

Compliance Nexus and Conflict between e-Commerce and Value Added Tax in Kenya

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Abstract
The current study was to establish the level of e-commerce and level of vat compliance with respect to international e-commerce in electronic goods and services. The study adopted a descriptive research design. The population of this study was 199 VAT officials of the Kenya Revenue Authority (KRA) that deal in VAT audit and a total of twenty e-businesses found to be operating in Kenya through a preliminary survey. Ten more e-businesses were identified through the snow-balling method. The sample size in this study was 30 e-businesses and 50 VAT officers. Both secondary data and primary data were used in this study. For primary data, the data collection instrument used in this study was questionnaires. As seen from the results, the average number of business processes supported online for the 24 e-businesses was 4.83 out of 12. Apart from this there was a significant level of online activity carried out by the businesses, for example, online payment mechanisms and electronic methods of keeping records were used by many e-businesses. Most e-businesses carried out a minimal level of international trade. From these results, it can be concluded that the existing e-businesses in Kenya do carry out a significant level of electronic activity locally, and a minimal level of international trade. However, VAT compliance may be poor, as both the tax authority and website owners did not understand well the value added tax implications of electronic trade.There was a significant level of e-commerce in Kenya carried out locally, and a minimal level of international e-commerce. This sheds doubt on the level of tax compliance in the industry. It is therefore recommended that KRA carry out appropriate research on the level of e-trade in Kenya and tax implications of the same. Relevant stakeholders should be involved in such consultation and research, for example, it is recommended that banks and financial institutions dealing with money transfers for e-transactions should provide statistics on the level of international e-commerce in Kenya to determine the seriousness of the trade. This information would enable KRA to determine the tax implications of such transactions and accord appropriate resources to monitor the industry. The unique contribution of this study is the closure of a previously identified research gap and the discovery that poor VAT compliance for Ecommerce businesses, is caused by both tax man and Ecommerce business owners, as both the tax authority and website owners did not understand well the value added tax implications of electronic trade.
Keywords:E commerce, Vat Compliance, Electronic Goods and Services

1. Introduction

Today, electronic commerce (e-commerce) has aided much in international expansion, through the global network of the internet. According to McLoughlin (2002), the convergence of computer and telecommunications technologies has revolutionized how we get, store, retrieve, and share information. Commercial transactions on the internet have grown substantially since the mid-1990s. E-commerce as a facilitator and means to international trade is a global phenomenon and has affected developing countries as much as developed ones.

E-commerce can take many forms depending on the degree of digitization of the product (service) sold, the process and the delivery agent (or intermediary), of which, each can be physical or digital (Turban, King, Lee, Warkentin and Chung, 2002). According to Ali (2003), the mechanics of e-commerce are somewhat at odds with VAT principles. While the internet market is global in its reach and is characterized by interoperability, VAT laws are based on territorial concept and have strong jurisdictional geographic boundaries.

E-commerce as a new kind of business has made the distinction between goods and services hazy. According to Javalgi, Martin and Todd (2004), products that have traditionally been delivered as goods and services can now be sent across borders in a digital form, for example, games and printed material, consulting and entertainment services and so on. International electronic delivery has been made possible by information and communication technologies (ICT).

It is unquestionable that developments in e-commerce and new business models have allowed all kinds of businesses to change their trading practices in ways that were unimaginable when tax rules were developed for traditional business models. Almost any goods that can be digitized can be bought, sold, and distributed quickly and inexpensively through the internet to consumers worldwide (Horn, 2003).

Therefore, 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 Cockfield (2001), 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.

2. Objective

The objective of the study was to establish the level of e-commerce and level of VAT compliance with respect to international e-commerce in electronic goods and services.

3. Literature Review

According to Salman (2004), much light is being thrown on macroeconomic aspects and emergent issues like legal, regulation, and taxation of e-commerce in developing countries, through international organizations such as United Nations Conference on Trade and Development (UNCTAD), United Nations Development Program (UNDP), Development Gateway of World Bank Group and the World Trade Organization (WTO). These organizations help governments of developing countries by raising awareness about ecommerce, providing policy, consultancy on technology transfer and know-how and infrastructural support.
According to Lau and Halkyard (2003) e-commerce is a major concern for international agencies and tax authorities worldwide. According to Ali (2003), countries like Australia, Canada, China, Colombia, Japan and Singapore have made serious attempts at extending the VAT laws to e-commerce. Majority of the countries have taken the EU VAT as a model, whereby the consumption tax treatment of supplies from nonresident suppliers to domestic recipients is generally the same in the EU and other jurisdictions with a VAT system. Tax is imposed on domestic consumption. Supplies of services or intangible property to domestic businesses that are registered for VAT or GST purposes are subject to the reverse charge rule (as is the case with Australia and Canada) or indirectly taxed when the recipients make taxable supplies. Supplies of services or intangible property to private consumers may or may not be subject to tax (taxable in Canada and Colombia and not taxable in Australia) (Ali, 2003).

4. Methodology

The study adopted a descriptive research design. The population of this study was 199 VAT officials of the Kenya Revenue Authority (KRA) that deal in VAT audit and a total of twenty e-businesses found to be operating in Kenya through a preliminary survey. Ten more e-businesses were identified through the snow-balling method. The sample size in this study was 30 e-businesses and 50 VAT officers.
Both secondary data and primary data were used in this study. Depending on availability, secondary data was sourced from relevant authorities such as the KenyaRevenue Authority, which was approached to provide information on any studies that the Research and Corporate Planning Department at KRA may have undertaken with regard to international e-commerce and VAT compliance in Kenya. For primary data, the data collection instrument used in this study was questionnaires.
These questionnaires were used to collect data from e-businesses and the taxation authority officials dealing with VAT. The questionnaires were administered via e-mail surveys and personal visits to respondents, that is, managers of e-businesses and 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

A total of thirty-seven e-businesses were identified for interviews. Feedback was obtained from the following categories of e-businesses, as shown in Table 1:

Table 1: Feedback Obtained by Category of Business

Type of Website Number Interviewed	**Number Interviewed**
Internet Service Provision	2
Jobs database	3
Publishing	3
Sms commerce	2
Online stores	4
Classifieds	3
Physical companies (both retailing and services with online presence)	3
Dating sites	2
Music online	1
Internet based B2B (business to business) Commerce	1
Total	**24**
No response	6
Others that did not qualify	
Not for Profit online organizations 3	3
Sites abroad, with Kenyan base 4	4
Total	37

Level of E-Commerce With Respect To International E-Commerce in Electronic Goods and Services

The website owners interviewed were asked how they identified the location of their buyers in supplying digital electronic goods and services. There was a response to this question from 19 (79.17%) of the e-businesses interviewed.

For 37.5% e-businesses, the way of identifying clients was online. These included online forms, online orders and registering on their website and so on. Nine respondents (37.5%) mentioned only physical ways of identifying their clients, for example, through contract documents, data collection forms, direct sales forms, and so on.

The respondents were asked what their main payment mechanism was. There were 19 (79.17%) responses to this question. Eleven businesses (45.83%) said that their clients used online mechanisms to pay them, these including cell phone airtime sent by users to their mobile phone number and credit card guarantee; 33.33% said that their clients used only offline methods to pay them, these including cash, cheque and money transfers.

The e-businesses interviewed cited online methods that they used to pay, including credit card guarantee (only 20.83% used these). On the other hand, the majority, 58.33% said that they used only offline methods to pay others. These included cash, cheque and money transfers.

The website owners were asked what their main receipting mechanisms, and record keeping mechanisms were. The response has been summarized in the table below:

Table 2: Receipting Mechanism and Record Keeping Mechanism

	Receipting Mechanism Includes Paper Methods		**Receipting Mechanism Includes Online Methods**		**Record Keeping Mechanism Includes Paper Methods**		**Record Keeping Mechanism Includes Electronic Methods**	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Yes	18	75	12	50	23	95.8	22	91.7
no	6	25	12	50	1	4.2	2	8.3
Total	24	100	24	100	24	100	24	100

Fifty percent of the respondents used online receipting mechanisms while 50% did not. Most of the businesses had electronic methods of keeping records, at 91.7%, as well as paper methods at 95.8%. This suggests that the electronic record keeping methods were complemented by paper methods.

The website owners were asked which commerce processes they supported online in their business. A count of the number of commerce processes supported by businesses is given in the table as follows:

Table 3: Number of Commerce Processes Supported Online

Number of Commerce Processes Supported Online	Frequency	Percent
1	1	4.2
3	5	20.8
4	6	25
5	3	12.5
6	5	20.8
7	3	12.5
10	1	4.2
Total	24	100

Twenty-five percent of the businesses supported commerce processes online. The number of commerce processes supported at most by any business was four. The average number of business processes supported online for the 24 e-businesses was 4.83.

The business processes that businesses ticked against as applying to them or not are depicted in the table below:

Table 4: Online Business Processes

Search (buyers and sellers locating each other online)	Logistics: support for online logistics for physical products
Valuation (process of price discovery and negotiation)	Logistics: Support for offline logistics for physical products
Authentication of website	Logistics: Support for digital products logistics
Authentication of product quality	Customization and personalization of customer services
'Other' processes. 'Other' processes mentioned by businesses included statistics and information logs available online	Authentication of buyer
Payment: online payment support	Payment: offline payment support

Websites owners were also asked how business inputs were procured and business outputs marketed. The response is given in the following table:

Table 5: Method of Procuring Business Inputs

	Direct Sales		Sales Agents		Online Sales		Other	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Yes	22	91.7	9	37.5	14	58.3	2	8.3
No	2	8.3	15	62.5	10	41.7	22	91.7
Total	24	100	24	100	24	100	24	100

The highest number of respondents using direct sales to procure inputs was 91.7%, followed by online sales at 58.3%.

The way in which business outputs were marketed is shown in the table below:

Table 6: Method of Marketing Business Outputs

	Direct Sales		Sales Agents		Online Sales		Other	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Yes	20	83.3	16	66.7	18	75	1	4.2
No	4	16.7	8	33.3	6	25	23	95.8
Total	24	100	24	100	24	100	24	100

The highest number of respondents using direct sales to market outputs was 83.3%, followed by online sales at 75%.

Level of VAT Compliance With Respect to International E-Commerce In Electronic Goods and Services

Respondents were asked whether they were registered with the KRA, in terms of Income Tax, and VAT. The responses are given below:

Table 7: Registration Status with KRA

	Income Tax		**VAT**	
	Frequency	Percent	Frequency	Percent
Yes	20	83.3	17	70.8
No	4	16.7	6	25
Missing	0	0	1	4.2
Total	24	100	24	100

The majority of the e-businesses reported that they were registered, at 83.3% for Income Tax and 70.83% for

VAT.

Respondents were asked to give reasons why they may not be registered for Income Tax or VAT. Reasons cited for this included the minimum threshold not being met, as required of a business to register as a VAT agent by KRA and the business being too small and new to be able to register for VAT or income tax due to low sales and profits.

When asked if the e-businesses had made any tax return to KRA in the past 3 years, website owners responded as shown in the following table:

Table 8: Tax Return Made in the Past Three Years

	Income Tax		**VAT**	
	Frequency	Percent	Frequency	Percent
Yes	22	91.7	18	75
No	2	8.3	5	20.8
Missing	0	0	1	4.2
Total	24	100	24	100

The majority of the e-businesses reported that they had made tax returns in the past three years, at 91.7% for income tax and 75% for VAT.

Website owners were also asked if they had been visited or audited by an Officer from the Kenya Revenue Authority (KRA) in the past 3 years. Their responses are summarized as follows:

Table 9: Visited (and/or audited) by KRA in the Past Three Years

	Income Tax		**VAT**	
	Frequency	Percent	Frequency	Percent
Yes	14	58.3	12	50
No	8	33.3	9	37.5
Missing	2	8.3	3	12.5
Total	24	100	24	100

Not all of the e-businesses reported to have been visited or audited. While 58.3% of the businesses had been visited by KRA for income tax, and 50% had been visited for VAT, 33.3% had not been visited for income tax and 37.5% had not been visited for VAT.

E-businesses were asked whether they were required to remit VAT to any other country than Kenya for their exports of digital products, and if they were required to remit VAT for their imports of digital products. Their responses are shown in the table 10 as follows.

Table 10: Obligation to Remit VAT to Any Other Country than Kenya

	Of Exports		**Of Imports**	
	Frequency	Percent (%)	Frequency	Percent (%)
Yes	1	4.2	5	20.8
No	10	41.7	8	33.3
Not sure	0	0	2	8.3
Missing	2	8.3	3	12.5
Does not apply	11	45.8	6	25
Total	24	100	24	100

Of the respondents that did export digital products, only one respondent affirmed having an obligation to remit VAT to any country other than Kenya, saying that at times, they did, to the UK and USA. The rest said no, or that it did not apply to their business. When asked whether they remitted VAT for imports within Kenya, only 20.8% said yes.

6. Conclusions

As seen from the results, the average number of business processes supported online for the 24 e-businesses was 4.83 out of 12. Apart from this there was a significant level of online activity carried out by the businesses, for example, online payment mechanisms and electronic methods of keeping records were used by many e-businesses. Most e-businesses carried out a minimal level of international trade. However, many e-businesses and KRA VAT officers were not sure whether there was a requirement to remit VAT for some electronic products being transacted for both exporting and importing. Besides this, only 10% of the KRA VAT officers interviewed appeared to have audited an e-commerce case in the past three years. From these results, it can be concluded that the existing e-businesses in Kenya do carry out a significant level of electronic activity locally, and a minimal level of international trade. However, VAT compliance may be poor, as both the tax authority and website owners did not understand well the value added tax implications of electronic trade.

7. Recommendations

It recommended that KRA carry out appropriate research on the level of e-trade in Kenya and tax implications of the same. Relevant stakeholders should be involved in such consultation and research, for example, it is recommended that banks and financial institutions dealing with money transfers for e-transactions should provide statistics on the level of international e-commerce in Kenya to determine the seriousness of the trade. This information would enable KRA to determine the tax implications of such transactions and accord appropriate resources to monitor the industry.

8. Recommendations for Further Studies

It is recommended that more research be carried out on the statistics of imports and exports by private/unregistered entities, for a clearer picture on the potential revenue lost from many small individuals that goes unnoticed. Overall volumes of e-commerce trade should also be studied to determine whether they pose a significant revenue risk to the government.

However, it is recommended that e-commerce should be studied in a unique way, and any possibility of bringing it into the taxation legislation should be carefully weighed against allowing it to grow, being an infant industry.

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