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University of the Witwatersrand
School of Accountancy, Johannesburg

A research report to be submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Commerce (Specialising in Taxation); March 2016.

Application of South African VAT on e-commerce transactions

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Date : 31 March 2016

I declare that **the Application of South African VAT on e-commerce transactions** is my own work and that all the sources I have used or quoted have been indicated and acknowledged by means of complete references.

N.J. Xaba Date: 31 March 2016

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"*Teachers open the door, but you must enter by yourself."* -- Chinese Proverb

1. ABSTRACT

Technological advances have had a major impact on traditional retail shopping changing it from a physical undertaking to a completely new experience where consumers buy digital media online. This report identifies that e-commerce is growing annually and has a significant impact on the South African economy. VAT systems that do not specifically provide for, or which have not been adapted to cope with, technology-driven advances, generally do not provide for the adequate levying and collection of VAT on e-commerce of goods and services imported. The South African VAT system is no different. The taxation of e-commerce should not artificially advantage or disadvantage e-commerce over comparable traditional commerce, or unnecessarily hinders the development of e-commerce.

Therefore, the development and implementation of VAT on e-commerce transactions in New Zealand (New Zealand was chosen because Value-Added Tax Act, 1991 (Act No. 89 of 1991) ("VAT Act") and its principles were adopted from New Zealand and New Zealand is more developed than South Africa in terms of cost of living comparison per indices) were researched and discussed in this report to obtain an understanding of the similar current VAT systems in New Zealand. The report determines whether the South African VAT Act 89 of 1991 in its current form, can be applied adequately to raise and collect VAT on e-commerce transactions such as goods and services imported to South Africa.

It was identified during the research that there are still shortcomings in the VAT Act on e-commerce transactions. The challenges range from the anonymity of the parties to the identification of the permanent establishment of the supplier and lacking a place of supply rules which often creates uncertainty about whether a product is subject to VAT, which are discussed in detail. These challenges can lead to tax evasion and the erosion of a country's tax revenue base.

2. KEYWORDS

B2B transactions; B2C transactions; Banker-customer confidentiality; Electronically supplied services; Exempt supplies; Fractionated VAT; Goods and services; Payment method; Place of consumption; Place of supply; Taxable supplies; Time of supply; Value Added Tax; Value of supply; Voucher; Webpage; Website; Representative taxpayer; BIT-rate tax; blocked VAT account; consumption taxes; Cross-border digital trade; destination principle; digital technology; electronically supplied services; European Union; exempt supplies; fractionated VAT; General Sales Tax; goods and services; intangible goods; multi-purpose voucher; OECD; origin principle; payment method; place of consumption; place of supply; real-time VAT; reverse-charge mechanism; self-assessment; single-purpose voucher; standard rated supplies; tangible goods; taxable entity; taxable supplies; time of supply; use-and-enjoyment principle; utilised and consumed; Value Added Tax; value of supply; VAT collection model; vendor registration; voucher; webpage; website; withholding tax; zero-rated supplies; representative taxpayer; tax free.

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3. CHAPTER 1

3.1 INTRODUCTION

In the early commercial exploitation of inter-connected digital computers in the early 1980s, no-one expected the growth explosion it experienced in the latter part of the decade. It has been clear that man would enter an era of 'the connected world' However, it was not until 24 October 1995 that the Internet was formally defined

"as the global information system that -- (i) is logically linked together by a globally unique address space based on the Internet Protocol (IP) or its subsequent extensions/follow-ons; (ii) is able to support communications using the Transmission Control Protocol/Internet Protocol (TCP/IP) suite or its subsequent extensions/follow-ons, and/ other IP-compatible protocols; and (iii) provides, uses or makes accessible, either publicly or privately, high level services layered on the communications and related infrastructure described herein."[1]

Since its inception, the Internet has continued to expand in use, size, reach, and impact. E-commerce is one of the fastest growing retail sectors in the global economy[1]. There is no question that e-commerce is here to stay as an integral component to a successful retail sales strategy. The growth of internet has reached the point where the society can no longer imagine an existence without the Internet[2]. It is estimated that the world's Internet population will increase to three billion users by 2016[3]. This growing phenomenon is not restricted to developed countries. Developing G-20 countries already have 800 million Internet users 80% of whom use the Internet

[1] http://www.patc.co.za/accounting-services/tax/vat-value-added-tax/ [Accessed on 19 November 2015]

[2] http://www.numbeo.com/cost-of-living/compare_countries_result.jsp?country1=New+Zealand&country2=South+Africa [Accessed on 19 November 2015]

[3] A Green Paper on Electronic Commerce for South Africa, www.ecomm-debate.co.za

to access social networks[4]. The introduction of mobile devices such as smart phones, tablets, and notebooks will dramatically influence the expansion of the Internet in developing countries. Retailers, service providers, and governments cannot afford to ignore the rapid impact the use of Internet applications has on society.[5]

The South African retail industry has seen a vigorous upturn in online sales and online business since the commercial exploitation of the Internet was introduced. From 2000 to 2009, South Africa's Internet population grew from 5,5% to 10,8% of the total population[6]. In 2011, online shopping accounted for 1,9% of the South African economy[7]. Online shopping is expected to account for at least 2,5% of South Africa's total economy by 2016[8]. With conventional retailers investing in online shopping, it is anticipated that an increasing number of Internet users is likely to use the Internet for online shopping, banking, and e-billing[9].

Technological advances have had a major impact on traditional retail shopping changing it from a physical undertaking to a completely unique experience where consumers buy digital media online. In a society where digital media is readily available, it is trite that consumer behavior will ultimately adapt to a digitised world. Digital files are entirely intangible, and the transfer of these

[4] Leiner BM, Cerf VG, Clark DD, Kahn RE, Kleinrock L, Lynch DC, Postel J, Roberts LG, Wolf S A Brief History of the Internet http://www.internetsociety.org/internet/internet-51/history-internet/brief-history-internet [Accessed on 19 November 2015].

[5] Leiner BM, Cerf VG, Clark DD, Kahn RE, Kleinrock L, Lynch DC, Postel J, Roberts LG, Wolf S A Brief History of the internet http://www.internetsociety.org/internet/internet-51/history-internet/brief-history-internet [Accessed on 19 November 2015].

[6] www.europa.eu.int/comm/taxation_customs/taxation/ecommerce/vat_en.htm [Accessed on 19 November 2015].

[7] Dean D, DiGrande S, Field D, Lundmark A, O'Day J, Pineda J, Zwillenberg P (2012) The Internet Economy in the G-20 http://www.internetsociety.org/internet/internet-51/history-internet/brief-history-internet [Accessed on 19 November 2015].

[8] https://www.google.co.za/?gfe_rd=cr&ei=CtXFVujhI4ep8wfZ_L-4Cw&gws_rd=ssl#q=bank+of+america+e+commere [Accessed on 19 November 2015].

[9] Dean D, DiGrande S, Field D, Lundmark A, O'Day J, Pineda J, Zwillenberg P (2012) The Internet Economy in the G-20https://www.bcgperspectives.com/content/articles/media_entertainment_strategic_planning_4_2_trillion_opportunity_internet_economy_g20/ [accessed on 19 November 2015].

files from one device to another can be effected through the Internet or Bluetooth technology[10]. No physical presence or physical form of delivery is required.

In September 1991, South Africa replaced its general sales tax (GST) with a consumption-type VAT[11]. It is an indirect tax based on consumption in the economy. Value Added Tax (VAT) systems were designed in an era pre-dating digital technology and the Internet[12]. The current VAT system is guided by current tax policy, tax administration, constitution and the bill of right for its meaning and application. If any of these are inadequate, any statute of the VAT act that contradicts with constitution will be invalid. As a result, VAT systems that do not specifically provide for, or which have not been adapted to cope with, technology-driven advances for goods and services imported to South Africa through e-commerce, generally do not provide for the adequate levying and collection of VAT on these e-commerce transactions. The South African VAT system is no exception.

This research report will determine whether the VAT Act in its current form can be used effectively to raise and collect VAT on e-commerce transactions. Where shortcomings in the VAT Act are identified, a recommendation for a possible solution will be made. The principal deficiency in modern VAT systems is their inability to levy VAT on affected transactions through a simplified collection mechanism that does not overburden taxable entities charged with VAT collection on e-commerce transactions, or is not inefficient from an economic point of view. The inadequacies of the reverse-charge and registration mechanisms will be discussed with a view to proposing a modern technology-driven VAT collection mechanism to be applied by financial institutions, where banks collect VAT on e-commerce transactions.

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[10] Mawson N (2012) SA's Internet Economy to Double http://www.itweb.co.za/index.php?option=com_content&view=article&id=52797:sas-internet-economy-to-double&catid=69[accessed on 19 November 2015].

[11] http://www.patc.co.za/accounting-services/tax/vat-value-added-tax/ [Accessed on 19 November 2015].

[12] Mawson N (2012) SA's Internet Economy to Double. http://www.itweb.co.za/index.php?option=com_content&view=article&id=52797:sas-internet-economy-to-double&catid=69[accessed on 19 November 2015].

3.2 RESEARCH QUESTION

This research report attempts to answer the following questions:

In what respects are the current South African VAT Act provisions in comparison to OECD, European Union and New Zealand VAT Act provisions (as one of the closest VAT ideal models in adopting VAT on e-commerce transactions)[13] applicable in respect of imported goods and services to South Africa inadequate?

To address the report's question above, the following research sub questions are applicable:

- What is meant by e-commerce transaction in respect of both goods and services imported to South Africa?
- What are the current and specific VAT Act provisions which are applicable to e-commerce transactions in respect of both goods and services imported to South Africa?
- What are the current and specific VAT Act provisions that are applicable to e-commerce transactions in respect of both goods and services imported to OECD, European Union and New Zealand? And
- In what aspects the comparison between the South African and the OECD, European Union and New Zealand VAT Act provisions indicates inadequacies in the application of South African VAT Act provisions to e-commerce transactions in respect of both goods and services imported to South Africa?

3.4 METHODOLOGY OF THE REPORT

The research is qualitative and desk based encompassing a literature study drawn from legislation, text books, professional subject journals and publications by government departments. The report shall also make use of reliable internet sources. This comparative report will be limited to the application of modern VAT system that exists in OECD, European Union and New Zealand (since

[13] http://www.patc.co.za/accounting-services/tax/vat-value-added-tax/ [Accessed on 19 November 2015].

manageable.

South African VAT Act was adopted based on OECD, European Union and New Zealand models); this will be reviewed on a high level to keep the scope of this inquiry

It should be noted that digital technology is constantly changing and expanding and possibilities are endless. For this reason, certain of the solutions, ideas and scenarios might seem futuristic or unrealistic.

3.5 CHAPTER OUTLINE

3.5.1 Chapter 1

Introduction, research question and research methodology

The objective of this chapter is to introduce the research topic, set out the research question and the research methodology.

3.5.2 Chapter 2

What is meant by e-commerce transaction in respect of both goods and services imported to South Africa?

The objective of this chapter is to examine the definition of e-commerce found in section 1 of the South African VAT Act, and Section 95(1)(a) of the Taxation Laws Amendment Act, 2014 read with minister's regulations to identify which type of transactions are regarded as e-commerce transactions. This chapter will examine in detail, the comparison between the South African and the OECD, European Union and New Zealand definition of e-commerce traction to indicate inadequacies in the South African definition of e-commerce.

3.5.3 Chapter 3

What are South African current and specific VAT Act provisions applicable to e-commerce transactions?

The objective of this chapter is to examine the current and specific South African VAT Act provisions applied and to highlight what weaknesses exist in the current VAT Act in respect of e-commerce transactions relating to both goods and services imported to South Africa**.**

3.5.4 Chapter 4

The comparison of South African and of OECD, European Union and New Zealand VAT Act provisions

The objective of this chapter is to compare the current South African VAT Act provisions to OECD, European Union and New Zealand VAT Act provisions which are applicable to e-commerce transactions in respect of goods and services imported to OECD, European Union and New Zealand. The above-mentioned comparison will indicate what aspects of the South African VAT Act provisions which are applicable to e-commerce transactions that are inadequate in respect of both goods and services imported to South Africa.

3.5.5 Chapter 5

Summary, conclusion and recommendations

This chapter will provide a summary of the findings from Chapters 2, 3, and 4 with regards to what respect in which the current South African VAT Act provisions are applicable to e-commerce transactions in respect of imported of goods and services are inadequate? In this chapter, recommendations will be made for the amendment of the current South African VAT legislation to provide an improvement in taxing of e-commerce transactions in respect of goods and services imported to South Africa.

CHAPTER 2

2.1. Definition of electronic commerce transactions

2.1.1 Introduction

The electronic transmission of images of certain products such as newspapers, magazines, reference material and photographs, and the downloading of computer software and recorded music, are becoming increasingly popular[14]. The rapid growth in both the number of people who use the Internet and its commercial applications has been stimulated by technological innovations and their diffusion[15]. It was identified early that electronic commerce transactions had the potential to be one of the great economic developments of the 21st century. The information and communication technologies, which underlie this new way of doing business, opened opportunities to improve global quality of life and economic wellbeing. Electronic commerce transactions had the potential to spur growth and employment in industrialised, emerging and developing countries.[16]

This above statement was proved correct. At the end of 2010, 6.8 million South Africans were using the Internet; but by the end of 2011, that figure had increased to 8.5 million; and by the end

[14] Hargitai, C. 2001. Value added taxation of electronic supply of services within the European Community. http://centers.law.nyu.edu/jeanmonnet/archive/papers/01/013301-03.html#P341_76626 Date accessed: 7 August 2015.

[15] OECD (Organisation for Economic Co-operation and Development). 2000b. Ecommerce: Impacts and policy challenges. Date accessed: 21 August 2015.

[16] Committee of Fiscal Affairs. 1998. Electronic Commerce: Taxation Framework Conditions. Date accessed: 10 August 2015.

of 2012, it was estimated to topple the 10-million mark[17]. Below indicates the growth that Internet sales in South Africa experienced from 1996 until 2011.

The sales of digital goods increased during the last few years in the European Union following the same trend as experienced in South Africa. When comparing the spending growth in the European Union against the spending growth of South Africa, it can be noticed that there is a parallel in the trend of the graphs[18]. The sales growth rates for digital goods have exceeded the traditional dispatch of physical goods by a wide margin during the last number of years in the European Union, and this trend is expected to continue[19]. When analysing below, it will be noted that, as the sales of the traditional dispatch of goods decreased, the sale of digital goods increased in the last years. The global digital and non-digital spending growth has shown a downward trend from 2006 until 2009. However, after 2009, global digital spending has started to grow again, whereas the non-digital spending had remained more or less constant[20].

In order to address the objectives of the dissertation, firstly an understanding of e-commerce should be obtained. The definition of e-commerce should be investigated as well as the components it can be classified into in order to obtain a better understanding of e-commerce. Secondly, after an understanding of e-commerce has been obtained, the research will go further and analyse how other countries have implemented VAT on e-commerce transactions. The term e-commerce has

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[17] Meahl, B. 2012. Insight on: E-commerce & collaboration. http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=14&ved=0CEQQFjADOAo&url=http%3A%2F%2Fwww.deliveringtomorrow.com%2Fwpcontent%2Fuploads%2F2012%2F11%2Finsighton_ecommerce_and_collaboration.pdf&ei=4vUoqBIWyhAes6oDIAQ&usg=AFQjCNF44mF5ExdTnNupJZ_0yEF0joeicg&sig2=9wPy4Z-CK-WbRr7AOpzivQ Date accessed: 11 September 2015.

[18] European Parliament. 1999. Electronic commerce and tax base erosion. http://www.europarl.europa.eu/RegData/etudes/etudes/join/1999/168015/DG-4-ECON_ET(1999)168015_EN.pdf Date accessed: 27 November 2013.

[19] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

[20] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

no widely accepted definition[21]. The definitions differ significantly depending on the various authors and sources. Some include all financial and commercial transactions that take place electronically; including electronic data interchange (EDI), an electronic fund transfers (EFT) and all credit/debit card activities. According to others, electronic commerce transactions are limited to retail sales to consumers for which the transaction and payment take place on open networks such as the Internet[22]. E-commerce transactions are also defined by Turban and King (2003) as the use of the Internet and the web to transact business. However, electronic commerce can also be defined in more detail as essentially the undertaking of normal commercial, government Non-Digital Expenditure Growth Digital Expenditure Growth and personal activities by means of computers and telecommunications networks and includes a wide variety of activities involving the exchange of information, data or value based exchanges between two or more parties[23]. The differences in the above definitions are mainly attributed to the activities in the business environment, applications of e-commerce transactions and communication networks used to construct the definition. Therefore, the definition will differ from one company to another depending on how and where e-commerce transactions are used. There are several existing models that attempt to provide a framework that can be used by parties of a transaction to define or understand the breadth and scope of e-commerce transactions[24]. Therefore, to obtain a better understanding of ecommerce and the definition thereof, one must investigate the different models that have been developed to date to define e-commerce.

[21] OECD (Organisation for Economic Co-operation and Development). 2000b. Ecommerce: Impacts and policy challenges. Date accessed: 21 August 2015.

[22] OECD (Organisation for Economic Co-operation and Development). 1999. Working Party on indicators for the information society. Defining and measuring e-commerce: A status report, 8. http://www.oecd.org/sti/ieconomy/2092477.pdf. Date accessed: 08 August 2015.

[23] Chang, O.H. & Yen, D.C. 2000. Electronic commerce: How should it be taxed? Journal of Contemporary Accounting, 1(1): 89-104. Date accessed: 16 December 2015.

[24] Chang, O.H. & Yen, D.C. 2000. Electronic commerce: How should it be taxed? Journal of Contemporary Accounting, 1(1): 89-104. Date accessed: 16 December 2015.

2.2. Definitions by the OECD, other countries and authors

As indicated in Chapter 1, the VAT system in the European Union is like the VAT system in South Africa. Because the European Union has based its changes to the VAT system on the recommendations made by the OECD, the definitions supplied by the EU and OECD will be considered and compared to the South African version. The OECD is involved in the forming of a framework for the taxation of e-commerce, therefore the definition the OECD has formed will be analysed. Another VAT system that was identified to be like the South African and European VAT systems is the system implemented in New Zealand.

The New Zealand GST system is considered superior to the EU VAT system in tax literature[25]. Therefore, consideration will also be given to how New Zealand is defining e-commerce for VAT purposes.

2.2.1. Organisation for Economic Co-operation and Development

The roots of the organisation go back to the rubble of Europe after the Second World War[26]. The Organisation for European Economic Co-operation (OEEC) was established in 1948 by 18 European countries to run the US-financed Marshall Plan for reconstruction of a continent ravaged by World War II[27].

George C Marshall, regarding the US Financed Marshall Plan, stated: "It is logical that the United States should do whatever it is able to do to assist in the return of normal economic health in the

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[25] Copenhagen Economics. 2013. VAT in the public sector and exemptions in the public interest. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector_exemptions_en.pdf Date accessed: 12 September 2013.

[26] Anon. 2013. VAT on electronic services - The new legislation http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/ Date accessed: 16 June 2015.

[27] OECD (Organisation for Economic Co-operation and Development). 1999. Working Party on indicators for the information society. Defining and measuring e-commerce: A status report, 8. http://www.oecd.org/sti/ieconomy/2092477.pdf. Date accessed: 08 August 2015.

world, without which there can be no political stability and no assured peace. Our policy is directed not against any country or doctrine but against hunger, poverty, desperation, and chaos[28]. Determined to avoid the mistakes of their predecessors in the wake of the First World War, European leaders realised that the best way to ensure lasting peace was to encourage co-operation and reconstruction, rather than to punish the defeated[29]. By making individual governments recognise the interdependence of their economies, it paved the way for a new era of co-operation that was to change the face of Europe[30]. Encouraged by its success and the prospect of carrying its work forward on a global stage, Canada and the US joined OEEC members in signing the new Organisation for Economic Co-operation and Development (OECD) Convention on 14 December 1960.

The OECD was officially born on 30 September 1961, when the Convention entered into force to create an organisation dedicated to global development[31]. The OECD uses its wealth of information on a broad range of topics to help governments to foster prosperity and fight poverty through economic growth and financial stability. It also ensured that the environmental implications of economic and social development are considered. The work is based on the continued monitoring of events in member countries as well as outside the OECD area, and includes regular projections of short- and medium-term economic developments.[32]

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[28] Marshall, G.C. 1947. The "Marshall Plan" speech at Harvard University. http://www.oecd.org/general/themarshallplanspeechatharvarduniversity5june1947.htm Date accessed: 5 October 2015.

[29] Anon. 2011. What is the OECD? The Telegraph http://www.telegraph.co.uk/finance/economics/8689078/What-isthe-OECD.html Date accessed: 5 October 2015.

[30] OECD (Organisation for Economic Co-operation and Development). 1999. Working Party on indicators for the information society. Defining and measuring e-commerce: A status report, 8. http://www.oecd.org/sti/ieconomy/2092477.pdf. Date accessed: 08 August 2015.

[31] OECD (Organisation for Economic Co-operation and Development). 1999. Working Party on indicators for the information society. Defining and measuring e-commerce: A status report, 8. http://www.oecd.org/sti/ieconomy/2092477.pdf. Date accessed: 08 August 2015

[32] OECD (Organisation for Economic Co-operation and Development). 1999. Working Party on indicators for the information society. Defining and measuring e-commerce: A status report, 8. http://www.oecd.org/sti/ieconomy/2092477.pdf. Date accessed: 08 August 2015

It was identified that electronic commerce transactions cause tax problems primarily when they cross boundaries between taxing jurisdictions, for example between members of the EU or between members and other nations[33]. While the evolution of electronic commerce transactions raises issues in the application of traditional consumption tax rules, these issues are compounded by the potential for different implementing legislation in individual countries[34]. Differences in the treatment of cross-border supply of services and intangibles across countries have become more tangible, with a resulting need to address them to prevent double taxation and unintended double non-taxation.[35]

Therefore, the OECD and the Government of Canada jointly organised a Ministerial Conference on Electronic Commerce in Ottawa from 7 to 9 October 1998[36]. For the first time at an OECD Ministerial event, leaders from national governments (29 member countries and 11 non-member countries), the heads of major international organisations, industry leaders, and representatives of consumer, labor and social interests came together to clarify respective roles, discuss priorities and develop plans to promote the development of global electronic commerce transactions[37]. The issue at the Ottawa conference was how to implement tax policies and procedures without distorting the new and traditional economies. Several approaches were discussed by the OECD's Committee on Fiscal Affairs (CFA).[38]

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[33] McLure Jr, C.E. 2003. The Value Added Tax on electronic commerce in the European Union. International Tax and Public Finance, 10: 753-762. Date accessed:20 June 2015.

[34] OECD (Organisation for Economic Co-operation and Development). 2003c. Implementation issues for taxation of electronic commerce. Date accessed 21 August 2014

[35] Charlet, A. & Buydens, S. 2012. The OECD International VAT/GST Guidelines: Past and future developments. World Journal of VAT/GST Law, (1): 175-184.

[36] Charlet, A. & Buydens, S. 2012. The OECD International VAT/GST Guidelines: Past and future developments. World Journal of VAT/GST Law, (1): 175-184.

[37]Charlet, A. & Buydens, S. 2012. The OECD International VAT/GST Guidelines: Past and future developments. World Journal of VAT/GST Law, (1): 175-184.

[38] Charlet, A. & Buydens, S. 2012. The OECD International VAT/GST Guidelines: Past and future developments. World Journal of VAT/GST Law, (1): 175-184.

Ministers also welcomed the report: Electronic Commerce: Taxation Framework Conditions, and endorsed the proposals on how to take forward the work contained in it[39]. The OECD has suggested that because of inherent differences in policy interests and feasibility of definitions, a framework to define various aspects of electronic commerce transactions for different purposes may be the most practical[40]. The OECD has defined an electronic transaction in April 2000 in their Annexure 4 as follow: "An electronic transaction is the sale or purchase of goods or services, whether between businesses, households, individuals, governments, and other public or private organisations, conducted over computer-mediated networks. The goods and services are ordered over those networks, but the payment and the ultimate delivery of the good or service may be conducted on or off-line"[41].

Electronic commerce transactions can therefore be defined as the application of information and communication technology to any of the activities involved in making commercial transactions[42].

2.2.2. European Union

The definition of e-commerce established by the European Union is important to consider as the European Union was the first to implement VAT on e-commerce and had many developments in this area.

Numerous problems occurred in the European Union when the previous system of VAT was applied to Internet transactions. In order to adapt the taxation mechanisms to the needs of e-commerce, several measures have been taken. One of the measures taken was defining e-commerce for VAT purposes. The definition implemented by the EU is investigated because the European

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[39] OECD (Organisation for Economic Co-operation and Development). 2003a. Implementation of the Ottawa taxation framework conditions: The 2003 Report. Date accessed: 21 August 2015.

[40] OECD (Organisation for Economic Co-operation and Development). 2003a. Implementation of the Ottawa taxation framework conditions: The 2003 Report. Date accessed: 21 August 2015.

[41] OECD (Organisation for Economic Co-operation and Development). 2003a. Implementation of the Ottawa taxation framework conditions: The 2003 Report. Date accessed: 21 August 2015.

[42] OECD (Organisation for Economic Co-operation and Development). 2003b. Summary of the methodology for assessing the dynamics and impacts of electronic commerce. Date accessed: 21 August 2015.

Union rule on the taxation of Internet transactions that was passed was in line with the principles of e-commerce taxation developed by the OECD[43].

In the Directive published by the European Commission when transforming their VAT system, the following was included in the definition of e-commerce: "Examples of services covered by the Directive include online information services (such as online newspapers), online selling of products and services (books, financial services and travel services), online advertising, professional services (lawyers, doctors, estate agents), entertainment services and basic intermediary services (access to the Internet and transmission and hosting of information)"[44].

2.2.3. New Zealand

In the literature, the EU VAT system is often compared with the 'modern' GST systems in Australia and New Zealand[45]. Because the New Zealand GST system is considered more modern and superior than the European VAT system[46], the definition provided for e-commerce is important to consider in the current research to achieve a well-rounded conclusion on this matter.

New Zealand, like any other country, has needed to define what is meant by e-commerce transactions and to then decide how it affects the law and how the law affects it[47]. In a paper published by the New Zealand Parliament, the following definition was noted:

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[43] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

[44] European Commission. 2002. Council Directive 2002/38/EC: Amending and amending temporarily directive 77/388/EEC as regards the Value Added Tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services. Date accessed: 24 June 2013.

[45] Copenhagen Economics. 2013. VAT in the public sector and exemptions in the public interest. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector_exemptions_en.pdf Date accessed: 12 September 2013.

[46] Copenhagen Economics. 2013. VAT in the public sector and exemptions in the public interest. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector_exemptions_en.pdf Date accessed: 12 September 2013.

[47] Osborne, R. 1999. Electronic Commerce in New Zealand. E-Commerce Conference. Date accessed: 30 August 2015.

"E-commerce" refers to the buying and selling of goods and services via electronic networks, principally the Internet. Its definition is sometimes expanded to include other aspects of e-business[48].

E-commerce transactions are a generic name for business transactions that are entered into through electronic rather than paper-based means. It is not limited to the commercial use of the internet, although that is an important example of e-commerce transactions[49].

2.2.4. Comparison of the definitions in the OECD, European Union and New Zealand E-commerce transactions essentially mean the undertaking of normal commercial, government and personal activities by means of computers and telecommunications networks and include a wide variety of activities involving the exchange of information, data or value-based exchanges between two or more parties[50]. Based on the above definitions, it appears that none of these definitions are the same, but there are similarities. These definitions make it clear that e-commerce involves the use of computer and telecommunications technologies to improve business processes[51]. It can be noted that the fundamental characteristic of e-commerce is similar[52]. The conclusion that can be drawn from the comparison of the definition is that what distinguishes e-commerce from traditional commercial activity is that it is conducted by electronic means[53].

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[48] New Zealand Parliament. 2001. A layperson's guide to electronic commerce. http://www.parliament.nz/en-nz/parl-support/research-papers/00PLEcoRP01021/alaypersons-guide-to-electronic-co mmerce Date accessed: 22 August 2015.

[49] New Zealand Law Commission. 1998. Electronic commerce: Part One: A guide for the egal and business community. Date accessed: 30 August 2015.

[50] Chan, E. & Swatman, P.M.C. 1999. Electronic commerce: A component model. http://dlibrary.acu.edu.au/staffhome/elchan/pub/1999-1.pdf Date accessed: 22 August 2015.

[51] Chan, E. & Swatman, P.M.C. 1999. Electronic commerce: A component model. http://dlibrary.acu.edu.au/staffhome/elchan/pub/1999-1.pdf Date accessed: 22 August 2015.

[52] Chetcuti, J.P. 2002. The challenge of e-commerce to the definition of a permanent establishment: The OECD's response. http://www.chetcuticauchi.com/jpc/research/oecd-ecommercepermanentestablishment.htm. Date accessed: 9 August 2015.

[53] Chetcuti, J.P. 2002. The challenge of e-commerce to the definition of a permanent establishment: The OECD's response. http://www.chetcuticauchi.com/jpc/research/oecd-ecommercepermanentestablishment.htm. Date accessed: 9 August 2015.

2.3. E-commerce transactions in South Africa

2.3.1. Definition of e-commerce transactions

In the Green Paper on Electronic Commerce for South Africa, the following definition was stated: The use of electronic networks to exchange information, products, services and payments for commercial and communication purposes between individuals (consumers) and businesses, between businesses themselves, between individuals themselves, within government or between the public and government and, last, between business and government[54].

This definition encompasses the many kinds of business activities that are being conducted electronically, and conveys the notion that electronic commerce transactions are much more comprehensive than simply the purchasing of goods and services[55]. After the proposal made in the 2013/2014 budget speech by the Minister of Finance, a Draft Taxation Law Amendment Bill 2013 was published for public comments. In his draft Bill, the following definition for e-commerce was stated: "'E-commerce services' means the supply of any services where the placing of an order and delivery of those services is made electronically"[56]. With the new definition of e-commerce, it is presently unclear whether the definition is intended to apply only to goods ordered and delivered online – such as music, books and clothes – or whether the legislator has a wider application in mind to include, for example, the provision of virtual professional services[57].

2.4.2. Comparison of the South African definition with other countries' definitions

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[54] Department of Communications Republic of South Africa. 2000. A Green Paper on Electronic Commerce for South Africa (16) http://www.info.gov.za/view/DownloadFileAction?id=68917 Date accessed: 06 August 2015.

[55] Department of Communications Republic of South Africa. 2000. A Green Paper on Electronic Commerce for South Africa (16) http://www.info.gov.za/view/DownloadFileAction?id=68917 Date accessed: 06 August 2015.

[56] Minister of Finance. 2013. Draft Taxation Laws Amendment Bill. http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2013-28%20-%20Draft%20Taxation%20Laws%20Amendment%20Bill%202013.pdf Date accessed: 13 September 2015.

[57] Lessing, D., Mazansky, E., Rood, L., McGurk, P. & Malan, D. 2013. 2013/2014 Draft Tax Amendments –international highlights. http://www.werksmans.com/legalbriefs-view/20132014-draft-tax-amendments-internatinal-highlights/ Date accessed: 13 September 2015.

When comparing the new electronic commerce definition of South Africa with the definitions of other countries, it can be seen that they all have a similarity when placing an order. The ordering and delivering of the goods or services are made electronically. However, it will also be noticed that all these definitions include different types of services and goods, and it is left open for interpretation whether goods or services will fall into the definition of e-commerce for specific countries.

It can, however, be argued, although the definitions do not clearly define what goods or services are to be included in e-commerce, that the characteristics will be the same for these transactions. As can be seen from the above, there is no fixed indication of what type of goods and services will be regarded as e-commerce. Different types of e-commerce have already been identified in the models discussed; however, they differed from model to model.

2.5. Goods and services

To be able to understand the VAT implications on e-commerce, it has to be established whether e-commerce will be considered goods or services in terms of the South African VAT Act. The South African VAT Act has different rules with regard to the importation of services and the importation of goods. The classification of digitised products for VAT purposes either as goods or as services has a fundamental effect on the rules that apply to the imposition of VAT on the supply of such services[58].

2.5.1. Goods and services in the European Union

According to the sixth VAT directive, the goods and services can be defined as follow:

'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner.

In addition, each of the following shall be regarded as a supply of goods:

- The transfer, by order made by, in the name of a public authority, or in pursuance of the law, of the ownership of property against payment of compensation;

[58] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

- the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment;
- the transfer of goods pursuant to a contract under which commission is payable on purchase or sale[59].

'Supply of services' shall mean any transaction which does not constitute a supply of goods. A supply of services may consist, inter alia, in one of the following transactions:

- The assignment of intangible property, whether or not the subject of a document establishing title;
- The obligation to refrain from an act, or to tolerate an act or situation;
- The performance of services in pursuance of an order made by, in the name of a public authority, or in pursuance of the law[60].

When looking at the European Union VAT system, the categorisation of the EU-VAT rules of the Sixth Directive into goods or services seems clear, as electronic transactions are delivered digitally, this is classified to be intangible and therefore not in physical form. This corresponds to an EU proposal that for VAT purposes trade in digital goods be treated as a supply of services[61]. It follows that intangible property does not constitute goods, therefore falls within the definition of services[62].

2.5.2. Goods and services in South Africa

When referring to the VAT Act of South Africa for the definition of goods and services, the following was found:

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[59] Council Directive 2006/112/EC of 28 November 2006. Date accessed: 13 September 2014

[60] Council Directive 2006/112/EC of 28 November 2006. Date accessed: 13 September 2014

[61] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[62] Hargitai, C. 2001. Value added taxation of electronic supply of services within the European Community. http://centers.law.nyu.edu/jeanmonnet/archive/papers/01/013301-03.html#P341_76626 Date accessed: 7 August 2015

"Goods" are, inter alia, defined in section 1 as meaning "corporeal movable things, fixed property and any real right in any such thing or fixed property"[63]. From the definition of goods, it seems clear that intangible things such as intellectual property or personal rights will not be regarded as goods for VAT purposes.[64]

"Services" are, inter alia, defined in section 1 as "anything done or to be done, including the granting, assignment, cession or surrender of any right and the making available of any facility or advantage"[65].

This definition of services is very wide and includes almost any perceivable transaction[66]. In South Africa, there is no legislative definition of electronically supplied services for VAT purposes. The VAT Act does not contain a specific provision that determines how digitised goods will be taxed[67]. Ecommerce supplies are therefore deemed services, because they are not considered tangible items[68]. Intangible goods are defined as services for the VAT Act, but that is as far as it goes[69]. The Green Paper on Electronic Commerce[70] for South Africa confirms this view and is in accordance with the OECD's point of view that electronic products should not be classified as goods[71].

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[63] Value Added Tax Act No 89 of 1991. Date accessed: 8 August 2015

[64] Classen, L. 2004. Cyberlaw@SA. 2nd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[65] Value Added Tax Act No 89 of 1991. Date accessed: 8 August 2015

[66] Classen, L. 2004. Cyberlaw@SA. 2nd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[67] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

[68] Alexiou, C. &Morrison, D. 2004. The Cross-Border Electronic Supply EU-VAT Rules: Lessons for Australian GST. Revenue Law Journal, 14(1): 119-150. Date accessed: 22 August 2015.

[69] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile Law Journal, 22: 230-258. Date accessed: 28 August 2015

[70] Department of Communications Republic of South Africa. 2000. A Green Paper on Electronic Commerce for South Africa (16) http://www.info.gov.za/view/DownloadFileAction?id=68917 Date accessed: 06 August 2015.

[71] Classen, L. 2004. Cyberlaw@SA. 2nd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

2.5.3. Summary of e-commerce defined as services or goods

Based on the above definitions and discussions, it could be concluded that e-commerce would be defined as services. This would be in line with the policy implemented in the European Union. In addition, the OECD also proposed to treat digitised products as services when the original framework for taxation on e-commerce was developed[72]. Therefore, for this research, all direct e-commerce would be regarded as services.

2.6. Conclusion

Based on the information discussed in this chapter, certain characteristics of e-commerce were highlighted, as well as how they should be classified. E-commerce will be all transactions conducted via the Internet, in whichever form. Ecommerce can be divided into two types of e-commerce transactions, namely direct ecommerce and indirect e-commerce. The focus of this study will be on direct e-commerce, where all transactions conducted, and delivered are electronically or online. The goods that are delivered will be considered intangible goods. As per the definitions by the European Union and South Africa, intangible goods will be considered a service. Therefore, it will be taxed as a service being imported as per the VAT Act in South Africa. As there is now a clear understanding as to what constitutes e-commerce and what the focus of this research will be, the following chapter will address how different countries are treating VAT on e-commerce.

[72] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

6 CHAPTER 3

6.1 Current South African VAT system and e-commerce transactions

6.1.1. Introduction

A background was obtained in Chapter 2 as to how the European Union and government of New Zealand have implemented VAT on e-commerce. In Chapter 4, the challenges experienced with VAT on e-commerce transactions that were identified by different countries who already implemented VAT on e-commerce transactions were discussed. In this Chapter, the South African VAT system will be analysed to identify weaknesses in the system and to gain an understanding of how e-commerce transactions are treated under the current VAT legislation. This will be done to gain an understanding why the proposal was made by the Minister of Finance and a new Tax Bill is due to be implemented in the future.

6.1.2. Background of South African VAT legislation

In September 1991, South Africa replaced its General Sales Tax (also known as GST) with a consumption-type value added tax (VAT)[73]. The South African VAT system resembles the New Zealand model[74], as the South African VAT Act was based on the principles of the New Zealand GST system. South Africa, however, did not include place of supply rules in its VAT legislation when VAT was introduced in 1991[75]. The difference between VAT and the previous General Sales Tax in South Africa is that the latter is levied against a consumer and not against an intermediate

[73] Go, D.S., Kearney, M., Robinson, S. & Thierfelder, K. 2005. An analysis of South Africa's Value Added Tax. World Bank Policy Research Working Paper, 3671. Date accessed: 25 June 2015.

[74] Sherif, M.M. 2012. Tax reform in the context of new revenue authority administration for Liberia. Dissertation (MA: Taxation). Institute of Advanced Legal Studies. Date accessed: 24 February 2014.

[75] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

stage entity, whereas with VAT, everyone along the value chain pays VAT. Moreover, VAT is the value that is added to goods and services on consumption[76].

In South Africa, VAT is levied in terms of the Value[77]-Added Tax Act 89 of 1991 (PATC, 2013). The original statutory rate was 10 percent, which was subsequently raised to 14 percent in 1993[78].

Currently, VAT is a significant contributor to the South African fiscus[79]. VAT contributed 27.8% to total tax revenue for the 2013/2014 tax year[80]. Breakdown of South African tax revenue 2013/2014 VAT is an important component for South Africa's revenue base. If businesses exploit the fact that there is no specific legislation governing electronic commerce and virtual world transactions, the South African fiscus could potentially lose a significant portion of its revenue derived from VAT[81].

The VAT law in South Africa was not written to cater for digital transactions; such as online downloads of movies, music, games or access to content in the cloud (Internet-based storage mechanisms). South African VAT laws were written with a focus on physical goods and in person services[82]. E-commerce has not affected value-added tax (VAT) laws in the same manner as income-tax laws, but has led to an exponential increase in cross-border transactions in respect of

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[76] Janse van Rensburg, Z. 2011. An explorative study: Place of supply rules for Value Added Tax in South Africa. University of Pretoria. (Thesis: MCom Taxation).

[77] http://upetd.up.ac.za/thesis/submitted/etd-03192012-163350/unrestricted/dissertation.pdf Date accessed: 22 October 2015.

[78] Go, D.S., Kearney, M., Robinson, S. & Thierfelder, K. 2005. An analysis of South Africa's Value Added Tax. World Bank Policy Research Working Paper, 3671. Date accessed: 25 June 2015.

[79] National Treasury. 2013. Budget Review 2013. http://www.treasury.gov.za/documents/national%20budget/2013/review/FullReview.pdf. Date accessed: 7 January 2016.

[80] Lings, K. 2013. South Africa: National Budget 2013/2014.

http://www.stanlib.com/newsatstanlib/Documents/SANationalBudget2013-2014.pdf Date accessed: 14 April 2015.

[81] Johnston, G. & Pienaar, S. 2013. Value-Added Tax on virtual world transactions: A South African perspective. International Business & Economics Research Journal, 12(1): 71-78. Date accessed: 23 October 2015.

[82] Jooste, R. 2013. VAT rules in SA to be updated for internet age. http://www.bdlive.co.za/economy/2013/12/04/vat-rules-in-sa-to-be-updated-forinternet-age Date accessed:

which tax laws need to be adjusted[83]. The present position in South Africa is one of uncertainty as there are no clearly defined rules to tax ecommerce transactions and promises of clarity have been made but not fulfilled for several years[84]. Moreover, the South African VAT legislation is unclear and it is not possible to make any definitive statements for the global businesses regarding the importation of e-commerce in South Africa, except to say that they are likely to have a VAT liability in South Africa[85].

South Africa differs from other VAT jurisdictions, because it has not yet introduced any substantial guidance on electronic commerce or introduced legislative provisions to deal with electronic commerce efficiently. Traditionally, the current South African taxing principles must be applied in determining whether electronically supplied services are subject to VAT in South Africa[86]. The question therefore arises whether the VAT Act in its current form in fact provides for the imposition of VAT on the supply of digitised products and whether imposing VAT is consistent with the principles formulated by the OECD[87].

South Africa recognised the significant risks in respect of the cross-border supply of digital products by foreign multinational enterprises to South African consumers[88]; therefore, the proposal was made by the Minister of Finance that foreign suppliers of ecommerce must register for VAT

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[83] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cybe rspace Date accessed: 16 July 2015.

[84] Smuts, S. 2012. Understanding global tax exposure for businesses selling or distributing digital products in South Africa. http://deloitteblog.co.za/2012/05/11/understandingglobal-tax-exposure-for-businesses-selling-or-distributing-digitalproducts-in-southafrica/ Date accessed: 8 August 2014.

[85] Smuts, S. 2012. Understanding global tax exposure for businesses selling or distributing digital products in South Africa. http://deloitteblog.co.za/2012/05/11/understandingglobal-tax-exposure-for-businesses-selling-or-distributing-digitalproducts-in-southafrica/ Date accessed: 8 August 2014.

[86] Deloitte & Touche. 2010. VAT Flash 4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015

[87] Carstens, T. 2012. Charting the changes, 21 years of VAT in South Africa. www.pwc.co.za/en_ZA/za/assets/pdf/vat21-september-2012.pdf Date accessed: 24 February 2015.

[88] Badenhorst, G. 2013. The VAT challenges of cross-border supplies. Tax Talk (November/December): 46-49. Date accessed: 7 January 2015.

purposes. To create certainty and to curtail foreign suppliers of e-commerce from escaping the VAT net in South Africa, it will be implemented based on the Minister of Finance's proposal that all foreign suppliers are obliged to register as VAT vendors and account for output tax in respect of e-commerce supplies made to South African customers[89]. Therefore, the current South African VAT legislation and the effect on the imported e-commerce transactions will be discussed and analysed to identify why the Minister of Finance announced that foreign businesses need to register for VAT when supplying e-commerce in South Africa.

6.2.1. The South African VAT Act

Section 7(1)(a) of the South African VAT Act requires a vendor to impose VAT on a supply made if that vendor is carrying on an enterprise and the supply is made in the course or furtherance of that enterprise[90]. Based on this requirement of the VAT Act, the definition needs to be considered within the context of the imported e-commerce transactions and analysed to obtain an understanding of the current VAT system taxing e-commerce.

6.2.2. Enterprise

An "enterprise" is defined in section 1 of the VAT Act as "any enterprise or activity carried on continuously or regularly by a person in the Republic or partly in the Republic in the course or furtherance of which goods or services are supplied to another person for consideration provided that, a branch or core business permanently situated at premises outside the Republic, is a separate vendor, if it can be separately identified and an independent system of accounting is maintained"[91].

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[89] Lessing, D., Mazansky, E., Rood, L., McGurk, P. & Malan, D. 2013. 2013/2014 Draft Tax Amendments – internationalhighlights. http://www.werksmans.com/legalbriefs-view/20132014-draft-tax-amendments-internatinal-highlights/ Date accessed: 13 September 2015.

[90] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

[91] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

Furthermore, the definition of an enterprise in section 1 of the South African VAT Act and the VAT import and export rules operate together to determine whether the consumption of a service is considered to have taken place in South Africa and is consequently subject to South African VAT[92]. It was identified that while the absence of place of supply rules arguably creates flexibility in determining the jurisdiction of supply, it also creates uncertainty as to whether a non-resident meets the criteria for carrying on an 'enterprise' in South Africa[93]. It can be identified that the place of supply and enterprise needs to be discussed as well as determining what it specifically entails.

The interpretation when using words such as 'activity' or 'enterprise' is very wide and will lead to the understanding that most activities (unless specifically excluded) will constitute an 'enterprise'. An enterprise refers to the kind of activities that are carried out within a commercial context where goods or services are supplied for a consideration. Typically, this refers to a business or similar venture, conducted in an organised and business-like manner, where an element of risk-taking is involved, and where the aim is to grow or make a profit or to ensure that the organisation's activities are sustainable[94]. The definition of an enterprise in section 1 of the VAT Act requires an activity to be conducted continuously or regularly in, or partly in, South Africa. However, the concepts 'continuously' or 'regularly' are not defined in the VAT Act and have not been judicially considered within the context of VAT[95].

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[92] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

[93] Deloitte &Touche. 2010.VAT Flash4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015.

[94] SARS (South African Revenue Service). 2012. VAT 404- Value-Added Tax, Guide for Vendors. www.sars.gov.za/AllDocs/OpsDocs/Guids/VAT%20404%20-%20for%20Vendors%20-%External%20Guide.pdf Date accessed: 15 May 2015.

[95] Deloitte &Touche. 2010.VAT Flash4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015.

Consumption taxes were developed under the premise of the physical presence of a product within a specific taxation jurisdiction [96]. In practice, the fact that a business has a physical presence in South Africa, delivers goods or physically renders services, or concludes agreements in South Africa, whether through an employee, agent or subcontractor is normally indicative that it carries on an activity in South Africa[97]. However, the Internet has no physical location. Users of the Internet have no control and in general no knowledge of the path travelled by the information they seek or publish[98]. With e-commerce, such a physical presence is no longer necessary[99]. Therefore, there is no physical presence in South Africa for e-commerce and the services are not rendered physically in South Africa.

Whether 'premises' are the equivalent of a 'permanent establishment' is not clear, but the need for an independent system of accounting is one determinant. Whether a server, together with its administration, would be considered a vendor, is also questionable[100]. From a tax standpoint, websites and servers through which these transactions are made do not constitute a taxable presence in another country, since a website alone is not a fixed place of business[101]. For example, if a supplier is not established in South Africa, this leads to the understanding that only enterprises

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[96] Carstens, T. 2012. Charting the changes, 21 years of VAT in South Africa.www.pwc.co.za/en_ZA/za/assets/pdf/vat21-september-2012.pdf and also see Botes, M. 2011. South African VAT and non-resident businesses. International VAT Monitor – November/December: 396-399. Date accessed: 24 February 2015.

[97] Carstens, T. 2012. Charting the changes, 21 years of VAT in South Africa.www.pwc.co.za/en_ZA/za/assets/pdf/vat21-september-2012.pdf Date accessed: 24 February 2015

[98]Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015

[99] Department of the Treasury Office of Tax Policy. 1998. Selected tax policy implicationsof global electronic commerce. http://www.treasury.gov/resource-center/taxpolicy/Documents/internet.pdf Date accessed: 22 November 2015.

[100] Department of the Treasury Office of Tax Policy. 1998. Selected tax policy implicationsof global electronic commerce. http://www.treasury.gov/resource-center/taxpolicy/Documents/internet.pdf Date accessed: 22 November 2015.

[101] Department of the Treasury Office of Tax Policy. 1998. Selected tax policy implicationsof global electronic commerce. http://www.treasury.gov/resource-center/taxpolicy/Documents/internet.pdf Date accessed: 22 November 2015.

within the jurisdiction of South Africa are governed by the VAT legislation of South Africa, whereby foreign enterprises will not fall within the South African VAT net [102]. The lack of clarity regarding the question of when a foreign supplier is regarded as carrying on an enterprise in South Africa is a major deficiency in the current South African VAT system, specifically regarding the imposition of VAT on the supply of digitised products[103]. In the absence of clarity as to whether a foreign supplier of digitised products is carrying on an enterprise in South Africa, the supplier will not be able to make the correct tax decision[104].

6.2.3. Destination vs. place of supply

Tax jurisdictions apply similar principles and concepts with respect to VAT; however, there are differences that hinder the effective, fair and equitable application of VAT globally. An example is the application of 'place of supply rules' to provide clarity on where a product is considered to have been supplied and, therefore, subject to VAT[105]. The South African VAT system is based on the destination or consumption of the goods or services supplied[106]; therefore, if consumed in South

Africa, regardless of where the goods are produced or services are supplied[107], it will be taxed in South Africa. This implies that VAT is only payable on the consumption of goods and services,

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[102]Budlender, S. 2003. A descriptive study of the negative impact of e-commerce on the tax base and fiscal revenue collection of Value-Added Tax in South Africa. Thesis (Masters in Business Administration). University of Natal. Date accessed: 20 November 2015.

[103]De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

[104] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

[105] SARS (South African Revenue Service). 2013. Interpretation Note: No.70. http://www.jutalaw.co.za/media/filestore/2013/06/IN70-_Supplies_made_for_no_consideration.pdf Date accessed: 13 November 2015.

[106] SARS (South African Revenue Service). 2013. Interpretation Note: No.70. http://www.jutalaw.co.za/media/filestore/2013/06/IN70-_Supplies_made_for_no_consideration.pdf Date accessed: 13 November 2015.

[107] SARS (South African Revenue Service). 2013. Interpretation Note: No.70. http://www.jutalaw.co.za/media/filestore/2013/06/IN70-_Supplies_made_for_no_consideration.pdf Date accessed: 13 November 2015.

which takes place in South Africa, and on the importation of goods and services into South Africa. The initial place where these goods and services are supplied is not taken into consideration[108]. Exports that are not consumed in the country are therefore free of tax, and imports that are consumed in the country are taxed when imported[109].

A problem arises where intangible services are traded across borders and delivered electronically (e.g., consultancy, broadcasting, telecommunication services)[110]. An unusual feature of the South African VAT system is that it does not, unlike other VAT jurisdictions, use specific 'place of supply' rules to determine whether a supply is subject to VAT in South Africa[111]. Without clear place of supply rules, the South African legislation is open to interpretation[112]. It is not always clear where the services are utilised or consumed and the absence of 'place of supply' rules from the VAT Act enhances this problem[113]. Therefore, it makes it difficult to determine a particular foreign entity's obligation to register in South Africa[114]. At the stage of implementation of the VAT system, the system did not have 'place of supply' rules in place and they still have not been introduced fully into the system of taxation[115].

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[108] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

[109] SARS (South African Revenue Service). 2013. Interpretation Note: No.70. http://www.jutalaw.co.za/media/filestore/2013/06/IN70-_Supplies_made_for_no_consideration.pdf Date accessed: 13 November 2015.

[110] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile LawJournal, 22: 230-258. Date accessed: 28 August 2015.

[111] Carstens, T. 2012. Charting the changes, 21 years of VAT in South Africa. www.pwc.co.za/en_ZA/za/assets/pdf/vat21-september-2012.pdf Date accessed: 24 February 2015.

[112] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile Law Journal, 22: 230-258. Date accessed: 28 August 2015.

[113] Badenhorst, G. 2013. The VAT challenges of cross-border supplies. Tax Talk (November/December): 46-49. Date accessed: 7 January 2015.

[114] Deloitte & Touche. 2010. VAT Flash 4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015.

[115] Soverall, G. 2012. A history of SA's VAT. http://www.moneywebtax.co.za/moneywebtax/view/moneywebtax/en/page1/page267?oid=71926&sn=Detail&pid=267 Date accessed: 13 November 2015.

Based on the consumption-based VAT system of South Africa, services are therefore taxed in South Africa if the consumer is in South Africa[116]. It might be true that the VAT Act implies that VAT should be levied at the place of consumption[117]. However, although VAT is generally a consumption tax, consumption of the supply does not form the basis of determining whether the supply would be subject to VAT[118]. The concept of 'place of consumption' is difficult to define without proper guidelines in the South African legislation[119].

In South Africa, the place of supply is connected to the definition of 'enterprise' in the VAT Act as discussed in the previous point. It follows that VAT is levied on supplies made by a person who conducts an enterprise continuously or regularly in South Africa, or partly in South Africa[120]. The basis of determining whether a supply is subject to VAT is whether it is being supplied by a person supplying goods and/or services, inside or partly inside South Africa, on a continuous and regular basis, for a consideration. Furthermore, there are no specific use and enjoyment rules applicable in terms of South African VAT. This means that merely because a service is not consumed or utilised in South Africa, it does not mean that it is not included into the South African VAT net[121]. Due to the lack of specific place of supply rules, it is often difficult to determine whether a non-resident business, which is not established in South Africa, will be regarded as carrying on a VAT enterprise in South Africa. From the definition of an enterprise, it follows that where a server has been placed

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[116] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015.

[117] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile LawJournal, 22: 230-258. Date accessed: 28 August 2015.

[118] SAICA (The South African Institute of Charted Accountants). 2012. Integritax Newsletter, (152): 1-22. http://www.saica.co.za/integritax/Archive/Integritax_May_2012_Issue_152.pdf Date accessed: 15 November 2015.

[119] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile Law Journal, 22: 230-258. Date accessed: 28 August 2015.

[120] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile LawJournal, 22: 230-258. Date accessed: 28 August 2015.

[121] SAICA (The South African Institute of Charted Accountants). 2012. Integritax Newsletter, (152): 1-22. http://www.saica.co.za/integritax/Archive/Integritax_May_2012_Issue_152.pdf .

within the jurisdiction, an enterprise is conducted in South Africa and such company would be exposed to local VAT, even though the company is incorporated outside South Africa[122].

Considering the above principle, in practice, the view has always been taken that if the supplier has no presence or representation in South Africa and the digital product is supplied through a server located outside South Africa, the non-resident business will not be liable for VAT registration[123]. However, the determination of the location of the server can create difficulties. It is complicated to locate the jurisdiction in which these services are being consumed. Where an order is placed via the Internet, for instance, it may be difficult to identify or locate the parties to the transaction, especially if the customer is a private consumer. The domain name in the e-mail address or top-level domain name of the website of a contracting party does not provide sufficient proof of the supplier's location, purely because domain names are no longer territorial[124].

Since the supply of the service is from a foreign source, it might arguably attract VAT in the country from which the services are rendered and not where it is consumed[125]. However, based on the current legislation of South Africa, imports in South Africa will be liable for VAT implications. The problem with the current treatment of imports is that it can result in double taxation. Where the service is rendered from a country that has place of supply rules dissimilar to South Africa, double taxation could occur. The recipient of the service can be liable to pay VAT in both countries[126]. South Africa has double taxation agreements, which aim to prevent or mitigate the

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[122] Michalson, L. & van Zyl, J. 2009. E-commerce in 31 jurisdictions worldwide. http://michalsons.co.za/wp-content/uploads/2008/09/Getting-the-Deal-Through-South-Africa-2009.pdf Date accessed: 15 November 2015

[123] PWC (PricewaterhouseCoopers). s.a. A guide to VAT in the EU of 27 countries. http://www.pwc.be/en/publications/executive-summ-pwc-09.pdf Date accessed: 27 March 2015.

[124] Steyn, T. 2010. VAT and e-commerce: Still looking for answers. SA Mercantile Law Journal, 22: 230-258. Date accessed: 28 August 2015.

[125] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

[126] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

effect of taxing transactions in both signatory countries and to provide mutual assistance in administering the collection of taxes[127]. Although South Africa has various signed double tax agreements in place, they mainly cater for double taxation of income tax and none of them cater for VAT[128]. It is evident that the existing rules may no longer be sufficient, or may have to be revisited because of identification and compliance problems[129]. Evidently, the huge increase in the advent of electronic commerce transactions makes South African VAT legislation outdated and consequently the taxable nature of transactions difficult to determine[130].

6.3. Implications for electronic transactions under the current VAT system

An understanding was obtained of the current VAT system in South Africa in section 5.2. In the following points, it will be considered how the implementation of VAT on e-commerce transactions will be affected under the current VAT system. E-commerce customers are unaware of their obligation under the current VAT legislation to account for VAT at the standard rate of 14% in respect of their purchases of e-products from foreign suppliers. This is known as the reverse VAT charge[131].

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[127] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

[128] Janse van Rensburg, Z. 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 Date accessed: 22 October 2015.

[129] Van der Merwe, B.A. 2004. VAT in the European Union and electronic supplied services to final consumers. SA Mercantile Law Journal, 16: 577-588. Date accessed: 21 August 2015.

[130] Deloitte & Touche. 2010. VATFlash 4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015.

[131] Martineau, F., McFadden, C. & Naidoo, C. 2013. Proposed new VAT rule for foreign ecommerce suppliers. http://sataxguide.wordpress.com/2013/07/13/proposed-new-vatrule-for-foreign-e-commerce-suppliers/ Date accessed: 1 March 2016.

6.3.1. Reverse charge mechanism:

Section 7(2) of the VAT Act states that "the tax payable in terms of paragraph (b) of that subsection shall be paid by the person referred to in that paragraph"[132]. This creates the situation that it is not the vendor who is responsible for the collection of the tax, but the person who imported the goods or services into South Africa. This is known as the reverse charge mechanism[133]. The VAT Act currently states that a resident has to account for VAT on services acquired from a supplier who is not a resident of South Africa, or who carries on a business outside South Africa to the extent that the services are not used in the course of making taxable supplies[134]. Because of the lack of 'place of supply rules' in the South African legislation, South Africa applies the 'reverse charge mechanism' with respect to imported services acquired from a non-resident business, consumed in South Africa and not bought for purposes of making taxable supplies subject to VAT. In terms of this mechanism, the South African consumer must account for the VAT on such a purchase[135].

This means that when consumers download software, music, movies and so forth from foreign suppliers, they must account for the VAT on the supplied products[136]. In South Africa, the reverse charge mechanism is applied on both B2B and B2C transactions, whereby the South African resident (whether VAT registered) is required to account for the VAT on imported services, but the reverse charge applies only to the extent the supplier is not carrying on an enterprise in South

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[132] Value Added Tax Act No 89 of 1991. Date accessed: 8 August 2015.

[133] Budlender, S. 2003. A descriptive study of the negative impact of e-commerce on the tax base and fiscal revenue collection of Value-Added Tax in South Africa. Thesis (Masters in Business Administration). University of Natal. Date accessed: 20 November 2015.

[134] BDO South Africa. 2013. VAT on imported services. http://www.bdo.co.za/resources/showitemarticle.asp?ResourceSectionId=4&ResourceSectionName=Publications&ResourceId=7&ResourceName=Tax%20Flash&IssueId=417&ContentPageID=4&Archive=&articleid=429 Date accessed: 28 February2016.

[135] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cybe rspace Date accessed: 16 July 2015.

[136] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cybe rspace Date accessed: 16 July 2015.

Africa and is required to register for VAT in South Africa[137]. The supplier is not responsible for the VAT because the supplier is not in the geographic region of the Republic, and in terms of the South African legislation is not governed by the Act, nor is the supplier within its jurisdiction[138].

The South African customer is liable for the payment of VAT on imported services under the reverse charge rule, to the extent that the digital products are acquired for non-taxable purposes and if the invoice value exceeds R100.00. If the customer is a VAT vendor, the VAT on imported services must be accounted for on the normal VAT return form, while a customer who is not a VAT vendor must, within 30 days, declare and pay the VAT on imported services to SARS.

The broadened scope and obligation placed on non-registered consumers to account for output tax on imported services are generally not enforced, as the administrative costs are both unrealistic and impractical[139]. The purchase of an online service is very simple at present for the customer, but very difficult to control and monitor by the government[140]. This system relies on the honesty of the consumer of the products and is very difficult to enforce[141]. This has the effect that South African consumers often buy imported digital goods or services without paying VAT[142].

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[137] Deloitte & Touche. 2010. VAT Flash 4 of 2010: Deductibility of Input Tax. http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/VATFlash%204%20of%202010.pdf Date accessed: 24October 2015.

[138] Budlender, S. 2003. A descriptive study of the negative impact of e-commerce on the tax base and fiscal revenue collection of Value-Added Tax in South Africa. Thesis (Masters in Business Administration). University of Natal. Date accessed: 20 November 2015.

[139] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015.

[140] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: PostgraduateDiplomainTaxation).http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

[141] Johnston, G. & Pienaar, S. 2013. Value-Added Tax on virtual world transactions: A South African perspective. International Business & Economics Research Journal, 12(1): 71-78. Date accessed: 23 October 2015.

[142] PWC (PricewaterhouseCoopers). s.a. A guide to VAT in the EU of 27 countries. http://www.pwc.be/en/publications/executive-summ-pwc-09.pdf Date accessed: 27 March 2015.

While no statistical studies have been found on the ensuing loss of revenue, it may prove to be a large loss for South Africa and for other jurisdictions globally. It is evident that the South African government is aware of this problem, as shown by the Minister of Finance's proposal in his 2013-14 Budget Speech to require non-resident e-commerce businesses that supply goods or services in South Africa to register for VAT[143].

However, South Africa already has specific registration rules set out in the current VAT legislation. It is important to consider how this will be affected by the new proposal of the Minister of Finance regarding VAT registration for foreign suppliers of e-commerce.

6.3.2. Registration implications for non-residents

The current VAT system provides for compulsory and voluntary registration as a VAT vendor. Every person who carries on any enterprise must be registered if the total value of his/her taxable supplies made in the course of carrying on all enterprises has exceeded R1 million in the preceding 12 months or if there are reasonable grounds for believing that he/she will exceed that limit in the next 12-month period[144]. However, foreign suppliers of e-commerce having no physical presence in South Africa are not obliged to register as VAT vendors in terms of the current VAT legislation[145]. Furthermore, it is difficult to determine whether the foreign supplier carries on an enterprise as discussed earlier. For e-commerce transactions, the current VAT Act exempts imported services into South Africa with an invoice value of less than R100.00. For supplies exceeding R100.00, it is difficult to collect VAT from individual consumers as discussed in section

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[143] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015.

[144] Botes, M. 2011. South African VAT and non-resident businesses. International VAT Monitor – November/December: 396-399. http://www.empcom.gov.in/WriteReadData/UserFiles/file/No_6%20A-5.pdf Date accessed: 13 November 2015.

[145] Lessing, D., Mazansky, E., Rood, L., McGurk, P. & Malan, D. 2013. 2013/2014 Draft Tax Amendments– international highlights. http://www.werksmans.com/legalbriefs-view/20132014-draft-tax-amendments-internatinal-highlights/ Date accessed: 13 September 2015.

5.3.1, thereby placing the foreign enterprise in a competitive advantage compared to local suppliers that must charge VAT[146].

6.4. Conclusion

In Chapter 2, an understanding of the current South African VAT legislation was obtained. The weaknesses relating to e-commerce in the current VAT legislation were identified and discussed as well as the VAT implications for imported e-commerce transactions under the current VAT legislation. It was identified that South Africa lacks place of supply rules, which often creates uncertainty about whether a product is subject to VAT and when a foreign supplier is carrying on an enterprise for VAT purposes in South Africa[147]. If place of supply rules were specifically incorporated in South African VAT legislation, the imported services would be taxed in the country of supply and therefore would avoid any double taxation of the imported services[148].

However, it should be considered whether place of supply rules will be the most favorable for the South African government, as they will not then receive VAT on imported services. It was suggested that governments should align their VAT principles, descriptively defined as the harmonization of VAT, which will allow them to collect VAT more efficiently and reduce double taxation. It will also create a more equitable playing field for suppliers by ensuring that foreign suppliers are not granted an economic advantage over local ones[149].

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[146] Badenhorst, G. 2013. The VAT challenges of cross-border supplies. Tax Talk (November/December): 46-49. Date accessed: 7 January 2015.

[147] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015.

[148] Janse van Rensburg, Z. 2011. An explorative study: Place of supply rules for Value Added Tax in South Africa. University of Pretoria. (Thesis: M. Com Taxation). http://upetd.up.ac.za/thesis/submitted/etd-03192012-163350/unrestricted/dissertation.pdf Date accessed: 22 October 2015.

[149] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015.

Under the current VAT legislation, South Africans are liable for VAT on imported ecommerce transactions. Digital products, which are not intended to be used for the making of taxable supplies in South Africa, acquired from a foreign supplier, who is not a VAT registered supplier in South Africa, will be subject to VAT in South Africa under the current VAT legislation. The recipient of the service or digital product is obliged to account for the VAT on the transaction by paying the VAT to SARS within 30 days of receiving the invoice from the supplier or paying for the product or service. SARS is therefore reliant on the honesty of the taxpayer to declare and remit the VAT[150].

[150] Naicker, K. 2010. The VAT implications of e-commerce. TAX talk, January/February 2010: 8-9. Date accessed: 28 August 2015

CHAPTER 4

7. Challenges concerning VAT on e-commerce

7.1. Introduction

In Chapter 2, an understanding was obtained of how different countries have implemented VAT on e-commerce transactions in their VAT systems. However, the implementation of VAT on e-commerce transactions was not without any challenges. These problems will be considered in Chapter 4 to identify possible challenges that may arise when implementing VAT on e-commerce in South Africa. This could indicate for South Africa what problems should be considered when adjusting the current VAT system to implement the Minister of Finance's proposal.

The problems presented by electronic commerce transactions for the calculation of VAT are not in themselves new[151]. The mechanism of the VAT system works well where the VAT-registered supplier and recipient reside in the same country, but poses a challenge when they are situated in different countries[152]. Tax rules under domestic laws as well as treaties impose different tax treatment on several types of cross border income[153]. Each country will impose its own VAT rules, which could lead to double taxation or non-taxation of the supply[154]. It is more a question of electronic commerce transactions exacerbating existing tensions and difficulties inherent in the tax when dealing with cross-border transactions, relating particularly to the place of supply and enforcement issues for non-resident suppliers of services[155].

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[151] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015

[152] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015

[153] Cockfield, A.J. 2006. The rise of the OECD as informal 'World Tax Organization' through national response to e-commerce tax challenges. Yale Journal of Law and Technology (8): 136-187. Date accessed: 18 January 2016.

[154] Bardopoulos, A. 2013. Applying tax laws is a tricky proposition in cyberspace. www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-atricky-proposition-in-cyberspace Date accessed: 16 July 2015

[155] De Swart, R.D. & Oberholzer, R. 2006. Digitised product: How compliant is South African value-added tax? Meditari Accounting Research, 14:14-28. Date accessed: 28 August 2015

Multinational enterprises are therefore able to exploit the arbitrage between the VAT systems of countries, thereby minimising their tax burden and obtaining a competitive advantage [156]. Businesses exploit the fact that there is no specific legislation governing electronic commerce and virtual world transactions[157]. Global e-commerce makes the cross-border movements in goods, capital and labor less transparent allowing companies and individuals to exploit tax differences between countries, or even to evade taxation[158].

The borderless nature of e-commerce makes it difficult to define where income is earned, when a product is purchased, or value is added. As a result, it is difficult to determine at what point profits are realised and which country is the recipient[159].The challenge facing tax administrators is to adapt existing legislation, procedures and practices to overcome any deficiencies that emerge because of new means of communication and product delivery[160].

Difficulties were experienced when taxing cross-border e-commerce transactions. Over the last few years, several tax administrations and international organizations have been studying the impact of e-commerce on tax policy and tax administration [161] . The EU, however, has considerable concerns over the increasing import of digital content and services from outside the EU, which would be exempted from VAT payments in the EU. In terms of the current legislation for the European Union, foreign suppliers may be tax exempted, whereas local suppliers are normally

[156] Badenhorst, G. 2013. The VAT challenges of cross-border supplies. Tax Talk (November/December): 46-49. Date accessed: 7 January 2015

[157] Johnston, G. & Pienaar, S. 2013. Value-Added Tax on virtual world transactions: A South African perspective. International Business & Economics Research Journal, 12(1): 71-78. Date accessed: 23 October 2015.

[158] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[159] Gillanders, N. 2010. Electronic commerce and the Irish tax system. Date accessed: 6 September 2013.

[160] Owens, J. s.a. Answering the emerging taxation challenges govinfo.library.unt.edu/ecommerce/document/JeffOwens.doc Date accessed: 18 January 2015.

[161] Gillanders, N. 2010. Electronic commerce and the Irish tax system. Date accessed: 6 September 2013.

required to charge value added tax[162]. The challenges posed by electronic commerce transactions for taxation have been well documented, which include how to identify taxpayers [163]engaged in ecommerce and to determine their taxing jurisdiction; how to ensure that appropriate records are created of business conducted by e-commerce; and how to collect taxes in the ecommerce environment[164]. Possible challenges that countries may experience relating to taxing cross-border e-commerce transactions were identified that will be discussed in this chapter[165].

From the above, the following tax issues were identified by different countries relating to taxing cross-border e-commerce transactions, which will be considered in this chapter:

- Verifying the details of a transaction;
- Identifying the parties to a transaction;
- Determining the permanent establishment;
- The effect on the Double Tax Treaties; and
- The erosion of the tax base.

7.2. Verifying the details of a transaction

Historically, transactions were entered into with relevant source documentation that contained information such as the date, parties, products and value of the transaction. The applicable source documents are also considered reliable because they cannot easily be altered without leaving evidence of such an alteration[166]. However, ecommerce transactions have a more anonymous character than the traditional ways of commerce, because it is carried out without papers and pens, offices and warehouses, and even without employees. In such an environment, tax authorities may

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[162] Teltscher, S. 2000. Tariffs, taxes and electronic commerce: Revenue implications for Developing Countries.http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.197.9764&rep=rep1&type=pdf Date accessed: [163] August 2015.

[164] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[165] Gillanders, N. 2010. Electronic commerce and the Irish tax system. Date accessed: 6 September 2013.

[166] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

not easily keep track of the identity or location of the parties to a transaction concluded over the Internet.

In the physical world, the information to support the existing tax base is found in the financial records of a taxpayer or other entities such as banks and deed offices and, at the lowest level, source documents such as receipts and invoices[167]. Many online shoppers do not feel comfortable providing unnecessary personal information to a website. Consequently, they may refuse to type it in, shop at a site that does not require it or simply provide false information. The result is an inability to tax and an erosion of the total tax base[168].

The move to paperless trade also presents some legal problems to the international business community[169]. Electronic records, such as those that might be produced in an ecommerce environment, are not as robust[170]. Without the appropriate controls, electronic records are more easily forged than traditional paper documents and their true origin more difficult to establish[171]. Electronic records can be altered without trace and therefore the reliability of these records may be more questionable[172].

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[167] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[168] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[169] Laryea, E. 2001. E-commerce in trade: Some solutions to the particular problems facing Africa in the digitisation of trade documentation. http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=8&ved=0CGgQFjAH&url=http%3A%2F%2Fwww.bileta.ac.uk%2Fcontent%2Ffiles%2Fconference%2520papers%2F2001%2FE-Commerce%2520in%2520Trade%2520-%2520Some%2520Solutions%2520to%2520the%2520Particular%2520Problems%2520Facing%2520Africa%2520in%2520the%2520Digitisation%2520of%2520Trade%2520Documentation.pdf&ei=863iUuCXL4GAhAfm0oCIAg&usg=AFQjCNFd5KN_BchyVzkqrHEwxF4ZBtmG1w&sig2=G6lBxEOrEYY4TCt-dJtklQ Date accessed: 24 January 2015.

[170] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[171] Cohen, E. s.a. The need for and issues surrounding the seamless audit trail. Date accessed: 24 January 2016. [169] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[172] Chang, O.H. & Yen, D.C. 2000. Electronic commerce: How should it be taxed? Journal of Contemporary Accounting, 1(1): 89-104. Date accessed: 16 December 2015.

Moreover, electronic records may be more easily destroyed or altered than paper records without leaving evidence of such destruction or alteration[173]. Although the paper source documents can also be altered, it is not as easy to alter the documents without leaving evidence of such an alteration[174]. E-commerce leaves less of a 'paper trail', such as invoices and receipts, which tax authorities often use to track down and verify conventional transactions, and even when electronic records are available, they are more subject to tampering than paper records are[175]. This is often referred to as the dematerialisation[176].

As all users of computers know, this creates the possibility for tax evasion and fraud due to the easy alteration of computerised records[177] . Although many taxpayers rely largely on computerised record-keeping systems, many transactions are still originated as paper records, which can be used to verify the accuracy of the electronic records. However, for taxpayers engaged in the sale of electronic goods or services, no physical records are likely to be created because customer orders are placed and completed electronically and therefore the only record that exists of these transactions could be an electronic one. It is also questionable whether the evidence that tax administrators would be able to produce on transactions that take place in cyberspace would satisfy the documentation and evidence standards set by tax laws [178]. Moreover, an encrypted electronic record might not reveal any information about the value of a transaction[179].

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[173] Cohen, E. s.a. The need for and issues surrounding the seamless audit trail. Date accessed: 24 January 2016.

[174] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[175] McLure Jr, C.E. 2003. The Value Added Tax on electronic commerce in the European Union. International Tax and Public Finance, 10: 753-762.Date accessed: 20 June 2015.

[176] United Nations Conference on Trade and Development. 2003. E-commerce and Development Report2003. http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CDgQFjAA&url=http%3A%2F%2Functad.org%2Fen%2Fdocs%2Fecdr2003_en.pdf&ei=DqviUtm0DsiBhAecjYDgBw&usg=AFQjCNHDz

[177] Chang, O.H. & Yen, D.C. 2000. Electronic commerce: How should it be taxed? Journal of Contemporary Accounting, 1(1): 89-104. Date accessed: 16 December 2015.

[178] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

[179] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

The possibility of changing details on the invoice also relates to the avoidance of tax, as will be discussed in section 7.3. If there is no real distinction between items, or you can easily substitute one item for another, taxpayers have an incentive to favour whichever item is taxed the least[180]. In Chapter 2, it was discussed whether e-commerce can be defined as goods or services. Although it was concluded in Chapter 2 that e-commerce should be treated as services, not all countries apply the same basis. The more numerous and diverse the characteristics and attributes of items, the easier it is to tax them differently[181].

As seen above, the risk exists that there may be alterations made to source documentation relating to information regarding the products or services and the relevant parties of the transaction. The most essential qualities of a record are that it is authentic and that its content is fixed over time. In other words, people must have confidence that a record is what it says it is. Electronic records, unfortunately, do not intrinsically inspire this confidence in the same way that paper records do. The ease with which electronic documents can be created, altered, accessed, duplicated, and shared jeopardizes their value as records.

Therefore, the customer can alter the documentation in such a way to pay minimum tax and VAT to authorities; for example, stating that a service was provided rather than product to parties from tax havens. E-commerce transactions make it difficult to obtain reliable transaction information, which is necessary to determine the value of the taxable element of a transaction[182]. Furthermore, it is important for the tax authorities to verify the parties that are involved in the transactions as

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[180] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

[181] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

[182] Oguttu, A.W. 2009. The challenges that e-commerce poses to international tax laws: 'Controlled Foreign Company Legislation' from a South African perspective (Part 2).

stated on the documentation to determine the place of supply and the relevant tax legislation applicable[183].

7.3. Identifying the parties to a transaction

As discussed in the previous section, it has been identified that the validity of information on electronic documents may pose to be a challenge. To enforce taxation laws, it is essential to ascertain where the e-commerce transaction has taken place and between whom[184]. The identification of the parties and location of the transaction are therefore interlinked with the information obtained from the records relating to the e-commerce transaction. Moreover, the determination of the location is of crucial importance to determine whether a transaction has a taxation effect or not. When a company is supplying cross-border services, it is important to understand in which country this service is subject to VAT[185] to apply the correct VAT principles to the transaction. Based on the above challenges identified, the question whether a certain e-commerce transaction has tax implications or not, will currently largely depend on the honesty of the participating parties[186].

To determine the country in which the service will be subjected to VAT, the parties of the transaction need to be identified to determine the place of supply and the place of consumption. Where an order is placed through the Internet, it may be difficult to identify and locate the parties to the transaction, especially if the customer is a private consumer[187]. Moreover, the Internet offers

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[183] Oguttu, A.W. 2009. The challenges that e-commerce poses to international tax laws: 'Controlled Foreign Company Legislation' from a South African perspective (Part 2).

[184] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

[185] Praxity – Global Alliance of Independent Firms. 2013. European Value Added Tax (VAT). http://www.bkd.com/docs/solution-sheets/european-value-added-tax.pdf Date accessed: 18 November 2015.

[186] 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: 22 October 2015.

[187] Van der Merwe, B.A. 2004. VAT in the European Union and electronic supplied services to final consumers. SA Mercantile Law Journal, 16: 577-588. Date accessed: 21 August 2015.

a great deal of anonymity and, furthermore, the OECD has described anonymity as one of the great challenges[188]. The reason for the difficulty in identifying the parties is that electronic commerce transactions on the Internet are decentralised and do not take place at any physical location[189]. Currently, the links between activities on the Internet and the physical parties associated with the Internet are weak[190]. E-mail addresses and Internet domain names can hide the identity of the parties; and the location of a party may not at all be detectable[191]. The composition of an Internet address, or domain name, only indicates who is responsible for the maintenance of that name. It has no relationship to the computer or user corresponding to that address or even where the machine is located. Moreover, in e-commerce, there is not necessarily any relationship between an Internet address and a physical location[192].

Therefore, taxing the online sales of intangible products is problematic because the location of customers cannot always be known with certainty[193]. There is also currently no facility to determine the owner of an existing website. Furthermore, monitoring Internet sites is not an option, as they may not leave a trail to the ultimate owners. The owners could use fictitious names or

[188] 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: 22 October 2015.

[189] Pastukhov, O. 2007. The E-VAT Directive: Mitigating tax competition or spurring it? Journal of International Commercial Law and Technology, 2: 54-57. Date accessed: 5 October 2015.

[190] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[191] Pastukhov, O. 2007. The E-VAT Directive: Mitigating tax competition or spurring it? Journal of International Commercial Law and Technology, 2: 54-57. Date accessed: 5 October 2015.

[192] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[193] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

complex networks to hide the existence or location of websites[194]. Verifying the identities of parties to a business transaction may be difficult in the world of e-commerce[195].

It has been pointed out that the Internet removes the need to be in the physical presence of your business party; however, what is more, it also removes the need to reveal your actual identity and location. If tax authorities cannot trace a taxable transaction, identify the buyer, seller, the relevant locations, and obtain access to verifiable financial records of the taxpayer, the levying of VAT will prove difficult and compliance may not be enforced. Taxpayers are likely to use the superficial anonymity offered via the Internet to conceal their commercial activities and escape taxation, and this poses a real threat to national tax bases and puts businesses that play by the rules at a disadvantage[196].

Another concern relating to the anonymity of the parties is the need to verify the identity of counter-party for double tax treaty purposes. For example, a seller of electronic information may claim to be a resident of a treaty country and thereby entitled to a reduced or zero rate of withholding tax on royalties[197]. Double tax treaties will be discussed in more detail later in 7.4.2 below.

The Committee for Fiscal Affairs of the OECD has responded to this issue by recommending that revenue authorities may consider requiring that businesses engaged in electronic commerce transactions identify themselves to revenue authorities in a manner that is comparable to the prevailing requirements for businesses engaged in conventional commerce in a country[198]. However, the authorities will need to think carefully before responding to this problem by

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[194] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[195] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

[196] 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: 18 September 2015.

[197] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[198] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

instituting identification and registration requirements as it is likely that such requirements will have limited success due to the growing ease with which websites can be located offshore.

From the above, the mechanisms to trace identity are weak, in that it is a relatively simple matter to arrange for the untraceable use of an Internet website[199]. Without accurate identification of taxpayers, it is difficult to levy taxes. Even if you can identify the taxpayer, but not its physical location in the world, this will give rise to jurisdictional disputes between tax authorities, with all the attendant risks of double taxation[200]. When the parties of the transaction are determined, the place of supply needs to be determined to indicate which party is liable for reporting and paying the VAT due to the relevant tax authorities[201].

7.4. Permanent establishment

As mentioned in the previous point, the next issue to be considered is the determination whether a taxable transaction arises, and if so, in which jurisdiction that transaction should be taxed. Establishing the location of the transaction is essential to apply the correct rules and rates, and paying the tax to the relevant country.

A fundamental problem posed by e-commerce is the identification of the country or countries that have the jurisdiction to tax transaction income[198]. As the use of technology has increased, the connection between the location of the service provider and the location of the consumer has become less significant. The essence of electronic commerce transactions is that transactions are carried out without having any relation to national or geographical borders. Due to the advent of the Internet, cross-border commercial transactions can be enabled by computer servers (i.e. a computer that has been networked to the Internet) instead of traditional business intermediaries

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[199] Owens, J. s.a. Answering the emerging taxation challenges. govinfo.library.unt.edu/ecommerce/document/JeffOwens.doc Date accessed: 18 January 2015.

[200] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[201] Praxity – Global Alliance of Independent Firms. 2013. European Value Added Tax (VAT). http://www.bkd.com/docs/solution-sheets/european-value-added-tax.pdf Date accessed: 18 November 2015. [198] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

such as retail stores [202]. E-commerce does not occur in any physical location, but instead takes place in cyberspace. Parties engaged in e-commerce could be located anywhere in the world, and their customers will be ignorant of, or indifferent to, their location[200]. Moreover, with the present technology, digitised products cannot be stopped and checked at the customs, while they are transferred from one country to another via the networks.

To be taxable in a specific jurisdiction, certain connecting factors need to be present. Traditional principles of international income tax are closely tied to the question of physical presence[203]. The problem is created that the services or products ordered via the Internet may be supplied from unknown locations for the purchaser and by different entities that, because of being in different countries, have combined activities[204].

However, because of the unknown locations and different entities, the problems arise with companies that trade online and sell goods in another country, if the place where their permanent establishment is situated differs from their online establishment. For example, a company XYZ Ltd may be incorporated in South Africa (a South African resident) and decides to establish its online business through a server in America[205]. The challenge is which country or countries may tax the South African company's business profit on the sale to a foreign customer, for example from Australia[206].

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[202] Cockfield, A.J. 2006. The rise of the OECD as informal 'World Tax Organization' through national response to e-commerce tax challenges. Yale Journal of Law and Technology (8): 136-187. Date accessed: 18 January 2016. [200] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[203] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[204] Cockfield, A.J. 2006. The rise of the OECD as informal 'World Tax Organization' through national response to e-commerce tax challenges. Yale Journal of Law and Technology (8): 136-187. Date accessed: 18 January 2016.

[205] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

[206] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

This example illustrates how difficult it can be to apply the concepts of permanent establishment, residence or source to tax the transaction[207]. Individuals and entities engaging in electronic commerce transactions will be able to create an Internet address in almost any taxing jurisdiction irrespective of the location of their residence or the source of their activities[208]. Moreover, enterprises carrying on business in multi-jurisdictions could move their businesses from one country to another, in a matter of hours. They can locate their business in a country beyond the reach of other countries' tax authorities because the Internet servers can be located anywhere in the world[209].

In addressing, the OECD has amended Article 5 of the OECD Model Tax Treaty to clarify the interpretation of the permanent establishment concept in the circumstances of uncertainty. An Internet website (a combination of hardware, software and data) does not in itself give rise to a permanent establishment, although the hosting server may under certain circumstances[210]. The commentary concludes that equipment, standing alone, could constitute a "fixed place of business". In describing the complete analysis of whether such a place of business could constitute a permanent establishment, the commentary expresses several important principles[211].

Software and data constitute intangible property and therefore do not have any specific location. It therefore follows that they also cannot have a "place of business", as required by the treaty. On the other hand, a server consists of computer hardware that has a location and may under certain

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[207] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

[208] Pinto, D. 1999. Taxation issues in a world of electronic commerce. Journal of Australian Taxation: 227-280. Date accessed: 4 September 2015.

[209] McLure Jr, C.E. 2003. The Value Added Tax on electronic commerce in the European Union. International Tax and Public Finance, 10: 753-762. Date accessed:20 June 2015.

[210] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[211] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

circumstances constitute a fixed place of business. Furthermore, the commentary notes that some uses of the equipment might constitute preparatory or auxiliary activities[212]. If the only use of the computer equipment is to conduct such preparatory or auxiliary activities, then the computer equipment, while it still may constitute a fixed place of business, does not create a permanent establishment on the basis that the business of the enterprise is not carried on through that place[213]. When a company complies with the requirements as set out in the OECD model, a server may give rise to a permanent establishment[211]. When the permanent establishment is determined, the applicable country will be able to impose VAT on the company's sales.

In addition, other factors still need to be determined relating to the Internet servers, for example whether they are fixed in nature and whether the servers were in the specific location for a sufficient amount of time. As it is often with taxation, this will be considered within the context of a specific set of facts and circumstances[214]. Furthermore, the correspondence, between the Internet address (the computer 'domain name') and the location where the activity is supplied carried out or consumed is tenuous: although the address will tell you who is responsible for maintaining that site, it may not tell you anything about the computer that corresponds to the actual Internet address, or even where that machine is located[215].

Consensus must be reached on the question of which country has the right to collect the VAT from a transaction, so that double taxation or unintentional non-taxation is prevented from occurring[216]. Double tax treaties were implemented between countries to prevent double taxation. However, as

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[212] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[213] Sprague, G.D. 2013. Canada Revenue Agency issues important ruling on PE aspects of data center. http://www.bna.com/canada-revenue-agency-n17179873785/ Date accessed: 19 January 2015.

[214] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[215] Owens, J. s.a. Answering the emerging taxation challenges. govinfo.library.unt.edu/ecommerce/document/JeffOwens.doc Date accessed: 18 January 2015.

[216] 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: 18 September 2015.

discussed above, it is difficult to determine the location of the e-commerce transactions and this will pose a challenge for double tax treaties to prevent double taxation[217]. In the following section, a better understanding will be obtained of double tax treaties and the possible challenge originating from ecommerce transactions.

7.5. Double tax treaties

'Double taxation' has been defined as "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods"[218]. Double taxation can arise from dual residence conflicts between countries using different tests of residence under their domestic laws. To prevent double taxation, tax treaties were implemented. Tax treaties provide residents of a state with certainty on how their income will be taxed in the other state, which, in turn, encourages international trade. The purpose of double tax treaties is primarily to avoid double taxation of residents of the two states and to prevent fiscal evasion[219].

It is believed that the existing tax treaty network can accommodate the changes in the way that international commerce is conducted; however, minor modifications to the definitions in those treaties may be required to clarify their application to electronic commerce transactions[220]. Tax treaties should continue to serve the purpose of reducing double taxation by minimising the income tax burdens of non-resident taxpayers in the host country[221]. This is a crucial consideration in the removal of tax obstacles from cross-border commerce (both in its traditional and electronic form).

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[217] Alexiou, C. &Morrison, D. 2004. The Cross-Border Electronic Supply EU-VAT Rules: Lessons for Australian ST. Revenue Law Journal, 14(1): 119-150. Date accessed: 22 August 2015.

[218] Vann, R.J. 1998. International aspects of income tax. Tax Law Design and Drafting (2): Chapter 18. Date accessed: 18 September 2015.

[219] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[220] Alexiou, C. &Morrison, D. 2004. The Cross-Border Electronic Supply EU-VAT Rules: Lessons for Australian ST. Revenue Law Journal, 14(1): 119-150. Date accessed: 22 August 2015.

[221] Anon. 2011. What is the OECD? The Telegraph http://www.telegraph.co.uk/finance/economics/8689078/What-is-the-OECD.html Date accessed: 5 October 2015.

Generally, tax treaties affect source base taxpayers by narrowing the scope of taxability in the source country. As discussed in section 7.4 above, there are difficulties to determine the correct place of supply and whether there is a permanent establishment. Therefore, the application of a permanent establishment in an e-commerce environment is not that clear[222]. Moreover, double tax treaties are bilateral and generally cover income and capital taxes[223]. It should be taken into consideration that the existing double tax treaties are not covering VAT or other consumption taxes as they are excluded. Without double tax treaties, the international community has only avoided double taxation thus far by establishing a general principle, which states that the state of consumption shall be entitled to tax the consumer[224].

Therefore, a key concept of any double taxation treaty is that of a permanent establishment. A permanent establishment is the concept used to determine under a double tax treaty whether a resident of one state has a taxable presence in the other contracting state[225]. However, it was already identified with electronic commerce transactions that it is very difficult to apply the source principle to link a transaction to a certain geographical location[226]. It is already getting more difficult to apply the current tax treaties and the general principles of the Income Tax Act. Moreover, as the tax treaties do not specifically address consumption taxes on transactions, there is a void in the tax treaties between South Africa and other countries and this create challenges for

[222] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[223] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[224] Krensel, A. 2005. VAT Taxation and E-commerce –under special consideration of the 6th EU VAT Directive.

[225] Du Plessis, B. 2006. Cyberlaw@ SA. 3rd Edition. South Africa: Van Schaik Publishers. Date accessed: 17 September 2015.

[226] Stelloh, M. & Stack, L. 2007. Taxation and electronic commerce. Rhodes University. (Thesis: Postgraduate Diploma in Taxation). http://eprints.ru.ac.za/1076/1/Stack_AAPaper09Tax%26E-commerce.pdf Date accessed: 24 October 2015.

all consumption tax transactions. The current tax treaties should be reconsidered and possibly include changes relating to e-commerce transactions and consumption taxes[227].

7.6. Erosion of tax base

When compounding the problem of the existence of an audit trail as discussed in section 4.1 above, the fact is that the Internet makes it difficult for countries to keep track of income generated in their territory, since no government can be aware of all or even most of the websites in the world that offer products or services to their residents[228]. This will lead to the erosion of the tax base for countries. The erosion of the tax base can be defined as the shifting of profits in ways that decrease the taxable base to locations where it is subject to a more favorable tax treatment[229]. The Internet may drain governments' tax revenues either by making evasion easier or by encouraging economic activity to shift to lower-tax countries[230].

The erosion of the consumption tax base resulting from e-commerce has caused considerable concern among governments, given the steep growth of e-commerce in the past years and predictions for the next few years. Differentiated Internet taxation rules among countries could have a significant impact on consumers' purchasing behavior, shifting from domestic to foreign suppliers. Foreign suppliers may be tax-exempted, whereas local suppliers are normally required to charge value added tax (VAT) or sales taxes[231]. The erosion of the tax base is caused by the tax evasion and tax avoidance, which is an integral problem relating to e-commerce transactions.

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[227]Alexiou, C. &Morrison, D. 2004. The Cross-Border Electronic Supply EU-VAT Rules: Lessons for Australian ST. Revenue Law Journal, 14(1): 119-150. Date accessed: 22 August 2015.

[228] McLure Jr, C.E. 2003. The Value Added Tax on electronic commerce in the European Union. International Tax and Public Finance, 10: 753-762.Date accessed:20 June 2015.

[229] OECD (Organisation for Economic Co-operation and Development). 2013. Addressing base erosion and profit shifting. http://www.loyensloeff.com/nl-NL/Documents/OECD.pdf Date accessed: 6 April 2015.

[230] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

[231] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem. International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

Tax authorities have always contended with problems such as tax evasion and tax avoidance [232]. Moreover, the problems relating to tax avoidance and tax evasion have increased and are important issues when it comes to concerns about tax compliance in relation to e-commerce transactions[233]. Electronic commerce could result in an increase in tax avoidance schemes. With international offline transactions, customs could check the import and export of goods. Concerning *bona fide* online transactions, customs will not be involved as the services and goods will be delivered via the Internet. The international sale of goods or services can happen unnoticed by state authorities[234]. It has been recognised that tax evasion can occur when e-commerce businesses mask their identities[235].

Current website name and registration procedures require nothing more than a credit card. There is no existing process to accurately verify ownership or the physical location of the beneficial owner of the website. In an e-commerce environment, the possibilities of hiding transactions are vast and the possibilities of identifying parties to a transaction are in many cases virtually non-existent[236]. Therefore, the potential for tax evasion through e-commerce is very high[237] and the opportunities for tax evasion seem endless[238]. Governments are continuously striving to reduce the

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[232] Basu, S. 2008. International taxation of e-commerce: Persistent problems and possible developments. The Journal of Information, Law and Technology 2008(1). Date accessed: 7 January 2015.

[233] Westberg, B. 2002. Cross-border taxation of e-commerce. Date accessed: 22 November 2015.

[234] 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: 22 October 2015.

[235] 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: 25 November 2015.

[236] Basu, S. 2008. International taxation of e-commerce: Persistent problems and possible developments. The Journal of Information, Law and Technology 2008(1). Date accessed: 7 January 2015.

[237] 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: 25 November 2015.

[238] Basu, S. 2008. International taxation of e-commerce: Persistent problems and possible developments. The Journal of Information, Law and Technology 2008(1). Date accessed: 7 January 2015.

problem of tax evasion because, without taxation, the survival of any government is at stake[239]. It was specifically identified in the European Union that problems relating to possible tax evasion and avoidance arise due to differences in the definitions of services and intangible property in member countries that lead to uncertainty about the tax treatment of such supplies provided by overseas businesses. These differences may open up opportunities for tax avoidance and evasion[240]. It is therefore necessary to establish definitions and rules that are international and applied by all the countries to tax e-commerce. It is possible that e-commerce will result in an erosion of the consumption tax base[241].

Furthermore, e-commerce also makes it easier for businesses to migrate 'overseas'. There can be legitimate commercial reasons why businesses move to another jurisdiction, but there is also a desire to reduce and avoid tax. This highlights another area that has consequences for tax revenues. Since e-commerce provides such mobility and flexibility, businesses will be tempted to locate in low and nil taxed jurisdictions. Consequently, this represents a source for erosion of tax bases[242].

7.7. Conclusion

Challenges experienced by countries that have already started to implement VAT rules on ecommerce transactions were discussed in this chapter. The VAT taxation issues of international transactions are far from being solved and are still a topic of discussion worldwide[243].

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[239] Jain, N. 2013. Tax evasion: A dark side of e-commerce. International Journal of Engineering and Management Research, 3(5): 16-18. http://www.ijemr.net/October2013Issue/TaxEvasionADdarkSideOfE-Commerce(16-18).pdf Date accessed: 25 November 2015.

[240] European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912 EN.pdf Date accessed: 11 September 2013.

[241] Jones, R. & Basu, S. 2002. Taxation of electronic commerce: A developing problem.International Review of Law Computers & Technology, 16(1): 35-52. Date accessed: 21 August 2015.

[242] 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: 25 November 2015.

[243] 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).

Firstly, the challenge exists that there is a limited physical audit trail to verify the details of a transaction and the only verification that exists is electronic versions of invoices, which can be easily altered. This can lead to the changing of details such as the products or services delivered and the relevant parties of the transaction. This can be done to promote the most tax favorable position for tax parties. It might pose a challenge for the South African taxing authorities to verify the details of the transactions and this could lead to a tax loss for the government.

The next challenge that was discussed was the identification of the relevant tax parties to a transaction and the anonymity of the parties. As the parties can supply false details for the transactions, it could be difficult to verify the details of parties by the South African tax authorities. The anonymity of the Internet also increases the challenge to identify the parties of the transaction. It is important to identify the parties to a transaction to determine the relevant tax authorities and the relevant tax legislation that will be applicable. The relevant tax authority is determined by the principle of permanent establishment. The permanent establishment is difficult to determine, as the use of a website alone cannot be used to identify the permanent establishment. The permanent establishment can possibly be determined where the server is located together with other requirements.

The determination of the permanent establishment of the supplier and the relevant tax parties to a transaction may be important for South Africa in order to avoid double taxation and to apply double tax treaties, if applicable, in order to determine which country can tax the transaction. Established double tax treaties can be helpful to identify the relevant taxing authority; however, most tax treaties were created for income tax purposes and not VAT purposes. Moreover, it will be difficult to implement the double tax treaties if the permanent establishment cannot be determined by the

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http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.102.8607&rep=rep1&type Date accessed: 22 October 2015.

South African tax authorities, as the tax treaties are based on the relevant countries where the permanent establishment is.

In addition to the above, the challenge experienced with determining the permanent establishment will give rise to possible tax evasion and avoidance and the erosion of the tax base of a country as the servers can be in tax havens and countries where lower tax rates will be applicable. The Internet may drain governments' tax revenues either by making evasion easier or by encouraging economic activity to shift to lower-tax countries[244]. This can lead to a decrease in the South African revenue base, which is an important source of income for the government.

As can be seen from the discussion in Chapter 4, there are challenges related to imposing VAT on e-commerce. The challenges identified are relevant to all countries that have already implemented VAT on e-commerce. The systems are not yet perfect and alterations are still made to the systems in many jurisdictions to address the challenges. The identification and analysis of the challenges might be helpful for South Africa with the implementation of VAT on e-commerce transactions to avoid similar problems.

In the following chapter, the South African VAT system will be discussed. This is done to identify the impact of the proposal made by the Minister of Finance will have on the current system and whether the above challenges will also need to be considered with the implementation.

[244]European Parliament. 2012. Simplifying and modernising VAT in the digital signal market for e-commerce. http://www.europarl.europa.eu/document/activities/cont/201206/20120628ATT47912/20120628ATT47912EN.pdf Date accessed: 11 September 2013.

CHAPTER 5

8. Conclusion

8.1 Introduction

This research identified that the volume of e-commerce transactions is growing annually and has a direct or indirect significant impact on the economy of South Africa. When the Minister of Finance announced that VAT registration would become compulsory for foreign suppliers importing e-commerce transactions into South Africa, there were many speculations regarding the implication it will have for South Africa.

This research further identified that the current South African VAT legislation has weaknesses that need to be considered for implementation. Furthermore, the current South African VAT structure is much more reliant on the honesty of the taxpayer to declare all imported e-commerce transactions that were incurred. This is difficult to control for the South African tax authority, SARS, and may lead to tax evasion and the erosion of the tax base. Unless South African Tax Authority implements new rules regarding compliance and collection of VAT on e-commerce transactions, the current VAT legislation will not be able to sustain the tax evasion and accuracy and efficient of collecting VAT on e-commerce transactions.

The main objective of this research, as set out in Chapter 1, is to determine whether the current VAT structure and VAT Act in South Africa can support the proposal made by the Minister of Finance and what possible challenges and tax reform should be considered regarding VAT on e-commerce transactions that were already identified by other countries.

8.2. Limitations experienced during the research

During the research, several important limitations were experienced regarding the international and the national VAT systems relating to e-commerce transactions. Limitations experienced on the international VAT system included the lack of a single definition and model for e-commerce transactions. It is difficult to define e-commerce transactions as there are many aspects to the transaction and there is no constant definition or model considering the same factors. Furthermore, the study was limited by the other countries' VAT systems that are still undergoing changes to

perfect the system for ecommerce transactions. This leads to no perfect VAT system that can be used as a benchmark for the implementation of VAT on e-commerce transactions. During the research, it was noted that South Africa lacks place of supply rules resulting in South Africa being one of few countries that have yet not adjusted their VAT systems. This leads to different VAT systems not working coherently together with different rules applicable in the different countries. This leads to inconsistencies in the VAT treatment of e-commerce transactions and the harmonisation of the VAT systems worldwide. The most current legislation and announcements up until the finalisation of the research were taken into consideration.

8.3. Conclusion and recommendation

8.3.1 Conclusion:

E-commerce is creating a new mode of delivering products in a global market in which geographical boundaries and location lose their meaning. There is an abundance of evidence to show that the digital industry is extremely large and rapidly growing as shown in the above chapters. Software products can be converted into bits and shipped directly over the Internet. Most countries' VAT systems require distinguishing between goods and services, yet newspapers, software packages and CDs can now be converted into bits and delivered electronically, and the same will be true for other goods in future. This trend (the electronic software distribution (ESD) revolution) will increasingly redefine domestic and international transactions from physical transactions to intangible electronic exchanges. The Internet entails worldwide sales, which require tax compliance in an undefined number of foreign jurisdictions. For an enlightened and dishonest taxpayer, the Internet may present opportunities as a tax-free haven where anonymous buyers and sellers, offshore web sites and untraceable cash make tax evasion easy.

The main challenge to fiscal and custom authorities dealing with cross-border e-commerce will come from supplies of online activities. Electronic transactions are difficult to monitor, and international electronic transactions might be technically impossible to trace as discussed above, although it may be possible to develop technology for auditing international transactions of some digital products. The Internet, as a globally contestable market, is creating pressure and momentum for trade liberalisation and international harmonization of regulations.

With an expanding market of information technology in South Africa, people require novel ways of dealing with legal issues that arise in the electronic business arena. To remain up to date, SARS has launched a comprehensive web site where essential information such as tax and VAT legislation, rulings, case law, revenue statistics, and forms can be viewed and downloaded. Another enormous stumbling-block to the adoption and growth of e-commerce is the fear of consumers that they might be 'fleeced by unscrupulous web-based business operators and have no legal redress'.

These fears are justified by the current South African legal framework that is designed specifically to provide for paper-based transactions. Basic issues that require attention include developing innovative ways of recovering levies such as VAT from online transactions. If no steps are taken to create solutions, there is a real threat that the further development of the Internet may shrink the tax base and reduce fiscal revenue in South Africa. SARS believes that it will be able to deal with taxing issues surrounding e-commerce by merely modifying existing tax legislation. This remains to be seen. For the time being, there are relatively few indications from SARS that new tax laws relating specifically to e-commerce will be drafted.

In the 2015 Budget Speech presented to the National Assembly on 25 February 2015 the Minister of Finance announced that amendments will be proposed to change the rules for the digital economy in line with the latest guidance issued by the Organisation for Economic Co-operation and Development ("OECD") in its report on base erosion and profit shifting ("BEPS").

The changes proposed for South Africa are based on the interim report of the Davis Committee (the "Report") which submitted that there is limited scope for South African residents to shift profits to offshore tax haven jurisdictions via e-commerce transactions, however, the opposite holds true with respect to e-commerce transactions conducted by non-residents with South African customers. Non-residents are only subject to tax in SA on income derived from a source in South Africa however, the source rules do not deal specifically with e-commerce transactions. As a

result, non-residents can avoid paying tax in South Africa because the source of their income is not in South Africa.

As much as e-commerce presents some difficult challenges to tax administrations, on the other hand it stimulates the challenge of tax collection through more efficient and lower administration and compliance costs. It also further stimulates the review of domestic tax principles, as the policy framework for international tax rules is an important part of establishing the detail. The downside is that this feature of e-commerce poses a threat to the integrity of the consumption tax base. But it also has an upside; it stimulates global competition and may result in a more efficient domestic economy.

The advantages of the transformations taking place in tax regulations must also be kept in mind. As tax systems progress, global competition is stimulated and this may result in a more efficient domestic economy. Areas that might benefit from the review of a tax system include the computer industry, which will have to develop innovative technology capable of providing timely and correct information to taxpayers and administrations. The goal should be to replace the paper documentation using innovative technology.

Conscious of the global scope of the problems, the OECD has been advising countries not to adopt unilateral solutions, even when the slow pace of decision making is criticized. Variations of VAT are in place in 29 of the 30 OECD countries and in various non-OECD countries. To avoid VAT taxation that creates double taxation or unintentional non-taxation, distorts international competition, and restricts international trade, common definitions and rules of interpretation should be detailed in general, multilateral agreements among OECD member states, or in bilateral agreements by other countries, following some or other model VAT convention. Also, all solutions should be measured against the principles of a `good tax' neutrality, efficiency, legal security, simplicity, equity, and flexibility[245].

[245] Charlet, A. & Buydens, S. 2012. The OECD International VAT/GST Guidelines: Past and future developments. World Journal of VAT/GST Law, (1): 175-184.

8.3.2 Recommendations

Improvements and systems that needs to be installed in the republic include computerisation to assist and inform taxpayers, and in this way to replace paper documentation; closer monitoring; new advanced payment systems; and the appearance of new intermediaries in charge of tax. In brief, the current fiscal frameworks must be adapted successfully to face the challenges that have emerged because of the development of the information society, but at the same time we have the chance to make the most of all the new opportunities that it offers. Advanced payment methods should be explored, and the appearance of new intermediaries might present itself as a viable solution. As the information revolution continues to take the world economy by storm, tax principles and systems of tax administration will have to keep up with the changes. The Internet provides a borderless platform for trade, and tax drafters should ensure that the tax systems can cope with this ever-increasing brand of trade. It is well known that officials at SARS are aware of these problems in the field of e-commerce and its application to tax. But for solutions they look to Parliament for new and relevant ideas.

The problems that tax authorities and parliamentarians face are not simple, and the Katz Commission rightly state that 'to seek a pioneering role here, would be both arrogant and dangerous'. What is clear is that the international harmonisation of tax laws is an inevitable product that will result from the current confusion, especially when considering VAT. A future tax system should be based on international consensus to ensure the efficacy of the system. I propose that legislatures should strive for flexible tax systems to allow tax rules to keep pace with further international technological developments.

The OECD plays an integral part in forming and proposing internationally standardised taxation rules. South Africa should be anticipating a clear defining of place of supply rules that it is hoped

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http://www.oecd.org/ctp/consumption/OECDInternationalVATGSTGuidelinesWorld%20 Journal.pdf Date accessed: 07 October 2015.

would accord with global developments in VAT and ensure that the globalisation of VAT is incorporated into our system. What also seems to be clear is that South African parliamentarians and SARS alike are unsure of the VAT treatment of certain transactions relating to the Internet and cyberspace. For the moment, it would be wise for tax advisers to recommend that their clients obtain rulings from SARS to clarify the legal position where a client faces an 'electronic transaction' that is a grey area in the South African law of VAT.

More research can be done in future to determine the impact on the South African economy and feasibility of the new rules in practice with the release of the new Tax Bill regarding the VAT registration for suppliers of e-commerce transaction. A few factors that can be noted on the new tax bill will be highlighted below.

Suppliers of electronic services will face various compliance challenges, including the system changes to cater for these changes; however, this will only be a once-off cost, but can be costly. The new legislation will require that the systems of foreign companies need to be changed to effect price adjustments resulting for the inclusion of the 14% VAT in the prices and invoices and to identify SA resident customers and payments made through SA bank accounts. VAT registration will be a once-off cost and depending on whether SARS streamlines the VAT registration process, it can be expensive and time-consuming exercise. VAT filing costs will be a continuous cost and the frequency of filing will depend on whether SARS will create a special category or period within which these suppliers would need to file. Furthermore, for all foreign electronic service providers, appointing a VAT representative in South Africa who needs to be natural person would be a low but a continuous cost.

It is therefore evident from the research that it is necessary to implement the Tax Bill with recommendations mentioned above and taking to account Davis committee's report on this matter as well, however it will not without enforcement challenges. The implementation of the new Tax Bill is a move in the right direction to create a better South African VAT system in line with international VAT systems.

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