and Trade
11. GATS- General Agreement on Trade in Services
12. RTAs- Regional Trading Arrangements
13. VAT- Value Added Tax
14. VPB -Virtual Product Bundling
15. GST- Goods and Service Tax
16. HSN-Harmonized System of Nomenclature- HSN code
17. CGST- Central Goods and Services Tax
18. IGST -Integrated Goods and Services Tax
19. ESCO-Energy Service Company
20. ATO- Australian Tax Office
21. BAS- Business Activity Statement

## **ABSTRACT**

This research thoroughly examines the ambiguity within Kenya's Digital Tax framework on the taxation of bundled digital services. Bundled digital services offer multiple services as a package to consumers, they often combine taxable and non-taxable elements in the digital market. The core issue lies in the lack of clear definitions and classifications for taxable elements in a bundled package. Kenya's DST framework currently applies a blanket approach treating all listed digital services within the Incomes Tax Act as taxable regardless of the compositions in which these services are offered. As a result, there exists confusion for businesses and inefficient revenue collection. It is thus important to define taxable and non-taxable entities in a bundle more precisely to ensure tax fairness and administrative efficiency.

This paper, therefore, addresses the following key question: How can Kenya's DST framework be refined to more effectively tax bundled digital services? The study adopts a doctrinal methodology analyzing legal cases, tax reports, and relevant acts. A comparative analysis will also be adopted comparing the digital tax framework of India and Australia. There is a clear distinction between taxable services in India's goods and Service Tax framework and the periodic review mechanisms in Australia making these countries more relevant studies on addressing the complexity of taxing bundled digital services.

Some key findings have determined that the unclear broad-based approach of Kenya's DST hardens compliance for those business ventures offering various streamed services, cloud storage, and even e-commerce. Business enterprises find difficulties defining their liabilities for tax obligations without appropriate guidance; hence, they file taxes inconsistently with increased compliance costs. The government thus loses potential revenue. The research recommends clarity about the definition of bundled services and putting in place mechanisms that allow periodic reviews to adapt to the rapidly changing digital economy. These reforms will be key in improving equity, reducing compliance burdens, and simultaneously assure Kenya of sustainable revenue from the growing digital sector.

## CHAPTER 1

### 1.0 INTRODUCTION TO DIGITAL SERVICE TAXATION

The digital economy's rapid growth has changed how businesses operate and deliver services. This has prompted governments to introduce tax regimes like Kenya's Digital Service Tax (DST) to capture revenue from digital transactions.<sup>1</sup> However, taxing the digital economy presents enforcement challenges due to the complex nature of these transactions.<sup>2</sup> Kenya introduced its DST in 2021, imposing a 1.5% tax on gross income from digital services provided to Kenyan users, even for foreign companies with no physical presence in the country. The recent trend by digital providers is the provision of bundled services that combine taxable and non-taxable elements (e.g. software packages with free upgrades) or which combine many taxable digital elements as one package. The major challenge arising is calculating tax liability from these bundles. For example: If a multinational e-learning platform offers a subscription in Kenya for KES 3000 per month, this subscription includes access to live online classes which are taxable, recorded courses on demand available for a fixed duration which is taxable, and the provision of physical textbooks which are not taxable under the Section 12E of the Income Tax. There exists ambiguity in revenue allocation because KRA might tax the entire subscription as a digital service. Companies could exploit the bundling to minimize taxable digital revenue by artificially inflating the value of physical textbooks. Kenya's DST does not clearly distinguish taxable and non-taxable elements in bundled digital services which leads to an inconsistent application of tax. This lack of clear definitions and classifications within Kenya's DST framework creates a gap and inefficiency in tax administration and compliance.

This dissertation will follow this structure, Part I examines Kenya's DST framework and focuses particularly on taxing bundled digital services. Part II will identify gaps in definitions, classifications, and periodic review mechanisms, which complicate compliance and undermine effective revenue collection. Part III compares Kenya's framework with those of India and

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<sup>1</sup> United Nations Publications, *Digital Economy Report*, 2024, xxiv

<sup>2</sup> Kapkai P, Muthee I, Ngala B, Musa N, Wanyeri A & Gathoni E, *Enforcement of the Digital Economy Taxation*, 4 African Tax and Custom Review 1, 2021, 2

Australia- jurisdictions with clearer definitions and review systems, lessons will be drawn from these international jurisdictions to inform policy recommendations. Part IV will conclude the research with proposals and recommendations to enhance clarity, fairness, and efficiency in Kenya’s DST framework, alongside recognizing trends likely to emerge from these reforms.

## **1.1 BACKGROUND TO THE PROBLEM**

### **1.1.0 The Origin of Digital Service Tax**

Digital Service Tax (DST) arose in response to global concerns about multinational companies (MNCs), especially giant tech firms, not paying their fair share of taxes in countries where they generated a lot of revenue from users but had no physical presence.<sup>3</sup> As digital platforms grew, governments realized that previously existing tax systems were ill-equipped to capture profits created by users in different regions due to the nature of digital transactions.<sup>4</sup> This led to the Organization for Economic Cooperation and Development’s (OECD) Base Erosion and Profit Shifting (BEPS) project, which aimed to address these challenges and ensure taxes were paid where economic activity occurred. The OECD proposed reallocating tax rights and the idea of a global minimum tax for taxing digital services, it later began advocating for interim measures like DST.<sup>5</sup> In Europe, countries like the UK, France, Spain, and Austria began implementing DSTs to capture revenue generated from local users by foreign digital platforms.<sup>6</sup> Their main goal was to allocate a share of MNC profits to the countries where the gain is from user transactions. These proposals have led to the introduction of unilateral solutions, most notably the Digital Service Tax (DST) which imposes taxes on revenue from digital services.<sup>7</sup> Though these unilateral measures have faced

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<sup>3</sup> Stotzky R, Fano A, *Taxation in the Digital Economy: Digital Services Taxes, Pillar One, and the Path Forward* Bipartisan Policy Center,2023

<sup>4</sup> Enache C, *Taxation around the world*,2024,4

<sup>5</sup> KPMG, *Digital economy impact checklist: Update on Digital Services Tax developments*, Spain, 2019, 3 SEE ALSO, Johnston S , *Austria Proposes 5 Percent Digital Advertising Tax*, 2019, 4

<sup>6</sup> KPMG, *Digital economy impact checklist: Update on Digital Services Tax developments*,Spain, 2019, 3 SEE ALSO, Johnston S , *Austria Proposes 5 Percent Digital Advertising Tax*, 2019,

<sup>7</sup>Cui W, *The Digital Service Tax: A Conceptual Defense, Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*, National Tax Association,2018, 4

criticism, they reflect a growing recognition that digital platforms possess unique factors that challenge existing tax frameworks.<sup>8</sup>

### 1.1.1 Digital Service Tax in Kenya and Proposed Transformations

Through the Finance Act of 2020, Kenya introduced DST effective January 1, 2021, at a rate of 1.5% on the gross transaction value from digital services provided to Kenyan users. The tax applies to various services, including streaming, online advertising, and data monetization.<sup>9</sup> Both resident and non-resident service providers must register and remit taxes, moreover, non-residents file online every month. Initial revenue collections were low with KES 0.34 billion (USD 3.4 million) collected in the 2020/2021 financial year, falling short of the target. However, collections improved to KES 1.84 billion (USD 18.4 million) in 2021/2022 and KES 2.57 billion (USD 25.7 million) in 2022/2023<sup>10</sup>, this indicated better compliance among service providers. However, major tech firms like Google and Netflix have voiced concerns over the complexity of tax compliance and potential double taxation.<sup>11</sup> If these issues remain unresolved it could chase away digital service providers and investors from the industry. These issues have prompted Kenya Revenue Authority (KRA) to reconsider the DST framework, by revising rates or provisions to enhance digital investments while ensuring tax compliance. The rejected Finance Bill 2024 proposed replacing DST with a Significant Economic Presence Tax (SEPT), taxing 30% on 20% of gross profits based on economic activity rather than physical presence.<sup>12</sup> Although SEPT aimed at broadening the tax base, it failed to address gaps in defining bundled digital services and compliance complexity it thus faced criticism for increasing compliance burdens. Kenya's DST requires clearer definitions and classifications for bundled services as the current ambiguities undermine tax equity. This study proposes a detailed tax guide matrix to address the gaps and enhance the framework.

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<sup>8</sup> Organisation for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, 2018 [hereinafter OECD 2018 Report]. See especially Chapter 2.

<sup>9</sup> Wambui R, *Demystifying Digital Service Tax* Kenya Revenue Authority Blog 2021 < <https://www.kra.go.ke/news-center/blog/1074-demystifying-digital-services-tax> >- link on 06 December 2024

<sup>10</sup> Indenje D, *Kenya's Digital Tax Tightrope: Balancing Revenue with Growth*, KICTANet, 2024.

<sup>11</sup> Aloo H, *U.S tech giants push Kenya to drop 30% digital tax*, The Africa Report, 4 June 2024

<sup>12</sup> Clause 8, Finance Bill (2024) See also proposed amendment Section 12E, Income Tax Act(1974)

## **1.2 STATEMENT OF THE PROBLEM**

Regulations 3(1) and 3(3) of the Income Tax (Digital Service Tax) Regulations provide a clear and detailed distinction between taxable and non-taxable components relating to digital services. However, the framework does not take into account circumstances where digital service providers provide bundled services. This vulnerability continues to create room for manipulation and misinterpretation of taxes by service providers which affects effective collection of taxes. Digital service providers can assign higher values to non-taxable components like free delivery while assigning low values to taxable elements. This lack of compliance contravenes principle of taxation such as fairness and efficiency. Therefore this study will seek to examine the effects of lack of incorporation of bundled services in the Digital Service Tax framework while it proposes necessary recommendations.

## **1.3 PURPOSE OF STUDY**

The main aim of this study is to critically analyze Kenya's DST framework specifically on the taxation of bundled digital services to identify specific gaps and propose actionable recommendations. This research examines definitions, categorization challenges, and tax compliance issues within the DST framework. The research will further compare Kenya's approach to those of other jurisdictions such as India and Australia, which have developed more refined tax mechanisms for digital services. By exploring Kenya's DST challenges and examining international practices, this study contributes to the ongoing discourse on digital service taxation, providing policymakers with insights to improve DST efficiency and fairness.

## **1.4 HYPOTHESIS**

The lack of clear definitions, classifications, and periodic review mechanisms within Kenya's DST framework creates significant gaps in the taxation of bundled digital services, which results in inconsistent tax compliance and administrative difficulties. These loopholes hinder the effectiveness of DST in distinguishing between taxable and non-taxable components leading to an unfair tax burden for digital service providers.

## **1.5 RESEARCH QUESTIONS**

1. What is the legal framework on taxation of digital services?

2. What specific gaps and ambiguities exist within Kenya's Digital Service Tax (DST) framework on taxation of bundled services?
3. What lessons can be drawn from India and Australia which have successfully addressed taxing bundled digital services?
4. What policy recommendations can be proposed to refine Kenya's DST framework in taxing bundled services?

## **1.6 RESEARCH OBJECTIVE**

1. To examine the legal framework that justifies taxation of digital services.
2. To identify specific gaps in Kenya's Digital Service Tax framework and its effects on tax compliance.
3. To conduct a comparative analysis between India, Australia, and Kenya to draw lessons on how to successfully tax bundled digital services in Kenya.
4. To propose policy recommendations to improve Kenya's DST framework to better accommodate complexities associated with bundled services.

## **1.7 JUSTIFICATION OF STUDY**

This research addresses a gap in understanding the taxation of bundled services under Kenya's DST framework. By analyzing the existing framework and identifying its ambiguities, the study contributes to digital taxation knowledge in the context of Kenya's unique challenges and needs. The research provides practical recommendations for policymakers, tax administrators, and digital businesses. For policymakers, the research offers insights into refining the DST to enhance tax clarity and compliance. The dissertation also provides a clearer understanding of DST requirements for digital service providers, reducing compliance burdens. In conclusion, the research aims to support a fairer, more effective tax regime for Kenya's growing digital economy.

## **1.8 METHODOLOGY**

This dissertation adopts a doctrinal research approach and a comparative analysis to examine gaps and ambiguities in Kenya's Digital Service Tax framework to propose actionable reforms. The doctrinal research will focus on thoroughly interpreting legal texts, such as Kenya's Finance Act 2020, DST Regulations, and related judicial decisions, to identify gaps and inconsistencies in taxing bundled services. Comparative analysis is also used to benchmark Kenya's framework against those of India and Australia, these jurisdictions have clearer mechanisms established for defining and taxing bundled services while implementing periodic reviews. Data for this study is sourced from Kenyan statutes, International guidelines (OECD), BEPS Action Reports, and scholarly works by authors such as Lukas Erbrich and Tereso S. Tullao Jr. Kenya Revenue Authority complements these reports and other public documents. Comparative insights from India and Australia inform practical recommendations to meet Kenya's unique context. This methodology ensures a structured approach to addressing research objectives while acknowledging limitations for example limited data availability. These limitations will be mitigated by relying on publicly available reports, and relevant jurisdictions for comparison, and recommending periodic review mechanisms for the DST framework.

## **1.9 SCOPE AND LIMITATION OF STUDY**

The research focuses on Kenya's DST framework specifically, taxation of bundled digital services, in particular, the lack of clear definitions and guidelines for distinguishing taxable from non-taxable components. This study is limited by the availability of data on DST compliance among digital businesses in Kenya. In addition, the analysis is focused on Kenya and does not fully cover the broader international tax landscape beyond selected comparative jurisdictions

## **1.10 THEORETICAL FRAMEWORK**

### **1.10.1 Introduction**

This research is grounded in fundamental principles within the tax theory. Scholars have emphasized the necessity of these principles in developing a fair and efficient tax policy. The

hypothesis posits that the insufficiencies within Kenya's Digital Tax (DST) framework hinder compliance and undermine tax equity. By clearly defining and categorizing bundled services, this study explores how the mentioned theoretical constructs impact the effectiveness of Digital Service Tax. This research focuses on the **Ability to Pay principle and Benefit principle** to allow for the evaluation of fairness and accountability in Kenya's Digital Service Tax framework, ensuring providers contribute equitably based on their financial capacity and the benefits they receive from users.<sup>13</sup> Moreover, The dissertation further incorporates **Tax Neutrality** to emphasize the need for consistent treatment among service providers and promote economic efficiency, ultimately guiding recommendations for a more effective and equitable tax system.<sup>14</sup>

### 1.10.2 Tax Theories

#### i) Ability to Pay Theory

This principle is grounded in the tax equity theory and was notably advanced by Richard Musgrave.<sup>15</sup> He emphasizes the role of this principle when designing tax structures with specific benefits from public services that are difficult to ascertain. The ability-to-pay principle asserts that taxes should be distributed based on individuals' economic capacity, emphasizing equity over direct benefit from public services.<sup>16</sup> The principle is based on the concept of sacrifice, where individuals' contributions are assessed based on the burden they experience when paying taxes. According to this theory when one's wealth increases, the additional value derived from each currency unit diminishes, making it more equitable for the wealthier to bear a larger burden.<sup>17</sup>

This research concedes with Musgrave's analysis for the following reasons the tax burden should be distributed among individuals based on their economic capacity. He emphasizes the

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<sup>13</sup>Kenton W, *Ability To Pay Overview and Examples in Tax law*, 2020

<sup>14</sup> Donald R, *The Lindahl solution for economies with public goods*, 3 Journal of Public Economics 1,1974, 23-42  
See Also Jonathan G, *Public Finance And Public Policy*, 5ed, Worth Publishers Incorporated, 2016, 243-246

<sup>15</sup> Musgrave R, Musgrave P, *Public Finance And Theory in Practice*, 5 ed, McGraw-Hill Book Co Singapore, 223

<sup>16</sup> Musgrave R, Musgrave P, *Public Finance And Theory in Practice*, 5 ed, McGraw-Hill Book Co Singapore, 223  
See also See John Stuart Mill, *Principles of Political Economy*, edited by W. J. Ashley, London: Longmans, 1921, 804.

<sup>17</sup>Kendrick M, *The Ability to Pay Theory of Taxation*,29 The American Economic Review,1,1939,92-101

importance of defining all forms of income comprehensively when used as a measure of ability to pay. Musgrave's analysis provides a key framework for addressing equity issues in Kenya's DST on bundled digital services. Musgrave's Ability-to-Pay Principle provides a critical framework for addressing equity issues in Kenya's Digital Service Tax (DST) on bundled digital services. The principle emphasizes horizontal equity, requiring that entities with similar revenue capacities to face similar tax burdens, and vertical equity, mandating higher contributions from providers with greater economic capacities. However, Kenya's DST framework lacks clear guidelines for apportioning taxable and non-taxable components within bundled services, this leads to inconsistent applications that undermine fairness. Furthermore, the absence of comprehensive definitions for income and revenue from such services hinders accurate tax assessments. Based on Musgrave's insights, this dissertation proposes mechanisms to enhance equity, such as adopting clear apportionment rules, defining income comprehensively, and introducing tax structures to ensure larger providers contribute more proportionately. These measures would align the DST framework with the principles of fairness and equity, addressing its current ambiguities.

## **ii) Benefit Principle**

The benefit principle of taxation was proposed by classical economist Adam Smith and later refined by others. Adam Smith argues that taxpayers should contribute to public revenue in proportion to the benefits they receive from government services.<sup>18</sup> While he applied these principles to older forms of taxation, their relevance still extends to modern contexts like digital economies. In the context of digital services, taxpayers get different degrees of benefits from infrastructure, regulatory frameworks, and public services that enable the digital economy to thrive. The lack of clear definitions and periodic review mechanisms in Kenya's DST undermines the alignment between taxation and benefits received. Smith's emphasis on equity and proportionality provides a foundational argument for refining Kenya's approach to taxing digital services to ensure fairness.

Following Smith's ideas on these aspects, Ernst Lindahl took the development of Smith's arguments one step further, and the benefit principle was integrated with public goods.<sup>19</sup> In

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<sup>18</sup> Smith A, *Wealth Of Nations*, Wordsworth Classics of World Literature. England,2012, 330

<sup>19</sup>Peyton H, *Equity: In Theory and Practice*,Princeton University Press,1994, 103

that direction, Lindahl's model derives from the idea that everybody's taxes should be directly determined by his marginal gain or profit that he accrues from the public goods themselves and therefore reach an appropriate allocation of resources from society's perspective.<sup>20</sup> In the context of bundled digital services, Lindahl's equilibrium points to the need for appropriate mechanisms that would clearly identify and apportion tax liabilities in respect of benefits derived from taxable and non-taxable components of such bundled services. The application of Lindahl's insight in the Kenyan DST framework therefore requires periodic reviews to ensure that tax policies are in step with emerging patterns of benefit distribution in the digital economy. For instance, since many digital services have value-conferring elements in asymmetric ways for users, failure to address such nuances risks imposing disproportionate tax burdens that could stifle innovation and economic growth.

This research is in line with Adam Smith and Lindahl's preposition, basing the dissertation on this principle allows for a critical analysis of Kenya's DST through a dual lens, the proportional contribution of services, and equitable tax apportionment. This theoretical framework will guide the evaluation of the ambiguity in defining bundled digital services and the absence of mechanisms to adjust tax policies in response to market changes. Aligning Kenya's DST with the benefit principle enhances its effectiveness in ensuring that tax is fair and conducive to economic efficiency. The dissertation will provide practical recommendations for reforming Kenya's DST by incorporating the benefit-based principle by comparing jurisdictions that have successfully incorporated the principle into their digital tax regimes.

### **iii) Tax Neutrality**

Tax neutrality is a concept in public finance proposed by economist James Mirrlees. Mirrlees advocates for a tax system that balances efficiency and equity while minimizing distortions in economic behavior. Mirrlees explored how tax systems could be structured to achieve desired social outcomes without distorting individual incentives.<sup>21</sup> He argued that while some distortions in consumption and labor supply are inevitable, there is no justification

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<sup>20</sup> Donald R, *The Lindahl solution for economies with public goods*, 3 Journal of Public Economics 1,1974, 23-42  
See Also Jonathan G, *Public Finance And Public Policy*, 5ed, Worth Publishers Incorporated, 2016, 243-246

<sup>21</sup> Feldstein M, *The Mirrlees Review*, 50 Journal of Economic Literature 3,2012,781-790

for distorting production. This has implications for tax policy design, suggesting that optimal tax rates should be flatter than the previously assumed high marginal tax.

Adam Smith's argument is in line with James Mirrlees's, which emphasizes that a tax system should not interfere with the natural functioning of markets.<sup>22</sup> Tax neutrality is relevant to the taxation of bundled digital services under Kenya's DST framework. Bundled services include a mix of taxable and non-taxable components and the ambiguity in defining these bundles risks violating neutrality. Unclear tax guidelines could lead to over-taxation of certain digital services while undertaking others, thus distorting the market competition and influencing providers' pricing or service offerings. This lack of neutrality could discourage innovation in the digital sector by creating an uneven playing field where businesses face inconsistent tax burdens. In addition, the absence of periodic review mechanisms in Kenya's DST increases the risk of neutrality violations. As the digital economy evolves, outdated tax rules may impact certain services or sectors, leading to inefficiencies that undermine economic growth.

The dissertation will utilize the principle of tax neutrality to assess the DST framework's effectiveness and propose reforms to reduce distortionary effects. First, the study will analyze the current ambiguity in defining taxable and non-taxable components of bundled services that create distortions in the digital market. This analysis will highlight cases where tax policy has unintentionally favored certain services or providers in market competition. This principle will also serve as a criterion for evaluating Kenya's DST framework against international practices. By comparing Kenya's approach with other jurisdictions that have implemented neutral and efficient digital taxation systems, the dissertation will adopt a strategy to harmonize market dynamics while avoiding distortions.

### **1.10.3 Conclusion**

The ambiguity in Kenya's DST particularly how it addresses bundled digital services creates an obstacle to achieving equity and efficiency in taxation. These ambiguities result in

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<sup>22</sup> Smith A, *Wealth Of Nations, Wordsworth Classics of World Literature*, England, 2012, 330 See also Ralph T, Erik Lindahl, 62 *Ekonomisk Tidskrift* 1, 1960, 5-8

inequitable tax burdens, inconsistent treatment of businesses, and reduced economic efficiency. By applying the above principles, it becomes clear that clearer definitions, guidelines, and periodic reviews of the DST framework are necessary. These reforms will reduce distortions ensuring a level playing field and enhancing the predictability of tax obligations for digital businesses in Kenya for efficient tax administration.

## **1.11 LITERATURE REVIEW**

### **1.11.1 Introduction**

The taxation of bundled digital services is a relatively new and dynamic problem for the tax authorities, as such transactions reflect a range of service types, each with different taxation characteristics. Kenya's government gets its revenue through the Digital Service Tax (DST) but it still struggles with defining and categorizing bundled services. By analyzing these themes applied to the context of prior literature, this literature review provides information on how Kenya's DST framework can be improved and discusses other dimensions of bundled digital services and their tax characteristics.

Key themes covered include the behavioral aspects of consumption of bundled services, the implications of bundling for policy and the economy in the digital environment, and compliance and fairness issues that bundled services raise for tax systems. Lastly, the literature presents regional and global approaches to digital service taxation to help the reader gain a comparative understanding of the issue for the Kenyan environment. Lukas Erbrich, Tereso S. Tullao Jr., Jennifer Burney, and other sources including Agrilinks empirically analyze bundled digital services and stress the importance of definition, fairness, and regularity within DST categories.

These themes, develop the dynamics of taxing bundled digital services for understanding and highlight the gaps of knowledge that will set the future study of Kenya's DST approach. The analysis of these articles will guide the study in determining how Kenya's DST framework can be better formed to fit the current and changing environment of recessed digital services while at the same time being fair in its taxation.

### 1.11.2 Understanding Digital Service Bundling and Consumer Behaviour

Lukas Ebrich discusses the growing popularity of bundling in digital services, particularly in industries like music, video streaming, and digital journalism.<sup>23</sup> Bundling is where multiple products or services are offered together, is shown to increase consumers' willingness to pay, attract higher subscription rates, and boost engagement. Ebrich argues that in digital journalism, bundling attracts consumers who value variety and convenience over committing to individual content providers.<sup>24</sup> He terms this approach as the 'Spotify for News' which provides access to multiple news sources at a single price, this shows modern consumer preferences for flexibility and accessibility.<sup>25</sup> In addition, bundling helps address price sensitivity by lowering the perceived cost of accessing multiple services, this is a key factor in competitive markets. Younger consumers prefer cross-publisher bundles over single subscriptions since the latter is restrictive in the array of services that they receive.<sup>26</sup> Ebrich's research highlights how bundling expands the audience base, increasing consumer satisfaction, and reducing customer churn by aligning with digital consumers' demand for variety and more convenience.

Similarly, Stefan Holzweber agrees with Ebrich's findings, he highlights how tying and bundling practices in digital markets shape consumer behavior and market dynamics. He emphasizes that there exist consumer biases in these markets.<sup>27</sup> For example, in the Microsoft case, many users opted for pre-installed software like Internet Explorer because they lacked the willingness to seek alternatives.<sup>28</sup> Consumers perceive bundling as economically beneficial. Holzweber notes that bundling offers cost savings or simplifies access to multiple services, making it appealing to users. This preference for convenience often leads consumers

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<sup>23</sup>Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press,2024, 2 See Also Adams J, Yellen Y, *Commodity bundling and the burden of a monopoly*, 90 The Quarterly Journal of Economics 3,1976, 475-498

<sup>24</sup>Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press,2024, 4

<sup>25</sup>Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press,2024, 4

<sup>26</sup>Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press,2024, 4

<sup>27</sup>Holzweber S, *Tying and bundling in the digital era*, 14 European Competition Journal 2-3, 2018, 18

<sup>28</sup>*Microsoft Corporation v Communities of European Communities* (2007) Court of First Instance (Grand Chamber), European Court.

to favor bundled services, even when unbundled options might meet their needs.<sup>29</sup> The perceived value in bundling can reinforce the market position of firms that control access to key bundled services.<sup>30</sup> Through these observations, Holzweber provides a nuanced view of how consumer behavior and market dynamics interact with tying and bundling, particularly in the digital era. Echoing both authors, Richard Thaler supports that bundling affects consumer preferences, he highlights that consumers do have a bias when toward bundled services.<sup>31</sup> Dan Ariely also supports this by stating that consumers can purchase things out of perceived value other than utility.<sup>32</sup>

Guillaume Roels is of a contrary view on bundling digital services, he argues that the concept of bundling can be a strategic approach to product differentiation however it might also stifle competition by allowing firms to dominate and bar potential market entrants.<sup>33</sup> This perspective suggests that when a single firm bundles products and offers them exclusively, it can create barriers for new competitors, this limits consumer choices and potential higher prices in the future. He highlights that bundling is not inherently beneficial it can be used as a tool to extract surplus from consumers. This view raises concerns about the implications of bundling practices on consumer welfare.<sup>34</sup>

This study acknowledges the authors' insights that bundling leverages the modern consumer preference for variety and convenience, addressing cost concerns while increasing the perception of value. That is particularly true in subscription-based markets where competition and price sensitivity are major barriers to engagement. Ebrich's and Holzweber's analysis provides a strong foundation for discussing the ambiguity in taxing bundled digital services under Kenya's DST framework. His findings on consumer behavior such as the preference for variety and the economic appeal of bundled services support the argument that taxation policies need to distinguish between bundled and single services. By incorporating

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<sup>29</sup> Holzweber S, *Tying and bundling in the digital era*, 14 European Competition Journal 2-3, 2018, 23

<sup>30</sup> Holzweber S, *Tying and bundling in the digital era*, 14 European Competition Journal 2-3, 2018, 3

<sup>31</sup> Thaler R, *Nudge: Improving Decisions About Health, Wealth, and Happiness*. New Haven, Yale University Press, 2008, 293

<sup>32</sup> Ariely, D, *Predictably Irrational: The Hidden Forces That Shape Our Decisions*. New York: HarperCollins, New York, 2008, 138-153

<sup>33</sup> Roels G, Khodabakhshlan A, Karmarkar, *Competitive Bundling and Offer Design in a Symmetric Bertrand Duopoly Service Science*, 15 Informs 4, 2023, 250-265

<sup>34</sup> Roels G, Khodabakhshlan A, Karmarkar, *Competitive Bundling and Offer Design in a Symmetric Bertrand Duopoly Service Science*, 15 Informs 4, 2023, 250-265

these insights, I can argue that the current lack of clarity in Kenya's DST might inadvertently stifle innovation or misclassify bundled services, thus undermining its effectiveness in the rapidly evolving digital economy. This analysis will help demonstrate how other jurisdictions could handle similar issues paving a proposed tailored policy recommendation for Kenya.

### **1.11.3 Policy and Economic Implications of Bundling Mechanism and Digital Services**

Tullao's insights on the policy and economic implications of bundling mechanisms in digital services explain that bundling allows service providers to combine digital services with other offerings creating a seamless user experience. This approach enhances consumer adoption and drives revenue streams for businesses.<sup>35</sup> However, the bundling mechanism complicated tax policies, as existing frameworks are often inadequate to address the layered nature of bundled services. Tullao also highlights the economic implications of bundling, particularly for emerging markets. He notes that bundling increases market competitiveness by enabling businesses to offer diverse packages and cater to a broader audience.<sup>36</sup> However, this diversification can blur the lines between taxable and non-taxable services. Ambiguities in classifying bundled services can unfairly burden businesses incorporating taxable components or overlook potential tax revenue from certain digital transactions.

Furthermore, Gilles Le Blanc adopts a qualitative research methodology and empirical case study to explore the implications of bundling. Gilles Le Blanc explores the policy and economic dimensions of bundling, especially in telecommunication and digital services, shedding light on its implication for market efficiency, competition, and regulatory frameworks. He argues that bundling aims to enhance consumer satisfaction and offer comprehensive service packages.<sup>37</sup> Economically, bundling enables firms to achieve significant cost savings and economies of scale, especially with digital services, companies can streamline operations and reduce transaction costs.<sup>38</sup> However, bundling also increases

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<sup>35</sup> Tullao T, Croce D, *Resurgence of Bundling Mechanisms in Digital Services Trade*, Working Paper Seies No. 8, 073,2021, 5 <[https://animorepository.dlsu.edu.ph/res\\_aki/12](https://animorepository.dlsu.edu.ph/res_aki/12)>- link on 8th November 2024

<sup>36</sup> Tullao T, Croce D, *Resurgence of Bundling Mechanisms in Digital Services Trade*, Working Paper Seies No. 8, 073,2021, 14 <[https://animorepository.dlsu.edu.ph/res\\_aki/12](https://animorepository.dlsu.edu.ph/res_aki/12)>- link on 8th November 2024

<sup>37</sup> Leblanc G,*Bundling Strategies, Competition and Market Structure in the Digital Economy*, 41 Communication & Strategies 1,2001, 190 See Also Khodabakhshian A, Bundling under Competition: Duopoly and Oligopoly, Published PhD,University of Carlifornia, Los Angeles, 2019, 18

<sup>38</sup>.Leblanc G,*Bundling Strategies, Competition and Market Structure in the Digital Economy*, 41 Communication & Strategies 1,2001, 200

switching costs for consumers raising barriers to entry of smaller competitors. This can consolidate the market power of big firms and stifle the innovation of small players.<sup>39</sup>

Bundling presents problems for sector-specific regulation and competition law from a policy standpoint. Stricter regulatory control and coordination are required due to dominant businesses' potential to use bundling to expand their market clout across multiple sectors. Furthermore, the combination of competitive markets with monopolistic services creates complications that need flexible regulatory solutions. Pricing transparency and unambiguous service terms are crucial for safeguarding customers, as bundling frequently takes advantage of their need for ease and convenience. Bundling has also become a potent entrance technique due to the convergence of industries including media, telecom, and the internet. This can change market dynamics and raise worries about using dominance in one area to influence others. Joseph Stiglitz gives an opposing view that information asymmetry also appears in highlighting how bundling can obscure the true costs from consumers making it a better marketing strategy for service providers<sup>40</sup> thus large firms can use this to create monopoly dominance.<sup>41</sup>

This research acknowledges the authors' assessment of the complexities introduced by bundling especially in the Kenyan context. The ambiguity in classifying bundled digital services is indeed a significant challenge that can lead to inconsistent taxation, undermining the effectiveness and fairness of the DST framework. The argument that bundling provides economic benefits is valid but failure of the current tax structure to address complexities could lead to economic distortions, such as unintended tax burdens or missed revenue opportunities. Le Blanc's insights provide a foundation for understanding the complexities of taxing bundled digital services under the DST framework which is the main focus of this study. The findings emphasize the need for transparent policies that account for innovation and ensure fair competition. The study of empirical case studies and theoretical models in this research serves as a guide for developing a structured analysis of how bundling impacts taxation, consumer

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<sup>39</sup> Leblanc G, *Bundling Strategies, Competition and Market Structure in the Digital Economy*, 41 *Communication & Strategies* 1, 2001, 187

<sup>40</sup> Stiglitz J, Weiss A, *Credit Rationing in Markets with Imperfect Information*, 71 *American Economic Review* 3, 1981, 393-410

<sup>41</sup> Krugman P, *Competitiveness: A Dangerous Obsession*, 73 *Foreign Affairs* 2, 1994, 28-44

behavior and market dynamics will help recommend tax policies that balance efficiency without affecting the growth of Kenya's digital economy.

Tullao's suggestions lay the foundation of my dissertation. The issue of ambiguous tax definitions is at the core of this research. He calls for a more nuanced approach that aligns with the objectives of proposing a more precise effective taxation mechanism for Kenya's DST framework. This perspective will support the analysis of how bundling complicates the application of DST and informs the policy recommendations.

#### **1.11.4 Bundling in the Context of Agricultural Digital Services**

Abdul Latif's article from Jameel Poverty Action Lab highlights the potential of digital and bundled services in agriculture, framing research to address gaps in how these services impact small-scale farmers. The initiative (DAISI) prioritizes exploring adoption rates, outcomes, and performance factors of bundled agricultural services to inform policy and practice, especially in regions like sub-Saharan Africa and South Asia.<sup>42</sup> Amartya Sen argues that bundled services are key in the provision of essential services, especially to marginalized groups.<sup>43</sup> Diane Coyle supports this argument claiming that technology is now advanced and its ability to provide more than one service at once can help rural communities through effective bundling mechanisms.<sup>44</sup>

Concerning Kenya's Digital Service Tax (DST), this theme underscores the need for a framework that accommodates the economic and social benefits of bundled services. As bundles help fight multiple constraints for farmers, equitable tax treatment becomes important to prevent hindering access to essential services. Incorporating these findings advocates for Kenya's DST framework to provide clearer guidelines and potential tax exemption for socially beneficial bundles, ensuring the DST policies do not hinder agricultural development.

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<sup>42</sup> Digital Agricultural Innovations and Services Initiative (DAISI). Poverty Action Lab  
<<https://www.povertyactionlab.org/initiative/digital-agricultural-innovations-and-services-initiative-daisi>>-link  
on 8th October 2024

<sup>43</sup> Sen A, *Development as Freedom*, Knopf, New York, 1999,366

<sup>44</sup> Coyle D. *Cogs and Monsters: What Economics Is and What It Should Be*. Princeton University Press, Princeton, 2019, 192

There is an increasing awareness that the bundling of digital services can be a vital strategy for enhancing access to essential resources for smallholder farmers and improving fundamental needs in rural communities. According to Larsen, bundled digital services—delivered via mobile platforms or through multi-channel approaches such as combining radio with mobile—have shown significant potential to boost agricultural productivity, resilience, and food security in low- and middle-income countries (LMICs).<sup>45</sup> By providing a unified platform offering various services, including financial, advisory, nutritional, and weather-related information, bundling addresses persistent challenges like digital literacy and infrastructure limitations. These bundled services promote inclusiveness by targeting women, youth, and other marginalized groups often excluded from accessing agricultural innovations.<sup>46</sup>

Abate Gashaw opposes Latif’s positive framing of bundled digital services in agriculture. He critiques the effectiveness and scalability of bundling digital services for smallholder farmers. He argues that while bundling has potential to enhance access to essential resources, there are barriers that limit its success.<sup>47</sup> He highlights that high cost and lack of digital literacy and infrastructure challenges bar the widespread adoption of these services.<sup>48</sup> This perspective contrasts with Latif’s view on bundled services suggesting that without addressing these challenges, benefits of bundling may not be realized. Moreover he emphasizes that the complexities in bundling can confuse farmers on which services are most beneficial for their needs. This can result to lack of trust in digital platforms limiting effectiveness and adoption.<sup>49</sup>

This holds clear implications for Kenya’s DST framework. A thoughtfully designed, Kenya's DST can foster equitable access by adopting tax policies that encourage, rather than discourage, the deployment of such beneficial services. However, the current DST framework lacks clarity on the taxation of bundled services, potentially increasing tax burdens on critical

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<sup>45</sup> Larsen L, *Frontiers of Ecology and The Environment*, 13 Ecological Society of America (United States) 9, 2003,490

<sup>46</sup> Larsen L, *Frontiers of Ecology and The Environment*, 13 Ecological Society of America (United States) 9, 2003, 488

<sup>47</sup> Kieti J, Waemaa T, Baumüller H, Ndemoc E, Omwansaa T, *What really impedes the scaling out of digital services for agriculture? A Kenyan users’ perspective*, 2 Smart Agricultural Technology 100034, 2022, 5

<sup>48</sup> Kieti J, Waemaa T, Baumüller H, Ndemoc E, Omwansaa T, *What really impedes the scaling out of digital services for agriculture? A Kenyan users’ perspective*, 2 Smart Agricultural Technology 100034, 2022, 5

<sup>49</sup> Kieti J, Waemaa T, Baumüller H, Ndemoc E, Omwansaa T, *What really impedes the scaling out of digital services for agriculture? A Kenyan users’ perspective*, 2 Smart Agricultural Technology 100034, 2022, 5

agricultural bundles. This dissertation emphasizes the need to differentiate between purely commercial digital bundles and those with developmental impacts, recommending that Kenya's DST framework consider exemptions or favorable tax treatment for bundled services aimed at rural and agricultural sectors. Resolving these tax ambiguities can help Kenya build a more inclusive digital economy that supports sustainable development in underserved communities.

### 1.11.5 Challenges in Taxing Bundled Digital Services

Lyla Latif's research on fairness in digital taxation looks at how underdeveloped nations, such as Kenya, confront considerable opportunities and challenges when it comes to taxing the internet economy through consumption taxes like VAT.<sup>50</sup> While these taxes can extend the tax base and raise revenue, they also provide administrative and compliance concerns. The IMF's Fiscal Monitor (2021) echoes this sentiment, discussing options for successfully taxing the digital economy while taking into account the issues created by bundled services.<sup>51</sup> Thomas Piketty raises concerns that poorly structured tax systems can increase economic disparities.<sup>52</sup>

Tereso S. Tullao, Jr.'s paper highlights the complexities introduced by bundling mechanisms in digital services trade, particularly in the context of taxation and international trade policies. Bundling, where goods are sold alongside services such as delivery, online shopping, and transportation, creates significant challenges in applying trade policies. A primary issue is determining the appropriate tax jurisdiction and rules for transactions that span multiple regions.<sup>53</sup> For example, a product consumed in one country might involve services delivered from several others, complicating tax enforcement and compliance. Existing frameworks like the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS) struggle to address these intricate transactions. Issues such as rules of origin and preferential treatment under Regional Trading Arrangements

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<sup>50</sup> Latif L, *The Evolving Thunder: The Challenges Around Imposing the Digital Tax in Developing African Countries*, University of Nairobi, Centre for Financial Studies, Nairobi, 2022, 34-50

<sup>51</sup> International Monetary Fund, *Fiscal Monitor: Addressing the Crisis*, 2021

<sup>52</sup> Piketty T, *Capital in the Twenty-First Century*, Harvard University Press, Cambridge, MA, 2014, 330

<sup>53</sup> Tullao T, Croce D, *Resurgence of Bundling Mechanisms in Digital Services Trade*, Working Paper Series No. 8, 073, 2021, 25 <[https://animorepository.dlsu.edu.ph/res\\_aki/12](https://animorepository.dlsu.edu.ph/res_aki/12)>- link on 8th November 2024

(RTAs) become problematic when goods and services cross borders as interconnected packages.<sup>54</sup>

Moreover, digital platforms often generate additional economic value through the collection and monetization of user data used to apportion where profits are gained, this adds another layer of complexity to tax systems due to the nature of the transactions. The ability to monetize data not only reduces operational costs through economies of scale but also raises critical questions about tax jurisdiction and the fair allocation of revenue among countries.<sup>55</sup> Without adequate policies, this data-driven economic model risks exacerbating global inequities, increasing tax evasion, and fostering a race to the bottom in tax rates, which could undermine fiscal capacities. Tullao emphasizes the urgent need for international cooperation to create adaptive tax frameworks that reflect the realities of digital services trade, ensuring fair taxation and reducing ambiguities.<sup>56</sup>

In the context of Kenya's Digital Service Tax (DST) framework, Tullao's insights underscore the importance of addressing ambiguities in taxing bundled services. Kenya needs clear guidelines to distinguish between commercial bundles and those with developmental purposes, such as services aimed at underserved communities in agriculture or education. Establishing a fair and coherent DST framework would encourage service providers to offer valuable services to marginalized groups, reduce uncertainty, and foster both economic growth and social equity. By addressing these gaps, Kenya can ensure its tax system supports its digital economy while promoting inclusivity and sustainable development. Michael Porter argues that a competitive advantage framework with clear tax policies can enhance market efficiency promoting innovation rather than creating barriers.<sup>57</sup>

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<sup>54</sup> Vincent W, *Trade Rules for the Digital Age*, Cambridge University Press, 2008, 2

<sup>55</sup> Mooji R, Klemm A, Perry V, *Corporate Income Taxes under Pressure Why Reform Is Needed and How It Could Be Designed*, International Monetary Fund, 2021, 388

<sup>56</sup> Tullao T, Croce D, *Resurgence of Bundling Mechanisms in Digital Services Trade*, Working Paper Seies No. 8, 073, 2021, 14 <[https://animorepository.dlsu.edu.ph/res\\_aki/12](https://animorepository.dlsu.edu.ph/res_aki/12)>- link on 8th November 2024

<sup>57</sup> Porter M, *Competitive Advantage: Creating and Sustaining Superior Performance*, Free Press, New York, 1985, 392

### **1.11.6 Conclusion**

The authors and articles examined reveal a shared recognition of both the potential and challenges presented by bundled digital services in low- and middle-income countries. Authors like Larsen, Tullao, and others agree that bundled digital services, particularly in sectors like agriculture, enhance accessibility, economic productivity, and inclusivity for marginalized groups. However, they consistently highlight that the lack of a clear tax policy for these bundles leads to legal and operational ambiguities, especially when combined with developmental and commercial services.

This consensus underscores the legal gap you are addressing in Kenya's Digital Service Tax (DST) framework: the need for clear, nuanced guidelines that distinguish between bundles with purely commercial value and those serving essential developmental purposes. This gap creates uncertainty, potentially deterring providers from offering valuable bundled services to underserved communities. Establishing a more precise DST framework would ensure fair taxation that supports both economic growth and social equity in Kenya's digital economy.

### **1.12 CHAPTER BREAKDOWN**

This dissertation will be structured as follows:

**Chapter 1:** Introduces the research topic, problem, research methodology, and objectives. It further provides a theoretical framework linked to the objectives and literature review.

**Chapter 2:** Analyzes Kenya's DST framework and its scope, focusing on its application to bundled digital services.

**Chapter 3:** Identifies gaps in Kenya's DST framework and its implication on bundled services.

**Chapter 4:** Compares Kenya's approach to those of other jurisdictions, particularly India and Australia

**Chapter 5:** Offers recommendations and conclusions, proposing reforms to improve Kenya's DST framework

## **1.13 CONCLUSION**

This chapter introduced the research topic, identified the key problem, and outlined the research questions and objectives. It highlighted the ambiguity within Kenya’s Digital Service Tax framework in taxing bundled digital services and analyzed Kenya’s approach compared to other jurisdictions. The chapter outlined the study's scope, significance, and expected contribution, providing an overview of the structure and anticipated conclusions. Overall, the study aims to propose practical policy recommendations for a more effective and equitable DST framework in Kenya.

## **CHAPTER 2**

### **2.0 ANALYSIS OF KENYA’S DIGITAL SERVICE TAX FRAMEWORK**

#### **2.1 Introduction**

Kenya’s Digital Service Tax (DST) was introduced as part of the OECD's broader strategy to capture revenue from the rapidly growing digitized business landscape.<sup>58</sup> While Kenya’s DST is a significant step towards modernizing tax collection, its application to bundled digital services remains underdeveloped. Bundled digital services, which often combine taxable and non-taxable components, present unique challenges in taxation, including defining taxable elements, apportioning value, and ensuring compliance.

This chapter analyses Kenya’s DST framework, focusing on its application to bundled digital services. It begins with an overview of the legislative and regulatory context, highlighting the aim and scope of DST. This chapter then examines the framework’s approach to bundled digital services, thus identifying ambiguities in definitions and enforcement. Challenges, such as revenue apportionment and the risk of double taxation, are also analysed to understand the framework’s limitations. Highlighting these issues, this chapter lays the groundwork for identifying gaps in Chapter 3 and proposing comparative insights in later chapters.

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<sup>58</sup> *Congressional Research Service, The OECD/G20 Pillar 1 and Digital Service Taxes: A Comparison*, 2024, 4

## 2.2 Legal Basis of Kenya's DST Framework

Article 209 of the Constitution of Kenya provides for the government's authority to impose tax on income, capital, and wealth and on goods and services in the national government.<sup>59</sup> It also provides for the legal requirement on how the tax should be imposed, its assessment, collection, and enforcement under Article 210.<sup>60</sup> The Constitution also provides that the taxation framework introduced should be efficient, effective, and fair. These constitutional obligations are justified by reference to the Finance Act and Income Tax (Digital Service) Regulations. In addition, the legal framework ensures that the government can fairly tax the digital economy while protecting the rights of both users and providers.

Kenya's DST was legislated in the Finance Act 2020 and commenced on 1st January 2021.<sup>61</sup> The Finance Act 2020 amended Section 12 (A) of the Income Tax Act by inserting Section 12E of the Act, which provides for the taxation of digital services. DST is rated at 1.5 % on the gross transactional value for digital services under the Act.<sup>62</sup> Thirdly, the subsidiary legislation justified by Section 130 of the Income Tax Act is the Income Tax (Digital Service Tax) Regulations, 2020, which came into force in January 2021 and offset the rules in the taxation of digital services. Regulation 2 defines key terms that play a key role in understanding where the context of Kenya's DST lies. A digital service means any service delivered or provided over a digital marketplace.<sup>63</sup> A digital market provider is a person who provides a digital marketplace platform for digital transactions. On the other hand, a digital service provider is the person providing the services in the digital market.<sup>64</sup> A platform means any electronic application that allows digital service providers to access service users, directly or indirectly, through websites and mobile applications.<sup>65</sup>

Digital Service Tax is the tax payable on income or gains derived or accrued in Kenya from services offered through the Internet or any electronic network, application, or website.<sup>66</sup>

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<sup>59</sup> Article 209, *Constitution of Kenya* (2010)

<sup>60</sup> Article 210, *Constitution of Kenya* (2010)

<sup>61</sup> Section 4, *Finance Act* (2020)

<sup>62</sup> Section 9, *Finance Act* (2020)

<sup>63</sup> Regulation 2, *The Income Tax (Digital Service Tax) Regulations* (2020)

<sup>64</sup> Regulation 2, *The Income Tax (Digital Service Tax) Regulations* (2020)

<sup>65</sup> Kenya Revenue Authority Publications, *Demystifying Digital Service Tax*, 2021.

<sup>66</sup> Section 12E, *Income Tax Act*, 1974

This applies to income derived or accrued in Kenya for both residents and non-residents from the provision of services through the digital marketplace. This, therefore, implies that the income is deemed to have accrued or derived in Kenya regardless of the place of the taxpayer.<sup>67</sup> The concept of permanent establishment comes under Kenya's income tax, which refers to a fixed place of business where business is conducted wholly or partly.<sup>68</sup> This makes it easy to tax such businesses. The use of the internet as a medium of transacting business made this tax a reality, to ensure that the income accruing in Kenya from service providers who are foreigners with no permanent residency was chargeable to tax.<sup>69</sup> Moreover, DST is an advance tax for resident and non-resident persons having a permanent establishment in Kenya and a final tax for non-residents without a permanent establishment in Kenya.<sup>70</sup> Advanced Tax refers to income tax paid in installments during the financial year on estimated income rather than a lump sum at the end of the year. On the other hand, final tax refers to tax that is considered fully paid upon its assessment and does not require any further payment or declaration.<sup>71</sup>

### **2.3 Scope of Digital Service Tax Framework**

Kenya's DST applies to a wide array of digital services people and businesses utilize daily. The rules apply to streaming and downloadable services of digital content; transfer of data collected about users which have been generated from such users' activities on a digital marketplace, however, monetised; provision of a digital marketplace, website or other online applications that facilitate a link between buyers and sellers; subscription-based media including news, magazines and journals; electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services; supply of search-engine and automated helpdesk services including supply of customised search engine services; tickets bought for live events, theatres, restaurants, etc. through the internet: online distance teaching via pre-recorded medium or eLearning, including online courses.<sup>72</sup>

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<sup>67</sup> Section 3, *Income Tax Act*, 1974

<sup>68</sup> Section 2, *Income Tax Act*, 1974

<sup>69</sup> Regulation 3(1), *The Income Tax (Digital Service Tax) Regulations* (2020)

<sup>70</sup> Regulation 3(2), *The Income Tax (Digital Service Tax) Regulations* (2020)

<sup>71</sup> Yaniv G, *Tax compliance and Advanced Tax Payment*, 52 *National Tax Journal* 4, 1999, 755-764

<sup>72</sup> Regulation 3(1), *The Income Tax (Digital Service Tax) Regulations* (2020)

The DST regulations also apply to any other service provided or delivered through an online digital or electronic platform but exclude such services subject to withholding tax under the Income Tax Act.<sup>73</sup> This means that payments made for sales promotion, marketing, and advertising services chargeable to withholding tax under the Income Tax Act will not be subject to DST. DST therefore spans a wide definition of digital services to ensure that no service is excluded. Another exemption from chargeable services is the services offered by licensed financial service providers undertaking online services that facilitate payments, lending, or trading of financial instruments, commodities, or foreign exchange.<sup>74</sup> This is because licensing requirements demand that the sector players be established in Kenya, thus creating a requisite element for taxation. The DST Regulations state that a person is subject to DST if the person provides or facilitates the provision of a service to a user located in Kenya.

It is, therefore, necessary to consider when a user is treated to be located in Kenya.<sup>75</sup> The regulations give four criteria of determination under Regulation 5: a) Assess the digital interface from the device situated in Kenya b) Payment of the service using a credit/debit facility by a Kenyan company c) Acquire the services using an IP address registered in Kenya or an international mobile phone country code assigned to Kenya d) have a business, residential or billing address in Kenya. The DST does not say whether the above requirements are disjunctive or conjunctive; however, this research reasons that they are disjunctive, provided that any thresholds are met, the person becomes chargeable. As earlier stated, the Finance Act 2020 introduced DST to be chargeable on the gross transactional value.<sup>76</sup>

There is a need to define the gross transactional value to ascertain the scope of the DST. It is noted, however, no such definition is highlighted in the regulations. The DST regulation hints at distinguishing between the gross transactional value of services provided by the iDigital service provider, who receives the payments as consideration for the service offered and ii) the digital market provider who commissions a fee paid to the users of a platform. DST

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<sup>73</sup> Regulation 3(3), *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>74</sup> Regulation 3, *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>75</sup> Regulation 4, *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>76</sup> Section 7, *Finance Act (2020)*

clearly differentiates between the two providers, establishing a bright line between direct providers and providers of platforms on which buyers and sellers of digital services interact.<sup>77</sup>

### **VAT and Its Interaction with DST**

In Kenya, the Value Added Tax also applies to digital services, especially those provided by resident and non-resident entities. Section 5(2) of the Value Added Tax Act includes the services provided over electronic means subject to DST, including streaming, digital publications like e-books, online advertising, software apps, cloud-based services, and online subscriptions and services.<sup>78</sup> VAT is to be charged where the customer is located rather than where the service is provided.<sup>79</sup> This means that if a non-resident service provider provides a digital service to a customer in Kenya, it is assumed that the service was provided in Kenya. Resident and non-resident service providers that offer digital services to consumers in Kenya must register for VAT if their taxable services exceed the threshold set by KRA.<sup>80</sup> Non-residents may appoint VAT agents and charge VAT on their services despite not having a physical presence.<sup>81</sup>

The VAT rate on digital services is 16%.<sup>82</sup> Imported digital services are zero-rated according to the Second Schedule of the Act. Zero rating exemption means that when the services are supplied, digital providers are not to add tax when supplying.<sup>83</sup> Moreover, non-resident suppliers must charge VAT to Kenyan customers but are not required to collect VAT from non-customers.<sup>84</sup> If Kenyan residents provide digital services to customers outside Kenya, those services may be zero-rated for VAT purposes.<sup>85</sup>

DST and Value Added Tax are distinct taxes that apply to different aspects of digital transactions, but they overlap in certain situations. DST taxes the digital service provider's income while VAT focuses on the supply of goods and services. Moreover, VAT is charged on

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<sup>77</sup> Regulation 6, *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>78</sup> Section 7(1)(d), *Value Added Tax (2013)*

<sup>79</sup> Section 8, *Value Added Tax (2013)*

<sup>80</sup> Section 34, *Value Added Tax (2013)*

<sup>81</sup> Section 5(2), *Value Added Tax (2013)*

<sup>82</sup> Section 5(2), *Value Added Tax (2013)*

<sup>83</sup> Section 7, *Value Added Tax (2013)*

<sup>84</sup> Section 5(2), *Value Added Tax (2013)*

<sup>85</sup> Section 7(2), *Value Added Tax (2013)*

the value of the digital services provided to consumers in Kenya, regardless of whether it's a resident or non-resident. While DST targets the income generated from digital services. In cases where both taxes apply, service providers are required to account for each tax separately, ensuring the correct application based on the nature of the transaction and service provided. This analysis will focus on taxing digital services according to the Income Tax Act and Digital Service Tax Regulations articulation.

## **2.4 Implementation and Enforcement Mechanism of DST and its Impact**

### **Registration**

A resident or non-resident with a permanent establishment in Kenya providing a digital service in Kenya shall apply to the Commissioner for tax registration in respect of the Digital Service in the prescribed form.<sup>86</sup> A non-resident person without a permanent establishment in Kenya who provides digital services to a user in Kenya may register under a simplified tax registration under regulation 9 online registration in a form prescribed by the Commissioner.<sup>87</sup> The applicant files the necessary documents with the commissioner, who in turn assigns a personal identification number for filing and paying tax returns. A non-resident without a permanent establishment in Kenya who fails to register under Regulation 9 has to appoint a tax representative under Section 15A of the Tax Procedures Act, 2015.<sup>88</sup>

The Finance Act 2020 also makes provision for the appointment of digital service tax agents. These persons appoint digital service tax agents and provision is made for such agents to deduct, collect, and remit the digital service tax collected.<sup>89</sup> In addition, the Kenya Revenue Authority is the institution of the government that is depended upon to deduct, collect, and remit DST collected given authority under the Kenya Revenue Authority Act, 1995.<sup>90</sup> The DST Tax Regulation provides a digital service tax collection platform that DST agents will use to collect and remit DST to KRA, known as iTax. The tax is payable by the digital service provider or the person who collects the payment for digital services.<sup>91</sup> This is significant

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<sup>86</sup> Regulation 7(1), *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>87</sup> Regulation 9, *The Income Tax (Digital Service Tax) Regulations (2020)*

<sup>88</sup> Section 15A, *The Tax Procedures Act (2015)*

<sup>89</sup> Section 19, *Finance Act (2020)*

<sup>90</sup> Section 5(1), *Kenya Revenue Authority Act (1995)*

<sup>91</sup> Section 10, *The Income Tax (Digital Service Tax) Regulations (2020)*

where a digital service tax agent is designated as an agent for the state. In fact, the above position contrasts with withholding tax where the focus of paying is on the payor.<sup>92</sup>

The income tax declares that the DST will be payable when non-residents pay for the service.<sup>93</sup> The DST Regulations propose that a non-resident person appoint a tax representative and will be required to remit the tax due the 20th of the month following the end of the month the service was offered.<sup>94</sup> When a person ceases to provide digital services in Kenya, it shall apply to the Commissioners for deregistration in the prescribed form.

## **Compliance**

Failure to comply with DST can lead to penalties, fines or prosecution to deter evasion. Penalties involve failure to file returns or remit taxes.<sup>95</sup> The Kenya Revenue Authority (KRA) ensures compliance with Digital Service Tax through registration requirements, third-party tax collection, and strict enforcement mechanisms. KRA mandates registration for all digital service providers regardless of the location. Additionally, KRA conducts audits and investigations to verify transactions and ensure that taxes are filed well and paid. KRA also collaborates with international tax authorities to enhance global compliance.<sup>96</sup>

## **Impacts**

However, its enforcement has a lot of challenges, especially regarding the tracking of non-resident digital providers. The broadness of the definition of "digital service" creates ambiguity that may lead to potential non-compliance or even double taxation. Other complications arise from reliance on international cooperation with platforms such as Google and Netflix and the complexity of Double Taxation Agreements. Further, the enforcement mechanism in the case of non-compliance might be too weak to work effectively, especially when dealing with foreign companies that have no tangible presence in Kenya. This weakens the enforcement framework.

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<sup>92</sup> Section 35, *Income Tax Act* (1974)

<sup>93</sup> Section 12E, *Income Tax Act* (1974)

<sup>94</sup> Regulation 6, *The Income Tax (Digital Service Tax) Regulations* (2020)

<sup>95</sup> Section 43, *Income Tax Act* (1974)

<sup>96</sup> Kenya Revenue Authority, *Tax Investigation Handbook*, 2015, 10-24

## 2.5 Digital Service Tax in Bundled Services

Bundled digital services are defined as different digital offerings packed in one bundle to enhance user value.<sup>97</sup> A bundled service or product can be a collection of several products or services, such as software, online courses, or subscription-based media content, provided as one product, normally at a more favorable price than purchased separately. One of the interesting features of bundling is how the concept spans across industries.

The meaning of "bundled" could be different for various contexts. It means, in agriculture, the delivery of advisory, financial, or market access services bundled through digital platforms. This bundling could also include pure digital or hybrid models that feature in-person consultations.<sup>98</sup> In digital journalism, bundling entails cross-publisher offers, providing content from multiple sources for a fixed monthly fee.<sup>99</sup> There are various kinds of bundled digital services. Wholly digital bundles are purely digital services, such as software subscriptions like Adobe Creative Cloud or digital content providers like Netflix. Hybrid bundles combine digital and nondigital components. Examples might include the online advice aspect for agricultural applications via an app, together with an in-person consultative service component provided by experts.<sup>100</sup>

VPBs (Virtual Product Bundling) bundle related digital products or services, such as software suites like Microsoft Office.<sup>101</sup> In media, cross-publisher bundles grant the subscriber access to several publishers for one subscription, raising subscribers and revenues.<sup>102</sup> Finally, sector-specific service bundles are a set of services that target very specific needs—for example, agricultural bundles that include financial services, weather updates, and market insights to

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<sup>97</sup> Liberto D, *Bundling: Definition as Marketing Strategy and Example*, 2024

<sup>98</sup> Abdul Latiff Jameel Poverty Action Lab, *Evidence for digital and bundled services: Framing a research agenda for the Digital Agricultural Innovations and Services Initiative*, 2022.

<sup>99</sup> Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press, 2024, 2 See Also Adams J, Yellen Y, *Commodity bundling and the burden of a monopoly*, 90 The Quarterly Journal of Economics 3, 1976, 475-498

<sup>100</sup> Abdul Latiff Jameel Poverty Action Lab, *Evidence for digital and bundled services: Framing a research agenda for the Digital Agricultural Innovations and Services Initiative*, 2022.

<sup>101</sup> Liberto D, *Bundling: Definition as Marketing Strategy and Example*, 2024

<sup>102</sup> Ebrich L, Wellbrock C, Lobigs F, Buschow C, *Bundling Digital Journalism: Exploring the Potential of Subscription-Based Product Bundles*, 12 Cogitatio Press, 2024, 2 See Also Adams J, Yellen Y, *Commodity bundling and the burden of a monopoly*, 90 The Quarterly Journal of Economics 3, 1976, 475-498

enhance the productivity of small-scale farmers.<sup>103</sup> These examples show how digital service bundles can be used in many creative ways across industries to deliver value.

The Digital Service Tax in Kenya has, under its framework, issues related to taxation on bundled services under the Income Tax Act and the Digital Service Tax Regulations, 2020. A bundled service is bound to have various elements included within it that are liable to tax and others that may be exempt, with no definition or basis provided by law on how such would be treated. This creates uncertainty on the part of the taxpayer as to whether a whole bundle is taxable or only that part that can be taxed. If rules are not stipulated regarding how many different components should be separated, businesses might overpay the tax or experience compliance issues. This calls for fairer and more accurate levying of bundled digital services with greater clarity.

## **2.6 Appreciation and Limitation of the Digital Services Tax**

The Digital Service Tax is an innovation in Kenya in capturing tax revenues from the fast-growing digital economy, particularly from non-resident digital service providers. This ensures that businesses deriving their income from Kenyan consumers contribute to the national tax base to address the challenge of taxing these digital transactions, which existing tax systems often miss. It targets, among others, revenues from online advertising, digital marketplaces, and streaming services in line with global trends where many countries have introduced taxes on digital services to bridge revenue gaps in the digital era. The DST also creates a fair playing field since foreign digital service providers usually escape taxation without such a tax. Yet, they make revenue within the borders just like local businesses operating in Kenya.

Nevertheless, there are also several limitations with DST. To begin with, one of the biggest concerns about double taxation is when similar digital services are charged at a base, thus increasing Value Added Tax to the consumer or business. Besides, the imposition of a tax of 1.5% on the gross transaction value has a potential depressing impact on low-margin enterprises through diminishment in their profitability, thereby discouraging investment into Kenya's digital economy. Moreover, the DST Regulations do not consider that a number of

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<sup>103</sup> Larsen L, *Bundled Digital Service: Introduction, Agrilinks*, 2024

platform owners are simultaneously direct service providers to customers and, therefore, the Regulations should make them hybrid digital service providers. It may be implied, though, that the gross transaction value would be determined following the specific payments.

Other limitations include the administrative burden this will impose on non-resident digital service providers, who have to register and comply with Kenyan tax laws. This may prevent smaller foreign businesses from trying to penetrate the market. Without guidelines or dispute resolution mechanisms concerning the application of the DST, this exacerbates the reality that such periodic reviews and refinements are required to make this regime effective and equitable.

## **2.7 International View on Digital Service Tax**

Implementing the digital service tax into Kenyan law is justified under Section 3 of the Judicature Act, which gives authority to include foreign laws in Kenya's law. Digital service Tax is the tax levied on revenues raised from digital services. The tax mainly aims at non-resident companies that conduct businesses in the country without necessarily having a physical presence in the country.<sup>104</sup> Developing countries see the digital economy as a potential source of revenue. Meanwhile, the OECD has been working through periodic reports and engagements to arrive at a multilateral approach to tax digital services. In contrast, DST is a relatively recent phenomenon that most developed countries have implemented. Most of the countries which implemented digital taxes showed an increase in their tax revenues. In the case of *South Dakota v. Wayfair*, the United States Supreme Court authorized the states to impose requirements on out-of-state sellers to collect sales tax on the sale of goods to residents of such states even in cases where the seller did not maintain a physical presence within that state.<sup>105</sup> This judgment overturned an earlier *Quill Corp. v. North Dakota* decision that held only businesses with a physical presence were supposed to collect sales tax.<sup>106</sup>

This ruling was essential to the establishment of Digital Service Taxes in various jurisdictions. The decision in the Wayfair case realized the increasing significance of online

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<sup>104</sup> Asen E, *What European OECD Countries Are Doing about Digital Services Taxes*. Tax Foundation, Washington D.C, 2020.

<sup>105</sup> *South Dakota v Wayfair* (2018), The Supreme Court of the United States.

<sup>106</sup> *Quill Corp. v. North Dakota* (1992), The Supreme Court of the United States.

commerce and digital platforms that, under the physical presence nexus rule, had not previously been required to collect sales taxes. Throughout states and countries worldwide, a review of their tax regimes began to capture revenues derived from digital services even when companies provided them without a physical presence in a jurisdiction. It, therefore, catalyzed the global movement to digital taxation and acted as a precedent for the inclusion by countries such as Kenya that have crafted frameworks for taxing digital services with regard to the economic realities.

The OECD put forward a two-pillar approach to take up the tax challenges of the digital economy. Under Pillar One, there will be a proposed reallocation of taxing rights to the country of consumption, irrespective of the residence of the multinational business or physical presence thereof.<sup>107</sup> Pillar Two is a global anti-base erosion proposal aimed at ensuring a minimum level of tax for companies operating multi-nationally, no matter where their headquarters are.<sup>108</sup> While still waiting for the finalization of the OECD's multilateral DST proposal, many developing countries have gone ahead and implemented DSTs unilaterally. If it is to be effective, DST should be neutral and tax-efficient.<sup>109</sup> Tax neutrality, as earlier stated, refers to a situation where taxes do not affect the decisions of taxpayers. It also involves applying digital taxes in a way that each mode of trade is not rendered more attractive than the other-for instance, making cross-border trading look more attractive compared to local trading. Efficiency, on its side, implies that the tax system should be straightforward to administer and enforce from the perspective of both taxpayers and authorities.<sup>110</sup>

## **2.8 Conclusion**

To summarise, Kenya's DST framework is a significant step toward modernising the taxation system to capture revenue from the digital world. However, more is needed to tax bundled digital services. This lack of clarity leads to ambiguities in the application of the DST. A more sophisticated strategy, including specific categorisations, is required to produce a more

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<sup>107</sup>Deloitte, *Statement on two-pillar approach to tackling tax challenges of digitalization issued*, 2020.

<sup>108</sup>Deloitte, *Statement on two-pillar approach to tackling tax challenges of digitalization issued*, 2020.

<sup>109</sup> Bunn D, *The U.S. Trade Representative Expands Its Digital Services Tax Investigations*, Tax Foundation, 2020.

<sup>110</sup> Bloomberg Tax, *Global Value-Added Tax Crackdown Costing Companies Millions*, 2020.

equitable and effective taxing system. Furthermore, Kenya must implement a framework that is consistent with international norms to remain competitive and appealing to both local and foreign digital service providers. The comparative analytical insights and recommendations presented in the following chapters will guide the necessary changes to Kenya's DST framework. Building on this research, chapter 3 further exposes the gaps in the DST framework, identifying major flaws that impede its effectiveness. This chapter will examine the need for more clarity in definitions, the absence of periodic review processes, and other issues that must be addressed to improve DST's application.

## **CHAPTER 3**

### **3.0 GAPS IN KENYA'S DIGITAL SERVICE TAX FRAMEWORK**

#### **3.1 Introduction**

Kenya's Digital Service Tax framework was established to address the unique challenges the digital economy poses.<sup>111</sup> However, its implementation has revealed gaps, particularly in its approach to taxing bundled digital services. These gaps include the absence of clear definitions for bundled services, a lack of a standardised mechanism for allocating taxable value among components, and no periodic review processes to adapt to evolving digital business models. These deficiencies have led to administrative inefficiencies, compliance challenges, and a risk of double taxation or losses.<sup>112</sup>

This chapter explores these gaps in detail by analysing the legal, administrative, and economic framework they exist in. Real-world examples such as Safaricom's data and streaming bundles and Netflix's subscription models demonstrate the practical challenges businesses face under Kenya's DST. Highlighting these shortcomings establishes the need for reforms. It sets the foundation for a comparative analysis in chapter 4, where insights from other jurisdictions will guide recommendations to improve Kenya's approach to taxing digital services.

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<sup>111</sup> KICTANet, *Understanding Digital Taxation in Kenya: A Pathway to Fair and Inclusive Policy Reforms*, 2024, 1

<sup>112</sup> Organisation for Economic and Cooperative Development, *OECD Economic Outlook*, 2020, 39

## 3.2 Gaps in Digital Taxation

### Definition of a Tax Gap

Tax authorities often find a notable difference between expected tax revenue and what is collected, which is known as a tax gap.<sup>113</sup> In digital taxation, gaps refer to deficiencies in the legal, administrative, and implementation frameworks that hinder effective taxation. Legal gaps occur when the tax law lacks clarity or does not address specific challenges the digital economy poses.<sup>114</sup> Administrative gaps arise as a result of inefficiencies in tax collection.<sup>115</sup> Implementation gaps occur when the legal provisions cannot be applied in practice.<sup>116</sup>

A good tax system is built on principles proposed by the OECD<sup>117</sup>, including neutrality, efficiency, certainty, simplicity, effectiveness, fairness, flexibility, and equity to ensure fairness, functionality, and adaptability to modern challenges. Neutrality requires equal treatment of all business activities to minimise distortions and promote resource efficiency<sup>118</sup>, which is partially reflected in Kenya's Digital Service Tax (DST) framework. While DST demonstrates flexibility by addressing diverse digital business models under the Income Tax (Digital Service Tax) Regulations,<sup>119</sup> its unclear application to bundled digital services undermines neutrality by exposing businesses to disproportionate taxation. Similarly, efficiency, which minimises compliance and administrative costs<sup>120</sup>, is compromised by the DST's complex requirements for categorising and valuing taxable versus non-taxable components, straining businesses and tax authorities.

The principle of certainty and simplicity, which ensures clear and predictable tax rules<sup>121</sup>, is weakened due to the absence of defined criteria for allocating taxable value among bundled

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<sup>113</sup> United Nations World Institute for Development Economic Research, *Toolkit for the estimation of tax gaps using the bottom up approach*, 2024, 1

<sup>114</sup> Raczkowski K, Mroz B, *Tax gap in global economy*, 21 Journal on Money Laundering Control 4, 2018, 545-554

<sup>115</sup> Keen M, Slemrod J, *Optimal Tax Administration*, 152 Journal of Public Economics 1, 2017, 133-142

<sup>116</sup> 3ie Impact, *Practitioner Brief on Tax Reforms in Sub-Saharan Africa*, 2023

<sup>117</sup> Organisation for Economic and Cooperative Development, *Fundamental principles of taxation*, 2014, 30.

<sup>118</sup> Organisation for Economic and Cooperative Development, *Addressing the Tax Challenges of Digital Economy*, 2014, 29-50

<sup>119</sup> Section 3, *Income Tax (Digital Service Tax) Regulations* (2020)

<sup>120</sup> Organisation for Economic and Cooperative Development, *Fundamental principles of taxation*, 2014, 30.

<sup>121</sup> Yonah Avi, *The Structure of International Taxation: A Proposal for Simplification*, 74 Tax Law Review 1, 1301

services, leaving firms unsure of their obligations. Moreover, the DST's reliance on gross income taxation challenges fairness, particularly for low-margin services, increasing the risk of double taxation and inequitable tax treatment. While the DST incorporates certain principles, significant adjustments are needed to better align its framework with the OECD's guidelines and the unique realities of Kenya's digital economy. This alignment with the OECD principles is critical in ensuring coherence and consistency at the global level of tax practices, reducing conflicts between countries, and making Kenya more competitive in attracting foreign investment, which is important for economic growth and developing its digital economy.

### 3.3 Legal Gaps in the DST Framework

While the DST framework broadly defines taxable digital services under Section 3(1)(ca) of the Income Tax Act.<sup>122</sup> The significant legal gap in Kenya's DST framework is the lack of precise definitions for key terms, particularly concerning bundled digital services. The framework does not offer guidance on how to categorise bundled digital services. Vanistadael advocates for clear definitions in tax law. He argues that precise language is crucial for effective tax administration and compliance as it helps avoid ambiguities that can lead to disputes and inefficiencies.<sup>123</sup>

This view is highlighted in the case of *Inland Revenue Commissioner v Duke of Westminster*; the court held a strict approach to interpreting tax laws. The court emphasises that one should merely look at what is clearly said in the act. There is no room for any intendment and no equity about tax. There is no presumption, only how the language is used. Without a clear definition, businesses are forced to determine whether the entire bundle or part of the bundle should be subject to DST, leading to inconsistent application. For instance, e-commerce platforms that bundle digital services with physical goods or delivery discounts may avoid DST entirely due to ambiguities in categorisation. These challenges highlight the urgent need for clear definitions and guidance to ensure a uniform application of the DST framework.

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<sup>122</sup> Section 3(1)(ca), *Income Tax Act*(1974)

<sup>123</sup> Vanistadael F, *Tax Law Design and Drafting*, 1International Monetary 1,1996

Kenya's DST does not also address the complexities introduced by hybrid services. Hybrid services refer to business platforms that combine digital services with physical goods or delivery services<sup>124</sup>; they often blur the line between taxable and non-taxable components. Businesses thus rely on subjective interpretations, leading to inconsistencies in tax reporting and collection. If a Safaricom bundle is priced at KES1000 and includes KES 600 for data and KES 400 for streaming, it remains unclear whether the tax applies to only the streaming revenue or a proportion of the entire bundle. This lack of clarity disproportionately affects compliance, especially for non-resident digital service providers who lack the local expertise or infrastructure to separate and report components accurately.

*The Digital Box Limited v Commissioner of Domestic Taxes* case highlights a dispute over tax obligations made by the Kenya Revenue Authority stemming from an ambiguous statutory provision and reliance on improperly analysed data.<sup>125</sup> This case illustrates how interpretation challenges in tax assessment can arise due to ambiguous statutory and reliance on incomplete and improperly analysed data. Concerning bundled digital services, these ambiguities become even clearer due to the lack of clear guidance on revenue allocation. Moreover, the risk of double taxation increases in the case of overlapping taxes like VAT and DST, which can be applied to the same revenue stream without clear categorisation of taxable and exempt components.<sup>126</sup>

### **3.4 Administrative and Implementation Challenges**

The segregation and categorization of these services present some of the major administrative challenges to the taxation of bundled digital services, especially those provided through global platforms. Most of these platforms operate across borders, a factor that makes tracking and enforcing liabilities from the tax authorities a challenge. Mohammed Abdullahi says that lack of categorization leads to massive administrative inefficiencies in tax administration.<sup>127</sup> For example, ill-defined fiscal responsibilities lead to overlapping systems that frustrate the taxpayer and lower compliance. To boot, what the author strongly emphasises is

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<sup>124</sup> Interaction Design Foundation, *What are products-service hybrids*, 2016

<sup>125</sup> *Digital Box Limited v Commissioner of Domestic Taxes*(2017) eKLR

<sup>126</sup> Jones A, *Confusion and concern amounts in Asia over DST double taxation risks*, International Tax Review,2020

<sup>127</sup> Abdullahi M,Festo N, *Challenges of Tax Administration in Developing Countries*, 3 Journal of Tax Administration 2 2017,108-123

the deficiency of the systemic approach to reach categorization inside the system of the taxes, a process which promotes obscurity leading to high levels of compliance cost. This also relates to another aspect of electronic service provision which suffers from continuously altering offerings". In Kenya, the DST structure does not define what bundled services means, thus creating confusion in the implementation of tax rates and identification of the right service to be subjected to tax. Such global platforms may not have a physical presence in Kenya; hence, enforcement and resulting in a possible loss of tax revenue.<sup>128</sup>

In the case of *Bluejay Limited v. Commissioner of Legal Services and Board Coordination*,<sup>129</sup> the tribunal addressed the issues surrounding compliance with withholding tax and digital service tax obligations. The appellant argued that KRA assessments included ambiguous amounts and lacked clarity, particularly on how DST was integrated into their overall tax obligations. This ambiguity is relevant for bundled services and leads to disputes on how to separate the components and subject them to tax accurately. The case epitomizes the challenges businesses face in navigating Kenya's DST framework. Without clear rules on the apportionment of revenue within bundles or detailed breakdowns in tax assessments, businesses risk overpaying or underpaying taxes, potentially triggering disputes with tax authorities.

Workable mechanism for charging the DST can be achieved with a self-declaration system through an enhanced digital filing facility created at KRA.<sup>130</sup> There is a need for service providers of bundled services to declare the revenues periodically who get registered themselves with tax authorities. What makes this mechanism not work perfectly is the inefficiency of law on the two important issues regarding classification and apportionment of revenue from 'bundled services', hence confusions arising:. Businesses may underreport revenue or misclassify services as nontaxable because of a lack of guidance. Where there is ambiguity in the statutes regarding how to classify bundled services, both taxing authorities and taxpayers want to ensure compliance that needs extra supervision and enforcement mechanisms like audits. This leads to a heightened possibility of mistakes being made in the

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<sup>128</sup> Kapkai P, Muthee I, Ngala B, Musa N, Wanyeri A, Gathoni E, *Enforcement of Digital Economy Taxation*, 4 African Tax and Customs Review 1, 2021,1-23

<sup>129</sup> *Bluejay Limited v. Commissioner of Legal Services and Board Coordination*(2024)eKLR

<sup>130</sup> Kenya Revenue Authority Publication, *Demystifying Digital Service Tax*,2021

collection of taxes. These errors can lead to administrative costs for businesses, primarily smaller entities that lack the resources to navigate the complexities of DST. Additionally, companies may need to invest in new technology or engage tax experts to ensure compliance, increasing the business cost. Businesses that bundle content or digital services may also struggle with distinguishing taxable and non-taxable entities, risking penalties for non-compliance.

The cases illustrated in the KRA Digest reveal repetitive instances of tax administration, primarily where the vagueness and procedural defects permit disputes. *In the case of Republic v Kenya Revenue Authority Ex Parte Funan Construction Limited*<sup>131</sup>, imprecise objections and ambiguous tax assessments were big issues. This is closely related to the issue of taxation of bundled digital services, in which ambiguity exists in apportioning revenue into taxable and non-taxable components. In *Fleur Investments Limited v Commissioner of Domestic Taxes & Kenya Revenue Authority*,<sup>132</sup> it was also emphasized that taxpayers and tax authorities are responsible for ensuring accurate records and openness. To avoid inconsistency and dispute in composite services, service providers should separate the taxable portion, while the tax authority needs to develop enforceable regulations.

Another important lesson learned from these cases is procedural fairness. This is well evidenced in the case of *Total Kenya Limited v Kenya Revenue Authority*<sup>133</sup>, where delay and lack of clear findings led to procedural unfairness. Similarly, with the taxation of bundled digital services, delays or uncertainties about what constitutes taxable revenue lead to administrative inefficiencies and loss of revenue. Courts, as evidenced in *Republic v Commissioner of Domestic Taxes (Mkopa Limited)*<sup>134</sup>, have always ruled on substance over form in disputes. This becomes a very relevant consideration in packaged services where tax authorities have to focus on the real composition of revenue streams, as opposed to merely formal definitions.

These examples show that what is urgently needed is a clear, timely, and enforceable solution to the special issues of taxing bundled digital services, with a guarantee of justice and

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<sup>131</sup> *Republic v Kenya Revenue Authority Ex Parte Funan Construction Limited* (2015)eKLR

<sup>132</sup> *Fleur Investments Limited v Commissioner of Domestic Taxes & Kenya Revenue Authority*(2024)eKLR

<sup>133</sup> *Total Kenya Limited v Kenya Revenue Authority*(2018)eKLR

<sup>134</sup> *Republic vs Commissioner of Domestic Taxes Mkopa Limited*(2024)eKLR

consistency. In this dynamically changing environment, there should be mechanisms for review and updates of the DST framework.<sup>135</sup> The rapid evolution of technology and new digital services also puts the current DST frameworks at risk of becoming outdated. Without regular reviews or updates, the tax regime might not have captured new services or innovations in the digital economy.

### 3.5 Policy and Economic Gaps

The DST framework of Kenya may have several policy gaps that hinder its effectiveness in taxing bundled digital services. Policy gaps are the result of legislative decisions that are purposed to modify standard regulations of tax through the introduction of specific exemptions, deductions, or reduced rates for particular cases.<sup>136</sup> According to Hutton, a policy gap is the difference between the potential revenues and actual collections due to the choice of legislation, such as exemptions and deductions.<sup>137</sup> This gap either widens or closes according to changes in tax policy, showing at the same time how certain legislative decisions may restrain revenue generation from a tax base.<sup>138</sup>

One of the key policy gaps is the lack of clear, comprehensive policies that address the unique nature of digital services, especially when these services are provided as bundles by global platforms. This lack of clarity can lead to inconsistent enforcement and an uneven playing field for domestic versus international digital service providers, as Hutton addressed.<sup>139</sup> The framework of DST may not provide for specific provisions to address the emerging digital business models, leaving substantial revenue untapped.

#### Economic Gaps

The digital economy is expanding rapidly and has significant potential to tap into this growth. However, the existing DST framework does not fully cover the full extent of digital

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<sup>135</sup> Aslam A, Shah A, *Tectonic Shifts: Taxing the Digital Economy*, International Monetary Fund Working Paper 20/2020, 216- <<https://www.elibrary.imf.org/display/book/9781513511771/ch010.xml>>- link on 13 December 2024

<sup>136</sup> Hutton M, *The Revenue Administration–Gap Analysis Program: Model and Methodology for Value Added Tax Gap Estimation*, International Monetary Fund, 2017, 23

<sup>137</sup> Hutton M, *The Revenue Administration–Gap Analysis Program: Model and Methodology for Value Added Tax Gap Estimation*, International Monetary Fund, 2017, 4

<sup>138</sup> Hutton M, *The Revenue Administration–Gap Analysis Program: Model and Methodology for Value Added Tax Gap Estimation*, International Monetary Fund, 2017, 24

<sup>139</sup> Hutton M, *The Revenue Administration–Gap Analysis Program: Model and Methodology for Value Added Tax Gap Estimation*, International Monetary Fund, 2017, 23

services provided by international platforms. The IMF argues that inefficient tax systems limit the potential to address income inequality through fiscal measures.<sup>140</sup> This also results in a loss of tax revenue that could be reinvested into public services, infrastructure, and economic development. Moreover, the current framework may disproportionately affect small businesses and start-ups integral to Kenya's budding tech ecosystem. For these businesses, the tax burden can be too high thus reducing competitiveness in local and international markets.

Another economic gap is the underdevelopment of effective implementation of the DST. While the tax regime may be designed to capture revenue from digital services, Kenya may struggle with technological infrastructure to effectively collect, monitor, and enforce the DST from international digital providers with no physical presence in the country. Economic disparities between regions and industries lead multinational companies to find ways to avoid taxation, while small local businesses face disproportional taxation.

### **3.8 Conclusion**

This analysis has identified several gaps, including the insufficiency and ambiguity in the definition of bundled digital services, the lack of clear guidelines for distinguishing between taxable and non-taxable services, and the absence of periodic review mechanisms to ensure that the framework is adaptable to the evolving digital economy. These gaps impact the effective implementation and enforcement of Digital Service Tax and may lead to challenges in its application. Chapter 4 will make a comparative analysis that shifts the focus from Kenya to other jurisdictions like India and Australia that have faced similar challenges in their taxation frameworks. This comparison will be important in proposing practical recommendations to address the identified gaps in Kenya's DST.

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<sup>140</sup> Tanzi V, Zee H, *Tax Policy for Developing Countries*, International Monetary Fund, Working Paper No.35,27,2001,2 <<https://www.imf.org/external/pubs/ft/issues/issues27/>> - link on 19th December 2024

## **CHAPTER 4**

### **4.0 COMPARATIVE ANALYSIS OF DIGITAL SERVICE TAX FRAMEWORK: INDIA AND AUSTRALIA'S VIEW ON TAXING BUNDLED SERVICES.**

#### **4.1 Introduction**

As earlier established, digital transactions have increasingly dominated global commerce and have become a critical area of focus for many jurisdictions. Kenya's DST framework struggles with ambiguities in defining and taxing bundled services creating gaps in compliance and enforcement. To address these issues, this comparative study examines the approach taken by India and Australia, jurisdictions with advanced digital taxation frameworks. India's Goods and Services Tax (GST) provides a detailed mechanism for taxing digital services. At the same time, Australia's periodic review system offers a model for ensuring adaptability and relevance in a rapidly evolving digital landscape.

India and Australia, both developing and developed countries respectively, were selected for this study due to their innovative and well-documented approaches to taxing digital services. Both countries operate in distinct economic and regulatory contexts thus offering diverse perspectives to inform Kenya's efforts. This research acknowledges that every government has the power to enforce its tax laws. The comparative analysis of their frameworks will provide legal insights into reducing ambiguities, practical methods of enhancing compliance, and examples of periodic updates that ensure adaptability to technological advancements. By integrating these lessons, this research proposes actionable recommendations for Kenya to refine its DST framework thus bridging the gaps in compliance and ensuring equitable taxation of bundled digital services.

#### **4.2 Conceptual Framework**

This study uses a combination of fiscal federalism theory and tax compliance theory to analyze how different jurisdictions approach the taxation of bundled services. Fiscal federalism is an economic theory that examines the financial relationships and responsibilities among various levels of government specifically focusing on how taxing powers are divided

between central, state, and local governments according to Richard Musgrave.<sup>141</sup> In the context of digital service taxation, fiscal federalism provides a lens through which an understanding of the distribution of taxing rights is established.<sup>142</sup> Additionally, this framework is relevant when assessing autonomy and intergovernmental coordination by comparing Australia's federal system<sup>143</sup> to Kenya's unitary system and India's quasi-federal system. Examining the allocation of tax rights in these jurisdictions highlights how governance structures influence the effectiveness of tax administration.

The tax compliance theory, on the other hand, focuses on the behavioral and systematic factors that influence taxpayer compliance.<sup>144</sup> This includes clarity of tax laws, ease of compliance, and the effectiveness of enforcement mechanisms. By applying this theory, the study evaluates how the design and implementation of taxation policies in India and Australia encourage compliance and provide lessons Kenya can adopt to improve its DST framework. The key criteria for comparison include: legal definitions and tax scope, taxation mechanisms, review mechanisms, challenges, and impacts

### 4.3 An Overview of India's Goods and Service Tax

Goods and Service Tax similar to Kenya's VAT refers to an indirect tax levied on the supply of goods and services<sup>145</sup>. India's multi-tiered GST framework was introduced in 2017,<sup>146</sup> it combines excise duty, service tax, and value-added tax into a single domestic indirect tax. It is charged at each production stage from the manufacture to sale to the consumer. For instance, a manufacturer who makes biscuits: when he transforms flour and sugar into biscuits, adding value, GST is added onto it. He sells the biscuits to a wholesaler who adds value again by packaging them, and GST is applied. The retailer sells the biscuit to the customers who

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<sup>141</sup> Shoup C, *Theory of Public Finance*, 49 The American Economic Review 5, 1018-1021

<sup>142</sup> Shoup C, *Theory of Public Finance*, 49 The American Economic Review 5, 1018-1021

<sup>143</sup> Australian Government, *Australia's Federal system*, 2017

<sup>144</sup> OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks*, 2016, 16 See Also OECD, *Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance*, 2013

<sup>145</sup> Kumar C, *The Political Economy of India's Transition to Goods and Services Tax*, German Institute for Global and Area Studies (GIGA), Working Paper No.325, 2021, 6

[https://www.jstor.org/stable/resrep28523?searchText=goods+and+service+tax+in+india&searchUri=%2Faction%2FdoBasicSearch%3FQuery%3Dgoods%2Band%2Bservice%2Btax%2Bin%2Bindia%26so%3Drel&ab\\_segments=0%2Fbasic\\_search\\_gsv2%2Fcontrol&refreqid=fastly-default%3A1c6a071a35794268933e792c793c1433&seq=5](https://www.jstor.org/stable/resrep28523?searchText=goods+and+service+tax+in+india&searchUri=%2Faction%2FdoBasicSearch%3FQuery%3Dgoods%2Band%2Bservice%2Btax%2Bin%2Bindia%26so%3Drel&ab_segments=0%2Fbasic_search_gsv2%2Fcontrol&refreqid=fastly-default%3A1c6a071a35794268933e792c793c1433&seq=5) -link on 24 December 2024

<sup>146</sup> ClearTax, *Structure of GST in India: Four-Tier GST Tax Structure Breakdown*, 2024

bear the GST. There are three types of GST. Central GST is collected by the central government in respect of sales within the state, State GST is collected by states in respect of sales within a state; Integrated GST is collected in respect of inter-state sales between the Centre and state, and Union Territory Goods and Service Tax levied on the supply of good and services to the union territories of India.<sup>147</sup> The supplier collects and pays GST to the government, and the tax deduction is at source while he is making payments for services. The main advantage of this tax system is that it eliminates double taxation and makes it easier for businesses to comply with tax regulations.<sup>148</sup>

India's GST has elaborately defined 'services' under its statute. Section 2(102) of the Central Goods and Services Tax Act, 2017, states that "service" means anything other than goods, money, and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one currency or denomination to another form for which a separate consideration is charged.<sup>149</sup> The above definition states that services means all the economic activities except in the form of goods, and except money and securities, as has been clearly exempted from taxation. But such activities employ money as consideration against the rendering of services. It means it includes all those intangible transactions which are not considered as a good.

Notification No.11/2017 of the Central Tax Rate provides the detailed classification of services under the GST framework aligned with the Harmonized System of Nomenclature, popularly known as HSN code.<sup>150</sup> Each of the types of service is given an HSN code, and taxes are levied accordingly.<sup>151</sup> Composite and mixed supplies are further elaborated under Section 8 of the CGST Act.<sup>152</sup> A composite supply includes two or more taxable supplies, which are normally bundled and supplied in conjunction, such as when there is a bundle package of software along with maintenance. The entire bundle shall be levied at the tax rate of the principal supply. In case of mixed supply- If it comprises two or more supplies that are not naturally bundled, for example, a gift box containing items that are taxable and exempt. The

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<sup>147</sup> Khungar R, Kaur A, *GST: Its Types and Advantages* 6 International Journal of Finance and Management Research 1, 2024, 2

<sup>148</sup> Tyagi A, *The Analysis of Indian Tax Structure*, Published, Alliance University, School of Law, Anekal, 2021, 7

<sup>149</sup> Section 2(102), *Central Goods and Services Tax (CGST) Act*, 2017

<sup>150</sup> <<https://gstcouncil.gov.in/node/4432>>- link on 25th December 2024

<sup>151</sup> <<https://gstcouncil.gov.in/node/4432>>- link on 25th December 2024

<sup>152</sup> Section 8, *Central Goods and Services Tax (CGST) Act*, 2017

highest tax rate on the components prevails over all items in the bundle. Sections 12 and 13 of the IGST indicate the place of supply rules; for services supplied to registered persons, the place of supply is determined by the location of the recipient and for unregistered persons, the place is considered as that of the supplier unless specific rules apply.

Section 2(17) of the IGST defines online information and database access or retrieval services as services over the internet without substantial human intervention, including digital content, e-learning platforms, and cloud-based services.<sup>153</sup> The special provisions ensure that these kinds of services are taxed even when provided by non-resident entities to Indian consumers. In certain circumstances, especially when the services are provided by non-resident suppliers, and specific categories of services like legal services by advocates or sponsorship services, the recipient of the service and not the supplier will be liable to pay GST under the reverse charge mechanism as stipulated by Section 9(3) and (4) of the IGST.<sup>154</sup> Exemptions to this are further listed in Notification No. 12/2017 of the Central Tax Rate, which includes healthcare services, educational services from approved institutions, and services from charitable organizations. The liability to pay GST for services arises at the time of supply, that is, the earlier date of the issue of invoice and the date of receipt of payment.<sup>155</sup> Section 15 of CGST details rules for determining the value of taxable services, including considerations for discounts, bundled pricing, and additional charges.<sup>156</sup> Discounts provided before or at the time of supply that are shown in the invoice are allowed to be deducted. Where the value cannot be determined by transaction value, then specific valuation method such as open market value, cost-based valuation, or residual method is used.

#### **4.4 Treatment of Bundled Digital Services**

Section 15 is closely related to bundled digital services. The value of a taxable supply under GST is essentially the transactional value, being the price payable for the goods and services concerned, but this is where the supplier and recipient are unrelated, and the price is the sole consideration for the supply. Related persons in this context mean business partners,

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<sup>153</sup> Section 2(17), *Integrated Goods and Services Tax (IGST) Act, 2017*

<sup>154</sup> Section 9(3)(4), *Integrated Goods and Services Tax (IGST) Act, 2017*

<sup>155</sup> Section 13, *Central Goods and Services Tax (CGST) Act, 2017*

<sup>156</sup> Section 15, *Central Goods and Services Tax (CGST) Act, 2017*

employees, family members, companies, distributors and agents of each other.<sup>157</sup> The consideration includes taxes and charges levied under the laws other than GST and charged separately by the supplier.<sup>158</sup> Costs incurred by the recipient on behalf of the supplier cannot be included in transactional value and also include incidental costs at the time of delivery of goods or services, penalties and subsidies directly related to the price. Discounts, if reflected on invoice and if agreed upon prior to supply, are also not included in the supply value.<sup>159</sup>

In special cases, where determination of the value of supply is difficult as per the standard transactional value rules, alternative methods are provided by the government for calculating it. These include open market value, that is, what such goods or services would fetch in an open market; cost-based valuation at 110% of the cost incurred by the supplier; and the residual method based on the value of similar supplies at the same time and place.<sup>160</sup> For certain notified supplies, special guidelines might also be issued by the government to accurately ascertain valuation. This inclusive framework ensures that the taxable value reflects the consideration for goods or services so that the levy of GST is fair and transparent. Once the value of the taxable amount is determined, GST is payable on such value at the rate as prescribed under section 15.<sup>161</sup>

Under GST, multiple rates of tax can be adopted for different categories of goods and services.<sup>162</sup> The rates have been conceptualized to achieve equity and address a range of socio-economic objectives. GST rates on services include the following: 5% on essential services, including transportation services like rail and air and some services related to tourism. 12% on standard services includes restaurant services that are non-AC and some works contracts. 18% on most of the services would also include IT services, telecom, financial services, and digital services that are bundling. 28% on luxurious or high-end services, like premium hotel accommodations.<sup>163</sup> For bundled services supplied digitally, GST

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<sup>157</sup> Sharma K, Gupta, R, GST in India: Challenges and Prospects. 15 *Journal of Financial and Economic Policy*, 2, 2023, 234-256.

<sup>158</sup> Sharma K, Gupta, R, GST in India: Challenges and Prospects. 15 *Journal of Financial and Economic Policy*, 2, 2023, 234-256.

<sup>159</sup> Sharma K, Gupta, R, GST in India: Challenges and Prospects. 15 *Journal of Financial and Economic Policy*, 2, 2023, 234-256.

<sup>160</sup> Rule 27-31, Central Goods and Service Tax (CGST) Rules, 2017

<sup>161</sup> Section 14, *Central Goods and Services Tax (CGST) Act, 2017*

<sup>162</sup> Section 15, *Central Goods and Services Tax (CGST) Act, 2017*

<sup>163</sup> Section 15, *Central Goods and Services Tax (CGST) Act, 2017*

categorizes bundled services as composite supply or mixed supply, levying the rate of the principal supply in the case of composite bundles and the highest applicable rate in the case of mixed bundles.<sup>164</sup>

In the case of *G.A. Infra Pvt. Ltd. (Applicant) vs. Authority for Advance Rulings (AAR)*, AAR held that operation and maintenance services provided by G.A.<sup>165</sup> Infra Pvt. Ltd. under the Energy Service Company (ESCO) model were composite supplies, as they were integrated and indivisible. In addition, in the case of *M/s Sarj Educational Centre vs. West Bengal Appellate Authority for Advance Ruling (WBAAAR)*, the issue before the WBAAAR was whether the services of lodging and supply of food provided by the educational center were to be treated as a mixed supply under the GST Act.<sup>166</sup> It was held that the services were not being naturally bundled, thus the services shall be considered as separate supplies. As such, GST shall be levied proportionately in respect of the taxable components of services provided.

India's framework under GST adopts a systematic mechanism of appeals and review for redressal of disputes relating to taxes by weighing principles of natural justice with the efficiency of disposal.<sup>167</sup> It also gives taxpayers or aggrieved persons chances of being heard and granting adjournment for sufficient reasons. Decisions of the said authorities are appealable before the AA within three months and one month extension for valid reasons.<sup>168</sup> The appeal to the Tribunal covers the orders of AA or revisional authorities. In that respect, the tribunal will have both National/ Regional Benches in cases involving place of supply disputes and State/Area Benches for all other matters, providing a platform for exhaustive legal review.<sup>169</sup>

Beyond this, appeals on substantial questions of law are available to the High Courts or Supreme Court. While the High Court takes up only questions of law, the Supreme Court

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<sup>164</sup> Section 8, *Central Goods and Services Tax (CGST) Act, 2017*

<sup>165</sup> *G.A. Infra Pvt. Ltd. (Applicant) vs. Authority for Advance Rulings* (2019), Authority for Advance Rulings (AAR), India

<sup>166</sup> *M/s Sarj Educational Centre vs. West Bengal Appellate Authority for Advance Ruling* (2019), West Bengal Appellate Authority for Advance Ruling, India

<sup>167</sup> <<https://cbic-gst.gov.in/aces/Documents/appeal-rules.pdf>>-link on 8th January 2024

<sup>168</sup> <[https://gstcouncil.gov.in/sites/default/files/e-version-gst-flyers/Appeals\\_Review\\_Mechanism.pdf](https://gstcouncil.gov.in/sites/default/files/e-version-gst-flyers/Appeals_Review_Mechanism.pdf)>-link on 8th January 2024

<sup>169</sup> <<https://cleartax.in/s/gst-appeals>>-link on 8th January 2024

considers cases from the High Court or disputes from the Tribunal.<sup>170</sup> In addition, commissioners are allowed powers of review and revision regarding decisions made by subordinate officers that were considered improper.<sup>171</sup> All these features will go to show that the mechanism is oriented toward fairness, quick disposal of disputes, and clarity in interpretation of law and, therefore, a judicious balancing of taxpayer rights with protection of revenue.

GST rates, exemption, and other rules are revisited by the GST Council of central and state representatives from time to time—quarterly meetings or whenever felt necessary. Their comments and suggestions by all categories of stakeholders like industry associations, tax practitioners, and businesses have been actively considered while reviewing and carrying out the essential changes along with public responses.<sup>172</sup> This has, over time, translated into significant reforms, such as rationalization of tax rates, ease of compliance through e-invoicing and QR-based billing, and resolution of classification disputes on bundled services and digital offerings. Yet, the challenges persist with regard to a complex rate structure, coordination between state and central governments, and taxing of cross-border digital services.<sup>173</sup>

#### **4.5 Strengths and Weaknesses of India’s GST framework**

India’s GST has had both positive and negative impacts. On the positive side, it has simplified taxation by replacing multiple indirect taxes, reduced overlapping effects, and encouraged digitization through mandatory e-filing and electronic payments thus fostering greater transparency and compliance.<sup>174</sup> The unified system has also improved ease of doing business and boosted revenue collection in sectors like IT and e-commerce. However, negative impacts include high compliance costs for SMEs, frequent rule changes that create uncertainty, and initial economic disruptions, particularly for small businesses. Additionally, the taxation of essential goods and services at higher rates has had a regressive impact, disproportionately

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<sup>170</sup> <<https://cleartax.in/s/gst-appeals>>-link on 8th January 2024

<sup>171</sup> <<https://cleartax.in/s/gst-appeals>>-link on 8th January 2024

<sup>172</sup> <<https://cleartax.in/s/gst-news-and-announcements>>-link on 8th January 2024

<sup>173</sup> <<https://cleartax.in/s/gst-news-and-announcements>>-link on 8th January 2024

<sup>174</sup> <<https://cleartax.in/s/gst-news-and-announcements>>-link on 8th January 2024

affecting lower-income groups, while litigation and disputes over classifications and valuations still remain prevalent.<sup>175</sup>

India's GST framework has revolutionized its taxation system, thus creating a more transparent and efficient mechanism. However, challenges in rate structure, compliance, and cross-border service taxation remain significant. By refining its review mechanisms and addressing structural issues, India could further enhance the efficiency of its GST system. Kenya, or other nations considering GST-like reforms, could learn from India's successes and challenges to design adaptable and context-specific frameworks.

#### **4.6 An Overview of Australia's Goods and Service Tax**

Goods and Service Tax was introduced in Australia on 1st July 2000 to replace the wholesale sales tax system to provide a less complicated indirect tax structure. It is a broad-based value-added tax levied at 10% on most goods and services consumed and sold in the country.<sup>176</sup> The New Tax System, the Goods and Services Tax Act 1999, is the legislation that underpins GST. It includes core principles in respect to taxable supplies, input tax credits, and requirements and obligations for registration. The final consumer ultimately bears the burden of the tax.

Section 9(5) of the New Tax System (Goods and Services Tax) Act provides that a supply will be treated as taxable only if: i) It is made for consideration (a payment), ii) In the furtherance of an enterprise iii) Connected with Australia and v) Not as a GST-free or input-taxed supply.<sup>177</sup> Section 38 of the GST lists services which are exempt- similar to zero-rated supplies under other VATs.<sup>178</sup> These include healthcare services such as medical consultation and hospital treatments, educational services, and basic food items. Businesses turning over AUD 75,000 annually, or AUD 150,000 for non-profits, are supposed to register for the GST, although the smaller ones are allowed optionally.<sup>179</sup> The GST would also fall on

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<sup>175</sup> DeepawareN, Dwivedi S, GST in india: its impact on indian economy, 7 International Journal of Novel Research and Development 12,2022,338-344

<sup>176</sup> Parliamentary Educational Office, *Goods and Service Tax* (2000)

<sup>177</sup> Section 5(9), *New Tax System (Goods and Services Tax) Act*, (1999)

<sup>178</sup> Section 38, *New Tax System (Goods and Services Tax) Act*, (1999)

<sup>179</sup> Section 23(15), *New Tax System (Goods and Services Tax) Act*, (1999)

imported services and goods valued below AUD 1000, like streaming services and streamlining platforms, when these are supplied to Australian customers.

The reverse charge mechanism works under B2B supplies. It becomes the liability of the recipient, instead of the supplier, to self-assess and pay for the GST, particularly under services offered by non-resident suppliers; therefore, shifting it from the supplier to the recipient.<sup>180</sup> Australia's GST also draws a line between mixed and composite supplies, stating that composite supplies, like a bundled product with one main taxable component, are treated as a single supply, while in mixed supplies where one item is taxable and the other is exempt, or each has a different tax status, GST is applied proportionally to the taxable components only.<sup>181</sup>

The Australian GST system is fairly simple: most taxable goods and services are burdened with a standard rate of 10%, such as retail items of clothing and electronics, digital services such as streaming, and professional services such as accounting and legal work.<sup>182</sup> Supplies that are GST-free are taxed at a rate of 0%, and these include health care, basic food, education, and exports. Input-taxed supplies, including residential rent and financial services, do not attract GST.<sup>183</sup> To ease the administrative burden, registered businesses lodge quarterly Business Activity Statements, as most transactions, reporting, and payments are done electronically. Australia's GST system is somewhat of a model for simplicity, providing a clear framework for exemptions, registration, and compliance.<sup>184</sup>

#### **4.7 Treatment of Bundled Services in Australia's GST**

Australia's GST system handles bundled services through its provisions on mixed and composite supplies.<sup>185</sup> Composite supplies, where goods or services are naturally bundled together and one component is dominant, are treated as a single supply, with GST applied to

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<sup>180</sup> Section 84(5), *New Tax System (Goods and Services Tax) Act*, (1999)

<sup>181</sup> Section 9(80) *New Tax System (Goods and Services Tax) Act*, (1999)

<sup>182</sup> <<https://docs.oracle.com/en/applications/jd-edwards/localizations/9.2/eaal/understanding-australian-goods-and-services-tax-gst.html> >-link on 9 January 2024

<sup>183</sup> <<https://docs.oracle.com/en/applications/jd-edwards/localizations/9.2/eaal/understanding-australian-goods-and-services-tax-gst.html> >-link on 9 January 2024

<sup>184</sup> <<https://docs.oracle.com/en/applications/jd-edwards/localizations/9.2/eaal/understanding-australian-goods-and-services-tax-gst.html> >-link on 9 January 2024

<sup>185</sup> Section 9(80) *New Tax System (Goods and Services Tax) Act*, (1999)

the main component. For example, a subscription bundle that includes taxable software and GST-free educational content would apply GST only to the software. Mixed supplies, on the other hand, consist of distinct components that are treated separately. Each component is assessed individually, with GST applied proportionally to the taxable items. This approach ensures fair taxation while maintaining clarity for businesses and consumers dealing with bundled offerings.

Australia employs a flexible review system to ensure the GST framework remains relevant. The system undergoes periodic reviews to ensure compliance and address emerging issues.<sup>186</sup> Since 1 July 2012, a four-year period of review allows the Australian Tax Office to amend assessment for GST. If an assessment is amended within this period, a refreshed 4-year periodic review applies to the amended particular.<sup>187</sup> Under the GST assurance program, the ATO performs initial and yearly refresh reviews for the top 100 taxpayers to maintain high compliance levels. Large companies are also required to submit an additional annual GST return to report significant changes and guarantee continued compliance.<sup>188</sup> These reviews help maintain the integrity of the GST system, ensuring businesses adhere to their tax obligations effectively. Past reviews such as the Henry Tax Review evaluated GST's efficiency and suggested broadening the tax base to reduce exemptions.<sup>189</sup> Since GST revenue is distributed to states, periodic assessments ensure equity in allocation and address concerns raised by state governments.

Australia's court system handles disputes related to the Goods and Services Tax (GST) through various legal mechanisms. The Australian Taxation Office (ATO) can initiate legal proceedings in court if there are disputes over GST liabilities, compliance, or other related matters.<sup>190</sup> In addition, taxpayers can also take disputes to court if they disagree with the ATO's decisions regarding GST. To appeal a decision related to GST in Australia, the case is referred to the Federal Court of Australia.<sup>191</sup> The Federal Court handles disputes involving GST and

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<sup>186</sup> Australian Taxation Office, *Period of Review*, 2024

<sup>187</sup> Australian Taxation Office, *Period of Review*, 2024

<sup>188</sup> Australian Taxation Office, *Top 100 GST Assurance Program*, 2024

<sup>189</sup> Creighton A, *The Henry Tax Review: A Liberal Critique*. Centre for Independent Studies, 2012, 2-11

<sup>190</sup> Australian Taxation Office, *Goods and Services Tax: GST consequences of court orders and out-of-court settlements*, 2001

<sup>191</sup> Australian Taxation Office, *Goods and Services Tax: GST consequences of court orders and out-of-court settlements*, 2001

decisions from this court can be further appealed to the Full Federal Court if necessary.<sup>192</sup> In some cases, appeals may reach the High Court of Australia.<sup>193</sup>

#### **4.8 Positive and Negative Impacts of Australia's GST**

The Goods and Services Tax in Australia has had both positive and negative impacts. On the positive side, the GST has provided a stable and reliable revenue stream for the government.<sup>194</sup> It has also simplified the tax system, making it more transparent and efficient, and helped broaden the tax base. However, the GST has faced its fair share of criticism on account of being a regressive tax, since it burdens lower-income households that spend a higher fraction of their income on taxable goods and services.<sup>195</sup> This is basically because most goods and services attract a single rate of tax under GST, irrespective of the income level of the buyer.<sup>196</sup> Generally, the share of expenditure on goods and services subject to GST, such as food, transportation, and utilities, is higher for low-income households. For that reason, they pay a greater percentage of their income in taxes than do richer people who might spend a smaller part of their income on taxable goods. It contributes to a situation in which the burden of taxation weighs most heavily upon those least able to bear it. In addition, compliance with the GST has been costly for business since its inception due to the required reporting and administrative responsibilities.<sup>197</sup>

#### **4.9 Lessons Drawn in the Analysis of Kenya's DST, India, and Australia's GST concerning Bundled Digital Services.**

Kenya, Australia, and India have different approaches to taxing bundled digital services under their respective tax systems. Kenya's Digital Service Tax (DST) framework, introduced in 2021, applies a 1.5% tax on the gross transaction value for digital services. However, it

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<sup>192</sup> Australian Taxation Office, *Goods and Services Tax: GST consequences of court orders and out-of-court settlements*, 2001

<sup>193</sup> Gorhe A, *Raising an Appeal under GST to the High Court and Supreme Court*, IRISGST, 2023

<sup>194</sup> Klynveld Peat Marwick Goerdeler, *Economic Analysis of the Impacts of Using GST to Reform Taxes*, 2011, 2

<sup>195</sup> Breen J, Bergin S, Roberts I, Sims R, *The impact of the introduction of the GST on small business in Australia*, 10 *Asian review of accounting* 1, 2002, 89-104

<sup>196</sup> Tran-Nam, B, *The Goods and Services Tax (GST)* in Luetjens, Joannah, Michael Mintrom, and Paul 't Hart, (eds). *Successful Public Policy: Lessons from Australia and New Zealand*, 1ed, ANU Press, Australia, 235-255.

<sup>197</sup> Breen J, Bergin S, Roberts I, Sims R, *The impact of the introduction of the GST on small business in Australia*, 10 *Asian review of accounting* 1, 2002, 89-104

lacks clear guidelines on how to treat bundles with both taxable and non-taxable components, which creates ambiguity for businesses and tax authorities. Kenya can learn from the clear definitions and structured frameworks adopted by India and Australia in their taxation of bundled digital services. Both jurisdictions eliminate uncertainty for enterprises and tax authorities by making a distinction between mixed supply (individually assessed components) and composite supplies (naturally grouped and taxed as a single unit). Furthermore, India provides a transparent technique for figuring out the taxable value of services, especially for complicated bundles from its strong valuation mechanisms, which include transaction value, open market value, and cost-based methodologies while Australia has a standard 10% valuation on goods and services. Valuation procedures from India can be incorporated into Kenya's DST framework to address the ambiguities that currently hinder compliance, assure equitable tax application, and give clarity.

Additionally, Australia and India both have different periodic reviews India's periodic reviews, conducted by the GST Council, are frequent and collaborative, focusing on rate adjustments, exemptions, and stakeholder feedback. While this approach is dynamic, it can create uncertainty for businesses. In contrast, Australia's reviews, led by the Australian Taxation Office, follow a structured four-year cycle with annual compliance checks emphasizing stability and clarity. India prioritizes adaptability, while Australia focuses on long-term consistency and efficiency. Kenya could implement Australia's system of periodic evaluations to guarantee flexibility in a rapidly changing digital economy.

Frequent reviews help frameworks remain current by taking stakeholder concerns and technology developments into account. Digital reporting platforms like Australia's Business Activity Statement (BAS) are two examples of simplified compliance procedures that can reduce administrative workloads and promote greater compliance rates. Furthermore, as seen in Australia and India, exclusions for critical services can strike a balance between income generation and equity. Kenya may improve its DST framework to offer precise instructions, improve compliance, and guarantee equity in taxing packaged digital services by incorporating these lessons.

#### **4.10 Conclusion**

Both India and Australia provide effective frameworks for taxing bundled digital services; however, Australia's approach stands out more as it is more adaptable to Kenya's context. Australia's periodic review system ensures that its GST framework remains relevant in the face of evolving technological and economic advancements. By systematically assessing compliance and addressing new challenges, the Australian model provides an adaptable taxation mechanism which is vital for rapidly growing digital economies like Kenya. Australia's simpler tax structure with a single GST rate of 10% on most services reduces administrative complexity thus making it easier for businesses. This clarity contrasts with India's multi-tiered GST system which can be cumbersome due to its frequent rate changes and the complexity of multiple tax rates for various services despite its comprehensiveness.

India's valuation mechanism and detailed guidelines for composite and mixed supplies provide a comprehensive framework for determining tax treatment of bundled services which Kenya can learn from. Both jurisdictions clearly define bundled services and ensure equitable treatment for taxpayers, however, Australia's simplicity and adaptability make it a better fit for Kenya's current challenges this is because its review mechanisms and compliance processes are straightforward. Kenya could also benefit from India's strong valuation techniques to refine DST to diminish its ambiguous provisions. By blending these approaches, Kenya can create a more balanced and futuristic system to address the complexities of taxing bundled digital services effectively.

### **CHAPTER 5**

#### **5.0 RECOMMENDATIONS AND CONCLUSION**

##### **5.1 Introduction**

Kenya's adoption of the Digital Service Tax is a transformative step toward taxing digital services and has expanded the tax base. However, the findings highlight gaps in Kenya's DST framework, particularly in the taxation of bundled digital services. These gaps include the lack of clarity on guidelines for apportioning values to bundles with both taxable and non-taxable components leading to ambiguity in interpretation and potential compliance issues for

business. The absence of periodic review mechanisms makes it difficult to keep the framework aligned with the evolving nature of digital services thus leading to outdated applications. This chapter concludes the study by summarizing the key findings and their implications and offering recommendations to enhance Kenya's DST framework. It integrates insights from the analysis of Kenya's current approach to taxing bundled digital services and the lessons drawn from the comparative study of Australia and India.

The focus is centered on proposing actionable strategies to address the gaps and ambiguities identified in the DST framework, especially on definitions, periodic review mechanisms, and treatment of bundled services. The chapter explores the implications of these recommendations for Kenya's digital economy, revenue generation, and international competitiveness in digital taxation. By building on the analysis of previous chapters, this chapter aims to provide a clear guide for policymakers, tax authorities, and stakeholders for a more precise equitable, and efficient taxation system for digital services.

## **5.2 Key Findings in Taxation of Bundled Digital Services in Kenya**

One primary finding is the ambiguity in the definition of bundled digital services. The current DST framework in Kenya lacks clear definitions for services that combine taxable and non-taxable elements leading to confusion in determining applicable tax rates and valuation. The ambiguity hinders effective policy implementation as policymakers are unable to craft revenue-targeting strategies for the digital economy. Tax authorities also face challenges in enforcing tax consistently leading to discrepancies in how bundled services are taxed. Businesses offering digital services on the other hand face increased compliance costs and uncertainty, which could discourage investments in that sector.

Another major finding is the inefficiencies in the current DST framework. The absence of periodic review mechanisms means the framework is more reactive rather than proactive, this leaves little room for timely adjustments as the digital economy evolves. The gap makes it difficult for policymakers to track the impact of the tax and adjust the policies. Tax authorities find that the inefficiency results in outdated enforcement practices that do not account for business models or technological advances. Stakeholders are faced with an unstable tax environment making it harder to plan for future and unexpected changes in tax policy.

Moreover, there exists an issue of apportioning value in bundled digital services that combine both taxable and non-taxable digital services. The risk of legal clarity by policymakers diminishes public confidence in the tax system. Tax authorities on the other hand face challenges in accessing the correct tax liabilities, leading to disputes and inconsistencies. Digital service providers face the risk of being overtaxed which would increase operating costs, and potential fines, and affect their competitive position in the market.

### **5.3 Policy Recommendations for Kenya's DST Framework**

The DST framework in Kenya needs an express and detailed definition of what constitutes bundled digital services to eliminate ambiguities that exist. Such a definition should categorize components of bundled services that constitute a taxable or a non-taxable supply for clarity to both taxpayers and the KRA. For instance, streaming services sometimes package non-taxable educational content with taxable entertainment; a clear definition will reduce disputes. The government can also, in practice, consult with industry players and consider contributions from comparable jurisdictions such as Australia and India to provide a detailed definition.

The periodic review of the DST framework is necessary, to keep it in tune with technology advancement and market dynamics. This may be institutionalized through a statutory review clause that may have a biennial assessment. In this regard, leading such reviews could be a task force consisting of stakeholders from KRA, representatives from the tech industry, and law experts. This also emulates Australia's proactive changes in its tax policy and ensures Kenya's DST is agile and forward-looking.

Borrowing from international best practices, Kenya can incorporate aspects of Australia's GST framework and India's GST to appropriate value in bundled services. Australia and India have a clear distinction between mixed and composite digital services and have clear rates of income arising from digital transactions. Kenya can adopt a clear distinction of the type of bundled service. A blend of India's valuation methods and Australia's simple rates will establish low compliance costs for the state.

Kenya could make it easy to comply by introducing an e-filing and payment portal, user-friendly for tax registration, filing, and payment. The system would include automatic calculations, with detailed guidance given to digital service providers. Such a practical solution will reduce administrative burdens and improve voluntary compliance. Second, Kenya may also engage in consultations with stakeholders to co-develop practical solutions and provide incentives for early adopters, such as reduced penalties.

A revenue apportionment model would address the complexity of taxing bundled services. Businesses can comply without disputes by apportioning revenues into their respective taxable and nontaxable segments based on service usage. For instance, a streaming service can apportion revenue between non-taxable educational content and taxable entertainment content based on user consumption data. This model is practical given the increasing use of data analytics by businesses.

The dispute resolution mechanisms need to be enhanced in order to handle the disputes relating to DST efficiently. This, in essence, will reduce delays and bring clarity in the establishment of a specialized tribunal to handle DST disputes. To make this a reality, Kenya can train legal and tax professionals to handle cases touching on the digital economy. This will complement the KRA's role in clarifying complex cases through alternative dispute resolution frameworks.

However, sensitization and education campaigns are equally vital. The government can liaise with industry associations to sensitize businesses about their obligations regarding DST through workshops, webinars, and published guidelines. Such campaigns ensure better awareness among taxpayers about their compliance. This could practically begin with targeted awareness for major players like e-commerce and streaming platforms.

Kenya should promote regional and international cooperation to harmonize DST policies. For instance, collaborating with African countries through regional economic blocs like the African Union can help develop unified standards that avoid double taxation. Additionally,

Kenya can align its policies with the OECD/G20 Inclusive Framework on BEPS, ensuring that they meet international benchmarks.

Finally, for the promotion of innovation, Kenya can exempt startups and small businesses from the application of the DST or accord them reduced rates for their initial years of operation. In this way, it will enhance growth in the digital economy while compliance is ensured progressively. For instance, the exemption will apply to startups generating below a certain threshold, making this policy very workable. These recommendations balance revenue generation for Kenya from the digital economy while nurturing growth and clarity toward making the country closer to international best practices.

Challenges Kenya may face in implementing these recommendations include defining and categorizing bundled digital services, which might be complicated due to the varied nature of digital transactions. Administrative obstacles and lack of consensus from all stakeholders might raise resistance to the establishment of a periodic review mechanism. The adoption of international best practices might entail far-reaching adjustments at both the legislative and policy levels, which may be time-consuming. This in turn, demands huge investments in technology and capacity building to make compliance smooth through e-filing systems and revenue apportionment models. Efficient dispute resolution requires special training and capacity building for lawyers and tax consultants. Sensitization demands continuous coordination and financing. Finally, balancing revenue generation with exemptions for startups might result in initial shortfalls in revenue accumulation, which again creates challenges in finding the right balance between promoting growth and ensuring tax compliance.

#### **5.4 Conclusion**

Whereas Kenya is moving to adopt a more comprehensive and structured system of digital services tax, the general trend in many countries is the shift towards Single Event and Periodic Taxation. SEPT provides that tax can be levied at the time of, for example, the supply or consumption of a service rather than over a continuous or periodic period. This model provides a lot of clarity and simplicity for the business as well as the tax authorities. It allows

businesses to better estimate and report their tax liabilities because of the application of tax at consumption. Besides, SEPT decreases the administrative burden part of the businesses as well as the tax authorities, since it makes collection and reporting processes easier. Many jurisdictions are considering adopting SEPT to make digital tax systems more efficient, especially with the growth of the digital economy and the inability of traditional taxation systems to keep pace with new business models.

In Kenya, the transition to a SEPT model of bundled digital services could alleviate part of the ambiguity characterizing the current framework for DST. It would simplify the level of specific taxable events, such as when a consumer uses or buys a particular bundle of digital services. This would enable the KRA to more easily monitor and enforce tax compliance, while at the same time giving businesses a more predictable and simplified regime to work with. The SEPT model could further enhance Kenya's digital economy by ensuring the facilitation of adaptability in the system of taxation to the rapid evolution of digital services and that it would be able to accommodate new types of service bundling when they are developed. On the other hand, SEPT will require careful planning and considerable investment in infrastructure and training but could have long-term benefits in clarity, efficiency, and compliance for Kenya's digital tax system.

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