LAWYERS HUB
Tech for Justice

SUBMISSION OF MEMORANDA TO THE DEPARTMENTAL COMMITTEE ON FINANCE AND NATIONAL PLANNING ON THE FINANCE BILL, 2024 (NATIONAL ASSEMBLY BILLS NO. 30 OF 2024)

DATE: 30/05/2024

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Dear Sir/Madam,

RE: SUBMISSION OF MEMORANDA TO THE DEPARTMENTAL COMMITTEE ON FINANCE AND NATIONAL PLANNING ON THE FINANCE BILL, 2024 (NATIONAL ASSEMBLY BILLS NO. 30 OF 2024)

In line with the constitutional imperative of ensuring wide consultations and public participation, the Committee invited stakeholders to submit their comments on the Finance Bill, 2024.

As an innovative Legal-Tech organization incorporated within the Republic of Kenya, with a focus on technology-driven enterprises and policy alternatives, the Lawyers Hub is pleased to make submissions to the Committee in order to enhance the quality of the Bill. We herein provide a summary of our submissions;

1. Clause 63 is misplaced and should be removed from the Bill because it does not belong in a money bill. The Bill should restrict itself to matters that directly affect finances. The Data Protection Act is not related to financial matters in the country, so including it in the Finance Bill is inappropriate.

2. It is our submission that the provision in clause 8 is unconstitutional as it is not enacted in accordance with Article 201(b)(i) of the Constitution since it violates the principle that the burden of taxation should be shared fairly. Nonetheless we propose that tax non-resident persons based on their actual net profits rather than gross turnover. This ensures that businesses are taxed on their real financial performance, taking into account their expenses.

3. It is our submission that software payments only be considered royalties subject to withholding tax if the payer acquires rights that allow them to commercially exploit the software, including the exclusive right to reproduce the software in any material form and the exclusive right to translate or adapt the software.

Yours Sincerely
Linda Bonyo,
C.E.O. Lawyers Hub.

Submissions

The Lawyers Hub read the Bill and held a public discussion on May 27, 2024. The policy discussion attracted over 200 participants and featured a range of experts who shared their views and proposals. In line with our views and the recommendations from the policy discussion, the Lawyers Hub submits the following recommendations to enhance the Finance Bill:

CLAUSE	DESCRIPTION OF THE CLAUSE	PROPOSAL	JUSTIFICATION
Clause 8	The Bill proposes to repeal section 12E of the income Tax Act and add a tax known as **Significant Economic Presence Tax** that is 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 a digital marketplace. For the purpose of computing the tax, the taxable profit of a person liable to pay the tax shall be deemed to be 20% of the gross turnover	Tax non-resident persons based on their actual net profits rather than gross turnover. This ensures that businesses are taxed on their real financial performance, taking into account their expenses. Develop clear and fair guidelines for determining taxable income for non-resident businesses to ensure transparency and predictability in tax obligations.	This provision is unconstitutional as it is not enacted in accordance with Article 201(b)(i) of the Constitution since it violates the principle that the burden of taxation should be shared fairly. Imposing this tax will unfairly target businesses in loss-making positions, forcing them to pay taxes from their capital rather than profits, unlike profitable businesses. Taxing non-resident persons at 20% of their gross turnover, without considering actual profits, disproportionately affects businesses with high turnover but low profit margins or losses. Therefore, similar to the argument in ***Constitutional Petition E005 & E001 (Consolidated) of 2021***, there are concerns about the fairness and negative impacts of taxing non-resident persons based on gross turnover without accounting for expenses. Taxation should not add to the burdens of those who have less. This proposal fails the fairness test under Article 201(b)(i) of the Constitution. The use of the word "deemed," meaning income assumed to be received even if not, must be clear and certain in taxation. Tax laws should precisely target their intended subjects and not unfairly assume figures based on turnover due to unverifiable tax losses.

Clause 63	The Bill proposes to **amend Section 51(2) of the Data Protection Act** by inserting a new paragraph; "disclosure is necessary for the assessment, enforcement or collection of any tax or duty under a written tax law."	Remove the Data Protection Clause from the Bill.	Finance Bills should strictly address financial matters such as taxation, government revenue, and fiscal policy. Including provisions that amend the Data Protection Act, which primarily deals with privacy and data protection, diverges from the primary purpose of a Finance Bill. The Data Protection Act is not related to financial matters and should be debated within the context of privacy and data protection laws, ensuring proper scrutiny and deliberation. Kenyan courts have emphasized the importance of legislative clarity and appropriateness. In ***Institute of Social Accountability & Another v National Assembly & 4 Others***, the High Court of Kenya highlighted the necessity for adherence to constitutional provisions and legislative focus. Similarly, courts in the UK and India have stressed that while ancillary matters may be included in Finance Bills, they must be closely related to financial administration. Including data protection amendments does not meet this criterion. Including data protection exemptions in the Finance Bill without adequate debate and scrutiny undermines public trust in both the legislative process and the protection of personal data. Data protection laws have far-reaching implications across various sectors, not limited to financial matters. Therefore, any amendments should be considered in a broader context to ensure they are well-considered and balanced. The Finance Bill should be restricted to matters directly affecting finances to maintain legislative clarity and focus. The inclusion of data protection exemptions is inappropriate as it pertains to privacy and data protection, not financial matters. Constitutional and procedural principles support the need for such amendments to be introduced through the appropriate legislative channels, ensuring adequate scrutiny and debate If we allow this amendment to go through, it will dilute the data protection principles and undermine the structure and intent of the Data Protection Act. Instead, support should go to the Office of the Data Protection Commissioner, focusing on building robust data protection laws without unnecessarily pushing people to comply.

Clause 9	The Bill proposes **a Minimum Top-Up Tax for residents or entities with a permanent establishment in Kenya and an annual consolidated turnover of EUR 750 million or more, payable if their combined effective tax rate for a year is less than 15%.** This tax is part of implementing Pillar 2 of the OECD's Two-Pillar Inclusive Framework, which will replace the current 1.5% Digital Service Tax. Pillar 2 and the Global Anti-Base Erosion (GloBE) rules aim to impose a 15% minimum tax on multinational enterprises (MNEs) with revenues of at least EUR 750 million, ensuring a minimum tax rate of 15% on global income to deter base erosion and profit shifting.	We propose that the Minimum Top-Up Tax should not be adopted as the Bill also proposes the introduction of the Significant Economic Presence (SEP) tax. Conduct a proper comparison between the proposed OECD Pillar 2 and the United Nations Model Treaty on Automated Digital Services Tax (article 12b) to determine which model will net more taxes from the targeted non-residents.	Give adequate time to the Affected taxpayers for them to familiarize themselves with the Pillar Two rules within the Kenyan context, as the effective tax rate of 15% under Pillar Two is calculated by dividing Adjusted Covered Taxes by GloBE income or loss. Regarding Pillar Two, we acknowledge its merit in halting the race-to-the-bottom and leveling the playing field, as well as attributing additional taxing rights over certain payments to developing countries under the Subject to Tax Rule (STTR). However, we believe there is room for further development and consideration. Leveling the playing field by eliminating competition based on taxation requires jurisdictions to preserve their attractiveness for foreign investments. This necessitates deep reforms in some cases, aimed at identifying and introducing or redesigning non-tax incentives. Such reforms would require considerable time and effort to design, enact, and test effectively. The STTR could pose significant challenges for Kenya and may not generate the expected tax revenues. We have seen that we already struggle to identify Base Erosion and Profit Shifting (BEPS) payments in practice, and the implementation of STTR in Double Taxation Treaties (DTTs) could complicate this further. New tax planning schemes are likely to be developed by multinational enterprises (MNEs) in response to the STTR, particularly since no tax relief is granted by the state of residence of the payment recipient concerning the STTR top-up tax. Moreover, the overall complexity of Pillar Two is very high, which is especially challenging for low-capacity administrations in developing countries like Kenya. These administrations may face significant difficulties in implementing and managing the intricate rules and regulations associated with Pillar Two, potentially undermining its effectiveness and the intended benefits. In our Opinion, while Pillar Two has significant potential, careful consideration and additional measures are needed to ensure that it can be effectively implemented in Kenya without imposing undue burdens or creating new challenges.

Clause 20	The Bill proposes to **introduce Withholding Tax (WHT) to both residents and non-residents on income derived from a digital marketplaces and platforms at 5% residents and 20% non-residents.** The Bill also places the obligation to withhold the tax on payments for goods and services on the owners or operators of digital marketplaces and platforms.	We propose that this provision be deleted. Alternatively, To address these issues, we recommend a maximum gross withholding tax rate of 3% or 4%. This would be more equitable and less likely to deter non-resident service providers from engaging with the market. On the other hand non-resident ADS service providers could elect for a net approach to taxation, applying the domestic tax rate of Kenya to the "qualified profits" earned annually. Qualified earnings should be 30% of the amount resulting from applying the profitability ratio of the service provider's ADS segment to the gross annual revenue from ADS derived from the source state.	A high withholding tax rate of 20% on non-resident service providers can lead to several negative consequences. Non-resident service providers are likely to pass on the tax cost to customers, leading to higher prices for goods and services. This increased cost burden on consumers could make digital marketplaces less attractive and accessible. A withholding tax rate higher than the foreign tax credit granted in the service provider's residence state might deter trade and investment in Kenya. Non-resident providers may avoid engaging with markets where they face a high tax burden, limiting the availability of services and hindering market growth. Furthermore, some non-resident service providers incur high costs to provide Automated Digital Services (ADS). A high withholding tax on the gross payment can result in an excessive effective tax rate on their net income, reducing their profitability and potentially driving them out of the market. This could lead to decreased competition and innovation in the digital economy
Clause 34 (b)(i)	The Bill proposes to **standard rate various financial services,** including the issuance of credit and debit cards, telegraphic money transfer services, foreign exchange transactions, cheque handling, the issuance of securities for money, the assignment of debt for consideration, and the provision of these financial services on a commission basis	Provide tax incentives or lower VAT rates for digital transactions to encourage the use of electronic payment methods. This can help maintain the momentum of e-commerce growth while ensuring tax compliance. Provide targeted tax reliefs or exemptions for small and medium-sized enterprises (SMEs) operating in the digital economy. Supporting SMEs can foster innovation and competitiveness, leading to long-term economic benefits.	While the intention behind these measures might be to increase tax revenue, such a move could have significant negative implications for the digital economy. The growth of e-commerce has been phenomenal, offering considerable benefits to businesses, such as faster, easier, and more efficient ways of engaging with consumers, suppliers, and government agencies. This digital transformation has facilitated an increase in real-time, paperless transactions, which are crucial for the efficiency and growth of the digital economy. However, imposing VAT on financial services integral to e-commerce could hinder its growth. E-commerce relies heavily on seamless financial transactions, including the use of credit and debit cards, money transfers, and foreign exchange. Adding VAT to these services increases costs for businesses and consumers, potentially making e-commerce transactions less attractive and more expensive. This could

			stifle innovation and discourage both local and international companies from participating in Kenya's digital marketplace. Taxation in the e-commerce sector poses unique challenges due to its online nature. The inherent dematerialization in e-commerce leads to a situation where material assets lose significance in favor of new intangible assets. A tax regime must be adaptable to the rapidly changing digital world. Currently, measures relating to e-commerce taxation are not fully established in Kenya. Implementing VAT on essential financial services without a comprehensive understanding of its impact on the digital economy could create more problems than it solves.
Clause 35(h) and Clause 35(j)	The Bill **proposes to delete the supply of electric bicycles and electric buses of the tariff heading 87.02 from the zero-rated supplies** listed in Part A of the Second Schedule	We proposal that we maintain the status quo and delete this provision	The Finance Bill 2023 introduced the zero-rating of these e-mobility related supplies in an effort toencourage the use of renewable energy within the transportation sector. Also in a landmark visit to the US, President William Ruto delivered a compelling speech advocating for the adoption of electric vehicles (EVs) as a pivotal strategy in combating climate change and fostering sustainable development. The removal of this incentive is likely to result in reduced growth within the e-mobility sector and goes against the government's green agenda and the government's commitment to provide tax stability by not reversing laws on a yearly basis. We are moving 5 steps ahead and 20 steps back in our goal to attain Net Zero by 2050 while growing the economy and taking advantage of the green growth opportunities.
Clause 45	The Bill proposes **the introduction of an eco-levy on certain goods and products**, listed in the Fourth Schedule of the Miscellaneous Fees and Levies Act. Items subject to this levy include office machines, calculating machines, telephone sets	The proposed Eco Levy, while new and potentially positive, lacks specific allocation for benefits in the Finance Act. Clearly outlining how the collected levy will be used to manage waste disposal. The current draft of the law does not specify whether the collected funds will be used for	Kenya already has regulations for dealing with e-waste, but these are not yet implemented. The Eco levy would add $20 to the price of a laptop and $3 to a phone, which are prices many Kenyans struggle to afford. This increase comes on top of existing high taxes on devices, including excise duty, import duty, and other levies, which already make gadgets significantly more expensive in Kenya.

	(including smartphones), rubber tyres, and diapers.	environmental restoration, nor does it detail the restorative measures the funds can support.	These high costs fuel a black market and deepen the digital divide. In Nairobi, 40-50% of people own a laptop or tablet, but in northern Kenya, ownership can be as low as 3-5%, with women being particularly marginalized. Additional levies will further marginalize the most digitally excluded groups.
		The proposal to increase excise duty from 15% and remove the ability for businesses to claim it back as an input cost is particularly damaging.	Investors in infrastructure have significant concerns about the proposed changes to excise duty. Kenya already has one of the highest excise duties in the region, with Tanzania planning to eliminate it and Uganda's rate being lower. For providers like Liquid Telecom, this means that internet service providers (ISPs) will face a 5% increase in excise duty on bandwidth without the ability to offset this cost. Consequently, the cost to consumers for broadband could rise by 30-35%. Given the price sensitivity of internet users, this could lead to reduced internet accessibility, especially in marginalized areas, and hinder the government's Digital Super Highway initiative, which aims to expand fiber infrastructure across the country. This will make internet services less affordable for average Kenyans, countering efforts to enhance digital connectivity and economic transformation.
Clause 39	The excise duty on internet data services is set to increase from 15% to 20%.	Retain the excise duty at 15% or lower it to 5%.	This provision to us is a Regressive tax that will have a greater impact on lower-income individuals than on the wealthy. This hike will likely burden consumers, making online education and other internet-based activities less affordable for the average Kenyan. While the government aims to encourage digital participation, these tax increases could counteract those efforts, resulting in higher costs for consumers and potentially stifling growth in the digital economy.
Clause 2	The Bill **proposes to amend the definition of royalty to include 'any software, proprietary or off the shelf whether in the form of license, development, training, maintenance or support fees and include the distribution of the software**'.	We propose that software payments only be considered royalties subject to withholding tax if the payer acquires rights that allow them to commercially exploit the software, including the exclusive right to reproduce the software in any material form and the exclusive right to translate or adapt the software. This revision would align the Bill	The Bill proposes to tax the purchase of software, whether by license or otherwise, as the acquisition of royalty. This approach goes against international best practices as envisaged under the Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital, which recognizes that software distributors make payments for copyrighted software but do not commercially exploit such software. If adopted, this provision

		with international standards and judicial precedent, ensuring that software distributors are not unduly taxed for non-commercial activities.	would present an interesting divergence from the decision of the ***High Court in Seven Seas Technologies Limited v. the Commissioner of Domestic Taxes***, which held that for a software-related payment to amount to a royalty subject to withholding tax, the payer must have acquired any or all rights that enable them to commercially exploit the software as envisaged under the Copyright Act. These rights include the exclusive right to reproduce the software in any material form and the exclusive right to translate or adapt the software. We need to distinguish between businesses buying software as an expense and those buying it to monetize. Taxing software purchases as royalties unfairly burdens businesses by treating essential expenses as taxable income.

SOME OF THE HIGHLIGHTS AND RECOMMENDATIONS FROM THE POLICY DISCUSSIONS INCLUDE (Link to the Discussion - https://lawyershub.events/digitaltax)

- “The digital service tax has been ineffective. It was initially set at 1.5% and proposed to increase to 3%, but it hasn’t met expectations. Now, the government is scrapping this tax and introducing the significant economic presence tax, which proposes a 20% tax on the turnover of non-resident tech companies. I’d be very surprised if these companies, whose software generates some profit, have a 20% profit margin in terms of actual net profit. **Typically, taxes are levied on net profit, not gross turnover. This change presents a significant challenge and may render Kenya unattractive to these tech companies.**”

- The fluctuating taxes, year on year, have created an unpredictable environment. Over the past four to five years, constant changes in tech tax regimes have led to decreasing tax revenue from the sector. This instability makes Kenya less attractive to investors, resulting in more companies leaving the country. While the social impact of gambling for example is debatable, the revenue from gambling taxes has been declining due to these frequent changes.

- The new withholding tax on digital platforms requires non-resident platform owners to pay this tax and comply with registration and regulatory requirements. While a simplified compliance platform exists, it is uncertain how many non-residents will adopt it. Monitoring and ensuring compliance by the Kenya Revenue Authority (KRA) poses a significant challenge. Although KRA claims to have verification methods, the effectiveness of these measures remains to be seen. This could further complicate compliance and potentially discourage non-resident platform owners from engaging with the Kenyan market.

- The Bill proposes to amend the withholding tax system for digital content creators, targeting those earning income from platforms like TikTok. The government’s intent is to broaden the tax base and ensure that all income earners pay taxes. However, this move risks deterring foreign investors and increasing the cost of services, making digital participation more expensive.

- On Data protection, Speakers expressed concern over proposed changes in data protection laws that would grant authorities broad access to personal data without notice or warning. They argue that existing laws already provide a framework for accessing information through due process. Granting unfettered access could lead to arbitrary assessments and infringe on privacy rights.
- Participants raised concerns about the proposed changes regarding claiming input VAT, which could potentially discourage investors. Currently, investors have the right to claim input VAT, which helps reduce their tax liability by offsetting it against output VAT. However, the proposed changes seem to restrict this right, which could impact investors' willingness to invest. This change could be seen as a disincentive for businesses looking to operate in Kenya, as it would increase their tax burden and reduce their ability to offset expenses against VAT. This could have negative implications for businesses' cash flow and overall competitiveness, ultimately affecting Kenya's attractiveness as an investment destination. The speakers suggested that this issue needs to be carefully reconsidered to avoid unintended consequences on investment and economic growth.
- There is an anticipated resistance from non-resident individuals who may not earn any income from Kenya but are required to deduct withholding tax. This additional compliance burden could lead them to question the necessity of subjecting themselves to this regime when they earn sufficient income from other jurisdictions that do not impose such requirements. There's also a concern about transactions being taxed where the income is not generated or accrued in Kenya.
- We need to encourage small businesses by making compliance less burdensome for them. We need alternative ways to achieve compliance within the tech system, such as sharing resources. For instance, in Paris, there is an Innovation Hub that assists businesses with compliance. Tanzania has also adopted a similar approach for foreign businesses by offering a VIP service that acts as a one-stop shop for all government compliance needs. We need to start pushing for such initiatives in Kenya to give small businesses a fair chance to thrive and compete.
- People are still opting for cash, so taxing digital money use actually encourages people to leave the digital economy. As a result, they won't be paying taxes on digital transactions. Even if we tax big tech companies and hope they pass this tax to local users, it won't work because people will find ways to avoid the platforms. They might register on sites, do the work, but then conduct transactions off-platform.

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