Value-added Tax on electronic services

A STUDY OF THE SOUTH AFRICAN TAX MODEL

This research dissertation is presented for the approval of Senate in partial fulfilment of the requirements for the postgraduate degree: Master of Commerce in South African Tax at the University of Cape Town.

I confirm that I have read and understood the regulations governing the submission of dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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The dedication of this dissertation is split in seven ways: to God, my parents, wife, brothers, family, teachers & colleagues, and to you for contributing to my growth and happiness, always.

"The only rock I know that stays steady, the only institution I know that works, is family"

- Lee Iacocca

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ABSTRACT

As a general guiding principle, the Commissioner of the South African Revenue Service (SARS) is mandated to collect all tax that is legally payable. This should be done in the most efficient and effective manner, which creates certainty for the taxpayer, reduces the likelihood of tax leakages as far as possible, and should not envisage inhibition of trade.

Value-Added Tax (VAT) is a consumption tax aimed at taxing the consumption of goods and services in South Africa. The mechanism where services supplied by non-residents are taxed within a taxing jurisdiction, is more commonly referred to as the imported services/reverse charge mechanism. As consumers seldom use these provisions to accurately account for VAT on purchases made, the legislature decided to introduce new rules governing the supply of electronic services by a foreign supplier to South Africa to level the playing field between foreign and local service providers.

The 2013 amendments to the VAT Act, which introduced the treatment of the supply of electronic services, provides focus on a tax specific element of imported services as a local supply. This inherently places certain compliance requirements on foreign suppliers to account for and pay tax to the South African Revenue Service (SARS) where certain electronic services are supplied to consumers in South Africa.

These legislative amendments took the initial step to ensure that revenue to the *fisc* was not being lost by implementing provisions that could keep pace with the rapid growth and development of technology globally. About six months after the introduction of the South African model, the European Union sought to address the same concerns by introducing its own version of these provisions to tax certain electronically supplied services.

Both efforts have been successful to date and while the implementation of the South African model is just under three years old, the provisions already seem too narrow and dated when applied to current technological trends. This dissertation has considered the electronic services provisions for both jurisdictions with a view of understanding how the models work, and to identify potential amendments and recommendations which could be applied in the South African context in future (i.e. “Version 2.0”).

Based on the research concluded, the opportunity to increase the tax base by broadening the electronic services provisions in South Africa cannot be missed by SARS and National Treasury and while the South African electronic services model may not be perfect, it has significantly changed the space of digital taxation and is one of the pioneers in this field of taxation. While there is still much change that needs to be brought to the current legislative provisions, the initial attempt by SARS and National Treasury is laudable as they have managed, in most instances, to address key concepts with simplified rules and

relaxed provisions in order to make the provisions work within the current framework. It is submitted that this bodes well, as an indication to a more vibrant future for the taxation of electronic services in South Africa.

CONTENTS

1. AN INTRODUCTION

Background

With the advent of globalisation and the meteoric rise of online shopping, traditional brick-and-mortar retailers are struggling to keep pace with their online counterparts. While this does not necessarily mean that the traditional stores are losing out on those sales, as these products are simply moved from shelves to store websites, it is evident that technological advancement has catalysed increased activity in the digital economy (Cook, 2015, p. 1).

With this increased activity in the digital economy, revenue authorities across the globe had to establish and implement mechanisms which both promotes and effectively taxes e-commerce businesses and transactions. "According to the Organisation for Economic Co-operation and Development (OECD), revenue authorities have an important role to play in realising the full potential of e-commerce. Their twin objectives are to provide a fiscal environment within which e-commerce businesses can flourish, while also ensuring that e-commerce does not undermine the ability of government to raise the revenues required to finance public services for their citizens" (OECD, 2001, p. 1)

Prior to the introduction of electronic services provisions and in terms of South African law, foreign suppliers of electronic services were not compelled to register as vendors for value added tax (VAT) purposes. While there existed a plethora of South African consumers who would enter into transactions with foreign suppliers over the internet, revenue authorities were unable to tax these supplies as these foreign suppliers had no physical presence in South Africa.

"The VAT Act does not contain any place of supply rules to determine which jurisdiction (South Africa or another country) has taxing rights in respect of electronic services transactions. The lack of specific place of supply rules in South Africa therefore required a foreign supplier to undergo an interpretative analysis of the legislation in order to assess its VAT registration liability" (National Treasury, 2013, p. 90).

It has been generally accepted that the rule to determine "which jurisdiction has taxing rights is based on consumer location. This rule appears appropriate in the case of foreign supplies of electronic services to South African customers. In this regard, the foreign supplies should be subject to VAT at a zero-rate in the foreign country based on the consumer's location (i.e. destination principle), and the supply to the South African recipient would be subject to VAT in terms of the imported services provisions (i.e. reverse charge mechanism)" (National Treasury, 2013, p. 90).

On this basis, the South African recipient would be required to account for the VAT to the South African Revenue Service (SARS). While this practice is feasible in theory, the implementation of this reverse charge mechanism remained impractical due to the low levels of compliance by South African customers and the lack of enforceable internal controls by SARS.

The lack of VAT compliance by consumers can be attributable to two fundamental causes:

- the consumer has a lack of awareness and education in respect of this aspect of the law; or

- the consumer perceives the tax to be of a voluntary nature especially given the impracticality relating to its enforcement.

This lack of VAT compliance had left local suppliers of electronic services at a competitive disadvantage when compared to their foreign counterparts. While local suppliers were required by law to levy VAT on electronic supplies made, foreign suppliers were not subject to this requirement and the onus relating to the accountability for such taxes in respect of imported services rested with the South African consumers. As a result thereof, foreign suppliers were left with a 14 per cent competitive advantage over their South African counterparts (National Treasury, 2013).

Legislative developments

During the 2013 National Budget Speech, National Treasury proposed that place of supply rules be introduced in South Africa for VAT purposes with respect to the supply of electronic services. These place of supply rules were envisioned to reduce and/or eliminate the need for the imported services provisions for such electronic supplies. It must be noted that the imported services provisions would however still be relevant in the case of non-electronic services that are supplied to South African customers.

In terms of this proposal, foreign suppliers of electronic services would, in certain circumstances, be required to register as a VAT vendor in South Africa based on the supply of electronic services made to South African customers.

Whether or not a foreign supplier would be liable to register for VAT in South Africa was dependant on whether the electronic services supplied by it fell within the list of electronic services as prescribed in terms of a regulation issued by the Minister of Finance, and whether the registration threshold of ZAR 50,000 was exceeded.

Legislative amendments

The objective for National Treasury was to ensure equality between South African and foreign suppliers of electronic services by eliminating, to an extent, any competitive advantage experienced by foreign suppliers. As set out in the International VAT/GST guidelines issued by the OECD, the destination principle should be implemented to ensure that the net tax burden on imports is equal to the net tax burden on the same supplies in the domestic market.

With this in mind, the Taxation Laws Amendment Act No. 31 of 2013 amended the definition of ‘enterprise’ in section 1 of the VAT Act, on 12 December 2013, to include the supply of ‘electronic services’ in an effort by Treasury to establish equal treatment of local and foreign suppliers of electronic

services in South Africa. The introduction of these amendments have since substantially changed the way foreign businesses provide electronic services to South Africa, and has as a result, generated additional tax revenue for the Treasury *(VAT Act, No. 89 of 1991, section 1).*

Vendors are now required to account for taxes that were previously left unaccounted for due to the self-assessment nature of the imported services provisions. In addition, these amendments have addressed the perception that foreign businesses are not subject to tax in South Africa in the same manner as local businesses.

The regulation in respect of electronic services (Government Gazette No. 37489) (Regulation) governing the operation of the legislation provides a list of limited electronic services covered by the legislation. Examples of these services include the supply of electronic games, e-books and music, audio-visual content, still images, web / phone applications and certain online subscription based services.

At the time of its introduction, Treasury stated that the list of electronic services covered by the Regulation would be broadened in the future, and in the 2015 National Budget speech, Treasury advised that the electronic services regulations will be expanded to include software (initially present in the draft regulation but excluded in the final version of the Regulation on electronic services).

The inclusion of additional items in the Regulation is important to ensure that the provisions remain relevant in the context of electronic services and the evolving nature of e-commerce in South Africa and the rest of the world. The overall application of these provisions remain limited, and do not reflect the intention of neutrality in the South African market place. Accordingly, consideration must be given to the extent of the Regulations application and whether all or rather, the 'right' services, are being taxed in terms of the electronic services provisions.

In light of the narrow provisos to the definition of 'enterprise' as contained in paragraph (b)(vi) of section 1 of the VAT Act and given the limited list of electronic services provided for in the Regulation, it is challenging for foreign suppliers of electronic services to determine whether or not they are carrying on an enterprise for South African VAT purposes.

Foreign suppliers of electronic services are further hindered by the ability of South African consumers to mislead or provide inaccurate information to these foreign electronic services suppliers, which is required to determine whether a VAT registration liability exists in South Africa.

Research objective

The VAT Act had been drafted at a time where the supply of services in an electronic form were not contemplated. "With the advent of globalisation, trade is no longer constrained by geographic or economic borders, and it becomes possible for businesses to perform transactions in jurisdictions in which it has no fixed place of business. This dramatic shift from the old conditions governing commercial activity requires an adjustment of the legal principles governing various aspects of trade, as the existing position results in distorted consumption patterns – where businesses may be induced

to supply their services from countries with a more advantageous VAT system or for that matter, none at all" (Van Der Merwe, 2004, p. 577).

The South African legislation and Regulations in respect of the supply of electronic services remains narrow and prescriptive. The advantage of this is that it resolves any problem in defining each type of service on the list, while running the risk of quickly becoming outdated, thus creating a fence around which avoidance and tax planning can occur.

The objective of this dissertation is to review the inclusion of electronic services in the South African VAT legislation and identify whether South Africa is required to:

- amend the Regulations to a less prescriptive list in order to avoid the risk of quickly becoming outdated (i.e. are the correct electronic services being taxed?);

- amend the current provisions in order to align itself with the guidelines issued by the OECD and the Davis Tax Commission ('DTC'); and

- streamline itself with other jurisdictions such as the European Union (which has recently prescribed to special rules governing the supply of electronic services).

Research methods

The research methods used in this dissertation contain elements of:

- an applied doctrinal research approach, in order to theoretically analyse the current electronic services provisions to determining the advantages and disadvantages that exist within its framework; and

- an exploratory approach, which will consider global best practice due to the limited availability of published guidance in respect of the application and interpretation of the South African electronic services provisions.

Furthermore, content experts have been referred to as appropriate and relevant precedent has been consulted in order to further the arguments and findings contained herein.

The core objectives of this dissertation will be achieved once the aforementioned research is collated in a manner from which recommendations for the improvement of South Africa's VAT legislation, specifically in respect of the electronic services provisions, may be extracted.

Limitations of scope

This dissertation will be limited to the legislative and regulative framework of the electronic services provisions as a 1 February 2017.

Dissertation structure

This dissertation will set out to determine the efficacy of the electronic services provisions in its current structure as well as provide recommendations for the improvement of South Africa's VAT legislation, specifically in respect of the electronic services provisions.

The dissertation chapters are structured as follows:

- Chapter One provides an introduction to the dissertation content and identifies the research objectives that this study seeks to achieve as well as establishing the research methodology for the remainder of the study.

- Chapter Two sets out the underlying VAT principles governing the South African VAT system as well as the supply of electronic services by foreign suppliers to South Africa.

- Chapter Three sets out the underlying VAT principles governing the supply of electronic services by foreign suppliers in the European Union. This jurisdiction has been specifically chosen as it has recently implemented rules to ensure taxation of electronic services supplied from outside a recipient's country. In this regard, the EU model provides insight specifically relating to the manner in which the electronic services are taxed, which services have been included within the taxing provisions and how the jurisdiction has managed implementation across the EU Member States.

- Chapter Four outlines the issues concerning the implementation of the electronic services provisions in South Africa and details concerns surrounding the protection of the tax base from a revenue perspective while questioning the reach of the provisions in its current form as compared to models adopted in other jurisdictions. This chapter will also highlight comparisons between the implementation in the EU and the current legislative framework and the policies adopted in South Africa with an aim to identify the limitation of the South African provisions when compared to global best practice and provide proposed considerations for amendments to the South African legislation.

- Chapter Five sets out a summary of the dissertation and concludes on the research conducted in this specialised area of indirect taxation.

2. SOUTH AFRICAN VAT APPLICATION

Implementation of VAT in South Africa

In his opening speech in Parliament in February 1988, then State President PW Botha, intimated that government had decided to replace sales tax with a value-added tax i.e. VAT. The formal announcement was announced by the then Minister of Finance in the 1988 Budget Speech. The following is an extract from the budget speech:

> "After further investigation and careful consideration it has been decided not to accept the proposal for a comprehensive business tax but rather to convert Goods and Services Tax to VAT on the well-known European pattern of a tax on value added and based on invoices" *(Morris, Huxham, & Haupt, 1988, p. 1)*.

In September 1991, South Africa replaced GST with a consumption-type VAT which was seen to be more beneficial as compared to its predecessor.

In the 1991/1992 Budget Review the view was expressed that the benefits of a VAT system would be realised only if two requirements were met, namely:

- The base must be as broad as possible and should tax all goods and services if possible; and
- A uniform rate must be imposed. This is in keeping with the view expressed in the Margo Commission that every attempt should be made to keep tax neutral. A single uniform rate will ensure that VAT will be neutral in production and consumption decisions *(Huxham & Haupt, 1991, p. 1)*.

What is VAT?

VAT is a tax that is levied on goods and services indirectly by means of a "value-add" in the supply chain aiming to tax on final consumption. This means that the person who bears the tax is assessed, not directly taxed by SARS, but indirectly through the taxation of the transactions into which he enters *(Clegg, 2015, p. 1)*. Revenue is raised for government by requiring certain businesses, who carry on a VAT enterprise and exceed the compulsory monetary registration thresholds, to register and to charge VAT on the supply of taxable goods and services. These businesses would become registered VAT vendors who act as agent for the government in the collection of the VAT *(SARS, 2014, p. 1)*.

"VAT is charged at each stage of the production and distribution process and is proportional to the price charged for the goods and services. VAT is presently levied at the standard rate of 14 per cent on the supply of most goods and services and on the importation of goods" *(SARS, 2014, p. 1)*.

"The generally accepted essential characteristics of a VAT-type tax are as follows:

- The tax applies generally to transactions related to goods and services;
- It is proportional to the price charged for the goods and services;
- It is charged at each stage of the production and distribution process; and
- The taxable person (i.e. a vendor) may deduct the tax incurred which is used in the course and furtherance of making taxable supplies of goods and services during the preceding stages on goods and services acquired (that is, the burden of the tax is on the final consumer).

VAT is only charged on taxable supplies made by a vendor. Taxable supplies include supplies for which VAT is charged at either the standard rate or zero rate" *(SARS, 2017, p. 1)*.

"It is well-known that VAT is a multi-stage tax, aimed at taxing consumption of goods or services in South Africa. A fundamental pillar of the VAT system is its credit mechanism that allows VAT registered businesses a deduction of the VAT they pay on expenses to avoid a cascading effect of the tax. Consequently, the burden of VAT falls on the final consumer. The mechanism of the VAT system works well where the VAT registered supplier and recipient reside in the same country, but poses a challenge where they are situated in different countries. Each country will impose their own VAT rules which could lead to double taxation or non-taxation of the supply". *(Badenhorst, 2013)*.

"The South African VAT system is destination based, which means that only the consumption of goods and services in South Africa is taxed. VAT is therefore paid on the supply of goods or services in South Africa as well as on the importation of goods into South Africa. VAT is currently levied at the standard rate of 14% on most supplies and importations, but there is a limited range of goods and services which are either exempt, or which are subject to tax at the zero rate (for example, exports are taxed at zero percent under certain circumstances). The importation of services is subject to the reverse-charge mechanism i.e. the services are only subject to VAT where the services are imported for private, exempt or other non-taxable purposes" *(SARS, 2017, p. 1)*.

The purpose of a VAT system is to ensure that companies making supplies of goods and services should, where applicable, have such transactions be subject to tax. Where the company supplies services, the company would be liable to account for output tax on the supply which will be paid over to SARS as part of its filing obligations. The company receiving the services will, subject to certain exclusions or exemptions, be able to claim an input tax deduction for the value of the tax levied on the service. The differential between output tax paid and input tax claims deducted would result in the total VAT payable by a company to SARS.

While the transactional functionality of the tax is important to note, it is vital to understand that VAT is charged only on the supply of goods or services in the commencement, course or furtherance and termination of a registered 'enterprise'. It is therefore important to understand the concept of enterprise *(Clegg, 2015, p. 1)*.

The definition of 'enterprise' is defined in section 1 of the VAT Act as follows:

> "(a) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club;
>
> (b) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern-
>
> (vi) the supply of electronic services by a person from a place in an export country, where at least two of the following circumstances are present:

- The recipient of those electronic services is a resident of the Republic;
- any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990);
- the recipient of those electronic services has a business address, residential address or postal address in the Republic" *(VAT Act, No. 89 of 1991, section 1).*

It is noted that the definition of 'enterprise' is broad and refers to taxable activities performed on a 'continuous' and 'regular' basis. This relates to any activity carried on continuously or regularly in (or partly in) the Republic in which goods or services are supplied to another person for a consideration, whether or not for profit *(VAT Act, No. 89 of 1991, section 1).*

- 'Continuously' is generally interpreted as ongoing, i.e. the duration of the activity has neither ceased in a permanent sense nor has it been interrupted in a substantial way. Accordingly, the logical progression of the relevant steps needed to bring the activity to conclusion would indicate a continuous activity. 'Regular' refers to an activity which takes place repeatedly, i.e. when an activity is repeated at reasonably fixed intervals considering the type of supply and the time taken to complete the activities associated with making the supply.

The definition of 'enterprise' in section 1 of the VAT Act has since been amended to addresses non-traditional operations and transactions (i.e. e-commerce supplies) by the insertion of subparagraph (vi) to this definition, which sets out that "the supply of 'electronic services' by a person from a place outside South Africa to a recipient, where at least two of the following circumstances are met, may be required to register for VAT in South Africa:

- the recipient is a resident of South Africa; or

- any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of South African law; or

- the recipient of those electronic services has a business address, residential address or postal address in South Africa" *(VAT Act, No. 89 of 1991, section 1)*.

While the South African VAT system works well when applied to more traditional brick and mortar transactions, the borderless nature of e-commerce however makes it difficult to define where value is added. As a result of this, it is difficult to define when profits are being made and which country is allowed in terms of the law to tax them. This is particularly challenging for the effective operation of consumption taxes, which depend "heavily on the ability of the taxing authority to find traces or records of transactions. This is especially difficult when the transactions at stake involve the purchase of a digital product from a seller located in an offshore tax haven" *(IBLS, 2007, p. 1)*.

"The internet offers the opportunity for consumers to enter into transactions at a distance giving rise to several difficult issues, such as determining the location of a transaction, since a website alone is not a fixed place of business. Indeed, from a tax standpoint, websites and servers through which these transactions are made do not constitute a taxable presence in another country. The collection of VAT from a transaction involving digital products and conducted with offshore e-businesses is one of the most difficult issues regarding e-commerce taxation" *(IBLS, 2007, p. 1)*.

The difficulties presented by electronic commerce are "not in themselves new; it is more a question of electronic commerce exacerbating existing tensions and difficulties inherent in the tax when dealing with cross-border transactions, relating particularly to place of supply and enforcement issues for non-resident suppliers of services. In finding solutions, the underlying principle of any VAT system (i.e. of taxing the final consumer in the jurisdiction where the particular goods or services have been consumed and enjoyed) will have to be taken into account. An equally important principle is that goods and services that are provided across borders are zero-rated by the supplier in the country of origin. This is to ensure that consumers in the recipient country do not carry the burden of foreign tax. Thus double taxation of services is avoided (i.e. the services are not taxed in the country of origin and destination)" *(Buys & Conje, 2004, p. 276)*.

The principle of neutrality is supported by most countries and it has been determined that a level playing field be created for countries in order to ensure fair and equitable taxation (i.e. economically similar income should be treated equally notwithstanding the manner in which the income was earned).

"The underlying question is whether existing indirect tax principles have been successfully applied to the taxation of electronic commerce in a way that will satisfy the competing demands of national revenue collecting agencies.

For VAT purposes it is important to consider the following three concepts:

- time of supply (i.e. the tax period in which VAT must be accounted for);

- value of supply (i.e. the value of the supply upon which VAT is calculated in respect of the supply); and

- place of supply (i.e. the place of supply determines where a particular supply will be taxed for VAT purposes).

In traditional business these concepts are relatively easy to define and straightforward rules could be applied. The advent of electronic commerce and by virtue thereof, the supply of electronic services to South Africa, has however, complicated this issue" *(Buys & Conje, 2004, p. 276)*.

Imported services

"The lack of formal VAT 'place of supply' rules in South Africa has resulted in widespread confusion regarding the obligations of foreign suppliers to register as South African VAT vendors when supplying goods and services to South Africa. This confusion was particularly rife in cases where services are supplied electronically and neither the location of supply, nor consumption, was known because the supply took place online" *(Watson, 2014, p. 15)*.

"Where these rules have been incorporated into the Act, they have been couched in vague general terms not designed to meet the requirements of an electronic era. The phrase 'utilised and consumed in the Republic' is not clear, and the question arises whether services are utilised and consumed at the place where they were physically rendered, or where the recipient resides or conducts its business in terms of the destination principle" *(van Zyl, 2013, p. 68)*.

The destination principle aims to tax supplies of services and tangible or intangible goods according to the rules of the jurisdiction where final consumption occurs. "An example is the application of 'place of supply rules' to provide clarity on where a product is considered to have been supplied and, therefore, subject to VAT. As set out above, South Africa lacks such rules, which often creates uncertainty about whether a product is subject to VAT and when a foreign supplier is considered to be carrying on an enterprise for VAT purposes in South Africa" *(Bardopoulos, 2013, p. 1)*.

In an initial attempt to 'level the playing field' between South African and foreign suppliers, National Treasury introduced the imported services provisions also referred to as the 'reverse-charge mechanism'.

The VAT Act defines 'imported services' to mean:

> "a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies" *(VAT Act, No. 89 of 1991, section 1)*.

Imported services refers to services acquired from a non-resident business which are consumed in South Africa for non-taxable purposes i.e. not bought for purposes of making taxable supplies which are

subject to VAT. In terms of this mechanism, the onus was on the South African consumer to account and pay for the VAT on such a purchase.

With the rapid growth of e-commerce, a high volume of transactions are entered into without any indirect tax obligation. This results in a strain on SARS as purchasers ignore the obligation to account for VAT.

In terms of electronic services, South African consumers were required to self-account for VAT on electronic services purchased from foreign suppliers in terms of the imported services provisions. In reality, it is easily understandable why enforcement of these provisions proved difficult for SARS and Treasury as South African consumers would not self-account for the output tax on receipt of the electronic service.

Treasury proposed in the 2013 National Budget Speech that foreign businesses which sell electronic services should be required to register as VAT vendors, in line with regulations which have been adopted by the European Union and other jurisdictions. This is largely attributed to the lack of policing and enforcement mechanisms by SARS to identify persons purchasing electronic services and not accounting for the VAT in terms of the imported services provisions. *(National Treasury, 2013, p. 21)*.

What is e-commerce?

Due to the lack of clear 'place of supply' rules and enforcement difficulties in respect of the imported services provisions, Treasury sought methods to regulate e-commerce transactions by introducing legislation requiring the compulsory VAT registration of foreign suppliers that supply electronic services to South Africa.

"E-commerce, has been defined broadly by the OECD Working Party on Indicators for the Information Society as "the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. The goods and services are ordered by those methods, but the payment and the ultimate delivery of the good or service do not necessarily have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organisations" *(OECD, 2014, p. 55)*.

"In this regard, e-commerce includes orders made over the Internet, through an extranet (a network where outside business partners, supplier or customers can have limited access to a portion of enterprise intranet/network), or through an electronic data interchange (EDI - a proprietary electronic system used for exchanging business data over networks). These services can be used either to facilitate the ordering of goods or services that are then delivered through conventional channels (indirect or offline e-commerce) or to order and deliver goods or services completely electronically (direct or on-line e-commerce)" *(OECD, 2014, p. 73)*.

Policy considerations - why tax electronic services?

The introduction of the new rules governing the taxation of electronic services was made against a "backdrop of efforts, both internationally and locally, to bring cross border e-commerce (specifically the digital economy) into the VAT regime. The application of VAT on imports does not lend itself to the effective enforcement on imported services or e-commerce where no border posts (or parcel delivery agents, i.e. the Post Office) can perform the function as collecting agents, as is the case with physical goods" *(National Treasury, 2014, p. 1)*.

> Example: A South African electronic services supplier would be required to register and account for VAT on supplies made to consumers while a non-resident supplier (prior to the introduction to the electronic services provisions) would not be required to account for VAT on the same or similar supplies made to South African consumers as the onus to account for the VAT on such supplies fell on the consumer.
>
> The net result is that the local consumers can buy imported digital products without paying VAT. This outcome not only places local suppliers of digital services at a competitive disadvantage (compared to suppliers from abroad) but also results in a loss of revenue for the *fiscus*.

"While foreign content providers relish the 'tax-free' nature of their services supplied to South African consumers, local suppliers are feeling the 'economic 'pinch, as domestic content providers are required not only to levy South African value-added tax on services supplied to the local marketplace, but pay South African corporate income tax of 28 per cent on profits generated" *(PwC, 2015, p. 1)*.

"The VAT legislation was amended to bring the digital economy more comprehensively into the VAT net and it permits the Minister of Finance to issue Regulations prescribing which services will be covered by the new electronic services definition in the VAT Act" *(National Treasury, 2014, p. 1)*.

Implementation considerations - which electronic services are taxed?

Treasury issued the draft Regulation prescribing those services which fall within the definition of 'electronic services' as set out in section 1 of the VAT Act during January 2014. This Regulation, however, was amended on finalisation during March 2014. Since then, this Regulation has not been amended, however Treasury has announced that the scope of the Regulation will be broadened in 2017.

At present the following services fall within the definition of 'electronic services':

> '**3. Education services**
>
> The supply of any –
>
> (a) distance teaching programme;

(b) educational webcast;

(c) internet-based course;

(d) internet-based education programme;

(e) webinar,

if the person making the supply of the electronic services is not regulated by an educational authority in that export country.

4. Games and games of chance

The supply of any –

(a) electronic game, including any –

(i) internet-based game; or

(ii) multiplayer role-playing game;

(b) interactive game, where such interactive game is a –

(i) game of chance;

(ii) game where the result is influenced by the skill of the player; or

(iii) game which is a combination of chance and skill, or

(c) electronic betting or wagering, where such electronic betting or wagering constitutes acceptance of a bet or wager on –

(i) the outcome of a race; or

(ii) any other event or occurrence.

5. Internet-based auction service

The supply of an internet-based auction service facility.

6. Miscellaneous services

The supply of any –

(a) e-book, which for the purposes of this regulation means, any-

(i) digitised content of any book; or

(ii) electronic publication;

(b) audio-visual content, which for the purposes of this regulation means-

(i) any set of moving visual images or other visible signals, whether with or without accompanying sounds where the visual images are such that sequences of them are seen as moving pictures; and

(ii) any right to view the visual images or visible signals contemplated in subparagraph (i);

(c) still images, which for the purposes of this regulation means, any –

(i) desktop theme;

(ii) photographic image;

(iii) pictorial image; or

(iv) screensaver,

and any right to view any item listed in this paragraph; or

(d) music, which for the purposes of this regulation means, any –

(i) audio clip;

(ii) broadcast not simultaneously broadcast over any conventional radio network in the Republic;

(iii) jingle;

(iv) live streaming performance;

(v) ringtone;

(vii) sound effect,

and any right to listen to any item listed in this paragraph.

7. Subscription service

Any subscription service to any-

(a) blog;

(b) journal;

(c) magazine;

(d) newspaper;

(e) games;

(f) internet-based auction service;

(g) periodical;

(h) publication;

(i) social networking service;

(j) webcast;

(k) webinar;

(l) web site;

(m) web application; or

(n) web series. *(SARS, 2014, p. 4)*'

On release of the final Regulation, it was interesting to note that the scope of the draft provisions had been reduced regarding aspects associated with 'Information System Services' as well as 'Maintenance Services'. These exclusions consisted of databases, system and application software which forms a large portion of South Africa's business-t0-business transactional environment.

In this regard, there is a very important distinction between South Africa's approach to the taxation of electronic services as opposed to other jurisdictions in that it taxes business-to-business supplies in addition to business-to-consumer supplies.

The Regulation was drafted with the intention to capture business-to-consumer supplies but inevitably also captures some business-to-business supplies. The current list of electronic services is very limited, however, it is expected that it will be expanded in the coming year as proposed in the 2015 National Budget Speech.

Administrative considerations – how are these electronic services taxed?

Where a foreign supplier supplies any of the listed electronic services in excess of the ZAR 50,000 threshold, and is deemed to be carrying on an enterprise for VAT purposes, the foreign supplier is required, inter alia, to:

- register for VAT;

- account for output tax on the payments basis (sometimes known as the cash basis) of accounting;
- submit VAT returns on a monthly basis, regardless of turnover;
- issue tax invoices; and
- retain and store records in South Africa.

For completeness, these administrative tasks can be split into three distinct categories:

VAT registration process

SARS have established a specialised e-commerce registration unit which deals specifically with electronic services VAT registrations. As a result, the registration process is largely without any major delay and can be processed quite efficiently where SARS is satisfied with the registration documentation submitted.

In terms of the rules, suppliers of electronic services are required to register as South African VAT vendors where their turnover in South Africa exceeds or has already exceeded the annual threshold of ZAR 50,000. The registration threshold for electronic services suppliers is significantly lower than the standard registration threshold of ZAR 1 million for a South African VAT registration in terms of the normal processes.

Contrary to the ordinary VAT registration process, the electronic services VAT registration process is more efficient and can be obtained with little to no hassle and the ecommerce unit has been able to manage all electronic services related registration applications and queries in as little as 72 hours. The only issue identified is that in some instances, the registration details have not been captured correctly, or the vendor has been registered for two-monthly tax periods instead of monthly tax periods.

As a result of the simplified registration process, the documentary requirements, when compared to the requirements for a VAT registration under the normal processes are simplified, and have been set out below:

- The certificate of incorporation of the foreign entity;
- The proof of tax registration with the foreign entity's tax authority;
- The identity document or passport of the representative vendor (representative for the foreign entity in relation to its tax affairs in South Africa);
- A signed special power of attorney; and

- A signed version of the VAT101 registration application form. "A foreign electronic service entity that applies for registration is required to complete the VAT101 in English, and where the relevant support documents are not in English, the foreign electronic service entity is required to produce a translation of those documents in English" *(SARS, 2015, p. 2)*.

In this regard, no other supporting documents are required for the application process, however should SARS so request, recent bank statements may need to be provided *(SARS, 2015, p. 7)*.

VAT returns

The SARS e-commerce registration unit requires all electronic services suppliers to be registered for VAT with a monthly filing obligation. As the registration application is processed by SARS' specialised unit, this filing obligation will be allocated to foreign entities based on the nature of their operations and does not provide alternate options to account for the VAT collected.

Accounting and invoicing requirements

An electronic services supplier may account for South African VAT on the payment basis (or cash basis). This means that a foreign supplier will only be required to account for VAT on actual payments made and actual payments received in respect of taxable supplies during the relevant tax period.

For completeness, the example below highlights how the accounting process would work based on a monthly filing obligation for a foreign supplier:

> Example: Where a foreign supplier (i.e. Apple) releases an application in February 2017, and only receives payment in respect of such sales in March 2017, Apple will be required to file and pay its VAT return and liability in respect of such sales made by close of business on the last business day of April 2017.
>
> In terms of the South African VAT Act, the time of supply in respect of sales made via the Apple Application Store is the date on which Apple receives payment in respect of the supply of the application. This would therefore create an obligation on Apple to account for such payments in the same month's VAT201 return in which the funds are received.

On 11 March 2016 however, SARS provided for an alternative approach to the accounting of VAT for a foreign supplier by issuing a draft Binding General Ruling (draft BGR)[1] for public comment which deals specifically with the supply of electronic services via intermediaries.

This purpose of the draft BGR was to allow the electronic services supplier to enter into an agreement with an intermediary, whereby the intermediary makes its platform (for example, the intermediary's website) available to the electronic services supplier to facilitate the supply of electronic services to customers.

The draft BGR would therefore provide circumstances under which an:

- "electronic services supplier will not be required to register as a vendor in the Republic; or
- electronic services supplier will not be required to account for output tax for the supply of electronic services facilitated by intermediaries; and
- intermediary is required to account for output tax in relation to the supply of electronic services by an electronic services supplier to a recipient" *(SARS, 2016, p. 2)*.

The draft BGR is intended to have retrospective application from 1 April 2015, to all electronic services suppliers who have supplied electronic services via an intermediary's platform. As such, an arrangement has been made in terms of section 72 of the VAT Act, whereby an electronic services supplier will not be required to register as a vendor provided the intermediary accounts for VAT on such supplies and certain other conditions (as set out in the draft BGR) are met.

Notwithstanding the above, the electronic services supplier will be required to register and account for VAT on all supplies of electronic services not made via an intermediary's platform where these supplies at the end of any month are in excess of ZAR 50,000.

For completeness, the example below highlights how the accounting process would work based on a monthly filing obligation where an intermediary is involved:

> Example: Where Google releases an application in February 2017 onto Apple's Application Store, and Apple receives payment in respect of such sale in March 2017, Apple will be required to file and pay the VAT on behalf of Google in its VAT return by close of business on the last business day of April 2017 as per the conditions set out in the draft BGR.

[1] The draft BGR in respect of the supply of electronic services had not yet been finalized at the time of submission of this dissertation.

Based on the above, Apple is acting as an agent for Google in terms of this process. In terms of section 54(1) of the VAT Act, Apple can issue a tax invoice/receipt to the recipient of the application using its own VAT number and as such would not be required to reflect Google's details on the invoice.

Notwithstanding the above, and where no agreement in terms of the draft BGR is entered into, Google will remain liable for VAT due in respect of sales made via Apple's platform.

Where this approach is adopted, Apple is required to provide Google with an agency statement setting out the payments received in respect of application sales each month, in order for Google to correctly account for output tax on the applications sold in terms of section 54(3) of the VAT Act.

The invoicing requirements, like the registration requirements, have too been relaxed in order to ensure maximum compliance by foreign entities. The requirements for a valid tax invoice as set out in section 20 of the VAT Act refer the below:

- The words "tax invoice", "VAT invoice" or "invoice".
- Supplier's name, address and VAT registration number.
- Recipient's name, address and VAT registration number.
- Invoice number (individual, serialised).
- Invoice date.
- Description of the goods or services.
- Quantity or volume of the goods or services.
- Either
    - Value, tax charged and consideration for the supply; or
    - The consideration and i) the tax charged; or ii) a statement that it includes tax and the rate of tax charged.

A tax invoice must be issued in the currency of South Africa (ZAR), except for zero-rated supplies (for example, services exported in certain instances) *(VAT Act, No. 89 of 1991, section 20)*.

Notwithstanding the above, SARS Binding General Ruling 28 on electronic services (BGR 28)[2] sets out the:

- information that must be contained on a tax invoice, credit or debit note in order to satisfy the requirements of sections 20(7) or 21(5);
- exchange rate that must be applied in order to determine the amount of the VAT charged in the currency of the Republic; and
- manner in which prices must be advertised or quoted,

for the supply of electronic services by an electronic services supplier.

SARS in terms of BGR 28, allowed electronic service providers to issue abridged tax invoices (i.e. it is not necessary to include the details of the recipient on the tax invoice).

Where the foreign supplier reflect the consideration for a supply in the currency of any country other than South Africa, the supplier must convert the tax charged to South African Rand. In this regard, the exchange rate that must be applied in order to determine the tax charged, is the rate published by either the South African Reserve Bank, Bloomberg, or the European Central Bank *(SARS, 2016, p. 3)*.

"The applicable exchange rate is the –

i. daily exchange rate on the date the time of supply occurs;
ii. daily exchange rate on the last day of the month preceding the time of supply; or
iii. monthly average rate for the month preceding the month during which the time of supply occurs" *(SARS, 2016, p. 3)*.

Foreign suppliers of electronic services however should not act in a manner in which it may be construed that they are 'shopping' for the best exchange rate and these rates in (ii) and (iii) should not be used during exceptional circumstances where the equivalent rand value is distorted due to the exchange rate used *(SARS, 2016, p. 3)*.

SARS have also made provision for foreign suppliers of electronic services as of 1 April 2015 to advertise or quote the price of its electronic services exclusive of VAT on condition that it has a statement on its website indicating that VAT will be levied on supplies of electronic services to electronic services recipients *(SARS, 2016, p. 3)*.

[2] Second version of BGR was issued on 23 February 2016.

Storage and Archiving

South African tax legislation requires that, unless otherwise authorised by a senior SARS official, records in electronic form must be kept and maintained at a place physically located within South Africa.

Section 29(1) of the Tax Administration Act No. 28 of 2011 (the TAA) essentially requires a person to keep records, books of account or documents which enable it to observe the requirements of a tax Act, or are specifically required by public notice. This would of course include tax invoices *(Tax Administration Act, No. 28 of 2011, section 29)*.

Section 29(3)(a) of the TAA requires a person who submits a return for a tax period to keep relevant records for five years from the date of submission of a return. The table below illustrates the documentation retention periods for specific scenarios *(Tax Administration Act, No. 28 of 2011, section 29)*:

Person	**Time Period**
A person who has submitted a return.	Five years counting from the date of submission of a return.
A person required to submit a return but has not complied.	Indefinitely.
A person who is not required to submit a return, but has during a tax period, received income, has a capital gain or loss or engaged in any other activity that is subject to tax or would be subject to tax but for the application of a threshold exemption.	Five years after the relevant 'tax period' as defined.
A person who has lodged an objection or appeal against an assessment or decision under the Tax Administration Act (No. 28 of 2011).	Until the disputed assessment or decision becomes final.
A person who has been notified or is aware that the records are subject to an audit or investigation.	Until the audit or the investigation is concluded.

Section 30(1) of the TAA sets out the form in which records are to be retained. "In terms of section 30(1) records should be retained -

(a) in their original form in an orderly fashion and in a safe place;

(b) in the form as may be prescribed in a public notice; or

(c) in a form specifically authorised by a senior SARS official" *(Tax Administration Act, No. 28 of 2011, section 30)*.

Government Notice 787 (the Notice) was published in Government Gazette 35733 of 1 October 2012, in terms of section 30(1)(b) of the TAA.

The Notice confirms that records do not have to be retained in an original (paper) form, but can also be retained in an electronic form. The Notice sets out how records may be retained electronically and highlights three key factors:

- Firstly, the integrity of the Electronic Records must satisfy section 14 of the Electronic Communications and Transactions Act 25 of 2002. In short, that means the records must remain the same from the time they are first generated to the time they are displayed. Also, the information must be capable of being easily displayed.

- Secondly, it should be easy to provide SARS with a paper or electronic copy of the records that SARS can easily read/access.

- Thirdly, SARS must be able to access those records for any purpose they are entitled to in terms of a tax Act.

The legislation requires that the Electronic Records be retained at a place in South Africa. However, subject to certain conditions, one may seek permission from a senior SARS official for retention at a place outside South Africa.

Electronic Records must be available for inspection by SARS at all reasonable times and at premises in South Africa, or at a premises accessible from South Africa (if permission for the latter had been granted).

In the course of carrying out an inspection by SARS, the electronic system must be able to demonstrate that the Notice has been complied with. All information needed to access the Electronic Records must also be available at an inspection. It is noted that in terms of section 234 of the TAA it is a criminal offence to fail or neglect to maintain records as required.

Based on the legislation, no clear guidelines for foreign suppliers of electronic services exist in respect of the storage and archiving of records.

Structural and practical issues

Supplies to Businesses and Final Consumer ('B2B' and 'B2C')

The current legislative framework draws no distinction between supplies that are made between businesses ('B2B'), and between businesses and the final consumer ('B2C').

While it is understood that it is intended that there be no distinction between B2B and B2C supplies, in these circumstances, this is substantially different to the structure of similar provisions in other jurisdictions (as set out below in Chapter 3).

The lack of clarity in respect of this has created additional complexities for foreign entities, and in fact, caused an increased risk for SARS, as entities that are registered as vendors will be entitled to issue valid tax invoices.

To elaborate on this, if the services listed in the Regulation are supplied by a company that would ordinarily be making supplies of its services in a B2B environment, the foreign supplier will still have a VAT registration obligation.

On this basis, the National Treasury and SARS will need to clarify this point should this not be the intention of the electronic services provisions..

Bundled Supplies

In terms of the current structure of the VAT Act, services falling outside the ambit of the electronic services definition will be regarded as imported services to the extent that they are used for non-enterprise purposes. An invoice for bundled services would, accordingly, have to be split between electronic services and other services, and comply with section 10(22) of the VAT Act.

Section 10(22) of the VAT Act sets out that "where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it. This means that the consideration for a supply must be split between the element relating to a taxable supply and any other element" *(VAT Act, No. 89 of 1991, section 10)*.

This places an onerous burden on the non-resident supplier of electronic services and other services as they have to classify their services, and attribute consideration, according to the South African tax regime that is not necessarily aligned with global practice and definitions. The non-resident would also be required to implement a dual invoicing system; one for enterprise purposes, and one for the out of scope supplies.

In the event of an imported good or service, which incorporates the facilities of an online electronic medium, the electronic medium should constitute a separate taxable supply, distinct from the main core good or service.

> Example: Should importation of hard copy textbooks from a foreign supplier include a multimedia CD or online digital service, only the digital media would fall within the scope of the Regulation and be subject to VAT. It would therefore be helpful that guidance be provided by SARS by way of an Interpretation Note providing clarification.

A similar challenge arises when group companies charge an inter-company management fee, which often contains elements of electronic services. Currently, section 10(22) of the VAT Act requires that the consideration for a supply must be split between the element relating to a taxable supply and any other element. This will result in the global head offices of companies being impacted by the new legislation which will require a VAT registration that consists of additional compliance requirements.

Activities Included in 'Enterprise'

Based on the current wording of the legislation, it is not clear that other supplies made by the foreign entity will indeed constitute non-supplies for VAT purposes.

The issue for consideration is whether one can accept that the other activities are excluded from the South African VAT enterprise ambit on the basis that the underlying activity or enterprise is not partially conducted in South African. This aspect remains unclarified and requires confirmation by way of an Interpretation Note.

> Example: Where Bloomsbury Publishers (a non-resident) makes direct supplies of both hardcover and electronic versions of their books to South African consumers, only the electronic services supplied to South Africa would be taxed in terms of the electronic services provisions. The VAT treatment of the hard cover books supplied by Bloomsbury would depend on a number of other factors which includes customs and ordinary South African VAT rules.
>
> Where the customer imports the hard cover books to South Africa, Bloomsbury would potentially be entitled to zero rate the supply in its country of residence (as it would be seen as an export of goods) and VAT would be charged on the importation of the books by the customer in South Africa. Alternatively, where Bloomsbury imports the goods itself and sells it locally to either a retailer or customer, Bloomsbury may be required to register for VAT in South Africa.

Hybrid Enterprises

Another consideration is whether a foreign entity, already registered as a vendor as a result of non-electronic services related activities, is required to draw a distinction between normal supplies accounted for on the invoice basis and on electronic services; which are to be accounted for on the payments basis.

This creates an onerous compliance burden on the foreign supplier, and will as a result, lead to anomalies in the foreign supplier's accounting processes.

The ambiguities in the legislation has led many suppliers to obtain a dual VAT registration in South Africa.

> Issue: As in the example set out above, a foreign supplier will be required to register and account for VAT on the supply of electronic services as well as on the other supplies (i.e. goods) made to South African consumers using two different registrations.

On this basis, foreign suppliers would be required to oversee two registrations as well as its related compliance requirements. This process would be onerous on suppliers in this position.

Accounting and invoicing

While output tax must be accounted for on the payments basis, there is no clarity around the time of supply for the consideration received.

> Issue: Would the time of supply rules be triggered when the payment received reflects in the vendor's bank account, as is the case with most credit card transactions where payment takes a period of time to clear through the banking system, and a period of time to reflect in the vendor's bank account; or would the time of supply be triggered upon the initiation of such payment?

Further, most online services follow the market scheme of 'low value and high volume' to generate revenue. Thus, invoicing requirements, which require tax invoices to be issued in all instances, are extremely onerous for electronic services.

It would have been less onerous if SARS allowed suppliers of electronic services to issue invoices in a foreign currency on a similar basis to that which applied for tax invoices for zero-rated supplies. From a systems perspective, this process would be easier to manage, especially if foreign entities are already applying this methodology in other jurisdictions.

This would thus not require the value, VAT, and consideration to be in ZAR as these could be in any foreign currency, but it would reflect the ZAR amount that the supplier would declare as output tax, and also the ZAR amount that a South African vendor could claim as input tax.

These aspects would require an amendment to the legislation or at least, as an interim measure, be dealt with in a more expansive regulation.

Furthermore, the sequential numbering of invoices requirement in terms of SARS BGR 28 is limited to South Africa. As services are provided globally, in most circumstances, the sequential numbering is maintained globally, and is not sequential within a particular territory. This additional requirement remains practically infeasible and creates confusion for a foreign supplier trying to remain compliant with the legislation.

Maintenance of Records outside of the Republic

In terms of Government Notice No 787 dated 1 October 2012, there is a requirement that VAT vendors whose records are retained in an electronic form at a location outside South Africa are required to obtain authorisation from SARS to maintain these records outside South African.

As all foreign businesses who are registered as VAT vendors under the electronic services provisions are likely to maintain their records outside South African, it would therefore be helpful if SARS or Treasury provided blanket approval in respect of this process for all entities operating in this space. This will avoid the administration of all vendors requesting authorisation for this purpose.

Conclusion

Unlike days gone by, it is now possible for foreign companies to operate and sell electronic services in South Africa without having any physical presence. For many consumers who relished internet shopping in a 'tax-free' environment, the electronic services provisions bring additional 'tax costs' which in actual fact seek to incentivise consumerism in-country.

Aligning this concept with the economic benefits for South Africa, "President Jacob Zuma stated in the 2016 State of the Nation Address that a resilient and fast growing economy is at the heart of South Africa's radical economic transformation agenda. Expanding South Africa's tax base will allow government to increase funding in other areas and to address socio-economic issues" (National Treasury, 2016, p. 3).

While South Africa has made significant strides by expanding the scope of the electronic services provisions to "cover certain electronic supplies made by foreign suppliers, other opportunities to further broaden the tax base and protect local industry exist. Despite being just under two years old, the current legislation dealing with electronic services supplied by foreigners already appears "dated" due to the rapid advancement of technology" (PwC, 2016, p. 1).

Tied to this is the need for the legislature to revisit the compliance requirements for foreign suppliers of electronic services to ensure that the practical considerations addressed above are remedied while allowing the compliance process itself to remain relatively straightforward.

From a policy perspective, the implementation of the provisions allows for additional revenue to be generated by the *fiscus*, while ensuring that local and foreign suppliers of electronic services operate on a level-playing field to eradicate any competitive disadvantage that existed previously.

Further, the pace at which technology and e-commerce is advancing is unprecedented and not ensuring that the provisions cater for these advancements would be a disservice to the *fiscus*. In order to enable the *fiscus* to keep pace with these changes, amendments to the legislation and regulations are required to broaden the list of prescribed services falling within the ambit of its application.

Notwithstanding the shortcomings highlighted above, the South African electronic services provisions were introduced prior to other more developed jurisdictions with more sophisticated tax regimes. In this regard, the provisions represent a 'pioneer achievement' by Treasury and SARS by tackling an area of commerce with little to no practical guidance from other key players.

Chapter Three will highlight how the European Union have since implemented similar provisions in respect of the supply of electronic services.

3. TREATMENT OF ELECTRONIC SERVICES IN THE EUROPEAN UNION

"Simply defined, electronic commerce is the conducting of commercial activities through electronic means. The multimedia capability of the internet enables people in different locations to interact through voice, text, and/or image. Thus, e-commerce ignores distance, national boundaries and time differences. E-commerce makes it easier for enterprises to move their business operations across national boundaries and to shift income to tax havens. It also allows business functions to be more integrated, while becoming more distributed throughout the world, taking advantage of local conditions, including tax benefits. E-commerce directly challenges existing tax principles that were by and large conceived in an era that could not have foreseen the technological advances of the present. Virtually every aspect of the tax system is challenged by e-commerce" (Li, 2000, p. 313).

In response to these changes, tax authorities around the world have stated their positions on the taxation of e-commerce and implemented new legislation which caters for these technological advancements. This chapter highlights the application of such law in the European Union.

Place of supply rules

"In the European Union, supplies of services generally take place in the state in which the supplier has established his business, or has a fixed establishment from which to service his supply. Locating the real place of supply becomes complex when the exceptions to the general rules are identified. The rules are difficult to apply, and sometimes lead to distortions detrimental to operators based in the European Union, and are not consistently applied by all its Member States (van der Merwe, 2003, p. 371).

With the advent of e-commerce it became possible for businesses to perform transactions in jurisdictions in which the business has no fixed place of establishment. So it became necessary to amend the rules to eliminate distortions in the internal market, by introducing new place-of-supply rules for electronically delivered services supplied for consideration. A supply of electronically delivered services is now, in principle, taxable where the customer is located (where he has a business or fixed establishment, or a permanent address, or where he usually resides). This means that European Union suppliers no longer have to levy VAT on supplies customers outside the EU, whereas a non-EU supplier has to charge VAT on sales to private consumers, just as Union registered suppliers have to do. These measures imply that a supplier is able to distinguish between registered and private consumers, which may prove to be problematic" (van der Merwe, 2003, p. 371).

Policy considerations - why tax electronic services?

On 1 January 2015, the European Commission introduced new VAT place of supply rules for suppliers of electronic, broadcasting and telecom services to consumers. The fundamental change with the application of such rules was that VAT on digital services was no longer to be accounted for where the

supplier resides, but rather where the customer is located. In the case of non-EU suppliers, VAT was previously required to be accounted for based on the customer's location in terms of the VAT on Electronic Services (VoES) scheme. This scheme has now been incorporated into the reform of the EU rules. The new rules therefore require a supplier to gather and report information on its customers across all EU Member States resulting in a considerable administrative and compliance burden on the supplier (Taylor, 2015, p. 1).

Prior to the introduction of the new electronic services legislation in the EU, digital services supplied to businesses were already subject to VAT in the recipient's location. However where EU businesses supplied services to consumers (B2C supplies), the onus was on the supplier of electronic services to account for VAT. A concern existed that businesses established their business in lower tax Member States of the EU, such as Luxembourg, to obtain a competitive advantage through electing to apply lower rates of VAT. Whereas, businesses outside the EU have been obliged to charge VAT on B2C supplies of broadcasting, telecommunications and e-services since 2010 and will continue to be liable for VAT on B2C supplies of these services. Although the change primarily affects businesses based within the EU, businesses predominantly based outside the EU who have now established a business within the EU as a way to meet their obligations to account for VAT will now have to review those arrangements (Norton Rose Fulbright, 2014, p. 1).

"To further simplify the obligations of suppliers of such services, a new special scheme known as the Mini One Stop Shop (MOSS) also came into operation on 1 January 2015, allowing suppliers to submit returns and pay the relevant VAT due to Member States through the web portal of one Member State, instead of having to register for VAT in multiple Member States" (Revenue: Irish Tax and Customs, 2016, p. 1). In this regard, any EU Member State can be chosen unless the business has a permanent establishment in a specific country and suppliers will need to register for MOSS in that Member State (Taylor, 2015, p. 1).

"Under the "transitional" VAT system tangible products imported into the EU via commercial channels by either registered traders or others can be taxed at the border or at the post office, whether ordered electronically or by conventional means". This discussion ignores the problem of collecting a destination based VAT on cross-border shopping — the situation when a consumer who lives in one Member State buys a product in another Member State and takes it home. The primary administrative problem was due to the increased volume of small orders passing through the post office generated by the advent of e-commerce. A viable solution to negate the increased administration required would be to institute enhanced exemptions for small shipments. However, this would adversely affect both the economic neutrality and the fairness of the system, as well as tax revenues" (McLure Jr, 2001, p. 3).

In the circumstance where the supplier had an establishment in the EU, the previous place of supply for these services was the jurisdiction where the supplier was established. This enabled EU-based suppliers to charge VAT at a uniform rate to all consumers, relevant to the supplier's location regardless of where the consumers were based in the EU. Those previous rules led to perceived distortions as many non-EU businesses set up fixed establishments in Luxembourg to secure a low uniform VAT rate of only 15%

(i.e. a lower VAT rate applied in the case of certain electronic services). Since 1 January 2015, the general rule is that the place of supply for both EU and non-EU suppliers of these services has become the non-business customer's place of "belonging". "A non-business customer will generally belong where the customer is registered, has their permanent address, or usually lives. However, if a particular jurisdiction provides that VAT should be charged where the service is "used and enjoyed", and not where the customer belongs, VAT will be charged in the place of use and enjoyment, although the "use and enjoyment" rule only applies where the supply is enjoyed in the EU, but the customer belongs outside the EU (or vice versa). This is known as the "effective use and enjoyment rule" and it can be a trap in deciding where supplies (both B2B and B2C) take place, especially as the scope of the rules vary from jurisdiction to jurisdiction" (DLA Piper, 2016, p. 5).

The European Commission's Action Plan on VAT sets out its plan to modernise the current EU VAT system to make it simpler and more business-friendly. The Commission has committed to presenting legislative proposals on a number of the initiatives set-out in the Action Plan. These include the following proposals:

- To modernise and simplify VAT for cross-border e-commerce (as part of its Digital Single Market strategy);
- To provide greater autonomy to Member States on the setting of VAT rates;
- On a definitive VAT system based on the principle of taxation in the country of destination of the goods; and
- To improve cooperation between tax administrations including from non-EU countries and law enforcement bodies and to strengthen tax administrations' capacity for a more efficient fight against fraud (Irish Tax Institute, 2014, p. 1).

On this basis and to reduce the onerous requirement on suppliers to obtain evidence of where customers live at the point of sale, while ensuring that VAT is accounted for where B2C services are consumed, EU Regulation (1042/2013) (EU Regulation) has been introduced to assist suppliers to easily determine the place of supply of their e-commerce services. The EU Regulation is based on presumptions as to where the consumer's place of belonging is located and where their physical presence is required for the supply to take place (DLA Piper, 2016, p. 5).

Implementation considerations - which electronic services are taxed?

The new rules apply to the following services to the extent the services are supplied to non-business customers (i.e. consumers, or non-business customers receiving the services for private purposes) and certain non-VAT registered institutions:

- telecommunication services;

- television and radio broadcasting services; and
- electronically supplied services (including software subscription services, such as for games, music and other content) (DLA Piper, 2016, p. 5).

For completeness, the electronic services prescribed and referred to as "electronically supplied services" in Directive 2006/112/EC (Directive) include "services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology. "This includes the following services as listed in Annexure I of the Directive, but are not limited to:

a. the supply of digitised products generally, including software and changes to or upgrades of software;

b. services providing or supporting a business or personal presence on an electronic network such as a website or a webpage;

c. services automatically generated from a computer via the Internet or an electronic network, in response to specific data input by the recipient;

d. the transfer for consideration of the right to put goods or services up for sale on an Internet site operating as an online market on which potential buyers make their bids by an automated procedure and on which the parties are notified of a sale by electronic mail automatically generated from a computer; and

e. Internet Service Packages (ISP) of information in which the telecommunications component forms an ancillary and subordinate part (i.e. packages going beyond mere Internet access and including other elements such as content pages giving access to news, weather or travel reports; playgrounds; website hosting; access to online debates etc.)".

The following services however "do not fall within the ambit of "electronically supplied services" as per the Directive above:

a. broadcasting services;

b. telecommunications services;

c. goods, where the order and processing is done electronically;

d. CD-ROMs, floppy disks and similar tangible media;

e. printed matter, such as books, newsletters, newspapers or journals;

f. CDs and audio cassettes;

g. video cassettes and DVDs;

h. games on a CD-ROM;

i. services of professionals such as lawyers and financial consultants, who advise clients by e-mail;

j. teaching services, where the course content is delivered by a teacher over the Internet or an electronic network (namely via a remote link);

k. offline physical repair services of computer equipment;

l. offline data warehousing services;

m. advertising services, in particular as in newspapers, on posters and on television;

n. telephone helpdesk services;

o. teaching services purely involving correspondence courses, such as postal courses;

p. conventional auctioneers' services reliant on direct human intervention, irrespective of how bids are made;

t. tickets to cultural, artistic, sporting, scientific, educational, entertainment or similar events booked online;

u. accommodation, car-hire, restaurant services, passenger transport or similar services booked online" (European Commission, 2015, p. 8).

For completeness, examples of electronic services in terms of the EU regulation have been listed but is not limited to the following:

- Website supply, web-hosting, distance maintenance of programmes and equipment;
- Supply of software and updating thereof;
- Supply of images, text and information and making available of databases;
- Supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events; and

- Supply of distance teaching" (European Commission, 2015, p. 9).

Administrative considerations – how are these electronic services taxed?

- If a business has customers only in its Member State, the taxpayer will account for VAT only in its Member State (that is if its business is or has to be registered for VAT). Where a business has customers in another Member State, who are VAT registered (i.e. customers have provided the taxpayer with its VAT registration numbers), then these customers themselves account for VAT in their Member State (i.e. via the reverse charge mechanism) (European Commission, 2015, p. 2).

- If the taxpayer's services are provided through a marketplace then it is considered that the taxpayer is supplying the service to a VAT taxable person (i.e. to the operator of the marketplace) who in turn is supplying the service further to the final customer, to a non-taxable person. The operator of the marketplace will have VAT obligations in Member States where the final customers are located (European Commission, 2015, p. 2).

  VAT registration process

  While non-EU suppliers have been advised that they would be automatically transferred from VoES to VAT MOSS, tax authorities have indicated that this will not happen, and that suppliers will need to apply separately for a new registration with MOSS (Taylor, 2015, p. 1).

  The MOSS is a computerised system that allows businesses supplying telecommunications, broadcasting and electronically supplied services to customers in another Member State to account for the VAT due on those services via a web-portal in their own Member State. The following considerations need to be taken into account when registering for VAT MOSS:

  - If a person is already registered for VAT in a Member State, such person can register for VAT MOSS with the same VAT identification number that it uses for its domestic returns.

  - If a person is not registered for VAT in a specific Member State (e.g. because the domestic threshold for registration is not reached), a person can register only for the VAT MOSS. The sales in the Member State will remain VAT exempted as long as the business' annual turnover remains below the domestic threshold.

  - A taxpayer should submit a quarterly MOSS VAT return electronically to the Member State within 20 days after the end of the return period (i.e. the return for the first quarter of the year must be submitted by the 20th of April).

- In the VAT return, a taxpayer is required to declare the total turnover exclusive of VAT, the VAT rates applied and the total amount of VAT charged to its clients, per Member State, to which supplies have been made.

- A taxpayer should pay the total amount of VAT due following the VAT return to its tax authority by the deadline for submitting the VAT return (i.e. by the 20th April for the first quarter of the year).

- The Member State transmits the VAT return information to all Member States to which supplies have been made and distributes the VAT receipts to these Member States accordingly (European Commission, 2015).

EU VAT rates, formats and thresholds table

Country	VAT rates	VAT No. Format	Distance Selling Threshold
Austria	20% (Std) 10% (Reduced)	ATU12345678	€35,000
Belgium	21% (Std) 6%/12% (Reduced)	BE1234567890	€ 35,000
Bulgaria	20% (Std) 9% (Reduced)	BG123456789	BGN 70,000
Cyprus	19% (Std) 5%/9% (Reduced)	CY12345678X	€ 35,000
Czech Republic	21% (Std.) 10% / 15% (Reduced)	CZ12345678	CZK 1,140,000
Germany	19% (Std.) 7% (Reduced)	DE123456789	€ 100,000
Denmark	25% (Std.) N/A (Reduced)	DK12345678	DKK 280,000
Estonia	20% (Std.) 9% (Reduced)	EE123456789	€ 35,000
Greece	24% (Std.) 6% / 13% (Reduced)	ESX12345678	€ 35,000
Spain	21% (Std.) 4% / 10% (Reduced)	ESX12345678	€ 35,000
Finland	24% (Std.) 10% / 14% (Reduced)	FI12345678	€ 35,000
France	20% (Std.) 5% / 10% (Reduced)	FR12345678901	€ 35,000

Country	VAT rates	VAT No. Format	Distance Selling Threshold
Croatia	25% (Std.) 5% / 13% (Reduced)	HR12345678901	€ 35,000
Hungary	27% (Std.) 5% / 18% (Reduced)	HU12345678	HUF 8,800,000
Ireland	23% (Std.) 4.8% / 9% / 13.5% (Reduced)	IE1234567WA	€ 35,000
Italy	22% (Std.) 10% (Reduced)	IT12345678901	€ 35,000
Lithuania	21% (Std.) 5% / 9% (Reduced)	LT123456789	€ 35,000
Luxembourg	17% (Std.) 3% / 8% / 14% (Reduced)	LU12345678	€ 100,000
Latvia	21% (Std.) 12% (Reduced)	LV12345678901	€ 35,000
Malta	18% (Std.) 5% / 7% (Reduced)	MT12345678	€ 35,000
Netherlands	21% (Std.) 6% (Reduced)	NL123456789B01	€ 100,000
Poland	23% (Std.) 5% / 8% (Reduced)	PL1234567890	PLN 160,000
Portugal	23% (Std.) 6% / 13 % (Reduced)	PT123456789	€ 35,000
Romania	20% (Std.) 5% / 9% (Reduced)	RO1234567890	RON 118,000
Sweden	25% (Std.) 6% / 12% (Reduced)	SE123456789012	SEK 320,000
Slovenia	22% (Std.) 9.50% (Reduced)	SI12345678	€ 35,000
Slovakia/Slovak Republic	20% (Std.) 0% / 5% (Reduced)	SK1234567890	€ 35,000

(VATGlobal, 2016)

VAT returns

As set out above, the MOSS enables reporting VAT through a single web portal for all countries that digital services providers are selling into. Registered taxpayers submit a single quarterly online return and pay VAT covering all the countries through the single portal.

It is then the responsibility of the tax authority to divide up the VAT received per Member State and transfer it to the relevant Member States of the consumers (Helleputte, Scornos, & Bouvy, 2016).

Structural and practical issues

Supplies to Businesses and Final Consumer ('B2B' and 'B2C')

Where an electronic services supplier supplies digital services to a customer that does not provide the supplier with a valid VAT registration number, the supplier should then treat it as a business to consumer supply and charge the VAT due in the customer's Member State. This process would however differ where the supply would be treated as a B2B supply (i.e. no VAT charged on such supplies) (HMRC, 2016, p. 5).

While suppliers have the discretion to determine whether they will accept alternative supporting documentation (in the instance where a customer is not a registered vendor, but operates as a business), this ultimately creates inconsistencies with the treatment and application of the rules by Member States creating the perception that some Member States may be losing out on revenue based on the decisions made by businesses outside the Member State. For completeness, where the supply is treated as a B2B supply, the customer will be responsible for accounting for any VAT due to the tax authorities in its Member State (HMRC, 2016, p. 5).

Bundled Supplies

The issue with bundled supplies is that the place of supply rules in respect of the parts of the supply differ. This would mean that where a physical product which is 'bundled' with an electronic service is supplied to a customer, the place of supply rule changes will only apply to the portion of the supply that relates to the electronic service (HMRC, 2016, p. 4).

Presumptions in respect of place of supply

Before the introduction to the EU electronic services model, B2C supplies when made to non-taxable persons within the EU would have attracted VAT at the rate applicable in the Member State where the supplier is established (PwC, 2013, p. 1).

As set out above, this approach has since changed further to the introduction to the new rules. In this regard, B2C supplies when now made to non-taxable persons within the EU attract VAT at the rate applicable in the Member State where the customer is established, has his permanent

address or usually resides. The EU model however does not impact the supply to non-taxable persons outside the EU. In this case, no EU VAT will levied by the supplier on such supplies (PwC, 2013, p. 1).

Suppliers of electronic services may make presumptions leading to unwanted consequences (as highlighted in the discussion above relating to supplied to business and final consumers). In an effort to streamline the rules relating to such presumptions regarding place of supply, a business will not be required to ascertain any further information to determine in which Member State VAT will be payable where the electronic services are supplied by or through the following means (HMRC, 2016, p. 6):

- "through a telephone box, a telephone kiosk, a wi-fi hot spot, an internet café, a restaurant or a hotel lobby, VAT will be due in the Member State where those places are actually located" (HMRC, 2016, p. 6);

  For example: Where a French tourist pays for use of an internet café in Germany, VAT will be payable in Germany where the service is being supplied.

- "on board transport travelling between different countries in the EU - VAT will be due in the Member State of departure" (HMRC, 2016, p. 6);

  For example: Where an Italian tourist boards a ship in France and pays for use of a telephone box, VAT will be payable in France.

- "through a consumer's telephone landline, VAT is due in the Member State where the consumer's landline is located" (HMRC, 2016, p. 6);

- "through a mobile phone, the consumer location will be the Member State country code of the SIM card" (HMRC, 2016, p. 6); and

  For example: Where an Italian tourist logs onto his iPhone and download a paid application in France, VAT will be due in Italy (on the assumption that the mobile sim is registered in Italy).

- "in the Member State for the postal address where the decoder is located or the viewing card is sent" (HMRC, 2016, p. 6).

  For example: Where a German resident has a satellite decoder system in their French home, VAT will be payable in France.

Where the presumptions do not apply

"Where the digital services are supplied other than in the circumstances listed above, the business making the supply must obtain and keep two pieces of non-contradictory information to support and evidence the Member State where the customer is normally located" (HMRC, 2016, p. 7).

"Examples of the type of supporting evidence that tax authorities will accept include:

- the billing address of the customer
- the Internet Protocol (IP) address of the device used by the customer
- customer's bank details
- the country code of SIM card used by the customer
- the location of the customer's fixed land line through which the service is supplied
- other commercially relevant information (for example, product coding information which electronically links the sale to a particular jurisdiction)" (HMRC, 2016, p. 7).

Future developments

In the European Union, a first step towards the taxation at destination of digital services was achieved in 2015. Business-to-consumer sales of telecommunications, broadcasting or electronically supplied services began being taxed at destination (irrespective of the provider's place of establishment) and a simplified collection mechanism (i.e. MOSS) began being applied for those services. On December 1, 2016, the EU Commission went one step further and issued proposals aimed at facilitating cross-border trade, combating VAT fraud, ensuring fair competition for EU businesses and providing equal treatment for online publications. The Commission expects the proposals to be adopted by the EU Council in 2017. Entry into force will come in two phases, one in 2018 and one in 2021 (Helleputte, Scornos, & Bouvy, 2016, p. 2).

"The Commission adopted a package of proposals which will:

- Facilitate cross-border trade
- Combat VAT fraud
- Ensure fair competition for EU businesses; and
- Provide equal treatment for online publications" (European Commission, 2016, p. 1).

The key actions are summarized below:

Modernisation of cross-border electronic services transactions

The Commission proposes in 2018 that a set of thresholds (EUR 10 000 and EUR 100 000) for cross-border supplies of electronic services be introduced to help small businesses within the electronic services landscape. This threshold will therefore ensure that only businesses which have transaction in excess of the EUR 100 000 will be subject to VAT based on the EU regulations (European Commission, 2016, p. 1).

It is also proposed that a one single EU threshold for intra-EU digital services with end consumers be adopted. "This proposal would mean that digital services provided by taxpayers established in only one Member State for a total value, exclusive of VAT, that does not exceed 10,000 EUR in the current or the preceding calendar year will be located in the Member State of the supplier. This implies that the VAT rules of the supplier's Member State will apply (including the VAT rate)" (Bellheim, Brown, Erneholm, & Jundt, 2014, p. 24).

In 2021, the EU will look to increase the reach and application of MOSS in order to extend to goods and other cross-border services and will look to include imports in order to move away from current practice where VAT is accounted for at the point of sale to EU customers by sellers or market places (European Commission, 2016, p. 1).

Accounting and invoicing requirements

Businesses making supplies of electronic services may issue a tax invoice or similar document which sets out transaction detail for the consumer's receipt. While there are no special rules for issuing tax invoices, businesses are not required to issue tax invoices in respect of B2C supplies as the end consumer is unable to claim input tax deductions in this regard.

"The rules of the supplier's Member State will be applied for invoicing requirements. As a rule, invoicing is subject to the rules of the Member State where the supply of goods or services is located for VAT purposes. This rule combined with the destination principle implies that EU companies active in the business of intra-EU distance sales of goods have to comply with the invoice requirements of each Member State where a consumer is located. In order to lighten this administrative burden, invoicing will be subject to the provisions of the Member State where the supplier makes use of the MOSS" (Bellheim, Brown, Erneholm, & Jundt, 2014, p. 24).

Why is the EU changing current practice?

The proposals are being introduced to address three aspects of the current treatment of electronic services in the EU. In short, this proposal seeks to:

- Reduce compliance costs in each Member State where a business has customers ensuring that the aforementioned costs do not become administratively burdensome and therefore unaffordable for businesses. The proposal is expected to reduce these costs by 95% (resulting in savings for business of approximately EUR 2.3 billion) *(European Commission, 2016, p. 1)*.

- Close the gap between non-EU sellers and EU sells to place them on a level playing field. This process will be done by means of a thorough review of the VAT exemptions relating to the importation of small packages within the EU and imposing strict compliance requirements to ensure no disadvantage to non-EU sellers. It is estimated that as much as EUR 25 billion in trade (25% of total cross-border B2C sales of goods) is non-compliant *(European Commission, 2016, p. 1)*.

How will business benefit?

In order to maximise cross-border trade, the proposals will seek to alleviate the high compliance costs and aspects related to a VAT system. This reduction in cross-border compliance costs will ensure that EU businesses will not have be disadvantaged by non-EU businesses that are not liable to charge and account for VAT in the Member State (European Commission, 2016, p. 1).

Proposal on VAT Rates for e-books and e-publications

Based on the current application of the rules governing the supply of electronic services in the EU, electronic books/electronic journals (e-publications) must be taxed at the standard VAT rate.

Unfortunately e-publications do not benefit from the VAT treatment applicable to its printed counterparts, thus creating a less favourable system for e-publications. As part of its Action Plan on VAT, the Commission proposed that the VAT treatment of e-publications and printed publications be streamlined (European Commission, 2016, p. 1).

Conclusion

While the rules in respect of the EU treatment of electronic services lean towards a progressive and forward thinking system, work still needs to be done to ensure that the modern system is simple enough to allow for maximum compliance by Member States. The end result should effectively make it easier for online businesses to access other markets while ensuring that EU businesses are placed on a level playing field with non-EU counterparts.

Notwithstanding the concessions made in the current and proposed rules for the EU system, it is clear that the system, however much more advanced from VAT systems in other jurisdictions, still requires tweaking in order to achieve the outcome for which the EU rules were specifically introduced.

4. LIMITATIONS OF THE SOUTH AFRICAN LEGISLATION

Further to National Treasury's announcement, as part of the 2015 National Budget, that the scope of the South African VAT electronic services regulations will be expanded to include the provision of software, this chapter considers other amendments which should be considered to ensure equality between South African and foreign providers of electronic services while taking into account aspects of the EU legislation which could be implemented in future. While the issues identified in this chapter highlight specific electronic services, the discussion points in this chapter will no doubt apply more broadly to all electronic services and should be considered in light thereof.

According to the OECD, "revenue authorities have an important role to play in realising the full potential of e-commerce. Its twin objectives are to provide a fiscal environment within which e-commerce businesses can flourish, while also ensuring that e-commerce does not undermine the ability of government to raise the revenues required to finance public services for their citizens" *(OECD, 2001, p. 10)*.

An objective of Treasury is to ensure equality between South African and foreign providers of electronic services. As set out in the International VAT/GST guidelines issued by the OECD, the destination principle should be implemented to ensure that the net tax burden on imports is equal to the net tax burden on the same supplies in the domestic market *(PwC, 2015, unpublished)*.

The introduction of these amendments substantially changed the way foreign businesses provide services to South Africa and has, as a result, generated additional tax revenue for Treasury as vendors are now required to account for taxes that were previously left unaccounted for due to the self-assessment nature of the imported services provisions (i.e. the reverse charge mechanism). The concern that foreign businesses are not subject to tax in South Africa is regularly identified in a number of South African media publications. The amendments have helped address the perception that foreign businesses are not subject to tax in South Africa in the same manner as local businesses *(PwC, 2014, (PwC, 2015, unpublished)*.

Notwithstanding the above, there remains a perception that foreign suppliers of electronic services continue to remain non-compliant with the existing legislation. This has resulted in amendments to the tax laws in other jurisdictions to ensure that taxes are collected on electronic services. Companies are now required to publicise company tax payment information to address these perceptions.

At the time of introduction, Treasury stated that the list of electronic services covered by the Regulation would be broadened in the future and, in the 2015 National Budget speech, advised that the electronic services regulations will be expanded to include software (initially present in the draft regulation but excluded in the final Regulation on electronic services).

While the inclusion of additional items in the Regulation is important to ensure that the provisions remain relevant in the context of electronic services, it may be construed that the overall application of

these provisions continues to remain limited, and does not reflect the intention of neutrality in the South African market place. This is due in part to the narrow requirements to meet the definition of 'enterprise' in paragraph (b) (vi) of section 1 of the VAT Act, and furthermore the ability of South African consumers to mislead or provide inaccurate information to providers of electronic services, such that insufficient correct information is gathered by the electronic service provider which would require it to register for VAT and account for output tax in South Africa *(PwC, 2015, unpublished).*

Existing VAT provisions dealing with electronic service providers

The VAT Act provides that, subject to the exemptions, exceptions, deductions and adjustments provided for in the VAT Act, VAT shall be levied and paid for the benefit of the National Revenue Fund on the supply by any vendor of goods or services supplied by him on in the course or furtherance of any enterprise carried on by him *(VAT Act, No. 89 of 1991, section 7).*

"The term 'enterprise' is defined in section 1 of the VAT Act. Relevantly, paragraph (b)(vi) of the definition of enterprise specifically includes:

vi) the supply of electronic services by a person from a place in an export country, where at least two of the following circumstances are present:

aa) the recipient of those electronic services is a resident of South Africa;

bb) *any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990);*

cc) *the recipient of those electronic services has a business address, residential address or postal address in the Republic" (VAT Act, No. 89 of 1991, section 1).*

The 'electronic services' as defined in section 1 of the VAT Act, have been prescribed by Regulation which refers to, amongst other things, audio-visual content, websites and subscription services (as set out in Chapter 1).

Online service providers and the limitations of the law

Based on the comments above, the current provisions do not sufficiently capture certain services which are intended to fall within the ambit of the legislation and be subjected to VAT in South Africa. Accordingly, this chapter sets out proposed amendments to the relevant legislation to preserve the South African tax base and to further ensure equality between South African and foreign providers of electronic service providers.

In demonstrating the need for these amendments, it is apparent that certain electronic services content providers remain outside the South African VAT legislation due to the current form and

scope of the legislation and Regulation, which results in an unfair commercial advantage for these suppliers vis-à-vis local content providers.

For example: Hotstar is a subscription service provider (amongst others) for on-demand television and movie streaming to a mobile device, set-top box, internet TV, personal computer (PC) or Apple Macintosh computer. Hotstar's media is currently made available to its subscribers only in India, but not any other country outside this territory, which are currently 'geoblocked' on its subscription database. Similarly, content from most other online audio-visual content providers are also geo-blocked in South Africa meaning that South African consumers are not, *prima facie*, able to access and purchase content from such providers.

The process of 'geoblocking' services means locking content such that it cannot be accessed or viewed by consumers in a particular geographic region, often due to broadcasting or licensing restrictions. This could include, for example, not making the service available to subscribers with a stated address in a particular geographic area, or with a credit card issued by a bank in a particular geographic area, or alternatively, (and in the case of other online-content providers for example), not making content available where the Internet Protocol ("IP") address, signal or network is transmitted from a particular geographic location. An IP address is a numerical label assigned to each device connected to the internet which is used for network identification and location tracking.

Where the service is geoblocked from South Africa such that content will not be provided to a consumer where their IP address or signal is transmitted from South Africa, a South African consumer can nonetheless access the service via use of a Virtual Private Network (VPN) to circumvent these regional restrictions.

A VPN operates such that it enables a computer or network-enabled device to send and receive data across shared or public networks as if it were directly connected to the private network. In this regard it is able to connect to the network, whilst benefiting from the functionality, security and management policies of the public network *(CyberGenius, 2014, p. 1)*.

A VPN is created by establishing a virtual point-to-point connection through the use of dedicated connections, IP addresses, or traffic encryption. VPN technology is used by a majority of "individual internet users to secure their wireless transactions, to circumvent geoblocking restrictions and censorship, and to connect to dedicated servers for the purpose of protecting personal identity and location" *(CyberGenius, 2014, p. 1)*.

Certain VPN service providers charge a fee, while others are available to consumers free of charge. Once a South African consumer has used the services of a VPN provider to access a geo-blocked service provider, it is relatively simple to gain access to content by providing inaccurate residency and/or residential address details (such as a false address in another licensed jurisdiction) which cannot be meaningfully verified by the electronic service provider, in order to access online content. Online content providers do not necessarily monitor where their

subscribers are registering from, and do not actively take steps to counter circumvention websites (i.e. VPN service providers) that allow geoblocked consumers to otherwise subscribe to their services using incorrect/manipulated consumer information *(PwC, 2015, unpublished)*.

The Guardian has specifically highlighted that South Africa is among a number of countries where, despite content providers not providing a legal service to the country, there is a high user penetration of these services by means of VPN providers *(The Guardian, 2015, p. 1)*.

In this regard, and by their nature, VPN providers are difficult to detect, and result in other online content providers gaining access to the South African market on non-competitive terms such that they are not being required to register and account for VAT in South Africa. In light of this gap in the law, the definition of 'enterprise' for the purposes of determining whether such online content service providers would be required to register for VAT is not sufficiently broad as it may be only easy to identify where payment in respect of a service is received by an online service provider. In considering the other two requirements, it is noted that the South African consumer may provide incorrect information to the electronic service provider.

> Example: The South African consumer may provide incorrect residency information or address details which cannot in any case be easily or meaningfully verified by the supplier. This can result in the supplier being under the impression that it is not required to register for VAT in South Africa when in fact it does have the obligation.

Indeed, the levying and collection of VAT by non-resident suppliers of electronic supplies based on the "utilised and consumed" principle presupposes that the supplier can identify the customer's location, which as set out above, is not always the case *(Davis Tax Committee, 2014, p. 49)*.

Furthermore, it is noted that a number of VPN service providers do not charge a fee for their services and thus allow a South African consumer free access in order to conceal their IP address/electronic signal and access online content which is geoblocked in South Africa. As set out above, consumers are able to easily provide the online content provider with inaccurate residency and address details such that the supplier is not aware of its obligation to register and charge South African VAT for its electronic services. In this instance, no South African VAT is collected on these electronic services which are consumed in South Africa, on the presumption that the vast majority of consumers do not comply with the imported services provisions of the VAT Act.

In view of the intention of the South African VAT legislation that consumption of electronic services in South Africa should be subject to VAT in South Africa, consideration needs to be given to incorporating output tax deeming rules into the VAT Act to ensure that suppliers of such services consumed by South Africans are subjected to South African VAT. In this regard, legislation could be drafted such that the VPN service provider is required to account for output tax equal to the market value of the services supplied to a recipient in South Africa,

notwithstanding that no consideration may be charged or paid for such services *(PwC, 2015, unpublished)*.

As set out in Chapter 3, these challenges were considered by legislators in the European Union when considering the implementation of electronic services provisions, and in this regard, certain 'presumptions' were included into the various European jurisdictions' legislation which did not rely on information that could be manipulated or concealed by the consumer. Such 'independently verifiable' presumptions include the use and facilitation of mobile country codes, IP addresses, or fixed land lines which are set out in more detail below.

Additionally, the legislation in the European Union was developed more broadly such that registration could be required where other commercial information available to the supplier would suggest that consumption takes place in a particular jurisdiction or where the tax authority is aware of indications of misuse or abuse by the supplier. In the South African context, while it is well established that online audio-visual content service providers operate in the South African market, the current electronic services legislation is too narrow to require that South African VAT is accounted for on these services and there is no general or discretionary provision in the definition of 'enterprise' that could compel the Commissioner of SARS, to require VAT registration in these circumstances (assuming the VAT registration turnover threshold for electronic services is satisfied) *(PwC, 2015, unpublished)*.

On this basis, the definition of 'enterprise' in respect of electronic services as set out in paragraph (b) (vi) of section 1 of the VAT Act is not currently effective in ensuring that all electronic services as envisaged by the Regulation are captured and subjected to VAT in South Africa. In this regard, proposed recommendations include:

a. the expansion of the definition of 'enterprise' in respect of electronic services as set out in paragraph (b)(vi) of section 1 of the VAT Act either by:

    i. reducing the number of requirements from two to one in order to satisfy the definition of 'enterprise'; and/or

    ii. increasing the number of 'independently verifiable' requirements (currently the only verifiable requirement is subparagraph (bb)) in order to ensure that the intended suppliers of electronic services satisfy the relevant definitions and are required to register as South African VAT vendors; and

b. The scope of the electronic services regulations should be expanded to specifically include VPN and other services which re-route a consumer's IP address/electronic signal for the purpose of accessing online content which is geoblocked in South Africa; and

c. In the case where the VPN service provider does not charge a fee for use of its service, consideration should be given to incorporating output tax deeming rules into the VAT Act

to ensure that the provision of such services consumed by South Africans is subject to South African VAT, in line with the intention and design of South African VAT legislation that consumption in South Africa is taxed accordingly.

Recommendations

In setting out the below-mentioned recommendations, the focus should be on ensuring and maintaining neutrality for local and foreign suppliers of electronic services.

It is noted that the OECD, as part of the "Base Erosion Profit Shifting ("BEPS") Action 1 has addressed tax challenges of the digital economy, with a particular emphasis on the VAT implications that have arisen as a result of the strong growth in cross-border supplies of remotely delivered services. It is well established that these supplies often result in no or inappropriately low amounts of VAT being collected, and furthermore create potential competitive pressures for domestic suppliers" *(OECD, 2014, p. 60)*.

In this regard, "structures aimed at artificially shifting profits to locations where they are taxed at more favourable rates, or not taxed at all, will be addressed by ongoing work on the BEPS Action 1 Project so as to restore taxing rights at the level of both the market jurisdiction and the jurisdiction of the ultimate parent company" *(Davis Tax Committee, 2014, p. 48)*

Treasury should ensure that any amendments to the legislation and Regulations be in line with this approach to ensure that electronic service providers supplying such services to South Africa fall within the VAT net and are taxed as domestic suppliers of services would. "In other words, specific rules applicable to foreign businesses should not result in a disguised form of discrimination and any specific requirements should be clear, consistent and accessible to foreign businesses" *(OECD, 2013, p. 18)*

"While the current legislation does seek to create equality between local and foreign electronic service providers, it is submitted in this instances that the legislation remains narrow and there continues to be an unfair advantage in some areas" (as outlined above) *(PwC, 2015, p. 1)*.

The OECD notes that the digital economy is increasingly becoming the economy itself and submits that it is therefore difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes and it is the DTC's view that changes to the existing legislation should be made to ensure the South African VAT system remains relevant and effective *(Davis Tax Committee, 2014, p. 24)*.

Amending "enterprise"

As discussed above, the definition of 'enterprise' in respect of electronic services as set out in paragraph (b) (vi) of section 1 of the VAT Act is not sufficiently broad to capture all intended suppliers, and furthermore, is inadvertently open to manipulation by South African

consumers. In this regard, it would be beneficial to the State where Treasury reduce the number of requirements from two to one to take into account that South African consumers may not provide accurate information *(VAT Act, No. 89 of 1991, section 1).*

It is anticipated that subparagraph (bb), will remain applicable in the case of many suppliers which receive payments in respect of electronic services from a South African bank account as it is an independently verifiable presumption that cannot easily be manipulated by a South African consumer. This being said, South African consumers could, however, purchase vouchers for a particular website using a South African credit card, and then use such vouchers to access online content, which would disguise the location of consumption and lead the supplier to believe that subparagraph (bb) is not satisfied.

Based on the findings of Chapter 3, it is furthermore "recommended that the following qualifying presumptions be included in the legislation:

> *dd) where the electronic signal, internet protocol (IP) address, network access, SIM card, Wi-Fi hotspot, or services supplied by any third-party intermediary identifies to the supplier that electronic services are delivered, made available, or consumed by any person in the Republic; or*
>
> *ee) other information available to the supplier or to the Commissioner indicates that the electronic services are delivered, made available, or consumed by any person in the Republic" (PwC, 2015, unpublished).*

These proposed recommendations are intended to shadow the approach adopted by the EU Regulations. The EU Regulation has set out the details that will serve as evidence of where an electronic service is being consumed and accordingly what tax rate will be charged to such services. "Such presumptions, in the EU context, include:

> *a. the billing address of the customer;*
>
> *b. the internet Protocol (IP) address of the device used by the customer or any method of geolocation;*
>
> *c. bank details such as the location of the bank account used for payment or the billing address of the customer held by that bank;*
>
> *d. the Mobile Country Code (MCC) of the International Mobile Subscriber Identity (IMSI) stored on the Subscriber Identity Module (SIM) card used by the customer;*
>
> *e. the location of the customer's fixed land line through which the service is supplied to him; or*

f. *other commercially relevant information"* (HMRC, 2016, p. 7).

Another area of consideration is the design of the electronic services provisions, the design of the VAT Act in its entirety. In general terms, the VAT Act is drafted on a broad, all-encompassing basis, with a narrow, defined list of exemptions as set out in, for example, sections 11 and 12 of the VAT Act. The purpose of the VAT Act is to capture and tax all supplies made, unless specifically carved outside the ambit of the VAT net as defined.

The nature of the electronic services provisions, contained in paragraph (b) (vi) of the definition of 'enterprise' in section 1 of the VAT Act, which sets out whether a foreign electronic service provider is conducting an enterprise in South Africa and which could lead to VAT registration and taxation, are, in the context of the broader definition of 'enterprise', extremely narrow and limited in application *(VAT Act, No. 89 of 1991, section 1)*.

The current definition contained in paragraph (b) (vi) serves rather to exclude many foreign electronic services providers as opposed to including these suppliers, and which is not in line with the overall intention and design of the South African VAT legislation. In this respect, the electronic services legislation, tautly drafted, leaves little or no room for its broader application *(PwC, 2015, unpublished)*.

Expanding the Regulations

In addition to the aforementioned proposed amendments to bring the South African legislation in line with international practice, Treasury's proposals to expand the scope of the existing electronic services regulations is essential to the continued relevance and application of the legislation to supplement the needs of the *fiscus*. In this regard, Treasury should consider expanding the scope of the regulations to cover additional areas such as, for example, software, online advertising/promotions and virtual support services.

Accordingly the scope of the Regulation should be expanded to specifically include the use of VPN's and other services which re-route a consumer's IP address/electronic signal for the purpose of accessing online content which is geoblocked in South Africa. Such services may be used by both South African businesses and consumers as a means of accessing other electronic services and should, in accordance with the intention of the law, be subjected to South African VAT. While the list of services in the Regulations provides limited definitions, which causes some confusion, the definitions in the Regulations, as they stand, may not necessarily require further amendments *(Davis Tax Committee, 2014, p. 39)*.

Further guidelines providing clarification should accompany the Regulations. Furthermore, these guidelines are not subject to the long and complex legislative process and can be amended with greater ease in order to stay relevant and applicable as the nature of electronic services changes over time. Such guidelines should be updated regularly to ensure that new technology cannot escape the South African VAT legislation as a result of the dynamic

evolution of the Internet and e-commerce, where many transactions that should in principle be taxed *(Davis Tax Committee, 2014, p. 39)*.

5. CONCLUSION

"President Jacob Zuma stated in the 2016 State of the Nation Address that a resilient and fast growing economy is at the heart of South Africa's radical economic transformation agenda. Expanding South Africa's tax base will allow government to increase funding in other areas and to address socio-economic issues" *(National Treasury, 2016, p. 3)*

Opportunities

While South Africa has made advances by expanding the scope of VAT to cover certain electronic supplies made by foreign suppliers, other opportunities exist. Many foreign suppliers of electronic goods and services to South African consumers are not subject to South African corporate income tax on profits generated here, and this is an area that National Treasury must be considering in light of declining revenues and a stalling economy. South Africa is not alone, and globally there is an increase in sentiment to embrace laws which ensure a fairer tax treatment of these types of technological advances. Despite global efforts, South Africa will need further work to be done to ensure that foreign suppliers operating in the South African digital marketplace are taxed in line with local businesses *(PwC, 2015, p. 1)*.

While the South African legislation is not without its problems, opportunities exist for National Treasury to strengthen the effectiveness of existing laws. The Minister of Finance stated during the 2015 Budget Speech that the regulations governing the provision of electronic services in South Africa would be broadened to include the supply of 'software', which is one type of 'electronic service' not currently covered by the law which could be included in future to protect and expand the South African tax base *(PwC, 2015, p. 1)*.

Bearing this in mind, South Africa needs to consider the recommendations made by the DTC in the Interim VAT Report (Report) which dealt with the practical and technical areas surrounding the implementation of taxation relating to electronic services as well as ensure that the law is developed in the spirit of ensuring a level playing field for both local and foreign electronic services suppliers.

Neutrality

The Report states that cross-border transactions will continue to grow at a rapid pace and the OECD notes that the digital economy is increasingly becoming the economy itself. It is the DTC's submission therefore that it is difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes *(Davis Tax Committee, 2014)*.

It therefore seems only conclusive that changes to the existing legislation should be made to ensure the South African VAT system remains relevant and effective and most importantly, in line with the principle of neutrality.

According to the OECD, "revenue authorities have an important role to play in realising the full potential of electronic services. Their twin objectives are to provide a fiscal environment within which electronic services can flourish, while also ensuring that electronic services do not undermine the ability of government to raise the revenues required to finance public services for their citizens" *(OECD, 2001, p. 1)*.

It is submitted that Treasury must remain cognisant of the OECD's twin objectives for the electronic services industry as it becomes increasingly necessary to level the playing field, and require foreign electronic service providers to pay their share of taxes in South Africa. While this remains the chief objective, the current overall application of the electronic services provisions remain limited, and does not seem to reflect the intention of neutrality in the South African market place.

As set out in this dissertation, the limitations behind the application of taxation on electronic services in the South African context is due in part to the narrow requirements to meet the definition of 'enterprise' in paragraph (b) (vi) of section 1 of the VAT Act, and furthermore, the ability of South African consumers to mislead or provide inaccurate information to electronic services suppliers, such that insufficient correct information is gathered by the electronic service supplier, which would require it to register for VAT and account for output tax in South Africa.

Accordingly, amendments need to be considered in light of the fast-paced technological landscape. In light of this ever-changing reality, consideration in respect of a 'catch-all' proxy or other relevant additional proxies should be had in order to accommodate for a flexible interpretation of the provisions in order to better determine whether a particular supply would be subject to the electronic services provisions.

Additional proxies

In this regard, South Africa could glean from the approach adopted in the EU where multiple proxies and access points have been used to broaden the use of the electronic services provisions. In this regard, South African could adopt the following as alternative proxies to determine consumption, and therefore taxation in country:

- an electronic signal, internet protocol (IP) address, network access, SIM card, Wi-Fi hotspot, or services supplied by any third-party intermediary identified to the supplier that electronic services are delivered, made available, or consumed by any person in the Republic; or

- other information available to the supplier or to the Commissioner indicates that the electronic services are delivered, made available, or consumed by any person in the Republic.

As set out above, these recommendations are intended to shadow the approach adopted by the EU Regulation).

As the current legislation seeks to tax foreign entities who satisfy two of the necessary three circumstances as set out in the South African VAT Act, it does not allow for "VAT to be levied on foreign suppliers who are able to circumvent these requirements by, for example, making services available through VPN services which serve to hide the true identity of a South African recipient, or who receive payment by way of prepaid payment/gift cards and other means which cannot be traced back to a South African bank account" *(PwC, 2015, p. 2)*.

In some instances electronic services suppliers may be under the impression that they are not required to register as VAT vendors on the basis of the information provided to them by South African consumers are open to consumer manipulation and many electronic services suppliers place little or no emphasis on determining whether the information they receive from consumers is accurate in order to determine whether a South African VAT registration is necessary.

In light of the strict banking rules and exchange control legislation applicable in South Africa, it is unlikely that electronic services suppliers would not be able to determine whether all or some of the proxies required are met. Being mindful of this however, additional proxies should be included into the legislation in order to substantially broaden the legislative provisions and provide more guidance regarding the application thereof.

B2B and B2C distinction

While South African legislation does not make a distinction between B2B and B2C transactions, it steered away from making a distinction between these transactions when implementing the rules on electronic services in South Africa.

Notwithstanding this, South Africa then proceeded to "grant" certain concessions in relation to B2B transactions by "manipulating" the list of qualifying electronic services (i.e. Microsoft computer operating systems where classified as software in order to ensure that the supply of these services would fall outside the ambit of the Regulation).

"The provision of concessions for B2B transactions by altering or manipulating the types of services which will qualify as electronically supplied services may result in supplies made in terms of B2C transactions falling outside the scope of electronic service VAT provisions, which may therefore go untaxed" *(Davis Tax Committee, 2014, p. 36)*.

As the structure of South African legislation does not provide for the distinction between B2B and B2C transactions, all electronic services transactions should be included under the purview of the electronic services provisions and any exemptions from this aspect could lead ultimately to a loss of revenue by Treasury.

Where concessions are deemed to be necessary in respect of B2B transactions, then this point should be addressed by making such a distinction by adding further proxies to the legislation (as discussed above) in order to provide for certain transactions which should be specifically excluded (i.e. intra-group transactions) *(Davis Tax Committee, 2014, p. 36)*.

In this regard many foreign businesses that only supply electronic services to other businesses within a group of companies would be caught within the VAT net and be required to register and account for South African VAT on intra-group supplies *(Davis Tax Committee, 2014, p. 37)*. In this instance, it would be beneficial for Treasury to introduce rules which specifically exclude supplies in this context alleviating the administrative burden that would arise should such foreign businesses be required to register for VAT.

Furthermore and to the extent that this is not excluded from the ambit of the provisions, consideration should be given to the broader VAT principles (i.e. VAT cascading and VAT grouping), which would appear out of place where these were applicable only within the electronic services context.

VAT registration threshold for foreign electronic service providers

The disparity between the VAT registration threshold applicable to domestic vendors and foreign suppliers of electronic services is notable. While there is a need for a differential and competitive threshold, the differentiation can be justified in that it is aimed at the protection of domestic markets in order to keep as many foreign electronic service suppliers in the tax net *(Davis Tax Committee, 2014, p. 45)*.

Based on the purpose of implementing this legislation, an increase in the registration threshold would not be appropriate as it would not seek to achieve Treasury's objectives in increasing revenues by taxation of such electronic services. In this regard, an increase in the threshold should not be effected in the interim term until this aspect of the law has been more developed.

As in the EU, each country adopting the model have set out varying registration thresholds either in Euros or in its local currency. Based on the table, set out in Chapter Three, it is clear that these thresholds too are competitively low to ensure maximum application to cross-border transactions and in effect, maximise the revenues which may be incurred in terms of taxation of electronic services.

Specificity of the Regulation

In its current form the South African Regulation does not seem to allow for the required flexibility which legislation should carry in order to effectively adapt to technological changes globally. In this regard, South Africa should look to the EU model in order to provide a set of broader principles that may be applied to the electronic services provisions as opposed to the

exhaustive list that currently is reflected in the Regulation (i.e. the inclusion of IP addresses/a wider definition of services).

Providing a non-exhaustive set of principles or even a list of categories, which are then further explained in a guide or interpretation note would be a useful tool in order to cope with the ever-changing nature of technology globally. As noted by the DTC that to the extent that an exhaustive list be the preferable route, the Regulation should specify that the list must be reviewed and updated frequently to ensure it is in line with the current technological trends.

As set out in the 2015 National Budget Speech, it was stated that the existing electronic services legislation are not broad enough to capture all supplies, and a move to include 'software' into the scope of services is being finalised to come into effect as an amendment in 2017.

As in the case of other electronic services, software is another area absent from the Regulation which highlights the need for the existing regulations to be amended to either specifically include certain electronic services within the scope of the Regulation or alternatively, detailed guidance should be released to note that certain electronic services already fall within the existing provisions.

The interpretation and application of the South African electronic services Regulation should therefore be considered in a broader manner akin to the EU model. This will help alleviate instances where businesses and SARS are required to interpret the existing Regulation to determine whether an electronic service falls within its ambit in order to determine whether the business has a VAT registration liability in South Africa.

It is submitted based on the aforementioned arguments that the Regulation, in its current form, remains prescriptive and narrow. Ultimately a more flexible legislative provision will be necessary to ensure the law remains relevant and keeps pace with the technological advancements globally.

Levelling the playing field?

The Minister during the 2016 National Budget Speech failed to provide further guidance in respect of introducing measures for the continued implementation of VAT on electronic services in South Africa, while choosing to focus on government's spending rather than necessarily expanding South Africa's tax base. "While such measures would ultimately represent a welcome expansion to South Africa's tax base, and better align the tax system to those of more developed countries, such measures also present an opportunity to better protect local industry against larger multinationals by ensuring a more even playing field" *(PwC, 2016, p. 1)*.

An example of this is the current application and development of VAT legislation in respect of the supply of electronic services to consumers in South Africa. “Despite being just under three years old, the current legislation dealing with electronic services supplied by foreigners already appears “dated” due to the rapid advancement of technology. While it was stated during the 2015 Budget Speech that the provisions governing electronic services in South Africa would be broadened to include the supply of other services (e.g. software), the Minister did not take the opportunity to provide further details on this change and other developments which could further broaden the base” *(PwC, 2016, p. 1)*.

It was expected that the 2016 Budget Speech would include the broadening of the current electronic services provisions which would level the playing fields between local and foreign business while growing and protecting the tax base. Disappointingly however the budget speech was silent on this and Treasury is yet to provide any further guidance of development of the law in this space. Based on the overall view by tax practitioners in South Africa, it seems vital that the legislature consider current global trends in the electronic services arena and ensure that South Africa does not get left behind in the developing digital age *(PwC, 2016)*.

An indication to the future

It is clear that while the South African electronic services model may not be perfect, it has significantly changed the space of digital taxation and is one of the pioneers in this field of taxation. While there is still much change that needs to be brought to the current legislative provisions, the initial attempt by SARS and National Treasury is laudable as they have managed, in most instances, to address key concepts with simplified rules and relaxed provisions in order to make the provisions work within the current framework. It is submitted that this bodes well, as an indication to a more vibrant future for the taxation of electronic services in South Africa.

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