VALUE ADDED TAX ON ELECTRONIC SERVICES

An Explorative Study on the current Regulations Prescribing Electronic Services and the proposed amendments as at 01 October 2018.

By

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"It always seems impossible until it's done"

- Nelson Rolihlahla Mandela

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GLOSSARY

Business to Business (B2B) supplies: Refers to the supply of electronic services made to other VAT vendors who are eligible to deduct input tax.

Business to Consumer (B2C) supplies: Refers to electronic supplies made to end/final consumers who are not registered VAT vendors and not eligible to deduct input tax.

Consideration: The amount of a payment made or to be made for the supply of goods or services which includes VAT.

Customer: A person who purchases goods or services from another, also generally referred to as a buyer.

Destination Base VAT System: VAT is imposed according to the destination of goods or services. Also refer Consumption Base VAT System.

Double Taxation Agreement: An agreement between two countries to ensure that tax is not paid in both countries. A mutual arrangement which provides relief to a taxpayer to ensure that the taxpayer is not burdened with double tax on income in the resident and non-resident country.

Enterprise: An enterprise of activity which is carried on continuously or regularly by any person in, or partly in SA in the course or furtherance of which goods or services are supplied to any other person for 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.

GDP: Gross domestic product measures the total volume of goods and services produced in an economy over a period. Exports and imports need to be considered when calculating GDP. GDP is calculated by adding exports to the country's GDE and subtracting imports.

Goods: Corporeal moveable things, fixed property, any real right in any such things or fixed property, and electricity. This excludes money, any right under a mortgage bond and any stamp form or card which has money value and has been sold or issued by the State for the payment of tax or duty levied (defined in section 1 of the VAT Act).

Imported Service: A supply of services that is made by a supplier who is resident or carries on business outside SA to a recipient who is a resident of SA to the extent that such services are utilized or consumed in SA otherwise than for the purpose of making taxable supplies (defined in section 1 of the VAT Act).

Republic: In the geographical sense the territory of the Republic of SA and includes the territorial waters, the contiguous zone and the continental shelf referred to in the Maritimes Zones Act, 1994 (Act No. 15 of 1994) (defined in section 1 of the VAT Act).

Resident of the Republic (SA): A resident as defined in section 1 of the Income Tax Act. In terms of the VAT Act, a person or company shall also be deemed to be a resident of SA to the extent that such a person or company carries on any enterprise or other activity in SA and has a fixed of permanent place in SA which relates to such an enterprise or activity (defined in section 1 of the VAT Act).

SAICA: The SA Institute of Chartered Accountants. SAICA serves the interests of the chartered accountancy profession and society. It upholds professional standards for accountancy.

Services: Anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in the definition of goods (defined in section 1 of the VAT Act).

Supplier: The person supplying the goods or services to the consumer or recipient. Supply: The performance in terms of a sale, rental agreement, and instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected (defined in section 1 of the VAT Act).

Standard VAT Rate: Vat calculated at the rate of 15% (as of 01 April 2018).

Taxable Supply: Any supply of goods or services which is chargeable with tax under the provisions of the VAT Act. This includes tax chargeable at the standard rate of 15% and VAT charged at the zero-rate (0%) VAT.

Threshold: The VAT registration threshold in SA is currently set at R1million taxable supplies per year.

Vendor: Any person who is or is required to be registered under the provisions of the VAT Act (defined in section 1 of the VAT Act).

ABSTRACT

Value-Added Tax (VAT) was introduced in South Africa ("SA") on 29th September 1991 to replace GST (General Sales Tax) as an indirect system of taxation. It is levied in terms of the Value-Added Tax Act 89 of 1991. The Commissioner of the South African Revenue Service (SARS) is a mandated collector of all tax that is legally payable. SARS has a duty to ensure that the collection of tax is efficient and effective.

VAT is a transaction and consumption-based tax that is triggered upon the consumption of goods and services in South Africa. South Africa operates a destination-based VAT system, which means that exports are zero-rated, and imports are subject to VAT at the standard rate of 15 per cent. The upshot of the destination-based VAT system is that it is designed to tax the consumption (in economic parlance) that takes place in South Africa (SA).

For the purposes of VAT, revenue loss as a result of cross border supply of goods is insignificant in comparison to revenue loss experienced in the cross-border supply of services supplied via electronic means. This is due to the tangible nature of goods which would be required to be channelled through the border and/or customs, which are generally strictly controlled areas. Such goods could be subject to domestic tax (including VAT), thereby limiting the trade distortions as the foreign supplier will be put in the same tax position as the local supplier. However, all of this will be dependent on domestic legislation and value thresholds in a particular jurisdiction.

In the instance of cross border supplies of services supplied electronically, there is increased exposure or risks to trade distortions since these are provided via the internet or through other forms of electronic agents or communication methods. These supplies do not have to physically pass through the border or customs, thereby limiting the control and monitoring of tax authorities.

Imported services/reverse charge mechanism is where services supplied by non-residents are taxed within a taxing jurisdiction. This means that a resident of South Africa must account for VAT on services acquired from a non-resident or a person who carries on a business outside of South Africa, to the extent that such services are not used in the furtherance of taxable supplies. Essentially, the responsibility for the collection of tax does not lie with the non- resident but the person who imported the goods or services into South Africa. This is known as the reverse

charged mechanism and is applied with respect to imported services acquired from non-resident businesses, consumed in South Africa and not for the furtherance of taxable supplies. In order to level the playground between foreign and local suppliers, the legislature introduced new rules governing the supply of electronic services by a foreign supplier to South Africa. This was done to eradicate the incorrect interpretation & application of the provisions governing imported services.

In the 2018 National Budget Speech, released on 21 February 2018, the Minister of Finance announced that the regulation defining "electronic services" for VAT purposes would be updated. This resulted in an amended draft regulation being published on the same date.

On 24 October 2018, the Minister of Finance presented the Medium-Term Budget Policy Statement which was accompanied by the Amendment of Revenue Laws Bill 37 of 2018 ("the Bill). Amongst those amendments contained in the Bill was the changes in the VAT treatment of the supply of electronic services ("e-services") in South Africa. These amendments and the revised e-services regulations are due to take effect on 1 April 2019.

The objective of this paper is to discuss to what extent the SA regulations are in line with regulations introduced in the Ottawa Taxation Framework. This paper will also discuss the Amendment of Revenue Laws Bill 37 of 2018 considering electronic services. Lastly, the EU, New Zealand and Australia's frameworks will be looked at to establish if they have also amended their local VAT/GST legislation considering the Ottawa Taxation Framework. New Zealand, Australia and EU were chosen as target jurisdictions of comparison because they are more developed than South Africa. Furthermore, South Africa has economic relations with Australia and some countries which form part of the European Union. It is also understood that Australia's GST and South Africa's VAT are similar in terms of certain aspects. Collectively, South Africa's VAT and Australia's GST were both based on the New Zealand's GST model.

This paper finds that the recent amendments by the National Treasury are broad and do not conform to the Ottawa Taxation Framework. The paper also finds that the regulations looks fine on paper, but the implementation thereof will be challenging to both SARS and the VAT vendors. The paper suggests that the National Treasury should look at what countries i.e. New Zealand have done to address the challenge of taxing 'electronic services' to ensure that the SA VAT legislation is amended in accordance with the suggested guidelines.

CHAPTER 1: INTRODUCTION

Background

Value-Added Tax ("VAT") was introduced in South Africa (SA) in 1991. VAT in SA is administered through the Value Added Tax Act No. 89 of 1991 (the VAT Act).[1] The South African (SA) VAT system is based on VAT being payable at the destination of the goods or service which are supplied.[2] This implies that VAT is only payable on the consumption of goods and services which take place in SA and on the importation of goods and services into SA.[3]

The initial place where these goods and services are supplied is not taken into consideration.[4] As a result of the above non-residents in some instances will be liable to register as VAT vendors and account for VAT even if they are not physically present in SA.[5] Goods and services consumed outside SA should therefore, in principle, be subject to VAT at the rate of zero percent.[6] However, the absence of 'place of supply' rules in the VAT Act makes it very difficult to determine where services in particular, are consumed.[7]

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.[8] 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.[9]

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[1] Kearney, M, *'Introducing Value-Added Tax'*, University of Pretoria etd – (2003) accessed at: https://repository.up.ac.za/bitstream/handle/2263/27705/02chapter2.pdf?sequence=3 24 September 2018
[2] *Ibid*
[3] M. Kleu, et al, 'Notes on the value-added tax base of South Africa'. Accessed at: https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/5182/04Notes%20on%20the%20value-added%20tax%20base%20of%20South%20Africa.pdf 24 September 2018
[4] *Ibid*
[5] *Ibid*
[6] *Ibid*
[7] *Ibid*
[8] *Ibid*
[9] *Ibid*

Generally, "a person who carries on an enterprise becomes liable to register for VAT where its taxable supplies exceeds or is likely to exceed R1 million in any 12 month period.[10] This can result in non-residents becoming liable to register for VAT as a result of a single transaction, where their taxable supplies relating to that transaction exceed or is likely to exceed R1 million in a 12 month period.(Section 23 of the VAT Act)".[11]

Globalization has encouraged international trade and the increased supply of electronic products has seen businesses crossing borders to countries other than where their consumers are based. This has opened the door for establishing businesses in countries which operate a destination-based VAT system.[12] The destination based system taxes goods or services in the country where they are consumed and assume that the supply will be taxed in the country of destination, but this may not always be the case.[13] Multinational enterprises have been seen to be taking advantage of the different VAT rules of countries, thereby minimizing their tax burden and obtaining a competitive advantage.[14]

SA's gross domestic product ("GDP") has shown steady growth, with the internet being one of the contributors towards that growth. The number of SA using mobile communication and the internet has increased over time.[15] The increasing use of the internet has given the economy a boost and effectively decreased the gap between international markets.[16] The international landscape has decreased and has been made instant through technology. Such evolving and rapid growth has not been witnessed when it comes to tax policies that monitor internet-related transactions. VAT is a consumption tax, it should be levied on the use of electronic services in SA.[17] With the absence of place of supply rules to determine which jurisdiction has taxing rights with respect to the supply of electronic services, it is not always clear whether a foreign supplier must register as a vendor in SA.

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[10] See SARS website at http://www.sars.gov.za/ClientSegments/Businesses/My-Bus-and-Tax/Pages/Register-and-Deregister-for-VAT.aspx
[11] *Ibid*
[12] *Ibid*
[13] *Ibid*
[14] *Ibid*
[15] *Ibid*
[16] *Ibid*
[17] *Ibid*

Prior to 01 June 2014, a reverse-charge mechanism was used to collect VAT on imported services.[18] A South African customer who purchased digital services (such as e-books, e-music, e-movies or mobile applications) from a non-vendor foreign supplier for final consumption had to account for the VAT on the purchase.[19] The foreign supplier was thus not compelled to register as a vendor. As a result, there was a major concern that locally supplied goods and services were becoming less competitive. South African suppliers of electronic services had to levy VAT at 15% (effective from 1 April 2018), whereas it was not the same case for foreign suppliers.[20]

Foreign suppliers were perceived to be cheaper than South African suppliers, therefore SA consumers preferred them, thereby leading to economic inequality between the two.[21] A further concern was the erosion of the tax base, as VAT was not collected when South African consumers downloaded items such as applications (apps) for their cellular phones, movies, music, games and software from foreign suppliers.[22]

The amendments effective from 1 June 2014 resulted in the tax liability being moved from the South African consumer to the foreign supplier. As of this date, all foreign suppliers supplying "electronic services" to SA consumers are liable to register for VAT in SA and levy VAT at the current rate of 15%. National Treasury published the Electronic Services Regulations (the Regulations) defining the term "electronic services". As from 1 June 2014 a foreign supplier of electronic services is obliged to register as a vendor as soon as the aggregate of electronic services supplied exceeds R50 000 in any consecutive 12-month period.[23]

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'. Thee amendments meant that the playing fields for both local and foreign suppliers of electronic

[18] South African National Treasury, 'Draft Explanatory Memorandum on Regulations Prescribing Electronic Services For The Purpose Of The Definition Of "Electronic Services" In Section 1(1) Of The Value-Added Tax Act, 1991', 21 February 2018. Accessed at http://www.treasury.gov.za/public%20comments/RMTAB2018/Draft%20Explanatory%20Memorandum%20-%20Regulations%20Prescribing%20Electronic%20Services%20For%20The%20Purpose%20Of%20The%20Definition%20Of%20Electronic%20Services%20In%20Section%201(1).pdf
[19] *Ibid*
[20] *Ibid*
[21] *Ibid*
[22] *Ibid*
[23] *Ibid*

services in South Africa were level. This immensely changed the behaviour of foreign businesses which provide electronic services to South Africa, resulting in a large tax base to generate additional revenue.

The existing Regulation prescribing those services which fall within the definition of 'electronic services' were issued by Treasury and have been in place since 1 June 2014.

The scope of the existing e-services regulations which will attract VAT in South Africa is limited and includes *inter alia* the provision of:

- education;
- games and games of chance;
- internet-based auction services;
- e-books;
- audio-visual content;
- still images; and
- music and subscription services.

Services such as cloud-computing and software are specifically excluded from the existing regulations.

Persons required to register for VAT

"The supplier of the electronic services will be required to register for VAT in the Republic if the supplier meets the following:[24]

- Where electronic services are supplied by a person from a place in an export country (an electronic service supplier); and
- Such person is conducting an "enterprise" in the Republic, as defined in section 1(1) of the VAT Act; and at least two of the following circumstances are present:
    - The recipient of the electronic services is a resident of the Republic;

[24] See SARS website at http://www.sars.gov.za/ClientSegments/Businesses/My-Bus-and-Tax/Pages/Register-and-Deregister-for-VAT.aspx last accessed 21 September 2018

- Any payment made to the supplier in the export country (for the supply of the electronic services) originates from a bank registered or authorized in SA, in terms of the Banks Act 94 of 1990;
- The recipient of those electronic services has a business, residential or postal address in the Republic; and

- The total value of the taxable supplies made by that person in the Republic has exceeded R50 000 within any consecutive 12-month period (section 23 (1A))".

Exclusions from the definition

It is proposed that the amended and revised draft regulations will take effect on 1 April 2019. In the proposed e-services regulations, the definition of e-services has been vastly broadened to include any services supplied by means of an electronic agent, electronic communication or the internet for any consideration. This definition however excludes under the following:

- the supply of "telecommunications services" as defined;
- the supply of educational services by a person regulated by an educational authority in a foreign country; and
- certain inter-company supplies within a "group of companies" as defined. In this regard, both companies must form part of the same group of companies, the supplying company must not be a resident of South Africa, and the supplying company must supply the services itself and exclusively for the South African resident company.

The revised draft regulation will be discussed in detail in Chapter three of this dissertation.

Research Methodology

The research is initially conducted in the form of a literature review. The legislation applicable and/or proposed in SA as at 1 June 2014 and after 1 October 2018 is reviewed. Legislation in the

European Union (EU), Australia and New Zealand (NZ) is also reviewed. After a review of the literature, a doctrinal investigative method will be adopted.

An analysis in the differences in legislation will be performed to critically evaluate the changes to the SA VAT Act. Applicable legislation, as well as commentaries and articles accessed by way of an online search, are used for the literature review. For the purpose of the critical evaluation, commentary documents submitted to National Treasury and the South African Revenue Service on the amendments as initially proposed in the Draft Taxation Laws Amendment Bill, 2013 and the Draft Explanatory Memorandum are used as the primary data sources.

Research question

This study aims to provide answers to the following questions:

How extensive and adequate are the amendments of the current regulations prescribing VAT on electronic services, considering the OECD principles, European Union, New Zealand and Australia legislations?

To address the research question above, the following research sub-questions are applicable:

- To what extent does the South African VAT legislation make provision for the supply of electronic services by non-residents?
- To what extent were the Regulations prescribing electronic services in South Africa amended (as at 01 October 2018)?
- Does the South African legislation adhere to the Ottawa convention framework on the imposition of VAT on cross-border electronic services?
- How does the South African legislation for cross border electronic services compare to Australia, New Zealand (NZ) and European Union (EU) legislation?
- What are some of the challenges faced by VAT on e-commerce?

Research Objective

The objective of the research is to:

- Enunciate the regulations developed in the Ottawa Taxation Framework on the imposition of VAT on cross-border electronic services;
- Perform an analysis on the recent SA VAT developments considering the regulations developed in the Ottawa Taxation Conference;
- Determine if SA's VAT system needs to streamline itself with that of the EU, NZ and Australia in respect of the treatment and regulation of supplies of electronic services.
- Identify challenges for VAT on e-commerce and propose possible alignment and/or recommendations where necessary.

Limitations of scope

This dissertation will be limited to the legislative and regulative framework of the current electronic services provisions as at 1 June 2014 and the proposed amendments to the regulations which will come into effect on 1 April 2019.

Dissertation Summary

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 the reader with an introduction to the dissertation content and/or question. The research objectives that the study seeks to achieve are indicated and the research methodology as well as limitations to the study are established for the remainder of the study.
- Chapter Two introduces the reader to the literature review of the study whereby the underlying VAT principles (with emphasis to "Tax Neutrality') governing cross border supply of electronic services are discussed with reference to the Ottawa Taxation Framework.

- Chapter Three sets out the recent South African developments in respect of the electronic services Regulation. The reader will have an understanding of the amendments to the VAT Act and technical meaning of the provisions governing electronic services.
- Chapter Four outlines comparisons between the policies adopted in South Africa and that of the EU, NZ and Australia in respect of the supply of cross border electronic services. This chapter analyses the VAT on inbound digital supplies specifically in these jurisdictions in order to draw any correlation and where necessary make recommendations.
- Chapter Five evaluates the possible challenges and shortcomings faced by VAT on e-commerce that the government should be aware of before the implementation of e-commerce regulations.
- Chapter Six sets out a high-level summary of the dissertation and concludes on the research undertaken in each aspect as discussed in Chapters 1-5. This chapter will also include recommendations for SA's VAT system in respect of cross border electronic services.

CHAPTER 2: OTTAWA TAXATION FRAMEWORK

In 1998, the OECD held a conference titled 'A Borderless World: Realizing the Potential of Electronic Commerce'.[25] The conference was held in Canada's capital city, Ottawa. On this basis the taxation framework that the OECD conference developed was later named the 'Ottawa Taxation Framework' (the Framework).[26]

In that conference, digital economy and the development of domestic laws that govern it were the primary concern.[27] The neutrality and equitability of VAT is imperative for vendors, such that tax and VAT laws need to be enacted in a way that effectiveness and efficiency is achieved, while ensuring certainty and fairness in treatment for all taxpayers. The Framework also emphasized that tax rules should be simple and easy to understand.[28]

Following that conference, the OECD Committee on Fiscal Affairs ("hereinafter referred to as the CFA") launched a project to enable the development of the guidelines regarding cross border VAT/GST.[29] The purpose of the Guidelines was to develop a framework for ensuring globally agreed VAT principles. This initial guideline discussed the principles set out in the Ottawa Taxation Framework. About electronic commerce across borders, this guideline referred to existing taxation frameworks such as "VAT on imported services"/ "reverse charge mechanisms".[30]

In 2012, the CFA created the Global Forum wherein various countries were engaged and involved on discussions relating to global VAT challenges.[31]

In addition to the above, Base Erosion and Profit Shifting (BEPS) practices were one of the challenges discussed - thereby leading to the launch of an action plan by OECD to address tax

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[25] Dimitri Y, (1999) *"A borderless world: the OECD Ottawa Ministerial Conference and initiatives in electronic commerce"*, info, Vol. 1 Issue: 1, pp.23-33, https://doi.org/10.1108/14636699910800882 last accessed 19 September 2018
[26] *Ibid*
[27] OECD,*'Electronic Commerce: Taxation Framework Conditions'.* A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference, "A Borderless World: Realizing the Potential of Electronic Commerce" on 8 October 1998. Last accessed 23 September 2018
[28] *Ibid*
[29] *Ibid*
[30] *Ibid*
[31] *Ibid*

revenue losses as a result of BEPS.[32] Furthermore, on July 2013, the OECD further released a report titled 'Addressing Base Erosion and Profit Shifting' in terms of which it pointed out that BEPS not only constituted a serious risk to tax revenues, but also to the tax sovereignty and tax fairness for both OECD member countries and non-member countries.[33]

In that report, the OECD proposed 15 action items which endeavor to address BEPS challenges. Of relevance action point 1 deals with the challenges posed by the digital economy and as such, there is a call for action to address the tax challenges of the digital economy.[34] In addition to this, 'Working Party 9, was created based on action point 1 with the intention of developing guidelines relating to cross-border VAT. The focal point of these guidelines were the internationally agreed principles relating to the BEPS concerns from a VAT point of view.[35]

It is understood that the cross border supply of goods presented less threat to revenue loss compared to services supplied electronically.[36] This is on the basis that goods are tangible and would be required to pass either through the border or the harbor which are both strictly controlled.[37]

Depending on domestic legislation and value thresholds, these goods could be subject to both Customs Duty and VAT, thereby placing the foreign supplier in a similar tax position as a domestic supplier and thus reducing distortions in trade competitiveness.[38]

The same could not be said of the cross-border supplies of services supplied electronically since these are provided via the internet or cloud or through other forms of electronic agents or communication methods.[39] These were largely invisible to tax authorities.[40]

Countries relied on domestic legislation such as those dealing with "imported services" or "reverse charge mechanisms" for the collection of VAT on these supplies of services.[41] The

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[32] *Ibid*
[33] *Ibid*
[34] *Ibid*
[35] *Ibid*
[36] *Ibid*
[37] OECD, *'Taxation and Electronic Commerce Taxation and Electronic Commerce – Implementing The Ottawa Taxation Framework Conditions Implementing The Ottawa Taxation Framework Conditions'*
[38] *Ibid*
[39] *Ibid*
[40] *Ibid*
[41] *Ibid*

heavy reliance on recipients declaring VAT on imported services in SA (as in most jurisdictions) was problematic since it could not be monitored for compliance and collection purposes.[42]

As the digital trade in goods and services grew, so too did the potential for tax avoidance. Often these were done within the ambit of domestic legislation.[43] The BEPS report highlighted the need to introduce domestic legislation to combat the potential unintended non-taxation and to provide clarity and certainty regarding taxing the digital economy. The OECD's revised "International VAT/GST Guidelines" provides broad guidelines on the framework for developing domestic legislation in this area.[44] It encompasses internationally agreed upon principles and discusses the various options available to countries.

In response to the Ottawa Taxation Framework, the SA National Treasury introduced various VAT amendments aimed at curbing the challenges posed by cross-border provision of electronic services.[45]

South Africa's VAT is based on the destination principle which, the Ottawa Taxation Framework endorsed.[46] As such, it is important to note that in accordance with this principle, the place where VAT will be imposed will be where the product is consumed.[47]

Before the year 2014, the SA VAT Act catered for the inbound supply of electronic services. These electronic services were to be taxed in terms of the 'imported services' provisions. Recipients of the supply of electronic services were to declare VAT on those services received.[48]

Further, in keeping with the OECD Guidelines1, SARS provided for a streamlined VAT registration and administrative process that significantly reduced the compliance burden on foreign suppliers that are required to register in terms of the Regulation.[49]

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[42] *Ibid*
[43] *Ibid*
[44] *Ibid*
[45] *Ibid*
[46] OECD, 'Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions (Taxation (Organisation for Economic Co-Operation and Development).) Paperback – September 1, 2001 page 9 - 17. Can be purchased on Amazon website - https://www.amazon.com/Taxation-Electronic-Commerce-Implementing-Organisation/dp/926418595X
[47] *Ibid*
[48] *Ibid*
[49] *Ibid*

Following the issues raised in Ottawa, SA introduced some definitions into the Regulations (i.e. software and other electronic services), to address the uncertainties and to further broaden the scope of electronic services.[50]

"The Guidelines on VAT neutrality would be designed and developed on a gradual basis.[51] The output from each stage would be a building block contributing to the complete Guidelines.[52] Since the start of this project, public consultations have been held on (i) draft Guidelines on neutrality of VAT in the context of cross-border trade, (ii) a draft Commentary for the application of the Guidelines on neutrality in practice and (iii) draft Guidelines on place of taxation for cross-border supplies of services and intangibles to businesses that are established in one jurisdiction only".[53]

Core features of VAT covered by the Guidelines

Value added taxes on international trade have core features. The OECD's cross-border VAT guidelines report lists and describes these core features and their application thereof.[54] The Value added taxes' overall aim or purpose, design and implementation are at core and need to be widely defined and described through shared understandings among tax administrations, business enterprises and academic and other tax experts.[55]

Purpose of VAT

VAT's main purpose is to tax final consumption consumers or end-users of products or services.[56] On this basis, private individuals are understood to be the primary consumers of goods and services for the purposes of VAT. However, it is important to note that final

[50] *Ibid*
[51] *Ibid*
[52] OECD, *'Fundamental principles of taxation'.* Accessed at https://www.oecd-ilibrary.org/docserver/9789264218789-5-en.pdf?expires=1538374109&id=id&accname=guest&checksum=34AEF5A02B753EC762D2793FF16ED789 last accessed 27 September 2018
[53] *Ibid*
[54] *Ibid*
[55] *Ibid*
[56] *Ibid*

consumers may include businesses as well. VAT can be classified as a broad-based tax and its treatment varies with specific forms of consumption such as the purchase of fuel or alcohol.[57]

Following the above, the imperative proposition fundamental to VAT is that, VAT is a tax on final or household consumption and as such, the liability of VAT should not be borne by the business.[58] Practically, if a business acquires goods or services that are used in wholly or partly for the private consumption of the business owners, the extent to which the purchase was made for business or private consumption needs to be determined by VAT regimes.[59] In most cases businesses acquire goods and services for the furtherance of trade, whether wholly or in part. This makes it tricky for businesses to therefore be final consumers of goods or services for VAT purposes.

VAT design

The VAT structure is built in a sense that enterprises in the supply chain, which are registered VAT vendors, act as collecting agents of VAT on behalf of SARS. The business enterprises have significant control in the process of VAT collection and the primary design feature of VAT is that businesses charge to the purchaser the applicable percentage of VAT on a supply over and above the cost price or margin of that supply. This means that businesses also incur VAT upon purchases made from other VAT vendors. It can be said that the VAT charged by the business on its sales is output tax and the VAT incurred by the business from its purchases is input tax.

The VAT design enables the purchaser to deduct that input tax from purchases against the output tax charged on its sales, transmitting the balance to SARS and receiving refunds when there are excess deductions.[60] It is through this mechanism that businesses are relieved of the burden of VAT that they pay when acquiring goods or services. In essence, the tax burden is not meant to be borne by the businesses – as they are a mere channel to the collection process on behalf of SARS.[61]

[57] *Ibid*
[58] *Ibid*
[59] *Ibid*
[60] *Ibid*
[61] *Ibid*

VAT and cross-border transactions

It is noted by the OECD that, the purposes of VAT as a levy on final consumption, together with its central design feature of a staged collection process, lays the foundation for the core VAT principles bearing on international trade.[62] As such, on cross-border transactions, there is still a grey area on whether the rightful taxing jurisdiction should be the one of origin or destination. The destination tax principle is a concept that allows for VAT to be levied only on final consumption that occurs in the taxing jurisdiction where the product is sold. Under the origin principle, VAT is levied in the jurisdictions where the value was added.[63] In essence, the origin principle taxes the supply in the country of production while the destination principle taxes the supply in the country of consumption.

It is understood that the destination principle in VAT attain neutrality in international trade. Under the destination principle, a VAT vendor's exports are taxed at a rate of zero percent with a possible deduction of input taxes at the standard rate and imports are taxable are taxable at similar rates and basis as domestically supplied products.[64] Accordingly, various jurisdictions have different rules in determining the taxes payable, the destination principle sets out that all revenue accrues to the jurisdiction where the final consumption of a supply occurs.[65]

For these reasons, there is widespread consensus that the destination principle is theoretically and practically advantageous. It is preferable to the origin principle, in fact, the destination principle is the international norm and is endorsed by World Trade Organization rules.[66]

Implementing the Destination Principle

Due to the broad acceptance of the destination principle worldwide regarding the application of VAT to cross-border transactions, the current rules that are in force are intended for tax on the supply of goods, services and intangibles in the jurisdiction within which consumption takes

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[62] OECD, *'International VAT/GST Guidelines'*. November 2015 accessed at - https://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.pdf Last accessed on 20 September 2018
[63] *Ibid*
[64] *Ibid*
[65] *Ibid*
[66] *Ibid*

place.[67] The implementation of this principle will vary across countries and may in some instances lead to double taxation or unintended non-taxation, ultimately affecting the tax base. Its practical implementation could also foresee uncertainties for both business enterprises and tax administrations.[68]

The application and implementation of the destination principle with respect to the supply of goods and tangibles seem to be less complicated.[69] Therefore, when a seller and purchaser of goods are located in different countries or jurisdictions, the said goods will only be taxed in the country where they are delivered.[70] By so doing, a harmonious approach on the deduction of the VAT incurred at importation and input tax incurred on a domestic supply is created. Furthermore, international trade distortions are limited, while ensuring neutrality across board.[71]

On the other hand, the implementation of the destination principle with regards to international trade in services and intangibles is more challenging.[72] The nature of services and intangibles disables customs from having significant and effective controls in validating the exports and their consequent right to be free of VAT in the export country.[73]

Ottawa Taxation Framework Conditions

Following the Ottawa Taxation Framework, certain principles were developed to guide various countries when developing their VAT system to curb the challenges posed by cross-border provision of services.[74] These principles can be summed up as follows:[75]

- *"Neutrality: Taxation should seek to be neutral between forms of commerce, between businesses in similar situations carrying out similar transactions, between foreign and domestic businesses, and between international and domestic trade".*

[67] Kathryn James, *'Relevance of the OECD International VAT/GST Guidelines for Non-OECD countries'*. Accessed at: https://www.up.ac.za/media/shared/58/ZP_Files/2016/VAT%20Symposium/Papers/t-ecker_k-james.zp103866.pdf last accessed 1 September 2018
[68] *Ibid*
[69] *Ibid*
[70] *Ibid*
[71] *Ibid*
[72] C Alexiou, *'The Cross-Border Electronic Supply Eu-Vat Rules: Lessons For Australian GST'*. 2004 accessed at: http://classic.austlii.edu.au/au/journals/RevenueLawJl/2004/7.pdf
[73] *Ibid*
[74] OECD, *'Fundamental Principles of Taxation'*. Accessed at http://www.oecd-ilibrary.org/docserver/download/2314251ec005.pdf?expires=1460815071&id=id&accname=guest&checksum=3777D2823C148F8A98741EA8BDB39484 last accessed 2 September
[75] *Ibid*

- *"Efficiency: Compliance costs for businesses and administrative costs for the tax authorities should be minimized as far as possible".*
- *"Certainty and simplicity: Tax rules should be clear and simple to understand so that businesses can anticipate the tax consequences of a transaction, including knowing when, where, and how the tax is to be determined and reported".*
- *"Effectiveness and fairness: Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counteracting measures proportionate to risks involved".*
- *"Flexibility: The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments".*

Neutrality of VAT in the context of Cross-Border Trade

This paper will focus in detail on the principle of tax neutrality only because it seeks to advocate for a neutral tax environment across borders. The concept of tax neutrality in VAT has several dimensions and advocates for a tax environment that is without discrimination and biasness. It also eliminates undue tax burdens, impartial, disproportionate or inappropriate compliance constraints for businesses.[76] Neutrality is one of the principles that ensures that tax authorities collect the right amount of tax while ensuring compliance.[77]

These Guidelines are concerned with neutrality as a concept from an international point of view. Although they draw from the basic principles that apply to domestic transactions, domestic aspects of neutrality are barely covered, such as the effect of the tax structure (e.g. different rates and exemptions) on consumption decisions by consumers.[78]

Basic Principles and the relevant Guidelines

As explained each business pays VAT to its providers on its purchases (input tax) and receives VAT from its customers on its sales (output tax). To ensure that the "right" amount of tax is transmitted to tax authorities, input tax incurred by each business is offset against output tax,

[76] *Ibid*
[77] *Ibid*
[78] *Ibid*

resulting in either a refund or liability to pay the net amount or balance of those two.[79] This means that VAT normally "flows through the business" to tax the final consumers. This principle can be found in Guideline 2.1.[80]

Guideline 2.1 deals with the burden of VAT.[81] It states that it is unfair for businesses to bear the burden of VAT, unless there is proviso in the legislation dealing with same.[82]

A neutral and equitable tax ensures proportional collection of tax in correspondence with the amount paid by the consumer, regardless of the nature of the supply, distribution chain process and the number of transactions involved.[83]

Business decisions are influenced by various factors, some of which include financial, commercial, social, environmental and legal factors.[84] Whilst VAT is also a factor that is likely to be considered, crucial business decisions should not be primarily influenced by it. For example, a legal form of a business or entity (under which it operates, whether in a subsidiary or a branch structure) should not be influenced by VAT rules or policies.[85]

Neutrality – International Trade

The basis for general principles of neutrality and the Guidelines that flow from them apply equally to national and international trade.[86] Taxation on e-commerce should desire to be neutral, fair and impartial. This means that taxpayers that engage and operate in correlative tax environment and that carry out comparable transactions should be subject to the same taxation levels alike. Therefore, both e-commerce transactions and physical transactions should have a similar liability and proneness to taxation.[87]

It is particularly important that the VAT legislation supports physical and electronic transactions in a similar manner without showing over one or the other. The neutral tax environment is not

[79] *Ibid*
[80] *Ibid*
[81] *Ibid*
[82] *Ibid*
[83] Jason Furman, *'The Concept of Neutrality in Tax Policy'.* April 15, 2008. Accessed at: https://www.brookings.edu/wp-content/uploads/2016/06/0415_tax-_neutrality_furman-1.pdf last accessed 21 September 2018
[84] *Ibid*
[85] *Ibid*
[86] *Ibid*
[87] *Ibid*

just limited to national border, it is also important that the application of rules governing global supplies create nil advantages for comparable domestic supplies.[88] This includes the manner in which tax is applied, administration costs and burdens resulting from the collection process.[89]

Application of the Principle of Neutrality

As indicated above, Guideline 2.1 indicated that businesses should not be in a position where they carry the burden of VAT but rather the end consumers.[90] In accordance with Guideline 3.2 VAT neutrality can be achieved through the destination principle. This principle allows a business to deduct input tax on the importation of services.[91] There are, however, instances whereby countries have a different interpretation of place of supply rules, which could lead to a non-neutral taxing environment.

Principles of good tax administration - the Guidelines on neutrality are not intended to be in dominion over tax rules of jurisdictions, especially in the treatment of input & output tax and exempt supplies.[92]

Reciprocity – according to the Guidelines on neutrality, both national and international businesses should enjoy similar advantages and incur similar disadvantages. This would mean that there should be limited to nil unjustified and discriminative processes in the treatment of VAT.[93]

Implementation of specific rules on taxation of cross border B2B supplies

As discussed above, the application and implementation of the destination principle with respect to the supply of goods and tangibles seem to be less complicated.[94] Therefore, when a seller and purchaser of goods are located in different countries or jurisdictions, the said goods will only be taxed in the country where they are delivered.[95] The implementation of the destination principle

[88] OECD Committee on Fiscal Affairs Working Party N°9 on Consumption Taxes, *'International VAT/GST Draft Guidelines on Neutrality Invitation for Comments'*. December 2010. Accessed at http://www.oecd.org/tax/consumption/46801871.doc last accessed at 21 September 2018
[89] *Ibid*
[90] *Ibid*
[91] *Ibid*
[92] *Ibid*
[93] *Ibid*
[94] *Ibid*
[95] *Ibid*

with regards to international trade in services and intangibles is more challenging. The nature of services and intangibles disables customs from having significant and effective controls in validating the exports and their consequent right to be free of VAT in the export country.[96]

Business-to-business supplies

Business entities engage in the purchase of services from service providers located in other jurisdictions and such purchases are usually made for the furtherance of trade.[97] As such, the location of the purchasing entity can be a proxy for the jurisdiction of business use as it achieves the objective of neutrality through the implementation of the destination principle.[98] This is the jurisdiction where the purchasing entity has situated its permanent business presence.[99]

This proxy is referred to in these Guidelines as the "Main Rule".[100] In terms of the Main Rule, cross-border services are taxed in the jurisdiction where the customer is located.[101] At the same time, the service provider will make the supply at zero percent VAT in its jurisdiction but will have the right to the deduction of input tax in relation to that supply (subject to legislated exceptions in that jurisdiction).[102] The challenge experienced by many is determining the jurisdiction of a customer's location, however, Guideline 3.3, sets out that the customer's identification is "normally determined by reference to the business agreement". This is because business agreements explicitly reflect detailed information on the supply.

It's advisable to first identify the identity of the customer before determining their location, more especially for supplies made between separate legal entities with solitary locations.[103] In order to determine the place of taxation under the Main Rule, the nature of the supply, identity of supplier and customer must be demonstrated.[104]

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[96] *Ibid*
[97] Sokolovska, Olena, 2016. "Cross-border VAT frauds and measures to tackle them," MPRA Paper 70504, University Library of Munich, Germany. Accessed at: https://ideas.repec.org/p/pra/mprapa/70504.html
[98] *Ibid*
[99] *Ibid*
[100] *Ibid*
[101] *Ibid*
[102] *Ibid*
[103] *Ibid*
[104] *Ibid*

Conclusion (relevance of the chapter)

This chapter presents an in-depth analysis of the principles of the Ottawa Taxation Framework with the aim of informing the current misconceptions, uncertainties and challenges faced by the global markets in respect of cross-border supply of electronic services. An analysis of the Ottawa Taxation Framework (with emphasis to neutrality) was performed to encourage comparison with the SA legislation for electronic services and stress out the importance of SA adhering to the principles set out in that Framework, especially the principle of neutrality. Furthermore, given the cross-border nature of electronic services, this chapter emphasises how imperative it is for South Africa to avoid implementing rules and provisions which are not in harmony with international principles.

The spread of VAT has been the most important development in taxation globally. Various countries globally have adopted and implemented VAT in their jurisdictions. It can therefore be said that VAT is recognised as the most efficient consumption tax both in terms of revenue for governments and neutrality towards international trade.

The principles and conditions in the Ottawa Taxation Framework will challenge the SA government to undertake common action to ensure a smooth interaction between VAT systems in the context of a global economy.

In the development of globalisation and cross-border trade, it became apparent that the challenges surrounding the application of VAT was widely rooted in e-commerce, especially the taxing of services and intangibles. This would often result in double taxation and unintentional non-taxation.

Other issues faced in cross-border trade of services and other tangibles was the definition of the 'place of taxation'. The Ottawa Taxation Framework provides with guidelines on the place of taxation for cross border trade. In order to ensure tax neutrality, the revenue of the tax should ultimately accrue to the jurisdiction where final consumption occurs.

Furthermore, we can see that the Framework also addresses issues such as improving the efficiency of the tax, the fight against VAT fraud and tax administration issues. Without principles and conditions like these (Ottawa Framework) the lack of consistency across countries

will vastly increase and may lead to significant compliance and administrative burdens for businesses and tax administrations.

Lastly, this chapter will have an impact to the rest of the study as one of the major objectives of this study is to compare the current and proposed SA regulations governing e-commerce with international principles. It is through this chapter that we can establish if SA is in harmony with international standards and where it can improve.

CHAPTER 3: SA VAT DEVELOPMENTS

Technical definitions

The VAT Act defines **'electronic service'** *as "those electronic services prescribed by the Minister by regulation in terms of this Act".*

The definition of **'enterprise'** (b)(vi) means-

"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 the Republic;

(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".

"**Resident of the Republic'** means *a resident as defined in section 1 of the Income Tax Act , (Act 58 of 1962)*[105] *: Provided that any other person or any other company shall be deemed to be a resident of the Republic to the extent that such person or company carries on in the Republic any enterprise or other activity and has a fixed or permanent place in the Republic relating to such enterprise or other activity".* (Value Added Tax Act 89 of 1991 and Income Tax Act, 58 of 1962).

The existing Regulation prescribing those services which fall within the definition of 'electronic services' were issued by Treasury and have been in place since 01 June 2014.

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[105] "**Resident means**: *natural person who is- (i) ordinarily resident in the Republic; or*
(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic-

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the three years of assessment preceding such year of assessment; and
(bb) for a period or periods exceeding 549 days in aggregate during such three preceding years of assessment,
in which case that person will be a resident with effect from the first day of that relevant year of assessment."

The current electronic services regulation

The existing e-services regulations have been in place since 01 June 2014 and a foreign e-services supplier is currently required to register for VAT as soon as the value of the services exceeds R50,000 in a 12-month period. In terms of the Regulations the scope of services which will attract VAT in South Africa is limited. It includes *inter alia* the provision of:

- **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".

- **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.

- **Internet-based auction service**

The supply of an internet-based auction service facility.

- **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

(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".

- **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".

Services such as cloud-computing and software are specifically excluded from the existing regulations.

Revised electronic services regulation

In SA's 2018 National Budget Speech, released on 21 February 2018, the Minister of Finance announced that the regulation defining "electronic services" for VAT purposes would be updated and this resulted in an amended draft regulation being published on the same date.[106]

On 24 October 2018, the Minister of Finance presented the Medium-Term Budget Policy Statement which was accompanied by the Amendment of Revenue Laws Bill 37 of 2018 ("the Bill). Amongst those amendments contained in the Bill was the changes in the VAT treatment of the supply of electronic services in South Africa.

In the proposed e-services regulations, the definition of e-services has been vastly broadened to include any services supplied by means of an electronic agent, electronic communication or the internet for any consideration. This definition however excludes the following:

- the supply of "telecommunications services" as defined;
- the supply of educational services by a person regulated by an educational authority in a foreign country; and
- certain inter-company supplies within a "group of companies" as defined. In this regard, both companies must form part of the same group of companies, the supplying company must not be a resident of South Africa, and the supplying company must supply the services itself and exclusively for the South African resident company.

[106] National Treasury, *'Draft Explanatory Memorandum: Regulations Prescribing Electronic Services For The Purpose Of The Definition Of "Electronic Services" In Section 1(1) Of The Value-added Tax Act, 1991'*. 21 February 2018
http://www.treasury.gov.za/public%20comments/RMTAB2018/Draft%20Explanatory%20Memorandum%20-%20Regulations%20Prescribing%20Electronic%20Services%20For%20The%20Purpose%20Of%20The%20Definition%20Of%20Electronic%20Services%20In%20Section%201(1).pdf
https://www.gov.za/documents/rates-and-monetary-amounts-and-amendment-revenue-laws-bill-b37-2018-24-oct-2018-0000

The Bill contains the following proposed amendments:

- The introduction of a definition of "intermediary" into the VAT Act. The definition contemplates a person who facilitates the supply of e-services and who is responsible for issuing the invoices and collecting payment for the supply;
- An amendment to specifically deem the supply of e-services by an intermediary (as defined) to be supplied by that intermediary and not by the actual supplier; and
- An increase in the VAT registration threshold in relation to the supply of e-services from the current R50 000 to R1 million. The R1 million threshold is to be calculated with reference to any consecutive 12-month period.

Business-to-business (B2B) transactions

The revised regulations don't make a distinction between B2B and business-to-consumer (B2C) transactions. This means that foreign e-services suppliers to South African customers will be required to register for VAT in South Africa if their customers are situated in South Africa.

To minimize the administrative burden on global suppliers of electronic services, most jurisdictions differentiate between B2B and B2C supplies. The reason behind this differentiation is that in most instances where it is a B2B supply the recipient of the service will be allowed to claim the VAT charged as an input tax deduction. The regulation currently in effect, as well as the draft regulation, does not make this differentiation thereby subjecting B2B supplies to SA VAT.[107]

In the previous year's Budget Speech, the Minister of Finance announced that specific guidance would be given to provide more clarity on the current services which fall within the regulation and mentioned that the intention was to expand the specific electronic services subject to VAT in SA.

As much as the lack of distinction between B2B and B2C transactions is not in harmony with international standards, it should be noted that this distinction does not exist in the VAT Act for local suppliers. It is this paper's view that National Treasury intentionally avoided this concept as it would create an unfair advantage for non-resident suppliers.

[107] *Ibid*

Notwithstanding that the regulations were first introduced to address concerns about non-compliance by recipients of imported services, which specifically excludes services acquired for making taxable supplies. The inclusion of B2B transactions might lead to discrepancies between supplies of e-services and supplies of any other services by foreign suppliers. This is because supplies of any other services are only taxed if they are acquired for purposes other than making taxable supplies.

B2B and B2C transactions need to be carefully distinguished in order to ensure the limitation of administrative constraints during enforcement. This paper is of the view that the treatment of e-services should be aligned with international treatment and be in harmony with the OECD.

Registered VAT vendors are entitled to deduct the total amount of VAT they pay as input tax and can partly account for the VAT by way of the imported services rules. Therefore, administration such as VAT registration process, subsequent submission of VAT returns, processing and policing of VAT returns should be considered. Such a significant burden is futile as it brings no additional revenue for the fiscus.

Intra-group transactions

In order to limit the administrative burden, e-services supplied between companies in the same group are excluded. However, in terms of the definition of 'group of companies' in the regulations, the local recipient company must be a wholly owned subsidiary of the foreign group for the exclusion to apply. Consequently, if the local company has Black Economic Empowerment shareholders the exclusion will not apply.

The exclusion also does not apply where the foreign company procures e-services (such as IT services) from a third party for supply to the local company. To qualify for the exclusion, the foreign company must supply the services itself.

Intermediaries

For Intermediaries to be liable to register for VAT in South Africa they must; facilitate the supply of e-services or provide their platforms to foreign suppliers for rendering the e-services to South African customers; be responsible for invoicing and collecting payment for the e-service. Accordingly, where e-services are supplied via an intermediary, who then facilitates the supply

of the electronic services and is responsible for the issuing of the invoice and collection of the payment, such e-services will be deemed to be supplied by the intermediary.

Registration threshold

It is a relief to foreign e-services providers to learn that the current registration threshold of R50,000 has been increased to R1 million for any 12-month period, which is now in correspondence with local suppliers.

One might argue and say that the empowerment of local business should be a priority, however, the R50,000 threshold for foreign e-services suppliers is unfairly low, considering the varied currency exchange rates. It is rather easy for foreign e-services suppliers to reach and exceed the threshold, which might potentially require them to unintendedly register for VAT.

It is good to note that the playing fields have been levelled and can result to healthy competition.

Obligation to Register for VAT

Certain categories of “electronic services" are currently still prescribed by regulation. Simply stated, the VAT rules compel foreign merchants to register as SA VAT vendors and to account for VAT, *inter alia,* where the foreign merchant provides electronic services to SA consumers or receives payment for such electronic services from a South African bank and the revenue exceeds ZAR 50,000 in a 12 month period.[108]

This registration threshold is significantly less than the registration threshold of ZAR 1 million that applies in relation to all other types of supplies.[109]

The latest definition of electronic services is so wide that possibly every supply of services by way of "the internet, an electronic agent or electronic communication" could be caught in the net.[110]

It is noted that there is also concern about the low threshold of R50,000 for foreign companies to register for VAT in SA.[111] Local companies are required to register for VAT only when their taxable turnover exceeds R1m.

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[108] *Ibid*
[109] *Ibid*
[110] *Ibid*

The Davis tax committee says in its final report on VAT it sees no justification for the very low registration threshold (R50,000) applicable to suppliers of electronic services.[112]

Resident Customer

Customer is considered a resident of SA if any of the below conditions applies:

- The recipient is a resident of SA.
- The payment originates from a bank registered or authorized in SA.

SARS will therefore in practice deem that an e-service has been provided to a SA resident if any of the following applies:[113]

- SA residency address has been used for the purposes of the supply of e-service.
- The payment has been made from a bank SA account.
- A credit card issued by a SA bank has been used.

The above definition of a resident differs from the definition used in the EU, which could lead to double taxation of which SARS might not check. In a case where VAT is due both in SA and in some other jurisdiction (e.g. in EU), SARS might nevertheless require the foreign supplier to charge, collect, and pay the SA VAT.[114]

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[111] Amanda Visser, 'Tax practitioners favour move to simplify VAT rules for foreign e-commerce'. 29 April 2016. Accessed at: https://www.thesait.org.za/news/287478/Tax-practitioners-favour-move-to-simplify-VAT-rules-for-foreign-e-commerce-.htm

[112] *Ibid*

[113] Tax ENSight, 'registration requirements for foreign suppliers of electronic services clarified'. 23 April 2014. https://www.ensafrica.com/news/registration-requirements-for-foreign-suppliers-of-electronic-services-clarified?Id=1410&STitle=tax%20ENSight

[114] *Ibid*

SA's Recommendations

As part of its review of the SA tax system and relying on international best practice, the DTC in the DTC VAT Report made certain recommendations to the Minister of Finance in relation to VAT and e-commerce transactions.[115]

As noted, these include: (i) that supplies qualifying as electronically supplied services should be categorized and elaborated upon in a guide or interpretation note; (ii) that a distinction should be made between supplies made between businesses, so-called business-to-business (B2B) and business-to-consumer supplies (B2C), with only the latter being subject to the e-commerce rules; (iii) that the invoice basis of accounting for VAT be the default position; and (iv) that the VAT registration threshold for foreign electronic suppliers (as defined) be made the same as the compulsory VAT registration threshold i.e. a taxable turnover of ZAR 1 million in any 12 month period.[116]

In considering the VAT e-commerce regulations in a broad manner, the DTC recommended that more flexible legislation is required to ensure SA VAT legislation regulating e-commerce stays relevant.[117]

Contrary to the DTC recommendations and seemingly to exploit the relatively low VAT policy gap in SA, the Minister of Finance announced in the Budget Speech 2018 that the VAT base for the supply of electronic services by foreign businesses to SA consumers would be broadened.[118]

The prosaic draft regulations accompanying this announcement state that "electronic services" will be defined as:[119] *"…any services to be supplied by means of an electronic agent, electronic communication or the internet for any consideration…"* subject to certain exclusions for educational services provided by a person regulated by an educational authority in the export country and telecommunication services.

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[115] *Ibid*
[116] Corrie Meiring, *'An evaluation of the practical application of the South African VAT legislation on electronic services: A case study'*. 13 November 2015. https://repository.nwu.ac.za/bitstream/handle/10394/20671/Rooi_TK_2015.pdf?sequence=1
[117] *Ibid*
[118] *Ibid*
[119] Baker Mckenzie, *'The Broadening of the VAT Base for Electronic Services'*. 6 March 2018. http://www.polity.org.za/article/the-broadening-of-the-vat-base-for-electronic-services-2018-03-06

This is to say that anti-virus software, online advertising, broadcasting, online gaming, cloud computing, online consulting, online software supplies and training services will all now fall within the definition of electronic services.[120]

Practically, the draft regulations target all foreign businesses that supply electronic services to SA businesses for inclusion in the VAT net.[121] Intermediaries facilitating the supply of electronic services and responsible for issuing invoices and collecting payments are also affected and will be deemed to be the supplier for VAT purposes.[122]

The usual penalties and interest will apply where such businesses are liable and yet fail to register for VAT timeously.[123]

Conclusion

It appears that National Treasury and SARS have adopted a rigid approach to regulate a fluid issue. In particular, the failure to distinguish between B2B and B2C supplies is a step away from the international harmonization of taxing e-commerce transactions and may potentially create enforcement problems for SARS on cross-border transactions in future.[124]

As noted in many reports relating to the taxation of cross-border supplies of electronic services, it makes no sense to impose VAT on B2B transactions where the relevant jurisdiction has a reverse charge mechanism ("imported service" in SA VAT parlance), as any VAT imposed on B2B transactions where the recipient would not be entitled to a full input deduction would be caught by the reverse charge mechanism.[125]

It is also concerning to note that the approach adopted by National Treasury and SARS stands in stark contrast with the recommendations made by the DTC.[126]

In the draft regulations published on 21 February 2018, the Minister of Finance has proposed the deletion of the specific types of services currently regarded as electronic services and with effect

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[120] *Ibid*
[121] *Ibid*
[122] *Ibid*
[123] *Ibid*
[124] *Ibid*
[125] *Ibid*
[126] Graeme Palmer, 'Overhaul of the VAT treatment of electronic services'. 18 April 2018. Accessed at: https://www.iol.co.za/mercury/overhaul-of-the-vat-treatment-of-electronic-services-14513102

1 October 2018 include any type of service supplied electronically.[127] The only exclusions provided under the draft regulations are educational services supplied by a person regulated by an educational authority in an export country and telecommunications services.[128]

The impact of this proposed amendment stretches widely and will include most services provided by a non-resident.[129] Among others, any multinational group of companies with a cost sharing structure will need to analyze whether its inter-group transactions subject a non-resident supplier to SA VAT.[130]

SA should reconsider the recent amendments to the definition of 'electronic services' as it seems to be broad and possibly against the guidelines laid down in the Ottawa Taxation Framework. The current draft regulations have been drafted as a catch all 'rule' and this can pose a challenge to both SARS and VAT vendors. This amendment to the Regulations has led to greater uncertainty and impractical application.

[127] *Ibid*
[128] *Ibid*
[129] *Ibid*
[130] *Ibid*

CHAPTER 4: DEVELOPED COUNTRIES

Countries around the globe have undertaken unprecedented co-operative efforts to align this world-wide-VAT web in developing cross-border VAT guidelines.[131] Internationally, regionally, nationally and sub-nationally, bodies and organizations have worked together in response to the complex tax implications arising from the burgeoning digital market.[132]

To evaluate the progress of co-operative efforts on an international level, this paper critically analyses the VAT on inbound digital supplies in four jurisdictions that do not form part of the same region (namely, Australia, European Union, New Zealand and South Africa).[133] The Organization for Economic Co-operation and Development (OECD) already recognised the need for this kind of international co-operation and development before the turn of the century and in 1998 issued a set of conditions to govern the taxation of e-commerce (the Ottawa Taxation Framework).[134]

VAT, also known as goods and services tax ("GST") and the internet are not mechanisms of ancient history.[135] VAT as form of taxation was firstly implemented by the French and soon was widely spread cross-border. The popularity of VAT can now be seen in more than 165 jurisdictions and is a significant source of revenue among others.[136] The idea was to initially tax domestic consumption of goods and services and use businesses as collecting agents on behalf of the government.[137]

However, the "Big Bang occurred: thanks to the internet", products and service providers saw trade shifting from national to international platforms and the "World Wide Web" radically changed trading space and made it small, easily accessible and instant.[138] "The environment is so fast-paced in a sense that, "*a company operating from a garage in America (or any place on the*

[131] Naoki Oka, 'IRAS-OECD Regional GST/VAT Conference (May 2013) Taxing cross-border supply of services and intangibles'. Accessed at: https://www.oecd.org/tax/consumption/iras-oecd-vat-conference-technical-summary-of-examples.pdf
[132] *Ibid*
[133] *Ibid*
[134] *Ibid*
[135] *Ibid*
[136] *Ibid*
[137] *Ibid*
[138] *Ibid*

globe with a decent internet connection), can sell its digitized products to millions of customers around the globe without a single sales representative setting foot in a foreign country".

The internet made it simple to grow e-commerce, however, that rapid growth also came with its shortfalls. The VAT and overall tax legislations were not solid enough to monitor this new space of trade. The tax rules applicable to the traditional "brick & mortar" businesses soon proved to be impaired when it came to digital e-commerce.[139] A lot of countries saw it fit to modify and fast track their legislations in order to control and suppress the challenges. A need for global tax citizens grew rapidly, pulling domestic businesses into the global village.[140] This article is intended as a guide to clarify the new VAT rules applicable to digital goods and services, assist with the identification of VAT obligations, and set out compliance requirements.[141]

The Digital Economy

As a consumption tax, VAT traditionally applies where the consumption occurs following the so-called destination principle. As already mentioned, applying the destination principle to services and intangibles is seen to be a challenge due to the difficulty in identifying the jurisdiction of consumption. Furthermore, service providers that are present in multiple jurisdictions could potentially result in compliance constraints.[142] As a" rule of thumb", most jurisdictions apply the following rules to sales of services and intangibles generally:[143]

- For business-to-business ("B2B") transactions, VAT is due in the country of the customer; AND
- For business-to-consumer ("B2C") transactions, VAT is due in the country of the vendor

These rules were developed when most VAT systems were originally implemented and consumers acquired goods and services primarily from domestic vendors.[144] At that time, the

[139] Richard L. Reinhold, '*Some Things That Multilateral Tax Treaties Might Usefully Do*'. Vol. 57, No. 3 (Spring 2004), pp. 661-708. https://www.jstor.org/stable/20772481?seq=1#page_scan_tab_contents – accessed required
[140] *Ibid*
[141] *Ibid*
[142] *Ibid*
[143] The DTI, *'National Export Strategy: Summary of the Research Findings'*. Accessed at: http://www.thedti.gov.za/invitations/SA_Exports2013.pdf
[144] *Ibid*

places of sale and consumption were generally located within a single jurisdiction.[145] For B2C transactions, the location of the vendor seemed to be a reasonable proxy for the place of consumption since.

Many countries are seen to be adopting the Guidelines and being in the process of streamlining their VAT/GST rules to match the OECD Guidelines, including "Australia, Albania, the Bahamas, Belarus, Colombia, the 28 Member States of the EU, the six member states of the Gulf Cooperation Council, Ghana, Iceland, India, Japan , Kenya, New Zealand, Norway, Serbia, SA, South Korea, Switzerland, Taiwan, and Tanzania". Countries have redesigned their VAT laws to suit the challenges faced in e-commerce and this number is expected to grow in the upcoming future.[146]

Businesses engaged in international trade, specifically for electronic services need to be fully aware of their VAT obligations on a global perspective.[147] It is important to keep up to date with the changes in technology, the digital space and the VAT rules governing this environment.[148] Digital services include "downloaded or streamed books, music, and movies, online games, software, and telecommunications services". However, the scope of such services has potential for further stretching.[149]

The taxation of the intermediaries may vary across jurisdictions depending on contractual terms.[150] For instance, the EU and Australia have rules that deem an intermediary involved in "key aspects of the sale" to be the vendor. Under the EU approach, "for each transaction in the supply chain, each entity is deemed to have received and resold the digital service itself (reseller assumption).[151] Thus, under this assumption, an e-marketplace operator involved in "key aspects of the sale" to the final consumers is required to account for VAT. In assessing whether a taxable person is involved in "key aspects of the sale," both facts and legal relationships need to be considered".

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[145] *Ibid*
[146] *Ibid*
[147] Walter Hellerstein, 'A Hitchhiker 's Guide to the OECD's International VAT/GST Guidelines'. 1 January 2016. Accessed at: https://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?referer=https://www.google.co.za/&httpsredir=1&article=2062&context=fac_artchop
[148] *Ibid*
[149] *Ibid*
[150] *Ibid*
[151] *Ibid*

New Zealand

New Zealand is the earliest of the so-called "New World" VAT regimes. It introduced a comprehensive Goods and Services Tax in 1986. The New Zealand GST is seen as relatively simple and comprehensive. It was introduced at a rate of 10% but this has risen to the current 15% which became effective in 2010. The GST applies to the supply of most goods and services inside New Zealand and most goods imported into New Zealand as well as to specified imported services. Legislation affecting imported intangibles was introduced in 2015 and became law in 2016. It is applicable from 1 October 2016. The affected supplies are described as cross-border "remote" services supplied by non-resident suppliers.

The provision giving effect to this is a new section 8B inserted into the Goods and Services Tax Act 1985 as read with the amended definition in section 2 of "remote service".

According to the New Zealand Inland Revenue Report explaining the changes:[152] 'A "remote service is defined as a service where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance".[153] The definition includes electronic services, such as "e-books, music, videos and software downloads, as well as non-electronic services, such consulting, accounting and legal services."

A remote service can thus be distinguished from a service such as a haircut. To these authors the provision of intangibles such as music, books, videos and the like are not self-evidently "services".[154] The resolution of this apparent strangeness lies in the existing definition of "services" in s2 of the Goods and Services Tax Act 1985 which "means anything that is not goods or money". It remains to be seen how the provision is interpreted.[155]

As regards imported intangibles, the place of taxation rule for "remote services" in New Zealand is given effect through taxation based on the "residence" of the recipient of the supply. This is used as a proxy for the place of consumption of the cross-border intangible supply. A diverse set of characteristics is used in order to establish the residence of the recipient of the supply. These

[152] New Zealand Minister of Revenue, 'GST: Cross-border services, intangibles and goods'. https://taxpolicy.ird.govt.nz/sites/default/files/2015-dd-gst-cross-border.docx
[153] *Ibid*
[154] *Ibid*
[155] *Ibid*

are set out in section 8B (2) and require the non-resident supplier to treat the recipient as New Zealand resident if they have non-contradictory information as to two of six items.

The items that support the conclusion that the recipient is resident in New Zealand are:[156] the recipient's billing address; the internet protocol (IP) address of the device used by the recipient; or "…another geolocation method"; the bank details of the recipient "including the account the person uses for payment or the billing address held by the bank; the country code of the mobile device's subscriber identity module card (SIM card) that was used by the recipient; the location of the recipient's fixed land line used to supply the service to them; or "other commercially relevant information".

The legislation includes rules that assist in determining the place of supply where the evidence is ambiguous, such as when the supplier has two non-contradictory indications of residence in some other place – in which circumstances the more reliable evidence must be chosen. The Commissioner of Inland Revenue can, in certain circumstances, prescribe the use of another method to determine a recipient's residence, or may agree with the supplier on the use of another method, if a supplier is unable to establish a recipient's residence as suggested by the items on the list discussed.

Where such supplies are made on any significant scale to consumers that are not businesses the new rules require the non-resident to register in New Zealand and to remit GST on the supplies if they, in aggregate, exceed NZ$60,000 in a 12-month period or are expected to do so. It should be noted that only B2C supplies are taxed and that B2B supplies are zero-rated. New Zealand thus operates in consistency with the OECD Guidelines in taxing supplies to final consumers and not taxing supplies to businesses. The zero-rating of supplies in this way "…may allow the supplier to claim back New Zealand GST costs incurred in making zero-rated supplies to GST-registered businesses."[157]

The operation of the rules imposes some complexity and thus compliance costs, considering the need for suppliers to identify the residence of recipients and to treat different recipients differently. The default position is, however, that the non-resident suppliers will regard recipients

[156] Zendi Janse van Rensburg, 'An Explorative Study: Place of Supply Rules for Value-Added Tax in South Africa'. https://repository.up.ac.za/bitstream/handle/2263/23329/dissertation.pdf?sequence=1
[157] *Ibid*

as final consumers unless provided with evidence of GST registration of the recipient. There is some prospect of relief from overly burdensome compliance activities as the Commissioner can agree or prescribe an alternative manner of determining whether the recipient is registered.

European Union

The European Union was the first to implement VAT on e-commerce and had many developments in this area, therefore, the definition of e-commerce established by it is imperative to consider. When the European commission transformed its VAT system, it published a directive which included the definition of e-commerce and example of services covered included the following:

- Online selling of goods and services e.g. travel & tourism packages, books;
- Online information services e.g. magazines;
- Online advertising;
- Online professional services e.g. legal or medical advice;
- Entertainment and other intermediary services.

VAT in the EU is a broad- based consumption tax that applies to taxable goods and services that are bought and sold for use or consumption in the jurisdiction. Exported goods and services to consumers outside of the jurisdiction are not subject to VAT. The EU also has VAT rules applicable to importation of goods and services, which are there to harmonize the European market and its producers against suppliers outside the EU. These rules aim to ensure that amongst other things, EU suppliers compete on level terms with foreign suppliers. EU is made up of various member states or countries and such countries apply different tax rates or percentages. This makes the treatment of VAT difficult. It is also of importance to note that the EU adopted “place of supply” rules (These will be briefly discussed for the purposes of this paper). Generally, VAT on the supply of services is levied at the “place” where the service originates or is supplied. This means that often a service supplier will account for VAT in the country in which they are situated. This is, however, not always the case. There are instances whereby VAT may be accounted in another country than where the supplier is situated. This would be in the case of supply of services connected with entertainment, sports, immovable

property, arts and cultures, etc. The EU has since introduced rules to ensure that VAT levied on services accrues to the country in which they are consumed[158].

Australia

The Australian General Sales Tax ("GST") was introduced in 1999 by "A New Tax System (Goods and Services Tax) Act 1999" (Australian GST Act). The application and the implementation of the GST system was effective from 01 July 2000.

GST *inter alia* applies to the following type of taxable supplies:

- Goods and services: The Australian GST Act provides that a supply is taxable when it is made in the course of carrying on of an enterprise, for a consideration, by an entity which is or required to register for GST in Australia.
- Importation: This relates to the importation of tangible goods into Australia.
- Reverse charge: This relates to supplies of an intangible nature i.e. services, which are supplied to recipients situated in Australia for consideration and are acquired by the recipient solely or partly for the purposes of carrying on an enterprise in Australia.

The Australian GST Act also provides for GST free supplies, which include goods and/or services that are exported or supplied to recipients situated outside of Australia. This makes the Australian GST Act destination based. GST is levied on goods or services which are consumed within its jurisdiction and that is guarded by place of supply rules. Australia favours EU's place of supply rules.

Under the Australian GST Act, for a taxable supply to be treated as such, it is required to satisfied certain elements. One of the most important elements is the "actual connection". The place of supply rules are therefore incorporated to look at when a supply or goods or services is "actually connected" to Australia. This essentially means that a supply or importation of goods or services becomes taxable as soon as a connection or link to Australia can be established and GST will *generally* become payable. Any supply of intangible nature is "connected" with

[158] Zendi Janse Van Rensburg, 2011. An Explorative study: Place of Supply rules for Value Added Tax in South Africa. University of Pretoria (Thesis: MCom: Taxation). http://upetd.up.ac.za/thesis/submitted/etd-03192012-163350/unrestricted/dissertation.pdf. Accessed on 13 October 2019

Australia if such a supply is performed in Australia or is made through an entity that carries on an enterprise in Australia. The connection can be wholly or in part.

COMPARISON

The VAT rules governing inbound digital supplies vary among the sample jurisdictions.[159] These rules constitute a range of approaches:[160] European Union, on the one end of the spectrum, relies on the general VAT rules governing traditional supplies, while New Zealand, on the other end, makes use of detailed, inclusive and targeted rules that not only require registration of foreign inbound digital suppliers, but also ensure that such foreign suppliers do not incur irrecoverable VAT.[161]

The two popular methods ensuring the application of the destination principle to inbound digital supplies is either the traditional reverse charge mechanism or the more recent requirement that the foreign supplier should register for VAT in the jurisdiction of consumption.[162]

All four sample countries provide for the reverse charge mechanism.[163] For both EU and SA this mechanism is required for inbound digital supplies to final consumers. These consumers include both private individuals and businesses.[164] In SA the reverse charge mechanism is only required if the foreign digital service provider is not required to register. In both Australia and New Zealand, the reverse charge mechanism is only required of GST-registered businesses in receipt of partially creditable supplies.[165]

The requirement that the foreign inbound digital supplier has to register in the country of consumption was first required by SA in 2014.[166] This requirement has only recently become

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[159] *Ibid*
[160] *Ibid*
[161] *Ibid*
[162] *Ibid*
[163] DLA Piper Global VAT guide, 'Cross Border Supplies Of Intangible Services, Rights And Digital Content'. https://www.dlapiper.com/~/media/Files/Insights/.../Global_VAT_Guide_2015.pdf
[164] *Ibid*
[165] *Ibid*
[166] Deborah Patience Beelders, '*Value Added Tax – Place Of Supply And The Taxation Of Electronic Cross Border Supplies Of Services And Intangibles*'. April 2015. Accessed at: https://open.uct.ac.za/bitstream/handle/11427/16574/thesis_com_2015_beelders_deborah_patience.pdf;sequence=1

applicable in New Zealand (on 1 October 2016) and will only apply to Australia in 2017.[167] This registration requirement is usually accompanied with a specific definition that demarcates the application of this requirement.[168] These definitions could be very broad, such as the one in Australia that includes everything other than goods or real property, or the definition applicable in New Zealand that is also very wide and that distinguishes between digital and non-digital supplies with examples only meant to clarify and not to limit. The definition in SA is more limited and constitutes a finite list, with different headings, that does not include all intangibles.[169]

The requirement for the foreign inbound digital supplier to register is usually also only applicable to inbound digital supplies supplied to residents of the jurisdiction of consumption.[170] SA and New Zealand require an objective test to determine the residency of the consumer.[171] In SA, a "two of three item"-test ensures residency and in New Zealand a "two of six item"-test does the same. Australia's test is more subjective and requires the foreign digital supplier to have reasonable belief that the consumer is an Australian resident.[172]

The registration of foreign inbound digital suppliers will only result in a net inflow of VAT in a specific jurisdiction to the extent that the supplies are made to final consumers.[173] In acknowledging this fact, both Australia and New Zealand require such registration only for supplies to final consumers.[174] SA neither distinguishes between inbound digital supplies in a business context (B2B) nor between final consumers (B2C), requiring both to register.[175]

- A threshold for registration is allowed for all four countries requiring the registration of the foreign digital supplier.[176] Again, Australia and New Zealand are comparable to the

[167] *Ibid*
[168] *Ibid*
[169] *Ibid*
[170] *Ibid*
[171] *Ibid*
[172] *Ibid*
[173] OECD, *'Tax Policy Reforms 2018'*. Accessed at: https://big.assets.huffingtonpost.com/athena/files/2018/09/05/5b8f7b10e4b0cf7b003add7e.pdf
[174] Kathryn James* and Thomas Ecker, *'Relevance of the OECD International VAT/GST guidelines for non-OECD countries'*. Accessed at: https://www.pc.gov.au/__data/assets/pdf_file/0019/221419/sub028-collection-models-attachment.pdf
[175] *Ibid*
[176] OECD, *'Electronic Commerce: Taxation Framework Conditions, A report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference "A Borderless World: Realising the Potential of Electronic Commerce"'*, 7-9 October 1998.

extent that both allow the same threshold to both local and foreign suppliers.[177] In SA, the vast discrepancy between the threshold for local and foreign businesses (R50 000 vs R1 million) could be a token.

CONCLUSION

VAT generally follows the destination-based principle and will apply where the consumption occurs. We've established that applying the destination principle to services and intangibles a challenge due to the difficulty in identifying the jurisdiction of consumption.

In Australia the connection between the goods or services which are supplied is important. In terms of the place of supply rules, such a connection can give rise to a taxable supply or importation. In New Zealand the "residence" is seen to be important to determine where the supply took place. Imported intangibles in New Zealand is given effect through taxation based on the "residence" of the recipient of the supply. This is used as a proxy for the place of consumption of the cross-border intangible supply. A diverse set of characteristics is used in order to establish the residence of the recipient of the supply.

The European Union has to reside overdifferent treatment or application by each member state; however, the principles remain the same . We've established that these jurisdictions are different in their own rights and apply different treatments, however, similarities were observed in each of their legislations. New Zealand and Australia have a high match in similarity, while the EU is low. We've also seen that all 3 jurisdictions have adopted place of supply rules, while South Africa has not at this stage.

[177] *Ibid*

CHAPTER 5: CHALLENGES CONCERNING VAT ON ELECTRONIC SERVICES

Introduction

VAT as a structure works in harmony when the registered VAT vendor and consumer reside in the same country. However, in cases where the service provider and recipient of services are situated in different countries, challenges are often experienced. Domestic tax rules in one country often differ in comparison to another country. This is due to the different VAT treatment imposed by different countries on certain supplies, which can often result in double taxation or no taxation of that supply.[178] The implementation of VAT on e-commerce comes with challenges, this chapter will focus on those possible challenges in detail, which is something that may be of interest prior to the implementation and application of the amended e-services regulations.[179]

The world we live in has become small and borderless. The purchase of a product anywhere in the world is a "click" away and that has made it difficult to define where income is earned, where and when a product is purchased. This borderless nature has made it a challenge to determine which country has taxing rights to a supply.

Taxation of cross-border e-services transactions often leads to tax administration difficulties, however, due to the increasing number of electronic and digital content purchase from foreign service providers, tax legislation needs to be put in place to govern electronic commerce (e-commerce).[180]

E-commerce comes with its own challenges which includes; identification of taxpayers involved and their taxing jurisdiction; ensuring appropriate records are created and overall effective collection of taxes. In this chapter we will identify and discuss possible challenges that countries may experience relating to taxing cross-border e-commerce transactions.[181]

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[178] OECD, List of OECD Member countries – Ratification of the Convention on the OECD. Available at http://www.oecd.org/about/membersandpartners/list-oecd-member-countries.htm.
[179] EY. 2016. *Digital developments of indirect tax*. Online. Available from: http://www.ey.com/Publication/vwLUAssets/ey-digitaldevelopments-map-indirect-tax-april-2016/$FILE/ey-digital-developments-map-indirect-tax-april-2016.pdf.
[180] *Ibid*
[181] Canada Revenue Agency. 2016. GST/HST and e-commerce. Online. Available at: http://www.craarc.gc.ca/tx/bsnss/tpcs/cmm/gst-tps/menu-eng.html

Here are the most common tax challenges which were identified by various countries, in respect of cross-border electronic services, which will be considered in this chapter:

·Verifying the details of a transaction;

· Identifying the parties to a transaction;

· Determining the permanent establishment; and

· The erosion of the tax base.

Verifying the details of a transaction

Tangible goods purchased internationally can be easily verified and traced through source documentation that contain specific information relating to the product. Information such as the date, seller, buyer, value, etc leave a verifiable trail which cannot easily be altered and is reliable for audit. However, e-services have an intangible and unidentifiable character that cannot be easily traced. E-services supplies can be carried out without source documentation i.e. papers, contracts, workplace offices, etc. This makes it a challenge for the tax authorities to keep track of the supply and to ultimately audit such supply for tax compliance.[182]

In the paper environment information about the taxpayer and parties involved are usually found in the financial records and other paper trail relating to a supply. Tax authorities can also liaise with financial institutions and/or state institutions to attain detailed information on a taxpayer or supply. This is because a physical sale or purchase of an item attracts completion of forms and the provision of personal information. In most cases the information provided is usually verified by an official and the parties involved seal the deal through their signatures.[183]

However, many online shoppers are not comfortable with providing their personal information to a website. Online shoppers would rather use a website that does not require personal information

[182] Bristol, M. A. 2001. The impact of electronic commerce on tax revenues in the Caribbean community. http://www.caricom.org/jsp/community/cota/ecommerce _ tax_revenues_bristol.pdf Date accessed: 01 December 2018.

[183] Krensel, A. 2005. VAT Taxation and E-commerce –under special consideration of the 6th EU VAT Directive. University of Cape Town. (Thesis: Faculty of Law). http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.102.8607&rep=rep1&type Date accessed: 01 December 2018.

or alternatively provide with false and inaccurate information. Since this information cannot be readily verified by an official, it's usually not reliable to use.

Electronic supply of services can also lead to legal challenges because electronic records are prone to alterations and forgery and in most cases, it may be without trace. This paper agrees that non-electronic records can also be altered and forged, however, evidence of such forgery can be picked up. This paper also understands that due to technology advancement, taxpayers prefer computerised record keeping. Furthermore, it's understandable that the sale of goods and services nowadays commences and finishes electronically for both local and foreign supplies. Therefore, this is not a debate of which system (paperless vs physical records) is better, but merely a discussion of challenges faced in a paperless environment, particularly, on the supply of e-services.[184]

In overall, tax authorities must have assurance that a source document is authentic and is what it says it is, and not subject to forgery of the essential content. One of the dangers with paper lessness is that a customer can alter the documentation in such a way that minimal tax or VAT is paid to authorities; for example, editing a tax invoice or contract to overstate or understate figures. It is imperative that tax authorities conduct thorough verification of the parties involved, authenticity of the supply and its origin in order to determine the relevant tax legislation applicable.

Identifying the parties to a transaction

It is relatively easy to remain anonymous when making online transactions. This is one of the challenges as it results in a disconnect between the activities taking place on the internet and the parties involved. It is common of people to replace their identities with just email addresses, making it even more difficult to identify the party and trace their location. In VAT it is important to determine where the e-services transaction has taken place and between whom.

The information obtained from the source documents of the e-service transactions should contain information relating to the identification of the parties and their location. By determining the location, one can determine the tax treatment of supply and possibly applicable legal provisions.

[184] Jain, N. 2013. Tax evasion: A dark side of e-commerce. *International Journal of Engineering and Management Research,* 3(5).

Taxation of online sales of intangible supplies is a challenge, especially when a party can use fabricated names and complicated networks to hide their location.[185]

With such challenges the enforcement of compliance and levying of VAT can be difficult, more especially in situations where tax authorities cannot obtain access verifiable to financial records, buyer & seller information and their respective locations. This poses a real threat to national tax bases and creates an imbalanced playing-field for other businesses.

It is well-defined that online transactions can easily hide the identity of the user and their location. Without accurate information of the user and their location, levying VAT can prove difficult and could lead to disputes between taxing jurisdictions (double taxation). Being able to identify the parties of the transactions, it's easy to determine who must bear the liability to pay the VAT due.[186]

Permanent establishment

Technology has taken down all the silos as a result of geographical borders and created a single, big global market. Trading in the international space has become so instant and convenient. The location of the service provider and the consumer has become less significant.

E-services transactions are carried out without any consideration to geographical barriers and this makes them invulnerable to customs inspection when transferred from one country to another. Parties engaging in e-services could be situated anywhere in the world, this means that there's a possibility that such services can be supplied from conflicting or unknown locations. Conflicting locations are seen in a case where a company has an online establishment and a physical establishment in different locations.[187]

A company can trade using an online establishment through a server located somewhere in Europe, while it has a permanent establishment in Africa. In this instance, determining the taxing

[185] Fridensköld, E. 2004. VAT and the Internet: The application of consumption taxes to ecommerce transactions. *Information & Communications Technology Law,* (13:2): 175-203. Date accessed: 02 December 2018.

[186] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. *International Review of Law Computers & Technology,* 16(1): 35-52. Date accessed: 02 December 2018.

[187] Pinto, D. 1999. Taxation issues in a world of electronic commerce. *Journal of Australian Taxation*: 227-280. Date accessed: 02 December 2018.

jurisdiction might be a challenge and it poses a risk of double taxation or no taxation all together. Due to the difficulties experienced when determining permanent establishment, it is easy for service providers to manipulate the system – thereby carrying on the trade activities in multi-jurisdictions, most of which will be out of reach from taxing authorities in other countries.

Interpretation of permanent establishment can lead to uncertainties; however, Article 5 of the OECD Model Tax Treaty provides clarity in that regard. In terms of the model, a permanent establishment is not determined by a mere Internet website (a combination of hardware, software and data) on its own, notwithstanding that the hosting server may under certain circumstances. In terms of the commentary, equipment standing alone could constitute a "fixed place of business". In terms of the commentary, intangible property such as software and data do not have an exact location, it therefore follows that they also cannot have a "place of business", as required by the treaty.[188]

However, a server may under certain circumstances constitute a "place of business" because it is made up of computer hardware which has a specific location. One should however keep in mind that a place of business does not necessarily mean "permanent establishment". A place of business which is used to carry out supplementary/ secondary activities of any business, does not constitute a permanent establishment. It is evident that in terms of the commentary, one of the factors of a permanent establish is the carrying on of the main activities of the enterprise or trade at a location.

The determination of a permanent establishment is not casting stone, this is due to the complex nature of e-services and the difficulty in determining the location of e-services. Without a permanent establishment, it might be a challenge for a country to collect VAT from a specific transaction – also the risk of double taxation is significant.[189]

Erosion of the tax base

Without taxation the government cannot fund its operations, hence the reason why the government is constantly battling the challenges of tax evasion. E-commerce environment is complex by nature and it's even worse when the supplies made are of an intangible nature. Due

[188] Van der Merwe, B.A. 2003. VAT and e-commerce. *South African Mercantile Law Journal*: 15(3): 371-387. Date accessed: 02 December 2018.
[189] *Ibid*

to the significant number of transactions made over the internet, it becomes a challenge for countries to keep track and up to date with global e-services transactions. This often leads to the erosion of the tax base. The erosion of the tax base happens when taxpayers identify gaps and mismatches in tax rules, then come up with tax avoidance strategies to take advantage of those gaps. This usually involves shifting of profits to low or no tax locations[190].

Base erosion does not only apply in direct income tax but consumption tax as well. Given the significant growth of e-commerce – more especially e-services, the erosion of the tax base has raised concern amongst the government. Tax avoidance and/or evasion are not the on only cause of tax base erosion, however, various e-commerce taxation rules from country to country also contribute a fair share. It is the taxation rules of a country that influence purchasing behaviours of consumers as well as business decisions of service providers.

For instance, there are situations whereby a foreign service provider will be exempted from paying tax, while a local supplier is liable for tax, in this case VAT. This would mean that the foreign supplier has an advantage of quoting a competitive and reasonable price as it would be exclusive of VAT. This then creates a perception that foreign suppliers are cheaper than local suppliers thereby making them thrive in the battlefield while paying nil tax.

Every business owner's desire is to reduce their taxes as much as possible, whether direct or indirect. This increases the willingness of such business owners to partake in tax avoidance and tax evasion schemes. This results in businesses wanting to relocate to low or no tax jurisdictions and/or other profit shifting mechanisms, thereby reducing the taxing base and opportunities for tax authorities[191].

Conclusion

VAT on e-services is a complex matter globally, irrespective of the rules that have been implemented to govern the environment. Challenges such being able to identify a physical trail pf a transaction to be able to verify the its details are amongst the many. Reliance on tax invoices

[190] Basu, S. 2008. International taxation of e-commerce: Persistent problems and possible developments. *The Journal of Information, Law and Technology 2008(1).* Date accessed: 03 December 2018.

[191] Bristol, M. A. 2001. The impact of electronic commerce on tax revenues in the Caribbean community. http://www.caricom.org/jsp/community/cota/ecommerce_ tax_revenues_bristol.pdf Date accessed: 03 December 2018.

only can be detrimental to the fiscal as tax invoices can be tampered with. A taxpayer can alter an invoice to their best tax advantage, thereby leading to a tax loss for the state.

The next challenge discussed was the anonymity of the parties. Identification of the relevant tax parties to e-services transactions proves difficult. Parties can easily provide with inaccurate or false information. Identifying the parties to a transaction enables tax authorities to determine the taxing jurisdiction and relevant tax legislation that will be applicable. This interlinked to the principle of permanent establishment. The challenge in determining the permanent establishment is the use of a website – which alone cannot be used to establish the permanent establishment.

In addition to the above, another challenge discussed is the possibility of tax evasion and avoidance which may lead to the erosion of the tax base of a country. The imposing VAT on e-commerce is without its challenges and this can be seen from the previous chapter. Such challenges identified not only affect local businesses but have a global impact, more especially to countries that have adopted and implemented VAT on e-commerce. No country has mastered the systems to this point, many jurisdictions are seen to be adjusting their systems quite often in order to address these challenges. It is wise that South Africa identifies and analysis the challenges and put internal control to safeguard against risks associated with VAT on e-commerce.

CHAPTER 6: CONCLUSION

Overview of the Ottawa tax framework

SA observes the destination principle in terms of which VAT is levied where the goods and services are consumed. It has been easier to have foreign companies who deliver goods and services to SA to register for VAT. However, recent digital economy developments have proven difficult on the basis that electronic services are delivered online and the services providers are dominantly foreign companies.

The OECD organized the Ottawa Taxation Framework in terms of which certain guidelines were development to ensure that countries develop their VAT/GST legislation in a manner that is fair. These guidelines were adopted by SA and as such, some amendments were effected on the definition of 'electronic services'. The SA's definition as per the proposed amendments discussed above see to be broad and do not conform to the guidelines suggested by the OECD in the Ottawa Taxation Framework.

The extent to which SA e-services regulation was amended

National Treasury's perception on the current regulations is that the scope of electronic services that are taxable is significantly limited. Therefore, the amended regulations' intention is to widen the scope so that all 'services' as defined in the VAT Act that are provided electronically can be covered. The proposed, and much wider, definition of electronic services will include '…any services supplied by means of an electronic agent, electronic communication or the internet for any consideration…' but excluding educational services that are regulated by an educational authority in an export country and telecommunications services.

Cloud computing, software supplies, anti-virus, online advertising, broadcasting, gaming, online consulting and training services would all now fall within electronic services. This change of policy is intended to reduce and/or eliminate the risk of distortions in trade between foreign suppliers and domestic suppliers for VAT purposes. Even though the scope has been broadened, no distinction is made between business-to-business and business-to-consumer transactions.

Foreign suppliers of any electronic services to a South African resident who has an address in South Africa and payment originates from a South African bank, then where the value of your

electronic supplies (in terms of the current Regulation) exceeds R50,000 in any 12 month period you will be required to register as a VAT vendor in South Africa and levy VAT on those services.

National Treasury went further and introduced amendments to specifically deal with 'intermediaries' and 'platforms. This means, a supplier that provide electronic services using the electronic platform of another person (an intermediary) that person will be deemed to be the supplier for VAT purposes where that person facilitates the supply of the electronic services and is responsible for, *inter alia*, the issuing of the invoice and the collection of the payment. This, however, excludes intermediaries that are only facilitating payment i.e. pure payment platforms.

The VAT regulations were enacted **on 1 October 2018** and will effectively apply as of **01 April 2019.**

Comparison against developing countries

New Zealand legislation for GST on remote services applies to Business to Consumers supplies. The legislation is focused on taxing consumption in New Zealand on services supplied remotely to consumers directly. Included in these are any services supplied digitally or remotely, including electronic services and remotely provided traditional services like accounting, legal and consultancy work.

By so doing, the playing field is level and remote service suppliers are treated equally, which is not currently the case with the South African legislation. Furthermore, the registration threshold of R50,000 is also believed to be little compared to what other countries require for suppliers to register for VAT if they are supplying some electronic services in their jurisdiction.

Challenges in e-commerce

This research finds that businesses locally and internationally find the digital space intensely competitive. Due to the vast and competitive nature of the environment, consumers have created a perception that it is reasonably cheaper to acquire electronic services from foreign service providers. This perception is driven by the fact that services acquired from foreign service providers do not fall within the ambit of the South African VAT. It is therefore perceived that they are cheaper options compared to local services whose prices have been inflated by VAT.

This perception has created unfair and unhealthy competition between local and offshore service providers, thereby having an unfavourable effect on the longevity of local supplier businesses. Local service providers normally charge VAT on their services to local consumers and are most likely to be liable to pay corporate income tax to SARS.

On the other hand, foreign service providers of electronic services typically do not have a permanent establishment in South Africa and thus pay no corporate income tax to SARS. In a case where the foreign service providers are not required to charge VAT on their services, the onus will be on the consumer in South Africa to self-account to SARS for the VAT on the services. Due to the lack of knowledge and admirative burden on the consumer for self-accounting of VAT, consumers don't often do it. This leads to cracks on system for VAT to slip through.

Conclusion and recommendation

Following the amendments to the current e-services regulations, many foreign service providers have registered as VAT vendors with SARS. This has resulted to no additional burden, or cost, for the consumer in South Africa to collect and pay VAT over to SARS.

While South Africa has been proactive in terms of seeking to tax the online economy, more work needs to be done to eliminate the gaps, create consistency of treatment and to address the perceptions that foreign is not always cheaper. On this basis, SA should consider amending the definition of 'electronic services' to conform to the guidelines as prescribed by the OECD in the Ottawa Taxation Framework. Lastly, the principles of neutrality and efficiency should be observed to ensure that the definition does not deter any possible revenue stream from foreign companies.

This research identified that the current South African VAT legislation has weaknesses that need to be considered when the Minister of Finance's proposed amendments are implemented. There is room for additional research in future to determine the impact on the South African economy and feasibility of the new rules in practice. Suppliers of electronic services will face various compliance challenges, administrative burden and technical challenges resulting from system changes to cater for the amendments.

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