The Value Added Tax (Digital Marketplace Supply) Regulations

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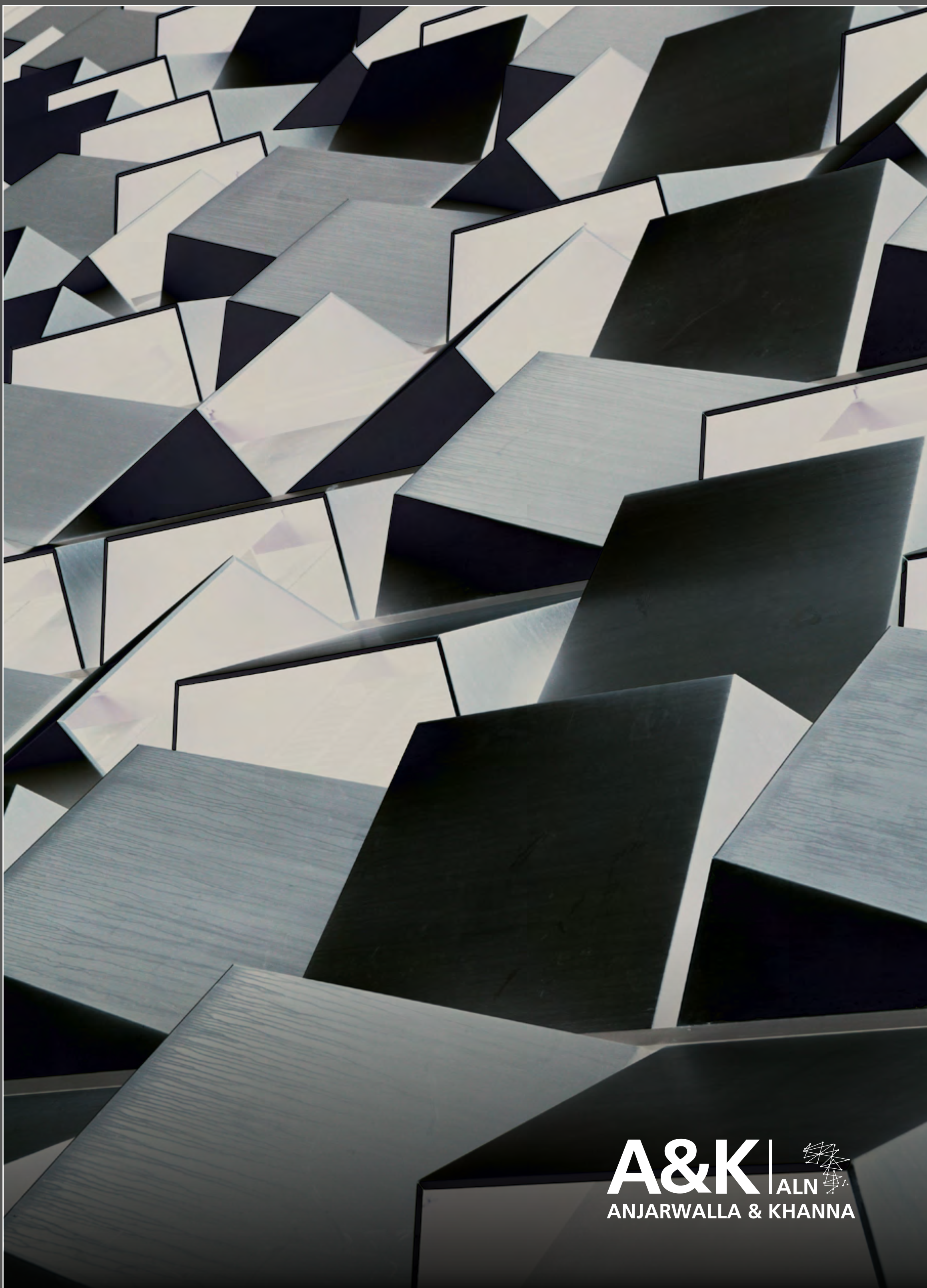


Introduction

IThe Finance Act, 2019 amended the Value Added Tax Act, 2013 (the **VAT Act**) by introducing a new provision stating that supplies made through a digital marketplace would be subject to Value Added Tax (VAT) in accordance with the provisions of the VAT Act. The term ''digital marketplace'' is defined in the VAT Act as *"a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means."*

The Finance Act, 2019 also amended the VAT Act to grant powers to the Cabinet Secretary for National Treasury and Planning (the **Cabinet Secretary**) to make regulations to provide for the mechanisms of implementing VAT on taxable supplies made through a digital marketplace. These powers were in any event already provided for under Section 67 of the VAT Act which provides that the Cabinet Secretary can make regulations under the VAT Act for the better carrying out of the provisions of the VAT Act.

Pursuant to the provisions stated above, the KRA published the draft Value Added Tax (Digital Marketplace Supply) Regulations, 2020 (the **Regulations**) on 29 May 2020. The KRA then requested members of the public, sector players and other key stakeholders to provide their comments on the same with a view of finalising the Regulations for gazettement and thereafter entering into law. The Regulations have now been gazetted through Legal Notice No. 190 of 2020 dated 25 September 2020 which was released to the public on 16 October 2020. We have analysed the pertinent provisions of the Regulations in this Legal Alert.

Digital Services Subject to VAT in Kenya

While the VAT Act already provides that electronic services (such as websites, software, information, broadcasts, music, films and games) are subject to VAT, the new Regulations have expanded the scope of digital services subject to VAT to cater for new-age digital inventions supplied in Kenya to include:

i. downloadable digital content including mobile applications, e-books and films;

ii. subscription-based media including news, magazines and journals;

iii. over-the-top services including streaming television shows, films, music, podcasts and any other form of digital content;

iv. software programs including software, drivers, website, filters and firewalls;

v. electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services;

vi. music and games;

vii. search engine and automated helpdesk services including customisable search engine services;

viii. tickets for live events, theatres or restaurants;

ix. distance teaching through pre-recorded media or e-learning including online courses and training;

x. digital content for listening, viewing or playing on any audio, visual or digital media;

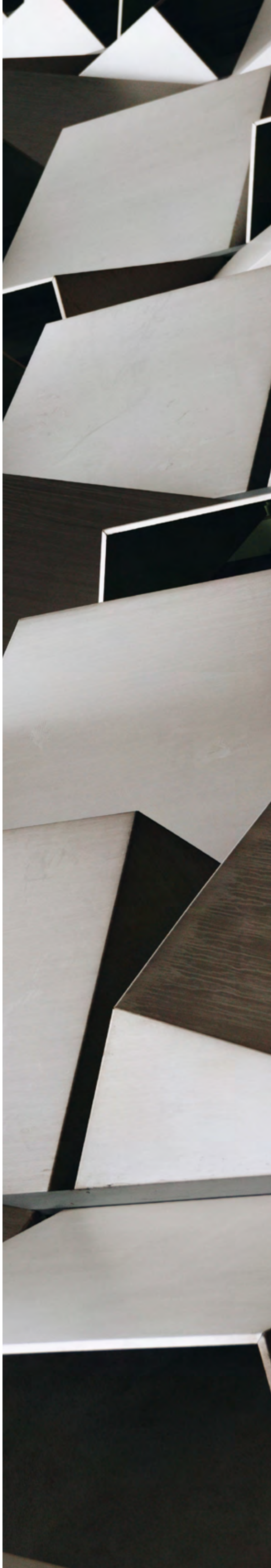
xi. services that link suppliers to recipients including transport hailing services;

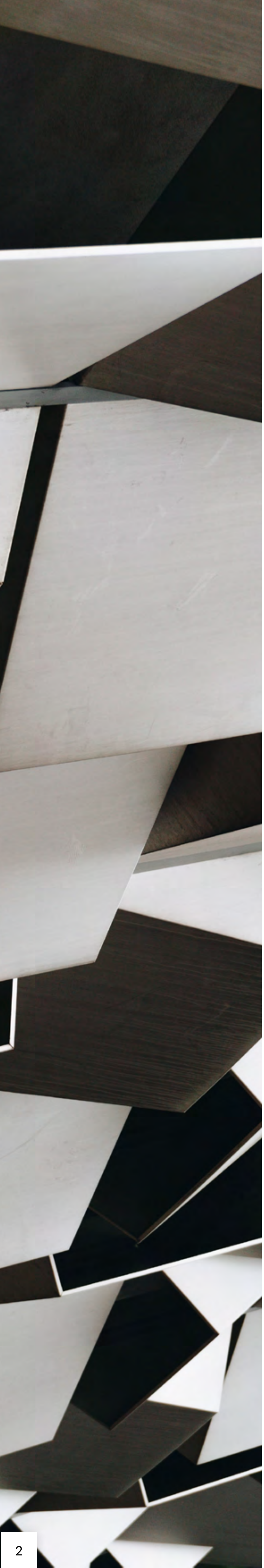
xii. electronic services under section 8 of the VAT Act; and

xiii. any other service provided through a digital marketplace that is not exempt under the VAT Act.

This means that non-resident digital service providers offering any of the above services will be required to register, charge and remit VAT to the KRA at the prevailing rate of 14%. It is likely that these service providers will pass on the VAT cost to their customers by way of increased prices for their services as has been the case in other jurisdictions which have introduced similar taxes.

It could be argued that the extension of the scope of services on which VAT is applicable is ultra vires the powers of the Cabinet Secretary. This is on the basis that the relevant provisions under which the Regulations have been issued only permit the Cabinet Secretary to issue regulations for implementation of VAT on supplies made on a digital marketplace and not to expand the scope of services on which VAT is applicable, which can only be achieved by way of an amendment to section 8(3) of the VAT Act.





Persons Liable for the VAT Obligation

The Regulations are only applicable to services provided by a **non-resident person** to a **consumer based in Kenya** and the obligation to charge and remit VAT lies with the non-resident supplier of the services. However, the requirement to account for VAT only applies in relation to services provided to a Kenyan consumer in a business-to-customer (**B2C**) transaction.

Where a non-resident supplier engages in a business-to-business transaction (**B2B**), such transactions will be deemed to be imported services and the Kenyan business importing the services will be liable to account for VAT on the imported services, through the reverse VAT charge mechanism, in accordance with Section 10 of the VAT Act. In such a case, the Kenyan business which is the recipient of the services will be required to notify their supplier that they will not be required to charge VAT on the supplies. In the event they fail to do so, and the non-resident supplier charges VAT on the supplies, the Kenyan business recipient will not be permitted to deduct and/or credit the input VAT incurred.

Further, the Regulations provide that a non-resident supplier will not be required to issue an electronic tax invoice but will only be required to issue an invoice or receipt showing the value of the supply and the amount of tax deducted. This is a welcome provision as it will reduce the compliance costs which would have otherwise been incurred if non-resident suppliers were required to issue electronic tax invoices which comply with the VAT Act and the Value Added Tax Regulations, 2017.

The Regulations also provide that non-resident suppliers shall not be eligible to claim input VAT, which imposes an unfair burden on suppliers who incur input VAT in Kenya in the course of making taxable supplies to consumers in Kenya. Other jurisdictions which have introduced similar provisions such as South Africa, permit non-resident suppliers of electronic services to claim input VAT.

Registration for VAT Purposes

The KRA has adopted a simplified VAT registration framework which allows non-resident providers of digital services to register for VAT through the online iTax platform, without creating a legal presence in Kenya. The simplified registration regime has been successfully adopted in other jurisdictions such as South Africa. As an alternative, non-resident persons can appoint a tax representative in Kenya to undertake the compliance obligations on their behalf (discussed further below).

While it would have been expected that the VAT registration threshold of KES 5 million (approx. USD 46,000) under the VAT Act would have equally applied to the simplified VAT registration regime, this has not been clarified in the Regulations. It is therefore the case that in the absence of specific provisions on this issue in the Regulations, it could be argued that the VAT registration threshold of KES 5 million (approx. USD 46,000) under Section 34 of the VAT Act should also apply under the Regulations and non-resident suppliers who do not meet this threshold may not be required to register under the simplified registration regime until they meet this threshold. It would be expected that the KRA will provide further guidance on this issue in due course.

Persons Required to Register for VAT Purposes

The Regulations clarify that registration for VAT will only be applicable where the services are provided in a B2C transaction and where the recipient of the services:

i. is in Kenya;

ii. makes payment for the services through a bank registered in Kenya; or

iii. the payment for the services is authorised in Kenya.

The Registration Process

The registration process will be simplified and will be undertaken online through a registration form which will be provided by the KRA, but which is yet to be provided as at the date of this Legal Alert. Any documents and information that may be required by the KRA to support the application will also be submitted online. These include:

a. the name of the business;

b. the name, address, telephone contact and email address of the contact person responsible for tax matters of the business;

c. the website of the supplier's business;

d. the national tax identification number of the supplier provided in their jurisdiction;

e. the certificate of incorporation or registration of the business; and

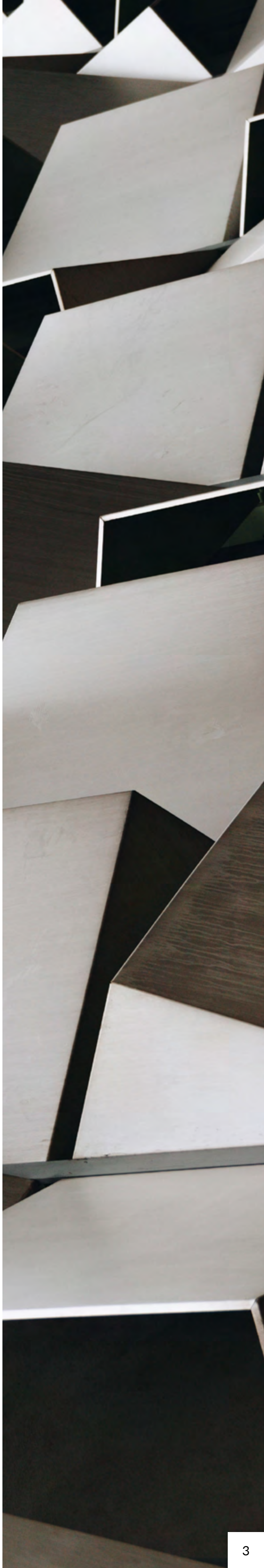
f. any other information required by the KRA.

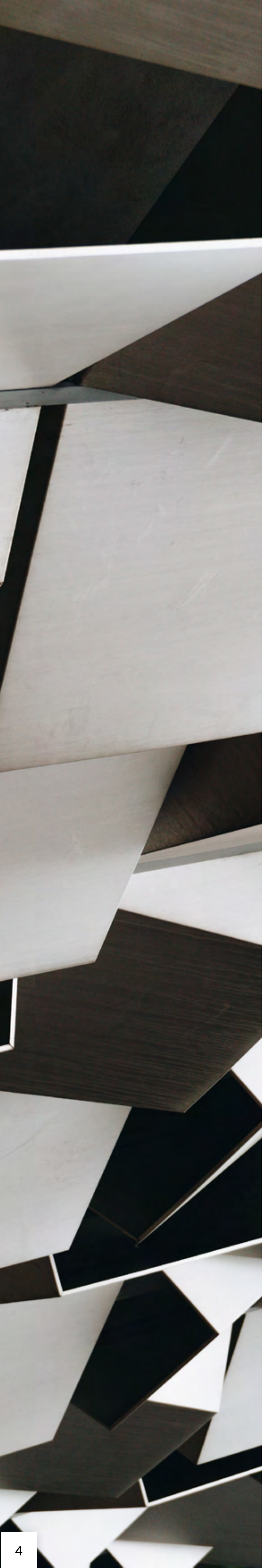
After registration, the non-resident supplier will be issued with a Personal Identification Number (PIN) for purposes of filing returns and payment of VAT.

Appointment of Tax Representatives

The Regulations provide for the appointment of tax representatives as an alternative for non-resident suppliers who opt not to register for VAT. The responsibility of the tax representative, where one is appointed, is to account for and remit the VAT on the supplies made by the non-resident supplier on their behalf.

While the Tax Procedures Act, 2015 (the **TPA**) provides that a tax representative would be required to undertake a separate registration for each client they represent, this is yet to be fully operationalised on the iTax platform and it would be expected that the relevant configurations will be made soon to allow for non-resident service providers of electronic services to opt for this route, if they so choose.





Place and Time of Supply

The Regulations provide that a supply will be deemed to have been made in Kenya when the recipient of that supply is in Kenya. The criteria for determining whether such a recipient is in Kenya state that either:

i. their payment proxy (including debit/credit card information) and bank details are in Kenya; or

ii. their residence proxy (including billing/home address) or access proxy (including internet address or mobile country code) is in Kenya.

In our view, the place of supply rules set out above could result in VAT being applicable in instances where there is insufficient nexus with Kenya. For example, a customer's bank account details could be in Kenya but the customer could have relocated and is accessing the digital services from a foreign jurisdiction. Based on the criteria above, VAT would be applicable in such circumstances whereas it could be argued that Kenya should not have the taxing rights as the services were enjoyed by a person who was not based in Kenya. The Regulations should therefore have provided, in our view, that the place of supply will only be in Kenya where both tests set out above have been met.

In determining the time of supply (which is the date on which VAT should be accounted for), the Regulations provide that this will be determined as the earlier of:

i. the date the payment for the supply was received whether in whole or in part; or

ii. the date of the invoice or receipt issued.

The time of supply rules require that VAT be accounted for on an accrual basis, which could be prior to the receipt of payment in certain cases. In instances where payment is not received (e.g. due to a bad debt on credit sales), the VAT payment on such credit sales would have been funded by the non-resident supplier and the Regulations do not provide a refund mechanism in such circumstances. In our view, the Regulations should have permitted suppliers to account for VAT either on a cash basis or an accrual basis, to allow businesses which face challenges in collection of payments to account for VAT only when payment is actually received.

Accounting for and Payment of VAT

Non-resident suppliers in a B2C transaction will be required to submit returns in the prescribed form and remit the VAT due to the KRA on or before the twentieth day of the following month from when the transaction took place. This may be done by the supplier, where they have been registered for VAT, or through an appointed tax representative. The Regulations also permit a supplier to amend returns in accordance with the provisions of the TPA.

Further, the Regulations clarify that where a non-resident person's business is such that an intermediary makes a supply on its behalf to Kenyan consumers, the VAT obligation will lie with the intermediary in such circumstances, whether or not the non-resident supplier is registered for VAT. Intermediaries will therefore have to shoulder the compliance burden on supplies made on their platforms, which is likely to result in additional compliance costs. In most jurisdictions where similar provisions have been introduced, the obligation for intermediaries to account for VAT is optional and it only applies where an intermediary has been appointed to undertake this role by the relevant supplier.

Penalties

The Regulations provide that a person who fails to comply with the provisions therein shall be liable to penalties under the TPA. These penalties include payments of fines or imprisonment or both, upon conviction. In a welcome move, the proposal which had been included in the draft Regulations for persons who fail to comply to be liable to restriction of access to the digital marketplace in Kenya has been deleted. Not only would have the provision been ultra vires the powers of the Cabinet Secretary, but it could also have been prone to abuse.

Transitional Provisions

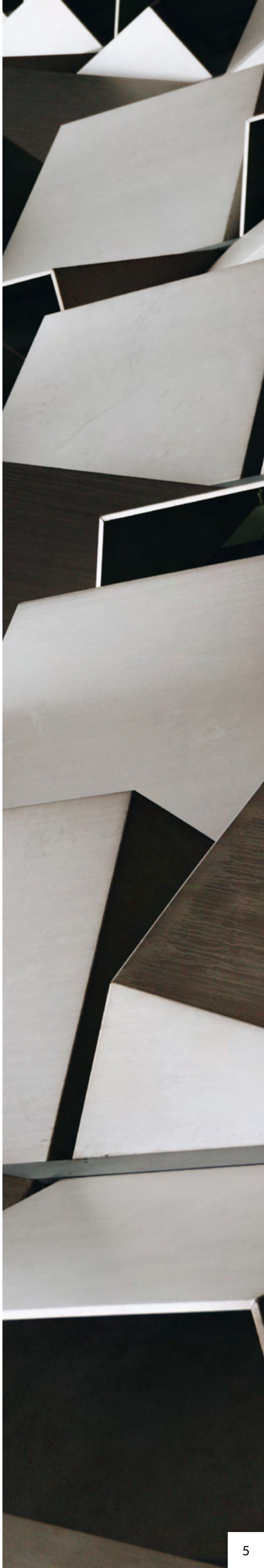
It is crucial to note that the Regulations provide that non-resident suppliers who are required to register under the Regulations are required to do so within 6 months from the date of publication of the Regulations. However, there could be various interpretation issues, since the Legal Notice which published the Regulations is dated 25 September 2020 and the Regulations were only published in the Kenya Gazette on 9 October 2020 with the official Kenya Gazette Supplement made publicly available on 16 October 2020. This therefore means that there are potentially, 3 different dates which can be used as the ''date of publication''. It will therefore be critical for suppliers who will be required to register under the Regulations to carefully consider the timelines for registration in light of the potential interpretation issues above.

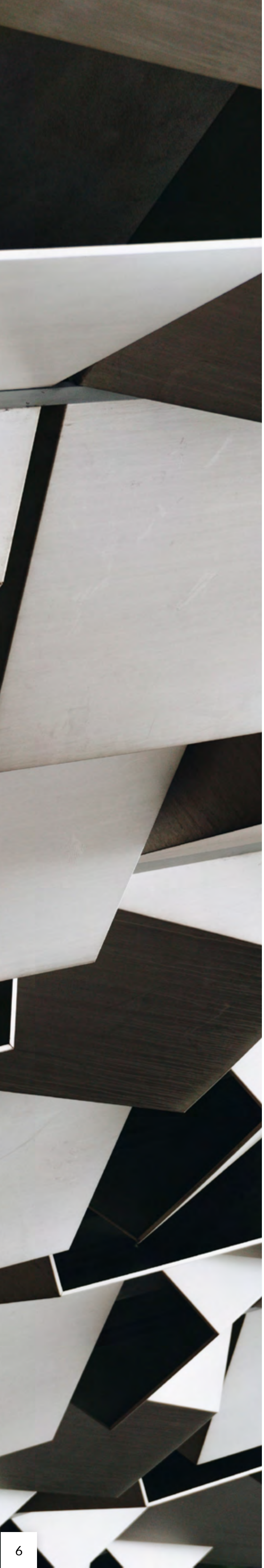
Nevertheless, the 6 month registration period is a welcome change from the provision contained in the draft Regulations which provided that registration of non-resident suppliers was to be done within 30 days from the date of publication of the Regulations. The 6 month period will provide sufficient time for non-resident suppliers to re-configure their systems to automate compliance for large volumes of small transactions.

Next Steps

Formulation of regulations in Kenya is governed by the Statutory Instruments Act, 2013 (the **Statutory Instruments Act**) which provides a comprehensive regime for the making, scrutiny, publication and operation of statutory instruments for them to have the force of law. The Regulations are a statutory instrument and should therefore be made in accordance with the provisions of the Statutory Instruments Act.

The Statutory Instruments Act requires regulations to be tabled before Parliament within 7 sitting days of publication, and the Committee on Delegated Legislation is





then responsible for the review of the regulations to ascertain whether they are in compliance with the Constitution of Kenya and other relevant legal requirements.

We would therefore expect that the Regulations will be tabled in Parliament imminently, as required by the Statutory Instruments Act.

Key contacts

Should you require more information, please do not hesitate to contact:

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