

# TAXATION OF DIGITAL SERVICES: UGANDA'S SOCIAL MEDIA TAX LAW

## Introduction

The internet has transformed the way people transact over the past few years. With more and more sales and purchases being completed online, one would agree that the traditional “brick and mortar” stores have since been out fashioned, and governments want their share in this new phenomenon.

In recent times, several governments<sup>1</sup> such as Australia,<sup>2</sup> Albania, Belarus, European Union, Iceland, Japan, India<sup>3</sup>, New Zealand, Norway, Russia, Saudi Arabia, Serbia, South Africa, South Korea, Switzerland, Taiwan, Turkey, United Arab Emirates, United States and Uganda,<sup>4</sup> among others, have levied taxes on digital services. The governments' actions are not to be begrudged considering that the responsibility to formulate tax policies in the best interests of the citizenry lies with the government.<sup>5</sup> In Uganda, for instance, under Article 17(1)(g) of The Constitution of the Republic of Uganda, 1995, it is a duty of every citizen to pay taxes. Do recall that usually where there is a duty, there is a right, implying thus that the Government has a right to impose taxes against citizens, provided this is done under authority of an Act of parliament.<sup>6</sup>

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<sup>1</sup> Katie, 'Digital Taxes Around The World: What To Know About New Tax Rules' (2016), Quaderno <<https://quaderno.io/blog/digital-taxes-around-world-know-new-tax-rules/>> accessed 20 November, 2018.

<sup>2</sup> Eryk Bagshaw, 'New levy on digital giants sways crossbench on tax cuts' (2018), The Sydney Morning Herald <[www.smh.com.au/politics/federal/new-levy-on-digital-giants-sways-crossbench-on-tax-cuts-20180514-p4zf7b.html](http://www.smh.com.au/politics/federal/new-levy-on-digital-giants-sways-crossbench-on-tax-cuts-20180514-p4zf7b.html)> accessed 20 November, 2018.

<sup>3</sup> Hema Ramakrishnan, 'Foreign or local, digital services companies equal before tax law' (2018) Economic Times <<https://economictimes.indiatimes.com/news/economy/policy/foreign-or-local-digital-services-cos-equal-before-tax-law/articleshow/62748372.cms>> accessed 20 November, 2018

<sup>4</sup> Erias Biryabarema, 'Uganda levies unpopular social media tax, criticized by Amnesty' (2018) Reuters <[www.reuters.com/article/us-uganda-internet-idUSKBN1JS1SM](http://www.reuters.com/article/us-uganda-internet-idUSKBN1JS1SM)> accessed 20 November, 2018.

<sup>5</sup> Article 189(1) of The Constitution of the Republic of Uganda.

<sup>6</sup> Article 152 of The Constitution of the Republic of Uganda, 1995.

Every individual person or corporate entity carrying on business in Uganda's jurisdictional space is duty bound to make a fair contribution to the government's revenue to support public service. An individual who runs a traditional "brick and mortar" store finds themselves in a position where they have to pay a number of taxes that include Income Tax<sup>7</sup>, Value Added Tax if they are trading taxable supplies<sup>8</sup>, and Excise Duty if they trade excisable goods or excisable services<sup>9</sup>. But how should the government collect such taxes from persons using the new online spaces?

## **The Trends**

As noted earlier, various states have enacted digital tax laws. For most of these states (in particular South Africa, Serbia, Belarus, Iceland, Norway, Russia, South Korea, Switzerland, Taiwan, Turkey, United Arab Emirates, among others) the tax is imposed in form of a Value Added Tax (VAT) at a fixed rate on providers (usually foreign) of digital services who meet the specified threshold of gross revenue generated from the state's citizens. The providers are expected to register for VAT with the relevant state authorities and then collect and remit the taxes.<sup>10</sup>

## **The test for the right tax subject**

Leaning on the reasoning employed by Erika K. Lunder & Carol A. Pettit<sup>11</sup> it is plausible to argue that before such a tax can be imposed, there must exist a nexus between the State seeking to impose the tax and the Seller. The authors discuss the U.S Supreme court decision in *Quill v North Dakota*<sup>12</sup> to highlight that if the seller directs purposeful contact at the state's residents, the requisite nexus exists. Whereas the court had previously found that physical presence in the state was necessary (for due process) before a seller could be taxed by a state, the authors note that the U.S

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<sup>7</sup> Section 4 read with Section 15 of the Income Tax Act, Cap 340.

<sup>8</sup> Section 5 read with Section 6 of the Value Added Tax, Cap 349.

<sup>9</sup> Section 4 of the Excise Duty Act, 2014.

<sup>10</sup> Katie (n 1).

<sup>11</sup> Erika K. Lunder, Carol A. Pettit, "Amazon Laws" and Taxation of Internet Sales: Constitutional Analysis' (2015), Congressional Research Service 2.

<sup>12</sup> 504 U.S. 298 (1992).

Supreme Court's jurisprudence has since evolved to the effect that physical presence is no longer necessary so long as the seller has directed sufficient action toward the state's residents.<sup>13</sup> This position was fortified by the same court's decision in *South Dakota v. Wayfair, Inc.*<sup>14</sup> where it was observed that,

“*Quill* creates rather than resolves market distortions. In effect, it is a judicially created tax shelter for businesses that limit their physical presence in a State but sell their goods and services to the State's consumers, something that has become easier and more prevalent as technology has advanced.”

In a word therefore, this would mean that a corporation/company that sells its goods and/or services to a state's consumers via digital means is the appropriate digital tax subject.

### **The Uganda Social Media Tax**

In July, 2018, the parliament of Uganda passed the Excise Duty (Amendment) Act, 2018 which imposes a tax of 200 Ushs (approximately USD 0.05) per user per day on access to Over The Top (OTT) services. The OTT services include WhatsApp, Twitter, Facebook, YouTube, Skype, Instagram, among others.

Interesting to note is the fact that the tax is levied as an “excise tax”. Excise taxes (also known as “sin taxes”) are usually levied on goods and services that are considered superfluous or unnecessary.<sup>15</sup> Raising taxes on them raises their price and thus the rate at which they are used diminishes.

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<sup>13</sup> Lunder (n 11) 3.

<sup>14</sup> 585 U.S. \_\_\_, 2018, Decided June 21, 2018.

<sup>15</sup> ‘Investing Answers: Excise Tax’,

<<https://investinganswers.com/financial-dictionary/tax-center/excise-tax-1495>> accessed 20 November, 2018

The introduction of the tax was greeted by public outcry all over social media, and a constitutional petition challenging its constitutionality hours after its commencement.<sup>16</sup>

### **Impact of the tax**

Alliance for Affordable Internet (A4AI) observed that before introduction of the tax, Uganda was one of six countries in Africa with the most expensive mobile internet plans, with a 1GB mobile broadband plan costing more than 15% of average monthly income.<sup>17</sup> It was also observed that the cost to connect is higher for low income earners whom it would cost 30% of their average monthly income.<sup>18</sup> A4AI projected that with the Excise Duty on access to OTTs in place, it would cost the low income earners 40% of their average monthly income.<sup>19</sup> This shows that the tax hampers access to internet in Uganda which was itself still very low before introduction of the tax and could use room for improvement. As of 2017, only 31.3% of Uganda's population (which was standing at 41,652,938 at the time) were using the internet.<sup>20</sup> With access to internet standing as such the last thing Uganda needs is the social media tax.

It would be in Uganda's best interest to enhance access to internet considering the fact that "wider broadband use would increase economic growth and jobs, not only in the ICT sector but in Uganda as a whole."<sup>21</sup>

A report by Dr Christoph Stork & Steve Esselaar shows that through provision of better access to information, productive efficiency, newjobs, eEducation,

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<sup>16</sup> Stephanie Busari, 'Uganda government sued over social media tax' (2018), CNN [www.cnn.com/2018/06/01/africa/uganda-social-media-tax/index.html](http://www.cnn.com/2018/06/01/africa/uganda-social-media-tax/index.html) accessed 21 November, 2018

<sup>17</sup> Web Foundation, 'Uganda: New Social media tax will push basic connectivity further out of reach for millions' (2018), World Wide Web Foundation <https://webfoundation.org/2018/06/uganda-new-social-media-tax-will-push-basic-connectivity-further-out-of-reach-for-millions/> accessed 21 November, 2018.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Internet World Stats [www.internetworldstats.com/af/ug.htm](http://www.internetworldstats.com/af/ug.htm) accessed 21 November, 2018

<sup>21</sup> Mihasonirina Andrianaivo, Kangni Kpodar, 'Mobile Phones, Financial Inclusion and Growth' (2012) 3 Review of Economics and Institutions [www.rei.unipg.it/rei/article/view/75](http://www.rei.unipg.it/rei/article/view/75) accessed 21 November, 2018.

eGovernment, eHealth and eAgriculture, ICTs enhance economic growth.<sup>22</sup> Furthermore, digital connectivity as an enabler of economic and social development has been recognized in the United Nations (UN) Global Goals. The former UN Secretary-General Ban Ki-moon once observed that;

*“Broadband connectivity is a transformative tool to achieve the three pillars of sustainable development – economic growth, social inclusion and environmental balance. It is a key element for the post-2015 development agenda.”*<sup>23</sup>

Studies show that digital inclusion has vast economic and social benefits which include; facilitation of exchange of ideas and information which in turn fosters a shift towards a knowledge-based economy; enabling faster delivery of services by businesses and governments, enhancement of productivity in the public and private sectors through reduced costs which in turn supports the expansion of businesses and enterprises; improved international competitiveness and standards of living; *inter alia*.<sup>24</sup>

The Uganda Social Media tax – as is today – hampers enjoyment of all the aforementioned benefits of digital connectivity.

### **What went wrong?**

Much of the concern about the social media tax is not in regard to “**whether**” the government should have levied a tax on access to social media, but rather, “**How**”.

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<sup>22</sup> Christoph Stork, Steve Esselaar, ‘ICT Sector Taxes In Uganda’ (2018) Research ICT Solutions [www.google.com/url?sa=t&source=web&rct=j&url=https://researchictolutions.com/wp-content/uploads/2018/08/Unleash-not-squeeze-the-ICT-sector-in-Uganda.pdf&ved=2ahUKEwiugg-oy9PeAhXCaVAKHXSBcxcQFjAAegQIBRAB&usg=AOvVaw2Pezv APQZtW-c2Pc65mII](https://www.google.com/url?sa=t&source=web&rct=j&url=https://researchictolutions.com/wp-content/uploads/2018/08/Unleash-not-squeeze-the-ICT-sector-in-Uganda.pdf&ved=2ahUKEwiugg-oy9PeAhXCaVAKHXSBcxcQFjAAegQIBRAB&usg=AOvVaw2Pezv APQZtW-c2Pc65mII) accessed 21 November, 2018.

<sup>23</sup> GSMA, ‘Digital Inclusion and Mobile Sector Taxation’ (2016) 9 [www.google.com/url?sa=t&source=web&rct=j&url=https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2016/07/Digital-Inclusion-and-Mobile-Sector-Taxation-2016.pdf&ved=2ahUKEwiDzr6o4NPeAhWBaFAKHRYdDiQQFjAAegQIAhAB&usg=AOvVaw24LkRmB-oKXrhYLTvYI](https://www.google.com/url?sa=t&source=web&rct=j&url=https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2016/07/Digital-Inclusion-and-Mobile-Sector-Taxation-2016.pdf&ved=2ahUKEwiDzr6o4NPeAhWBaFAKHRYdDiQQFjAAegQIAhAB&usg=AOvVaw24LkRmB-oKXrhYLTvYI) accessed 21 November, 2018.

<sup>24</sup> Ibid.

Suffice to note is the fact that the tax offends all the five tax best practice principles as summarized by Dr Christoph Stork & Steve Esselaar.<sup>25</sup> They are as listed hereunder;

1. Broad-based

The tax should have a broad base in that a lower tax rate is required to raise the same revenue. It should not be sector specific as that would distort incentives and require higher levels of taxation to get the same revenue.

2. Take into account externalities

Excise duties should be imposed on activities with negative externalities where the objective is to lower consumption, such as alcohol or tobacco, and should not be imposed on sectors with positive externalities, such as telecoms.

3. Simple and enforceable

The tax should be clear enough to be easily understood and predictable, such that investor uncertainty is reduced and better compliance is ensured.

4. Incentives for competition & investment should be unaffected

The tax should not make investment in the sector to which it applies unfavorable.

5. Progressive not regressive

The tax rate should increase as the taxable amount increases. Specific value taxes on small amounts should be avoided because they make the poor pay more.

The authors observed that the social media tax;<sup>26</sup>

a) is not broad-based as it singles out the ICT sector;

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<sup>25</sup> Stork (n 22) 5.

<sup>26</sup> Ibid.

- b) penalizes positive externalities since it is a tax on a sector that has potential to foster economic growth;
- c) is not simple and enforceable as social media users can easily circumvent the tax using Virtual Private Networks (VPNs) and Wi-fi;
- d) bears significant effects on competition highlighted by declining data revenues that may discourage investment regarding 3G, 4G and 5G upgrades.
- e) is regressive as the poor and the rich pay the same amount of tax, their average individual income notwithstanding.

### **How should it have been done?**

One of the reasons given by parliament for the social media tax was the need to widen the tax base. The better way of doing this is by levying taxes on the revenues of multinational companies that reflect the value that such companies derive from users within Uganda's jurisdiction.

The UK government has done consultation on the issue of Digital Services Taxation and arrived at the above approach which seems to be the most plausible.<sup>27</sup> It was proposed that the tax be a narrow one of, for instance, 2% on the Uganda revenues of digital businesses that derive value from participation of Uganda-based users.

Following the UK approach<sup>28</sup> the tax would not apply to all digital businesses but rather, to only those considered to be deriving significant value from Uganda-based users, and the revenues taxable would be those linked to participation of Uganda-based users. Further, a digital business would only be taxable if it meets a certain fixed threshold of annual revenue linked to the participation of Uganda-based users.

Such a taxation policy would leave digital access and connectivity intact and leave room for its improvement given that the tax burden will lie with those with the 'deep

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<sup>27</sup> HM Treasury, 'Digital Services Tax: Consultation' (2018) HM Revenue & Custom <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/754975/Digital\\_Services\\_Tax\\_-\\_Consultation\\_Document\\_FINAL\\_PDF.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf)> accessed 20 November, 2018.

<sup>28</sup> HM Treasury (n 27) 4-5.

pockets' i.e. the multinational digital companies with millions in revenue. This way the government will be in position to increase its tax revenue without suffocating the ICT sector and frustrating its potential for the Ugandan economy.

## **Conclusion**

While the government reserves the right to levy taxes on activities carried out by those in its jurisdiction for profit, including those leveraging the new online opportunities, the digital taxation policies should be painstakingly crafted not to smother the vast benefits presented by the ICT sector to the economy. A sustainable tax system in the digital age would require a tax policy that would ensure all businesses, including the digital ones, make only an equal fair contribution to the government's revenue to support public services. Such a policy would need to be followed up by the government to monitor its progress and effectiveness over a given period of time and assess the need for a review.