

The source of income from the  
sale of goods electronically: an  
analysis of the division of the  
taxing rights in cross-border  
situations

Zafar Harnekar

Minor Dissertation presented for the Degree of

**Masters of Commerce**

In the Department of Finance and Taxation

**University of Cape Town**

The copyright of this thesis vests in the author. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.

Published by the University of Cape Town (UCT) in terms of the non-exclusive license granted to UCT by the author.

## **Abstract**

The digital economy is rapidly evolving and changing the way businesses operate. This is as a result of the increased use and reliance of technologies in business processes. As more companies adopt technology in their operations and as technology is continually developing, it becomes cheaper to implement technology in business processes over time.

Traditional tax principles, domestic and international are reliant on some level of physical activity being performed in a country before the taxing right is granted. In the past, businesses required a level of physical presence in each country they operated in, in order to generate a significant level of economic activity. However, through the use of technology, businesses are now able to centralise their core business functions by operating on a global or regional level, and thereby foregoing the need to establish subsidiaries or branches in the countries they operate in. As a result of this, businesses are able to separate the location of the activities that generate economic value from the physical location of the customer. This creates tax challenges as businesses are able to manipulate their operations such that their 'core business activities' are performed in low tax jurisdictions.

Base erosion and profit shifting (BEPS) has been on the agenda for a number of years as countries have become increasingly concerned about profits being shifted to other jurisdictions. At the request of the G20 leaders in 2013, the Organisation for Economic Co-operation and Development (OECD) prepared a 15 point action plan in order to address such concerns. The final version of the report was released in September 2015.

Action Plan 1 of the report deals specifically with the tax challenges raised by the digital economy. The report states that the recommendations in the report in its entirety will address BEPS risks, but specifically that Action Plan 7 will serve to mitigate any risks introduced by the digital economy.

To this extent, the permanent establishment (PE) definition as detailed in the OECD Model Tax Convention on Income and on Capital (OECD MTC) will be modified to only exclude activities conducted from a fixed place of business from being classified as a PE, if such activities are preparatory or auxiliary in nature. The PE definition will also include a new anti-fragmentation

rule to prevent businesses from physically separating activities across locations or subsidiaries in order to argue that each in isolation is preparatory or auxiliary in nature.

The implications of these changes will be far reaching as most businesses will have to reconsider whether any of their offshore operations will fall short of the PE exclusion. Challenges will also arise for local revenue authorities as they may have difficulty enforcing compliance.

This dissertation explores the concept of the digital economy and its exponential growth over the last decade and the tax challenges this has introduced, with a particular focus on the sale of goods and services via electronic means. The South African tax framework applicable to such transactions is considered in order to determine whether domestic legislation caters for the digital economy and to identify any shortcomings. The OECD report on Action Plan 1 and Action Plan 7 are summarised to analyse the changes that will be implemented to address the challenges presented by the digital economy. These proposals are considered in a South African context and the practical challenges are explored. Recommendations are proposed and the proposed amendments are assessed by means of case studies to analyse the impact.

## Abbreviations and glossary

BEPS	Base Erosion and Profit-Shifting
B2C	Business-to-consumer
CFC	Controlled foreign company
DTT	Double Taxation Treaty
DTC	Davis Tax Committee
EBITDA	Earnings before interest, tax, depreciation and amortisation
E-commerce	Electronic commerce
IBFD	International Bureau of Fiscal Documentation
ICT	Information and communication technology
ITA	Income Tax Act, No. 58 of 1962
MNC	Multi-national corporation
OECD	Organisation for Economic Co-operation and Development
OECD Commentary	Commentary on the OECD MTC
OECD MTC	OECD Model Tax Convention on Income and on Capital
PE	Permanent establishment
SARS	South African Revenue Service
TFDE	Task Force on the Digital Economy
TP	Transfer Pricing
WHT	Withholdings tax

## Contents

1	Introduction and overview	1
1.1	Title of this dissertation	1
1.2	Background, rationale and purpose of the study	1
1.3	Research question	3
1.4	Research method	3
1.5	Scope and limitations of this study	4
1.6	Structure of this paper	4
2	The digital economy	6
2.1	Introduction	6
2.2	Growth of the digital economy	7
2.3	Key features of the digital economy and new business models	8
2.3.1	Key features of the digital economy	9
2.3.2	The development of traditional business models	11
2.3.3	The continuous evolution of the digital economy	12
2.4	Tax challenges of the digital economy	13
2.5	Conclusion	14
3	Taxing the sale of goods via electronic means in South Africa	16
3.1	Introduction	16
3.2	The South African concept of source	16
3.2.1	The originating cause	16
3.2.2	The dominant cause	17
3.2.3	The source of income from the sale of goods	17
3.3	Deeming source provisions	18
3.4	International taxing rights	18
3.4.1	Article 7 – business profits	19
3.4.2	Article 5 - permanent establishments	19
3.4.3	Summary	21
3.5	Withholdings tax	21
3.6	Conclusion	21
4	Local and international developments on the taxation of the digital economy	23
4.1	Introduction	23
4.2	The OECD BEPS project	23
4.3	Potential for BEPS opportunities in the digital economy	24
4.3.1	Eliminating or reducing tax in the market country	24
4.3.2	Eliminating or reducing WHT in the source country	25
4.3.3	Eliminating or reducing tax at the level of the recipient of the income	25
4.3.4	Eliminating or reducing tax at the level of the ultimate parent	25

4.4	Addressing BEPS in the digital economy	25
4.4.1	Measures that will restore taxation in the market jurisdiction	25
4.4.2	Measures that will restore taxation in both the market and ultimate parent jurisdictions	26
4.4.3	Measures that will address BEPS issues in the ultimate parent jurisdiction	27
4.4.4	Summary	27
4.5	Challenges raised by the digital economy	27
4.5.1	Income nexus	28
4.5.2	Data	29
4.5.3	Characterisation of income	29
4.5.4	Other administrative challenges introduced by the digital economy	30
4.6	OECD recommendations to counter BEPS risks in the digital economy	31
4.6.1	A new nexus based on significant economic presence	31
4.6.2	Determining the income attributable to significant economic presence	33
4.6.3	Withholding tax	34
4.6.4	Equalisation tax	35
4.7	The recommendation proposed by the TFDE	35
4.8	Changes to the PE definition	36
4.8.1	Preparatory and auxiliary activities	36
4.8.2	Anti-fragmentation rule	39
4.9	Future developments and action points	40
4.10	Conclusion	40
5	The framework for taxing the digital economy in a South African context and other considerations	41
5.1	Introduction	41
5.2	Implications for South Africa	41
5.2.1	Growth of the South African digital economy	41
5.2.2	The e-commerce industry in South Africa	42
5.2.3	Non-residents operating in South Africa	44
5.2.4	Possible options to ensure compliance by non-residents operating in South Africa	45
5.3	Criticism of the BEPS Project on taxing the digital economy	48
5.4	Conclusion	49
6	Case studies	51
6.1	Introduction	51
6.2	Case study A	51
6.2.1	The facts	51
6.2.2	Application of the current South African domestic tax law	52
6.2.3	Application of the current OECD MTC	52
6.2.4	Application of the proposed changes to the OECD MTC	52

6.2.5	Outcome and other considerations	53
6.3	Case study B	53
6.3.1	The facts	53
6.3.2	Application of the current South African domestic tax law	54
6.3.3	Application of the current OECD MTC	54
6.3.4	Application of the proposed changes to the OECD MTC	54
6.3.5	Outcome and other considerations	55
6.4	Case study C	55
6.4.1	The facts	55
6.4.2	Application of the current South African domestic tax law	56
6.4.3	Application of the current OECD MTC	57
6.4.4	Application of the proposed changes to the OECD MTC	57
6.4.5	Outcome and other considerations	58
6.5	Case study D	58
6.5.1	The facts	58
6.5.2	Application of the current South African domestic tax law	59
6.5.3	Application of the current OECD MTC	59
6.5.4	Application of the proposed changes to the OECD MTC	59
6.5.5	Outcome and other considerations	60
6.6	Case study E	60
6.6.1	The facts	60
6.6.2	Application of the current South African domestic tax law	60
6.6.3	Application of the current OECD MTC	61
6.6.4	Application of the proposed changes to the OECD MTC	61
6.6.5	Outcome and other considerations	61
6.7	Conclusion	62
7	Conclusion and recommendations	63
7.1	The emergence of the digital economy	63
7.2	The taxation challenges arising from the digital economy	63
7.3	The BEPS Project	64
7.4	Proposal to address the tax challenges arising from the digital economy	65
7.4.1	The introduction of a new nexus based on significant economic presence	65
7.4.2	Withholding tax	66
7.4.3	Equalisation tax	66
7.4.4	Proposal by the OECD	66
7.4.5	Implementation of the proposed changes	68
7.5	The implications of the proposed changes	68
7.6	Conclusion	69
8	Bibliography	70

# **1 Introduction and overview**

## **1.1 Title of this dissertation**

The source of income from the sale of goods electronically: an analysis of the division of the taxing rights in cross-border situations.

## **1.2 Background, rationale and purpose of the study**

The digital economy has significantly changed the landscape in which businesses operate. Traditionally, businesses have operated through physical offices, buildings, manufacturing plants, agricultural sites etc. However, with the rapid development of technology, many businesses, both large and small, local and international, have been able to conduct some, or even all, of their business activities electronically via the internet. Businesses are also able to conduct transactions across any border and at any time they want to.

This has largely been facilitated through the development of information and communication technology (ICT) as a result of rapid technological advances which have decreased the price of ICT products and services.<sup>1</sup>

Due to these technological developments, traditional business models, whereby multi-national corporations (MNCs) would be required to have a physical presence in a jurisdiction in order to generate a significant amount of activity, are no longer necessary. Advances in ICT have enabled MNCs to operate at a regional or global level, rather than at a country basis.<sup>2</sup>

Traditional tax principles (both local and international) are based on the residence and source concepts. However, as no domestic tax regimes are identical, the application of domestic law to a company operating in more than one jurisdiction, can lead to double taxation in some cases. Double Taxation Treaties (DTTs) were developed to address the issue of double taxation. DTTs between developed nations, and also some developing nations, are largely modelled on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on

---

<sup>1</sup>OECD (2015). *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20, Base Erosion and Profit Shifting Project*, OECD Publishing, Paris. Available at <http://dx.doi.org/10.1787/9789264241046-en>, p36.

<sup>2</sup>OECD: Action 1 – 2015 Final Report (2015), p92.

Income and on Capital (OECD MTC).<sup>3</sup> When the OECD MTC was first developed, it was designed to cater for business activities conducted physically, rather than electronically, as the concept of the digital economy was never envisaged. The physical location of the income generating activity was an important factor that determined where the profits were to be taxed.<sup>4</sup> In the digital economy, it is now possible to conduct business activities in any country with little or even no physical presence.<sup>5</sup>

What complicates matters further is that, through the use of ICT, MNCs are able to split transactions into several steps, which can be performed from different locations. In these cases, not only will it be difficult to establish the true nexus of the income, the MNC will also be able to avoid creating a taxable presence in multiple jurisdictions as currently a physical presence threshold has to be crossed before a jurisdiction can exert its taxing rights to the income.

The purpose of this study is to investigate the current South African and international taxation frameworks for e-commerce businesses and to apply this to a number of different scenarios presented in case studies. This will facilitate an evaluation of the appropriateness of the framework.

Specific to this study is the location of where value is created in the digital economy and the jurisdiction entitled to tax the profits generated (i.e. the income nexus). An analysis of South African legislation as well as the OECD MTC articles and the related commentary (OECD Commentary) dealing with permanent establishments (PEs) will be necessary as this will essentially determine the jurisdiction with the taxing rights to the profits generated in the digital economy. Although South Africa is not a member of the OECD (having observer status and an enhanced relationship only) many of South Africa's DTTs are based on the OECD MTC and therefore it is deemed appropriate to use this model in the analysis.

The term PE is defined in Article 5 of the OECD MTC<sup>6</sup> as "a fixed place of business, through which the business of an enterprise is wholly or partly carried on". The OECD Commentary<sup>7</sup> on

---

<sup>3</sup>Haupt, P. & Huxham, K (2015). *Notes on South African Income Tax 2015*. 34<sup>th</sup> edition, Roggebaai: H & H Publications, p658 and p660.

<sup>4</sup>Bal, A (2012). *Tax Implications of Cloud Computing - How Real Taxes Fit into Virtual Clouds*. 66 Bull. Intl. Taxn. 6 (2012), Journals IBFD, p366.

<sup>5</sup>Gupta, P (2014). "Cloud" – *A Technological Odyssey*. 20 Asia-Pac. Tax Bull. 5 (2014), Journals IBFD, p310.

<sup>6</sup>OECD (2014). *Model Tax Convention on Income and Capital*. OECD Publishing.

<sup>7</sup>OECD (2014). *Commentary on the Model Tax Convention on Income and Capital*. OECD Publishing.

Article 5 of the OECD MTC provides specific guidance on whether computer servers, software and websites can be regarded as PEs.

Despite the definition and commentaries provided in the OECD MTC and OECD Commentary, there is no hard and fast interpretation of whether digital transactions through the use of a server, for example, creates a PE. Thus, there is scope for a taxpayer to try and use an interpretation that will enable it, possibly, to attribute profits to a low tax jurisdiction. This may also lead to taxpayers adopting incorrect tax positions, through no fault of their own.

In February 2013, the OECD raised concerns that tax laws are needed to keep up-to date with the digital economy in order to retain the fairness and integrity of tax systems. At the request of the G20 Finance Ministers in 2013, the OECD launched an action plan (known as the OECD Base Erosion and Profit-Shifting (BEPS) Action Plan) to address the challenges introduced by the digital economy.

This study will also examine recent developments (i.e. the OECD BEPS Action Plan and related deliverables) to assess whether any concerns identified in the case studies will be addressed.

### **1.3 Research question**

In a South African and international context, is there a framework to determine the income nexus of digital transactions in order to establish where the income should be taxed and is this framework appropriate?

### **1.4 Research method**

This study will entail an analysis of South African domestic legislation and case law, the OECD MTC and the OECD Commentary, the writings of experts, the OECD BEPS Action Plan and the Davis Tax Committee's (DTC) interim report on the BEPS Action Plan.

Case studies will also be introduced to determine the income nexus of the sale of goods via electronic means using the existing framework in various circumstances and also to determine whether this framework is appropriate. The case studies will also be analysed in terms of any proposed changes to the framework noted in this paper.

## **1.5 Scope and limitations of this study**

In its interim report on the OECD BEPS Action Plan 1, the DTC notes that there is limited scope for South African residents to shift profits to low tax jurisdictions due to the controlled foreign company (CFC) and transfer pricing (TP) rules contained in the South African Income Tax Act, No. 58 of 1962 (the Act). Furthermore, non-South African resident businesses effectively managed in South Africa are treated as South African residents for tax purposes.<sup>8</sup>

The scope of this paper will therefore be limited to determining the income nexus for the sale of goods via electronic means by non-South African residents operating in South Africa.

This study will be limited to the direct income tax consequences of the sale of goods via electronic means, and will specifically exclude royalties, the right of use of software and other types of intangible assets, TP and capital gains implications. Indirect tax implications are also not considered in this study.

A number of different cases will be presented (using a number of hypothetical situations) to establish the income nexus using the existing framework and proposed changes discussed in this dissertation. Certain facts in the scenarios will also be altered in order to determine if different conclusions will be reached.

## **1.6 Structure of this paper**

Each chapter of this dissertation investigates different aspects relating to the central theme of the income nexus of the digital economy, in a South African and international context.

The focus of Chapter 2 is to highlight the rapid growth of the digital economy due to the constant development of ICT. This has enabled MNCs to depart from traditional business models, which usually required some form of physical presence in order to have a large scale operation in a particular jurisdiction. This Chapter will also identify the challenges from a taxation perspective resulting from the evolution of the digital economy.

South Africa taxes residents on their world-wide income, while non-residents are taxed on their South African sourced income. Chapter 3 will set out the relevant source rules South Africa

---

<sup>8</sup> The Davis Tax Committee (2014). *Addressing Base Erosion and Profit Shifting in South Africa, Davis Tax Committee Interim Report, Action 1: Address the tax challenges of the digital economy*. Available: [http://www.taxcom.org.za/docs/New\\_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf](http://www.taxcom.org.za/docs/New_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf). Last accessed 21/09/2015, p26.

applies to non-residents as this will establish the South African framework for taxing the sale of goods via electronic means in South Africa.<sup>9</sup> Chapter 3 will also investigate the concept of PEs and withholdings taxes in the context of the sale of goods via electronic means.

Chapter 4 will set out the international and local developments on the taxation of the digital economy. Specifically, the OECD BEPS Action Plan 1 and the DTC Interim Report on the BEPS Action Plan 1 will be analysed.

The South African framework for taxing the sale of goods via electronic means will be assessed in terms of findings by the OECD and the DTC in Chapter 5. Areas of concern will be identified and recommendations will be made.

Chapter 6 will present and analyse a number of different scenarios in the form of case studies in terms of the existing framework and the proposed changes.

Chapter 7 provides other considerations and the conclusions of the study.

---

<sup>9</sup>As this dissertation is limited to the sale of goods via electronic means by non-South African residents, it is not necessary to address the taxation of residents.

## 2 The digital economy

### 2.1 Introduction

The term ‘the digital economy’ has not been decisively defined.<sup>10</sup> As found by the European Commission, defining the term ‘the digital economy’ has proven to be challenging due to the constant evolution of ICT, its use in business practices and integration with the economy as a whole.<sup>11</sup>

Literature has, however, recognised that ICT plays an important role in the digital economy.<sup>12</sup> This has been acknowledged by the OECD, which has stated that:

*“The digital economy is the result of a transformative process brought by information and communication technology (ICT). The ICT revolution has made technologies cheaper, more powerful, and widely standardised, improving business processes and bolstering innovation across all sectors of the economy.”<sup>13</sup>*

The OECD goes further to state that:

*“The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs”.<sup>14</sup>*

The term ‘the digital economy’ can be described as a form of business model that relies primarily on the use of ICT.<sup>15</sup> Businesses, including MNCs, are able to deliver<sup>16</sup> their offerings, whether physical goods or services, to customers around the world via electronic means. This

---

<sup>10</sup>Blum, DW (2015). *Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative – The Nexus Criterion Redefined?* 69 Bull. Intl. Taxn. 6/7, Journals IBFD, p314; Cockfield, AJ (2002). *The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles*. 56 Bull. Intl. Fiscal Docn. 12, Journals IBFD, p607; see also Hellerstein, W (2014). *Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments*. 68 Bull. Intl. Taxn. 6/7, Journals IBFD, p346.

<sup>11</sup>The European Commission Expert Group on Taxation of the Digital Economy (2014). *Report of the Commission Expert Group on Taxation of the Digital Economy*. Available at <https://ec.europa.eu/futurium/en/content/report-commission-expert-group-taxation-digital-economy>. Last accessed 22/09/2015, p11

<sup>12</sup>Blum (2015), p314.

<sup>13</sup>OECD: Action 1 – 2015 Final Report (2015), p11.

<sup>14</sup>OECD: Action 1 – 2015 Final Report (2015), p26.

<sup>15</sup>Gaoua, N (2014). *Taxation of the Digital Economy: French Reflections*. 54 Eur. Taxn. 1, Journals IBFD, p11.

<sup>16</sup>Deliver in this context does not mean the physical delivery of goods or services.

has enabled businesses to depart from traditional business models that required a certain level of physical presence in order to generate a significant amount of activity in a jurisdiction.

Another common factor of the digital economy is that it relies heavily on the mobility of intangibles, users and business processes, data and networks.<sup>17</sup>

What complicates matters further is that ICT is developing rapidly, making it difficult to predict future trends, let alone implement legislation that would be effective for years to come.

For the purposes of this dissertation, the broad definition set out by Gaoua (2014) will be applied when referring to the term ‘the digital economy’; that the digital economy is a business model that relies on the use of ICT.

It should be emphasized that the digital economy is not separate from the overall economy. It forms part of the real economy and merely represents a transformation of traditional business models that required physical presence to generate a significant amount of economic activity. The OECD points out that it is not possible to isolate the digital economy from the real economy, as the digital economy is becoming more and more integrated with the real economy.<sup>18</sup>

As noted in Chapter 1 of this dissertation, the tax principle of source traditionally required some level of physical presence in order to grant the taxing right to a particular jurisdiction. However, with the rapid growth of the digital economy, businesses, and in particular, MNCs, may be able to escape taxation in certain jurisdictions by structuring its operations in a way that it is able to provide its offerings remotely.

The aim of this Chapter is to discuss the growth of the digital economy and how this has impacted traditional business models, of MNCs in particular, and to note the tax challenges and BEPS opportunities the digital economy has introduced.

## **2.2 Growth of the digital economy**

The growth of the digital economy is the result of the rapid technological advances in ICT in recent years. These developments have brought the prices of ITC products down significantly,

---

<sup>17</sup>These concepts are described in detail later in this Chapter.

<sup>18</sup>OECD: Action 1 – 2015 Final Report (2015), p11.

which has enabled more businesses to adopt ICT in their processes more regularly, which in turn, has fuelled the further development of ICT.

Box (2014) points out that the main drivers behind the growth of the digital economy relates to its ability to reach the global market, a reduced reliance on infrastructure, increased use of ICT by governments and businesses, a greater access by consumers to networked devices and increased security and privacy measures employed by businesses in conducting activity via electronic means.<sup>19</sup>

The use of ICT has also enabled businesses to have a global audience as they are able to reach customers around the world with very little effort. As a result, MNCs are favouring business models developed around ICT, as opposed to establishing some form of physical base, to earn significant revenues in many jurisdictions while operating from limited locations.

In terms of a study conducted by the United States Bureau of the Census, it was estimated that e-commerce sales in 2010 amounted to USD 4.1 trillion, which amounted to 16.1% of the total shipments and sales in the United States of America in that year.<sup>20</sup>

According to the OECD's BEPS Action Plan 1 Deliverable, global business-to-consumer (B2C) e-commerce sales in 2014 was estimated to exceed USD 1.4 trillion, which represents a growth of 20% from 2013. B2C transactions are expected to reach USD 2.4 trillion by 2018.<sup>21</sup>

These facts indicate that e-commerce transactions are increasing at a rapid pace and they also clearly illustrate the significance of the digital economy and therefore highlight the need to ensure that it is regulated correctly.

This rapid growth of the digital economy has been facilitated through the mobility of assets (tangible and intangible), users and business processes, which have transformed business models to operate more efficiently, be cost effective and easier than ever before.

## **2.3 Key features of the digital economy and new business models**

To understand the challenges of the digital economy, it is important to investigate its key features and the business models that have developed as a result.

---

<sup>19</sup>Box, J (2014). *E-Commerce and Tax – An Australian Perspective*. 20 Asia-Pac. Tax Bull. 3, Journals IBFD.

<sup>20</sup>Maguire, S (2013). *State Taxation of Internet Transactions*. Available <https://www.fas.org/sgp/crs/misc/R41853.pdf>. Last accessed 22/09/2015.

<sup>21</sup>OECD: Action 1 – 2015 Final Report (2015), p76.

## **2.3.1 Key features of the digital economy**

In its BEPS Action 1 Deliverable, the OECD identifies mobility, the reliance on data, network effects, the use of multi-sided business models, the tendency towards monopoly or oligopoly relying on network effects and the volatility due to low barriers to entry and rapidly evolving technology as key features of the digital economy.<sup>22</sup> These key features will be summarised below.

### **2.3.1.1 Mobility**

#### *Intangibles*

The development of intangible assets has created significant value in the digital economy and has contributed to its growth. MNCs commit substantial resources to upgrade existing, and to develop new, intangible assets (such as software). MNCs are able to transfer such intangible assets to jurisdictions that are more favourable from a tax perspective, which will result in the legal ownership being separated from the development activities that created the intangible asset.

#### *Users*

Consumers are able to interact with businesses from virtually anywhere in the world and across different platforms (for example, through the internet on personal computers or dedicated applications on tablet devices or cell phones). Transacting via electronic means also leads to difficulty in establishing the identity of the user.

#### *Business functions*

As ICT has improved the efficiency and reduced costs of business processes, MNCs are able to centralise their global operations to limited locations, which could be in jurisdictions that are different to that of its customers and suppliers. Furthermore, ICT has made it possible for MNCs to interact with markets without a need for personnel in that market. MNCs are able to operate at a global or regional level rather than at a jurisdiction level. MNCs are thus able to migrate its operations to a low tax jurisdiction.

---

<sup>22</sup>OECD: Action 1 – 2015 Final Report (2015), p64.

### **2.3.1.2 Data**

Significant amounts of data is collected and analysed by MNCs to gain insights into consumer behaviour and preferences. Intangible assets are created which adds value for the MNC as they are able to deliver better offerings to their consumers more efficiently.

### **2.3.1.3 Network effects**

The constant interaction between consumers and ICT creates an environment where the ICT is continually being developed, creating benefits for other consumers.

### **2.3.1.4 Multi-sided business models**

Multi-sided business models are those where decisions of certain consumers affects the outcome for other consumers. An example of this is the flexible pricing structure adopted by the Valve Corporation's<sup>23</sup> Steam platform. The Steam platform is an application through which the Valve Corporation offers video games (and related software updates and other software) to consumers. Every week, the Valve Corporation offers a collection of games, known as a "Humble Bundle", to consumers for any price they are willing to pay. If a consumer pays a certain amount or an amount more than the current average purchase price<sup>24</sup> for the Humble Bundle, the consumer is entitled to additional games. The price certain consumers pay will have an impact on the average price for the Humble Bundle.

### **2.3.1.5 Tendency towards monopoly and oligopoly**

The first to enter a particular market is most likely to dominate that market in a short amount of time. This is due to the fact that the creation of patents or intangible assets often give the business exclusive rights to operate in that market.

### **2.3.1.6 Volatility**

The cost of ICT products and services have decreased due to constant development of ICT. This has resulted in lower barriers to entry for electronic based businesses. Furthermore, the constant

---

<sup>23</sup> The Valve Corporation is a company incorporated in the United States of America.

<sup>24</sup>The current average purchase price is the average purchase price paid by consumers that have already bought the Humble Bundle.

development of ICT has resulted in business models constantly changing as more efficient structures and processes are being implemented.

### **2.3.2 The development of traditional business models**

The growth of the digital economy has shifted traditional business models that generally relied on physical presence to those based on ICT. The DTC<sup>25</sup> highlights such changes in relation to various industries, based on the OECD BEPS Action Plan 1 Deliverable, as follows:

#### *Retailers*

Retailers can offer their products and services to customers electronically. Retailers are able to gather and analyse customer data to analyse trends, which enables them to target customers with related offerings and advertisements.

#### *Logistics and transport*

Vehicles and parcels can be tracked globally. Logistics can be managed in an efficient way that minimises fuel and storage costs.

#### *Financial services*

Financial institutions have enabled customers to manage their accounts, transact and access new products and services electronically. ICT has also facilitated the rise of high-frequency trading.<sup>26</sup>

#### *Manufacturing and agriculture*

ICT has facilitated the remote monitoring and the use of robots in the production process.

#### *Education*

Institutions are able to offer classes and courses via the internet. Education without face-to-face interaction is now possible.

#### *Healthcare*

Patients can be diagnosed remotely and their history can be accessed electronically. Robots could be used in certain surgical procedures.

---

<sup>25</sup>DTC (2014), p16.

<sup>26</sup>High frequency trading makes use of powerful computers to analyse market data to identify temporary arbitrage opportunities.

### *Broadcasting and media*

ICT has introduced multiple ways in which media (news, videos, music, advertisements etc.) can be delivered to consumers.

## **2.3.3 The continuous evolution of the digital economy**

The nature of the digital economy is that it is continually evolving and it must therefore be monitored to evaluate any potential impact it may have. Such developments are discussed below.

### *The internet of everything*

The internet of everything refers to the ongoing value creation as a result of the network effect connecting businesses and consumers.<sup>27</sup>

### *Virtual currencies*

Virtual currencies are those that are not backed by government issued legal tender, and include crypto-currencies such as bitcoins. Their emergence in recent years recognises the fact that they have acquired economic value.

### *Robotics and 3D printing*

These developments will enable manufacturing of products closer to the consumer. Blueprints for the product can be designed by the supplier who in turn can send them to the customer who manufactures the product.

### *The sharing economy*

Consumers may engage in peer-to-peer sharing of goods and services. This includes services such as AirBnB which offers its users the ability to rent out personal accommodation to other users for a set period of time.

---

<sup>27</sup>Evan, D (2012). *The Internet of Everything How more Relevant and Valuable Connections Will Change the World*. Cisco IBSG.

## 2.4 Tax challenges of the digital economy

Taxation challenges brought about by the digital economy are not new, as potential problems were identified in literature long before the BEPS initiative<sup>28</sup> and as noted by Bird,<sup>29</sup> countries have to do more to protect their tax base due to the growing importance of e-commerce.

In the past, MNCs would most likely have established subsidiaries in each of the jurisdictions it operated in, for the purpose of managing its business in each of those jurisdictions. Various factors contributed to inefficient business processes, such as slow communications, currency exchange regulation, customs duties, high transportation costs and government bureaucracy.

The development of ICT, and, thereby, the digital economy, has facilitated a more efficient and cost effective method of conducting business as MNCs are able to operate as global firms. MNCs are able to employ business models that function on a global or regional level.

As a result of operating on a global or regional level, a situation can arise where income is separated from the activities that generate it. With the digital economy, businesses are able to shift their profits to a more favourable jurisdiction, which undermines the integrity of tax systems. Such businesses gain an ‘unfair’ position in the market as they are able to offer products and services at lower prices than that of local competitors, which will further decrease domestic tax collection.

As the OECD<sup>30</sup> points out, strategies used by traditional or digital businesses to achieve BEPS do not differ significantly in nature. The rise of the digital economy has merely exacerbated BEPS risks.

Digital business models are centred on the fact that transactions with customers are initiated and concluded via the internet. Domestic tax laws of most countries require some level of physical presence before the income of non-residents is subject to tax. Through transacting with customers electronically, digital businesses forego the need to establish some form of physical presence.

---

<sup>28</sup>Blum (2015), p315.

<sup>29</sup>Bird, RM (2005) *Taxing Electronic Commerce: The End of the Beginning?* 59 Bull. Intl. Fiscal Doctr. 4, sec. 1, Journals IBFD

<sup>30</sup>OECD: Action 1 – 2015 Final Report (2015), p78.

Thus, the main concern that needs to be addressed is the fact that significant profits can be earned in a particular jurisdiction without the need for establishing a certain level of physical presence.

## 2.5 Conclusion

This Chapter, described the digital economy and analysed how it has evolved over recent years to become so integrated in business practices that it cannot be isolated from the real economy. The rapid pace with which ICT is constantly developing has resulted in more and more businesses adopting some form of ICT in their processes as the cost of ICT has become affordable.

Through the use of ICT, businesses have also been able to operate more efficiently as they are now able to centralise and streamline their operations from limited locations. Businesses are able to operate on a global or regional level rather than at a jurisdiction level. This change has seen businesses move away from traditional structures, which typically required them setting up subsidiaries in each country they operated in. The change to operate on a global or regional level makes commercial sense as it is often more cost effective and better from a control perspective.

Traditional tax principles are based on the concepts of residence and source. The concept of source requires a level of physical presence for income to be subject to tax in that jurisdiction. Through the use of digital business models, businesses may, intentionally or unintentionally, shift profits between jurisdictions.

What further complicates matters is that digital transactions are conducted electronically and it may be difficult to establish where they actually occur. In these cases, the concept of source will be tested.

As stated by the G20 leaders:

*“[...]Profits should be taxed where economic activities deriving the profits are performed and where value is created [...]”<sup>31</sup>*

---

<sup>31</sup>G20 (2012).*Leaders’ Declaration*. St. Petersburg, Russia. Available [https://www.g20.org/sites/default/files/g20\\_resources/library/Saint\\_Petersburg\\_Declaration\\_ENG\\_0.pdf](https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG_0.pdf). Last accessed 23/09/2015, p12.

As this dissertation will focus on the sale of goods via electronic means by non-residents operating in South Africa, it is necessary to analyse the concept of source in a South African context in order to establish how the sale of goods via electronic means are treated for tax purposes in South Africa. The next Chapter analyses the concept of source in the context of the digital economy and will also assess whether the current rules for source are sufficient given the fact that the digital economy is continually evolving.

## **3 Taxing the sale of goods via electronic means in South Africa**

### **3.1 Introduction**

South Africa used to tax residents and non-residents on the source basis. In 2001, the tax system in South Africa changed to the residence basis, where residents are subject to tax on their worldwide income and non-residents are taxed on their South African sourced income only.

As the focus of this dissertation is the sale of goods via electronic means by non-residents to residents, the concept of source must be analysed in order to determine South Africa's taxing rights to the profits from such transactions.

Section 9 of the ITA deems the source of certain categories of income to be South Africa. Where a category of income is not covered by section 9, common law rules that have developed over time must be looked at to determine the source of the income.

In this Chapter, common law principles will be reviewed before investigating whether the ITA contains specific provisions that deem income from the sale of goods via electronic means to be located at a source within South Africa. This Chapter will also consider the concept of PEs and withholding taxes (WHT), as these are relevant to this dissertation.

### **3.2 The South African concept of source**

The ITA does not contain a definition of the term 'source', as it is not possible to define the criteria for the source of income under all situations.<sup>32</sup> However, the general principle for the source of income is where the origin of such income is located.

Over the years, numerous cases have dealt with the interpretation of source, which have resulted in useful tests that can be used to determine the location of the origin of income.

#### **3.2.1 The originating cause**

In the case of the *Commissioner of Inland Revenue v Lever Brothers and Unilever Ltd*<sup>33</sup> ("the Lever Brothers case"), Judge Watermeyer stated:

---

<sup>32</sup>Stinlingh, M; et al (2013). *Silke: South African Income Tax 2013*. LexisNexis, p63.

<sup>33</sup>*Commissioner of Inland Revenue v Lever Brothers and Unilever Ltd*, 1946 AD 441, 14 SATC 1.

*“The word “source” has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word “source” and the inference, which, I think, should be drawn from those decisions is that the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these.”*

Thus, the principle test for the source of income, as extracted from Judge Watermeyer’s judgement, is determining the originating cause of the income.<sup>34</sup>

### **3.2.2 The dominant cause**

In some instances, there may be more than one originating cause, as was considered by the court in *Commissioner for Inland Revenue v Black*.<sup>35</sup>

In this case, the principle test was to establish the dominant, main, substantial or real and basic cause of the income, where there is more than one originating cause.

### **3.2.3 The source of income from the sale of goods**

As the focus of this dissertation is the sale of goods via electronic means, it is also necessary to consider the source rules currently applicable to the sale of goods.

---

<sup>34</sup>Haupt (2015), p37.

<sup>35</sup>*Commissioner for Inland Revenue v Black*, 1957 (3) SA 536(A), 21 SATC 226.

In *Commissioner for Inland Revenue v Epstein*,<sup>36</sup> the source of the taxpayer's income from the sale of asbestos was under consideration. It was held that the originating cause is where the taxpayer performed his work to earn the income.<sup>37</sup>

However, in *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana*,<sup>38</sup> the court found that the preparation of leather hides in Botswana, rather than the sale of those hides in South Africa was the more important factor in the taxpayer's operations.

The principles from these cases illustrate that source rules cannot be defined for each and every scenario. However, the common principle in these cases is that the source of income is where the work is done to earn the income.

Thus, in the case of the sale of goods via electronic means, the concept of source must be determined with reference to these principles.

### **3.3 Deeming source provisions**

Regardless of whether certain income is not sourced in South Africa using the principles from case law, income may be deemed to be sourced within South Africa in terms of section 9 of the ITA. One therefore needs to consider whether income arising from the sale of goods via electronic means would be subject to the provisions in section 9.

An analysis of section 9 indicates that there is currently no provision that deems income from the sale of goods via electronic means to be sourced within South Africa. Therefore, when determining the source of the income from the sale of goods via electronic means, the case law tests<sup>39</sup> must be applied. This has also been confirmed by the DTC.<sup>40</sup>

### **3.4 International taxing rights**

The aim of DTTs is to prevent a business being taxed twice (in different countries) on the same income. This is achieved by giving a certain country the taxing right to the income or granting

---

<sup>36</sup>*Commissioner for Inland Revenue v Epstein*, 1954 (3) SA 690(A), 19 SATC 221.

<sup>37</sup>In this case, the taxpayer's sale of products in the market country was considered to be more important than the procurement activities.

<sup>38</sup>*Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana*, 29 SATC 97 1967 (BCA).

<sup>39</sup>Refer section 3.2

<sup>40</sup>DTC (2014), p27.

relief from taxes levied in the other country. Although not a member state of the OECD, South Africa uses the OECD MTC largely as a basis for negotiating DTTs with other countries.

Of most relevance to this dissertation are the Articles covering PEs and business profits (Articles 5 and 7 respectively). These Articles, together with the relevant OECD Commentary, will give insight into the taxation of the sale of goods via electronic means, and are analysed below.

### **3.4.1 Article 7 – business profits**

Article 7 of the OECD MTC gives the primary taxing right to the profits of an enterprise to the state of that enterprise, unless the profit is attributable to a PE of the enterprise in another state. In this case, such profit is subject to tax in the other state.

In the context of the digital economy, one also therefore, needs to consider whether any digital or electronic business models are considered to be PEs.

### **3.4.2 Article 5 - permanent establishments**

Article 5 of the OECD MTC defines a PE as:

*“a fixed place of business through which the business of an enterprise is wholly or partly carried on”*.<sup>41</sup>

Article 5(2) and 5(3) lists physical instances which give rise to a PE, while Article 5(4) lists instances which are excluded from being classified as a PE. A notable exclusion is

*“the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character”*.<sup>42</sup>

#### **3.4.2.1 Electronic commerce**

The OECD Commentary provides guidance as to whether the use of computer equipment in electronic commerce operations could constitute a PE.

The OECD Commentary notes that computer equipment needs to be distinguished from the data and software that may be installed or used by that equipment. The OECD Commentary goes on

---

<sup>41</sup>OECD MTC (2014), Article 5(1).

<sup>42</sup>OECD MTC (2014), Article 5(4)(e).

to note that an internet website, which is a combination of software and data, does not constitute tangible property and thus will not have a fixed place of business. Therefore, websites will not constitute a PE.

A server, including those hosting websites, which has a fixed place of business may constitute a PE, provided that the server is at the disposal of the enterprise in question and despite the fact that no staff may be physically required to operate the server at its actual location. It is possible to move a server, which would impact the assessment of having a fixed place of business. However, in determining the fixed place of business, what is of relevance is whether the server has been moved, and not whether it can be moved.

Where the functions of the server are restricted to preparatory or auxiliary activities of the enterprise, the server will not constitute a PE. The OECD Commentary provides the following examples of preparatory and auxiliary services for servers:

- the provision of a communications link;
- advertising of goods or services;
- relaying information through a mirror server for security and efficiency purposes;
- gathering market data; and
- supplying information.<sup>43</sup>

However, to the extent that the examples above comprise a significant or core business activity, the server will constitute a PE with a fixed place of business. The OECD Commentary considers the case of an enterprise that sells products through the internet.<sup>44</sup> In this example, as the enterprise is not in the business of operating servers, the fact that it may sell its products through a server in a country may be no more than a preparatory or auxiliary activity. However, if the server processes the transaction, payment and delivery of the goods, the server may be performing more than a preparatory or auxiliary activity. Each particular case will have to be examined on its specific facts.

The shortcomings of the current definition of the PE concept is emphasized by Hongler and Pistone, who acknowledge that attempts have been made in the past to keep the PE definition

---

<sup>43</sup>OECD Commentary (2014), Paragraph 42.7.

<sup>44</sup>OECD Commentary (2014), Paragraph 42.9.

relevant, but all attempts have proven to be unsatisfactory. Furthermore, the allocation of profits to a server with no personnel may create an unfair allocation of taxing rights.<sup>45</sup>

### **3.4.3 Summary**

The OECD MTC and OECD Commentary provide useful guidelines to establish South Africa's taxing rights to the income of non-residents from the sale of goods via electronic means. These factors will be considered when analysing the Case Studies in Chapter 6.

## **3.5 Withholdings tax**

A country may impose a WHT on certain payments made to non-residents. Generally, the South African resident receiving the goods or services from the non-resident is required to pay the WHT to the South African Revenue Service (SARS).

The ITA imposes WHT on the following payments to non-residents:

- interest;
- royalties;
- fixed property acquired from a non-resident;
- fees earned by non-resident sports-persons and entertainers; and
- service fees.

Currently, there is no provision in the ITA that imposes a WHT on payments to non-residents for the sale of goods via electronic means.

## **3.6 Conclusion**

The concept of source is an important factor as it will determine whether South Africa has any taxing right to the income from the sale of goods via electronic means by non-residents. The general principle that should be considered is where the work is the principle of the originating cause of the income.

The DTC notes:

---

<sup>45</sup>Hongler, P & Pistone, P (2015). *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*. IBFD, p14.

*“However, the source rules in section 9 do not cover rules that deal specifically with electronic transactions. This implies that reference has to be given to common law principles. The common law source rules rely on the principle of originating cause (which is essentially what the taxpayer does to earn the quid pro quo and its location). However the common law guidelines developed by the South African courts to determine whether or not the source of income may be located in South Africa do not also take into account the complexities of the digital economy. Therefore, currently there is no adequate legal basis for the expansion of the South African fiscal jurisdiction to allow for the taxation of income derived by a non-resident from e-commerce transactions with South African residents. Thus companies like Google can avoid tax in South Africa because the originating cause of their income is not in South Africa.”<sup>46</sup>*

In the digital economy, it will prove challenging to establish where the work is performed to earn the income as a business may spread its activities across multiple jurisdictions. The strength of the concept of source will be tested in these situations.

In the next Chapter, local and international developments on the taxation of the digital economy will be explored.

---

<sup>46</sup>DTC (2014), p27.

## **4 Local and international developments on the taxation of the digital economy**

### **4.1 Introduction**

Addressing BEPS risks is a key concern for many countries around the world. Recognising the fact that the digital economy exacerbates BEPS risks as businesses are able to remove the activities generating revenue from the market jurisdiction where its customers may be located, in 2013 the G20 leaders instructed the OECD to prepare a 15 point Action Plan to address BEPS, with the object of restoring taxing rights with the activities that create value, by establishing consensus based international tax rules to protect tax bases and provide certainty to businesses. The key consideration of this project was to reduce the risks of double non-taxation and at the same time ensuring that any solutions proposed do not result in double taxation.<sup>47</sup>

In September 2014, the OECD released interim reports on some of the BEPS Action Plans and in September 2015, the OECD finalised and released its reports on all of the 15 Action Plans. In light of the OECD's final Action Plans for the BEPS project, the purpose of this Chapter is to analyse and summarise this report to explore in more detail the potential for BEPS opportunities in the digital economy, the options considered to address such challenges, the recommendations made, further developments and action points.

### **4.2 The OECD BEPS project**

The OECD released its interim report on Action Plan 1 of the BEPS project, entitled "Addressing the Tax Challenges of the Digital Economy" in September 2014, which was finalised in September 2015. The focus of this report was to assess the growth of the digital economy, its impact on businesses, identify the BEPS opportunities, to propose solutions for such challenges and to address future developments.

The OECD notes that the individual BEPS Action Plans cannot be assessed in isolation as the issues tend to overlap. The report on Action Plan 1 identifies the challenges of the digital economy and concludes that the risks are adequately addressed by the recommendations and

---

<sup>47</sup>OECD (2015). *OECD/G20 Base Erosion and Profit Shifting Project*. Available at [http://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project\\_23132612;jsessionid=8902n0lr371k2.x-oecd-live-03](http://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project_23132612;jsessionid=8902n0lr371k2.x-oecd-live-03). Last accessed 14/10/2015.

solutions detailed in other Action Points. The report on Action Plan 1 assesses these recommendations and solutions in the context of the digital economy.

As Hongler and Pistone (2015) note, any new proposal must be in line with international tax law, as this will increase acceptance.<sup>48</sup>

### **4.3 Potential for BEPS opportunities in the digital economy**

Taxpayers can essentially achieve BEPS by using the following strategies:

- Eliminating or reducing tax in the market country;
- Eliminating or reducing WHT in the source country;
- Eliminating or reducing tax at the level of the recipient of the income; and
- Eliminating or reducing tax at the level of the ultimate parent of the recipient of the income.

#### **4.3.1 Eliminating or reducing tax in the market country**

As discussed throughout this dissertation, businesses are able to interact with customers through the internet in order to earn significant amounts of income in jurisdictions where they may not have a physical presence. As local tax authorities will have difficulty in identifying the extent of such transactions and the parties thereto, MNCs may escape taxation in terms of domestic tax laws. Furthermore, international tax principles grant primary taxing rights to countries where a PE is located. However, such operations are unlikely to constitute a PE in the market jurisdiction (i.e. where the customer is located) as the PE definition is dependent on some form of physical presence.

Another tactic for eliminating or reducing tax in the market country can be achieved by limiting the income earned by a subsidiary or PE in a particular jurisdiction by allocating the functions, assets and risks giving rise to such income to other jurisdictions. This can be accomplished by limiting the delivery of goods in the market country, while the procurement, sales support and accounting functions are maintained in another country.

---

<sup>48</sup>Hongler and Pistone (2015), p15.

Businesses may also attempt to eliminate or reduce tax in the market country by claiming excessive deductions for payments made to offshore group businesses. These payments typically take the form of service, technical and management fees, royalties and interest.

#### **4.3.2 Eliminating or reducing WHT in the source country**

Businesses may take advantage of DTTs to eliminate or reduce the WHT it pays on its receipts by classifying them as royalties, interest, service fees etc.

#### **4.3.3 Eliminating or reducing tax at the level of the recipient of the income**

Businesses are able to eliminate or reduce tax in its state of residence by using favourable local tax regimes, excessive payments made to offshore subsidiaries and also by allocating the functions, assets and risks giving rise to such income in other jurisdictions.

#### **4.3.4 Eliminating or reducing tax at the level of the ultimate parent**

Through the same techniques mentioned above, the ultimate parent, in a group of companies situation, may eliminate or reduce tax in its jurisdiction of residence. The ultimate parent company may also choose to operate from a low-tax jurisdiction or one with poor CFC rules to ensure that income from its subsidiaries are not attributed to it.

### **4.4 Addressing BEPS in the digital economy**

In its BEPS Action Plan 1 report, the OECD states:

*“The comprehensiveness of the BEPS Action Plan will ensure that, once the different measures have been implemented in a co-ordinated manner, taxation is more aligned with the location in which economic activities take place”.*<sup>49</sup>

In order to achieve this goal, the measures that will be introduced are as follows:

#### **4.4.1 Measures that will restore taxation in the market jurisdiction**

Certain Action Plans of the BEPS project will focus on restoring source taxation.

---

<sup>49</sup>OECD: Action 1 – 2015 Final Report (2015), p86.

#### **4.4.1.1 *Action Plan 6 – prevention of treaty abuse***

MNCs will no longer be able to 'treaty shop' as a business has to operate in a country for business activities rather than its treaty network. Double non-taxation will also be prevented as the market country will have the right to apply domestic law regardless of the fact that the company may be non-resident in both states due to the application of a DTT.

#### **4.4.1.2 *Action Plan 7 – prevention of the artificial avoidance of PE status***

The PE definition will be modified to prevent MNCs from taking advantage of the PE exclusions.

#### **4.4.2 *Measures that will restore taxation in both the market and ultimate parent jurisdictions***

Certain Action Plans of the BEPS project will focus on addressing issues at the level of the market and the parent company jurisdictions.

#### **4.4.2.1 *Action Plan 2 – neutralise the effects of hybrid mismatch arrangements***

Situations will be addressed to prevent MNCs from taking advantage of unintended double non-taxation or long term tax deferral mechanisms. Examples of this includes claiming a deduction for expenditure incurred in multiple jurisdictions or claiming a deduction in one jurisdiction without reflecting the related income in another jurisdiction.

#### **4.4.2.2 *Action Plan 4 – limit base erosion via interest deductions***

Interest deductions will be limited to a formula based on earnings before interest, tax, depreciations and amortisation (EBITDA). The recommended limit will be a range of 10% - 30% of EBITDA.

#### **4.4.2.3 *Action Plan 5 – counter harmful tax practices more effectively***

In order to address situations where MNCs remove the intellectual property that generates income from the market jurisdiction, rules will be introduced stipulating that substantial economic activity must take place in the jurisdiction in which such intellectual property is located.

#### **4.4.2.4 *Action Plan 8 – 10 – ensuring that transfer pricing outcomes are in-line with value creation***

The focus of these Action Plans is to introduce TP rules to ensure that outcomes represent the economic reality of the transactions.

#### **4.4.3 Measures that will address BEPS issues in the ultimate parent jurisdiction**

One of the Action Plans will address BEPS issues in the ultimate parent jurisdiction to ensure that the ultimate holding company is fairly taxed.

##### **4.4.3.1 *Action Plan 3 – strengthening CFC rules***

CFC rules will be strengthened to ensure that the proper amount of income is attributed to the ultimate holding company. This will prevent MNCs from incorporating their ultimate holding company in low-tax jurisdictions or those with inadequate CFC rules.

#### **4.4.4 Summary**

As alluded to in Section 4.2, the individual Action Plans of the BEPS project cannot be analysed in isolation as they are all inter-related. However, of most relevance to addressing the issues of the digital economy are Action Plans 3, 7 and 8-10.

### **4.5 Challenges raised by the digital economy**

The digital economy, through the constant development of ICT, has enabled MNCs to coordinate their activities centrally, foregoing the need to have a physical presence in each jurisdiction of operation. This raises concerns in the international tax arena as traditional tax principles require a level of physical presence before the taxing right is granted to a particular jurisdiction.

The OECD notes the following three policy challenges presented by the digital economy:

- Nexus;
- Data; and
- Characterisation of income.<sup>50</sup>

---

<sup>50</sup>OECD: Action 1 – 2015 Final Report (2015), p99.

These issues often overlap, but will be discussed individually below:

#### **4.5.1 Income nexus**

The development of ICT has changed the manner in which business activities are performed, and not the nature of the fundamental and core business activities. The most significant change is the fact that substantial economic activity can be achieved in a country without the need to establish a physical presence therein. As a result of this, a business's taxable presence can be shifted between countries and the key factor to consider is where the taxable presence should actually be.

However, the OECD acknowledges that most MNCs may still have a physical presence in significant markets to ensure that they are able to deliver quality offerings to customers. Therefore, there may still be need for some level of infrastructure and staff to support the operations in the countries in which they operate. Despite this, the issue of the income nexus remains important as the issue of the ability to generate significant economic activity without the need for a physical presence still needs to be addressed.

Furthermore, contracts with customers can be concluded automatically through the use of technology and in a different jurisdiction to where that customer engages.

These issues may have further consequences as MNCs are able to make use of information from certain customers to create additional value elsewhere. This can be achieved by identifying trends to target potential customers. This is referred to as the network effect discussed in Part 2.3.1.3.

In the current economy, the PE definition and profit attribution rules, contained in the OECD MTC, are no longer appropriate as they were based on the principle of granting the taxing right where a physical presence was located. The issue of the nexus of income has become increasingly blurred.

A further point to consider in the digital economy is whether operations that were previously considered to be auxiliary and preparatory in nature have become core business functions. An example of this is an online retailer that requires the maintenance of a warehouse in the market jurisdiction, with limited employees, to ensure the efficient delivery of products to customers. If the success of the business relies on this, the maintenance of a warehouse may not be an auxiliary or preparatory activity.

The issue of the income nexus in the digital economy also extends to domestic legislation as non-residents are generally taxed on the source basis. With the digital economy, the source of the income may be difficult to establish.

Hongler and Pistone (2015) considered changing tax policy by introducing a new inclusion to the PE definition for the digital economy. This proposal is discussed in the next Chapter.

#### **4.5.2 Data**

Data has increasingly become a source of value in the digital economy. Data gathering, manipulation, mining and processing have become important activities for businesses to create value due to the following reasons:

- it allows businesses to tailor offerings to customers (i.e. identify a target);
- businesses are able to improve the development of their products and offerings; and
- businesses are able to improve decision making.

A key factor to consider is whether the gathering of data is taxable in the state in which it is collected. What could complicate matters further is that the manipulation, mining and processing of the data could be performed in another country using software developed in yet another different country. The OECD recognises this challenge by stating that:

*“The current tax rules for allocating income among different parts of the same MNE [MNC] require an analysis of functions performed, assets used, and risks assumed. This raises questions in relation to some digital economy business models where part of the value creation may lie in the contributions of users or customers in a jurisdiction. As noted above, the increased importance of users/customers therefore relates to the core question of how to determine where economic activities are carried out and value is created for income tax purposes.”<sup>51</sup>*

#### **4.5.3 Characterisation of income**

As previously noted in this dissertation, the digital economy has introduced new ways in which value can be created, which brings about new challenges in determining the location of value creation.

---

<sup>51</sup>OECD: Action 1 – 2015 Final Report (2015), p104.

Complications may arise as MNCs may treat the payment for the provision of goods or services in the digital economy differently. For example, should the income be characterised as royalties, technical services, license fees or business profits?

Different jurisdictions may also classify the income from the digital economy differently in terms of domestic legislation. Therefore, it is important to define the characterisation of such income in terms of international tax law.

#### **4.5.4 Other administrative challenges introduced by the digital economy**

In addition to the challenges discussed above, the digital economy also raises the following administrative challenges:

##### **4.5.4.1 *Identification of non-resident seller***

If the non-resident seller is not registered in the markets it sells remotely to, it will be difficult for the local tax authority to identify such non-resident sellers.

##### **4.5.4.2 *Determining the extent of business operations***

Without a physical presence, it may be difficult for local tax authorities to determine the extent of a non-resident seller's activities in a jurisdiction.

##### **4.5.4.3 *Information collection and verification***

The local tax authority may also find it challenging to obtain information regarding that non-resident's activities in its jurisdiction.

##### **4.5.4.4 *Identification of customers***

Due to the nature of electronic transactions, the identity of the customer may also be difficult to determine as transactions can occur anonymously. Furthermore, customers can enter into transactions via different electronic means, such as internet websites, dedicated applications accessed through smartphones or tablet devices or email.

## **4.6 OECD recommendations to counter BEPS risks in the digital economy**

As the problems of the digital economy overlap, the aim was to identify a solution that would focus on the ability to derive sales without a physical presence, use the contributions of users in the value chain and monetise such contributions.

A Task Force on the Digital Economy (TFDE) was established in 2013 and was tasked in 2014 to investigate proposals to address the challenges raised by the digital economy. Such proposals included:

- the modification to the exclusions to the PE definition;
- alternatives to the PE threshold;
- a WHT being imposed on certain digital transactions; and
- a bandwidth tax.

An alternative to the PE definition, the WHT and bandwidth tax options is summarised below.

### **4.6.1 A new nexus based on significant economic presence**

The OECD proposes that various factors should be considered to determine whether an entity has a significant economic presence in a country, through purposeful and sustained interaction therein. This will also provide certainty for businesses and limit compliance costs for tax authorities.<sup>52</sup>

#### **4.6.1.1 Revenue based factor**

Revenue is probably the most important factor to be considered as it will provide a degree of certainty, but should not be looked at in isolation. This is because the ability to earn revenue may be as a result of activities performed in another country (i.e. data processing, marketing and production).

The following points were considered by the OECD when the revenue based factor was developed:

*Transactions covered*

---

<sup>52</sup>OECD: Action 1 – 2015 Final Report (2015), p107.

The scope was limited to transactions concluded with customers through a digital platform that involved some form of an automation process. The problem with this factor is MNCs may manipulate the way transactions are concluded to avoid falling into this category. However, the other factors should mitigate such a risk.

#### *Level of threshold*

A threshold should be set based on the gross revenues collected from the transactions concluded with customers. The threshold should be predetermined in local currencies to avoid the risk of manipulation. Furthermore, the threshold should be high enough to minimise the compliance and administration burden and low enough to ensure that sufficient taxes are collected.

#### *The administration of the threshold*

Once the threshold is breached, non-resident businesses should be required to register as taxpayers. A simple and inexpensive registration process should be available to non-residents to ensure their compliance.

### **4.6.1.2 Digital factors**

There are certain digital factors that may be considered in determining whether a significant economic presence exists. These include:

#### *Local domain name*

The use of local website addresses may indicate that the MNC places some significance on its activities in that region. A local website address also serves a dual purpose for an MNC to protect its trademarks and the unauthorised use of its name.

#### *Local digital platform*

MNCs may also offer their products and services through local digital platforms where they are tailored to individual markets. Such features may include using local language and providing location relevant information.

#### *Local payment options*

Another factor that may indicate a significant economic presence is the offering to customers to be able to pay in their local terms of payment. Quite often, setting up such local payment

options requires a significant amount of resources and it is therefore unlikely for a MNC to invest resources without expecting a meaningful economic return.

#### **4.6.1.3 *User based factors***

Factors based on users may also be helpful in indicating whether a significant economic presence exists.

##### *Monthly active users*

The amount of users of a digital platform can give an indication of an economic presence. However, this factor can be manipulated through the creation of fake accounts.

##### *Online contract conclusion*

The amount of contracts with customers via the digital platform should be monitored as this could also indicate an economic presence.

##### *Data collected*

A further factor to consider is the amount of data collected from a certain jurisdiction relative to the total amount of data collected by the MNC. Of little relevance is where the data is subsequently stored and analysed.

#### **4.6.1.4 *A combination of the factors***

The OECD notes that the most effective measure is to establish a revenue threshold with a combination of some of the factors above in order to determine whether a significant economic presence exists. A revenue based threshold cannot be the sole criteria.<sup>53</sup>

#### **4.6.2 *Determining the income attributable to significant economic presence***

If a new nexus is adopted based on significant economic presence described in Section 4.6.1 above, parity needs to be sustained between MNCs that are taxed due to physical presence and those due to significant economic presence. The attribution of profits is therefore an important point to consider.

---

<sup>53</sup>OECD: Action 1 – 2015 Final Report (2015), p111.

Under existing rules, no income is to be attributed to a jurisdiction in which there is no physical presence. Two options were considered by the OECD to attribute profits based on significant economic presence.<sup>54</sup>

#### *Fractional apportionment methods*

This method results in income being apportioned according to a formula or factors determined on a case-by-case basis. However, fractional apportionment would go against traditional international tax principles.

#### *Methods based on modified deemed profits*

This method entails allocating expenses based on a ratio, which could be predetermined for industry types or the business' capital requirements. This method will be simpler to administer. However, MNCs may find the application of such a method to be complex in cases where they operate in multiple jurisdictions and the predetermined ratios may not be appropriate for their business models. Furthermore, under the deemed profit method, an MNC may calculate that it has taxable profits in a specific jurisdiction while its economic and financial reality reflects that it is making a loss.

### **4.6.3 Withholding tax**

A WHT could be imposed as a final tax on payments made to non-residents for goods and services purchased via electronic means. A WHT could also serve as a collection mechanism if a new nexus is adopted. However, the OECD notes that the imposition of a WHT may raise concerns regarding international trade obligations.<sup>55</sup>

#### **4.6.3.1 Transactions covered**

If a WHT is imposed, the transactions subject to the WHT must be clearly defined, as this provides certainty to taxpayers and to ensure that tax authorities do not abuse the provision. The definition should not provide a listing of transactions, but should rather be developed to cater for a wide range of similar digital transactions.

---

<sup>54</sup>OECD: Action 1 – 2015 Final Report (2015), p112.

<sup>55</sup>OECD: Action 1 – 2015 Final Report (2015), p113.

#### **4.6.3.2 Collection of WHT**

Collection of the WHT may be a challenge as customers cannot be expected to withhold the tax from a payment made for a transaction and then have to pay it over to the relevant revenue authority. Such a process will be very difficult to administer and monitor.

An option would be to impose the obligation to withhold the taxes on the financial intermediary processing the payment. However, this places an unfair burden on the financial intermediary as it will increase their operational costs and they may not have sufficient information to determine whether the WHT should be withheld from payments they process.

#### **4.6.4 Equalisation tax**

The TFDE also investigated an option to impose an equalisation levy on MNCs with a significant economic presence in order to ensure that resident and non-resident businesses are treated equally. However, such a levy is likely to be an issue for international trade agreements.

### **4.7 The recommendation proposed by the TFDE**

In evaluating the options for potential solutions to address the challenges raised by the digital economy, the TFDE assessed the options in terms of the following principles:

- **Neutrality:** taxpayers should be subject to the same principles;
- **Efficiency:** the benefits of any changes should justify its administrative and implementation costs;
- **Certainty and simplicity:** tax rules should be simple to understand and provide taxpayers with certainty;
- **Effectiveness and fairness:** taxpayers should be taxed the right amount and at the right time;
- **Flexibility and sustainability:** tax rules should be able to cater for future developments; and
- **Proportionality:** the broader implications of options should be considered.

The TFDE concluded that, as a result of the work performed on Action Plan 7, Article 5(4) of the OECD MTC will be modified to only exclude activities of a preparatory or auxiliary nature and a new anti-fragmentation rule will be introduced to prevent businesses from benefiting from

the exceptions by fragmenting operations through different subsidiaries in the same jurisdiction. These changes will be implemented across the treaty network in a synchronised manner.

The TFDE recommended that no other options analysed be adopted, because once implemented, the whole BEPS project will restore taxing rights to where value creation occurs.

The OECD notes that countries can adopt the measures described in Section 4.6 of this dissertation in its local tax legislation in order to protect its tax base. However, any measures implemented should be in good faith of international tax laws.

## **4.8 Changes to the PE definition**

The exceptions to the PE definition stipulated in Article 5(4) previously included activities that were generally considered to be preparatory or auxiliary in nature. However, through the rapid development of ICT, businesses have been able to change the way they operate. Activities that were previously considered to be preparatory or auxiliary in nature may now very well be a core business function. An anti-fragmentation rule will also be introduced to prevent MNCs from spreading their activities across multiple subsidiaries in the same jurisdiction in order to claim that individually, they are preparatory or auxiliary in nature.<sup>56</sup>

These proposed changes to the OECD MTC are detailed in the OECD's final report on Action Plan 7 and is summarised below.

### **4.8.1 Preparatory and auxiliary activities**

The current wording of Article 5(4) of the OECD MTC is as follows:

*“Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:*

*a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;*

*b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;*

---

<sup>56</sup>OECD (2015). *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: <http://dx.doi.org/10.1787/9789264241220-en>. Last accessed 16/10/2015, p10.

*c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;*

*d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;*

*e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;*

*f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.”<sup>57</sup>*

Through the work on the BEPS Project, the OECD will make all the exclusions subject to being preparatory or auxiliary in nature as follows (additions are in bold and deletions are marked in ~~strikethrough~~):

*“Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:*

*a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;*

*b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;*

*c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;*

*d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;*

*e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity ~~of a preparatory or auxiliary character~~;*

*f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), ~~provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.~~*

---

<sup>57</sup>OECD MTC 2014, Article 5(4)

*provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.”<sup>58</sup>*

The effect of this modification is that in order for an activity to qualify for the PE exclusion, it must be preparatory or auxiliary in nature. The current version of the OECD MTC only requires activity 5(4)(f) to be preparatory or auxiliary in nature (i.e. activities 5(4)(a) to (e) currently qualify for an exclusion from the PE definition regardless of whether they are preparatory or auxiliary in nature)

The OECD also intends to modify paragraphs 21 to 30 of the OECD Commentary on Article 5(4) in order to provide more clarity on the term “preparatory or auxiliary”. The key highlights of the relevant changes are summarised below.

The basic premise of preparatory or auxiliary activities is that they may contribute to the productivity of the business by acting as complementary functions, but they are so remote to the creation of value that it is almost impossible to allocate profits to such activities.<sup>59</sup> The guidance that will be provided is as follows:

*“As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else.”<sup>60</sup>*

It will be difficult to determine whether certain activities can be classified as preparatory or auxiliary as opposed to a core business function. In such cases, the merits of the facts will have to be examined.<sup>61</sup>

According to the OECD, some states are of the opinion that the existing exclusions contained in Article 5(4) of the OECD MTC infer that they apply to activities of a preparatory or auxiliary

---

<sup>58</sup>OECD: Action 7 – 2015 Final Report (2015), p28.

<sup>59</sup>OECD: Action 7 – 2015 Final Report (2015), p29.

<sup>60</sup>OECD: Action 7 – 2015 Final Report (2015), p30.

<sup>61</sup>OECD: Action 7 – 2015 Final Report (2015), p30.

nature and that the proposed changes to Article 5(4) are therefore unnecessary. This argument may be weak as there is explicit use of the term ‘preparatory and auxiliary in nature’ in the current OECD MTC Articles 5(4)(e) and (f), but it is excluded from the rest.

Nevertheless, to cater for this, the OECD has provided an alternative for these states on which to base their DTTs.<sup>62</sup>

#### **4.8.2 Anti-fragmentation rule**

The anti-fragmentation rule below will be included in paragraph 4.1 of Article 5 of the OECD MTC:

*“Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and*

*a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*

*b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

*provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”<sup>63</sup>*

The aim of this modification is to prevent businesses from fragmenting their core business activities into smaller activities across different locations in the same state that may be seen as preparatory or auxiliary in nature in isolation. Businesses will also not be able to spread such activities across different subsidiaries or locations in order to benefit from them being classified as a preparatory or auxiliary activity individually.

---

<sup>62</sup>OECD: Action 7 – 2015 Final Report (2015), p38.

<sup>63</sup>OECD: Action 7 – 2015 Final Report (2015), p39.

## **4.9 Future developments and action points**

The OECD acknowledges that, as the digital economy continues to develop, further consideration may be required as to the conclusions reached in its Action Plans, with a particular emphasis on robotics, 3D printing and the sharing economy. To this effect, the OECD proposes to continually monitor the digital economy in respect of data and information that becomes available over time in order to address any international taxation matters. The OECD intends to release a BEPS monitoring process in 2016 with the anticipation of releasing another report on the digital economy in 2020.<sup>64</sup>

## **4.10 Conclusion**

The direct outcome of the BEPS project to address concerns raised by the digital economy is to alter the exclusions listing from the PE definition (Article 5(4) of the OECD MTC) for activities that are only auxiliary and preparatory in nature. While some issues may still remain, the implementation of the BEPS Project in its entirety aims to allocate taxing rights to the location of value creation.

In light of the recommendations made by the OECD, an assessment of the impact on the South African fiscus is necessary and will be investigated in the next Chapter.

---

<sup>64</sup>OECD: Action 1 – 2015 Final Report (2015), p138.

## **5 The framework for taxing the digital economy in a South African context and other considerations**

### **5.1 Introduction**

As previously discussed in Chapter 3, South Africa subjects non-residents to tax on South African sourced income in terms of the originating and dominant cause principles and also, the ITA may deem certain categories of income to be from a South African source. However, the ITA currently contains no deeming provisions for the sale of goods via electronic means by non-residents.

In terms of international tax principles, South Africa may have the right to tax a non-resident if it can be established that the non-resident derives profits from a PE located in South Africa. The proposal by the OECD to narrow the exceptions to the PE definition will have far reaching implications, which will be investigated in this Chapter.

### **5.2 Implications for South Africa**

#### **5.2.1 Growth of the South African digital economy**

Data usage in South Africa is on the rise. It is reported that income from the provision of internet services rose by 8.6% between 2010 and 2013, with R35.1 billion income being generated in 2013. It is also reported that of the R224 billion income generated by the telecommunication services industry in South Africa, 69% arose from the usage of fixed telephone lines and mobile phones.<sup>65</sup> These statistics clearly indicate that ICT is a significant factor in the South African economy. The more that is spent on internet services the more the number of potential consumers able to make purchases electronically increases.

Research has revealed that the propensity for South African consumers to enter into electronic transactions is on the increase. Studies have indicated that 22% of South African internet users have purchased products and services online, and a further 48% intend on doing so in the future. Transacting via smartphones has become very popular, whereby South African consumers purchase products through specially designed smartphone applications by online retailers, such

---

<sup>65</sup>Evans, J (2015). *Income from internet services on the rise – Stats SA*. Available at: <http://www.news24.com/SouthAfrica/News/Income-from-internet-services-on-the-rise-Stats-SA-20151005>. Last accessed 18/10/2015.

as Takealot.com. These applications make the online shopping experience more convenient as consumers are able to research products, do price comparisons, access user reviews and enables quick and efficient payment. It is estimated that about 50% of South Africans owning smartphones have made purchases with their smartphone, with an additional 21% expecting to do so.<sup>66</sup>

It is interesting to note that in its 2014 South African eCommerce Report, Effective Measure and IAB South Africa have found that visits to South African online retail websites increase substantially over the Christmas and New Year period.<sup>67</sup>

Google South Africa has also noticed significant growth in South Africa's e-commerce industry and anticipates that a huge e-commerce market will materialise by 2017. Search trends indicate that internet users often conduct purchasing research.<sup>68</sup> This coupled with the fact that online retailers are incorporating detailed product information in their dedicated applications may result in increased e-commerce transactions.

## 5.2.2 The e-commerce industry in South Africa

Rode (2014) notes that e-commerce South Africa, compared to the rest of the world, is still in its infancy phase due to the following reasons:

- high delivery charges;
- consumers are under the impression that the only means of payment for transacting through the internet or dedicated applications is with a credit card;
- safety concerns, specifically due to credit card fraud;
- returns policy, specifically in respect of clothes that do not fit correctly; and
- the poor design of websites.<sup>69</sup>

---

<sup>66</sup>IT News Africa (2015).

<sup>67</sup>Effective Measure and IAB South Africa (2014). *South African Ecommerce Report*. Available at <http://www.effectivemeasure.com/south-african-ecommerce-report-february-2014>. Last accessed: 18/10/2015, p1.

<sup>68</sup>Du Plessis, AP (2015). *Google predicts massive growth in African e-commerce*. Available: <http://www.bdlive.co.za/africa/africanbusiness/2015/02/06/google-predicts-massive-growth-in-african-e-commerce>. Last accessed: 18/10/2015.

<sup>69</sup>Rode, H (2014). *E-commerce in South Africa in 2014*. Available at <http://limabean.agency/article/the-state-of-e-commerce-in-south-africa-in-2014#.ViNQFhHsnIU>. Last accessed 18/10/2015.

Durrant (2015) re-affirms that the e-commerce industry in South Africa lags behind the rest of the world, as online retail only accounts for less than 1% of the total market for consumer goods in South Africa, compared to 10-12% in developed countries. In addition to the challenges above, it was also found that South African consumers are also concerned about the quality of products offered, especially in the case of unknown brands, poor internet connections, slow speeds and high costs.<sup>70</sup>

Effective Measure and IAB South Africa (2014) have identified that the two key reluctances by South African consumers to purchase goods online are due to the security of online payment systems and that consumers prefer touching and feeling the products before purchasing them.<sup>71</sup>

According to a study conducted by Ipsos, on behalf of Paypal and FNB, IT News Africa (2015), factors that will drive the growth of e-commerce in South Africa are lower product costs, faster delivery, flexible delivery options and safer means of payment, while the main concerns regarding online shopping are security of payments and the delivery of goods.<sup>72</sup>

Significant investment is being poured into the e-commerce industry in South Africa. Takealot.com, South Africa's leading online retailer, received an investment of \$100 million from Tiger Global Management, a hedge fund manager, to expand its operations in South Africa and then sub-Saharan Africa.<sup>73</sup> This clearly indicates that e-commerce in South Africa is expected to grow exponentially and substantiates Google South Africa's prediction.

Despite such significant investments, of concern to the South African e-commerce industry is the reasons for the merger between Kalahari.net and Takealot.com, South Africa's largest online retailers, in 2014. Both businesses had been running at losses and it was anticipated that a merger between the two would turn a profit. If the largest online retailers in South Africa struggled to make profits, it does not create a sense of confidence that entering into the e-

---

<sup>70</sup>Durrant, N (2015). *The real state of ecommerce in South Africa: 9 things you need to know today*. Available: <http://ventureburn.com/2015/04/real-state-ecommerce-south-africa-9-things-need-know-today>. Last accessed: 18/10/2015.

<sup>71</sup> Effective Measure and IAB South Africa (2014), p7.

<sup>72</sup>IT News Africa (2015). *Study reveals that E-commerce is on the rise in South Africa*. Available: <http://www.itnewsafrica.com/2015/03/study-reveals-that-e-commerce-is-on-the-rise-in-south-africa>. Last accessed: 18/10/2015.

<sup>73</sup>Rao, L (2014). *South African E-commerce giant Takealot raises \$100m from Tiger Global*. Available: <http://techcrunch.com/2014/05/23/south-african-e-commerce-giant-takealot-raises-100m-from-tiger-global>. Last accessed 18/10/2015.

commerce industry will be fruitful. However, smaller online retailers, such as Yuppiefchef and Spree appear to be operating healthily.<sup>74</sup>

### **5.2.3 Non-residents operating in South Africa**

Effective Measure and IAB South Africa have estimated that 15% of the more than 10 000 South African consumers surveyed that purchase goods via electronic means, do so from non-resident online retailers. The most notable of such non-resident businesses are amazon.com, amazon.co.uk, ebay.com and ebay.co.uk.<sup>75</sup> This, coupled with the fact that the South African e-commerce industry is growing at an exponential rate, may result in such economic activity by non-resident businesses in South Africa, being considered as more than just preparatory or auxiliary in nature.

The current exclusions from the PE definition contained in the OECD MTC provides sufficient clarity as to what activities are precluded from being a PE. As these exceptions will now be limited to activities that are only preparatory or auxiliary in nature, many non-resident online retail businesses will have to re-consider whether any of its activities will constitute a PE in South Africa.

The case of Amazon.com is of particular interest. Amazon.com is predominantly an online retailer based in the United States of America, which ships products globally. Through its intricate network of subsidiaries, Amazon.com also offers various computer based services to businesses around the world. The Amazon Elastic Compute Cloud (Amazon E2C) is one such service that provides cloud based computing resources. Amazon established a presence in South Africa over 10 years ago only to assist in developing this Amazon E2C service. This South African company has no involvement with Amazon.com's online retail operations and should not be taken into account when considering whether Amazon.com's sales to South Africans may constitute a PE.

The impact of the proposed changes to the exclusions to the PE definition will have to be considered for businesses such as Amazon.com. The key issues for SARS, and likewise, any other revenue authority, would be:

---

<sup>74</sup>Durrant (2015).

<sup>75</sup>Effective Measure and IAB South Africa (2014), p1 and 9.

- how will SARS determine who the non-residents operating in South Africa via electronic means are;
- how to determine the extent of such non-residents' activities in South Africa;
- gathering the relevant information from the non-resident; and
- enforcing compliance from the non-resident.

The South African fiscus does not stand to lose significant revenue due to South African online retailers transacting with non-residents, as the current level of activity is very low.<sup>76</sup> This is confirmed by the DTC which notes that the real issue rests with non-resident businesses transacting with resident individuals.<sup>77</sup>

However SARS potentially stands to gain revenue by investigating whether the activities of non-resident businesses like Amazon.com have PEs in South Africa, but such investigations may prove costly.

#### **5.2.4 Possible options to ensure compliance by non-residents operating in South Africa**

Ensuring compliance with the proposed changes to Article 5(4) of the OECD MTC will prove to be a challenge for SARS and other revenue authorities alike for the reasons set out above. SARS may choose to adopt either or both of the following options:

##### **5.2.4.1 *Special registration process and income tax return for non-residents with a PE in South Africa***

In recent times, tax morality has been high on the agenda of MNCs as it enhances their corporate image.<sup>78</sup> SARS may therefore choose to rely on the integrity of such non-resident businesses to ensure their self-compliance with South African tax laws.

In this regard, SARS should create a special registration process for non-residents that are established to have a PE in South Africa. This registration process should be simple and efficient to further motivate non-residents to comply with South African tax laws. A simplified version of the income tax return should be developed which such non-residents would be

---

<sup>76</sup>IT News Africa (2015).

<sup>77</sup>DTC (2014), p26.

<sup>78</sup>Hyatt, J (2015). The new morality in tax strategies. Available <http://ww2.cfo.com/tax/2015/05/new-morality-tax-strategies>. Last accessed: 18/10/2015.

required to complete. When such returns are assessed, international payment details should be made clear on the assessment. SARS should make the compliance process as simple as possible, in order to ensure self-regulation.

Furthermore, it is proposed that non-resident online retailers who do not sell goods to South African residents for a value exceeding R1 million in total in their tax year should not be liable to tax in South Africa and therefore would not be required to register. This will ensure that the administration of such non-resident online retailers will not be burdensome.

#### **5.2.4.2 WHT on payments for goods bought via electronic means**

Another option would be to impose a WHT on payments made for the purchase of goods from non-residents via electronic means. This could be achieved by introducing a new section in the ITA. The following wording could be used:

**Levy of withholding tax on the purchase of goods via electronic means.**—(1) There must be levied for the benefit of the National Revenue Fund a tax, to be known as the withholding tax on electronic transactions, calculated at the rate of 15 per cent of the amount of any payment by any person to or for the benefit of any foreign person for the purchase of goods via electronic means.

(2) The withholding tax on electronic transactions is a final tax.

(3) For the purpose of this Part, “purchase of goods via electronic means” means the purchase of goods via the internet, digital platforms, such as dedicated applications accessible by smartphones, tablet devices and similar devices and other similar means.

The main issue with this option that needs to be addressed is which party should be liable to withhold the WHT. If the non-resident online retailer is made liable, it defeats the purposes of introducing the WHT. Imposing the WHT obligations on the consumer will be problematic for the following reasons:

- it is unlikely that individual consumers will take it upon themselves to withhold a portion of the payment for the goods and then subsequently pay it over to SARS;
- SARS would have to develop a special collection system to facilitate the receipt of such WHT, which could prove more costly than any potential benefit; and

- non-resident online retailers do, and would, not facilitate a payment option to settle an amount less than 100% of the selling price of the products selected.

The only other option is to impose the withholding obligation on the financial intermediary facilitating the payment. However, this will also be problematic for the following reasons:

- an unfair burden will be placed on the financial intermediaries who are already under strain as a result of SARS' far reaching powers to request information on taxpayers from them;
- the financial intermediary will not have sufficient details of the transactions to be able to make the decision on whether WHT should be withheld; and
- it is unlikely that the South African customer will receive the goods if the non-resident online retailer has not received the full amount from the sale of the goods.

The imposition of a WHT on the sale of goods by non-resident online retailers may have the effect of discouraging transactions with South Africa. At a time when foreign investment is needed, this may not be the best option to address the potential tax leakage.

#### **5.2.4.3 Summary of options**

Imposing the WHT on payments for goods purchased via electronic means may not be a feasible option for the reasons set out above and this is confirmed by Hongler and Pistone (2015).<sup>79</sup> Brauner and Baez also note that a transition to and the implementation of a WHT solution will be complex and will require the cooperation from all countries.<sup>80</sup> SARS should rather rely on the integrity of non-resident online retailers to self-comply.

SARS could also approach foreign revenue authorities by relying on the exchange of information Article in DTTs and tax information exchange agreements should they require information of non-resident online retailers which they believe may potentially have a PE in South Africa.

At this stage, it is not recommended that the other options mentioned in Section 4.6, namely introducing specific source rules or an equalisation tax, be introduced in South African tax law.

---

<sup>79</sup>Hongler and Pistone (2015), p46.

<sup>80</sup>Brauner, Y and Baez, A (2015). Withholding Taxes In the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy. IBFD, p22.

Further studies into the extent of South Africa's digital economy must first be performed in order to establish the feasibility of doing so.

### 5.3 Criticism of the BEPS Project on taxing the digital economy

Although the OECD released their final reports on the BEPS project recently in relation to the time of writing this dissertation, criticisms and comments on their recommendations must be taken into account.

With regard to the OECD's report on Action Plan 1, KPMG (2015) notes that taxing B2C supplies of digital services and low-value e-commerce in the consumer's country of residence will place a compliance burden on businesses operating in the digital economy, the cost of which could fall on consumers as a result of price increases. Uncertainty and inconsistencies across tax authorities may also result as it seems as though countries are encouraged to address BEPS challenges unilaterally. In respect of the proposed changes to Article 5(4) of the OECD MTC, the implications are far reaching as every MNC will have to consider the impact in relation to their operations.<sup>81</sup>

In a tax news flash, KPMG (2015) also stated the following:

*“The final report confirms that the OECD's BEPS recommendations should only find tax nexus where a foreign enterprise has a physical presence. However, this hoped-for outcome is significantly tempered by the TFDE's tacit approval for countries to go their own way by adopting economic nexus standards or other new DE [digital economy] taxes such as DE withholding tax or equalization levies. This development is particularly troubling because it presents a pathway for potentially significant double taxation of DE profits. The risk of double taxation could be fuelled by inconsistent views of how value is created within DE business models and the imposition of 'new' DE taxes and levies that are non-creditable in the resident or home-country jurisdiction. Evidencing the divergent views of members of the TFDE, the final report notes that the challenges of the DE raise*

---

<sup>81</sup>KPMG (2015). *In a Nutshell – The October 2015 BEPS Deliverables*. Available <http://www.kpmgpublications.ie/publication/in-a-nutshell-the-october-2015-beps-deliverables>. Last accessed 19/10/2015. Slides 1 and 2. Also refer The Davis Tax Committee (2014). Preventing Base Erosion and Profit Shifting in South Africa., Davis Tax Committee Interim Report, Summary of recommendations for South Africa: OECD September 2014 Deliverables. Available: [http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Last accessed 21/09/2015.

*important policy questions of how taxing rights of DE income should be allocated amongst resident and source countries. It is doubtful these policy issues will subside throughout the TFDE's ongoing work and may well drive future changes in the way DE income is taxed.”<sup>82</sup>*

Thus, in an attempt to address the tax challenges of the digital economy, the OECD may have made matters more complicated by allowing countries to introduce domestic legislation to tax profits arising from the digital economy. Without a bilateral consensus, solution or relief, such profits may be subject to taxation in more than one state, which has not been a problem before.

With the modification of the exclusions to the PE definition, MNCs will have to consider whether any of its offshore operations, not just those within the digital economy, are not preparatory or auxiliary in nature. Such an exercise may be challenging in its own right as there is little guidance, both locally and internationally, on what the term ‘preparatory or auxiliary’ actually means. Without an objective definition or detailed guidance, revenue authorities may subject the non-resident to tax and it will be left to the non-resident to argue that it does not have a PE in that state. This, coupled with the current burdensome registration and compliance requirements in South Africa, may result in non-resident businesses limiting their economic activity in South Africa. These concerns are not limited to non-resident online retailers only, but have far reaching implications.

The OECD intends on monitoring the conclusions reached as part of the BEPS Project, with specific emphasis on developments in the digital economy. A formal monitoring process will be released in 2016 and another report on the digital economy will be finalised in 2020. Any shortcomings of the current conclusions, identified above or not yet apparent, should, hopefully, be addressed by then.

## **5.4 Conclusion**

As numerous studies have found, the digital economy is constantly evolving and changing the way of conducting business. One of the consequences is that it has resulted in a significant increase in the number of transactions being concluded electronically. As emphasized throughout this dissertation, the digital economy has not changed the core functions of

---

<sup>82</sup>KPMG (2015). *TAXNEWSFLASH – BEPS Special Edition*. Available <https://home.kpmg.com/xx/en/home/insights/2015/09/taxnewsflash-beps-special-edition.html>. Last accessed 19/10/2015.

businesses, but has rather changed the ways in which businesses go about performing them. The OECD has recommended changes to the OECD MTC to address these challenges, with the aim of restoring the taxing right at the location of value creation.

As discussed in this Chapter, the proposed changes may have theoretical limitations. It will be useful to examine a few scenarios as case studies to determine whether such limitations are in fact issues that require further consideration or if all areas of concern will be adequately addressed. A number of scenarios are presented in the form of case studies and analysed in the next Chapter.

## **6 Case studies**

### **6.1 Introduction**

While there may be limitations to the changes proposed to Article 5(4) of the OECD MTC, the proposed changes must be considered from a practical perspective. This Chapter analyses a number of cases where non-resident online retailers transact with South African customers. The tax implications are considered in terms of the current South African tax legislation, the current OECD MTC and the proposed changes to the OECD MTC.

An assumption is made that for all cases examined below, South Africa has a DTT with all of the countries modelled on the OECD MTC.

### **6.2 Case study A**

#### **6.2.1 The facts**

Company A, a resident of Country A, is an online retail company that sells physical products. It sources its products from various manufacturers and wholesalers based around the world. Company A employs a number of staff that are capable of running its entire operations from its head office in Country A. These functions include procurement, logistics, sales, marketing, customer services, finance, accounting and administration.

Company A only has one website which customers may access, and its domain is registered in Country A. This website is hosted on servers physically located in Country A. Customers around the world can access the website and make purchases using credit cards.

The delivery of the products is outsourced to a third party courier company that is able to deliver globally.

When a customer transacts with Company A through its website, the transaction and payment is processed on servers located in Country A.

Company A does not have any presence in South Africa, other than for South African residents being able to access the website and make purchases.

### **6.2.2 Application of the current South African domestic tax law**

As Company A is a non-resident, it may be subject to tax in South Africa only if its income is derived from a South African source.

As discussed in Chapter 3, the originating and dominant cause tests must be considered.

Company A's operations are all based in Country A. The only activity in South Africa is that of a resident initiating the transaction by indicating they wish to make a purchase via Company A's website.

On these particular set of facts, it cannot be said that the originating or dominant cause of the earning of the income is in South Africa as all the staff running the operations of Company A and the servers processing the transaction and payment are located in Country A. None of Company A's profits derived from South African customers will be taxed in South Africa.

### **6.2.3 Application of the current OECD MTC**

Article 7 of the OECD MTC grants the taxing right to business profits to the state of residence, unless a PE is established in the other state. As Company A is resident of Country A, it is necessary to ascertain whether Company A has a PE in South Africa.

The key criteria in the definition of the term PE is that there must be a fixed place of business through which the activities of a company is wholly or partly carried on.

As Company A has no presence in South Africa, it does not have a fixed place of business in South Africa from which it operates, and consequently does not have a PE. Any profits derived from sales to South African residents are taxable in Country A only.

It is not necessary to consider whether any activity performed by Company A in South Africa (i.e. entering into transactions with customers) fall within the exclusions listed in Article 5(4) of the OECD MTC, as a fixed place of business is required first.

### **6.2.4 Application of the proposed changes to the OECD MTC**

The relevant changes proposed to Article 5 of the OECD MTC do not impact on the key requirement of the existence of a fixed place of business for there to be a PE. As such, Company A will only be subject to tax on income from South African customers in Country A.

### **6.2.5 Outcome and other considerations**

In this case study, there are no issues arising from the application of domestic tax law in South Africa and there is no difference in the outcome between the current and the proposed versions of the OECD MTC. However, these findings may differ if the operations of Company A are structured slightly differently.

## **6.3 Case study B**

### **6.3.1 The facts**

Company B, a resident of Country B, is an online retail company that sells physical products. It sources its products from various manufacturers and wholesalers based around the world. Company B employs a number of staff that is capable of running its main business operations from its head office in Country B. These functions include procurement, logistics, sales, marketing, customer services, finance, accounting and administration.

Company B only has one website which customers may access, and its domain is registered in Country B. This website is hosted on servers physically located in Country B. Customers around the world can access the website and make purchases using credit cards.

When goods are despatched to international customers, they are either sent directly to the customer via a third party courier company or to a warehouse located in the country of the customer. The need for a warehouse in certain countries may be necessitated due to various market factors, such as that country being a significant market for Company B's operations and the existence of a warehouse with support staff will facilitate the efficiency of Company B's transactions in that country. Once the goods are received by the warehouse, they are despatched to the customer using a local third party courier company. Company B maintains a warehouse in South Africa and employs support staff to facilitate the delivery of goods to its South African customers.

When a customer transacts with Company B through its website, the transaction and payment is processed on servers located in Country B.

Other than the warehouse used to facilitate deliveries to South African customers and the related support staff, Company B does not have any other presence in South Africa.

### **6.3.2 Application of the current South African domestic tax law**

Company B will only be subject to tax in South Africa if its income is derived from a South African source, and to establish this, the originating and dominant cause tests must be considered.

Company B's operations are split between Country B and South Africa. The main procurement and sales functions are performed from the head office in Country B, while only the delivery of the goods to the customer is facilitated through the warehouse in South Africa.

The delivery of the products is not an essential feature to making a sale. Company B may opt to deliver the products to customers in South Africa directly using a third party global courier company. However, Company B may have established the warehouse to facilitate a cost and time efficient means to deliver products to its South African customers. The originating and dominant cause of the income remains to be Company B's activities of procurement, setting up a website and processing the transaction and payment in Country B. On this basis, South Africa does not have the right to tax Company B's income from transactions with South African customers in terms of domestic legislation.

### **6.3.3 Application of the current OECD MTC**

As noted above, the key criteria in determining whether a PE exists is that there must be a fixed place of business through which the activities are wholly or partly carried on.

Although not specifically listed in the inclusions to the PE term in Article 5(2) of the OECD MTC, the warehouse in South Africa is a fixed place of business through which the business activities of company B are partly carried on. However, Article 5(4)(b) of the OECD MTC excludes fixed places of business from the PE definition, where such fixed place is used for the maintenance or delivery of goods.

Under the current version of the OECD MTC, Company B will not have a PE in South Africa.

### **6.3.4 Application of the proposed changes to the OECD MTC**

Article 5(4) of the OECD MTC has effectively been amended to only exclude a fixed places of business from being classified as a PE if the activity performed from that fixed place is preparatory or auxiliary in nature.

In line with the guidance offered by the OECD,<sup>83</sup> preparatory or auxiliary activities are those that contribute to the productivity of the company as complementary functions, but are so remote to the creation of value. Another characteristic of preparatory or auxiliary activities is that they are carried on during relatively short periods of time.

Using these guidelines, the maintenance of a warehouse to facilitate delivery to customers to ensure efficiencies cannot be considered to be a core business function. Therefore, in terms of the proposed changes to Article 5(4) of the OECD MTC, a PE will not exist in South Africa.

### **6.3.5 Outcome and other considerations**

The outcome under both versions of the OECD MTC is no different. However, if the level of activities performed in South Africa were to increase or if Company B had commercial reasons for establishing the warehouse in South Africa, the factors would have to be reconsidered to determine whether a PE exists.

In terms of the proposed changes, a factor that could potentially ‘tip the scale’ towards a PE, is that the maintenance of a warehouse being crucial to Company B’s success in South Africa. Reasons for this may vary from case to case, but could include, for example, local regulatory requirements or Company B marketing itself as a company with a quick turn-around time to attract South African customers, that may not have otherwise purchased products from Company B.

## **6.4 Case study C**

### **6.4.1 The facts**

Company C, a resident of Country C, is an online retail company that sells physical products. It sources its products from various manufacturers and wholesalers based around the world. Company C employs a number of staff that is capable of running its main business operations from its head office in Country C. These functions include procurement, logistics, sales, marketing, customer services, finance, accounting and administration.

Company C operates through the internet, with separate website domain names registered in significant markets in relation to its business. This is to protect Company C’s brand name and

---

<sup>83</sup>Refer Section 4.8.1

trademarks in such markets, as it prevents unrelated local businesses from using Company C's name. The local websites are hosted on servers located in these countries. However, when a transaction is initiated, it is transferred to servers based in Country C, which ultimately processes the transaction and the payment. Company C has a local website in South Africa hosted on local servers, which is managed by employees of Company C based at the head office in Country C. The local website also serves as a mechanism for South African customers to have quicker access to Company C's website as information will load faster.

When goods are despatched to international customers, they are either sent directly to the customer via a third party courier company or to a warehouse located in the country of the customer. The need for a warehouse in certain countries may be necessitated due to various market factors, such as that country being a significant market for Company C's operations. The existence of a warehouse with support staff will facilitate the efficiency of Company C's transactions in that country. Once the goods are received by the warehouse, they are despatched to the customer using a local third party courier company. Company C maintains a warehouse in South Africa with support staff to facilitate the delivery of goods to its South African customers.

Other than the warehouse used to facilitate deliveries to South African customers, related support staff and the servers on which the website is hosted, Company C does not have any other presence in South Africa.

#### **6.4.2 Application of the current South African domestic tax law**

Company C will only be subject to tax in South Africa if its income is derived from a South African source, and to establish this, the originating and dominant cause tests must be considered.

Company C's operations are split between Country C and South Africa. The main procurement and sales functions are performed from the head office in Country C, while the delivery of the goods to the customer is facilitated through the warehouse and access to Company C's website is through a server located in South Africa.

On its own, the delivery of the products is not an essential feature to making a sale. Company C may opt to deliver the products to customers in South Africa directly using a third party global courier company. However, Company C may have established the warehouse to facilitate a cost and time efficient means to deliver products to its South African customers. The originating and

dominant cause of the income is Company C's activities of procurement, setting up a website to process the transaction and payment in Country C. On this basis, South Africa does not have the right to tax Company C's income from transactions with South African customers in terms of domestic legislation.

### **6.4.3 Application of the current OECD MTC**

As noted above, the key criteria in determining whether a PE exists is that there must be a fixed place of business through which the activities are wholly or partly carried on.

Although not specifically listed in the inclusions to the PE term in Article 5(2) of the OECD MTC, the warehouse in South Africa is a fixed place of business through which the business activities of company C are partly carried on. However, Article 5(4)(b) of the OECD MTC excludes fixed places of business from the PE definition, where such fixed place is used for the maintenance or delivery of goods. On this basis the delivery warehouse will not create a PE for Company C.

However, the server on which the local website is hosted may constitute a PE. According to the OECD Commentary on PEs, servers which merely relay information through a mirror server for security and efficiency purposes will not constitute a PE.<sup>84</sup>

Therefore, in terms of the existing OECD MTC, Company C will not have a PE in South Africa in respect of both the delivery warehouse and the server used to host its website from.

### **6.4.4 Application of the proposed changes to the OECD MTC**

The proposed changes to Article 5(4) of the OECD MTC will exclude activities from a fixed place of business that are preparatory or auxiliary in nature from being classified as a PE.

As in case study B, the existence of a delivery warehouse, in isolation, will not be considered to be a PE.

The facts in this case differ slightly as Company C also hosts a local website on a local server which South African customers access to be able to enter into transactions. The OECD Commentary notes that a website will not constitute a PE, but the server which it is hosted from

---

<sup>84</sup>Refer Section 3.4.2

may be a PE. However, the server will still be acting as a medium for efficiency purposes and will qualify as being preparatory or auxiliary in nature.

It should be noted that the new anti-fragmentation rule might find application, as the total extent of Company C's activities in South Africa must be evaluated in order to determine whether a PE exists, as when preparatory or auxiliary activities are combined, they may start becoming core business activities.

If Company C can argue that it will derive the same amount of income from South African customers whether or not it has a local warehouse and website, on the balance of probabilities, this may indicate that its activities are indeed preparatory or auxiliary in nature as they serve as support functions to Company C's core business.

On the other hand, if the maintenance of a delivery warehouse and a local website is a key factor for Company C's success in South Africa, these activities together will constitute a PE.

#### **6.4.5 Outcome and other considerations**

The outcome from this case study is that Company C may establish a PE in South Africa in terms of the new version of the OECD MTC that will be implemented. The implications could be far reaching, as most MNCs will have to provide sufficient reasons to argue that its activities offshore are only of a preparatory or auxiliary nature in order to retain the status quo. As the facts may become more complex, it will become increasingly difficult to prove that certain activities are preparatory or auxiliary in nature when aggregated.

### **6.5 Case study D**

#### **6.5.1 The facts**

The facts of this case are similar to Case Study C. Company D, a resident of country D, is an online retailer that sells physical products, sourced from various manufacturers and wholesalers, to customers around the world. Company D's head office is in Country D with staff to manage the procurement, sales, marketing, accounting, finance and administration functions.

Company D transacts with customers through the internet, with a South African website domain hosted on servers physically located in South Africa. The transaction and payment is processed

through servers located in Country D. All websites are managed by staff at Company D's head office.

When South African customers purchase products from Company D, it is sent to Company D's warehouse in South Africa before it is despatched via an unrelated local courier company to the customer. Company D employs warehouse staff to ensure the deliveries are made.

Company D owns Subsidiary D, a South African resident company, which is responsible for providing customer support. Subsidiary D employs staff who work from an office that is in a different location to the warehouse.

#### **6.5.2 Application of the current South African domestic tax law**

The source of Company D's income still remains to be from Country D for the same reasons set out in case study C.

All income earned by Subsidiary D is taxable in South Africa due to it being a resident company. The transfer pricing implications are not included in the scope of this study and will therefore not be dealt with.

#### **6.5.3 Application of the current OECD MTC**

As with case study C, Company D will not have a PE in South Africa for the same reasons. The implications of Subsidiary D providing customer support services is of no consequence in terms of the current OECD MTC.

#### **6.5.4 Application of the proposed changes to the OECD MTC**

Taking into account Company D's activities in South Africa, i.e. the delivery warehouse and the website, would not result in Company D establishing a PE in South Africa. However, with the new anti-fragmentation rule, Subsidiary D's activities need to be considered together with the maintenance of a delivery warehouse and a local website.

Combined, these activities create value for Company D in South Africa, as they have become more than mere preparatory or auxiliary activities. Company D will have a PE in South Africa, the profits of which will be subject to tax in South Africa.

### **6.5.5 Outcome and other considerations**

On these set of facts, profits generated by Company D from South African customers will be subject to tax in South Africa. Company D will have to maintain records of transactions with South African customers and possibly develop a cost model to allocate a portion of its operational costs to such transactions, which may be a complex exercise in its own right.

## **6.6 Case study E**

### **6.6.1 The facts**

Company E, a resident of Country E, is a developer of computer software and games. The computer software and games are developed in Country E. All the business activities of Company E, such as sales, marketing, finance, accounting and administration, are performed by employees at the head office in Country E.

Company E offers its products to customers in the following two forms, a digital download of the product or in physical form (i.e. CD or DVD).

Customers can purchase the physical copy of the software and games from unrelated local retailers, who import Company E's products. Customers can also choose to download the software and games via the internet, through Company E's dedicated digital platform program which has been installed on the customer's computer. Company E maintains a server in South Africa which stores its products in digital format. When a South African customer purchases the digital version, the transaction and payment is processed through servers located in Country E, but the actual software is downloaded to the customer's computer from the local server.

Company E does not employ any staff in South Africa and its employees at the head office in Country E manage the local server. Physical maintenance of the server is performed by an unrelated South African service provider.

### **6.6.2 Application of the current South African domestic tax law**

Again, the tests of source must be applied as Company E is a non-resident.

Company E's operations are all based in Country E. The only activities in South Africa are that of a resident either physically purchasing Company E's products from a local retailer or digitally via Company E's digital platform.

As we are determining Company E's tax obligations, there is no need to consider the implications of a customer purchasing the products from a local retailer.

Company E's main business activities are performed in Country E. The sale of goods cannot be argued to be the main or dominant cause of earning income, as although Company E sells its products to customers around the world, the main activity giving rise to the income is the development of the software in Country E.

Therefore, Company E is not liable to tax in South Africa in terms of domestic legislation.

### **6.6.3 Application of the current OECD MTC**

As noted in case study E, a server may constitute a PE. However, as it only relays information through a mirror server for security and efficiency purposes, the server will not constitute a PE.

In Company E's case, the purpose of the server is to facilitate customers to download the software quickly, as it will take a considerably longer time to download the software from international servers. As the local servers do not serve any other purpose, it will not be considered to be a PE and any income derived from sales to South African customers will not be taxable in South Africa.

### **6.6.4 Application of the proposed changes to the OECD MTC**

In terms of the proposed version of the OECD MTC, a server will still be classified as a fixed place of business, unless its function is of a preparatory or auxiliary nature. The existing OECD Commentary provides examples of preparatory and auxiliary activities that can be performed by a server, and there is no indication that these examples will be changed.

Therefore, the use of a local server by Company E to facilitate more efficient downloads of its products to South African customers will still be considered to be preparatory or auxiliary in nature and there will be no difference in the treatment between the current and proposed versions of the OECD MTC.

### **6.6.5 Outcome and other considerations**

This case study also illustrates that the term 'preparatory or auxiliary in nature' will become increasingly important in determining whether a PE exists. If the facts of the case above were such that it was crucial for Company E to maintain a local server to increase profits, such

maintenance of a server may be more than just preparatory or auxiliary in nature. This can best be explained through the following example.

The cost price of a certain product, in its physical form, for Company E is \$45, with the recommended retail price (for sale to customers) being \$60. Through supply agreements, Company E may sell the product to South African retailers for \$50. Company E will make a profit of \$5 on such transactions. However, if Company E sells the product for \$60 directly to customers through its digital platform, it stands to make a substantially greater profit. Furthermore, the cost will be lower than \$45 as Company E does not have to incur costs for the materials and packaging. In this case, the maintenance of a local server becomes more than just preparatory or auxiliary, which deserves further consideration. However, it will be difficult to identify such cases in practice as SARS may not be privy to all the information.

## **6.7 Conclusion**

The case studies above have illustrated that the proposal to amend the OECD MTC may result in MNCs establishing PEs in states through activities therein, where previously such activities may have been excluded from the PE definition. Once the new OECD MTC is adopted and implemented in DTTs, MNCs will have to re-examine all their offshore operations in order to determine whether their activities may result in them establishing a PE in another state.

## **7 Conclusion and recommendations**

### **7.1 The emergence of the digital economy**

The emergence of the digital economy is as a result of the constant and rapid development of ICT. As more businesses adopt ICT in their processes, technologies become cheaper, which further fuels development. Through the use of ICT, businesses, especially the likes of MNCs, are able to centralise their core operations in order to achieve cost and control efficiencies. ICT has not changed the core business functions, but has significantly influenced the nature of how these functions are performed.

Key features of the digital economy include mobility of intangibles, users and data, the reliance on data, network effects, the use of multi-sided business models, the tendency towards monopoly or oligopoly relying on network effects and the volatility due to low barriers to entry and rapidly evolving technology.

Traditionally, businesses were required to operate through a subsidiary in each jurisdiction it operated in. However, with the help of ICT, there is no longer a need for physical presence to be a requirement to generate substantial profits from a particular geographical market. Businesses may choose to centralise their operations at a global or regional level thereby limiting its physical presence in each and every market it operates in. As the digital economy is constantly evolving, business models are likely to undergo an endless process of change. Furthermore, the digital economy has enabled all businesses to reach a greater base of customers, as an internet connection is all that is needed.

As studies have indicated, the number of transactions and the size of the e-commerce industry have increased substantially over the last decade with exponential growth expected in the near future. However, the digital economy cannot be isolated from the real economy as the two are intertwined.

### **7.2 The taxation challenges arising from the digital economy**

Traditional tax principles, both local and international, rely on some level of physical presence in a jurisdiction before the taxing right is granted. Through the development of digital business, businesses may operate at a global level and therefore forego the need to establish a physical presence in markets to generate substantial revenue. MNCs are now in a position to physically

separate, in terms of locations, the activities creating value from its customers. The main concern is that countries may lose their taxing right over income from economic activity in their country and experience BEPS problems.

This could arise as tax authorities will find it increasingly difficult to identify the nature and extent of such transactions and the parties thereto. MNCs may structure their operations by allocating the functions, assets and risks giving rise to income to a low tax jurisdiction. Another method MNCs could employ to eliminate or reduce its tax obligations in the offshore markets they operate in is by segregating their activities into those which in isolation can be seen to be preparatory or auxiliary in nature.

Further tax challenges of the digital economy include MNCs eliminating or reducing WHT in the source country by potentially abusing the classification of payments and eliminating or reducing tax at the level of the recipient of the income or at the level of the ultimate parent company. This can be achieved by taking advantage of favourable local tax regimes, 'treaty shopping', claiming deductions for excessive payments to offshore businesses and operating from low-tax jurisdictions or those with poor CFC rules.

Administrative challenges of the digital economy include the identification of parties to an electronic transaction, determining the extent of electronic economic activity of a non-resident company in a country and the collection and verification of information.

It should be noted that the risks identified above are not unique to the digital economy; they are pervasive throughout the economy. The digital economy has merely exacerbated BEPS risks.

### **7.3 The BEPS Project**

As BEPS risks have become a key concern for many countries, the G20 leaders instructed the OECD in 2013 to prepare a report to address such risks in order to restore taxing rights to the activities which create value. The OECD embarked on producing a 15 point action plan to address BEPS concerns, which was released in two parts. In September 2014, interim reports were delivered for some of the action points, with the final reports for all action points being released in September 2015.

Action Plan 1, entitled, "Addressing the Tax Challenges of the Digital Economy", assesses the growth of the digital economy, its impact of businesses, identifies the BEPS opportunities and proposes solutions for such challenges and to address future developments.

The OECD notes that the individual BEPS Action Plans cannot be assessed in isolation as the issues tend to overlap. The report on Action Plan 1 identifies the challenges of the digital economy and concludes that the risks are adequately addressed by the recommendations and solutions detailed in other Action Points. The report on Action Plan 1 assesses these recommendations and solutions in the context of the digital economy.

In its report on Action Plan 1, the OECD notes the following to be the core challenges raised in the digital economy:

- Income nexus – the ability for a business to generate significant economic activity in a jurisdiction without establishing a physical presence therein;
- Data – the gathering, manipulation, mining and processing of data is increasingly becoming a source of value creation; and
- Characterisation of income – complications may arise where there is no consensus for the categorisation of income from electronic transactions.

Of most relevance in addressing the tax challenges raised by the digital economy are Action Plans 3, 7 and 8-10. Central to the theme of this dissertation is the tax implications of a non-resident online retailer selling goods to South African residents. The outcome of Action Plan 7 therefore finds application.

## **7.4 Proposal to address the tax challenges arising from the digital economy**

In addressing the tax challenges raised in the digital economy, the OECD considered the following options:

### **7.4.1 The introduction of a new nexus based on significant economic presence**

Where a business has a significant economic presence, it will be subject to tax. In order to establish whether a significant economic presence exists, the following factors should be considered:

- Revenue based factor – a threshold taking into account the amount of revenue and the number of transactions should be set;
- Digital factors – various digital factors such as the use of a local domain name, digital platform or offering local payment options; and

- User based factors – various user based factors such as the number of monthly active users, online contract conclusions and data collected.

The OECD recommends that if a new nexus is introduced, it should be based on a combination of the factors above.

#### **7.4.2 Withholding tax**

A WHT could be imposed on payments for certain digital transactions. It could also serve as a collection mechanism if a new nexus is adopted. However, the imposition of a WHT may be contrary to international practices and the collection of such a tax will be difficult.

#### **7.4.3 Equalisation tax**

An equalisation tax could be implemented to ensure that international businesses are taxed the same as local businesses.

#### **7.4.4 Proposal by the OECD**

In its report on Action Plan 1, the OECD notes that it is not necessary to adopt any of the proposals mentioned above. The tax challenges arising from the digital economy will essentially be addressed through the implementation of the BEPS Project in its entirety. Specifically, to this dissertation, the OECD's proposal to modify Article 5 of the OECD MTC, as detailed in Action Plan 7 will address any tax concerns.

##### **7.4.4.1 Modification to Article 5(4) of the OECD MTC**

Article 5(4) of the OECD MTC will be amended to only exclude activities of a preparatory or auxiliary nature from creating a PE. The amended version will read as follows:

*Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:*

*a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;*

*b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;*

*c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;*

*d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;*

*e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;*

*f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e);*

*provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.”*

MNCs will now have to argue that their offshore activities are of a preparatory or auxiliary nature in order to be excluded from the PE definition. The OECD Commentary will also be updated to provide guidance on the term ‘preparatory or auxiliary’.

#### **7.4.4.2 The anti-fragmentation rule**

The OECD MTC will also contain the following clause:

*“Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and*

*a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*

*b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

*provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”*

The aim of this rule is to prevent businesses from fragmenting their operations across multiple locations within the same jurisdiction in order to argue that individually they are preparatory or auxiliary activities.

#### **7.4.5 Implementation of the proposed changes**

The OECD will implement the proposed changes across the treaty network in a staggered approach. At this stage, it is unclear when this will be completed.

### **7.5 The implications of the proposed changes**

E-commerce transactions are increasing at a significant rate around the world and in South Africa in particular. The changes proposed to the OECD MTC is not expected to impact South African businesses significantly as the current level of South African e-commerce businesses conducting business operations offshore is very low. However, this may change in the future given the amount of investment in the e-commerce industry in South Africa.

Through the application of the new OECD MTC, non-resident businesses may find that their operations in South Africa will now be subject to tax in South Africa. MNCs will have to assess all their offshore operations in order to determine whether they may still be able to argue that they are of a preparatory or auxiliary nature. As the exclusions to the PE definition have narrowed and little guidance is available for the term 'preparatory or auxiliary' MNCs may find that their tax burden has increased.

SARS and other revenue authorities may find it difficult to realise additional revenues afforded through the modification of the exclusions to the PE definition for the following reasons:

- determining the non-residents operating in the country;
- determining the extent of such activities;
- gathering the relevant information from the non-resident; and
- enforcing compliance from the non-resident.

A viable solution would be to introduce a special registration system for such non-residents which exceeds sales amounting to R1 million to South African customers and require them to complete a simplified version of the income tax return. This could ensure that this process is

self-regulated and would not require SARS to devote a significant amount of resources to enforce compliance, which could potentially negate the benefits.

## **7.6 Conclusion**

The implications of the proposed changes to the OECD MTC will have wide reaching implications as it requires MNCs to re-evaluate all of their offshore operations, which could place an additional tax compliance burden on their already strained resources. As a result, costs will increase and it will be the consumer that suffers at the end of the day.

Furthermore, there will be inconsistencies and uncertainties across tax authorities as it seems that countries are encouraged to address BEPS risks unilaterally. Without a bilateral consensus, solution or relief, such profits may be subject to taxation in more than one state, which has not been a problem before.

An attempt has, however, been made to address the tax risks introduced by the digital economy. Whether these proposals will be effective, remain to be determined. The OECD intends on monitoring the conclusions reached as part of the BEPS Project. A monitoring process will be released in 2016 and another report on the digital economy will be finalised in 2020. Any shortcomings of the current conclusions, identified above or not yet apparent, should, hopefully, be addressed by then.

## 8 Bibliography

### Published works

Evan, D (2012). *The Internet of Everything How more Relevant and Valuable Connections Will Change the World*. Cisco IBSG.

Haupt, P & Huxham, K (2015). *Notes on South African Income Tax 2015*. 34th edition, Roggebaai: H & H Publications.

G20 (2012). *Leaders' Declaration*. St. Petersburg, Russia. Available [https://www.g20.org/sites/default/files/g20\\_resources/library/Saint\\_Petersburg\\_Declaration\\_EN\\_G\\_0.pdf](https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_EN_G_0.pdf). Last accessed 23/09/2015.

Maguire, S (2013). *State Taxation of Internet Transactions*. Available <https://www.fas.org/sgp/crs/misc/R41853.pdf>. Last accessed 22/09/2015.

OECD (2014). *Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing. Available at <http://dx.doi.org/10.1787/9789264218789-en>. Last accessed 21/09/2015.

OECD (2015). *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20, Base Erosion and Profit Shifting Project*, OECD Publishing, Paris. Available at <http://dx.doi.org/10.1787/9789264241046-en>. Last accessed 13/10/2015.

OECD (2015). *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: <http://dx.doi.org/10.1787/9789264241220-en>. Last accessed 16/10/2015.

OECD (2015). *OECD/G20 Base Erosion and Profit Shifting Project*. Available at [http://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project\\_23132612;jsessionid=8902n0lr371k2.x-oecd-live-03](http://www.oecd-ilibrary.org/taxation/oecd-g20-base-erosion-and-profit-shifting-project_23132612;jsessionid=8902n0lr371k2.x-oecd-live-03). Last accessed 14/10/2015.

Stinlingh, M; et al (2013). *Silke: South African Income Tax 2013*. LexisNexis.

The European Commission Expert Group on Taxation of the Digital Economy (2014). *Report of the Commission Expert Group on Taxation of the Digital Economy*.

Available:<https://ec.europa.eu/futurium/en/content/report-commission-expert-group-taxation-digital-economy>. Last accessed 22/09/2015.

The Davis Tax Committee (2014). *Addressing Base Erosion and Profit Shifting in South Africa, Davis Tax Committee Interim Report, Action 1: Address the tax challenges of the digital economy*. Available:

[http://www.taxcom.org.za/docs/New\\_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf](http://www.taxcom.org.za/docs/New_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf). Last accessed 21/09/2015.

The Davis Tax Committee (2014). *Preventing Base Erosion and Profit Shifting in South Africa., Davis Tax Committee Interim Report, Summary of recommendations for South Africa: OECD September 2014 Deliverables*.

Available:[http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Last accessed 21/09/2015.

### **Model DTTs and treaties**

OECD (2014). *Model Tax Convention on Income and Capital*. OECD Publishing.

OECD (2014). *Commentary on the Model Tax Convention on Income and Capital*. OECD Publishing.

### **Articles**

Bal, A (2012). *Tax Implications of Cloud Computing - How Real Taxes Fit into Virtual Clouds*. 66 Bull. Intl. Taxn. 6, Journals IBFD.

Bird, RM (2005) *Taxing Electronic Commerce: The End of the Beginning?* 59 Bull. Intl. Fiscal Docn. 4, sec. 1, Journals IBFD.

Box, J (2014). *E-Commerce and Tax – An Australian Perspective*. 20 Asia-Pac. Tax Bull. 3, Journals IBFD.

Blum, DW (2015). *Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative – The Nexus Criterion Redefined?* 69 Bull. Intl. Taxn. 6/7, Journals IBFD.

Brauner, Y and Baez, A (2015). *Withholding Taxes In the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy.* IBFD.

Cockfield, AJ (2002). *The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles.* 56 Bull. Intl. Fiscal Docn. 12, Journals IBFD.

Gaoua, N (2014). *Taxation of the Digital Economy: French Reflections.* 54 Eur. Taxn. 1, Journals IBFD.

Gupta, P (2014). *“Cloud” – A Technological Odyssey.* 20 Asia-Pac. Tax Bull. 5, Journals IBFD.

Hellerstein, W (2014). *Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments.* 68 Bull. Intl. Taxn. 6/7, Journals IBFD.

Hongler, P & Pistone, P (2015). *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy.* IBFD.

### **Case Law**

Commissioner for Inland Revenue v Black, 1957 (3) SA 536 (A), 21 SATC 226.

Commissioner of Inland Revenue v Lever Brothers and Unilever Ltd, 1946 AD 441, 14 SATC 1.

Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana, 29 SATC 97 1967 (BCA).

### **Online research resources**

Durrant, N (2015). *The real state of ecommerce in South Africa: 9 things you need to know today.* Available: <http://ventureburn.com/2015/04/real-state-ecommerce-south-africa-9-things-need-know-today>. Last accessed: 18/10/2015.

Du Plessis, AP (2015). *Google predicts massive growth in African e-commerce.* Available: <http://www.bdlive.co.za/africa/africanbusiness/2015/02/06/google-predicts-massive-growth-in-african-e-commerce>. Last accessed: 18/10/2015.

Effective Measure & IAB South Africa (2014). *South African Ecommerce Report*. Available at <http://www.effectivemeasure.com/south-african-ecommerce-report-february-2014>. Last accessed: 18/10/2015.

Evans, J (2015). *Income from internet services on the rise – Stats SA*. Available: <http://www.news24.com/SouthAfrica/News/Income-from-internet-services-on-the-rise-Stats-SA-20151005>. Last accessed 18/10/2015.

Hyatt, J (2015). The new morality in tax strategies. Available <http://ww2.cfo.com/tax/2015/05/new-morality-tax-strategies>. Last accessed: 18/10/2015.

IT News Africa (2015). *Study reveals that E-commerce is on the rise in South Africa*. Available: <http://www.itnewsafrika.com/2015/03/study-reveals-that-e-commerce-is-on-the-rise-in-south-africa>. Last accessed: 18/10/2015.

KPMG (2015). *In a Nutshell – The October 2015 BEPS Deliverables*. Available <http://www.kpmgpublications.ie/publication/in-a-nutshell-the-october-2015-beps-deliverables>. Last accessed 19/10/2015.

KPMG (2015). *TAXNEWSFLASH – BEPS Special Edition*. Available <https://home.kpmg.com/xx/en/home/insights/2015/09/taxnewsflash-beps-special-edition.html>. Last accessed 19/10/2015.

Rao, L (2014). *South African E-commerce giant Takealot raises \$100m from Tiger Global*. Available: <http://techcrunch.com/2014/05/23/south-african-e-commerce-giant-takealot-raises-100m-from-tiger-global>. Last accessed 18/10/2015.

Rode, H (2014). *E-commerce in South Africa in 2014*. Available: <http://limabeen.agency/article/the-state-of-e-commerce-in-south-africa-in-2014#.ViNQFhHsnIU>. Last accessed 18/10/2015.