
Re-introduction of VAT on ICT Equipment in Kenya

Special focus on Mobile Phones

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About the author

Dr. Tonny K. Omwansa lectures at the School of Computing and Informatics, University of Nairobi in Kenya. He is the co-author of “Money, Real Quick: Kenya’s Disruptive Mobile Money Innovation”. He holds a PhD in Information Systems in which he researched on the adoption of mobile financial services at the base of the economic pyramid in Kenya. He is the coordinator of the C4DLab, a research and development arm of the School of Computing and Informatics, focusing on technology prototyping and startup incubation, research and capacity building based at the University of Nairobi. He is also member of ISACA and IEEE and serves as the Vice Chair of the IEEE Kenya Chapter.

Besides consultancy services in technology and innovation issues, he has conducted extensive research in financial inclusion and mobile transactions in Africa resulting in numerous publications including designing appropriate and innovative technologies, adoption and impact of technology, use of airtime transfers, mobile banking, virtual currencies among others.

His research interests are in the design, adoption and impact of innovative low-cost appropriate and innovative technologies in developing countries. His various research assignments have been commissioned by organizations like the Bill and Melinda Gates foundation, Rockefeller Foundation and Economic Commission of Africa among other global organizations. He is a recipient of the prestigious Bellagio Fellowship from the Rockefeller Foundation where he wrote the book on mobile money, published in 2012.

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Executive Summary

Mobile phones have the potential to transform peoples' lives. Their penetration growth in Kenya has been very encouraging in recent years. Governments play a key role in supporting mobile communications and wireless data growth and developments through creation of a favorable environment for penetration growth and backing the emergence of a local content and service industry. Taxation policies implemented by governments significantly impact speed of adoption and usage of the telecommunication services, particularly at lower income segments of the society. While seeking to raise revenue for government programs, revenue authorities have to consider the implications of tax structures from the viewpoint of broader national development, beyond the short term tax collection.

For example, handsets and smartphones represent the predominant access to wireless broadband in Kenya, such that handset taxes may also lead to under-consumption of Internet services. As devices become more expensive, it is likely that consumers will opt for less feature-rich options, thus reducing the potential impact of ICTs and making the attainment of Kenya's national broadband strategy to become a knowledge-based society and economy, among other target objectives, harder to achieve.

In 2009, the Government of Kenya zero-rated ICTs among other basic goods and services in order to make them more affordable and in particular for mobile technology, expand the subscriber penetration. In 2013, the government reversed this decision. Many stakeholders felt that in as much as reasons provided by government for re-introducing VAT on ICTs were justified, the decision was seen as being based on partly false data and assumptions and provide only a short-term fix, thus impacting negatively the growth of the sector and on Kenya's role as the leading digital economy in Sub-Saharan Africa. In addition, there were a number of concerns, particularly around the possibility of slowing down the pace of economic growth associated with the penetration growth of mobile devices and the use of associated services, the risk that this could reverse some of the gains made during the tax break, the realistic possibility of generating more revenue in the longer term if zero-rating remained in effect and

the need to explore other strategic means of generating revenue other than taxing mobile devices.

It's against this backdrop that this study was done to explore the potential effects of this policy change and make further recommendations based on the findings.

The study aimed to address the concerns of key stakeholders around the changes in the ICT industry, particularly on mobile devices sub-sector, that could occur as a result of the re-introduction of VAT on ICT equipment. Further the study explored various related aspects and attempted to quantify the short term as well as anticipated consequences of the re-introduction of VAT on the sub-sector.

The study relied on a number of sources generating a rich combination of qualitative and quantitative data sets. An extensive desk research and literature review of published reports in the area of taxation of mobile phones in the region was done. A total of 14 face-to-face informant interviews with key stakeholders, including regulators, academia and policy makers were done. An additional 13 questionnaire responses from mobile operators, wholesalers, distributors and software developers were received. A random sample of youths responded to key questions regarding mobile phone ownership and usage.

A synthesis of the data generated numerous findings that are expounded in the report. Below is a summary of the recommendations from the study.

Supporting the ICT sector

There is need for the government to support the growth of the ICT industry. CT is the fastest growing sector in Kenya. The liberalization of the telecommunications sector and affordability of mobile phones injected competition and innovation into the market to propel growth.

Taxation policies do have a direct and significant impact on the value that people derive from mobile telecommunication services. This study, similar to other related studies, established that higher taxes on ICTs and the services they provide run counter to government's commitment to improving access to communications. To foster the maturity and rooted establishment of this

sector in Kenya as a regional power, the removal of the tax holiday on mobile and computing devices is viewed as premature and is discussed further in this paper.

Dialogue between industry stakeholders

The ICT sector's cooperation and dialogue is very crucial, not only for taxation but on several other policy concerns. There is need for establishment of consultative forums with diverse participation to regularly and transparently discuss key policy topics. The study established that there are cases of conflicting views on some issues among stakeholders, even within government entities. The study recommends that consolidation and sharing of knowledge needs to be enhanced. The government is best placed to provide leadership in creating stimulating environments for open dialogue. There are case studies from other countries which give evidence of how collaboration between stakeholders can work to enable the collection of close to 100% of duties.

Moderate and balanced approach to taxation

Although the penetration of mobile phones appears impressive, research shows that the actual numbers of unique owners and users is lower, implying that many citizens remain unconnected. The total cost of ownership of mobile phones is still high, particularly for the less fortunate in society. Developing and implementing a balanced taxation profile for ICTs would lead to higher incentives for mobile consumption and purchase choices. It is the desire of stakeholders to have consumers move up the value chain from basic mobile consumption to more advanced services driven by the potential of wireless data and internet through mobile devices.

“The government, acting as a gardener, supports the innovators by providing appropriate financial and other measures (“watering the plant”); by removing regulatory, institutional, or competitive obstacles to innovation (“removing the weeds and pests”); and by strengthening the knowledge base through investment in education and research (“fertilizing the soil”).” - *The World Bank*.

Regular review of the effectiveness of policies

The nature of tax policies is that they understandably take time to undergo review. However, given the dynamic nature of the industry and the cascaded effect that fine-tuned policies would have, it makes it worth considering regular review. The growth rate of the sector, the demand for services, the facilitating role that the sector plays, the overlapping effect to other sectors, and the potential to create numerous opportunities, all point to the fact that careful monitoring and review of policies in this sector would be worthwhile.

Policy reviews need to be guided by empirical data and be informed by stakeholder feedback. Appropriate matrices need to be established to help quantify the effectiveness of existing policies, an input that would then assist when conducting reviews and introducing changes.

Sealing of loopholes

One of the reasons why the revenue authority supports the re-introduction of VAT is because of the complexity of processing tax refunds and the fact that a number of players exploit loopholes in the system to unfairly benefit or compete. The percentage of counterfeits in the country is still high and the telecommunications regulator faces huge challenges policing and controlling potential criminal activities as a result of counterfeit phones. Switching off such phones happens further down the supply chain when unsuspecting customers have already bought mobile devices. Suppliers and mobile operators face challenges regarding interpretation of the existing tax regime. While others have been frustrated trying to interpret, others have exploited the unclear aspects.

The introduction of taxation into a system that is not watertight, where the collection and enforcement infrastructure is not strong enough undermines formal growth of the sector by enabling tax evaders to exploit loopholes to compete unfairly.