

# Sagamore Hill.

# TAX NEWSLETTER.



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In this issue, we will look into the taxation in digital space by highlighting the recent court judgement that touched on digital platforms. The case was at the high court level and involved an appeal by Kenya Revenue Authority against a Tax Appeal Judgement where the commissioner had assessed Sendy limited, a digital marketplace platform provider connecting third party transporters to third party customers requiring transportation delivery services for the third parties' goods.

At the tribunal level, the decision was that, the Respondent was not a provider of transport services but a platform provider. It made a finding of fact that the actual **taxable supply of transport was made by the third-party transporters to the end customers**. The Tribunal reasoned that under section 5(1) of the VAT Act, the obligation to account for VAT lies with the person making the supply. In this transactional structure, the third-party transporter was the supplier of transport services, while the Respondent was the supplier of a platform service to the transporter. The Tribunal noted that the Respondent was an asset-light company that did not own any of the vehicles used for the deliveries, a fact that buttressed its finding that the Respondent was not engaged in the transport business itself. The Tribunal consequently allowed the appeal and set aside the Objection Decision in its entirety.

KRA submission was premised on the following grounds of appeal.

That the tribunal failed to look into the economic and commercial reality of the transactions facilitated by the tribunal.

KRA further argued that the Sendy was the principal supplier of the transport services. In the determination of the extent of control, various issues were highlighted by KRA to determine the level of control. These are;

1. Sendy controls the customer relationship through its digital application,
2. dispatches the nearest available driver,
3. determines the price, issues the demand for payment (RFP),

4. and most critically, collects the full consideration for the service **directly into its own bank accounts**. The subsequent payment made to the driver is merely a disbursement or cost of sale, not a remittance of funds belonging to the driver.

All these factors, KRA argued, constitute a single composite taxable supply of transport services made by the respondent to the end customer and as such, VAT would be chargeable to the full consideration charged and paid.

Additionally, KRA argued that the RFP functioned as a tax invoice as they represented a demand for a payment.

In the determination of the case, the High Court argued on several issues, First was on whether the VAT act clearly defines "supply of services". On this issue, the court held that, the VAT Act does not contain specific provisions or detailed tests for determining who the supplier is in complex, multi-party transactions facilitated on digital platforms. This gap in the VAT Act allowed the court to look into other jurisdictions with a comparable VAT Systems. It compared with the jurisprudence the Court of Justice of the European Union which has considered this issue comprehensively, and the same jurisprudence has heavily influence the VAT structure of Kenya.

The foundational principle in the EU is that the characterisation of a transaction must be based on it's objective characteristics, reflecting its economic and commercial reality. The substance over form doctrine means that commercial labels are not decisive. This fundamental principle mandates an analysis of the entire transaction to determine what is actually being supplied to the customer from their perspective.

TO help address the ambiguity of intermediary transaction, the EU law employs a legal function known as the "**deemed supplier**" as provided for in the EU VAT Directive, article 28. The Article provides that intermediaries acting in the name but on behalf of a principal are deemed

to buy-sell the services provided by the principal, therefore creating a fiction of two transactions for VAT purposes that the principal sells the services to the undisclosed agent who resells the services to the customer. The effect of this is to split to two separate suppliers for VAT purposes.

- a. a supply for the underlying service provider (the driver) to the platform and
- b. a supply from the platform to the final consumer.



In this regards, therefore, the platform becomes the principal for VAT purposes and is liable to account for VAT on the full consideration paid by the final consumer, not merely on it's commission or fee.

In comparative decided cases, the courts have greatly considered the degree of control the platform has, on the delivery of services. Some of these cases that have helped shape this area are as follows.

In the case *Fenix International Limited v HMRC* (Case C-695 20), popularly known as “OnlyFans”, that connects creators with fans. The platform collected payments from fans, retaining a 20% commission, and remitted the balance to the creators. Fenix argued that it was only liable for VAT on its commission. The Court confirmed that a platform is presumed to be **acting in its own name** (and therefore the deemed supplier) **it is involved in the supply**. This presumption becomes irrebuttable if the platform

- a. authorises the charge to the customer,
- b. or authorises the delivery of the service or

- c. sets the general terms and conditions of the supply.

The core of the decision is that where a platform controls the **key aspects of the transaction, it is no longer a mere intermediary but is, for VAT purposes, the supplier**.

In the other case of *Asociación Profesional Elite Taxi v Uber Systems Spain SL* (Case C-434 15), where the court decided that Uber provides transport services, and cannot be classified as an information society. This implied that Uber would be regulated as a transport company within the European Union. The Court found that that intermediation service must be regarded as forming an integral part of an overall service whose main component is a transport service and, accordingly, must be classified not as 'an information society service' but as 'a service in the field of transport'. The reasoning was that Uber exercises decisive influence over the conditions of service. It does this by, inter alia,

- a. setting the price (or the method of calculation),
- b. controlling the quality of the vehicles and drivers, - matches driver and passenger
- c. and determining the conduct of the drivers. - Exercises control over drivers

The intermediation service provided by the application was deemed to form an integral part of an overall transport service controlled by Uber. Conversely, the court found that AirBnB was an information society, unlike Uber. In this stance, the court reasoned that AirBnB did not exercise the same decisive influence over the essential elements of the accommodation rental. For instance, the host set their own prices, and the platform's role was not indispensable to the provision of the accommodation itself, unlike the Uber application.

The court in arriving at it's decision determined that the taxpayer controls the legal and operational framework within which the service is provided. By controlling the billing process and demanding payment in its own name, via RFPs, the Respondent authorises the charge. The contractual term that the driver “charges’ the

customer is a formality that does not reflect the economic reality of the payment flow, where the customer's payment obligation is to the Respondent.

The customer does not choose a specific driver; they accept the one assigned by the Respondent's algorithm. This algorithmic dispatch is a form of authorising the delivery.

The court highlighted that the tribunal's focus on lack of asset ownership is misplaced in the context of digital economy. A platform's power lies not in physical capital but in its control over the network, the data and the transaction itself. The Tribunal's finding that the transporter is the supplier because they "charge" the customer elevates form over substance. In reality, the Respondent authorises and executes the charge.

#### **Determination.**

By setting terms, authorising the delivery, and authorising and collecting the charge in its own name, the Respondent acts as a principal in the transaction. It is, therefore, deemed, for VAT purposes, to have received the transport service from the third party transporter and to have supplied that same service to the end customer. Consequently, the Respondent's liability for VAT is on the full value of the consideration paid by the customer, and not merely on its commission.

#### **Our commentaries and consideration.**

This decision underscores the importance of understanding the level of control the taxpayer has on the said transaction.

While the discussion above does provide for exemption cases where the full amount of consideration may be exempted, like for the case of AirBnB, where only the commission for the facilitation of the transaction maybe chargeable to VAT, taxpayers are advised to make a careful analysis of their business model to determine the level of control and on whether the amount chargeable to VAT would be full consideration, or a commission, or its equivalent, for facilitating trade on the platform.

The digital economy continues to evolve across the globe, and many jurisdiction grapple with

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applying the existing tax laws in manner that reflects the intention of the legislators. While new types of taxes have been introduced to bring to the ambit the taxpayers doing business using digital platforms, the developing jurisdiction continue to adopt what the developing countries, especially the EU, USA, India and Australia have already determined in their jurisprudence. The taxpayers who need to evaluate their business model are those who are engaged in the following business model to determine their level of control.

1. Digital content and creator platforms
2. Ride-hailing and transport apps
3. Accommodation and short stay rental platforms
4. Gig-work and freelancing platforms
5. Food delivery & on-demand service platforms
6. Logistics & courier aggregator platforms

While the above list is not exhaustive, it is prudent that taxpayer evaluate their case individually, including the listed business models to help determine their tax implications.

The last notable aspect of this decision was that there was a binding private ruling issued to Sendy by the commissioner. The court noted that such a private ruling cannot estop a court from applying the correct interpretation of a statutory provision and that the legitimate expectation create by such a ruling, cannot override judicial determination of the law. You can read our comprehensive issue covering private rulings and the concept of legitimate expectation created by such [rulings here](#).

It is advisable to keep tabs on this decision and we will keep you updated of any judgement regarding the same or similar issue.

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