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Kgomotso Mponwana; Jane Ndlovu

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Digital Services Tax: Analytical View of Challenges and Successes in Kenya and the United Kingdom

Kgomotso Mponwana[*] & Jane Ndlovu[**,***]

The rapid expansion of digital services is dramatically reshaping the panorama of global taxation. This transformation is notably impacting multinational enterprises (MNEs) that operate in countries where they lack a physical presence. In this study, the authors focus the attention on the implications of digital services offered by these non-resident MNEs operating in the Republic of Kenya and the United Kingdom and representing developing and developed economies, respectively.

The article delves into how the burgeoning digital economy challenges international tax laws by scrutinizing the implementation of the digital service tax (24DST) and highlighting the weaknesses of the two-pillar plan in comprehensively addressing the digitalization of the economy. It also broadens the comprehension of the unique obstacles and potential opportunities inherent in the digital economy from an international taxation perspective.

The significance of this research lies in its potential to inform tax policy in an increasingly digitalized global economy. Policymakers can develop strategies that are more effective in ensuring fair taxation practices by understanding the nuanced interactions between digital services and international tax regulations. Additionally, MNEs can use this research to better navigate the complex tax implications of their digital services in various economic contexts and thereby foster sustainable and ethical business practices.

Keywords: Digital economy, digital service tax (DST), Kenya, multinational enterprises (MNEs), organisation for economic co-operation and development (OECD), pillar one and pillar two, taxation, tax base, unilateral tax measure, United Kingdom (UK).

1 Introduction

Digitalization and the digital economy have brought about a profound transformation in the functioning of economies and businesses that has necessitated corresponding changes in the laws that govern them. The advent of technologies like mobile applications on smartphones, chatbots, intelligent virtual assistants (IVAs), web scraping, artificial Intelligence (AI)-driven price monitoring tools, e-wallets, image search engines, and warehouse automation technologies have facilitated various functions including service delivery and online trading. One notable outcome of digitalization is the rapid growth of electronic commerce (e-commerce) since its introduction in the early 1990s with the COVID-19 pandemic further fuelling its expansion.[1]

The growth in e-commerce has significantly impacted the operations of multinational enterprises (MNEs) and has led to a substantial increase in cross-border transactions. Statista projects a 13.21% growth in e-commerce in a developing country such as South Africa from 2023 to 2027 which will result in a market volume of USD 15.10 billion.[2]

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[*] University of the Witwatersrand (WITS), Johannesburg, South Africa.

[**] Senior Lecturer, Department of Taxation, School of Accountancy, University of the Witwatersrand (WITS), Johannesburg, South Africa. Email: Jane.Ndlovu@wits.ac.za.

[***] Acknowledgments: This work is based on the research supported in part by the WITS Chancellor's Female Academic Leaders Fellowship (FALF) research grant. Gratitude is extended to all the reviewers for their invaluable insights that significantly contributed to enhancing its overall quality.

[1] *See* Alexandra Loffstadt, Jane Ndlovu & Misha Padia. *Do South Africa's E-commerce VAT Rules Measure Up to International Trends and OECD Guidelines?*. 16(1) J. Econ. & Fin. Sci. 1–15 (2023), doi: 10.4102/jef.v16i1.815. Globally, the surge into e-commerce has surpassed traditional brick-and-mortar establishments in recent years with retailers consistently seeking online expansion. The primary catalyst for this trend is the increased accessibility of international markets through internet platforms coupled with the appeal of e-commerce as a lower-risk method for expansion offering the potential for rapid penetration into new markets. A significant driver of this expansion over the past two years has been an unforeseen consequence of the COVID-19 pandemic. The global response to the pandemic marked by widespread government-imposed lockdowns aimed at reducing physical contact has heightened consumer reliance on e-commerce purchases.

[2] Statista, *E-commerce – South Africa: Statista Market Forecast* (2023), https://www.statista.com/topics/11038/e-commerce-in-south-africa/#topicOverview (accessed 7 Dec. 2023).

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The expansion in the digitalization of the economy has evolved into an indispensable component of our economic framework and has fostered unparalleled connectivity.[3] This transformative shift positions digital technologies, digitalization, and the digital economy as powerful catalysts for innovation, enhanced efficiencies, and the increased rapidity of services.[4] They consequently play a pivotal role in fostering inclusive and sustainable business growth especially at the brink of a third (or arguably fourth) industrial revolution driven by the relentless digitalization of the economy. Reflecting on history, the genesis of the first industrial revolution dates back to the early eighteenth century which marked the onset of a contemporary economic era.[5] This transformative epoch instigated significant social upheavals that fostered phenomena such as population expansion and the burgeoning of urban centres.[6] The second industrial revolution unfolded in the late nineteenth century and was characterized by mass production and the revolutionary introduction of assembly lines.[7] This era not only redefined the paradigms set by its forerunner but also meticulously moulded the economy.[8] As stated by the Greek philosopher Heraclitus, 'the only constant in life is change', and our economy has indeed done so with four industrial revolutions. However, our taxation laws appear to lag behind the pace of change despite these profound occurrences. Accordingly, it is crucial for governments and tax authorities globally to address existing loopholes and establish effective tax laws governing e-commerce transactions and digital services to minimize potential loss of tax revenue.

The imperative to rectify tax loopholes within the framework of taxing the digital economy is driven by the rapid advancements in technology and the expansive surge of e-commerce detailed earlier. The transformative forces of digitalization are reshaping the business environment and ushering in a new era with profound implications for taxation. This evolution extends beyond mere adjustments to tax legislation; it permeates the very structure of tax administration.[9] This is because digitalization presents a plethora of challenges that affect tax policies and their execution at both domestic and international scales. Yet, it has also sparked a revolution in business models and is unlocking wider customer demographics, cultivating new revenue avenues, and promoting operational efficiency and cost-effectiveness.[10] Furthermore, digitalization empowers MNEs to conduct business operations without a physical presence which introduces complexities for jurisdictions that heavily depend on residency as the primary factor for tax obligations.

Notes

[3] Pistone & Weber, *infra* n. 5.

[4] *See* Loffstadt, Ndlovu & Padia, *supra* n. 1, at 1–15. An e-commerce business model proves to be highly adaptable and efficient as well as seamlessly integrating with various business facets such as sales and marketing. The advantages of employing these types of models are numerous including expanding the business to a wider market and minimizing operational costs traditionally associated with brick-and-mortar establishments.

[5] Pasquale Pistone & Dennis Weber, *Taxing the Digital Economy: The EU Proposals and Other Insights*, Taxing the Digital Economy 1–355 (2019).

[6] *Ibid.*

[7] *Ibid.*

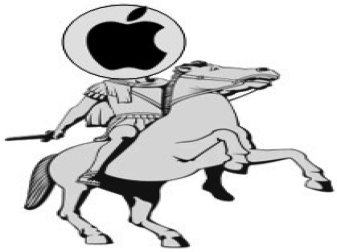
[8] *Ibid.*

[9] *See* Loffstadt, Ndlovu & Padia, *supra* n. 1, at 1–15. Companies and individuals can capitalize on tax disparities between countries and even circumvent taxation altogether in some cases as the inherent nature of direct e-commerce business models renders cross-border movements of goods, capital, and labour less transparent. Consequently, conventional tax regulations prove inadequate in effectively addressing the challenges posed by direct e-commerce business models.

[10] Q. Zhang, Y. Fan & B. U. Roy, *E-commerce Across Borders Logistics Platform System Based on Blockchain Techniques*, in *The International Conference on Cyber Security Intelligence and Analytics* 321–329 (2023).

Figure 1 The 'Four Horsemen' of Technology MNE[11]

Apple Inc.



Financial Analysis[12]

Sales/Revenue	383,285 USD Millions
Pretax Income	113,736 USD Millions
Income Tax	16,741 USD Millions
Effective Tax Rate	**14.71%**

Amazon.com Inc.



Financial Analysis[13]

Sales/Revenue	513,983 USD Millions
Pretax Income	(5,936) USD Millions
Income Tax	(3,217) USD Millions
Effective Tax Rate	**(54.19%)**

Meta Platforms Inc. (Facebook)



Financial Analysis[14]

Sales/Revenue	116,609 USD Millions
Pretax Income	28,819 USD Millions
Income Tax	5,619 USD Millions
Effective Tax Rate	**19.49%**

Alphabet Inc. (Google)



Financial Analysis[15]

Sales/Revenue	280,875 USD Millions
Pretax Income	71,328 USD Millions
Income Tax	11,356 USD Millions
Effective Tax Rate	**15.92%**

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[11] Kgomotso Mponwana & Jane Ndlovu, 2023.

[12] *See* Wall Street Journal Markets Financials for Apple Inc. (AAPL (US: Nasdaq)) (2022) https://www.wsj.com/market-data/quotes/AAPL/financials/annual/income-statement.

[13] *See* Wall Street Journal Markets Financials for Amazon.com Inc. (AMZN (US: Nasdaq)) (2022), https://www.wsj.com/market-data/quotes/AMZN/financials/annual/income-statement.

[14] *See* Wall Street Journal Markets Financials for Meta Platforms Inc. (META (US: Nasdaq)) (2022), https://www.wsj.com/market-data/quotes/META/financials/annual/income-statement.

[15] *See* Wall Street Journal Markets Financials for Alphabet Inc. (GOOG (US: Nasdaq)) (2022), https://www.wsj.com/market-data/quotes/GOOG/financials/annual/income-statement.

To illustrate, a cohort of highly successful MNEs primarily hailing from the United States and prominently exemplified by the 'Four Horsemen'[16] – specifically Apple, Amazon, Facebook, and Google[17] – has attained an unparalleled position of global economic prominence.[18] Despite their substantial market valuations and profitability that are reflective of the accumulation of significant rents or quasi-rents,[19] their overall global tax contributions remain relatively modest compared to the US corporate tax rate of 21%; this is illustrated in Figure 1 below. This phenomenon exemplifies MNEs' adeptness in generating income without clear national affiliations and thus manifesting a capacity to engender stateless revenue.[20]

The taxation quandary for MNEs' ability to do so gained prominence as these entities began leveraging tax havens or jurisdictions with minimal or absent tax laws thereby reducing their tax liability or relocating profits to low-tax regions with scant economic activity. To combat this predicament, the Organization for Economic Co-operation and Development (OECD) initiated a comprehensive action plan on base erosion and profit shifting (BEPS) in 2015. The principles developed to mitigate this did not alleviate the concerns regarding the adaptability of existing tax policies to the rapidly digitalizing economy. The OECD consequently introduced a two-pillar solution in 2021 via the OECD convention in order to address these matters.[21] Pillar one focuses on realigning sovereign taxing rights by employing the nexus rule and ensuring the taxation of large MNEs based on their market participation.[22] In contrast, pillar two empowers jurisdictions to tax profits falling below a certain minimum rate.[23] The two pillar approach introduced by the OECD was effectuated by a wave of digitalization and profoundly impacted global tax laws. The OECD responded to the advent of MNEs generating income without clear national affiliations.

The two pillar approach attempts to address challenges in applying the territoriality principle. The challenge of applying it to tax MNE profits in the digital era stems from the current international taxation framework that is contingent upon a dual attribution of taxing rights.[24] On one hand, the residence state is granted the authority to tax the global income of companies based on factors such as the place of effective management (POEM) or incorporation under its jurisdiction.[25] On the other hand, the source state is confined to taxing income generated solely within its borders. In this context, the territoriality principle signifies the imposition of taxes exclusively within a sovereign state's territorial jurisdiction.[26] Essentially, a state's authority is measured by its ability to assert and enforce tax jurisdiction over all income originating within its boundaries.[27]

Concerning MNE profits, scholarly discourse suggests that source state taxation is considered legitimate only

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16 *See* SeekingAlpha 'Is "FAANG" More Dangerous Than The "4 Horsemen" Of The Late 1990s And The "Nifty Fifty" Of The Early 1970s?', 9 Aug. 2017. The term 'the four horsemen' originated during the late 1990s technology boom which is a period marked by investor fascination with the remarkable stock value appreciation of four prominent mega-cap public corporations: Microsoft (MSFT, Fortune 500), Intel (INTC, Fortune 500), Cisco (CSCO, Fortune 500), and Dell (DELL, Fortune 500). These high-profile public technology companies were recognized for their unparalleled influence and were anticipated to consistently deliver robust growth to investors. Each of these entities played a pivotal role for nearly two decades in propelling the technology sector forward through their contributions to the personal computer domain: Intel manufactured processors, Microsoft developed software, Dell produced personal computers, and Cisco facilitated their networking. According to David Goldman's article, 'The new four horsemen of tech', dated 5 Jan. 2012, these companies were deemed the 'four horsemen' due to their strategic positions as key drivers of technology's growth engine during that era. Notably, Apple (AAPL, Fortune 500), Google (GOOG, Fortune 500), Amazon, and IBM (IBM, Fortune 500) have emerged as the contemporary successors to the original four horsemen. Strikingly, all currently lead in either mobility or cloud computing. Facebook is proposed to replace IBM in a modification to the initial set and align with the evolving backdrop of influential companies in the technology sector.

17 *See* Christian Sarkar *'The Four Horsemen' – An Interview With Scott Galloway* (20 Oct. 2017). The entities collectively referred to as 'The Four' – Apple, Amazon, Facebook, and Google – have generated an extensive number of well-remunerated employment opportunities and have pivotally participated in the provision of a diverse range of products and services that have become integral to the daily routines of billions of individuals.

18 D. Shaviro, *Digital Services Taxes and the Broader Shift from Determining the Source of Income to Taxing Location-Specific Rents*, NYU Law and Economics Research Paper 19–36 (2019).

19 Rent constitutes unearned income whereas quasi-rent represents a necessary payment. Unlike the former which is permanent, the latter is of a temporary nature. Rent is derived from land and other natural endowments while quasi-rent stems from man-made capital equipment. Additionally, the first emerges across both long and short periods whereas the second arises exclusively in brief periods.

20 Shaviro, *supra* n. 18.

21 *See* Wei Cui, 2021. Given the ongoing OECD's tax project titled 'Address the Tax Challenges Arising from the Digitalisation of the Economy', the underlying rationale appears pivotal in current deliberations on international tax collaboration. Nevertheless, the inferred requirements for coordination seem relatively moderate and indirect. Two specific needs have been discerned in this context. First, regulations that restrict and assign taxation rights based on the PE and related concepts are typically embedded in bilateral tax treaties. Consequently, treaty revisions are necessary to alleviate the constraints imposed by such rules on new corporate income tax (CIT) policies. By nature, coordination is essential to uphold the legal framework of treaties in response to evolving policies. Second, albeit less clearly defined, it is posited that any alteration in policy enabling a country to tax the profits of foreign MNEs may introduce the risk of 'double taxation'.

22 Renato E. Reside, *Digital Services Taxes: Multilateral and Unilateral Efforts and an Overview of Recent Economic Models* (University of the Philippines School of Economics 2022).

23 *Ibid.*

24 Pistone & Weber, *supra* n. 5.

25 *Ibid.*

26 *Ibid.*

27 *See* Pistone & Weber, *supra* n. 5. Within its territorial confines and free from external constraints, a state's sovereignty is accentuated by its capacity to exercise tax jurisdiction over all income. Specifically, the residence state establishes a robust link between the worldwide income of an enterprise and its territory through predetermined criteria like incorporation or the POEM. This attachment grants the residence state the authority to exert sovereignty over the entirety of the income. In contrast, the source state confines its sovereignty to the income generated within its geographic boundaries.

when an economic connection exists between income generation and the state's territory.[28] This implies that not only should the income possess a geographic nexus for source jurisdiction to be asserted, but this attachment must also be economic indicating that the income must be produced within that territory.[29] Such production is exclusively attributed to human activities as only animate individuals have the capacity to generate income.[30] Therefore, the intellectual component emerges as the pivotal element in income production as it is through the actions of these individuals that value is added to a given entity.[31]

One of the ways in which this borderless value is generated is when social media companies collect data from individuals that they monetize through advertising revenue. In her study, Dourado[32] argues that the predominant theme in existing literature aligns with advocating a unified approach to address this taxation challenge linked to the digital economy and specifically emphasizes the necessity for reform within the international tax system.[33] However, Dourado presents a counter perspective[34] and further asserts that a distinct tax levied within the market states in a digitalized economy is a viable recommendation. This particularly concerns the sale of data and associated business activities subsequent to the collection of data freely obtained when individuals engage with social networks and other online platforms.

While digital taxes such as the digital service tax (DST) may be a possible solution to the taxation quandary, their implementation can present challenges for jurisdictions that chiefly use residency as a foundation for tax liability. This is particularly valid when dealing with MNEs operating within their jurisdiction without a physical presence.

In April 2020, the DST was launched as a unilateral measure to acknowledge the value of digital MNEs and address the global concern of under-taxation of international digital services. The United Kingdom exemplifies a nation that has successfully implemented the collection of taxes from digital MNEs via DSTs. As per data from the UK National Audit Office (NAO),[35] DSTs accrued GBP 358 million from large digital MNEs during the 2020/21 tax year that exceeded the initial projection by 30% and confirmed the tax's revenue-generating efficacy. However, despite this favourable outcome, the UK NAO warns that His (formerly Her) Majesty's Revenue and Customs (HMRC) may face further obstacles in enforcing compliance especially when dealing with MNEs devoid of a physical presence within the United Kingdom.[36]

While a number of international rules have become more effective and have managed to alleviate certain deficiencies, others have inadvertently introduced new loopholes that legislatures continue to address. The recent amendments put forth by the OECD convention have sparked international debates and deliberations. The current deliberation scrutinizes how the complexity of DST rules can be overwhelming for many African countries with smaller economies. It also examines the impact of the restrictive definitions of DSTs and the ramifications for countries that did not reach consensus on these rules.[37]

Notably, there are African nations that have implemented DSTs successfully. For instance, in Nigeria, the Finance Act of 2021 implemented a 6% DST and targeted non-resident companies engaged in substantial economic activities. Nigeria generated an estimated NGN twenty-five million (USD 54, 230) in annual revenue from DST.[38] Nigeria's fiscal measure reflects a broader regional trend as several other African nations have likewise introduced taxes on digital services provided by non-resident companies. Zimbabwe established a DST rate of 5%, Tunisia at 3%, and Tanzania at 2%.[39] Sierra Leone and

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[28] *See* Pistone & Weber, *supra* n. 5. Taxation by the source state is grounded solely in the presence of an economic nexus between income generation and the territorial boundaries of the state. This requirement posits that the income not only needs to demonstrate a geographical link to establish source jurisdiction but must also be economically generated within that specific territory. The OECD Model succinctly outlines this interaction between residence and source states in Art. 7 and asserts that the profits of an MNE are taxable solely in the residence state unless the MNE maintains a permanent establishment (PE) in the other contracting state. Additionally, the latter is empowered to tax only the portion of profits attributed to the PE located in its territory and treat it as an 'independent and separate enterprise engaged in similar activities under comparable conditions'. This consideration encompasses the functions performed, assets employed, and risks assumed by the enterprise through the PE and the enterprise's other segments. The primary obstacle to advancement seems to lie in the existing versions of tax treaties based on the OECD Model that confine source taxation exclusively to scenarios where a PE is formally recognized.

[29] Pistone & Weber, *supra* n. 5.

[30] *Ibid.*

[31] *Ibid.*

[32] Ana Paula Dourado, *Taxing Consumer-Facing Business as a Regulatory Currency*, 13.4 World Tax J.-Amsterdam 533–573 (2021), doi: 10.59403/jfng6b.

[33] *See ibid.* There is a discernible reluctance toward endorsing specific taxes tailored to target digital business models that is often referred to as 'ring-fencing'. This hesitancy is grounded in the overarching digitization of the economy and poses difficulties in clearly distinguishing between digitalized and non-digitalized sectors. A prevalent focus in literature opposed to ring-fencing revolves around seeking solutions that facilitate the allocation of taxing rights to the market state.

[34] Dourado, *supra* n. 32.

[35] National Audit Office, *Press Release: Investigation into the Digital Services Tax* (23 Nov. 2022), https://www.nao.org.uk/press-releases/investigation-into-the-digital-services-tax/ (accessed 7 Dec. 2023).

[36] *Ibid.*

[37] *Digital Economy and Taxation Policy: National Treasury, PBO & SARS input*, PMG (2020) Parliamentary Monitoring Group , https://pmg.org.za/committee-meeting/30416/.

[38] Amamchukwu Okafor, . Will African countries align with the OECD framework on digital service tax?. 14 Jun. 2023.

[39] *Ibid.*

Kenya instituted DSTs at a rate of 1.5%. The latest entrant into this wave is Uganda which put forth a proposed DST of 5% effective from July 2023.[40]

The collection of DSTs has proven effective in countries with larger economies like the United Kingdom, however, issues related to the physical presence of MNEs still present significant challenges. Enforcing compliance continues to be a daunting task particularly with entities lacking a physical presence despite the success of tax collection initiatives. The DST tax regime has essentially witnessed a continuous evolution aimed at addressing loopholes exploited by MNEs to evade or reduce their tax liabilities.

2 Research problem, importance and methodology

As mentioned, numerous countries have instituted DSTs as a means to impose levies on non-resident digital MNEs. However, the delineation of which goods and services fall under the DST purview exhibits significant variation among nations.[41] The categories subject to DSTs are typically broad encompassing online advertising services, online gaming, streaming services, and more.[42] The majority critically focuses on the same set of MNEs despite disparities in the specific rules applied by each country.[43] This convergence is inherent in the design of the DSTs that primarily target large digital corporations with substantial revenue thresholds which creates various concerns.[44] Furthermore, there is a burgeoning advocacy particularly among US Republicans for replacing the corporate income tax (CIT) with a destination-based cash flow tax. This indicates ongoing efforts to align tax frameworks with the dynamic challenges presented by the digital economy.[45]

Moreover, the implementation of DSTs demonstrates variations from one country to another. For example, Australia applies it to digital electronic services such as streaming and e-books while Poland extends it to services encompassing online advertising and data transmission.[46] France's DST is directed at companies involved in online advertising, data sales for advertising, and acting as intermediary platforms.[47] France's DST applies to companies with a global revenue exceeding EUR 750 million from relevant projects and earnings exceeding EUR twenty-five million from such projects in France.[48] The tax rate on income from relevant projects is stipulated at 3% with an anticipated tax yield of approximately EUR two billion over the next four years.[49] Notably, France's DST has faced criticism for seemingly targeting American corporations, particularly the online advertising company Criteo which potentially makes it the solely affected French entity.[50]

Despite the diversity in the specific laws governing these unilateral measures, a common thread emerges whereby each country has adopted them for similar reasons. First, there is a recognition that existing international rules struggle to progress at the same rate as the rapidly evolving digital economy thereby necessitating reform. Second, there is a widely identified need to tax digital business models and companies operating in the digital realm.

2.1 *Statement of the Problem*

This article explores the impact of DST implementation in both Kenya and the United Kingdom while scrutinizing its influence on revenue collection and the taxation of digital services. Both nations stand among those that have embraced DSTs.

As previously noted, the United Kingdom introduced DSTs on 1 April 2020 to target MNEs by intending to tap into profits generated in the markets where value is created irrespective of physical locations. The UK's DST primarily focuses on large MNEs offering online services like social media, search engines, or digital marketplaces to UK users. The country applies a 2% tax rate to a group of companies under the same controlling interest. In contrast, Kenya's DST was effective beginning 1 January 2021 and applies to both resident and non-resident entities. It imposes a tax rate of 1.5% on income earned or accrued within the country from services facilitated through a digital marketplace.

To evaluate the effectiveness of DSTs, this research conducts a comparative analysis of its application in

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[40] *Ibid.*

[41] Christoph Jescheck, *The Substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD Model Convention (Taxes Covered) and the Rise of New Taxes*, 45(5) Intertax (2017), doi: 10.54648/TAXI2017030.

[42] *Ibid.*

[43] *Ibid.*

[44] *Ibid.*

[45] *Ibid.*

[46] D. González, *Digital Services Tax (DST): Alive and Well*, CIAT (2022) , https://www.ciat.org/digital-services-tax-dst-alive-and-well/?lang=en (accessed 7 Dec. 2023).

[47] *Ibid.*

[48] *Ibid.*

[49] *Ibid.*

[50] *Ibid.*

Kenya which is a developing economy and the United Kingdom which is a developed economy. The study addresses two main research issues:

(1) How do unilateral measures for taxing the digital economy, specifically the implementation of DSTs, address challenges posed by the digital economy, and what are the principal concerns and impacts associated with the introduction and subsequent repeal of DSTs in Kenya and the United Kingdom?
(2) Furthermore, how can a comparative analysis of the implementation of DSTs in these two countries inform recommendations for future tax policies in the context of the evolving digital economy?

Drawing from insights from the experiences of the United Kingdom and Kenya with DSTs, the study explores the repercussions for the jurisdictions that enacted this legislation. The article aims to dissect DST regulations within each jurisdiction, identify challenges faced, and contemplate the potential repeal of DSTs as the OECD advances its two-pillar solution.

The selection of the United Kingdom and Kenya as comparative subjects in this analysis stems from a strategic choice aimed at capturing a spectrum of economic and developmental characteristics. The United Kingdom has a highly developed economy with a well-established digital infrastructure and a significant presence of MNEs engaged in digital services. On the other hand, Kenya is a developing economy and provides a contrasting perspective characterized by emerging digital markets and evolving regulatory frameworks. By juxtaposing the United Kingdom's advanced digital economy with Kenya's developing digital ecosystem, this study seeks to offer insights into how the DST is applied and experienced as well as its impact in diverse economic contexts. The comparative analysis aims to uncover potential nuances in the challenges faced, effectiveness of DST implementation, and implications for future tax policies thereby contributing to a comprehensive understanding of the global implications of taxing the digital economy.

2.2 *Importance of the Research*

Countries advocating for DSTs as a temporary or unilateral solution are driven by concerns over inadequate corporate tax payments from digital platform corporations, such as Google and Facebook, within the countries where their user bases are located (hereafter referred to as the user country).[51] Complicating matters are existing international taxation regulations that pose challenges in effectively applying corporate taxes to platform corporations operating within these user countries.[52]

To understand this conundrum, consider the example used by Watanabe[53] that has been adapted for purposes of this article. Google is a US-based company that generates profits by selling advertisement slots to a German automobile company targeting users in Kenya or the United Kingdom.[54] From the perspective of the two countries, Google is not recognized as a PE.[55] Even if it was deemed as such, the advertising profits would not be attributed to it.[56] Users in the United Kingdom and in Kenya access Google's services at no cost and it amasses substantial information from user searches there despite its dominant position in search services.[57] The analysis and processing of this information empower Google to deliver targeted advertisements to users interested in purchasing German vehicles.[58] This mechanism enables it to sell advertising slots to German companies targeting car sales in the United Kingdom and in Kenya.[59] Each of the three involved parties – the German car company (in Germany), the user (in the United Kingdom or Kenya), and Google (in the United States) – potentially faces taxation on their earnings within the users' two countries.[60]

First, the German car company's taxation is typically regarded as the sale of manufactured goods through a subsidiary or a UK/Kenyan branch store (PE). This can be taxed in either country as sales profit given that the German car company has sold the product exclusively within them, and existing taxation rules adequately address this scenario.[61]

Secondly, there is the users' taxation.[62] Despite seemingly using the search service for free, it can be

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[51] Tetsuya Watanabe, *Rationales and Challenges for a Digital Service Tax: Focusing on Location-Specific Rent*', 17(1) Pub. Pol'y Rev. 1–17 (2021).

[52] *Ibid.*

[53] *Ibid.*

[54] *See* Watanabe, *supra* n. 51. Case example adapted for this article.

[55] *Ibid.*

[56] *Ibid.*

[57] *Ibid.*

[58] *Ibid.*

[59] *Ibid.*

[60] *Ibid.*

[61] *Ibid.*

[62] *Ibid.*

conceptualized as an exchange for their personal information.[63] While it might be argued that the user engages in a barter transaction by selling their personal information and purchasing the search service, the raw or unprocessed personal information holds only minimal value.[64] This significantly increases through big data – collecting, analysing, and processing large amounts of personal information which is a task performed by the platform corporation rather than the user.[65] Consequently, even if the user was to be taxed, it would likely be limited to a negligible amount.[66] Additionally, users of video streaming services such as YouTube encounter advertisements while using the service akin to those in commercial television broadcasting.[67] Historically, viewers watching television for free have not been subjected to taxation, and a parallel perspective suggests that taxing YouTube users is not realistic under prevailing circumstances.[68]

Last, the focus shifts to the taxation of Google. The income derived from advertising profits is sourced from the personal information of users in the United Kingdom or Kenya.[69] However, other than DSTs, existing taxation rules do not permit them to tax these earnings as both are not the taxpayers' source or residence country.[70]

This article therefore assumes profound significance in addressing the overarching question of how unilateral measures, specifically the implementation of DST, contend with the above challenges posed by the digital economy. The rapid evolution of the digital realm and the subsequent emergence of MNEs operating globally without clear national affiliations have prompted countries like Kenya and the United Kingdom to adopt DSTs. Understanding the effectiveness, challenges, and implications of such unilateral measures is crucial for policymakers, tax authorities, and businesses navigating the intricate dynamics of digital taxation.

Moreover, the objective of this research is to unravel the multifaceted layers of DST implementation by comparing the experiences of a developed economy like the United Kingdom and a developing one like Kenya. Insights garnered from this comparative analysis can inform not only these specific jurisdictions but also contribute to a broader discourse on the future of digital taxation. As the digital economy continues to reshape global business dynamics, this study also seeks to provide valuable perspectives that can aid in formulating informed policies and strategies adaptable to the evolving digital terrain.

2.3 *Research Methodology*

In pursuit of its overarching objective, this article has meticulously embraced a qualitative research approach characterized by its intrinsic interpretative nature. This methodological choice aligns with the complex and nuanced nature of the research subject, specifically the implementation and impact of DSTs in the United Kingdom and Kenya. The selected qualitative research framework intends to delve deeply into the multifaceted dimensions of DSTs by recognizing that the effectiveness and implications of this taxation mechanism extend beyond mere quantitative metrics. By employing the doctrinal research method, the study engages in inquisitive and analytical processes and meticulously examines legal doctrines, legislative provisions, and scholarly interpretations to construct a robust foundation for understanding the intricacies of the DSTs in both jurisdictions. The commitment to rigorous data collection, the analysis, and interpretation is paramount for ensuring the reliability and validity of the study's findings and fostering a comprehensive understanding of the subject matter. It also contributes valuable insights to the broader discourse on the taxation of the digital economy

3 Layout of the article

The article is systematically structured in order to provide a comprehensive understanding of the complex principles surrounding the implementation and impact of DSTs in the United Kingdom and Kenya. The subsequent section explores the concept of value creation within the digital economy. Following this foundational investigation, the narrative unfolds into a discussion on the global adoption of unilateral measures for taxing the digital economy that is underpinned by the OECD BEPS Model as a reference point. The section comprehensively examines the role of digitalization in reshaping the tax sector and offers a panoramic overview of unilateral initiatives to tax digital services. Central to this analysis is an exploration of DSTs as a unilateral measure complemented by an in-depth examination of the European Union (EU) proposal on significant digital presence and the OECD Pillar One Amount A as multilateral measures. This section further delves into the peculiarities and challenges associated with its implementation in order to provide a nuanced understanding of DSTs.

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[63] *Ibid.*

[64] *Ibid.*

[65] *Ibid.*

[66] *Ibid.*

[67] *Ibid.*

[68] *Ibid.*

[69] *Ibid.*

[70] *Ibid.*

Continuing, the article transitions to a focused discussion on the introduction of DSTs as a response to the challenges posed by the digital economy. Here, the principal concerns surrounding them are meticulously examined. The narrative then shifts to a rigorous evaluation of the impact of DST implementation in both Kenya and the United Kingdom. This involves a detailed exploration of the introduction of DSTs in these countries, the challenges encountered during implementation, and their subsequent repeal in both jurisdictions. The analysis commences with an examination of Kenya's DST by scrutinizing its definition, subsequent amendments, and the incorporation of an additional measure of value added tax (VAT). The challenges faced by Kenyan taxpayers under the DST and VAT regimes are also comprehensively explored.

Turning the focus towards the United Kingdom, the article focuses on the regulatory framework for its DST and probes potential challenges that surfaced during its implementation. Its influence on the United States is also investigated.

Intriguingly, the article also discusses the significant development of Kenya's repeal of its DST to align with the implementation of Amount A of Pillar One and examines its implications on both the UK and Kenyan tax systems.

The article culminates by offering a comparative analysis of DST implementation in both countries and concludes with insightful recommendations.

4 Value creation in the digital economy

This section delves into the nuanced discussion surrounding the value generated by MNEs engaged in providing digital services. The paramount significance of this exploration lies in gaining a profound understanding of the appropriate taxation frameworks applicable to these dynamic entities.

At its core, a digital economy encompasses various components including but not limited to e-commerce, online advertising, and cloud computing. Broadly characterized, it refers to an economy where customers can access goods and services without the necessity of physically visiting a business location. What sets the digital economy apart is its distinctive capacity to generate income and value that transcends national borders without reliance on physical offices or a substantial on-site personnel presence; this distinguishes it from traditional sectors of the economy. This inherent flexibility and borderless nature mark the digital economy as a dynamic and transformative force in contemporary business settings.

The nexus for digital services is fundamentally established by the concept of value as evident from the preceding discussion. Identifying the origin of value is pivotal for tax authorities for ascertaining their taxing rights. The exploration of the definition of value is presented below to elucidate the intricate dimensions that underlie this critical aspect.

While a universal theory encapsulating a singular definition of the concept of value remains elusive, the understanding of value creation by organizational entities, especially MNEs, is undergoing a transformative evolution.[71] It is notably propelled by the advent of digitalization and the myriad structural forms that businesses now adopt that range from traditional value chains to intricate value networks and innovative value platforms.[72] Within this context, two key realizations emerge:

- the attribution of value creation in a complex and globally integrated economy to specific inputs, activities, or territories is inherently challenging; and
- the relative significance of factors contributing to value creation fluctuates based on the nature of undertaken activities and the characteristics of the goods and services serving as carriers of the relevant value.[73]

Concretely, within a framework that subscribes to a firm theory approach to value creation, generating, preserving, and utilizing knowledge increasingly emerge as pivotal factors in creating surplus value.[74] This exacerbates the complexity of 'locating' value creation even within a production-based paradigm due to the spatial indeterminacy inherent in the nature of such 'knowledge'.[75]

In recent times, the rationale of value creation coupled with its spatial allocation has recurrently been invoked to warrant a comprehensive re-evaluation of the international tax framework.[76] The OECD initiative addressing BEPS

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[71] Werner Haslehner & Marie Lamensch, *General Report on Value Creation and Taxation: Outlining the Debate*, in *Taxation and Value Creation* 3–35 (2021).

[72] *See* Haslehner & Lamensch, *supra* n. 71. Economists have extensively endeavoured to theoretically elucidate the genesis and significance of value attributed to products and services. Generally, these efforts can be categorized into 'objective' (or 'intrinsic') and 'subjective' value theories. Objective theories posit that value is an inherent property of things arising from the factors responsible for their creation (e.g., the labour theory of value that equates value with the cumulative labour required for a good's production). In contrast, subjective theories anchor value in the individualized assessments made by those contemplating the acquisition of a good.

[73] Haslehner & Lamensch, *supra* n. 71.

[74] *Ibid.*

[75] *Ibid.*

[76] *Ibid.*

has specifically emphasized the concept of aligning taxation with the locus of value creation.[77] Proposals advocating for formulary apportionment premised on the idea that 'value' is generated independently of the assets themselves and is challenging to directly attribute to specific locations have gained prominence.[78]

Two additional theories of value creation are introduced: the value network and the value shop.[79] The former highlights the network as a pivotal factor in value creation emanating from endeavours to link MNEs with users and facilitate exchanges between them.[80] MNEs aspiring to establish a value network concentrate on various aspects including attracting and selecting users; establishing, maintaining, and terminating user connections; and ensuring the upkeep and operation of physical and informational infrastructures.[81]

Conversely, the value shop operates within single-sided markets and is characterized by the application of sophisticated technology to address customer issues.[82] It comprises five fundamental activities, specifically[83]:

- problem finding and acquisition involving documenting, reviewing, and formulating
- problems to be addressed;
- problem solving entailing identifying and evaluating different alternatives;
- choice encompassing all activities associated with determining the optimal solution;
- execution where the solution is communicated, organized, and implemented; and
- control and evaluation by measuring the extent to which the initial problem has been
- resolved.

An increasing number of countries have introduced DSTs that gauge the 'use' of digital services as a determinant for establishing national tax bases and departing from the conventional criteria outlined in existing tax treaties based on the OECD Model.[84] The foundational premise was that the evolution of value creation has undergone significant changes, particularly in the context of digitized MNEs that share common characteristics, distinctly[85]:

- cross-jurisdictional scale without mass signifying that digitalized businesses can actively participate in the economic activities of a country without possessing a physical presence within its territorial boundaries;
- dependence on intangible assets including intellectual property (IP) that is fundamental for supporting digital platforms, websites, and various other functions integral to the business model; and
- emphasis on data, user participation, and their synergies with intellectual property given that many social networks, for instance, would be unsustainable without the incorporation of data, network effects, and user-generated content.

MNEs embodying these attributes engage in competition within the distinctive digital market that is characterized by unique features when compared to other markets. These characteristics include[86]:

- direct network effects wherein the utility derived from the consumption of a particular good or service is contingent upon the number of other end-users also consuming the same good or service;
- indirect network effects manifesting in a multisided context where a specific group of end-users gains advantages through interactions with another group of end-users via the digital platform;
- economies of scale attributed to the prevalence of fixed costs over variable costs;
- switching costs and lock-in effects stemming from reliance on an operating system potentially hindering a seamless transition to an alternative system; and
- complementarity of goods sold in different markets.

These distinctive features culminate in the phenomenon wherein only a singular firm or a dominant entity can typically thrive and exert significant influence over market prices within each digital market.[87] Additionally, the swift conclusion of transactions with end-users reduces the time needed for product development, idea sharing, market creation, and the identification, engagement, and cultivation of new customer bases.[88] Moreover, the

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77 *Ibid.*

78 *Ibid.*

79 Mattia Calabrese, *Taxation of the Digital Economy: A New Dawn for Multilateralism and Mutual Recognition*' in *Taxing the Digital Economy. The EU Proposals and Other Insights* (Amsterdam: IBFD 2019).

80 *Ibid.*

81 *Ibid.*

82 *Ibid.*

83 *Ibid.*

84 Haslehner & Lamensch, *supra* n. 71.

85 Calabrese, *supra* n. 79.

86 *Ibid.*

87 *Ibid.*

88 *Ibid.*

capacity for cross-jurisdictional networks facilitated by the Internet has enhanced the functionality of multisided markets and giving rise to 'barter transactions' where valuable services are exchanged for other inputs, such as data.[89]

Paradoxically, the concept of value creation has been invoked at times to bolster proposals favouring rent-based over income-based taxation.[90] In essence, this approach suggests limiting corporate taxation to exceptionally high returns on investment that investors would pursue regardless of any tax burden.[91] However, while solely taxing rents may seem economically efficient, it diverges from the fundamental principle of taxing where value is created.[92] This incongruity stems from the fact that rents often arise not only from creative entrepreneurial acts but also frequently due to external circumstances such as monopoly rights.[93]

Haslehner and Lamensch[94] pose a compelling question: If an MNE generates value through the utilization of personal data belonging to a state's citizens, can the state be attributed as contributing to the creation of that value? It may take on a nuanced character whether by allowing the company to exploit data due to a lack of legal regulation, facilitating IT infrastructure for data access, or providing citizens with unrestricted Internet access.[95] While no default scenario is evident, it is clear that any jurisdiction capable of exerting authority significantly impacting the value creation process must offer at least tacit support.[96] Notably, this situation differs from instances in which a country provides benefits like infrastructure, access to resources (including a skilled workforce), or legal protection of intangible assets. Crucially, within this framework, a physical presence in a country is not a requisite condition for asserting a taxing right.[97]

The complexities ushered in by the digitalization of the economy have ignited debates regarding the adequacy of current tax regimes in grappling with the transformative impacts of the digital economy, especially concerning the allocation of taxing rights among diverse jurisdictions.[98] This can be segmented into the two key categories of indirect taxes that are designed to ensure effective tax collection and direct taxes that address both the prevention of double taxation and the equitable allocation of profits in cross-border activities within the digital economy.[99] Current regulations dictate that income is taxed where the user is located, particularly in a digital economy. However, a contention arises that businesses generate income from foreign users and thus create a tax gap when there is no physical presence thereby exempting these MNEs from corporate taxes.[100]

In response to issues of misalignment and double non-taxation, the OECD has taken a leading role in spearheading multilateral initiatives with the overarching aim of reforming international tax systems.[101] The ultimate objective is to streamline the collection of revenues from MNEs in the countries where their consumers are situated. Despite ongoing multilateral endeavours, several European and African nations have either implemented

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89 *Ibid.*

90 Haslehner & Lamensch, *supra* n. 71.

91 *Ibid.*

92 *Ibid.*

93 *See* Haslehner & Lamensch, *supra* n. 71. To elucidate this argument, consider the relationship between income and an economic rent. In neoclassical economic theory, rents are construed as income exceeding a normal market return for investment while accounting for entrepreneurial effort, skills, and risk-taking by the taxpayer. More precisely, the concept can be further nuanced to distinguish between pure rents and quasi-rents. The latter adheres to the definition of a rent and represents a return exceeding that required to incentivize the pertinent production factor's involvement in the production process. Yet, it does not surpass long-run marginal costs which makes them indispensable for attracting investors. In contrast, a true rent constitutes a return surpassing the long-run marginal costs of production. Such rents are not incompatible with competitive markets; rather, they emerge even in conditions of full competition due to diverging costs among competing producers. For instance, those with a competitive advantage, such as particularly fertile land or unique human genius, would anticipate earning such 'pure rent' or 'inframarginal profits'.

94 Haslehner & Lamensch, *supra* n. 71.

95 Haslehner & Lamensch, *supra* n. 71. *Also see* Dourado, *supra* n. 32, at 533–573. This business activity is denoted as knowledge discovery and data mining (KDDM) and encompasses the sale of profiles. This thereby enables manipulation in various decision-making processes including friend selection, purchasing decisions, forming opinions, and electoral choices. This lucrative undertaking is predominantly concentrated among technological giants and elicits substantial apprehensions. The ramifications of profile sales extend to companies' abilities to reject insurance contracts or credit applications without divulging the rationale and depriving individuals of the opportunity to counter-argue. Moreover, it empowers governments to predict, control, and regulate the behaviour of their citizens and other entities within their jurisdiction.

96 Haslehner & Lamensch, *supra* n. 71.

97 *See* Haslehner & Lamensch, *supra* n. 71. A fundamental question in evaluating any tax policy pertains to the relevance of tax incidence. For the link between value creation and income taxation, it becomes imperative to inquire about the economic party on whom the tax burden falls. If, in practice, income tax does not burden the individual earning that income but is rather shifted to another entity, does it not erode the established connection between the value creator (and income earner) and the justification for imposing taxes within a specific jurisdiction? Admittedly, those who 'create value' do not necessarily receive equivalent income and, likewise, those who pay taxes on their 'income' may not bear the true burden of that tax. Nevertheless, once the decision to tax income is made, employing 'value creation' as a proxy for the allocation decision is not unreasonable given that income partly reflects capturing created value by the individual earning it. It is essential to recognize that income does not encompass the entirety of surplus value arising in a transaction. As the part captured by the consumer – the disparity between the market price and their actual valuation of the purchased good or service – is not considered income, any economic incidence of income tax on the consumer is still inherently linked to the value captured by either party in a market transaction.

98 OECD, *OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports* (2015).

99 *Ibid.*

100 E. Asen & D. Bunn, *What European OECD Countries Are Doing about Digital Services Taxes* 25 (Tax Foundation 2021).

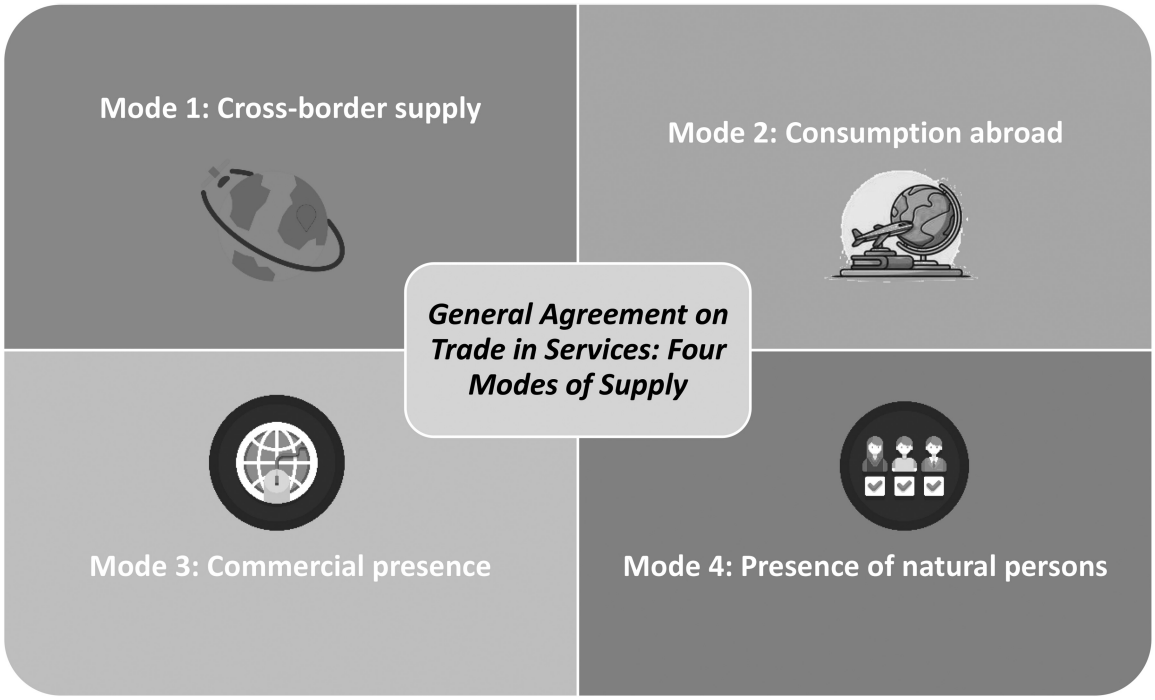
101 OECD, *Trust in Global Cooperation: The Vision for the OECD for the Next Decade* (2021).

or expressed their intention to implement unilateral measures, such as DSTs, to attempt to effectively address the challenges arising from the digital economy. International tax practitioners often contend that any perceived 'risk' regardless of its frequency and magnitude necessitates international coordination that exceeds mere adjustments to bilateral treaties.[102]

Before delving into these contentions, it is imperative to scrutinize their foundational factual premise. Notably, instances cited by the OECD and others as 'challenges arising from the digital economy' predominantly pertain to the services sector and encompassing distribution (e.g., online retail such as Amazon and content distribution platforms like Netflix and Spotify), advertising (Google and Facebook), transportation and lodging (Uber and AirBnB), business services (AWS, Apple), among others.[103] Using the terminology of the World Trade Organization (WTO) General Agreement on Trade in Services (GATS), the international tax community appears primarily concerned with the rise of 'Mode 1' service trade at the expense of 'Mode 3' trade.[104] The GATS classifies services trade into four modes of supply[105] (refer to Figure 2):

(1) Cross-border supply (Mode 1): Services provided from one country's territory into another, such as through the internet.
(2) Consumption abroad (Mode 2): Services delivered in one country's territory to another country's consumer, such as tourism.
(3) Commercial presence (Mode 3): Services rendered by one country's supplier through a commercial presence – like a controlled affiliate or branch – in the territory of another.
(4) Presence of natural persons (Mode 4): A supplier from one country provides services through the presence of natural persons in the territory of another, such as consultants.

Figure 2 The Four Modes of Supply in a Digital Economy



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[102] Wei Cui, *New Puzzles in International Tax Agreements*, 75 Tax L. Rev. 75 201 (2021), doi: 10.2139/ssrn.3877854.

[103] Cui, *supra* n. 102.

[104] *See* Cui, *supra* n. 102. The widely accepted assumption that the digital economy is fundamentally altering international commerce is challenged by trade statistics, particularly in the context of services trade. The dominance of Mode 3 (traditional physical presence) in global services trade persists and comprised 58.9% in 2017 while Mode 1 (electronic means) constituted a 27.7% share. Developed economies show marginal changes in Mode 3 trade from 2005 to 2017, and there is considerable diversity among countries in service types and quantities. Contrary to the perceived shift from Mode 3 to Mode 1, most countries, including advanced economies, do not show indications of revenue loss due to such a substitution. This raises the question of the shared issue necessitating coordinated action, especially considering the principle of applying consistent tax rules to different forms of international commerce known as 'no ring-fencing'. The challenge posed by remote business models seems less pronounced from a non-industry-specific standpoint.

[105] Cui, *supra* n. 102.

The initial rationale for coordinated changes in international tax is thus grounded in the assumption that traditional CIT rules primarily taxed Mode 3 service trade, and that this is now being significantly supplanted by Mode 1 trade.[106]

5 Global implementation of unilateral measures to tax the digital economy

This section delves into the detailed discussion of the implementation of unilateral measures. While both the United Kingdom and Kenya have opted for DSTs, it is noteworthy that various countries have chosen alternative tax strategies. Many nations have independently incorporated unilateral measures into their tax systems in the absence of a global consensus on multilateral measures to address taxation challenges arising from the digital economy. This strategic approach aims to mitigate tax risks associated with digital businesses. Countries are increasingly resorting to unilateral actions and introducing innovative taxes that defy easy classification for tax treaty purposes in tandem with coordinated efforts within the BEPS process.[107] Some of these measures may not perfectly align to establish a fair and equitable tax system, however, they are widely perceived as interim solutions until a global consensus is achieved.

Unilateral measures addressing challenges in the digital economy exhibit significant variations that are primarily rooted in their distinct designs.[108] Across nations, a spectrum of approaches exists. Some have adopted VAT for taxing digital services, others have embraced DSTs, some have introduced or modified withholding taxes, and a few have adopted a hybrid model combining these measures.[109] Consequently, certain countries choose to tax gross revenue while others focus on reshaping the localization and allocation of digital activities.[110] These diverse rules are crafted with the explicit goal of resolving issues inherent in the digital economy, and the variety in their designs reflects the multifaceted nature of challenges presented by the digital economy.[111]

This evolving trend seems to signal a retaliatory response to tax planners who have proven to be adept at devising and employing hybrid structures to their advantage.[112] In response, tax legislators are proactively introducing taxes crafted with specificity to navigate through gaps in treaty protection.[113] Illustrative examples of these new taxes include India's Equalization Levy,[114] the UK Diverted Profits Tax (DPT), Australia's Multinational Anti-Avoidance Law (MAAL),[115] the announced DPT, the Netherlands Excessive Severance Tax, and the Belgian Fairness Tax.[116]

The UK's DPT was enacted in 2015 as a response to counteract profit shifting by MNEs imposes a 25% tax in two specific scenarios.[117] First, the tax is effectuated when there is either a UK company or a foreign company with a UK PE, and arrangements lacking economic substance exist resulting in an effective tax mismatch. This discrepancy arises when a reduction in profits of the UK company or UK PE is not counterbalanced by a corresponding increase in profits for the other party. The second scenario arises when a non-resident company provides goods or services within the United Kingdom and it is reasonable to assume that any activity is strategically designed to ensure that the foreign company does not establish a UK PE; this is commonly referred to as an 'avoided PE'. Notably, it is essential to highlight that the DPT does not apply to small and medium-sized entities which provides a targeted scope for its application. The taxable profits of an 'avoided PE' under the DPT align with what would have been generated if the foreign company had a UK PE.[118] Moreover, both the DPT and corporation tax share analogous principles in profit calculation[119] with the determination of the tax base considered the most pivotal factor for establishing similarity.[120]

Turning the attention to the Southern Hemisphere with a specific emphasis on Africa, the African Tax Administration Forum (ATAF) took a significant step in 2020 by introducing a framework for DSTs. It serves as a valuable guide for African countries contemplating the

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[106] *Ibid.*

[107] Jescheck, *supra* n. 41.

[108] G. R. Faulhaber, *The Internet Trap: How the Digital Economy Builds Monopolies and Undermines Democracy* 444–447 (2019).

[109] *Ibid.*

[110] *Ibid.*

[111] *Ibid.*

[112] *See* Jescheck, *supra* n. 41.

[113] *See ibid.*

[114] *See ibid.*

[115] *See ibid.*

[116] *See ibid.*

[117] *See ibid.*

[118] *See ibid.*

[119] *See ibid.*

[120] *See ibid.*

enactment of DST laws by providing a structured and informative resource to navigate the complexities associated with taxing digital services in the region. Kenya, for instance, enacted a unilateral measure beginning 1 January 2021 levying a DST at a rate of 1.5% on income derived from digital marketplaces. Similarly, Zimbabwe instituted a DST that was initiated 1 January 2019 taxing gross income from satellite broadcasting at a rate of 5% that is applicable to entities generating revenue exceeding ZWL 500,000.[121] Contrastingly, several African countries including Botswana, Namibia, and South Africa have yet to enforce the unilateral DST measures proposed by the OECD.[122]

Contrary to opting for the implementation of a DST, South Africa recently chose to revise its VAT regulations. It specifically targets digital service and forms a pivotal component of broader adjustments to indirect taxes within the digital services sector.[123] However, noteworthy progress has yet to materialize in the imposition of direct taxes on digital services in South Africa unlike Egypt where the imposition of VAT extends to digital services. Non-resident registrants are obligated to declare and remit taxes on e-service supplies at a rate of 14%.[124] However, for professional and consultancy services offered by non-resident registrants, the applicable tax rate is reduced to 10% with corresponding declarations and payments required for supplies of this nature.[125]

For countries such as South Africa and Egypt that have embraced the VAT principle, this is rooted in the principle that VAT is levied on the subjective value[126] of specifically the amount 'objectively' paid to the supplier (the actual value received, possibly in kind) but corresponding to the 'subjective' value agreed upon by the customer for the respective good or service.[127] This agreement is founded on the customer's 'perceived value' of the item rather than an assessment based on objective criteria.[128] In instances where corrective measures are necessary, the 'open market value' may be employed, although it remains unclear if this concept aligns with the arm's length standard in direct taxation, particularly in transactions involving related entities.[129] However, even in such cases, the adjusted amount would only be applied on the 'perceived value' attributed to a good or service within a given market.[130]

It is imperative to note that the location where value is added to a product or service does not, in any way, determine the jurisdiction responsible for the final VAT taxation.[131] In principle, only the Member State of final consumption (expenditure) has the entitlement to a net tax.[132] There is no allocation among other Member States based on whether value may have been added or subtracted earlier in the transaction chain.[133] The Member State of final consumption essentially retains the entirety of the tax. Exceptions arise only when suppliers in the chain lack a full right of deduction due to special circumstances (either because of an exemption or a capped deduction right in national legislation) or are unable to recover it from a foreign administration (e.g., due to a negligible amount at stake or administrative deficiencies).[134] In such cases where the VAT system might be considered deficient from a neutrality perspective, other states besides the state of final consumption may retain a portion of the VAT.[135] However, this does not imply that these states are where most or all of the value has been added.[136]

Despite introducing VAT on digital services, South Africa is still awaiting a consensus on multilateral measures before introducing any unilateral measures.[137] The

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[121] Deloitte, *The income tax (Digital Service Tax) Regulations* Walking the Journey with you (2020).

[122] Deloitte, *supra* n. 121.

[123] *See* Loffstadt, Ndlovu & Padia, *supra* n. 1, at 1–15.

[124] *See* https://www.globalvatcompliance.com/globalvatnews/egypt-vat-digital-services/ (accessed 7 Dec. 2023).

[125] *See ibid.*

[126] *See* Haslehner & Lamensch, *supra* n. 71: VAT is designed to tax final consumption but is applied across the entire production chain to enhance efficiency. The expectation is that value is generated or enhanced at each stage of the production and distribution process through either improvement or transformation or by commanding a higher price. However, it is essential to note that there is no direct correlation between the effective addition of value and the imposition of the tax. The instigator for a tax payment is solely the objective payment made by a counterparty for a good or service. VAT is applicable whenever a supplier that is recognized as a taxable entity for VAT purposes provides a good or service to a counterparty. This is applicable even in scenarios where the supply results in a loss (e.g., during a sales period) or when there is a diminution in the value of the provided good or service (e.g., with used goods). There is an exception in specific instances when an exemption or a special scheme might be applicable taking into account the absence of value addition.

[127] Haslehner & Lamensch 2021, *supra* n. 71.

[128] *Ibid.*

[129] *Ibid.*

[130] *Ibid.*

[131] *Ibid.*

[132] *Ibid.*

[133] *Ibid.*

[134] *Ibid.*

[135] *Ibid.*

[136] *Ibid.*

[137] OECD, *OECD/G20 Base Erosion and Profit Shifting Project Progress Report on Amount A of Pillar One* (2022).

Davis Tax Committee (DTC) offered recommendations in 2016 on how South Africa could prevent double taxation or double non-taxation in the digital economy. The DTC suggested that South Africa wait for the outcome of the OECD's BEPS Project before implementing any new measures. Additionally, the DTC proposed expanding the existing South African source rules to stipulate that the source of revenue is located where the customer resides. These recommendations, however, remain unimplemented by the South African Government. South Africa's current President, Mr Matamela Cyril Ramaphosa, has proposed introducing the DST on large MNEs such as Amazon.com, Netflix.com, and the Meta platform. However, no such implementations have yet taken place.[138]

As explored earlier, unilateral measures have emerged as provisional strategies awaiting the implementation of the OECD's two-pillar solution. However, the protracted delay in the OECD's execution of this solution may prompt an escalating adoption of unilateral measures by more countries.[139] While countries like the United Kingdom and Kenya are prepared to eliminate existing unilateral measures upon the two-pillar solution's enactment,[140] others have indicated their intention to enforce proposed unilateral solutions in the absence of a comprehensive international agreement.[141] With continued delays, an expanding cohort of countries is likely to resort to unilateral measures to fortify their tax systems.

Yet, this strategy creates a tangible risk of inciting trade wars[142] or retaliatory measures among countries, especially when a jurisdiction perceives a significant number of MNEs within its borders as targets. An illustrative case is the authorization of retaliatory tariffs by the US Trade Representative (USTR) authorizing retaliatory tariffs against France in 2020 and subsequently extending them to the Austria, India, Italy, Spain, Turkey, and the United Kingdom under the Biden Administration in 2021.[143] Although the United States initially opted for such retaliatory tariffs,[144] they were later suspended in order to align with the OECD's proposal for the withdrawal of all DSTs by countries upon reaching an international tax agreement.[145] However, in the event that the OECD agreement was to falter[146] and the United States was to reinstate retaliatory tariffs against DST-imposing nations, these countries would likely reciprocate with their own tariffs against the United States and potentially spark trade wars.[147] This tit-for-tat dynamic could result in an ineffective cycle of taxation and tariffs ultimately

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[138] T. Karombo, *African Governments Now Want to Tax Your Netflix and Chill* Quartz. (2022), https://qz.com/africa/2122487/african-governments-now-want-to-tax-your-netflix-and-chill (accessed 7 Dec. 2023).

[139] Faulhaber, *supra* n. 108.

[140] E. Asen & D. Bunn, *supra* n. 100.

[141] OECD, *OECD Policy Responses to Covid-19. The Territorial Impact of Covid-19: Managing the Crisis Across Level of Government* (2021).

[142] *See* Cui, *supra* n. 102. The OECD conducted an economic impact assessment of its Two Pillar proposal in Nov. 2020, It asserted that the primary rationale for the proposal is to avert an undesirable alternative scenario that envisions trade wars diminishing global GDP by up to 1% in a 'worst-case' situation. A prominent OECD official expressed the sentiment that 'any agreement is better than no agreement' and suggested that the looming threat of conflict and the prospect of resolution drive countries to engage in cooperative efforts. The perceived threat of 'trade wars' materialized as the European Commission (EC) proposed coordinated adoptions of DSTs within the EU in 2018. However, due to the unanimity requirement for tax policy decisions at the EC and the objection of several EU Member States to a European DST, the proposal did not come into effect. Subsequently, several European countries led by France and including Britain independently enacted their own DSTs labelled as 'unilateral measures'. The United States argued that these DSTs unfairly targeted US tech companies and constitute discriminatory practices. During the Trump Administration, the USTR initiated investigations against countries implementing DSTs under s. 301 of the Trade Act of 1974.

[143] Cui, *supra* n. 102.

[144] *See* Cui, *supra* n. 102. The imposition of s. 301 tariffs against countries implementing DSTs likely violates US commitments under the World Trade Organization (WTO). This echoes the precedent set by the US imposition of s. 301 tariffs on Chinese imports since 2018 that was determined to be in violation of WTO law. Notably, the US tariffs against the EU in the large civil aircraft disputes are sanctioned by the WTO. Specifically, the USTR does not assert that the investigated DSTs breach existing international agreements, including WTO rules, regional trade pacts, or bilateral tax treaties. Rather, the USTR recognizes that DSTs operate beyond the scope of such agreements. Its stance is rooted in the argument that these taxes 'discriminate against major US digital companies and are inconsistent with prevailing international tax policy principles'. However, this determination is guided by ambiguous criteria and lacks a clear legal framework. Contrastingly, the US's announcement of retaliatory tariffs against France and other countries aligns with WTO regulations. Concerns about the WTO compatibility of numerous s. 301 tariffs have been raised not only by the European Union but also by US legal scholars and government agencies. Relying on US s. 301 tariffs as the basis for a new global tax agreement assumes the US's entitlement to breach WTO regulations and poses a fundamental question about how a nation willing to disregard obligations under an existing cooperative regime can commit to cooperation in a new framework arising directly from such a breach.

[145] Cui, *supra* n. 102.

[146] *See* Cui, *supra* n. 102. In the OECD's model illustrating trade wars involving a 'limited' set of countries and the United States, over 30 countries either implemented a DST or reportedly contemplated DST adoption by 2020. These are assumed to (1) impose taxes on all digital imports from the United States, (2) confront either a proportionate retaliatory tariff or a tariff equivalent to five times the value of DSTs imposed by the United States, and (3) implement proportionate counter-tariffs against the United States for these retaliatory tariffs. In a 'worst-case' scenario, all countries globally, except China and Hong Kong, would adopt DSTs; the United States would levy retaliatory tariffs on all of them (up to five times the value of the DSTs); and all of these countries would retaliate with counter-tariffs against the United States. These hyperbolic scenarios form the foundation for the OECD's alarming predictions regarding the consequences in the event of a breakdown in the agreement.

[147] *See* Cui, *supra* n. 102. It is notable that major proponents of international agreements in 2021, such as France, the United Kingdom, and the United States are potential participants in the scenario of potential trade wars. However, these proponents do not posit that preventing trade wars is the primary rationale for international agreements. Instead, they invoke either the evolving modes of global commerce or the imperative to curb tax competition and corporate tax avoidance. This incongruity holds significance. The OECD arguably provides a more forthright depiction of the true nature of the proposed international agreement by consistently emphasizing the rationale of averting trade wars. This arises from the understanding that an international agreement might not materialize if countries do not commit to withdrawing or refraining from imposing DSTs. Stated otherwise, irrespective of the merits of other policy objectives for international cooperation, the OECD's current proposed agreement fundamentally asserts that DSTs should not be employed to advance these objectives. However, the averting-trade-war rationale for international cooperation is notably superficially unusual as all of the 'trade wars' cautioned by the OECD involve a single common belligerent – the United States – with no instances of countries engaging in trade wars against each other.

harming consumers more than addressing the underlying tax issues.[148] The consequence of such retaliatory measures could lead jurisdictions to receive less tax revenue than anticipated as these measures essentially cancel each other out and therefore create overlapping and counterproductive outcomes.[149]

Another challenge lies in the potential for unilateral measures to foster double taxation due to the absence of bilateral agreements. Inconsistencies in defining what constitutes a digital economy across different jurisdictions can exacerbate this problem and potentially result in the same revenue being interpreted differently and taxed multiple times. For instance, an MNE could face taxation in multiple countries due to new nexus rules that would cause income to be taxed based on users in one country, customers in another, and suppliers in yet another. Moreover, unilateral measures could be deemed unlawful or unconstitutional, and there is no multilateral platform to dispute these measures or ensure their equity and legality.

6 Introduction of DST in response to digital economy challenges

In 2018, the European Council, the UK Government, and the Spanish Government independently championed the implementation of an EU DST that was designed to encompass revenues generated from online advertising, digital intermediary activities, and the sale of user data.[150] However, the EU DST proposal encountered a setback in 2019 when the Economic and Financial Affairs (ECOFIN) Council failed to garner unanimous support for the measure despite certain compromises aimed at narrowing its scope.[151] Pioneering the DST initiative, the French Republic successfully implemented it in 2019 and specifically targeted MNEs with a significant digital presence within the country. This proactive stance emphasizes the global momentum in adapting tax frameworks to grapple with the challenges presented by the digital economy.

The DST introduced by the France, Spain, and the United Kingdom aimed to tax the revenue generated by large digital platform companies involved in activities such as advertising, online intermediation, and data transmission.[152] These proposals were rooted in the belief that the existing international income tax framework for MNEs inadequately taxed such entities.[153] Consequently, the governments of the involved countries called attention to the imperative for urgent reform in the tax regime to allocate greater taxing authority to jurisdictions where users of digital platforms contribute to value creation.[154] The DST was presented as a temporary solution to address the under-taxation of digital platforms until a new consensus on multilateral tax reform could be achieved within the OECD.[155] Two key elements must be demonstrated to justify the DST as a tax on location-specific rents (LSR)[156]:

- digital platforms generate significant rent; and
- such rent can be attributed to specific user countries when these platforms operate globally.

Concerning the first aspect, the economic literature on platforms strongly indicates the potential for substantial economic rent primarily due to both direct and indirect network effects. Furthermore, the presence of monopoly rent aligns with the concept that substantial investments may be necessary to capture it.[157] Firms might exhibit low accounting profits or even sustained losses during periods focused on building market share.[158]

Two intuitions prove valuable for determining if these business models are generating LSR. First, in specific instances, identifying the causal origins of platform rent may be feasible. New producer or consumer surplus may emerge due to changes in the jurisdictions where platform users reside.[159] Second, in a broader context, when a technology's deployment in one country carries no opportunity cost regarding simultaneous deployment in other countries – when the use of that technology is non-rival – it becomes plausible to attribute any rent generated by its

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[148] Asen & Bunn, *supra* n. 100.

[149] *Ibid.*

[150] Wei Cui & Nigar Hashimzade, *The Digital Services Tax as a Tax on Location-Specific Rent* (2019).

[151] J. M. Vázquez, *Digital Services Taxes in the European Union: What Can We Expect?* Kluwer International Tax Blog (2023), https://kluwertaxblog.com/2023/02/14/digital-services-taxes-in-the-european-union-what-can-we-expect/ (accessed 7 Dec. 2023).

[152] Cui & Hashimzade, *supra* n. 150.

[153] *Ibid.*

[154] *Ibid.*

[155] *Ibid.*

[156] *Ibid.*

[157] *Ibid.*

[158] *See* Cui & Hashimzade, *supra* n. 150. Drawing parallels between platform users' activities and natural resources is straightforward in certain cases, particularly when dealing with data of significant economic value. However, the primary tax base for the DST is anticipated to be revenue derived from advertising and the intermediation of consumption transactions.

[159] Cui & Hashimzade, *supra* n. 150.

deployment in a given country to that country.[160] This holds true even when the technology can be deployed remotely or originates elsewhere. These insights are further clarified with illustrative examples.

Conventional tax policy frameworks become applicable for analysing the DST once platform rent is acknowledged as location-specific.[161] For example, the consideration between a revenue-based tax and one that is defined on a rent base is a familiar aspect in the context of taxing natural resources.[162] Existing literature on this recognizes that revenue-based taxes are more straightforward to implement, resistant to tax planning and profit shifting, and provide revenue to governments earlier than rent-based taxes.[163] The latter are less distortionary, however, their practical and political implementation is more challenging. In practice, both (revenue-based) royalties and rent taxes are often adopted alongside corporate income tax with the latter exhibiting a combination of the advantages and drawbacks of the former two tax instruments.[164]

The simultaneous imposition of various taxes in the digital domain should be no more contentious than in the natural resource sector.[165] Moreover, the taxation of the LSR is already of significance in the current international distribution of taxing rights. Describing the relationship of a DST designed as a tax on LSR with existing income tax treaties is straightforward. Although the multi-sided market business models of digital platforms differ from natural resource extraction in several aspects, the economic incidence and welfare effects of a DST imposed on digital service revenue depend on a complex array of factors of which some are elucidated in a simple model.[166]

When the marginal cost of providing services to advertisers/producers is not zero, a tax on platform revenue impacts both them and the platform with the effect on consumers being ambiguous.[167] Nonetheless, conventional tax policy considerations may lead countries to discount any cost pass-through to foreigners and view granting it to domestic users as an acceptable trade-off for capturing some platform rent. Additionally, uncertainty about the impact of a DST should not be solely construed as a deterrent to DST proposals.[168] Numerous business models become potential candidates for taxes on LSR upon recognizing platform rent as location specific.[169]

Examining the actual implementation of the DST in a narrow range of sectors could offer valuable insights. Indeed, DST-like taxes might play a distinctive role in fostering international equity in a future global economy characterized by AI and labour-replacing technology.[170] This is attributed to their capacity to allow a country to capture profits from foreign businesses even in situations when the local resources utilized by them (1) lack a market or have minimal opportunity cost and (2) result in no payments to or from the country. In such contexts, profit taxes relying on jurisdictional claims tied to payment streams are susceptible to erosion while DST-like taxes retain the ability to facilitate inter-nation redistribution.[171]

The DSTs instituted by several African and European nations has a primary function as a direct levy on revenue derived from a spectrum of digital services including online advertising and streaming services.[172] Additionally, the DST aims to guarantee that source countries gain expanded taxation rights over the profits of technology-based MNEs that sell and collect data and also target advertisements towards local consumers within these countries regardless of their physical location, as depicted in Figure 3.

Specifically, DST targets MNEs such as Amazon.com, Apple Inc, Google LLC, and others that deliver goods and services digitally. They must meet this standard to fall within the scope of DST taxation. A minimum threshold is enforced to ensure that countries apply it to the most significant enterprises.

For nations that have levied VAT on domestic digital goods and services, the DST serves as an additional tax policy designed to create equality and seal the loophole of non-tax collection on digital services.[173] Hence, the DSTs

Notes

[160] *Ibid.*

[161] *Ibid.*

[162] *Ibid.*

[163] *Ibid.*

[164] *Ibid.*

[165] *Ibid.*

[166] *Ibid.*

[167] *Ibid.*

[168] *Ibid.*

[169] *See* Cui & Hashimzade, *supra* n. 150. It is noteworthy that the DSTs currently proposed by the European Commission, Spain, and the United Kingdom target only a limited subset of these models.

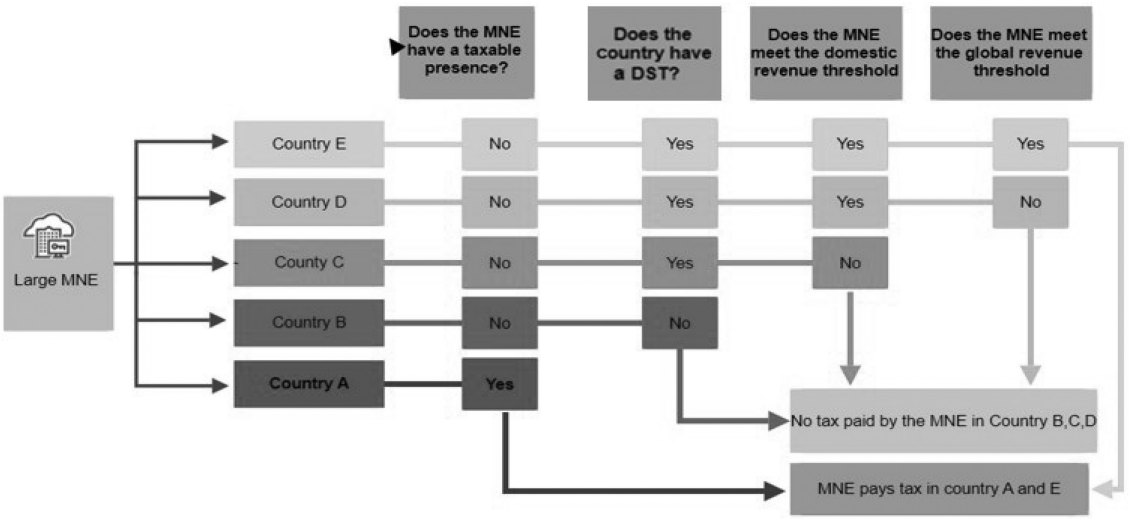
[170] Cui & Hashimzade, *supra* n. 150.

[171] *Ibid.*

[172] S. Lowry, *Digital Services Taxes (DSTs): Policy and Economic Analysis* Congressional Research Service Report 45532 (2019).

[173] Mullins, P. (2022), *Taxing Developing Asia's Digital Economy*. Asian Development Outlook, at 1-43.

Figure 3 How Does DST Work?[174]



(Source: Own)

are distinct from income tax, online sales tax, or VAT. In comparison, they typically impose a levy on gross revenue collected outside any treaty obligations.

Consider an example where an MNE headquartered in Country A sells digital services to consumers in Countries B, C, D, and E as depicted in Figure 3. As a resident of Country A, the MNE is taxed on its global income thereby making it liable for tax in Country A. Typically, a resident entity would establish a taxable presence in another country where it has income attributed to a PE. However, as shown in Figure 3, the MNE lacks a PE in Countries B, C, D, and E. Here, the DST serves as an alternative mechanism for establishing taxable presence.

As shown in Figure 3, Countries C, D, and E have implemented DSTs thereby potentially subjecting the MNE to taxation in these jurisdictions. Country B lacks DST measures and incurs a loss in potential tax revenue. However, the mere implementation of a DST in Countries C, D, and E does not automatically establish a taxable presence; certain thresholds must be met. Figure 3 demonstrates that, while revenues in Countries D and E exceed the domestic threshold, Country C's revenue is insufficient. Moreover, while Country D's revenue surpasses the domestic revenue threshold, it fails to meet the global revenue level thereby excluding both Country C and Country D from taxing the MNE. Ultimately, the MNE will pay tax in its resident country and in Country E, but it will remain tax-free in Countries B, C, and D due to the specific threshold parameters and the absence of a DST.

7 Principal concerns surrounding DSTs

This section delves into the comprehensive examination of the principal concerns surrounding the implementation of DSTs. Initially introduced as temporary strategies while awaiting the OECD's two-pillar solution, unilateral measures may see increased adoption if the OECD continues to delay implementation.[175] While countries like the United Kingdom and Kenya are poised to eliminate existing unilateral measures upon the two-pillar solution's enactment, others have indicated their intent to implement proposed unilateral solutions in the absence of an international agreement.[176] Consequently, further delays could lead to more countries adopting these to protect their tax systems.

The main controversy surrounding DSTs is their perceived discriminatory nature with critics arguing that they unjustly target US-based technology companies.[177]

Notes

[174] Kgomotso Mponwana & Jane Ndlovu, 2023.

[175] Faulhaber, *supra* n. 108.

[176] OECD, *supra* n. 141.

[177] Sarfo, N.A. (2023), *supra* n. 23.

The USTR has completed a report suggesting that certain DSTs such as those implemented in Australia, Spain, and the United Kingdom are discriminatory and contravene international laws.[178] According to Hunter (2021),[179] these DSTs impose burdens or restrictions on US commerce thereby leading to perceptions of them as being unfair and discriminatory measures.

Another concern is that DSTs are formulated outside of existing tax treaties which can destabilize the international tax system.[180] Given that they are unilateral measures enacted without bilateral agreements between jurisdictions, they amplify the risk of double taxation which further complicates matters.

The introduction of Pillar One is intended to resolve DST-related issues by offering a coordinated set of rules applicable to large MNEs.[181] Concerns have arisen over the definition of DSTs, but most jurisdictions support Pillar One's implementation. That definition encompasses levies on the total revenue generated through various digital services.[182] It also represents a combination of gross receipts taxes and transaction taxes applicable to earnings from activities such as advertising space sales, provision of digital intermediary services, and the sale of user-collected data.[183] DSTs maintain a distinct character separate from income taxes and online sales taxes, and they do not fall under the category of the VAT/Goods and Services Tax (GST).[184] Currently, the OECD has outlined the definition of DSTs based on three cumulative conditions[185]:

- the application of taxation grounded in market-based criteria;
- the confinement of such taxes to foreign and foreign-owned businesses; and
- the positioning of these taxes outside the income tax system thereby exempting them from treaty obligations.

The Digital Economy Group (DEG) voiced worries that the DST definition is too narrow and potentially fails to fully address the challenges of the digital economy and thus contribute to continued instability in the international tax regime.[186] Similarly, BMR Legal Advocates, a specialist corporate international tax and transfer pricing law firm in the Republic of India, has expressed concern that the language used in Amount A remains ambiguous. This could lead to jurisdictions not implementing the legislation as intended. Additionally, the requirement for all three elements of the definition to be met has been identified as a concern as it could result in only a few measures meeting the definition thereby curtailing the reform's effectiveness.[187]

The DST definition additionally presents significant concerns and limitations for countries that impose it on both domestic and foreign digital companies. It is recommended that clarity should be offered on which MNEs will be subject to Amount A. Additionally, the OECD should distinctly identify the removal of existing DST measures to provide certainty to jurisdictions that will be affected by their elimination.[188] The current Article 37 Model of Convention imposes limitations on the applicable juristic persons by referring only to companies. To resolve this issue, it is recommended that the section be revised to include all types of entities regardless of their legal status. This will ensure that all entities satisfying the criteria for a DST are governed by the same rules and regulations.[189]

Addressing these concerns is crucial for ensuring the effective implementation of Pillar One in effectively addressing DST-related issues. Both the DEG and the BMR Legal Advocates have raised pertinent concerns about the DST definition and addressing them is vital for avoiding confusion or ambiguity. It will also help minimize the risk of double taxation and ensure consistent application of rules across countries.

To address DST destabilization issues and the narrowness of definition, the DEG has proposed additional measures. It suggests that the OECD should review all existing DSTs that have led to instability in international tax laws and take these into account when designing the DST definition. Additionally, the DEG proposes adopting

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[178] A. Hunter, *Indian, Italian and Turkish Digital Service Tax Discriminatory: US Trade Representative*, International Tax News, Transfer Pricing News – TP News, https://transferpricingnews.com/indian-italian-and-turkish-digital-service-tax-discriminatory-us-trade-representative/ (accessed 7 Dec. 2023).

[179] Hunter, *supra* n. 178.

[180] Sarfo, N.A. (2023), *supra* n. 178.

[181] OECD, *0ECD/G20 Base Erosion and Profit Shifting Project Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy* (2021).

[182] Vázquez, *supra* n. 151.

[183] Vázquez, *supra* n. 151.

[184] *Ibid.*

[185] *Ibid.*

[186] OECD, *Public Consultation Document Pillar One – Amount A: Draft Multilateral Convention Provisions on Digital Services Taxes and other Relevant Similar Measures* (2023).

[187] *Ibid.*

[188] Deloitte Group, *0ECD Pillar One: Amount A. Removal of Digital Services Taxes and Relevant Similar Measures* (2023), https://taxscape.deloitte.com/article/oecd-pillar-one—amount-a—removal-of-digital-services-taxes-and-relevant-similar-measures.aspx (accessed 7 Dec. 2023).

[189] *Ibid.*

a disjunctive approach and considering a hallmark analysis that takes into account destabilizing features of unilateral measures aiming to create a more effective definition.[190]

The DEG also suggests that the Amount A rules should be modified to accommodate countries that tax both domestic and foreign digital companies. It recommends that the definition clarify which MNEs will be liable for Amount A. Additionally, the DEG recommends that the OECD stipulates a list of measures that constitute DSTs to provide certainty to jurisdictions subject to the removal of existing DST measures.[191]

Another significant challenge is that unilateral measures may result in double taxation due to the absence of bilateral agreements. Inconsistencies in understanding what constitutes a digital economy across different jurisdictions can exacerbate this problem and potentially lead to the same revenue being interpreted differently and taxed multiple times. For instance, an MNE could be subject to tax in several countries due to new nexus rules that would cause income to be taxed based on users in one country, customers in another, and suppliers in yet another. Moreover, unilateral measures could be perceived as unlawful or unconstitutional, and there is no multilateral platform to dispute these measures or ensure their equity and legality.

The adoption of DSTs by some countries specifically targeting US-based conglomerates has spurred concerns around fairness and the potential for aggressive tax planning tactics aimed at MNEs. Critics argue that a DST operates like a tariff and could be discriminatory in terms of scale as it solely targets specific MNEs. This approach may contravene the objective of international tax laws which is to promote fairness and eliminate double taxation.[192] The DST threshold is set high specifically aiming at certain MNEs. While this arrangement may benefit small businesses, it also affords opportunities for enterprises to modify their business models to generate revenue below the threshold.[193]

Additionally, discrepancies in DST laws among countries could result in administrative burdens and compliance challenges for non-resident taxpayers liable for tax in those jurisdictions.[194] Addressing these issues is essential to ensure that any implemented tax measures are fair and consistently applied across all affected parties.

There are also challenges in implementing DSTs. Addressing these as a unilateral measure involves identifying two primary concerns.[195] The first issue arises when the DST targets the LSR and necessitates coordination based on existing tax treaties governing income tax.[196] The second problem emerges when countries introduce unilateral measures for purposes other than taxing rent, such as an 'equalization' tax to create a fair and balanced situation between digital platform corporations and traditional companies. In such cases, it becomes imperative to reconcile these unilateral measures with the DST.[197]

Concerning the first challenge, countries where the LSR is generated are not deemed source countries under traditional tax rules, and they are not residence countries either. Consequently, even if they tax such corporations, they often fail to implement measures to eliminate double taxation, such as providing foreign tax credits.[198] This raises questions about the significance of the DST not being eligible for a foreign tax credit. If this is the case, most residence countries typically grant a deduction for foreign taxes paid.[199] Despite being designed as a tax on economic rent, deducting the DST from the income tax base would still allow for the imposition of income tax without causing distortions.[200] This approach aligns with the historical practice of standard corporate tax systems that have accommodated additional taxation on unusual returns, such as those with excess profits, alongside ordinary corporate tax.[201] Notably, many taxes on rent have traditionally been excluded from treaty-based coordination and treated as taxes covered by the treaties.[202]

The second issue involves coordinating DSTs specifically designed to tax the LSR with unilateral measures implemented for different objectives, such as achieving equal treatment.[203] For example, India's Equalization Levy and Italy's Levy on Digital Transactions are applied within the tax jurisdiction of advertisers. In a hypothetical scenario where

Notes

[190] *Ibid.*

[191] *Ibid.*

[192] Vázquez, *supra* n. 151.

[193] Asen & Bunn, *supra* n. 100.

[194] *Ibid.*

[195] *Ibid.*

[196] *Ibid.*

[197] *Ibid.*

[198] *Ibid.*

[199] *Ibid.*

[200] Watanabe, *supra* n. 51. The rationale for presuming that the DST should be eligible for a credit against income taxes rather than being deductible from taxable income remains unclear. Absent such a presumption, the lack of coordination between the DST and regular corporate income taxation does not create any specific concerns.

[201] Watanabe, *supra* n. 51.

[202] *Ibid.*

[203] *Ibid.*

Facebook sells advertising slots targeting French consumers to Italian or Indian manufacturers, the advertising profits received by Facebook might be subject to revenue-based taxation in India or Italy in addition to the DST in France.[204]

Given the implementation of unilateral measures by certain countries for digital services, conflicting perspectives on the attribution of profits from such services exist and leads to the potential for double taxation.[205] Resolving these issues through existing treaties is challenging as the elimination of double taxation in income taxes is constrained by treaty provisions.[206] Coordination becomes even more intricate when addressing matters beyond income tax. The 2018 EU proposal suggested allocating revenue among EU Member States based on the number of users within each state. However, this proposal was not enacted, and its scope would have been limited to the EU.[207] In the scenario mentioned previously, the likelihood of India as a non-EU country having a tax treaty with France and coordinating unilateral measures between the two nations seems improbable. Even if the second problem is viewed as a challenge in allocating new taxation rights related to corporate profits, achieving coordination among countries remains a formidable task.[208]

A perspective of suggesting that coordination among countries regarding DSTs could be achieved by acknowledging that these taxes do not conflict with existing international obligations. This is similar to the imposition of resource royalties, resource rent taxes, and other analogous levies by various governments and has gained acceptance in the international community.[209] This viewpoint asserts that unilateral measures for non-income taxes have already gained acceptance globally without the need for coordination to eliminate double taxation.[210] Addressing this second problem may not be necessary for DSTs as they share similarities with resource rent taxes.[211] While DSTs targeting the LSR may resemble turnover taxes, given the negligible marginal costs for taxpayers like Google and Facebook, they can be equated with profit taxes. DSTs essentially fall within the realm of income tax, particularly concerning the first problem.[212]

8 The OECDs' stance on the implementation of DST

This section delves into the OECD's position on DSTs. This exploration is imperative as numerous countries that have instituted them are under pressure from the OECD to rescind these measures.

The OECD contends that it should serve as the locus for international negotiations to pre-empt conflicts that, within the framework of existing international law, are anticipated to be resolved through the WTO.[213] This stance suggests that nations could potentially resolve disputes by shifting from one international forum to another.[214] Additionally, the OECD's oversight of the fact that US section 301 tariffs against countries implementing DSTs violates WTO law reveals a misunderstanding that tariffs are not only tools for initiating 'trade wars' but also mechanisms for upholding international agreements.[215]

The fundamental concept of the Income Inclusion Rule (IIR) is well known to tax policymakers and practitioners globally.[216] Ever since the United States implemented comprehensive controlled foreign corporation (CFC) rules in the early 1960s, numerous countries have introduced similar regulations to thwart tax avoidance by parent

Notes

[204] *Ibid.*

[205] *Ibid.*

[206] *Ibid.*

[207] *Ibid.*

[208] *Ibid.*

[209] *Ibid.*

[210] *Ibid.*

[211] *Ibid.*

[212] *Ibid.*

[213] *See* Cui, *supra.* n 181. The existing trade agreement was upheld and, in the event that the parties fail to reach a resolution, the new status quo accompanied by newly WTO-sanctioned tariffs on both sides can be considered a renegotiated outcome. When the United States imposes tariffs that breach WTO regulations, other nations have the right to seek redress within the WTO framework. Even if the WTO was to rule against the United States, its impact alone would be ineffectual if the countries adversely affected by US tariffs were unable to implement counter-tariffs. Tariffs authorized by the WTO and other measures compliant with WTO standards that are enacted to counter trade policies violating WTO agreements serve as enforcement mechanisms for such agreements. By characterizing tariffs and counter-tariffs as acts of war and by presenting the removal of these measures as a form of peaceful cooperation – without distinguishing between actions that violate agreements and those that enforce them – the OECD exposes a significant gap in its proposition for an international tax agreement, particularly regarding what constitutes the enforcement of such agreements.

[214] Cui, *supra* n. 102.

[215] *See* Cui, *supra* n. 102. No supranational governmental authority, including the WTO, possesses the capability to enforce trade agreements against their signatories; enforcement necessitates action by other signatories. In instances where a signatory is deemed to violate its WTO obligations, authorized retaliatory measures by other signatories are implemented to ensure compliance with these obligations or to provide compensation for such violations. For instance, in the large civil aircraft dispute between the United States and the EU, both parties imposed retaliatory tariffs with WTO endorsement. The WTO had ruled that each side had violated WTO law by adopting specific export subsidy policies. Characterizing this situation as one where 'war' erupted, existing international agreements became obsolete, and a new agreement needing negotiation would be erroneous.

[216] Cui, *supra* n. 102.

companies or individual shareholders residing within their jurisdictions.[217] These rules aim to tax the undistributed income of foreign subsidiaries which could potentially be utilized by taxpayers to shield income.[218] Countries essentially tailor their CFC rules to align with evolving domestic policy objectives whether directly related to taxation or not. Historically, governments seldom contended that the efficacy of CFC regimes is contingent on collective adoption.[219]

Thus, what justifies the need for global coordination in implementing the IIR? As mentioned earlier, the OECD does not anticipate universal commitment to adopting it which aligns with the presumed feasibility of unilateral adoption.[220] However, the intricacies of the OECD's Pillar Two blueprint largely stem from the assumption that countries adhere to a coordinated approach in embracing the IIR.[221] The primary rationale put forth by the OECD is that such coordination would offer 'certainty' to MNEs when numerous countries implement anti-avoidance measures.[222]

The second principal element of the OECD's Pillar Two recommendations, the Undertaxed Payments Rule (UTPR) diverges from the IIR in several aspects pertinent to the concept of cooperation.[223] First, rules resembling the UTPR have seldom been previously implemented.[224] Instead of pinpointing specific transactional structures susceptible to tax avoidance, it proposes increased taxation by the country of origin for payments made to any recipient situated in a jurisdiction that taxes such receipts below a specified minimum rate.[225] It is challenging to assert with certainty the efficacy of this approach in mitigating tax avoidance due to the absence of established precedents.[226]

Second, even assuming the potential effectiveness of the UTPR, the question arises as to why countries would benefit more from its collective adoption rather than pursuing unilateral implementation. It is essential to recall that rules akin to CFC regulations are typically viewed as having unilateral incentives for adoption by countries.[227]

Moreover, certain nations may face challenges in renegotiating bilateral tax treaties independently, particularly when counterpart states on the other side are reluctant and hold substantial bargaining power.[228] A multilateral accord involving numerous countries might enable some nations to collaborate and secure terms that would otherwise be unattainable. However, this reasoning prompts a fundamental question: Why would those countries resisting the renegotiation of bilateral tax treaties be inclined to participate in a multilateral agreement aimed at renegotiating the same treaties?[229] This inquiry is particularly relevant because multilateral bargaining in international taxation has limited historical precedent.[230] If the reluctance of certain powerful countries prevents renegotiating bilateral tax treaties, these influential nations must be presented with compelling incentives to engage in a multilateral agreement.[231]

In the context of the OECD's Pillar One, it has been widely acknowledged that the United States was a notable and powerful country resistant to participating in such multilateral agreements until 2021.[232] Even in 2020, it

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[217] Cui, *supra* n. 102. For instance, the highly regarded CFC rules of the United States were initially implemented in 1962 during a balance of payment crisis as the country explored various measures to repatriate capital. Likewise, the Trump Administration introduced strengthened provisions for US residence-based taxation through the global intangible and low-taxed income (GILTI) regime in 2017 that aligned with a political agenda aimed at revitalizing job prospects within the United States. The GILTI regime essentially represents another iteration of CFC rules akin to what the OECD now terms the IIR.

[218] Cui, *supra* n. 102. The implementation of CFC rules has predominantly been through unilateral legislation, and the international tax community has generally embraced non-coordination in adopting such rules. This acceptance stems not only from the belief that CFC rules are effective when adopted unilaterally and do not yield harmful externalities but also because they have been employed to achieve policy objectives beyond combating tax avoidance.

[219] Cui, *supra* n. 102.

[220] *Ibid.*

[221] *Ibid.*

[222] Cui, *supra* n. 102. The underlying implication is that there is a substantial risk of MNEs facing excessive taxation if CFC-like rules were independently adopted by countries. In line with this objective, the OECD proposal incorporates extensive provisions such as 'substance-based carveouts' that are regulations pertaining to 'excluded entities', and a prioritized hierarchy for applying the IIR – all designed to restrict the IIR's scope of application.

[223] Cui, *supra* n. 102.

[224] *Ibid.*

[225] *Ibid.*

[226] *Ibid.*

[227] Cui, *supra* n. 102. Perhaps, in contrast, the UTPR imposes a higher cost on the adopting country. While it could mitigate tax avoidance by MNEs and reduce their incentive to shift income to low-taxed jurisdictions, it might also amplify the tax burden on actual investment flows from countries with lower tax rates. Using the UTPR could therefore potentially divert foreign investment away from countries adopting the UTPR toward those that do not. It may not be the optimal choice for unilateral adoption if this diversionary effect is substantial. This might lead to the argument that, if major investment destinations worldwide (such as China, the EU, the United States, other OECD countries) collectively adopt the UTPR, the diversion of investment flows may be less pronounced. Stated differently, its adoption by any single country may be considerably less expensive if other countries also embrace it.

[228] Cui, *supra* n. 102.

[229] *Ibid.*

[230] *Ibid.*

[231] *Ibid.*

[232] *Ibid.*

was unconvinced that establishing international taxing rights based on sales was in its best interests. Furthermore, it strongly opposed proposals to apply these new methods selectively to specific sectors ('ring-fencing') where US MNEs held dominant positions.[233] The primary incentive offered by countries advocating for a new multilateral tax agreement, such as France and some EU allies, was the threat of DSTs that are not restricted by tax treaties.[234] However, this incentive was insufficient for the United States as the Trump Administration believed that retaliatory tariffs alone could deter DSTs. In the version of Pillar One announced by the OECD in July 2021, the scope of new taxing rights based on sales was limited to fewer than 100 multinational corporations.[235] This adjustment enabled Secretary Yellen to assure the US Congress that Pillar One would not lead to US revenue losses to foreign governments.[236] Consequently, a multilateral tax agreement became more appealing to the United States provided it still resulted in a prohibition on DST adoption.[237]

9 Evaluating the impact of DST implementation in Kenya and the United Kingdom

The following sections will delve into the heart and essence of this article. The focus will centre on comparing the implementation of DSTs in Kenya and in the United Kingdom.

The COVID-19 pandemic dramatically increased reliance on digital services as individuals worldwide pivoted to online platforms for purchasing goods, working remotely, and accessing entertainment. This transition had profound implications for economies and policymakers alike. While the OECD has been grappling with the deficiencies in international tax laws, no consensus on multilateral measures has been reached to date. However, some countries, including Kenya and the United Kingdom, have taken the initiative to implement unilateral measures for taxing digital services. The next section of this article aims to critically examine the implementation and effectiveness of DST in these two distinct contexts of the two countries.

This section will initially dissect the concept of the DST in Kenya by delving into its definition and its subsequent amendments as well as the additional measure of VAT. The challenges posed by the Kenyan DST and VAT on taxpayers will be discussed in detail by drawing from the analysis of audit firms and insights from tax experts. The section will then explore Kenya's decision to repeal the DST in order to facilitate the implementation of the OECD's Pillar One Amount A solution.

The section subsequently shifts its focus to the United Kingdom and details the rules instituted to regulate the DST and analyses the potential challenges encountered during the implementation process. It will also consider the possible challenges and recommendations proposed by the UK's NAO. The broader international impact of the UK's DST specifically on the United States will also be scrutinized which further advocates the UK's plan to repeal it upon the implementation of the Amount A rule under OECD's Pillar One solution.

10 Introduction of DST in Kenya

Kenya, alongside a select group of African countries like Nigeria, has implemented a DST to widen its tax base.[238] It took effect beginning 1 January 2021 and applies to both resident and non-resident entities[239] and levies a tax rate of 1.5% on income earned or accrued within the country from services facilitated through a digital marketplace.[240] Interestingly, this was not Kenya's inaugural attempt as it had initially proposed one in 2019. However, due to the vague definition of a digital marketplace, the concept was reintroduced with enhanced clarity in the Finance Act 2020.[241]

In its initial form, the term 'digital marketplace' referred to a platform for conducting transactions involving electronic goods and services, such as websites and software, as specified in the Kenyan Income Tax Act, Chapter 470. However, subsequent revisions expanded this definition to include online platforms that facilitate the sale or provision of goods, services, or other properties. Additionally, 'platform' was defined as any electronic application, including websites, that enable digital service providers to connect either directly or indirectly with

Notes

[233] *Ibid.*

[234] *Ibid.*

[235] *Ibid.*

[236] *Ibid.*

[237] *Ibid.*

[238] P. Kapkai, I. Muthee, B. Ngala, N. Musa, A. Wanyeri & E. Gathoni, *Enforcement of the Digital Economy Taxation* (2021).

[239] F. Y. Mpofu, *Taxing the Digital Economy Through Consumption Taxes (VAT) in African Countries: Possibilities, Constraints and Implications*, 10(3) Int'l J. Fin. Stud. 65 (2022), doi: 10.3390/ijfs10030065.

[240] The Income Tax Act (CAP. 470) in exercise of the powers conferred by s. 3(2A) of the Income Tax Act.

[241] *Ibid.*

service users. These amendments significantly broadened the scope of digital taxation in Kenya that sought to address the global tax challenge of ensuring fairness and equity in taxation norms.

In Kenya, the DST is levied on the gross transaction value (GTV), that is, the fee or commission earned from a digital marketplace, provided that the digital services are supplied to a user based in Kenya. For example, if a Kenyan resident uses TikTok, the video-sharing social networking platform created by ByteDance Ltd (a Chinese technology company) to sell goods such as clothing or to offer advertising services, it is ByteDance Ltd that will be liable for the DST and not the Kenyan resident.[242]

Digital service providers, such as ByteDance, engaging in the Kenyan digital marketplace are obligated to submit a DST return and remit the associated tax by the twentieth day of the subsequent month in which the digital service was provided.[243] For resident providers, a DST functions as an advance tax that enables offsetting/deduction when filing the annual income tax return.[244] Non-resident providers lacking a permanent establishment in Kenya treat a DST as a final tax.[245] Determining its application involves assessing whether the digital service is provided to a user in Kenya by considering parameters like payment methods, location of access, internet protocol addresses, and user addresses.[246] A DST encompasses the sale of goods on digital or social media platforms which necessitates individuals and companies to declare income earned under self-assessment.[247] Taxable services under the DST include downloadable content, over-the-top services, data monetization, digital marketplace provision, subscription-based media, electronic data management, online booking services, search engine provision, online training, and other digital marketplace services.[248] Overseas companies operating in Kenya's digital market can register for a DST through the iTax portal or appoint a tax representative for compliance obligations to ensure timely tax return submission and payment adherence.[249]

However, Kenya's approach to taxing digital services goes beyond just a DST. The nation has also introduced VAT on digital services provided within its borders. It applies to supplies made in the digital marketplace to Kenyan consumers at a rate of 16%. Moreover, non-resident companies are expected to charge Kenyan VAT on business-to-business digital transactions, and there is no threshold for VAT registration. These amendments to the Kenyan VAT Act aim to broaden the scope of taxable supplies, extend beyond merely business-to-customer VAT charges, and expand the number of suppliers liable for VAT by elucidating the threshold criteria.

11 Enactment of the DST in Kenya

The OECD's BEPS 2.0 Model consists of two pillars. The objective of Pillar One is to reallocate a portion of taxable profits to market jurisdictions which affects large MNEs. This could result in changes to their effective tax rate and cash tax obligations as well as modify their current pricing arrangements. Pillar Two seeks to guarantee that the income of MNEs with a turnover exceeding EUR 750 million is taxed at a minimum rate of 15%.

When the OECD proposed its two-pillar plan for international tax reform, Kenya was among the countries that refused to agree to it. The country believed that a unilateral approach could bring in revenue from more MNEs than the limited number targeted by the OECD.[250] Under Kenya's approach, approximately fifty MNEs – most of which were American – were initially targeted including Google LLC, Netflix.co, Meta Platforms Inc, and Microsoft Corporation. The Kenya Revenue Authority (KRA), however, managed to exceed its target by registering 178 companies as taxable under its DST.[251]

The KRA reported that it had collected approximately KES forty-two million within the first six months of implementing their DST in 2022 and aimed to collect KES 300 million by the end of June 2023.[252] Despite the DST's success in Kenya, the Kenyan Government faced some pressure from the OECD to withdraw its

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[242] G. Maina, *Digital Service Tax in Kenya, Legal, Tax, Audit and Management and IT Consulting* (2021), https://www.roedl.com/insights/kenya-digital-service-tax (accessed 7 Dec. 2023).

[243] *See* Kenyan Revenue Authority Introducing Digital Services Tax, https://kra.go.ke/images/publications/Brochure-Digital-Service-Tax-Website.pdf (accessed 7 Dec. 2023).

[244] *Ibid.*

[245] *Ibid.*

[246] *Ibid.*

[247] *Ibid.*

[248] *Ibid.*

[249] *Ibid.*

[250] R. Asquith, *Kenya Plans to Double Digital Sales Tax to 3%*, vatcalc.com., https://www.vatcalc.com/kenya/kenya-plans-to-double-digital-sales-tax-to-3/ (accessed 7 Dec. 2023).

[251] E. Kivuva, *KRA Nets Sh174m in Digital Service Taxes in Six Months*, Business Daily (2023), https://www.businessdailyafrica.com/bd/economy/kra-nets-sh174m-in-digital-service-taxes-in-six-months–4096648 (accessed 7 Dec. 2023).

[252] Kivuva, *supra* n. 251.

implementation.[253] In response, the Kenyan Finance Bill proposed in 2022 to double the DST rate from 1.5% to 3%. This proposal, however, was later declined by the Parliament of Kenya which decided to keep the DST rate at 1.5%.[254]

12 Challenges associated with DST implementation in Kenya

A number of reports from prominent accounting and auditing firms in Kenya, such as Deloitte[255] and KPMG Inc.,[256] have highlighted potential problems with the DST introduced there.[257] They assert that the rules put in place are rudimentary and pose a risk of double taxation for digital platform users. Additionally, they argue that the introduction of a DST coupled with the amendments to VAT may place an undue burden on both customers and suppliers, particularly given that online supplies are subject to VAT. This situation raises several key challenges.

First, in the initial phase of implementing the DST and VAT, there was no clear guidance on who should bear the tax liability between the buyer and the seller or how the rules should be applied.[258]

Second, a significant proportion of Kenya's youth population is reliant on the digital marketplace due to high unemployment rates, and the platform is also advantageous for reducing operational costs of start-up companies.[259] For instance, in 2017, one million young Kenyans enrolled in a digital skills training program focused on freelancing.[260] As there is a threshold for VAT, all buyers and sellers are targeted. Consequently, the tax amendments critically focusing the digital marketplace may negatively impact youth-led start-up companies and potentially undermine international trade and investment.[261] Furthermore, this could pose risks for foreign investors due to the threat of double taxation.[262]

Third, there is the issue of administrative burden. The VAT Act's rules subject not only the supply of goods and services in a digital marketplace to Kenyan customers to VAT but also classify non-residents who do so as having derived income in Kenya. Implementing these provisions on non-resident companies will be challenging due to their lack of physical presence there.[263]

Fourth, there are issues with the compliance and enforcement of VAT provisions for non-resident companies.[264] Kenya does not have the authority to compel them to pay VAT on exports which infringes upon the OECD's VAT guidelines advocating the destination principle (i.e., goods and services are taxed at the recipient's location).[265] This could potentially provoke retaliatory measures from source countries.[266] As such, authorities can only mandate residents to pay VAT on imported goods and services[267] which is a situation that could potentially result in double taxation.

Fifth, non-resident entities operating in Kenya without a Kenyan PE face compliance issues when fulfilling DST obligations.[268] There are currently no robust compliance measures in place to enforce tax payments[269] which could potentially lead to tax revenue losses. While MNEs bear the responsibility to stay informed about their tax obligations, the introduction of a new tax regime, such as the DST and VAT amendments in Kenya, necessitates widespread awareness. This demands that it informs all relevant countries of the implementation of these tax changes. However, the critical point arises as notifications might

Notes

[253] Asquith, R. (2022), *supra* n. 253.

[254] Kivuva, *supra* n. 253.

[255] Deloitte, *Digital Services Tax in Africa – The Journey so Far,* Implementation of digital taxes across Africa , https://www2.deloitte.com/za/en/pages/tax/articles/digital-services-tax-in-africa-the-journey-so-far.html (accessed 7 Dec. 2023).

[256] KPMG, *Digital Services*, https://chat.openai.com/?model=text-davinci-002-render-sha.

[257] Kapkai et al., *supra* n. 239.

[258] M. Muendo, *Kenya Is Moving Aggressively to Tax Digital Business. What Next?* (2021), https://theconversation.com/kenya-is-moving-aggressively-to-tax-digital-business-what-next-163901 (accessed 7 Dec. 2023).

[259] Kapkai et al., *supra* n. 239.

[260] D. Miriri. *Kenya Looks to Fix Finances by Nailing Tax Cheats, Cutting Borrowing* (2023):, https://www.reuters.com/world/africa/kenya-eyes-lower-local-foreign-borrowing-targets-it-cuts-deficit-2023-01-19/ (accessed 7 Dec. 2023).

[261] Kapkai et al., *supra* n. 239.

[262] *Ibid.*

[263] *Ibid.*

[264] *Ibid.*

[265] *Ibid.*

[266] Ngeno, n. 2020. *Taxing Kenya's Digital Economy: The Digital Service Tax (DST)*, Explained (Lawyer Hub 2020), https://lawyerhub.org/blog/Taxing-Kenyas-Digital-Economy-The-Digital-Service-Explained (accessed 7 Dec. 2023).

[267] Ngeno, n. 2020, *supra* n. 268.

[268] Kapkai et al., *supra* n. 239.

[269] Deloitte, *supra* 255.

not effectively reach all jurisdictions. This communication deficiency increases the likelihood of some MNEs unintentionally or deliberately evading taxation. This is especially more prominent because some MNEs engage in aggressive tax planning by leveraging legal but intricate structures to exploit tax laws' technicalities. This might involve creating complex financial instruments, engaging in hybrid mismatches, or utilizing other sophisticated strategies to achieve tax efficiency. MNEs can strategically structure their operations to exploit differences in tax rules and rates among countries. They can reduce their overall tax liability by allocating income and expenses in a way that maximizes deductions in high-tax jurisdictions and minimizes taxable income in low-tax jurisdictions. MNEs also might exploit the information gap in cases when countries do not effectively share information about tax changes or enforcement actions. This allows them to operate without sufficient oversight and potentially evade taxes in jurisdictions where they should be paying.

Sixth, the unilateral nature of a DST poses challenges in terms of fairness and equity.[270] After the first tax period, Kenya planned and proposed to double the DST rate to 3%.[271] This could be seen as inequitable to taxpayers liable to pay taxes there.

Seventh, there are concerns that the DST strategy for taxing digital goods and services could be overly expensive.[272] The associated administrative costs may outweigh the benefits when considering the need for potential amendments to the DST rules, such as the introduction of a threshold.[273]

Last, the definition of the GTV in the DST regulation does not provide a clear apportionment calculation when services are offered to Kenyan users who are located outside of the country.[274] In contrast, France has provided a formula for calculating the GTV that has brought clarity for users. Deloitte emphasized the importance of addressing this issue to alleviate their administrative burden.[275]

13 The repeal of the DST in Kenya

The OECD urged Kenya to collaborate on implementing a global minimum tax[276] rather than persisting with their independent measures.[277] USTR Katherine Tai initiated negotiations with Kenya in 2022 with an objective to achieve consensus to eliminate existing unilateral measures and prevent their future implementation.[278]

Kenya's unilateral measures made a substantial impact that led the government to propose doubling the DST rate. Nevertheless, Kenyan President Mr William Ruto emphasized the ongoing, meaningful dialogues with key sector stakeholders aimed at achieving a mutually advantageous agreement.[279] This commitment to repeal current DST measures facilitated the continuation of trade discussions between the United States and Kenya. The negotiations were conditional upon abolishing DST measures and adhering to the OECD's blueprint; their initial round concluded in February 2023.[280]

Following a year of negotiations and consultations, President Ruto announced on 30 March 2023 that Kenya intended to reassess the existing DST tax regimes and align these independent measures with the OECD's approach thus advocating for withdrawing such unilateral practices.[281] This decision reflects Kenya's readiness to collaborate with the global community in fostering a just and balanced international tax system.[282]

President Ruto's pledge to revise Kenya's existing DST tax regimes and harmonize these measures with the OECD's blueprint garnered positive responses particularly from economist Aly Khan Satchu who is an influential investor in the

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[270] Muendo, *supra* n. 258.

[271] V. Fakiya, *Kenya Plans 3% Tax on Digital Assets Revenue* (2023), https://techpoint.africa/2023/05/08/techpoint-digest-577/ (accessed 7 Dec. 2023).

[272] R. Mosoti, *A Commentary on the Proposed Digital Services Tax in Kenya: A Case of Premature Legislation?* (2020), https://www.afronomicslaw.org/2020/11/28/a-commentary-on-the-proposed-digital-services-tax-in-kenya-a-case-of-premature-legislation (accessed 7 Dec. 2023).

[273] *Ibid.*

[274] Deloitte, *supra* n. 255.

[275] Deloitte, *supra* n. 255.

[276] *See* Wei , *supra* n. 102. The finance ministers of the G7 group of advanced economies concluded a meeting in London on 5 Jun. 2021 and announced their tentative agreement to implement a 'global minimum tax' . This tax has not only captured the global public's imagination but has also gained overwhelming plausibility for two distinct reasons . First, numerous countries openly voiced their support for a new global tax agreement with the G7 countries notably positioning themselves as sponsors in Jun. 2021. Subsequently, finance ministers of the G20 countries convened in Venice on 10 Jul. endorsing the G7's proposal and securing the influential support of China, India, Russia, and other nations for the initiative . The G20's backing was essentially preordained as a forum known as the 'Inclusive Framework' (IF) comprising 140 countries convened by the OECD had earlier met in late Jun. 2021 to discuss the foundational elements of a global tax reform plan.

[277] D. Herbling, *0ECD Urges Kenya to Drop Plan to Double Digital-Services Tax* (2020), https://www.bloomberg.com/news/articles/2022-04-14/oecd-urges-kenya-to-drop-plan-to-double-digital-services-tax#xj4y7vzkg (accessed 7 Dec. 2023).

[278] K. Pinner, *Big Tech wants DST removed in US-Kenya trade deal, Law360 Tax Authority* (2022), https://www.law360.com/tax-authority/articles/1533475/big-tech-wants-dst-removed-in-us-kenya-trade-deal (accessed 7 Dec. 2023).

[279] *Ibid.*

[280] *Ibid.*

[281] K. Muiruri, *President Ruto Drops Digital Service Tax Against Multinationals*, Business Daily (2023), https://www.businessdailyafrica.com/bd/economy/ruto-drops-digital-service-tax-against-multinationals–4179322 (accessed 7 Dec. 2023).

[282] *Ibid.*

Nairobi Securities Exchange. He predicts that the revocation of Kenya's DST measures will effectuate a swift surge in tax collections from income earned by MNEs.[283] According to him,[284] the approximate KES two million amassed by Kenya under the DST is deemed inconsequential, and the benefits from this change are expected to be substantial.

While the OECD is dedicated to establishing equitable and certain tax practices, Satchu[285] cautions that an increase in tax rates resulting from DST measures could negatively impact MNEs by potentially obligating them to pay more than they would under Kenya's lower tax rate. Nonetheless, the decision to align Kenya's DST measures with the OECD plan is generally seen as a progressive step towards fostering a more balanced global tax system.

14 The implementation of a DST in the United Kingdom

The UK Government introduced a DST that was motivated by escalating concerns regarding large MNEs generating significant profits within the United Kingdom without corresponding UK corporation tax payments.[286] The rapid expansion of the digital economy has posed unique taxation challenges to these digital MNEs primarily due to the lack of modernized tax regulations. This prompted the country to enforce unilateral measures in the form of a DST.[287]

The UK Committee of Public Accounts voiced concerns regarding the tax evasion strategies employed by large MNEs with particular attention directed towards the digital sector.[288] The UK Government was troubled by the disproportionately low tax contributions from digital companies operating within the country and acknowledged that existing tax laws had not evolved to progress as the same rate as the digital economy.[289] This led to difficulties in taxing digital MNEs that were reaping profits within the United Kingdom but not paying the due UK corporation tax. In response to this issue, the UK Government implemented a DST as a unilateral measure aimed at taxing digital services offered to the UK market.[290]

As mentioned earlier, the United Kingdom implemented a DST effective from 1 April 2020 as a taxation scheme aimed at tapping into the profits of MNEs in the markets where value is created as opposed to their physical locations.[291] The UK DST primarily focuses on large MNEs providing online services such as social media, search engines, or digital marketplaces to UK users and applies a tax rate of 2% to a group of companies under the same controlling interest.[292]

The UK DST applies to MNEs with global revenue exceeding GBP 500 million that generate over GBP twenty-five million from UK sales.[293] The first GBP twenty-five million of UK sales are excluded from taxation indicating that the DST will not impact MNEs that are just breaking even or operating at a loss.[294] Hence, it is specifically targeted at MNEs profiting from their digital services within the United Kingdom.[295]

In the initial year of implementing the DST, the United Kingdom successfully garnered GBP 358 million in the 2020/21 tax year from large MNEs, including leading corporations such as Amazon.com, Google LLC, and Apple Inc.[296] Interestingly, approximately 90% of this tax revenue was sourced from just five business groups including these same giants Amazon.com, one of the targeted MNEs, initially resisted the DST and intended to transfer the tax burden to small traders selling on its platform.[297]

The UK's ability to identify a broader range of MNE groups for taxation led to a 30% increase in DST

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[283] E. Musambi, *Kenya's New Tax Package Angers Some Backers of the President Who Once Vowed to Reduce Cost of Living* (2023), https://abcnews.go.com/International/wireStory/kenyas-new-tax-package-angers-backers-president-vowed-100306101 (accessed 7 Dec. 2023).

[284] *Ibid.*

[285] *Ibid.*

[286] M. Alliston, *The UK's Digital Services Tax* (2020), https://www.nortonrosefulbright.com/en/knowledge/publications/24da19c2/the-uks-digital-services-tax-whats-new (accessed 7 Dec. 2023).

[287] *Ibid.*

[288] National Audit Office, *supra* n. 35 and Initial Impressions Of The United Kingdom's Digital Services Tax by Robert Goulder. 24 Apr. 2023.

[289] *Ibid.*

[290] National Audit Office, *supra* n. 35.

[291] National Audit Office, *supra* n. 35 and Initial Impressions Of The United Kingdom's Digital Services Tax by Robert Goulder. 24 Apr. 2023.

[292] National Audit Office, *supra* n. 35.

[293] *Ibid.*

[294] *Ibid.*

[295] Alliston, *supra* n. 286.

[296] M. Sweeney, *UK's Digital Services Tax Reaps Almost £360m from US Tech Giants in First Year*, The Guardian (2022), https://www.theguardian.com/technology/2022/nov/23/uks-digital-services-tax-reaps-almost-360m-from-us-tech-giants-in-first-year#:~:text=8%20months%20old-,UK%27s%20digital%20services%20tax%20reaps%20almost%20%C2%A3360m,tech%20giants%20in%20first%20year&text=The%20digital%20services%20tax%20has,paying%20in%20UK%20corporation%20tax (accessed 7 Dec. 2023).

[297] *Ibid.*

collections which exceeded initial projections.[298] The implementation of the measure proved notably successful in effectively addressing the issue of large MNEs channelling their profits into low-tax jurisdictions such as Ireland.

With the advent of the DST, digital companies are now mandated to pay taxes where they generate value rather than where they maintain physical establishments.[299] Consequently, most of these digital companies are paying more in DST than in corporation tax which reverses the prior scenario. The NAO reported that, of the eighteen affected firms, fourteen exceeded their expected payments under the DST.[300] Astonishingly, thirteen out of these eighteen companies contributed more to the DST than they did in corporate income tax.[301] The cumulative DST payments from the eighteen businesses surpassed the GBP 351 million they collectively paid in UK corporation tax.[302] The perplexity arises in understanding how a 2% DST can outpace the 19% corporate income tax.[303] Primarily, the tax bases are fundamentally different as companies can report substantial revenues while yielding minimal profits. Profit shifting might contribute to reported profits appearing to be meagre.[304] Notably, the DST intentionally disregards profitability and presents both a notable deficiency and a key reason for its adoption by various governments.[305] This stems from a post-BEPS legacy indicating a global desire for a corporate tax base that transcends mere profitability considerations.[306]

Historically, technology MNE giants have minimized their UK corporation tax payments by directing profits through low-tax jurisdictions such as Luxembourg and Ireland.[307] Examining Facebook's case illustrates the moral imperative for addressing the under-taxation of big technology MNEs.[308] Despite a GBP 15.8 million UK corporation tax bill aligning with declared UK profits of GBP sixty-two million, the question arises about the remarkably low level of UK profits that represent a mere 4.9% profit margin on revenues of GBP 1.27 billion.[309]

The DST is viewed as a corrective measure, and the HMRC, the non-ministerial department of the UK Government in charge of tax collection, has projected a revenue target of GBP three billion for the 2023–2024 tax year. This expectation is built on past DST collection records with instances of individual MNEs contributing five times more than initially estimated.[310] However, there is an impending replacement of the DST in 2024 by a new global tax system following the OECD-brokered deal among 136 countries. It aims to ensure large multinational companies pay taxes where they conduct business with a commitment to a minimum 15% corporation tax rate.

15 The challenges of implementing a DST in the United Kingdom

Despite the financial gains from implementing a DST, the United Kingdom continues to face challenges in enforcing compliance and ensuring that MNEs worldwide are both aware of and adhering to it.[311] In an attempt to effective address this, the HMRC has identified eight categories that could potentially lead to tax non-payment ranging from administrative errors in tax return completion to deliberate tax evasion.[312] It identifies an increasing number of MNEs that fall within the DST remit, therefore, the compliance challenge increases proportionally to this expansion.[313] Newly identified MNEs may bring diverse perspectives and attitudes towards tax payments which further complicates compliance enforcement.[314]

While the HMRC has yet to identify any explicit tax avoidance or evasion attempts by MNEs, it posits that the potential reputational damage from such actions would

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[298] S. Gough, *Digital Services Tax in the UK,* Bird & Bird (2023), https://www.twobirds.com/en/insights/2019/global/digital-services-tax-in-the-uk (accessed 7 Dec. 2023).

[299] Sweeney, *supra* n. 296.

[300] *See* Initial Impressions Of The United Kingdom's Digital Services Tax by Robert Goulder. 24 Apr. 2023.

[301] *See ibid.*

[302] *See ibid.*

[303] *See ibid.*

[304] *See ibid.*

[305] *See ibid.*

[306] *See ibid.*

[307] *See* UK finally takes on arrogant tech giants with digital services tax by Nils Pratley Financial editor. 29 Oct. 2018.

[308] *See ibid.*

[309] *See ibid.*

[310] National Audit Office, *supra* n. 35.

[311] O. Hornstein, *UK Collects £360m from Big Tech Via Digital Services Tax* (2022)https://www.uktech.news/news/government-and-policy/big-tech-gov-360m-digital-services-tax-20221123 (accessed 7 Dec. 2023).

[312] National Audit Office, *supra* n. 35.

[313] *Ibid.*

[314] *Ibid.*

likely surpass any financial benefits.[315] Nevertheless, the HMRC must persist in its monitoring and enforcement efforts to ensure that the DST remains an effective tool for collecting tax revenue from MNEs operating in the UK market.

Besides compliance hurdles, the HMRC grapples with several additional obstacles in DST enforcement.[316] Effectively communicating with non-resident MNE groups – those that lack a physical presence in the United Kingdom yet are still tax-liable under the DST – presents a significant challenge.[317] Another issue involves taking action against non-compliant MNEs that are not UK residents.[318] Moreover, managing those that contest their revenue's inclusion within the DST scope remains a notable dilemma.[319]

The UK Government's announcement regarding the implementation of the DST made a substantial impact and alerted many large non-resident MNEs about their new tax liabilities in the United Kingdom. However, three out of eight groups that submitted tax returns were not initially informed.[320] Consequently, some non-resident MNEs, particularly those without pre-existing relationships with the country, might still be unaware of their obligations under the DST. To address this, the HMRC must devise strategies to effectively communicate with and educate these groups about their tax responsibilities thus ensuring DST compliance.

In light of potential non-compliance risks, the HMRC has developed methods to secure payment from non-resident groups liable under the DST. One significant risk is the refusal of a non-resident group to pay.[321] Although measures such as website blocking or securing a retainment deposit were considered by the HMRC, these were ultimately deemed unnecessary. Instead, it plans to either issue a payment notice to a subsidiary of the MNE that owes the tax or collaborate with the tax authorities in the country where the group is located to recover the debt. The authors believe that this collaboration between the HMRC and the tax authorities in the country where the group is located could be effective if the following is enforced:

(1) If there are bilateral agreements or treaties between the United Kingdom and the country where the MNE is located, the HMRC and the tax authority of the country where the MNE is located may facilitate cooperation on tax matters including the recovery of debts.
(2) The existence of mutual legal assistance treaties (MLATs) or tax information exchange agreements (TIEAs) can enhance the legal basis for collaboration.
(3) The effectiveness of collaboration also depends on the enforcement mechanisms available in the jurisdiction where the MNE is based. Some countries may have robust processes for enforcing tax-related obligations while others may face challenges.
(4) The willingness of the foreign tax authorities to cooperate is crucial. Collaboration may be more effective if the country has a strong commitment to international tax cooperation and addressing BEPS.
(5) Differences in legal systems and administrative processes between jurisdictions can impact the feasibility and speed of collaboration. Harmonization of procedures can enhance the effectiveness of joint efforts.
(6) Political considerations may also be relevant. Geopolitical tensions or other political factors could affect the level of cooperation between tax authorities.
(7) In the context of global efforts to address taxation challenges, initiatives led by organizations like the OECD may influence collaboration. Common frameworks and guidelines can facilitate coordination.
(8) Effective communication and information sharing between tax authorities are essential. Transparent and timely sharing of relevant information can streamline the recovery process.

In addition to previously mentioned hurdles, a prospective challenge is the difficulty some MNEs might encounter in identifying whether their revenue is within the DST's scope.[322] This issue has been stressed by stakeholders who contend that certain aspects of the legislation remain ambiguous and that specific business models make it difficult to determine DST liability.

The challenges illustrated in Figure 4 demonstrate how a business model can determine whether an MNE is subject to UK tax. As depicted in the diagram, Group A offers online social media gaming options to its customers while Group B develops games for the

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[315] *Ibid.*

[316] National Audit Office, *supra* n. 35 and Initial Impressions Of The United Kingdom's Digital Services Tax by Robert Goulder. 24 Apr. 2023.

[317] National Audit Office, *supra* n. 35.

[318] *Ibid.*

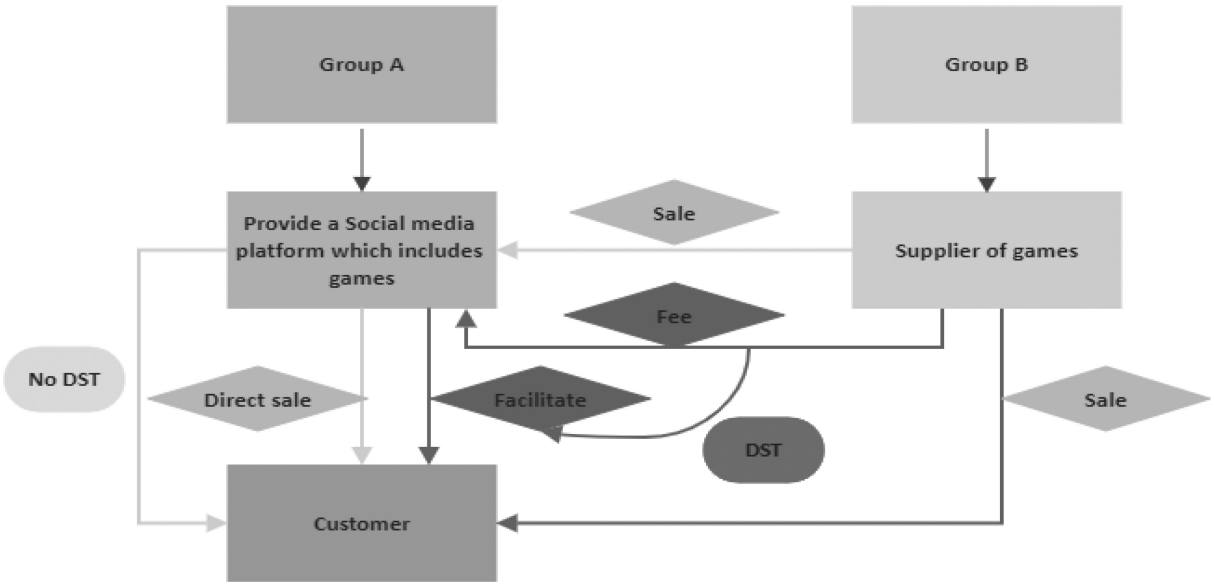
[319] National Audit Office, *supra* n. 35 and Initial Impressions Of The United Kingdom's Digital Services Tax by Robert Goulder. 24 Apr. 2023.

[320] National Audit Office, *supra* n. 35.

[321] *Ibid.*

[322] *Ibid.*

Figure 4 What Gives Rise to DST?[323]



(Source: Own)

social media platform of Group A. If Group A purchases games from Group B and sells them directly to customers, it is considered a direct sale that is specifically excluded from the UK's DST definition. Thus, the DST is not applicable in this scenario. However, if Group A facilitates the sale of the games between Group B and the customer, the DST would be levied, as Group A facilitated the transaction between an MNE and the UK user.

The potential for MNEs to alter their business structures and activities to evade the DST is clearly illustrated in Figure 4. For instance, Company A (an MNE) might transition from facilitating sales between customers and Company B to purchasing games from Company B and selling them directly to customers thus circumventing the DST. Fundamentally, the nature of business activities determines whether a business is liable for it in the UK, and this could significantly contribute to tax non-compliance.

To address the challenges mentioned, the NAO – an independent body responsible for auditing central government departments in the UK – has proposed several recommendations. These include consistently updating HMRC guidelines on the companies and revenues that are tax liable. The NAO also suggests conducting variance reports to compare macro-economic data with total revenue given the increasing number of affected groups.[324]

Additionally, it is imperative for the HMRC to devise a strategy for identifying groups that are unaware of this tax obligation, particularly non-resident groups. By implementing these recommendations, the HMRC can bolster its efforts in enforcing compliance, communicating with non-resident groups, and managing non-compliant groups that are not UK residents.

16 The repeal of the DST in the United Kingdom

While some nations struggle to reach an agreement on the terms for eliminating current DST measures, which could potentially delay the implementation of Pillar One: Profit Allocation and Nexus, the United Kingdom has a contrary stance with its firm commitment to repeal the DST measures implemented by the HMRC.[325] This intention aligns with the OECD reform and emphasizes its dedication to a global collaborative approach in addressing tax challenges posed by digitalization.

The United Kingdom's implementation of its DST was met with substantial international resistance, particularly from the United States.[326] The US Government perceived

Notes

[323] Kgomotso Mponwana & Jane Ndlovu, 2023.

[324] National Audit Office, *supra* n. 35.

[325] *Ibid.*

[326] Gough, *supra* n. 298.

it as a unilateral measure specifically targeting American MNEs and criticized the policy as discriminatory and unjust towards US companies.[327] Consequently, the country threatened retaliatory actions to shield its businesses from what it deemed as discriminatory practices and cautioned that any European country implementing a DST could face similar repercussions.[328]

Following the United Kingdom's implementation of the DST, the United States warned of imposing a 25% tariff on British exports thereby potentially amassing approximately USD 325 million. This sum was roughly equivalent to the UK's projected collection from its DST.[329] Such a move threatened to instigate economic tension between both countries and illustrated the challenges inherent in balancing the interests of different nations while implementing international tax policies.

The United Kingdom maintained that its DST measures were fair and justified and argued that US-based MNEs should contribute their fair share in taxes.[330] Despite these points of contention, the two countries managed to reach a provisional agreement pending the implementation of the OECD's Pillar One: Profit Allocation and Nexus solution. Similar agreements were established between the United States and other countries, including Austria, France, Italy, and Spain.[331]

This consensus permitted the United Kingdom to maintain its DST measures while also stipulating provisions for US MNEs liable to pay taxes there to receive future tax credits. Consequently, the United States rescinded its proposed tariffs[332] which represented a significant milestone in international tax diplomacy and a testament to the importance of negotiation and compromise in resolving global taxation disputes.

The UK Government has unequivocally expressed its commitment to adopting multilateral measures to address the tax challenges posed by the digital economy with its intention to rescind the DST upon successful implementation of the OECD's Pillar One: Profit Allocation and Nexus.[333] However, this provisional agreement between the United Kingdom and the United States is limited to the year 2023 which raises questions about what course of action might be taken if the implementation of Pillar One is further delayed or does not come to fruition.[334]

In such an event, it is anticipated that many jurisdictions would opt for unilateral measures to safeguard their tax bases and revenues generated within their borders and consequently potentially incite another round of retaliatory measures from the United States.[335] Similarly, the EU has signalled that it would be compelled to propose its own taxation solution for digital MNEs should adequate progress on Pillar One not be achieved by the end of June 2023.[336]

Consequently, while the temporary agreement between the United Kingdom and the United States has provided a reprieve in the DST dispute, a substantial risk remains of renewed conflicts if the enactment of Pillar One is either further postponed or fails entirely.

It is worth noting that the repeal of UK DST as part of the broader reforms announced by G7 ministers will have a noteworthy impact especially for major players like Facebook and eBay.[337] Both companies attribute a significant portion, if not all, of their fees through a UK entity which makes the DST an allowable expense.[338] This deduction would result in a discount against their corporation tax liability.[339] For companies subject to it, the proposed Pillar One reforms would substantially reduce the tax revenue generated in the United Kingdom.[340] Despite the G7 communiqué strongly suggesting the DST's removal, the consequential reforms project a net loss of tax in there from major players like eBay, Amazon, Google, and Facebook potentially totalling GBP 232.5 million less in tax based on their 2019 revenues.[341]

17 Conclusion

In conclusion, both Kenya and the United Kingdom have effectively implemented DST measures at rates of 1.5%

Notes

[327] *Ibid.*

[328] *Ibid.*

[329] P. Inman, *US Threatens Tariffs on UK Exports Over Digital Services Tax*, The Guardian (2021), https://www.theguardian.com/business/2021/mar/29/us-threatens-tariffs-on-uk-exports-over-digital-services-tax, (accessed 7 Dec. 2023).

[330] *Ibid.*

[331] González, *supra* n. 46.

[332] Gough, *supra* n. 298.

[333] Vázquez, *supra* n. 151.

[334] Gough, *supra* n. 298.

[335] Vázquez, *supra* n. 151.

[336] *Ibid.*

[337] *See* Will Facebook, Google, eBay and Amazon pay more in UK tax under the new global tax deal?by Alex Dunnagan 8 Jul. 2021.

[338] *See ibid.*

[339] *See ibid.*

[340] *See ibid.*

[341] *See ibid.*

and 2%, respectively, which has resulted in higher tax revenues than initially projected. These two nations introduced the DSTs as a provisional measure to address the taxation of digital services, albeit attracting potential retaliation from the United States. The latter argued that these measures were discriminatory as they primarily target American tech giants while the United Kingdom countered that these companies generate substantial value within the country and should pay their fair share of taxes. Eventually, a compromise was reached. The United States agreed to refrain from imposing tariffs that would generate an amount equivalent to the revenue expected from the UK's DST contingent upon the United Kingdom's commitment to repeal its DST upon the implementation of the OECD's Pillar One solution. This agreement illustrates the complex and evolving milieu of international tax policy in the digital age. Table 1 summarizes the comparison of the DST's implementation in Kenya and the United Kingdom.

Table 1 A Comparison of Implementation of DST in Kenya and the UK

Area of Discussion	*Kenya*	*UK*
DST implementation date	1 January 2021	1 April 2020
DST Tax rate	1.5%	2%
DST activities	Services resulting from digital marketplace through electronic means	Services on social media, search engines, or digital marketplace
Tax revenue collected in the first year of implementing DST	KES 241 million (USD 1.75 million)	GBP 358 million (USD 444.73million)
Threshold	N/A	Annual global revenue of more than GBP 500 million of which more than GBP 25 million is attributed to sales in the United Kingdom.
Challenges	– unfair DST rules as already impose VAT on exports – administrative burden due to ambiguous rules – no threshold (disadvantages start-upsbecause every user is liable to the DST) – double taxation due to implementation of VAT and the DST – no measure enforcing compliance – potentially not cost effective	– compliance – potential tax avoidance and evasion – potential of lack of awareness
Targeted companies	178 companies	No exact number. 90% revenue collected from five groups
Repeal of DST	Willing to repeal the DST and align to Amount A	Willing to repeal the DST and align to Amount A

In their inaugural year of implementing the DST, the United Kingdom collected an estimated USD 445 million and Kenya approximately USD 1.75 million. While the United Kingdom's rules are comprehensive and offer clear guidance to taxpayers, Kenya's approach appears to be insufficient. Despite it identifying and rectifying some of these issues by amending definitions related to the digital marketplace and the GTV, it has yet to address all concerns associated with DST regulations.

The allocation method of the GTV for services offered to users located in or outside of Kenya remains unclear. Moreover, the country currently lacks a revenue threshold for DST liability which is unlike the United Kingdom where MNEs are liable for the DST only when their annual global revenue exceeds GBP 500 million.[342] The absence of such a threshold in Kenya disadvantages start-ups as every user is subject to it. Consequently, to ensure fair and equitable application of DST, it is recommended that Kenya consider establishing a DST revenue threshold. It should be set high

Notes

[342] National Audit Office, *supra* n. 35.

enough to make fiscal sense and avoid undue burdens on start-ups and small businesses.

While the United Kingdom has confronted compliance-related challenges in the wake of the DST's introduction, an issue understandable given its novelty and the necessary adaptation period for jurisdictions, Kenya faces a broader set of problems. These range from unclear rules to potential breaches of the OECD VAT regulations due to the proposed taxation of exports. Despite the United Kingdom's effective implementation and collection of its DST, it is prepared to repeal the measure in favour of adopting the OECD's proposed Amount A when the global organization is ready to proceed with its implementation. Kenya, after over a year of resistance to adopting Amount A, is also now considering this thorough deliberations.

President William Ruto of Kenya recently agreed to dismantle DST measures and to implement Amount A; this signals a significant policy shift. This change indicates a recognition that implementing a DST in a developing economy presents many challenges and can incur substantial costs thereby making it less efficient than initially projected. The Amount A initiative seeks to institute rules that ensure fairness across all tax regimes and effectively distribute tax rights. However, its introduction is currently delayed due to certain jurisdictions' difficulties in achieving consensus on removing existing unilateral measures. These delays might provoke further retaliation from the United States considering the agreement signed between it and the United Kingdom. Thus, both Kenya and the United Kingdom find themselves in a holding pattern awaiting the implementation of Amount A.

18 RECOMMENDATIONS

The implementation of a DST in Kenya and the United Kingdom demonstrates varying successes and challenges in adapting to the digitalization of the global economy. Despite initial successes in generating revenue, both nations have faced significant hurdles from compliance issues to international disagreements. Proceeding forward, the focus should be on clarity, fair thresholds, and improved compliance measures. Moreover, both countries' readiness to align with the OECD's Amount A proposal reflects the growing global commitment towards creating a fair and inclusive international tax system. As its implementation continues to unfold, countries will need to carefully manage this transition and learn from the lessons of the DST and also strive for a global tax framework that effectively captures the digital economy's dynamism. Some considerations for nations that hope to implement a DST are presented below.

18.1 *Clarity of Regulations*

Developing nations, such as Kenya, should ensure clarity and comprehensiveness in their digital tax regulations. Definitions and terms, such as 'digital marketplace' or 'gross transaction value', should be explicitly defined to avoid confusion and enhance tax compliance.

18.2 *Implementation of Thresholds*

Countries like Kenya should consider implementing revenue thresholds for applying DSTs. This approach would protect start-ups and small businesses thereby encouraging innovation and economic growth.

18.3 *Compliance Measures*

Both developed and developing nations should strengthen compliance measures for their digital tax regimes. This could include improving methods of communication with non-resident businesses, enhancing enforcement mechanisms, and providing clear, accessible guidelines on tax obligations.

18.4 *Collaboration With International Community*

Countries should remain amenable to collaboration with the international community in crafting tax policies. Aligning with the OECD's global tax reform plans ensures a fair and equitable tax system and mitigates the risk of international disputes.