# Digital Service Tax or Withholding Tax? The Unanswered Question

For the past few years the OECD has been working towards reaching a consensus-based long-term solution to the tax challenges arising from the digitalisation of the economy with 139 countries collaborating through what is called the G20 Inclusive Framework. Despite these multilateral negotiations still ongoing, some member countries, Kenya included, went ahead and unilaterally introduced their own Digital Service Tax (DST) creating certain complexities for multinational entities.

The introduction of DST in Kenya tagged along its fair share of controversy and uncertainty. DST was first introduced in Kenya in the year 2019 through the Finance Act No. 23 of 2019. The Finance Act, 2019 amended the Income Tax Act, Cap.470 by inserting a new paragraph under Section 3(2) which is the charging section of the Act. The newly inserted provision; now Section 3(2)(ca) read as below;-

**"Subject to this Act, income upon which tax is chargeable under this Act is income in respect of-**
**(ca) income accruing through a digital marketplace"**

The Finance Act also introduced a new provision; Subsection 3(2A) which mandated the Cabinet Secretary to make regulations providing for the mechanisms of implementing the provisions of subsection 3(2)(ca). A further amendment to this section was made by introducing subsection 3(3)(ba) to define the term "digital marketplace" as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means.

These amendments were set to be operational on 7th November 2019. However, the tax was not fully implemented in Kenya until 2nd January 2021 when the DST Regulations published vide Legal Notice 207, came into force along with Section 12E of the Income Tax Act which was introduced by the Finance Act, 2020. Section 12E provided that persons; both resident and non-resident; whose income from the provision of services was derived from or accrued in Kenya through a digital market place would be liable to pay DST. However, resident persons or non-resident persons with a permanent establishment in Kenya would be entitled to offset the DST paid against the tax payable for that year of income.

The newly introduced DST was not without its problems, chief among them being the potential double taxation and reconciliation nightmare that would arise from charging DST on residents; and further the apparent clash between DST and withholding taxes in respect of certain payments already being remitted for services that were provided by non-residents in the digital space.

In a bid to address this issue and remove certain ambiguities, the Finance Act, 2021 which came into force on 1st July 2021, has deleted and substituted the previous paragraph 3(2)(ca) with a new provision which now reads as follows "Subject to this Act, income upon which tax is chargeable under this Act is income in respect of- income accruing from a business carried out through the internet or an electronic network including a digital marketplace." The previous paragraph 3(3)(ba) has also been deleted and substituted with a new provision redefining a digital marketplace to mean "an online or

electronic platform which enables users to sell or provide services, goods or other property to other users."

Further, section 12E (1) of Income Tax Act was also deleted and substituted with a new section 12E(1) which provides that Digital Service Tax will only be applicable to income of non-residents accruing from a business carried out through the internet or an electronic network including a digital marketplace. The Finance Act, 2021 also clarified that DST shall not apply to income subject to WHT pursuant to Section 35 of the income Tax Act or income from provision of radio, television or internet services pursuant to Section 9(2) of the Income Tax Act.

Despite the fact that the said amendments brought about a sense of clarity, the same is still not completely unambiguous. Taxpayers on both ends of the supply chain (digital service providers and digital service consumers) are having a problem arriving at a consensus on whether this income is subject to DST or to withholding tax under section 35. Some taxpayers have opted to seek clarification from the Kenya Revenue Authority on the correct position through private rulings.

Section 35(1)(a) of the Income Tax Act mandates every person, upon making payment of any amount in respect of management, professional or training fees, to a non-resident person not having a P.E in Kenya, to deduct the requisite tax at the appropriate rate and remit the money directly to KRA. This position has been used as the legal justification for withholding tax on payments to non-residents, including the payment of commissions and other fees for online services offered.

Prior to the introduction of DST and the subsequent amendments made through the various Finance Acts, payments to non-residents, including the commission or fee paid to the digital marketplace providers for the use of their respective platforms would ordinarily attract withholding tax. With the introduction of DST, there is disconnect as to whether commissions or fees paid to non-resident digital marketplace providers for the use of their respective platforms should be subjected to DST or withholding tax. This is on the backdrop of the new legal requirement that DST shall not apply to income subject to WHT pursuant to Section 35 of the income Tax Act.

In the absence of clarity or a clear response to such a question, it remains a tough balance act in determining as to which tax should take precedence. Are the parties at liberty to choose the tax obligation to abide by?

It is our opinion that DST should take precedence over withholding tax in such instances. This is based on the fact that Section 3 of the Income Tax Act which is the primary charging section of the Act; clearly recognizes income accruing from a business carried out through the internet or an electronic network, including a digital marketplace as taxable income. Accordingly, the tax payable under such this head is DST. This is buttressed by the provisions of Section 12E(1) which states that "Notwithstanding any other provision of this Act, a tax to be known as DST shall be payable by a non-resident person whose income from the provision of services is derived from or accrues in Kenya through a business carried out over the internet or an electronic network including through a digital marketplace"

The net implication of the said amendment is that such income is recognized as a distinct source

of income subject only to tax, known as digital service tax charged at the rate of 1.5% of the gross transaction value. The Income Tax (Digital Service Tax) Regulations, 2020 adds that income subject to DST is the gross transaction value of the payment received as consideration for the services in the case of the provision of digital services; and the commission or fee paid to the digital marketplace provider for the use of the platform in the case of a digital marketplace.

The second reason as to why we are of the opinion that DST takes precedence over WHT in this context is premised on the wording of section 35(1) of the Income Tax Act, which mandates certain payments to non-residents be subjected to withholding tax. The section is relatively broad, providing a range of payments such as management, professional and training fees. In the absence of DST, this section was sufficient to impose WHT on digital services provided by non-residents without PE as they would generally fall under any of the 3; management, professional or training fees. However, the advent of the DST provides a narrower and more specific scope of services that fall within the income subject to DST.

Both domestic law and international best practise dictates tax statutes should be interpreted strictly in the letter of the law. One is not to imply anything into the tax statute or look at the intention of the statute. In this case, while the provisions of section 35 ask us to look into the intention of the law, the provisions of Section 3(2)(ca) and Section 12E are clear and ambiguous about the income subject to WHT.

It would follow that withholding tax in respect of payments made as commission or fees paid to a (non-resident) digital marketplace provider for the use of the platform is only subject to digital service tax but not withholding tax.

**Case on point:**

Take an example of a non-resident digital marketplace provider offering a platform that links hotels and restaurants to clients, perhaps with additional services such as delivery. The price for the food ordered by the customers via the platform would comprise of the cost of the food as per the restaurant prices, the delivery charges, and the commission/fee payable to the digital marketplace provider. While paying the non-resident such fees/commission, the attendant tax obligation would be digital service tax at the rate of 1.5% of the gross transaction value (being the fee/commission) as opposed to a withholding tax of 20% of the payment (fee/commission).