UNIVERISTY OF NAIROBI

SCHOOL OF LAW

MASTER OF LAWS

GPR 699: RESEARCH PROJECT

TAXATION AND ELECTRONIC COMMERCE: AN ASSESSMENT OF THE KENYAN LEGAL AND REGULATORY FRAMEWORK

SUBMITTED BY

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A THESIS SUBMITTED TO THE UNIVERSITY OF NAIROBI IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF LAWS

SUPERVISOR: DR KEN OBURA

DECLARATION

I, Musau Susan Kavuu, declare that this is my original work and has not been presented for the award of a degree or any other award in any other university. Where works by other people have been used, references have been provided.

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Date: 19TH October, 2022

This thesis has been submitted for examination with my approval as university supervisor.

Supervisor: Dr. Ken Obura

Signature: Ken Obura ……………………………..

Date: 2022/10/25 ………………………………

DEDICATION

This thesis is dedicated to my family.

Thank you so much for your support and encouragement.

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I would like to thank the Almighty God for life and for enabling me to undertake this study. Secondly I would like to thank my parents for always motivating me to take on new challenges, including this study, with bravery.

Thirdly I would like to acknowledge my husband Tony Makau, my daughter Melanie Makau & my son Gabriel Makau. You have been a source of great inspiration.

LIST OF ABBREVIATIONS AND ACRONYMS

BEPS	Base Erosion and Profit Sharing
B2B	Business to Business
E-Commerce	Electronic Commerce
DST	Digital Service Tax
ICT	Information and Communication Technology
KICA	Kenya Information and Communications Act
KRA	Kenya Revenue Authority
URL	Uniform Resource Locators
UNCITRAL	United Nations Commission on International Trade Law

LIST OF CONVENTIONS, STATUTES AND OTHER LEGAL INSTRUMENTS

LIST OF STATUTES

The Constitution of Kenya, 2010

Finance Act

Kenya Information and Communications Act

The National Intelligence Services Act

Data protection Act No. 24 of 2019

Computer Misuse and Cyber Crimes Act No. 2 of 2018

Income Tax Act

Kenya Information and Communications Act (KICA Act)

REGULATIONS

Income Tax (Digital Service Tax) Regulations 2020

Value Added Tax (Digital Marketplace Supply) Regulations, 2020

INTERNATIONAL INSTRUMENTS

UNCITRAL Model Law on Electronic Commerce

OECD Inclusive Framework on Base Erosion and Profit Sharing (BEPS)

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ABSTRACT

This research project is aimed at analyzing the proficiency of Kenyan legal as well as regulatory framework in regulating taxation of electronic commerce in Kenya. The study addresses the following objectives: To identify the various modes and means by which taxation of electronic commerce is done as well as its impact; to identify and appraise the current legal, regulatory and institutional framework governing the taxation of electronic commerce in Kenya; and to propose measures and recommendations that can be employed to ensure effective assessment and taxing electronic commerce in Kenya. The main study methodology is desktop research conducting mainly based on available literature material. The study undertakes an in-depth analysis of the Kenyan regulatory framework governing taxation of the digital economy. This thesis also identifies various challenges and successes that have emanated out of the regulatory framework for taxing e-commerce. The study avers that Kenya has developed a robust framework for taxation of electronic commerce over the years by setting in place a regulatory framework on the same. The study proposes various measures to streamline electronic commerce taxation including, increased public awareness, introduction of minimum taxable amount, development of monitoring and evaluation policy to improve efficiency in tax collection, as well as cross boarder collaboration to minimize instances of tax avoidance and tax evasion.

CHAPTER ONE

INTRODUCTION AND RESEARCH PROPOSAL

1.1.Background of study

The amplified use of technology and ICT has revolutionized trade and electronic commerce around the world.[1] ICT has impacted our social, economic and political lives in totality across the globe. Business models have been transformed as well, with more and more people becoming conversant with information technology thanks to the high levels of connectivity throughout the world. Cyberspace is without geographical limits, and hence the world has been interlinked and made a global village. Electronic commerce has therefore been heralded as the new lifeblood of international trade.[2]The digital economy has continued to thrive as most businesses have shifted base to online platforms.

This allure of globalization has made electronic commerce enticing for many, with more and more businesses mutating their model of operations to incorporate ICT so as to expand and to integrate trade further.[3] The main goal of using the online platforms to conduct business is to reach a larger client base and in effect to improve efficiency. With the extensive use and reliance on ICT straddling private and public sectors, need for a safe and secure cyber space cannot be over emphasized.[4]The world is increasingly becoming reliant on ICT to bolster operations. In many developed nations, most services have been automated to be done remotely without the initial 'brick and mortar' designs.

The increased use of the internet has catalyzed economic growth in Kenya. After the advent of undersea cabling in 2009, there was significant growth which was attributed to ICT.[5] In 2015, the KES conducted research which established that the worth of the IT industry was over a

[1]Bidgoli, H. Electronic Commerce: Principles and Practice. (2001) San Diego, California: Academic.

[2] Ibid

[3]Rahman, S. (2014).Introduction to E-Commerce Technology in Business. Munich Grinn

[4] Schneider, G. P. (2017). Electronic Commerce. Boston Cengage

[5] Newfarmer, R. S.,et al Industries without smokestacks: Industrialization in Africa Reconsidered. (2018)

whooping Kshs 138 billion.[6] Electronic commerce has gained momentum in Kenya as a result of the continued availability of the internet to the larger public. It is estimated that the use of internet based avenue of trade will propel the African continent to increase trade by more than USD 115 Billion by the year 2024, with Kenya currently enjoying an internet penetration rate of 42%, which is representative of 23.35 million internet users.[7]Recent studies indicate that revenue from the Kenyan digital economy is estimated to increase to USD 1.1 billion when it reaches the year 2025.[8]

The European Commission defined electronic commerce as to involve the electronic tansmission and processing of data which involves a wide array of activities such as share trading, commercial fund transfers, public procurement, consumer marketing and the general trading of goods and services through electronic means. Trading in the digital economy involves trading in products and goods thus as well as traditional brick and mortar services such as education, healthcare and consumer services.[9]

An overriding advantage of this mode of business over the typical brick and mortar stores or even mail order requisitions that have been the norm before is that under the digital market regime consumers have an unprecedented access to the market.[10] Consumers can therefore easily conduct their own searches through a very large database of products and services and do this while seeing the actual prices of the goods and services. In Kenya, information technology has been greatly utilized to conduct businesses online where parties can interact virtually.

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[6] Ogutu Joe, Role of ICT in driving Kenya's Economic Growth 18th May 2015 https://www.standardmedia.co.ke/article/2000162611/how-ict-drives-kenya-s-economic-growth /Accessed on 7th June 2022

[7] Victor Oluwale, 'Top 10 African countries that have the highest number of internet users in 2022' May 30, 2022 https://africa.businessinsider.com/local/markets/top-10-african-countries-with-the-highest-number-of-internet-users-in-2022/zm280z1 Accessed 10/10/2022

[8] International Trade Administration, ' Kenya- country Commercial Guide' https://www.trade.gov/country-commercial-guides/kenya-ecommerce Accessed 13/10/2022

[9] European Commission,: 'A European Initiative in Electronic Commerce' The Economic and Social Committee and the Committee of the Regions, Brussels 16April 199

[10] Martínez-López, F. J., & D'Alessandro, S. (2020). Advances in digital marketing and eCommerce: First International Conference, 2020.

It is estimated that approximately 39.6 million Kenyans have subscriptions to the internet. Further, international Internet bandwidth in the country in the second quarter of the year 2020 has increased by 16.1% from the 1st quarter of the year. This increase may be attributed to the increased number of mobile phone subscriptions, which currently stands at 54.5 million, representing 114.8% penetration in the country[11]. The increased accessibility and use of internet has been catalyzed by the rampant use of social media communication platforms such as Facebook[12], WhatsApp[13], Twitter[14], E-mail and Instagram[15].

The penetration and growth of e-commerce in Kenya has with it meant certain challenges. One at the apex of the challenges has been the sufficient taxation of online trading platforms. There has thus been a challenge to develop an integrated approach to tax the digitized economy. In 2019, the tax regulator, Kenya Revenue Authority issued a public notice to the effect that traders who were engaging in online businesses were required to remit taxes and to file returns on their transactions.[16] That was seen as the first time that the regulator had woken up and smelt the coffee in so far as e-commerce was concerned. This was thereafter buttressed by the Finance Act of 2019 which provided emphasis that income earned from electronic platforms was subject to tax.[17]

Under the Kenyan taxation laws therefore, income accruing through a digital marketplace is subject to income tax and captures goods and services supplied in the digital marketplace as part of the taxable supplies for VAT purposes.[18] The law defines the digital marketplace under the Act to be a platform which facilitates the direct interaction between the various buyers and

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[11] CAK Sector Statistics Report (October- December 2019) https://ca.go.ke/wp-content/uploads/2020/03/Sector-Statistics-Report-Q2-2019-2020-1.pdf>Accessed on 13May 2020

[12] Facebook is an American online social media and social networking service that was founded by Mark Zuckerberg and operates worldwide

[13]WhatsApp Messenger is an American freeware messaging and voice IP service

[14] Twitter is a social site that subscribers can use to send and receive short texts of a maximum of 140 characters … on their timelines

[15]Instagram is a social photo and video sharing app owned by Facebook

[16] Available at https://kra.go.ke/en/media-center/public-notices/485-taxation-of-e-commerce Accessed 1 September 2022

[17] Section 3 of the Income Tax Act

[18] See the Kenya Institute for Public Policy Research Available at https://kippra.or.ke/ Available 23 July 2022

sellers of goods and services through electronic or digital means[19] There have however been concerns as to how effective the digital taxation regime has been over the years and if the laws and regulations that have been set in place have been sufficient in dealing with concerns of base erosion and widening the country's tax base.

This study seeks to evaluate the legal, policy as well as the regulatory framework for digital commerce and the nexus between this mode of commerce and taxation in Kenya. The research study will discuss the salient features of electronic commerce, the various forms taxation available to the digital economy in Kenya and the significance of an adequate legal framework to effectively tax the digital economy in Kenya. It will also attempt to propose certain measures and recommendations that if implemented can lead to the development of a successful taxation regime for electronic commerce in Kenya.

1.2.Statement of the Problem

It needs not be gainsaid that Kenya has made tremendous progress in so far as integration of electronic commerce to its trade structures is concerned.[20] This improvement has come with its challenges of having an efficient taxation regime as a consequence. This study will hence be evaluating the proficiency and the sufficiency of Kenya's regulatory framework in dealing with taxation of the digital economy. It will seek to in broad strokes assess the current regulatory plane and study what the successes and the challenges have been in taxing the digital economy.

When one looks at the BEPS Inclusive Framework developed under the Organisation for Economic Cooperation and Development (OECD), member states seek to advance the consistency in the framework of global tax laws which has the effect to create a more coordinated and actually transparent taxation regime which would incorporate the digital economy. The Action plans therein address the challenges that are associated with the digital economy be they issues of cross border trading or determination of taxation margins.[21] This

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[19] 'How ICT drives Kenya's economic growth', Leading Article, The Standard, (Nairobi 18th May 2015) https://www.standardmedia.co.ke/article/2000162611/how-ict-drives-kenya-s-economic-growth Accessed 24 August 2021

[20] Gatuyu J. Taxing a Digital Economy: Exploring Intangible Assets to Broaden Revenue Base in Kenya, (2019) Strathmore Law Review

[21] BEPS Framework https://www.oecd.org/tax/beps/ Accessed 19 August 2021

therefore goes on to show that the larger world has great interest in developing a suitable framework for taxation of electronic commerce.

Kenya therefore needs to develop a more robust regulatory framework to deal with taxation of e-commerce. This is because continued technological enhancements can only mean that more businesses will be shifting online and thus there is need for a tight framework which nips the concerns of evasion and avoidance of taxes in the bud. Kenya continues to lose very necessary revenue from online platforms which would otherwise greatly contribute to the country's budgeting and planning process. This thesis hence seeks to address the problem of the insufficiency of the legal and regulatory framework in dealing with taxation of electronic commerce.

1.3.Research Objectives

This dissertation strives to assess the effectiveness of the present regulatory and policy framework governing taxation of electronic commerce in Kenya.

The objectives it seeks to achieve are:

i. To identify the various types and the impacts of these modes of taxation on electronic commerce in the contemporary society.

ii. To identify and appraise the current legal, regulatory and institutional framework governing the taxation of electronic commerce in Kenya.

iii. To propose measures and recommendations which if implemented would ensure an effective tax system of the electronic commerce in the state.

1.4.Research Questions

This study strives to answer these research questions:

i. Which are the various modes of taxation in Kenya and what are their impacts on electronic commerce?

ii. What is the contemporary regulatory structure which governs the taxation of the Kenyan digital economy and what are their weaknesses and strengths?

iii. What measures and recommendations can be implemented to ensure the e-commerce sector is effectively taxed in Kenya?

1.5. Hypothesis

This paper is predicated on the following assumption:

The contemporary regulatory, institutional and policy regime in Kenya has not yet sufficiently addressed the issue of taxation of electronic commerce in the country and thus there has been a loss in the taxation base occasioned by poor collection of digital service taxes. There is therefore need for an enhanced regulatory framework.

1.6.Justification

In triangulating the research questions, this examination aims to contribute to available limited intellectual material on taxation of the digital commerce in the country despite the tremendous growth in e-commerce over the preceding years. It strives to highlight various shortcomings under the regulatory structures while at the same time make a contribution to the growing literature in the area of e-commerce and taxation within the country's tax base.

This study is justified as it will also provide material that policy makers and various industry stakeholders may find useful in addressing issues of electronic commerce and taxation broadly. Tax stakeholders for instance will find the study useful as it seeks to make a case for further widening of the tax base in Kenya by fully roping in the digital economy. In addition, the study will also be beneficial to the general public for the reason that it will not only be of intellectual value, but it is also aimed at addressing taxation concerns that indeed affect the public at large.

1.7 Literature review

John Rothchild[22] contends that the global economy has become much digitized and therefore states can no longer ignore the potential of electronic commerce. He argues that this meteoric growth of technology in so far as e-commerce is concerned means that states must put in place sufficient regulatory mechanisms to ensure that the digital economy contributes significantly to

[22] Rothchild J.A: The Research Handbook on Electronic Commerce Law. Cheltenham, UK: (2016) Edward Elgar Publishing.

the country's economy at large. Rothchild singles the issue of taxation and contends that the non-territorial nature of e-commerce means that there will be challenges posed with taxation and this would be an impediment if regulation is not prioritized. There is thus a need to have a regulated framework worldwide to deal with taxation of digital services. Since Kenya is also heavily reliant on taxation as the main source of revenue for its funding, this literature by Rothchild will form a great part of this study as it highlights the need for a domestic regulatory framework to gel with an international regulatory framework that has since been developed by the OECD. Rothchild addresses the need to ensure presence of robust laws to ensure protection of consumers while they use applications online, network neutrality as well as gambling. The text also shows the need to have some segments of the economy regulated even where they take place online. This study particularly seeks to rely on this scholarly work to address the gap of regulation that continues to plague in electronic commerce in various developing countries, such as Kenya which is currently attempting to set in place a framework.

Peter Misiani reviews the available literature on electronic commerce in Kenya and contends that despite the apparent advantages, this mode of commerce actually poses various challenges to existing tax systems at sub-national, national and even global levels and that these challenges have been well documented and include how to identify taxpayers engaged in e-commerce and determine their taxing jurisdictions as well as how to ensure that appropriate records are created of business conducted by e-commerce; and how to collect taxes in the e-commerce environment[23]. The seminal work by Misiani will be vital reading for this study as it goes ahead to cull out the various taxation challenges that subsist in the digital economy especially with regards to the digital economy. This study seeks to buttress the point that there are new modes of taxation that take in consideration the digital economy and thus there is need for a more aggregated legal and regulatory framework.

Victor Nzomo avers that countries are caught up in the dilemma of not setting in place appropriate and delicate structures for taxing e-commerce and risk the depletion of their tax bases or taxing e-commerce and risk the stifling of its development[24]. There is need to come up

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[23]Misiani, Mwencha. (2019). Taxation Of Electronic Commerce - A Commentary. 1. 10.1787

[24] See Victor Nzomo https://cipit.strathmore.edu/e-commerce-and-the-law-in-kenya-taxation/ Accessed 8 August 2021

with a feasible way of taxing e-commerce transactions so that the tax avoidance opportunities that e-commerce has created can be curbed.[25] This study speaks to the gap unaddressed by Victor on the very important issue of inclusion.

Isaac Rutenberg[26] argues that internet penetration in Kenya is at an all-time high and there is a need to establish a robust cyber law in the country which would enable the integrity of the digital economy. He argues that in 2017 alone, Kenya is reported to have lost a whopping 21 billion shillings to cybercrime. That is money that would have contributed to the tax base in one way or another. He contends that the major shortcoming of the Kenyan legal regime on cyber security is that they attempt to only offer criminal law remedies to cyber-attack victims. This is an inadequate approach for online traders as it doesn't address the threats to businesses per se and there is need to develop a proactive law to deal with cybercrime issues as opposed to simply being reactive. This seminal research work by Rutenberg and Murungi will be essential in this study as the central thesis of this study is that the current cyber law in Kenya is quite inadequate in enhancing the development of a tax framework.

1.8 Theoretical framework

This work will employ the necessity theory of taxation in its analysis. This theory of taxation proposes that taxes are the very essence of any government thereby being a necessity of the government to exist.[27] The theory contends that taxation is essential and that it is from taxes that the government can efficiently work. Proponents of this theory also argue that the imposition of taxes is quite essential for both the governments and the governed as well as were held in *Commissioner v. Algue*[28]

Some proponents of this theory also argue that an unwavering structure of taxation forms the prerequisite for the enduring existence of what you would call a bureaucratic administration.[29] A state thus is obligated to impose taxes upon its citizens in order to effectively run its affairs. Max

[25] ibid

[26]Rutenberg, Murungi, M. M. (2019).Cyber Law in Kenya. Alphen aan den Rijn: Wolters Kluwer

[27]Edgeworth, F. The Pure Theory of Taxation. The Economic Journal, (1897) 7(28), 550-571. doi:10.2307/2956603

[28]Commissioner v Algue G.R. No. L-28896 February 17, 1988

[29] Clemens, Kimberly J. Morgan and Andrea Louise Campbell, The Delegated Welfare State: Medicare, Markets, and the Governance of Social Policy (2011)

Weber argues that the system of taxation that a country employs informs its political, social and economic developments.[30] This research work thus relies on this theory of necessity in propounding its assertion that imposition of taxes to the digital economy is very important in widening the tax base of a country and the theory helps the study meet the set objectives in appraising the legal and regulatory framework concerning taxation of the digital economy.

1.9. Research methodology

This study will rely on the use of desktop/library research methods to look into the sufficiency of the policy and regulatory structure in dealing with the subject of taxation of electronic commerce. This methodology connotes the interpretation and analysis of already available literature and data on the subject matter without the use of qualitative research methodology. This study will therefore emphatically rely on statutory provisions, regulations, policies, books, journals, internet sources; opinion editorials and past research work on the subject matter. The reliance on various sources of information is so as to ensure that there is verification and that the study only relies on reliable and credible material.

1.10. Study Limitations

This study is heavily reliant on doctrinal research methods in the attempt to achieve its objectives. The author has not conducted quantitative research methodology to answer some of the research questions. I however intend to ensure that this limitation does not affect the achievement of the objectives of this study and the credibility of the information relied on.

1.11. Chapter breakdown

Chapter one gives an introduction to the thesis. It contains the background information, problem statement, study justification, objectives, hypothesis, questions to be answered, literature review, research methodology, and limitation of the study.

Chapter two analyses various categories of taxation and their effects on electronic commerce in the contemporary society.

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[30] Max Weber, "Politics as a Vocation" in From Max Weber: Essays in Sociology, ed. (1958) H.H. Gerth and C. Wright Mills New York: Oxford University Press,

The third chapter discusses regulatory, institutional and policy framework governing taxation of the Kenyan digital market .

Chapter four analyses the contemporaneous regulatory framework for the tax assessment of e-commerce by analysis of current successes and challenges in so far as taxation of electronic commerce in Kenya is concerned.

Chapter five summarizes the findings of the study and proposes certain measures and recommendations that if adopted will improve the status of electronic commerce in the country while at the same time sufficiently widening the taxation base.

CHAPTER TWO

CATEGORIES OF TAXATION AND THEIR IMPACT ON ELECTRONIC COMMERCE

2.1. Introduction

As highlighted in the first chapter, the pervasion of the internet in the commercial arena gave rise to the advent of electronic commerce. It is of note that trading in the digital market has created a more unified worldwide market and this is because it breaks off the brick and mortar system that existed initially. This permeation therefore calls for an appropriate structuring of tax revenue collection from internet business sources.

Governments fund their fiscal programs mostly through tax schemes.[31] Consequently, unnecessary losses of taxation income at the national, regional and transnational levels due to untracked e-commerce transactions are a cause for concern. There are various specific tax categories that exist and which are gazetted. The main types of taxes levied on e-commerce businesses include income, estimated, service, sales, and customs duties.

In order to effectively fund economies, governments must ensure that revenue collection systems from e-commerce transactions are managed under well-structured and effective mechanisms.

As expounded earlier in this study, e-commerce is the biggest economic catalyst for the 21st century. This mandates taxing authorities to shift focus from traditional base and types of taxes in order to maximise on the economic potential of commerce carried out on the internet

More particularly, governments need to provide fiscal environments which actually seek to foster the growth of e-commerce while at the same time operating anticipated and reasonable taxation systems. Generally, different types of taxes exist to collect revenue from e-commerce businesses and transactions. Most of the taxes are modelled after revenue collection ideals charged on brick and mortar businesses. Additionally, some of the tax types are implemented to protect local businesses. Most of the e-commerce services are multinational. Therefore, governments might implement tax obligations that make it expensive to operate over multiple borders. However, the companies might go around this by setting up regional services based in individual countries.

[31] Ibid

This way, the branches will pay the taxes within the areas they operate in. This approach makes it easier to track and settle tax obligations with easier record-keeping to validate and verify the remittances made.[32] This chapter thus looks at the various types of taxes and their application and impact on electronic commerce and cyberspace.

2.2 Categories of Taxation and Impact on E-Commerce

As has been mentioned in the preceding chapter, the already existing various modes of business taxation are in the same vein applicable to businesses that operate on digital platforms.[33] The various types of taxes applicable to e-commerce businesses are:

2.2.1 Direct Taxes

A. Income Taxes

Direct taxes such as income tax are applicable to all businesses. The basic rationale of taxation in its entirety encompasses the need and purpose to raise revenue. Often, this revenue is applied to government expenditures. The rationale of taxation has been subject to changes in terms of justifications throughout history. Income taxes are part of taxation, and there, they fall under the general rationale of taxation. E-commerce businesses have to bear their fair share of the tax burden in the form of income taxes. In E-commerce, businesses are charged a percentage of their profits in the regions registered as part of the income tax deductions. Ideally, the type of business structure will determine whether the e-commerce operations will be subject to income tax. All businesses, with the exception of partnerships, must file annual income tax returns.[34]Partnerships operating on e-platforms, on the other hand, are required to file information returns. In most jurisdictions, income tax for businesses is made on a pay-as-you-go basis. This means that businesses must remit the taxes as they make their income during the course of the year. Income tax is based on the number of profits reported by a business. Therefore, this is operationalized as a percentage of the total earning. This type of taxation does not potentially affect the operations of the business.

[32]Fotiou, A. Fiscal State-Dependent Effects of Capital Income Tax Cuts. S.l.: International Monetary Fund. (2020)

[33]Gupta, P., Singh, S., &Sasmal, S. (2020).E-Commerce Taxation. *E-Commerce in India: Economic and Legal Perspectives*, 148.

[34]Ndonga, D. "International taxation of e-commerce business income." *The International Tax Journal* (2019).

However, the taxation rate set in an area can affect the e-commerce businesses' prices for their services.[35] At the same time, the application of different tax policies in the originator and the destination places for the goods sold might predispose companies to aspects of multiple taxations.[36] This way, companies re-organize their structure and operation zones based on the tax policies.

Taxes in the physical world are basically levied on property or assets, income, or sales. Income taxes are part of corporate taxes that make up a significant amount of total tax collections in the country. Basic tax collection methods involve collection at the source, self-assessment, and the cadastral method. In the physical world, assets are registered according to the value they give, thus providing a basis for the calculation of average profitability. E-commerce companies' dedication to self-assessment and self-declaration of revenue constitute the collection of income tax in the psychical world. As a taxpayer, E-commerce companies are required to submit a self-assessment entailing deduction of some part of revenue after its receipt. Tax authorities are an integral part of the tax collection process. Taxation authorities have the responsibility to ascertain the accuracy of taxation calculation, especially if E-commerce companies have multiple streams of income.

Taxation at the source is another method of income tax collection in E-commerce companies. This method entails the calculation and deduction of a part of revenue at a company's accounting unit responsible for paying the income tax levied. It is imperative to consider the impact of a continuously growing online presence on taxation and tax collection. Technological advancements are taking E-commerce to greater heights. Many E-commerce companies have established an online presence through which they interact with customers and concurrently make sales. It goes without saying that traditional taxation has been greatly challenged by digital technology. There is a need for solutions for digital technology and the issue arising when it comes to taxation for E-commerce companies operating within an online presence. The application of tax theory in the digital economy has been proposed to bridge the rift between income taxation and digital technology.

[35] Ibid

[36] Mooij, R. A., In Klemm, A., In Perry, V. J., & International Monetary Fund. (2021). Corporate income taxes under pressure: Why reform is needed and how it could be designed.

B. Estimated Tax and Self-Employment Taxes

E-commerce attracts different types of business ventures. Some platforms are an extension of self-employed persons who make sales on personal websites. Therefore, another form of direct tax that is applicable to such e-commerce ventures includes estimated tax and self-employment taxes.[37] The rationale for estimated tax and self-employment taxes is based on a clear definition of self-employed persons. One is self-employed if they are the sole proprietor of a given business, a member of a trading partnership, or in business alone regardless of whether it is a full-time business or otherwise. Self-employed individuals are legally obligated to file tax returns in the form of SEs (Self-Employment) Taxes. The theory of SEs is to calculate net losses and profits to determine whether a business is subject to SEs or income tax, or both. Estimated taxes are paid quarterly as well as annual returns for self-employed income. The business owners make estimated tax payments if they do not receive a salary or have the taxes withheld for them. The estimated taxes are based on the received interests, self-employment income, and capital gains made through trading on e-commerce platforms.[38] Therefore, direct taxes such as income tax and estimated tax are among the key aspects of taxation that governments try to enforce on registered e-commerce businesses and platforms. SEs and estimated taxes operate like other taxes in the physical world; they are filed by business owners to aid in the traditional collection of taxes.

2.2.2 Indirect Taxes

A. Service Taxes

Electronic commerce businesses are subject to multiple indirect taxes that they must remain current with. Service tax is charged on any services that are provided by an e-commerce business. Services such as delivery charges are charged a service tax. For instance, Kenya Revenue Authority charges a 1.5% digital service tax for all income earned on digital marketplaces. The digital service tax was introduced by the Finance Act of 2020 and was made operational on January 1st, 2021. Service taxes are also charged on all the operations charged on

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[37]Kinuthia, James NK, and David M. Akinnusi."The magnitude of barriers facing e-commerce businesses in Kenya." *Journal of Internet and Information Systems* 4, no. 1 (2014): 12-27.

[38]Gupta, P., Singh, S., &Sasmal, S. (2020).E-Commerce Taxation. *E-Commerce in India: Economic and Legal Perspectives*, 148.

customers, such as warehousing, temporary storage, and delivery. Generally, all online service providers such as aggregators that connect the customer to buyers are required to pay service tax in different jurisdictions.

B. Sales Taxes

Sales taxes also need to be collected from online retailers and wholesalers. E-commerce platforms must operate under the set national, regional, and area-specific guidelines for value-added taxes and sales taxes. As indirect forms of taxation, the sellers have to add the tax charge on their products and remit it to the government. E-commerce sites selling goods and services must collect sales taxes in their pricing of the products they deal in. For businesses that buy products for resale, e-commerce wholesalers and retailers can issue resale certificates to exempt them from paying sales taxes. Generally, e-commerce platforms need to be tracked by the government to evaluate their financial statements for tax remittances. Sales taxes have an additive effect on the price of goods and services sold by e-commerce platforms. Therefore, under the permanent establishment principle, the businesses will decide on their physical locations based on the tax rates in the zones they decide to operate in.[39] Therefore, e-commerce businesses will decide on their office addresses based on the tax obligations offered in these zones.

C. Custom Duty Taxes

Custom duty is also another tax charged on e-commerce sites that operate internationally. The custom duty ideally applies to goods that are shipped internationally. This way, businesses need to register the types of goods and services that they ship internationally. The customs duty is often paid to the government after a period of time-based on the number of units that have been sold or shipped out of the country. The rationale of custom duty taxes also poses questions considering the fast-rising digital economy. The impact of a fast-rising digital economy is that more products are leaving the physical presence and being traded only; thereby raising the question of whether digitally delivered products are to be exempted from custom duty taxes.

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[39] Salameh, RafatSalameh, Omar Khader AL Fatafta, and TahaBarakat Al Shawawreh."The Possibility Of Applying The Tax Accounting System And Its Effectiveness On Electronic Commerce In Jordan." *Academy of Accounting and Financial Studies Journal* 25, no. 1 (2021): 1-13.

Many countries are therefore amending their tax acts to accommodate taxation for digital economy taxpayers. Kenya is also on the path towards introducing solutions to the taxation of digital economies through the introduction of certain taxes. Nevertheless, custom duty taxes are still facing a challenge in terms of digital taxation.

D. Excise Duty Tax

Excise duty is also charged on most e-commerce sellers. This is a form of tax imposed on goods for their production and sale. This type of tax applies to manufacturers that sell their goods on their online platforms within a country. Different types of excise duty are chargeable on companies selling their own produced goods. Therefore, e-commerce sites also need to file excise duty as a form of tax obligation. Some regions and countries apply entry taxes on goods that are brought in through online platforms. The entry tax can be levied on the logistics service providers or to the site operating and actuating the orders. Custom duty impacts the price that e-commerce services set for their products. Competition with other retailers might be impacted by the decisions based on location and areas that such businesses decide to operate in.

2.3 Taxation Principles

E-commerce taxation is broad, with policies being based on multiple intentions. Primarily, the taxes applied are based on traditional tax systems. The source rules and permanent establishment rules are mirrored in the determination of the types of taxes that e-commerce businesses should pay. Given that most international taxation systems are source-based with the country, the primary tax benefits are the ones where the business makes its income. On the other hand, the permanent establishment is based on taxing a business based on its residential address.[40] However, the operations of e-commerce businesses challenge these taxation principles due to the non-specificity of operation boundaries. The elimination of the territorial connections makes the application of taxes to e-commerce businesses more difficult. Therefore, the OECD set up guiding principles that regulate the tax treatment of international e-commerce operations and transactions. Through their specific tax authorities, the OECD members established the Ottawa

[40]Gupta, P., Singh, S., &Sasmal, S. (2020).E-Commerce Taxation. *E-Commerce in India: Economic and Legal Perspectives*, 148.

Taxation Framework, where they set up the conventional principles to be followed in the enforcement of taxes on internationally operated e-commerce businesses.

The principles include the need for efficiency, neutrality, simplicity, and certainty. This way, the different types of taxes are imposed on e-commerce businesses to ensure there are no aspects of double taxation or non-taxation of the businesses. However, there are multiple challenges relating to the implementation of the taxes and how to track them effectively. At the same time, identifying e-commerce taxpayers and their tax obligations is difficult. Therefore, the implementation of different types of taxes might impact the profitability and efficient operations of these businesses.

Taxation requires effective record-keeping and maintenance. Effective record-keeping is difficult during e-commerce transactions due to the digital nature of the transactions. Government agencies might find it hard to track earnings and impose different types of taxes. Generally, authorities need to set up reliable audit trails and verify the identity of parties in all the online transactions. Further, there is a need to obtain all the right documentation relating to transactions and establish the most convenient taxation points. With the setting up of such measures, authorities will minimize tax evasion.

The development of the internet and internet-related technologies has made it easier to enforce tax rules. Current e-commerce systems have automated record-keeping applications that allow transactions to be entered into records. Internet transaction tracking and recording make it possible for companies to track their earnings and remit the required tax obligations.[41] The internet makes it possible to ensure the effective collection of stipulated taxes.

Internet applications allow for tracking of sources of goods and the charges that care to be made. Further, authorities are able to better track e-commerce operations within the country. Businesses operating e-commerce services in the jurisdiction need to be registered. With effective registration, the executives can communicate tax obligations to allow for remittance.

[41]Salameh, Rafat Salameh, Omar Khader AL Fatafta, and Taha Barakat Al Shawawreh."The Possibility Of Applying The Tax Accounting System And Its Effectiveness On Electronic Commerce In Jordan." *Academy of Accounting and Financial Studies Journal* 25, no. 1 (2021): 1-13.

2.4 Conclusion

Over the past three decades, the internet has developed to allow seamless tracking of transactions. Further, improvement in security options has led to a boom in e-commerce services that allow consumers to place orders online and have them delivered. This has shifted most of the commerce and business transactions to online platforms. Generally, this creates a conundrum on the types of taxes imposed on these businesses, how they are monitored, and the collection procedures. Currently, most implemented taxes are based on the traditional tax systems imposed on brick and mortar businesses. At the same time, most businesses maintain both a physical and online presence. This makes it easy to track most of their operations. However, some of the businesses exclusively operate on the internet. This requires tax authorities to monitor their services and operations through tracking services on the internet. This way, the internet serves as an invaluable resource in collecting and validating the obligated taxes chargeable to e-commerce platforms.

REGULATORY, POLICY AND INSTITUTIONAL FRAMEWORK GOVERNING ELECTRONIC COMMERCE TAXATION IN KENYA

3.1. Introduction

Taxation of the digital commerce is subject to certain legal and regulatory frameworks which form the anchor for electronic commerce to take place in the first instance. These legal and regulatory frameworks may sometimes vary but work in concert to ensure that the digital economy is regulated. Since 2019, Kenya has put a great emphasis on operationalizing a regulatory context for taxation of the digital economy in the country. This Chapter therefore seeks to delve into the regulatory frame governing the operations of e-commerce and the taxation of the same. It discusses at length the various legal and statutory provisions that deal with the imposition of digital service tax in the country.

3.2. Legal and Regulatory Framework

3.2.1 The Constitution of Kenya, 2010

The Kenyan constitution being the primary source of law in Kenya sets out key principles that should govern a taxation regime. One of the main public finance principles are that the public finance system should be one that promotes an equitable society and in specific that the burden of taxation should actually be shared fairly.[42] This portends that the constitution anticipates that the various sectors of the economy and all stakeholders should pay their share of taxes for an effective economic development. This should therefore be applicable to the e-commerce sector in the same measure.

Further, the national law provides that it is just the national government that may impose income tax, Value-Added tax, customs duties and other duties on import and export of goods and excise tax.[43] It is also essential to note that the constitution requires that in the development of a public finance framework, there should be openness and accountability including public participation in all financial matters. This must therefore apply to the taxation regime in the e-commerce sector in equal measure where the taxation structures should be built with openness and accountability.

[42] See Article 201 (b) of the Constitution of Kenya.

[43] See Article 209 of the Constitution of Kenya

The Constitution similarly directs that an Act of Parliament may authorize the national government to impose any other tax or duty except for those taxes specifically delegated by the constitution to the counties.[44] This therefore shows that the constitution supports for the development of taxation law regime for electronic commerce in Kenya despite it not being explicitly provided for in it.

Although the Constitution does not explicitly provide for taxation of electronic commerce, however, it being a progressive document, it provides for leeway as discussed above for Parliament to enact necessary legislation to cater for electronic commerce taxation.

3.2.2 Finance Act, 2021

The Finance Act 2021 sufficiently expanded the scope of income that would be subject to income tax by including income accrued from businesses that are carried out over the internet in the digital marketplace. This is as a consequence of the operationalization of the Digital Service Tax by the Finance Act of 2020. The Act replaces Section 3(3) (ba) of the Income Tax Act and provides a broader definition of the digital marketplace as an online platform which enables users to sell or provides services, goods or other property to other users.

In the same vein, the Act repeals Section 3 (2) (ca) of the Income Tax Act to define income subject to the Digital Service Tax as 'income accruing from a business carried out over the internet or an electronic network including through a digital marketplace.'[45] It is essential to note that the Digital Service Tax (DST) was introduced in Kenya through the Finance Act 2019 and was further authorized by the Finance Act 2020. The effective date of the start of application was 1st January 2021. The Digital Service Tax was introduced to both the Income Tax Act and to the Value Added Tax.

DST is payable by both resident and non-resident persons with a permanent establishment in Kenya as provided for under Sec 2 of the Income Tax Act or as provided for under a double taxation treaty. The Finance Act 2021 repeals the Income Tax Act and provides that non-resident persons whose income has been derived through business carried out over the internet or an electronic network including a digital marketplace shall be subjected to Digital Service Tax

[44] See Article 209 (2) of the Constitution of Kenya

[45] Ibid

(DST).[46] Further, such non-resident persons shall be required to remit the DST on or before the twentieth day of the month following the end of the month that the digital service was offered.[47]

It is also vital to note that according to same Act, the digital service tax shall be payable at the time of transfer of payment for the service to the service provider.[48] However, for remittance purposes, the DST Regulations discussed hereunder have clarified that a DST return and tax payable are to be due by the twentieth day of the month following the end of the month that the digital service was offered. The Act succinctly provides that 'a person subject to digital service tax shall submit a return and pay the tax due to the Commissioner on or before the twentieth day of the month following the end of the month in which the digital service was offered.'[49]

3.2.3 Income Tax (Digital Service Tax) Regulations

Kenya enacted the DST Regulations in 2020 to provide for clarity and detailed implementation of the Digital Service Tax. The regulations provide that DST is to be paid by the digital service providers providing services through the digital marketplace or digital marketplace providers who provide a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.[50] Similarly, any non-resident persons providing digital services or digital market place to a user in Kenya shall need to appoint a tax representative in Kenya who shall be responsible for remitting the DST to Kenya Revenue Authority.[51]

The Regulations also provide on how DST is to be computed as being 1.5% of the gross transaction value of the digital service. [52] Under the Regulations, gross transaction value is defined as the consideration received in respect of the service provided in the case of a digital service provider and the commission or fee paid for the use of the platform in the case of a

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[46] Section 12E of the Income Tax Act

[47] Ibid

[48] Section 12E(2) of the Income Tax Act

[49] Ibid

[50] Regulation 2 of the DST Regulations

[51] ibid

[52] Regulation 5 of the DST Regulations

digital marketplace provider. It is vital to note that the gross transaction value shall be exclusive of VAT.[53]

The DST Regulations also provide for the scope of taxable services as being downloadable digital content including downloadable mobile applications, e-books and films; over-the-top services including streaming television shows, films, music, podcasts and any form of digital content; sale of, licensing of, or any other form of monetizing data collected about Kenyan users which has been generated from the users' activities on a digital marketplace; provision of a digital marketplace; subscription-based media including news, magazines and journals; electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services; electronic booking or electronic ticketing services including the online sale of tickets; provision of search engine and automated held desk services including supply of customized search engine services; online distance training through pre-recorded media or e-learning including online courses and training; and any other service provided through a digital marketplace.[54] It is important to mention these taxable services as an appraisal of them will be held in the subsequent Chapter.

3.2.4. Value Added Tax (Digital Marketplace Supply) Regulations

Kenya also formulated the VAT Regulations for the digital marketplace supply in September 2020 to provide a framework for remittance of value added tax (VAT). The regulations were enacted to provide clarity on the imposition of VAT in the digital marketplace.

Under the VAT Regulations, VAT will only be payable by the digital service provider or the digital marketplace provider (these are the vendors in this case) or the tax representative of a non-resident digital service provider or marketplace provider.[55] The Regulations similarly 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.[56]

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[53] Ibid

[54] Regulation 3(1) of the DST Regulations

[55] Regulation 5 of the VAT Regulations

[56] Regulation 8 of the VAT Regulations

It is also essential to note that where the supply of digital services is made by a non-resident provider to a registered business user (B2B) in Kenya, VAT on imported services regime shall apply on these transactions and will not be subject to VAT on the digital services regime. [57] In the same breath, the VAT Regulations require that the aforementioned registered business entity in Kenya should notify the non-resident supplier that they are not required to account for VAT in Kenya.

The VAT Regulations also provide that non-resident suppliers who do not have permanent establishments in Kenya and who make supplies on the digital marketplace shall register under a simplified tax registration framework which is to be done under the iTax platform provided by KRA.[58] In this case, the supplier is required to furnish the system with 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 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.[59] Once registered, the supplier is thereafter provided with a PIN for payment of VAT and for subsequent filing of tax returns.

In the case of the electronic commerce, VAT is due before the 20th day of the succeeding month in which the digital service has been offered through a return indicating the tax remitted and the value of transactions.

3.2.5. Kenya Information and Communications Act (KICA Act)

The KICA Act[60] establishes the Communications Authority which it mandates with[61]:

(a) Facilitating e-transactions;

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[57] The Digital Service Tax Overview https://www.rsm.global/kenya/insights/tax-insights/tax-alerts/digital-service-tax-overview Accessed 7 September 2021

[58] Regulation 7 of the VAT Regulations

[59] Ibid

[60] Kenya Information and Communications Act Cap 411A Laws of Kenya

[61] Section 83 of KICA Act

(b) Eliminating barriers such as uncertainties on writing and signature requirements;

(c) Promoting public confidence, integrity and reliability of e-records and e-transactions;

(d) Fostering development of e-commerce in any electronic medium and develop sound frameworks to minimize forgery and fraud in e-commerce

In order to ensure that the above mentioned mandates are fulfilled, the Act tasks the authority with facilitating electronic transactions by ensuring the use of reliable electronic records and with facilitating electronic commerce and eliminate barriers to electronic commerce such as those resulting from uncertainties of over writing and signature requirement.

In the same breath, the authority is required to promote public confidence in the integrity and reliability of electronic records and electronic transactions and to foster the development of electronic commerce through the use of electronic signatures to lend authenticity and integrity to correspondence in any electronic medium. From the same standpoint, the Authority is required to promote and facilitate efficient delivery of public sector services by means of reliable electronic records; and to develop sound frameworks to minimize the incidence of forged electronic records and fraud in electronic commerce and other electronic transactions.

It therefore goes without saying that the mandate given to the Communication Authority with regard to ensuring that electronic commerce is safe and well-structured is essential in building the right infrastructure that ensures that the frameworks for taxation of electronic commerce are set in place. For instance the Act prohibits a person from operating an electronic certification system or updating a repository or administering a sub-domain in the Kenya country top level domain unless they have been issued with certificates from the authority and those in contravention in effect commit an offence and shall be liable on conviction to a fine not exceeding three hundred thousand shilling. This ensures that those engaging in electronic commerce can easily be known for taxation purposes.

3.2.6 UNCITRAL Model Law on Electronic Commerce

The UNCITRAL Model Laws on Electronic Commerce were enacted in1996 to enable and facilitate commerce conducted using electronic means by providing national legislators with a set of internationally acceptable rules aimed at removing legal obstacles and increasing legal predictability for electronic commerce. [62] The model laws note that an increasing number of transactions in international trade are carried out by means of electronic data interchange and other means of communication, commonly referred to as “electronic commerce” which involve the use of alternatives to paper-based methods of communication and storage of information.[63]

Being a member of the United Nations, Kenya is therefore one of the countries that implement some of the rules envisaged by the model laws in order to streamline its electronic commerce sector as is discussed hereunder.

3.3. Institutional Framework

3.3.1 Kenya Revenue Authority

The Kenya Revenue Authority (KRA) is the institution mandated to govern the taxation regime in Kenya. The core functions of the authority are to assess, collect and account for all revenues in accordance with the written laws and the specified provisions of the written laws, to advise on matters relating to the administration of, and collection of revenue under the written laws or the specified provisions of the written laws, to perform such other functions in relation to revenue as the Minster may direct.[64] The authority seeks to enhance mobilization of government revenue and to facilitate growth in economic activities and trade by ensuring compliance with tax and customs laws.[65]

KRA thus is the entity that governs the taxation of electronic commerce in Kenya. It has developed the structure and frameworks that govern taxation of the digital economy in Kenya. One of the clear structures has been the development of the Tax Invoice Management System (TIMS) through the introduction of the electronic tax invoice. This ensures that entities engaged in the e-market are thus brought on to the taxation bracket without complexities. KRA has constantly assured players in the market that they are putting place more requisite measures

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[62] Resolution adopted by the General Assembly [on the report of the Sixth Committee (A/51/628)] 51/162 Model Law on Electronic Commerce adopted by the United Nations Commission on International Trade Law

[63] Ibid

[64] Kenya Revenue Authority https://kra.go.ke/en/about-kra Accessed 4 September 2021

[65] Ibid

ranging from system enhancements and continued stakeholder engagements to ensure that there are adequate frameworks to facilitate collection of digital taxes.

3.3.2. Communications Authority of Kenya

The Communications Authority is mandated with licensing, regulating the use of licenses and other telecommunication services in the country.[66] One of the other overarching responsibilities of the Communications Authority is to facilitate the development of e-commerce in the country and to regulate retail and wholesale tariffs for communications services. Thus, the Communications Authority is a very important institution in facilitating e-commerce in Kenya and therefore works in synergy with other institutions to ensure that the regulatory framework for the taxation of e-commerce is an effective one.

As mentioned above, KICA has elaborately provided for the development of online payment platforms through the protection accorded to consumers in Part VI (A) of the Act which deals with electronic transactions and cyber security.[67]This has been effectively applied by the Communications Authority as evidenced through the online payment of taxes in the country which has actually eased cross-border trade with Kenya. This is a clear example of the work that the authority has been able to achieve in synergy with other government agencies.

3.4. Conclusion

From the discussion above therefore, there is a robust legal, regulatory and institutional framework governing taxation of electronic commerce. The subsequent Chapter will seek to provide an assessment of the effectiveness of the regulatory framework based on the challenges that Kenya continues to face and the adequacy of the framework.

[66] Communications Authority of Kenya https://ca.go.ke/ Accessed 6 August 2021

[67] Ibid, Note 26

CHAPTER FOUR

A CRITICAL ANALYSIS OF THE REGULATORY FRAMEWORK FOR THE TAXATION OF ELECTRONIC COMMERCE IN KENYA

4.1. Introduction

The digital economy taxation regime in Kenya and all over the world has achieved certain measures of success but it has correspondingly been wrought with several challenges. These challenges are due to the constantly changing nature of doing business on the internet. Most of the challenges actually arise due to the fact that there is a blurred distinction between the traditional forms of commerce and the new modes of commerce that involve the digital economy and which were hitherto unregulated. There are however still a myriad challenges that are still faced by the regulatory framework. In the same measure, there are certain successes that have been achieved and progress made in the taxation of electronic commerce in Kenya.

In the contemporary society, sales and transactions occur through the internet and this has in effect created new channels of enforcing regulatory taxation regimes worldwide. Delivery of services and products online has greatly altered the traditional forms of conducting business to such a degree that e-commerce must be treated as a unique and distinguishable channel for purposes of taxation. The OECD and other world entities have over the years developed certain frameworks for taxation of e-commerce which have been adopted by most countries, Kenya included.

There however still remain certain teething troubles brought about by issues such as place of consumption of online products and services, sale points, classification of products and services and lack of mass awareness in Kenya which continue to plague the successful implementation of e-commerce taxation rules. This chapter seeks to discuss the sufficiency of set regulatory frame on the taxation of electronic commerce in the country by highlighting the challenges that have been faced since the 2019 onset of the digital service tax in the country.

4.2 The nature of e-commerce and challenges it poses to its taxation in Kenya

4.2.1. Geographical Boundaries

Kenyan tax laws are mainly structured to be source based and therefore this majorly calls for physical presence in the country by way of a permanent establishment of businesses.[68] Most of the tax laws in the country are therefore structured in such a way that they put emphasis on the physical location of the business being in the country. This is the position when you look at the country's initial income tax law structures.

As discussed in the preceding chapter, this is however not the nature of electronic commerce which is mainly carried out virtually and therefore defying the need for geographical boundaries. Under the digital economy, most of the transactions are done through digital means on the internet and this may leave little traces of transactions if not well monitored.[69] In addition, a single user can transact from different locations, posing a challenge due to reciprocity taxation laws.

It is important to note that one of the key principles of OECD was that of neutrality where taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and traditional forms of commerce. The OECD framework therefore requires countries to ensure that they develop systems which are able to contradistinguish the various forms of commerce especially for purposes of taxation.[70] Having physical location as an emphasis in guiding taxation thus makes it very difficult to tax local and foreign e-commerce companies that generate income from Kenya while tucked in the digital market singularly.

It is however vital to note that Kenya has made great progress on this front in so far as identifying the territorial and jurisdictional nature is concerned. The Digital Service Tax (DST) is defined to deal with income accruing from a business carried out over the internet or an

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[68]Waris, A. (2013). Tax and Development: Solving Kenya's Fiscal Crisis through Human Rights.

[69]Rahman, S. (2014).Introduction to E-Commerce Technology in Business. Munich Grinn

[70] O. E. C. D. Organisation for Economic Co operation and Development,. (2001). *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions*. Organisation for Economic Co-operation and Development.

electronic network including through a digital marketplace.[71] The section is therefore clear that the DST is not only territorial in nature by dealing with the physical geographical boundary but also in effect deals with business that are carried out in the digital marketplace at large and which Kenya has jurisdiction over.

This is welcome step in moving the taxation laws of the country from merely being source based but also catering to the set international taxation principles under the Ottawa Framework. It is clear that the current income tax framework in the country does not therefore look at geographical boundaries as a hindrance to the development of a wider tax bracket in the country.

4.2.2. Anonymity of E-commerce users and their transactions

It needs not be gainsaid that identifying users of e-commerce can be difficult depending on the tangibility or intangibility of the products and services involved. Transactions that occur in various digital platforms are sometimes carried out through anonymous entities whereby the various users have their real identities hidden including their locations and transaction details.[72] The anonymity of users and transactions that are carried out over the internet sometimes is also facilitated by dark websites or incognito sites that enable users make transactions without having to reveal their identities.[73] The dark web has especially been caricatured as a very sophisticated marketplace.[74]

Since the implementation of the DST and the VAT on digital services and products is new to Kenya, the country has barely been able to put in place foolproof systems that can be able to monitor digital transactions effectively. Kenya thus needs to develop significant technological transformations that change the architecture of the digital economy and which make the e-commerce transactions and financial outlays more apparent to the tax regulator. This should be done through sufficient benchmarking from other jurisdictions that have been able to effectively implement an e-commerce transactions framework as seen in the next Chapter.

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[71] Section (3) (2) (ca) of the Income Tax Act

[72] Basu, S. (2008). International Taxation of E-Commerce: Persistent Problems and Possible Developments. Journal of Information, Law & Technology, JILT 1.1, 1-25

[73] Asian Development Bank. 2018. Embracing the e-commerce revolution in asia and the pacific.

[74] Bartlett, Jamie. 2015. The dark net: inside the digital underworld. https://openlibrary.org/books/OL27186303M. Accessed 2 October 2021

Under the Kenyan Digital Services Tax (DST) framework for instance, foreign companies that operate in the digital market in Kenya are required to appoint local tax representatives who are required to remit taxes on their behalf.[75] Companies that are unable to employ local tax representatives or even to navigate the registration portal via iTax may decide to anonymously trade online in order to avoid or evade paying taxes and this in effect erodes the country's tax base as it were. It is also further important for the regulatory framework in Kenya to clearly define the digital marketplace and the various stakeholders of the digital economy.

4.2.3. Taxation Records

One of the other challenges that the State tax regulators face is in ensuring that there are adequate records kept of digital transactions as this would enable the regulators establish audit trails and verify the parties to the transactions.[76] Businesses are thus required to prepare electronic invoices and issue electronic receipts for ease of collection and payment of tax revenues. To alleviate this problem, the OECD developed a record keeping guidance paper to set out guidance that will encourage appropriate standards for record keeping by businesses offering services or products via the Internet.[77]

The Ottawa Frameworks similarly required that revenue authorities should maintain their ability to secure access to reliable and verifiable information in order to identify taxpayers and obtain the information necessary to administer their tax system.[78]

Due to the intangible nature of transactions, the task placed on the KRA to monitor digital transactions is very difficult to accomplish.

On the flipside, the Kenyan situation is that KRA is yet to develop record keeping guidelines for entities engaged in electronic commerce. It goes without saying that both the tax administrator and online business must endeavor to create reliable and authentic records which clearly enumerate their online functions and activities and which show the financial positions of the

[75] See KRA Brochure on Digital Service Tax Available at https://www.kra.go.ke/images/publications/Brochure--Digital-Service-Tax--final.pdf Accessed 22 September 2021

[76] Information economy report 2015: Unlocking the potential of E-Commerce for developing countries. (n.d.).

[77] See Paper at https://www.oecd.org/ctp/administration/31663114.pdf Accessed 16 September 2021

[78] Available at: http://www.oecd.org/daf/fa/E_COM/framewke.pdf Accessed 12 August 2021

entities for purposes of taxation. The Kenyan tax administrator should therefore seek to urgently develop guidelines for keeping taxation records in line with the OECD Record Keeping guidance paper discussed above. The DST Regulations as well as the Vat regulations require that there should be effective record keeping by entities that are engaged in the digital marketplace to ensure that they are able to account for their revenues and expenses for taxation purposes.[79]

4.2.4. Information sharing with stakeholders

The Ottawa Taxation Framework Conditions likewise required that tax regulators should consider developing portals or websites where the various stakeholders are able to get information such as the applicable legislation, tax rulings, case law and revenue statistics and where taxation forms can be viewed and downloaded.[80] In the same breath, the revenue authorities should develop an official guide on e-commerce taxation for purposes of stakeholder engagement.

Information sharing also enables external auditors, company directors, creditors, shareholders, investors and other interested stakeholders of a company to have information that reflects a true value of the affected business for purposes of taxation.[81] It is therefore very important for tax regulators to develop platforms where the e-commerce stakeholders can very easily gain information with regards to the taxation of their products and services. The KRA Website[82] has been very instrumental in providing a platform for information on taxation services and programs in the country but the regulator is yet to develop an interface for information sharing for issues to do with taxation of e-commerce products and services.

4.2.5. Double Taxation

The continued evolution of electronic commerce has with it orchestrated the need for countries to formulate specific taxation laws that deal specifically with the digital economy. There is also the potential for the enactment of different legislation in different countries. For such reasons therefore, the enactment of different and multiple laws to deal with taxation of e-commerce pose

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[79] ibid

[80] Misiani, Mwencha. (2019). Taxation of Electronic Commerce - A Commentary. 1. 10.1787/5k437p2gxw6g-en.

[81] Ibid

[82] Kenya Revenue Authority Available at https://kra.go.ke/en/ Accessed 1 October 2021

great challenges whenever the laws lack synergy or one single way to address the underlying taxation issues. This is often the case where countries form economic blocks which apply certain set taxation rules. The legal framework in Kenya recognizes mutual agreements in the country with other jurisdictions and this for instance is one of the reasons why there are various jurisdictions that have double taxation agreements with Kenya.

The OECD contends that in addition to creating high compliance costs for governments and suppliers, the implementation of inconsistent laws and definitions could also result in double taxation or unintentional non-taxation of e-commerce transactions.[83] The Ottawa Framework places the place of consumption as a key principle in determining the place of taxation of international services and intangibles.[84] Due to the fact that most countries apply their own localized taxation rules, this gives rise to the potential that double taxation may occur or in certain cases even non-taxation.

Double taxation is a tax principle referring to income taxes paid twice on the same source of income.[85] It goes without saying hence that tax regulators in individual countries should take into account that transactions that occur in the global digital economy are likely to alter the tax consequences that are particular to their individual countries and this may lead to some of those transactions being subject to double or non-taxation. Unfortunately, the Income Tax Act and the VAT Act have not specified who between the buyer and the seller pays for DST in the country. The regulations however have developed certain modalities in the calculations of the gross transaction values for purposes of determining the payable digital taxes by both local and foreign entities.

In Kenya for instance, income from sale of tangible goods via an online platform by either non-resident or resident persons is exempt from payment of digital service tax.[86] This is majorly due

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[83] The Role of Digital Platforms in the collection of VAT/GST on online sales: Report March 2019. (2019). Paris: OECD.

[84] Jeffrey Owens, 'Taxation and E-Commerce: Progress Report', (2001), 29, Intertax, Issue 1, pp. 10-13, https://kluwerlawonline.com/journalarticle/Intertax/29.1/316606 Accessed 27 September 2021

[85] Simiyu, N. T. T. (2003). Taxation in Kenya: (principles & practice); including CPA and KATC questions and suggested answers pilot. Nairobi: Foundation Inst. of Professionals.

[86] Ibid, Income Tax Act

to the belief that any goods sold by non-residents through online interfaces or internet platforms are captured through the physical border entries in the Kenyan case being the port for instance where there are taxes that are applicable on the goods upon clearance. The exemption is therefore factored in so as to avoid cases of double taxation of the same goods and services. It is also essential to note that of the progressive steps Kenya has made is to have double taxation agreements with various countries so as address double taxation concerns.[87] Double taxation agreements are international agreements between two countries meant to allocate taxing rights between two or more countries that have negotiated the particular agreement. They are thus meant to avoid double taxation at an international level. Kenya has therefore made tremendous progress at this level.

4.2.6. Lack of Mass Education on E-commerce

Under the Ottawa Framework Conditions, the principles of certainty and simplicity requires that the developed e-commerce tax rules should actually be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.[88] It therefore behooves the tax regulators to conduct mass awareness programmes so that various stakeholders in the e-commerce industry are sufficiently informed and there is enough general knowledge even amongst the public. This can be done by providing for various models of mass education through the formulated regulations.

The Kenyan tax regulator has not been very proactive on this front. In May 2021 for instance when the US based Tech company Netflix became one of the first non-residential digital companies to add VAT to their services in Kenya, there was great hue and cry from the public.[89] This was majorly because there were concerns from its customers as to where the taxes had emanated from because there had been very little awareness conducted by the tax regulators to the public. Kenya Revenue Authority thus needs to begin mass education programmes on

[87] Kenya has double taxation agrements with 49 countries. See Treasury records at https://www.treasury.go.ke/agreements/ Accessed 18 September 2021

[88] Ibid, Ottawa Framework Conditions

[89] The East African Available at https://www.theeastafrican.co.ke/tea/business/netflix-rates-inclusion-of-vat-tax-charge-3391120 Accessed 12 September 2021

taxation of digital services both to the various e-commerce stakeholders and to the larger public in the same measure.

4.2.7. Tax Registration Frameworks

There is need to facilitate the creation of simplified registration guidelines and rules and the establishment of dedicated interfaces which can actually facilitate the payment of taxes such as VAT on products acquired through e-commerce by non-resident suppliers. Under the Kenyan VAT regulations discussed in the preceding Chapter, VAT is payable by the digital service provider or the digital marketplace provider (the vendors) or their tax representatives. [90]There is however still concerns as to interfaces that have been developed to identify the vendors in the digital marketplace in Kenya.

In the same vein, there should also be enhanced access to information from financial intermediaries which should allow for the monitoring and evaluation of the applicable taxes by foreign and resident suppliers.[91] As a positive step though, Kenya has developed a simplified tax registration framework that is available under the KRA iTax platform and which will go a long way in simplifying the taxation registration rules in the country. It is thus a welcome move to have a simplified tax registration platform especially for non-resident persons who are likely to have issues getting local representatives and this in turn would hamper compliance.

To facilitate efficiency, Kenya should also have considered simplifying the digital taxation regime by setting a certain minimum threshold which would in effect exempt certain business that have very low margins.

It is, however, important to consider that the digital market place is highly preferred by Kenyan youths and small scale traders due to its low operational costs. Digital businesses have helped to curb the high levels of unemployment in the country as many people are able to run small business on-line. Introducing taxes on the digital space is likely to increase financial burden of many people in this category who rely on electronic commerce to earn a living.

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[90] See the 'Value Added Tax (Digital Marketplace Supply) Regulations, 2020

[91] Ibid

The idea of imposing a digital services tax on all digital services irrespective of the profit margins is objectionable and has been poorly received especially by persons under the minimum tax bracket who primarily conduct business in the digital marketplace.

4.2.8. Cross-border collaboration

Over the years that e-commerce has gained traction worldwide, most countries have relied on their sovereignty to design and administer e-commerce taxation rules that are in their interest only and in near isolation to other countries that border it for instance.[92] This development of state fiscal sovereignty has been detrimental to the development of a uniform taxation framework and it is thus vital for tax administrators of different territories and jurisdictions to work together and find consensus through mutually beneficial agreements.[93] This in effect also helps these countries avoid issues of double taxation or non-taxation.

Countries that border each other can also negotiate bilateral and multilateral tax treaties in order to harmonize their tax systems with internationally accepted tax principles. Kenya has made remarkable progress on this front through the aforementioned double taxation agreements which signal collaboration and through the development of economic partnership agreements and free trade agreements with the United Kingdom and The United States for instance.[94] These agreements go a long way in signifying the intention to have cross border collaborations on not only trade but also on the issue of taxation.

4.3 Conclusion

The discussion above hence shows that despite the evolution of trade and business to online platforms, e-commerce transactions have faced certain very particular challenges especially with respect to the development of taxation frameworks. Kenya continues to face challenges in the implementation of the digital services tax framework set in place but the discussion above

[92]Pieron A. and Helleputte C., ' Taxation of the digital economy; Toward a new. equalization levy in Europe ' Mayer Brown legal update, (20 I 7)

[93] Ibid

[94] Great Britain. (2021). Scrutiny of international agreements: Economic Partnership Agreement with Kenya, Trade in Goods Agreement with Norway and Iceland, and Free Trade Agreement with Vietnam : 2nd Report of Session 2019-21.

correspondingly also shows that the country has actually made incredible progress in setting in place structures to facilitate taxation of e-commerce.

CHAPTER 5: THESIS CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

This study looks into taxation of the digital economy and evaluates the legal, institutional and regulatory framework that governs electronic commerce in Kenya with a bias towards the taxation scheme. It discusses the significant features of electronic commerce that separate it from traditional forms of commerce. It also looks at the various forms of taxation that have been introduced in the country to deal with taxing the digital economy and also the significance of the legal and regulatory framework in addressing the same. Over the years, business has shifted to online platforms and there are various multinational and transnational businesses that conduct their commerce online due to the technological advancements witnessed in the recent years and hence it is this realization that animated this research. The essence of this study thus was to look into the gains and losses that are made by Kenya

The first chapter of the study introduced the research proposal and formulated the research objectives. The main objective of the study was to identify and appraise the current legal, regulatory and institutional framework governing the taxation of electronic commerce in Kenya. The proposal also set the research questions to be answered and formulated the hypothesis to be tested under the study. The study was premised on the assumption that the current legal and regulatory regime in Kenya does not sufficiently address the issue of taxation of electronic commerce in the country and this has led to loss on taxation revenue occasioned by poor collection of digital service taxes in the country. The justification for conducting the study was due to its significance to various practitioners, policy makers and even scholars in the academia to be able to assess the position and measures Kenya is taking to deal with taxation of electronic commerce. The proposal was built around the necessity theory of taxation and reviewed various literatures in the same measure.

The second chapter highlighted the types of taxes that are applicable to electronic commerce transactions. The section analyses both direct and indirect taxes that are chargeable to electronic transactions. The study found that direct taxes chargeable to electronic commerce include Income Tax, Estimated Tax and Self-Employed Tax Indirect taxes chargeable to electronic transactions are Service Tax, Sales Tax, Custom Duty Tax as well as Excise Duty Tax. The chapter also highlighted taxation principles of efficiency, neutrality, simplicity, and certainty which are also applicable to traditional commercial transactions. The study established that these core principles of taxation are also applicable to e-commerce transactions. Chapter third chapter of the study delved in-depth into the Kenyan legal and regulatory framework governing taxation of electronic commerce in Kenya. The central position of the chapter was that Kenya has actually put a great emphasis on operationalizing a legal and regulatory framework for taxation of electronic commerce since enacting the Finance Act 2019. The Chapter thus looked at the principles set in place by the Constitution on the public finance system and the fact that only the government should impose income tax, Value-Added tax, customs duties and other duties on import and export of goods and excise tax. The Chapter in the same vein looked at the statutory provisions contained in the Finance Act 2020 all through to 2021 which set in place mechanisms and provisions on the digital service tax. The section also looked at the regulations that have been enacted in the country since 2020. It wrapped up by looking at the institutional structure that executes and implements the legal instruments and sets in motion the administrative parameters.

The forth chapter evaluated the successes and challenges to the taxation of electronic commerce in Kenya. Over the last three years, Kenya has actually made tremendous progress in the field of e-commerce and this is true for taxation of digital economy in the same measure. It has developed a legal framework complete with sets of regulations and has in the same measure put in place certain institutional frameworks in place. The central finding in this Chapter was however that Kenya continues to face a myriad of challenges in implementing a legal and regulatory framework for the taxation of e-commerce. The study found that there are still challenges arising out of the lack of geographical boundaries in the digital marketplace and the issue of sale points and anonymity. The Chapter also delved into the global concern of double taxation and the positive step made by Kenya in ratifying double taxation agreements with various countries. The overarching position of the chapter was that Kenya continues to face challenges in the implementation of the digital services tax framework set in place even though the country has actually made incredible progress in setting in place structures to facilitate taxation of e-commerce.

This Chapter concludes the study and proposes certain recommendations that can be implemented to further ramp up the taxation of e-commerce framework in Kenya.

5.2 RECOMMENDATIONS

5.2.1. Mass Awareness on the digital services taxation framework

The Kenya Revenue Authority should try and create more awareness in the country in so far as taxation of the digital economy is concerned. The smart phone penetration in the country as has been discussed in this study shows that there is a shift from brick and mortal businesses to online commerce and this in effect means that there is need for sufficient information from both consumers and the suppliers of online goods and services. The authority in concert with other stakeholders should come up with various strategies for creating awareness be they in media and entertainment platforms to educate the larger public on the structures that are in place to levy digital services tax and the value added tax on the digital marketplace in the country.

5.2.2. Introduction of a Minimum taxable amount

Despite the fact that taxation is the lifeblood of any government, there are concerns that taxation should not be used as a means to frustrate businesspeople. To this end therefore, Kenya should introduce a minimum levy for which the taxes on the digital economy applies. This can be achieved by introducing an equalization levy, which would be charged to entities which make amounts exceeding a particular predetermined amount. The worth of this is that it actually promotes electronic commerce as it ensures that even micro, small and medium enterprises are able to be active players in the digital economy. It goes without saying that any tax revenues are bound to generate negative effects on SMEs as these companies are always more fragile from a financial standpoint. Wanton increases in their tax rates thus may actually drive such companies out of the market and ultimately stifle businesses.

5.2.3. Monitoring and Evaluation Infrastructure

Kenya should acquire and develop adequate infrastructure that enables the tax regulator to monitor the digital marketplace and therefore be able to sufficiently levy the digital services tax on online e-commerce operators. The tax regulator in the same measure therefore should develop a monitoring and evaluation policy that enables it to satisfactorily monitor the digital marketplace in the country.

5.2.4. Cross Border Collaboration

Cross border collaboration refers to the partnership and cooperation that the country should engage in with other players on the issues of taxation. It is a very positive step that the country has developed double taxation agreements with various countries. This progress should also be reflected in other areas that are discussed in Chapter three and which continue to be glaring challenges for the country. Kenya should also immediately sign the recently issued statement on a two-pillar solution to address the tax challenges arising from the digitalization of the economy and this is due to the fact that the statement seeks to create a global mechanism for taxing electronic commerce that on-boards the various challenges that have continued to dog electronic commerce over the years.

5.2.5. Fostering Innovation

The Kenyan government should foster innovation in the country and this it can do by developing simplified taxation regimes for the micro-business and small and medium sized enterprises in the country. To this end therefore, the government should take into consideration the ability of these businesses to sufficiently engage in the digital economy and this it can do through fostering government led innovation. This would in effect thus ensure that these players adequately contribute to the tax pool in the country and this in effect leads to substantially positive tax outcomes.

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