

Tax Alert

The Value Added Tax (Digital Marketplace Supply) Regulations, 2020

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In brief

The Cabinet Secretary for the National Treasury and Planning on 9 October 2020 gazetted the Value Added Tax (Digital Marketplace Supply) Regulations, 2020. We highlight, in this tax alert, the salient provisions of the Regulations and their impact on persons transacting via digital marketplaces.

Introduction

With advancements in technology and use of internet, more and more businesses and people are embracing doing business online also known as 'e-commerce'. E-commerce *inter alia* allows businesses to sell products and services to consumers through online markets, commonly referred to as 'digital marketplace'.

Whilst digital marketplaces, and the broader e-commerce industry, have presented immense economic growth and opportunities, they have in turn presented collection and administrative challenges for tax authorities world over. In response, we have seen Governments across the globe implement tax laws aimed at capturing the fast-growing digital economy.

In Kenya, on 9 October 2020, the Cabinet Secretary for the National Treasury and Planning ("CS NT") published in the Government Gazette the Value Added Tax (Digital Market Place Supply) Regulations, 2020 ("the Regulations"). The Regulations seek to operationalize the collection of Value Added Tax ("VAT") on digital marketplace supplies as enshrined in the Value Added Tax Act, 2013 ("VAT Act").

The VAT Act defines a "digital marketplace" as *a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means*. Further, the charging provision of the VAT Act (section 5) makes it clear that supplies through a digital marketplace are taxable but goes ahead to

require the CS NT to provide mechanism for implementing VAT in this sector.

The history of VAT on digital economy in Kenya

The imposition of VAT on e-commerce was first introduced into the VAT legislation following the enactment of the current VAT Act in September 2013. The VAT Act, 2013 introduced provisions requiring non-resident suppliers of '*electronic services*' (as defined in the Act) to account for VAT on their supplies to non-registered recipients in Kenya (B2C). The VAT legislation required the non-resident suppliers without a place of business in Kenya to appoint tax representatives to fulfill their VAT obligations.

However, the operationalization of the tax on such services has remained a challenge primarily owing to the onerous requirements associated with the registration process and the lack of clarity on the tax representative's appointment. For instance, non-resident suppliers seeking registration were required to provide Kenyan tax profiles - personal identification number (PIN) for their directors and local incorporation documents, which defeated the intention of the law.

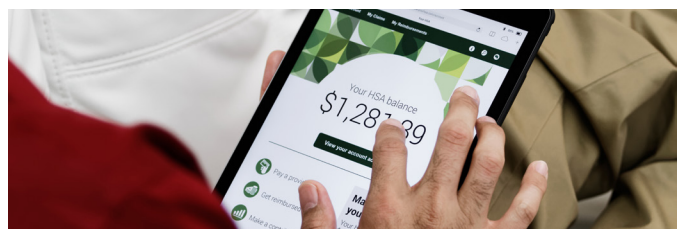
The provisions relating to appointment of tax representatives were transitioned from the VAT legislation into the Tax Procedures Act ("TPA") in 2015. However, the registration challenges noted above were not addressed – the Regulations have attempted to provide the much-needed guidance to taxpayers and the revenue authority alike.

The Regulations have *inter alia* sought to provide clarity on: the nature of supplies subject to VAT when supplied through a digital market place; who is liable for the VAT on digital market supplies; and importantly, a simplified VAT registration regime for non-residents liable to VAT in Kenya.

We have set out below our analysis of the pertinent provisions of the Regulations and our views on the implications for business including potential interpretation and implementation challenges.

Regulation	Provisions	Our comments
Regulation 2	Interpretation: "digital marketplace supply" means the supply of a services made on a digital marketplace.	<p>We note that while the VAT Act envisages the supply of both goods and services, the Regulations are restricted to services.</p> <p>Perhaps it is envisaged that supply of goods by non-resident suppliers through a digital marketplace will be captured by the importation processes and customs duty levied thereon.</p>
Regulation 3 – Scope of taxable supply through digital marketplace	<p>Taxable supplies made through a digital marketplace include—</p> <ol style="list-style-type: none"> downloadable digital content including downloadable mobile applications, e-books and films; subscription-based media including news, magazines and journals; over-the-top services including streaming television shows, music, podcasts and any form of digital content; software programmes including software, drivers, website filters and firewalls; electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services; music and games; search engine and automated helpdesk services including customisable search engine services; tickets for live events, theatres or restaurants; distance teaching through pre-recorded media or e-learning including online courses and training; digital content for listening, viewing or playing on any audio, visual or digital media; services that links the supplier to the recipient including transport hailing services or platforms; electronic services under section 8 (3) of the VAT Act; and any other service provided through a digital marketplace that is not exempt under the VAT Act. 	<p>The Regulation has set out an all-encompassing scope of taxable supplies that includes any services that are not exempt from tax under the VAT Act.</p> <p>Above said, the Regulation <i>inter alia</i> sets out the supply of "distance teaching via pre-recorded medium or e-learning including supply of online courses and training" as services subject to VAT.</p> <p>The VAT Act has exempted supply of education services provided by pre- primary, primary, secondary school, technical college or university or any institution established for the promotion of adult education, vocational training or technical education.</p> <p>In our view, there is a need to align the Regulation to the provisions of the VAT Act to ensure that exempt education services are not caught in the VAT net.</p> <p>Separately, the Regulation does not address the taxation of the listed services where supplied outside a digital marketplace.</p>
Regulation 4 – Application of tax	<ol style="list-style-type: none"> Tax shall apply to taxable supplies specified under regulation 3 when supplied in Kenya. Where the supply under regulation 3 is made in a business-to business (B2B) transaction, the provisions of section 10 shall apply. A business entity that is required to account for the value added tax on taxable supplies made on a digital marketplace under section 10 shall notify the supplier from the export country that the supplier is not required to account for the tax in Kenya for the supply. Where the supplier from an export country is notified as provided under paragraph (3), the supplier shall not be required to charge the tax on the supply to the business entity. Where a business entity fails to notify the supplier under paragraph (3) and the supplier charges tax, the business entity shall not be allowed to deduct the tax charged. 	<p>The Regulation gives clarity that B2B transactions subject to VAT on imported services will not be subject to VAT under the digital marketplace regime. This clarification avoids potential double taxation of such services.</p> <p>However, seeing that the scope of VAT on imported services extends to Business to Consumer ("B2C") services, the Regulation could have perhaps made it clear that B2C transaction taxed under the Regulations will not be subject to VAT on imported services. For now, such services risk double taxation.</p> <p>Additionally, we note that the Regulation has not provided clarity on how a non-resident supplier making both B2B and B2C supplies will account for VAT i.e. will B2B supplies be subject to VAT under section 10 even where made by a supplier that is already registered as a result of being involved in B2C supplies?</p>
Regulation 5 - Registration	<ol style="list-style-type: none"> A person supplying the taxable services specified in regulation 3 shall register for tax in Kenya if— <ol style="list-style-type: none"> the supplies are made by a person from an export country to a recipient in Kenya in a B2C transaction; and the person is conducting business in Kenya in accordance with section 8 (2) and any of the following circumstances apply— <ol style="list-style-type: none"> the recipient of the supply is in Kenya; the payment for the services is made to the supplier in the export country from a bank registered under the Banking Act; or the payment for the services that is made to the supplier in the export country is authorised in Kenya. A person from an export country who makes a business-to consumer (B2C) supply of services to a recipient who is in Kenya shall register for tax through a simplified tax registration framework in accordance with regulation 7. 	<p>The simplified VAT regime will hopefully alleviate the registration challenges faced by B2C suppliers in a digital marketplace.</p> <p>We note that the Regulation does not restrict the simplified VAT registration to suppliers of services through a digital marketplace. We trust this suggests that suppliers of electronic services outside a digital marketplace e.g. as envisaged in Section 8 (3) of the VAT Act will also qualify for simplified VAT registration.</p>

Regulation	Provisions	Our comments
Regulation 6 - Appointment of tax representatives	Despite regulation 5 (2), a person from an export country making a B2C supply to a recipient in Kenya who elects not to register in accordance with regulation 7 shall appoint a tax representative in accordance with section 15A of the Tax Procedures Act, 2015.	As much as the Regulations has provided for appointment of a tax representative by businesses supplying B2C services, the guidelines governing the appointment and operation of the tax representative system are yet to be published. The manner of appointment and the linkage between the tax representatives own tax profile/PIN and that/those of the non-resident suppliers remains unclear. In the absence of these guidelines, we foresee many businesses encountering challenges in attempting to comply with the VAT legislation. The onus is, therefore, on the Revenue Authority to fast-track the issuance of the guidelines governing the appointment and operation of the tax representative system.
Regulation 7 - Simplified tax registration framework.	<ol style="list-style-type: none"> An application for registration under the simplified tax registration framework shall be done through an online registration form prescribed by the Commissioner. The information required for registration under paragraph (2) shall include— <ol style="list-style-type: none"> the name of the business including the business's trading name; the name of the contact person responsible for tax matters; the postal address or registered address of the business and its contact person; the telephone number of the contact person; the email address of the contact person; the websites or uniform resource locators (URLs) of the supplier through which business is conducted; the national tax identification number issued to the supplier in the supplier's jurisdiction; the certificate of incorporation or registration issued to the business in the country where the business is incorporated; and any other information that the Commissioner may require. An applicant under paragraph (2) may be required to submit to the Commissioner additional documents that may be necessary to substantiate the information provided in the application. Upon registration under this regulation, the Commissioner shall issue the applicant with a PIN for the purpose of filing returns and the payment of tax. 	The simplified tax registration framework is a welcome move by the Government. However, we note that despite the gazettelement of the Regulations, the Kenya Revenue Authority iTax system is yet to be configured to accommodate registration through the simplified tax registration framework. The iTax system will need to be configured to accept simplified registrations with immediate effect to avoid a rush towards the end of the registration deadline set in law (discussed below). We also note that some of the documents/information required for the simplified VAT registration may not be applicable/available for some suppliers seeking VAT registration such as a national tax identification number and/or certificate of incorporation or registration. We implore KRA to configure iTax in a flexible manner to allow bypass on non-applicable fields. Further, the discretion given to the Commissioner with regards to documents required for VAT registration is too wide and open to subjectivity, which goes against the principles of certainty and simplicity in taxation.
Regulation 8 - Place of supply	<ol style="list-style-type: none"> A supply on a digital marketplace shall be deemed to have been made in Kenya where the recipient of the supply is in Kenya. In determining whether the recipient of a supply is in Kenya, the Commissioner shall consider: <ol style="list-style-type: none"> whether the payment proxy including credit card or debit card information and bank account details of the recipient of the digital supplies is in Kenya; or whether the residence proxy including the billing or home address or access proxy including internet address, mobile country code of the SIM card of the recipient is in Kenya. 	Similarly to the provisions of the VAT Act on electronic services, the Regulations provide that the key determinant of whether a supply on a digital marketplace shall be deemed to have been made in Kenya, is whether the recipient of the supply is in Kenya at the time of the supply.
Regulation 9 – Time of supply	The time of supply on a digital marketplace shall be the earlier of: <ol style="list-style-type: none"> the date on which the payment for the supply is received in whole or in part; or the date on which the invoice or receipt for the supply is issued. 	The Regulation aligns to the definition of 'time of supply' as defined in the primary VAT legislation. However, it remains unclear why the "date of delivery of services", which is a third item to consider when establishing the correct time of supply as per the VAT Act has been excluded from the Regulation. Perhaps on account of anticipated difficulty in tracking date of supply.
Regulation 10 – Exemption from issuing an electronic tax invoice	A B2C supplier on a digital marketplace from an export country who is registered under these Regulations shall not be required to issue an electronic tax invoice: Provided that the supplier shall issue an invoice or receipt showing the value of the supply and the tax deducted thereon.	The Regulation has exempted B2C suppliers from the requirement to issue an electronic tax invoice on supplies made. This is a welcome reprieve aligned to the simplicity canon of taxation.



Regulation	Provisions	Our comments
Regulation 11 – Claim for input tax	A deduction of input tax by a supplier shall not be allowed for business-to-consumer transactions for a supply on a digital marketplace.	<p>Section 17 of the VAT Act provides that a registered person shall be entitled to input tax deduction incurred on a taxable supply to the extent that the same was used to make taxable supplies. This Regulation, therefore, contradicts the primary VAT legislation on input tax deduction.</p> <p>It is debatable whether the CS NT can take away the entitlement of input tax deduction from businesses making B2C supplies as long as the input tax was incurred in making taxable supplies.</p> <p>While we do not expect the non-resident suppliers of services to incur significant VAT in Kenya, some of the expenses that they incur e.g. professional services including those offered by the tax representatives will be subject to VAT. The restriction of input tax claims will drive up the cost of doing business for digital marketplace suppliers and potentially make their services more expensive.</p>
Regulation 12 – Accounting for and payment of tax	<ol style="list-style-type: none"> The tax for a supply made on a digital marketplace from an export country to a recipient in Kenya in a B2C transaction shall be paid by the supplier or the tax representative of the supplier. Where an intermediary makes a supply on a digital marketplace on behalf of another person, the intermediary shall be required to charge and account for the tax on the supply whether such other person is registered for tax or not. 	<p>The requirement for an intermediary to account for VAT, whether or not the supplier is registered for VAT ignores basic principles of the Kenyan VAT regime. VAT registration and, by extension, VAT accounting is subject to a VAT registration threshold. In our view suppliers of services who do not meet the VAT registration threshold do not have an obligation to account for VAT.</p> <p>Accordingly, it is debatable whether the CS NT is empowered to impose a VAT obligation not enshrined in law. In our view, the obligations imposed on an intermediary should mirror the obligations of his/her principal. Otherwise, the Regulation presents a risk of supplies that fall outside the scope of VAT being subjected to tax.</p>
Regulation 13 – Amendment of returns	<ol style="list-style-type: none"> Any amendments to a return submitted in accordance with these Regulations shall be made in accordance with section 31 of the Tax Procedures Act, 2015. Where an amendment under paragraph (1) results in the overpayment of tax, the amount overpaid shall be retained as a credit in favour of the person who overpaid and offset against the tax payable in the subsequent tax period. 	The offset of overpaid taxes against payment in subsequent returns is a welcome inclusion vis-à-vis the onerous VAT refund provision currently enshrined in the TPA.
Regulation 15 – Transitional provisions	A supplier on a digital marketplace from an export country who is required to register under these Regulations shall apply to the Commissioner for registration within six months from the date of publication of these Regulations	<p>We note that whilst the Regulations were gazetted on 9 October 2020, the Regulations are dated 10 September 2020 thus bringing controversy on the effective date of the Regulations.</p> <p>Further, Section 67 of the VAT Act, 2013 provides that the CS NT is required to table the Regulations before the National Assembly for approval before they take effect. We note that the Regulations are yet to be tabled by the CS NT before the National Assembly, which suggests neither of the two dates referenced above qualifies as an effective date unless ratified by the National Assembly. We hope that CS NT will pronounce himself unequivocally on the effective date post the National Assembly approval to avoid the imminent confusion and potential retrospective application of the Regulations.</p>

Conclusion

In our view whereas the publication of Value Added Tax (Digital Marketplace Supply) Regulations, 2020 has brought more clarity on imposition of VAT on digital marketplace, and is therefore a welcome move, there are still some challenges posed by the digital economy that ought to be considered by the Revenue Authority and the tax policy makers to ensure smooth and seamless enforcement of compliance with the VAT legislation.

At PwC we have a dedicated team to assist you with carrying out a detailed review of the Regulations vis-a-vis your business operations and advise you on the next steps to ensure compliance with the Regulations. Please feel free to contact your usual PwC contact or any of the team above should you wish to discuss this or any other matter.