Challenges of Value Added Tax on International E-Commerce in Electronic Goods and Services in Kenya

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Abstract
The current study was on the effectiveness challenges of value added tax on international e-commerce in electronic goods and services in Kenya. The study adopted a descriptive research design. The target population was 199 KRA VAT officers. The sample size was 50 officers. Primary data were used in this study. For primary data, the data collection instrument used in this study was questionnaires. These questionnaires were used to collect data from the taxation authority officials dealing with VAT. The questionnaires were administered via e-mail surveys and personal visits to respondents, that is the KRA VAT officers. The research findings revealed that the major challenges against an effective VAT system for international e-commerce in electronic goods and services in Kenya included the lack of attention to e-commerce as a unique industry in the VAT Act and the lack of unique policies to regulate the sector. From questions posed to the KRA VAT officers, it emerged that there was a lack of proper and adequate resources, and their usage, within the taxation authority to monitor the industry. The website owners commonly complained of the lack of proper infrastructure that hindered the growth of the industry, for example, the lack of a proper banking and financial infrastructure. it is recommended that the taxation authority (KRA) should make its internal administration processes and policies more efficient and grow with the technology as it grows, for example, through providing e-services to taxpayers to start with. The industry must be regulated through proper policies and legislation before KRA can contemplate properly obtaining the rightful tax from it. There is need to address e-commerce as a unique medium of transactions, demanding its own tax legislation. KRA should solicit the cooperation of stakeholders to regulate the industry, for example, Internet Service Providers could bill their clients on behalf of KRA through a withholding tax. Similarly, banking institutions could withhold value added tax, if need be, on financial transfers for electronic transactions carried out online. There is scarcity of information about the effectiveness challenges of Value Added Tax on International E-Commerce in Electronic Goods and Services in Kenya and in developing economies in general and this paper expands the existing knowledge base. Therefore, the unique contribution of the study has been to bring to light what is unknown about the effectiveness challenges of Value Added Tax on International E-Commerce in Electronic Goods and Services in Kenya.
Keywords: Effectiveness Value Added Tax, International Ecommerce, Electronic Goods and Services

1. Introduction

According to international trade policy, free trade is known to maximize world output and benefit nations. However, practically all nations impose some restrictions on the free flow of international trade. These may be known as trade or commercial policies, and may involve import tariffs or export tariffs (Wheelen & Hunger, 2012).

Some of the VAT issues that international e-commerce raises include tax administration problems posed by e-commerce. A tax invoice is a primary instrument of a transaction that is liable to VAT. According to Rosenberg (2008), e-commerce brings with it a paperless environment, hence, many traders may not be issuing paper invoices and transactions may not be easily traceable. No audit trail is left, and compliance checking and monitoring of transactions are made too complex for a taxation authority to handle.

Besides this, whether or not tax is imposed, the collection of tax from private consumers or unregistered entities may be difficult, if not impossible. According to Rosenberg (2008), currently small in volume, this category potentially poses the most significant challenge to the VAT system in an electronic commerce environment. Because of these developments, many tax administrators have determined that certain aspects of the existing income and consumption tax regimes require review. Some reports suggest how technology can be used to address the challenges of taxation of e-commerce. Suggestions by different authors include the use of software and database technology to track tax rates by jurisdiction, authentication techniques, electronic audit logs, and use of encryption and authentication tools to prevent buyers and sellers from denying that they engaged in a transaction (Rosenberg (2008).

According to Hanefah, Hassan & Othman (2008), another problem that an international e-commerce raises on VAT is that of nexus and inconsistent taxation systems across borders. A firm may conduct business extensively in another country, and yet, not have a physical presence there. This makes it unclear whether the business has a permanent establishment there, and what its tax obligations are. For example, is it required to register as a VAT agent for the host country government or home country government? In e-commerce, business transactions may

not be bound by the same legal codes and regulatory procedures and legal frameworks have to be changed. The complexity of ecommerce and e-service in any one country is intimidating: when considering an international setting, the number and complexity of concerns becomes quite daunting (Hanefah, Hassan & Othman, 2008). Customs, taxation, and electronic payment systems are financial issues of concern. An additional issue is the efficient administration of policies in these areas when services are delivered electronically across borders.
According to Emenyi (2013), many companies that have long thought of their problems, opportunities and ambitions in purely domestic terms now find themselves having to look at their relationship to a world environment. Taxation as one of the financial forces that influence international business.

2. Objective

The objective of the study was to establish the challenges against an effective vat system for international ecommerce in electronic goods and services.

3. Literature Review

According to Emenyi (2013), the challenges posed by electronic commerce for taxation have been well documented by the OECD. Like direct taxes, the administration of indirect taxes presupposes that tax authorities are able to identify transactions when they take place, identify the parties involved in the transaction and their physical location, and, if necessary, follow a ‘paper trail’ in order to audit these transactions - all of which are conditions that e-commerce calls into question (Paris, 2003).
According to an OECD report (OECD, 2004), illustrative business models with a high degree of inherent risk by virtue of their respective business model and legal environment include sales on auction and bartering websites which is known as the ‘shadow’ or ‘underground’ economy such as gambling and adult entertainment (many of whose websites are located or are supposed to be located in tax haven jurisdictions). Therefore, causes of non-registration or of not reporting taxable events in such industries by themselves present a challenge to tax administrators from both a policy and enforcement perspective.
In Kenya, steps are being taken to address the problem by various non-governmental organizations that seek to formulate a policy to expound on the opportunities and threats posed by e-commerce to taxation. For example, plans are underway to adapt the United Nations Commission on International Trade Law (UNCITRAL) model law (Kiiru, 2002). According to this law, e-commerce activities would enjoy a near tax-free status. According to Teltscher, Barayre and Assaf (2006), the East African Community (EAC) Secretariat has also been working to develop a harmonized, integrated and coordinated e-Government Strategy since 2004 with the support of the Canadian e-Policy Resource Centre (CePRC). The creation of an enabling legal and regulatory environment has been identified in the regional e-government framework as a critical enabling factor for effective implementation of e-Government strategies at national and regional levels.

4. Methodology

The study adopted a descriptive research design. Out of the 199 KRA VAT officers identified as the population in this study, approximately 70% are located in the KRA headquarters, giving a total sampling frame size of 139. Only officers at the KRA headquarters were approached as this area was in close proximity to the researcher. A pilot study carried out on 20 officers at KRA headquarters revealed that approximately 10 were in audit programs, that is 50%.Therefore the minimum sample size of 50 officers to be interviewed was derived using the following formula (Saunders et al., 2003).
Primary data was used in this study. For primary data, the data collection instrument used in this study was questionnaires. These questionnaires were used to collect data from the taxation authority officials dealing with VAT. The questionnaires were administered via e-mail surveys and personal visits to respondents, that is, KRA VAT officers. The content and layout of the questionnaires for this study contained a mix of questions allowing both open-ended and specific responses to a broad range of questions. The statistical software, SPSS was used to analyze the quantitative data and results were presented in graphs, charts, and tables so as to provide a clear picture of the research findings.

5. Results and Discussion

When website owners were asked their opinion on whether VAT tax policy and administration affects the growth of international e-commerce and consequently their business, 45.8% said yes while 54.2% said no. For those that answered yes, they were asked what the specific tax related impediments were to the expansion of international e-commerce and their website in particular.
Officers were asked if they were aware of any loopholes in the VAT Act with regard to e-commerce. The majority said no (62%), while 36% said yes.
Officers felt that the VAT Act primarily lacked comprehensive guidelines about e-commerce as no provision directly relates to e-commerce either on operation of VAT or control of organizations operating under e-

commerce. For example, it does not give guidelines on Electronic Funds Transfer (EFT) and online services that are not classified (such as professional and management services). Officers also said that they are not empowered to detect e-commerce transactions and identify online traders.

When officers were asked whether tax is collected on electronic goods and services from private/unregistered entities such as individual importers, 64% said yes, 18% said no, while 18% were not sure. The officers were asked if they had access to the internet at their office. Their response is summarized in as follows:

Table1: Internet Access Enjoyed by Officers in Office

	Frequency	Percent (%)
Unlimited	18	36
Limited	28	56
None	2	4
Other	2	4
Total	50	100

The majority of the officers (56%) reported having limited access to the internet at their office. This was followed by those reporting that they had unlimited internet access at their office (36%). Four percent of the respondents said that though internet services were unlimited, the resources (computers) to access the same were few and shared.

When asked how often the officers used the internet in line with their duties as revenue officers, they responded as shown in Table 2 as follows:

Table2: Internet Used in Line of Duties as Officers

	Frequency	Percent (%)
Daily	6	12
Weekly	11	22
Never	20	40
Other	13	26
Total	50	100

The majority of the officers reported that they never used the internet in line with their duties as revenue officers (40%). This was followed by those that used it weekly (22%) and daily (12%). Twenty-six percent responded ‘other’, which included responses such as ‘rarely’ and ‘occasionally’.

Those respondents that did use the internet in line with their duties were asked what purpose they used the internet for as revenue officers. A commonly mentioned response was inquiry on tax institutions and revenue laws all over the world and comparison of the Kenyan tax system to the practice and rulings in other countries. The officers also mentioned using the internet for market information, industry knowledge and research taxpayers’ background. They reported using the KRA website for notices and publications, information on revenue collection at KRA and so on. Officers also used the internet for correspondence with taxpayers through email.

Respondents were asked if they had the right software/audit tools to track paperless transactions. Sixteen percent said yes while 78% said no. They were further asked if they were aware of any computer-aided audit techniques; here, 66% said yes while 28% said no. The officers that said yes to the latter were asked to state the computer aided tools and techniques they were aware of. Sixteen officers (32%) were aware of the Audit Command Language (ACL). According to Wikipedia (2005) (www.wikipedia.com), the ACL software can reach data from virtually most sources and systems, through a consistent user interface giving audit, financial, and controls professionals immediate insight into the transactional data underlying their business processes and financial reporting.

Officers were then asked if they had used any computer-aided audit techniques in the process of their work. The majority (68%) said no, while 32% said yes.

The KRA VAT officers were given a choice of factors and asked which ones they thought acted as impediments of e-commerce on VAT assessment, audit, payment and collection of tax. The required response ranged from a scale of ‘strongly agree’ to ‘strongly disagree’. Their responses are summarized in Table3 and Figure 1 as follows.

Table 3: KRA VAT Officers' Opinion on Impediments of E-commerce on VAT Tax Administration

	Strongly Agree (%)	Somewhat Agree (%)	Neutral (%)	Somewhat Disagree (%)	Strongly Disagree (%)	Missing (%)	Total
How to identify taxpayers engaged in e-commerce	52	24	14	6	2	2	100
How to determine taxpayers taxing jurisdiction	52	28	12	4	2	2	100
Products - identify electronic vs. physical products	38	30	20	8	2	2	100
Increased control risks	50	18	20	2	2	8	100
Lack of audit trails	56	22	14	2	2	4	100
Incompleteness of records	46	32	16	4	0	2	100
Lack of system controls	56	28	10	4	0	2	100
Payment system - monetary movements, e-cash	48	26	16	8	0	2	100

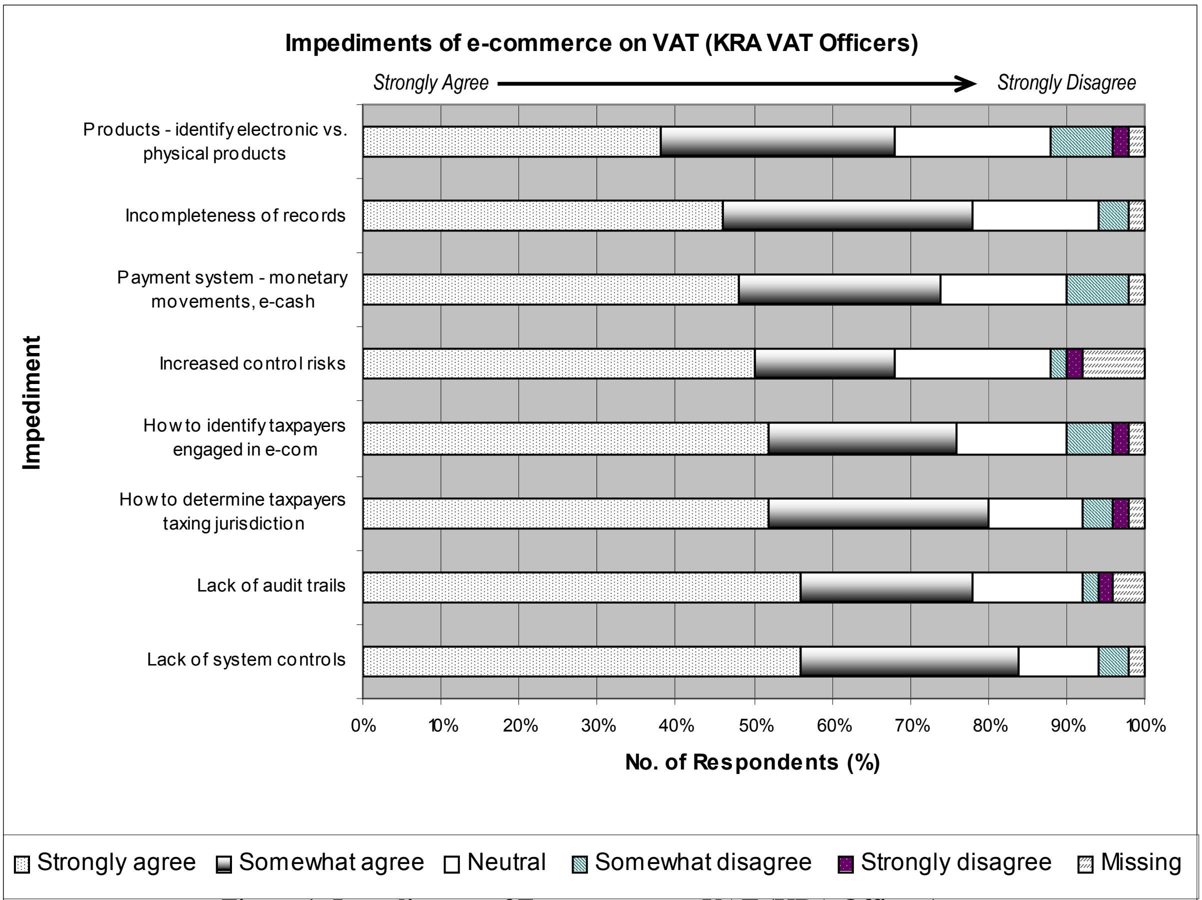

Figure 1: Impediments of E-commerce on VAT (KRA Officers)

From the above table and figure it can be seen that the greatest impediment of e-commerce on VAT, according to the respondents was lack of system controls and lack of audit trails at 56% each, followed by how to determine taxpayers' jurisdiction (52%), and thereafter, how to identify taxpayers engaged in e-commerce. On aggregate (strongly and somewhat agreed), the highest impediment that the KRA VAT officers cited was the lack of system controls (at 84%). Of the choices they were given, the data was highly skewed towards agreeing.

6. Conclusions

The research findings revealed that the major challenges against an effective VAT system for international e-commerce in electronic goods and services in Kenya included the lack of attention to e-commerce as a unique industry in the VAT Act and the lack of unique policies to regulate the sector. From questions posed to the KRA

VAT officers, it emerged that there was a lack of proper and adequate resources, and their usage, within the taxation authority to monitor the industry. The website owners commonly complained of the lack of proper infrastructure that hindered the growth of the industry, for example, the lack of a proper banking and financial infrastructure.

7. Recommendations

One of the major challenges facing the e-commerce sector in Kenya is that no major guidelines exist as yet to regulate the e-commerce industry in Kenya. Also lacking is proper infrastructure to support, tax, and regulate the industry. Therefore, it is recommended that the taxation authority (KRA) should make its internal administration processes and policies more efficient and grow with the technology as it grows, for example, through providing e-services to taxpayers to start with.

The industry must be regulated through proper policies and legislation before KRA can contemplate properly obtaining the rightful tax from it. There is need to address e-commerce as a unique medium of transactions, demanding its own tax legislation. KRA should solicit the cooperation of stakeholders to regulate the industry, for example, Internet Service Providers could bill their clients on behalf of KRA through a withholding tax. Similarly, banking institutions could withhold value added tax, if need be, on financial transfers for electronic transactions carried out online.

8. Recommendations for Further Studies

The study was not exhaustive in identifying the challenges facing the effectiveness of taxing electronic goods and services. Therefore, a factor analysis study is recommended. In addition, a comparative study across East Africa should be conducted and this will show whether the challenges are unique to Kenya only or they also affect other East Africa companies. It may also be important to carry a desk study review on best practices on taxing electronic goods and services from developed economies.

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