



**PARLIAMENT**  
OF THE REPUBLIC OF SOUTH AFRICA

## Tax Brief: Digital Economy and Taxation Policy Considerations- June 2020

Parliamentary

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Author: Dr Dumisani Jantjies

Enquiries: [djantjies@parliament.gov.za](mailto:djantjies@parliament.gov.za)

To obtain additional copies of this document, please contact:

Parliament of the Republic of South Africa

Parliamentary Budget Office

4<sup>th</sup> Floor Parliament Towers

103-107 Plein Street

Tel: +27(0) 21 403 2508

Fax: +27(0) 21 403 3153

Email: [pboinfo@parliament.gov.za](mailto:pboinfo@parliament.gov.za)

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## Executive Summary

In November 2019 during a Joint Meeting of Standing Committee of Finance (SCOF) and Select Committee of Finance discussion about 2019 Revised Fiscal Framework, the Committees raised concerns about the potential decline in tax revenue and closure of local businesses leading to loss of jobs as a result of growth of digitalisation of economic activities. The Committees subsequently requested further research and analysis to inform the Committees' deliberations on digitalisation of economic activities and its likely impact on government tax revenue.

This brief provides Members of Parliament (MPs) within the Finance and Appropriation Committees with an overview of issues within the digital economy and the implications for tax policy with regards to the generation of new income tax revenues. The brief offers some thoughts about the potential for reform of income tax policy in response to rapid growth of the digital economy. The brief also explores international experiences in relation to the taxation of commercial activities in the digital economy. Various stakeholders have expressed concern about how digitalisation of economic activities might adversely affect the government's ability to raise tax revenue.

The brief thus summarises the following key issues for further considerations by MPs:

- Over the past three decades, the global economy has rapidly digitalised, although the socio-economic impact has been different across countries. This transformation has been in part due to the advancement of technology and innovations;
- The expansion and digitalisation of economies has largely been driven by the growth and availability of digital data, parallel to the capacity and availability of processes to monitor the digital data. There is a lack of consensus in terms of the anticipated human and economic repercussion of the continued digitalisation of economic activities. However, there are some indications that many economies have been disrupted leading to loss of jobs and loss of government revenues;
- There is a great need to ensure that economic policies and governments regulatory frameworks, including tax rules keep up with the rapid digital transformation of economies. Failure to do so has the potential to accelerate economic inequalities and further hinder human and economic development of many developing countries;
- International taxation rules are intended to allocate taxation rights fairly for income generated cross-border transactions for different countries. Therefore, current international debate on how to transform the international tax rules should account for the rapid growth of the digitalisation of economies globally as a basis for reform.

- South Africa's green paper on electronic commerce, published in 2000, raised concerns about the progress of digital technology in business when a proper tax mechanism was lacking to ensure that tax revenue was generated from electronic economic activities;
- South Africa is one of the first countries to introduce taxation on the consumption of digital economy activities, VAT. The first four years of introducing VAT on digital economy raised more than R2 billion in additional tax revenue. However, the introduction of taxation measures for the income of digitalised economic activities is yet to be realised; As a result, South Africa continues to lose potential income tax revenue from digital economic activities;
- Due to the 1998 WTO Moratorium in Custom Duties on cross-border digitalisable products and services, a study by UNCTAD suggest that South Africa will continue to lose the revenue potential of more than R500 million annually;
- South Africa can consider a unilateral approach to taxing specific income from digital economic activities. However, government may require additional human and institutional technological capacity to develop and implement unilateral taxation effectively on the digital economy. There would also be a need to consider implications for international cooperation and the role of international agreements that are based on international tax rules;
- The current draft of the OECD Inclusive Framework recognises the need for unitary taxation. This is in addition to principles of ensuring international cooperation and predictability of an international tax system. However, the Inclusive Framework's current form makes it implausible for developing countries such as South Africa to implement it without a higher compliance cost; Further delays, in reaching consensus about the Inclusive Framework means a continued loss of potential additional tax income;
- Many countries have opted for a unilateral tax policy approach to taxing income from the MNEs operating in a digital economy. Many OECD countries are at the forefront of adopting a unilateral taxation approach in spite of the OECD having drafted an Inclusive Framework intended to develop a multilateral framework for taxing the digital economy; Examples of unilateral measures include, tax targeting specific digital driven commercial activities, withholding tax on cross border digital economy related income;

This brief gives an overview of the complex and, at times, highly contested international tax issues facing South Africa. It indicates that the oversight processes conducted by Parliament can be strengthened by more research on the impact of the South African tax system on the digital economy and accompanying socio-economic issues. This brief is largely based on desktop analysis, taking into account both global and domestic discourses around taxation and concrete experiences of fiscal issues in the digital economy.

## 1. Introduction

The outbreak of Covid-19 has led to the shutdown of many economies around the world to slow the spread of the virus while research for a vaccine continues. The national economic lockdowns have affected global supply chains, leading to the slowing down of the supply and demand sides of economies. As a result of these lockdowns, many economic sectors have been forced to close (e.g. the tourist and air travel sectors), while others have continued their economic activities exclusively online and via other digitised platforms. It is still too early to determine the societal and economic impact of the Covid19 confidently and accurately. However, there has been growing demand from governments around the world to provide both medical and fiscal support to societies in dealing with some of the worst effects of Covid19.

South Africa resembles other countries in that, since the national lockdown, there has been greater digitalisation of economic activities. According to surveys conducted by STATs-SA and Western Cape Provincial Government (WCPG) in April 2020,<sup>1</sup> many economic sectors operating in a non-digital environment are expected to see a decline in business, with the tourism, accommodation and entertainment subsectors expected to lose more than 60 per cent of their income in 2020. The anticipated decline in business activities is largely due to the fact that these subsectors depend upon physical human interactions and movement. The current national lockdown is therefore expected to lead to a further decline in these sectors of the economy.

According to the United Nations Conference of Trade and Development (UNCTAD), the number of online shoppers has doubled globally since the 2008 Global Financial Crisis (GFC). Business-to-consumer (B2C) e-commerce transactions having increased from less than \$1 trillion (R 18 trillion) to more than \$3.8 trillion (R68.4 trillion) since 2008.<sup>2</sup> The combined market value of digital multinational enterprises (MNEs) like Amazon, Apple, Facebook, Google and Microsoft was \$500 billion (R9.2 trillion) in 2008 and, by mid-2019, had peaked at more than \$7.5 trillion (R 138 trillion) before the outbreak of COVID19.<sup>3</sup> A recent report by Forbes shows that within two months of Covid19 lockdowns, from March 2020, technology and online oriented MNEs (Facebook, Amazon, Microsoft, Oracle, Google, TELECOM, Tencent Holdings, Alibaba Group, Dell Computers) accounted for more than 78 per cent of \$225 billion (R4.050 trillion) of value created in the stock market.<sup>4</sup>

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<sup>1</sup>Stats SA, (2020) Business impact survey of the COVID-19 pandemic in South Africa and Western Cape Provincial Government, (2020) Business Survey Report - the impact of COVID-19 on businesses

<sup>2</sup>Digital Economy Update- The COVID-19 Crisis: Accentuating the need to bridge Digital Divides, April 2020

<sup>3</sup>Rand amounts uses R/\$18 exchange rate. The rate will be applied through the brief

<sup>4</sup>Jonathan Ponciano, (2020) The World's 25 Richest Billionaires Have Gained Nearly \$255 Billion In Just Two Months, Forbes, <https://www.forbes.com/sites/jonathanponciano/2020/05/22/billionaires-zuckerberg-bezos/#668db447ed61>

According to the online research group, World Wide Worx, South African online shopping was expected to constitute 1.4 per cent (R 14 billion) of total retail trade in 2019.<sup>5</sup> These predictions are expected to increase and accelerate due to the Covid19 pandemic and related restrictions leading to more online trade. However, increase in unemployment during this period is likely to lead to a decline in demand in general. During the announcement of lockdown risk level 4 regulations in April 2020, the Minister of Trade, Industry and Competition, Mr. Ebrahim Patel, argued that restricting general e-commerce trading was intended to protect Small Medium and Micro Enterprises (SMMEs) and informal traders lacking access to e-commerce trading or digital markets.<sup>6</sup>

The continued digitalisation of economic activities is also expected to disrupt the working of governments. Over the past two decades, the ability of governments to raise tax revenue has, in part, been hindered by the lack of targeted digital economy taxation measures. Therefore, rapid growth in digitalisation of economic activities has led to failure to collect a new stream of government income taxes. The Covid19 crisis is expected to amplify the loss of government income tax revenue. The reason is that while many economic sectors have digitised their economic activities, non-digitalised sectors that contribute to government taxes will see a decline in their taxable income.

The brief begins with an overview exploring the trends towards transforming the present economy into a digital economy that is driven by the availability of digital data. This overview contextualises the environment within which taxation policy can be considered in terms of corresponding measures directing the activities of the digitalised economy. The next section of the brief continues with an account of the emergence of the digital economy taking into account recent discourses within finance and appropriations committees. The following section then provides the international context for taxation and explores discourses around taxation and the digital economy.

The brief will next provide an analysis of South African approaches to developments in the digital economy. The final section provides international experiences and developments in relation to taxation within digitalised economies and offers further observations about the South African approach. The insight into international taxation approaches and experiences provides patterns for MPs' consideration during the oversight over government measures of

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<sup>5</sup><http://www.worldwideworx.com/onlinetail2019/>

<sup>6</sup>Techcentral, (2020) Patel backs down, unbans unfettered e-commerce <https://techcentral.co.za/patel-backs-down-unbans-unfettered-e-commerce/98031/>

taxation in digital economy status on reform on current taxation measures on income tax. The final section provides a short conclusion to this brief.

## 2. Background in Context

Over the past three decades, global society has seen rapid technological advances growth of digitalisation of companies and organisations within the global economy. While Covid19 is a medical challenge facing humanity globally, it is expected to lead to rapid transformation in ways of doing business more digitally across the economy.

According to the UNCTAD 2019 report on digital economy,<sup>7</sup> the global economy is yet to realise the full potential of data-driven economy. Recent reports state that the impact of the Covid-19 pandemic<sup>8</sup> will lead to more digitalisation of economic activities that is likely to escalate the loss of Gross Domestic Products (GDP) in developing countries. If multilateral agencies fail to reform the multilateral economic system with due attention to developmental objectives of developing countries, then these losses could amplify global economic inequalities experienced predominantly by developing countries.

There has been a significant increase in global digital and data-driven economic activities over the past three decades. The size of global digital data exchange has increased from hundred (100) gigabytes per day in the year 1992 to forty-seven thousand (47 000) gigabytes per second in 2017. This surge in global digital data exchange is expected to surpass one hundred and fifty thousand (150 000) gigabytes per second by the year 2022.<sup>9</sup> Now, with the growth heightened experience of digital data exchanges resulting from the COVID19 crisis, the digital data exchange could easily surpass hundred and fifty thousand gigabytes by the year 2022.

**Table 1- Global growth in digital data exchange**

Year of Measure	Global digital data exchange	Gigabytes
1992	100	per day
2017	47 000	per second
2022	150 000	per second

Data source: UNCTAD, 2019

The growth of the digitalisation of economic activities presents huge implications for societies and those policymakers or government agencies charged with developmental governance. Taking into account the impact of Covid-19 on South Africa, and related lockdowns around the world, the continuation of work and learning online reveals a significant trend towards greater

<sup>7</sup>UNCTAD 2019 Digital Economy Report

<sup>88</sup>A Kwa, F. Rosales and P. Lunenburg, (2020) COVID-19 and WTO: Debunking Developed Countries' Narratives on Trade Measures, Policy Brief No 77, South Centre

<sup>9</sup>UNCTAD 2019 Digital Economy Report



digitalisation of many economic sectors. There is a corresponding impact on people's way of life. The growth in digitalisation has also created an opportunity for policymakers to develop and implement innovations in economic activity, like improving industrial and trade policy while ensuring that international tax rules are reformed and newly fit for purpose.

Since the 2008 GFC, many countries have considered, at both multilateral and unilateral level, the need to reform international taxation rules to limit fiscal losses resulting from the abuse and inherent gaps of the current tax rules. Taxing digitalised economic activities has featured more and more in such deliberations. However, there has not been a multilateral consensus on how to allocate the taxation rights with regard to the income and profits of MNEs in a digital economy. This lack of multilateral consensus has in part led to many developing and developed countries pursuing unilateral approaches to taxing the income accrued from digitalised economic activities.

### 3. Understanding digital economy

At the beginning of 2020, the owner of a local Cape Town bed and breakfast (B&B), who purported to represent the views of the local tourism sector, raised concerns about allowing technology-oriented accommodation providers (like Airbnb) to operate in the city. This B&B owner was concerned that allowing digital platforms to operate given the gap in rules and regulations (including local, provincial and national taxes, tariffs, fees and levies) is likely to lead to many local non-digital businesses closing down and further leading to loss of jobs in the industry within the city.

Of course, the situation of the tourism industry globally has become increasingly dire as a result of COVID-19 and the accompanying restrictive regulations, suggesting that many domestic companies are on the verge of collapse. Since many companies or operators have opted for temporary closure, this could be an opportunity for government to develop regulations and rules that transform the tourism sector to support broader socio-economic measures. The challenges facing the sector is reflected in government strategic policy documents, focused upon a vital sector able to support economic development and transformation.<sup>10</sup> Moreover, this sector is also able to absorb more low skill or semi-skill employment faster.

On numerous occasions, including SCOF meetings, the Chairperson Mr. Joseph Maswanganyi raised concerns about the potentially negative macroeconomic, socioeconomic and fiscal implications of digitally operating business being conducted without proper and targeted rules

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<sup>10</sup>Department of Tourism Annual Report 2019/20

and regulations. He raised one such concern in November 2019 in a discussion of macroeconomic and fiscal policy where the PBO and Treasury (NT) were in attendance. He said

*“Unregulated business, like the taxi app ‘Uber’ in the transport sector. Legal taxi drivers were complaining and protesting. ‘Uber’ operated without a permit and generated a lot of money. Due to its sophisticated technology from the United States, SARS could not properly regulate the app. The Fourth Industrialised Revolution had implications for SARS that needed to be discussed. The same held true for online shopping. Online shopping killed big retailers. Companies like Edgars struggled and collapsed; malls would be empty soon. The government could not be quiet when such huge retailers collapsed, as they employed thousands of people. The issues had to be included in the report in detail.”*

To take a more recent example. During the recent SCOF meeting briefing<sup>11</sup> by the NT and South African Revenue Services (SARS) on the subject of their 2020/21 Annual Performance Plans and Budget in May 2020, member of SCOF Mr. Floyd Shivambu raised a concern as to whether SARS has capacity to raise more tax revenue from digitalised economic activities, as he said:

*‘What is SARS’ strategy to collect revenue within the digital economy? I am asking for a concrete report from SARS on how revenue will be collected in the virtual and digital economy? The shift into that space has been happening even before the pandemic.’*

At the heart of these three examples, and many other similar cases in South Africa and elsewhere in the international community, is the feeling that there should not be a new innovative business model or that technology advancement should be stopped. Instead, it is believed that regardless of their being online, all economic activities should be subjected to similar taxation rules and related regulations. The advancement of technology and introduction of innovative measures into production and consumption should avoid perpetuating economic inequalities, unfair competitive environment and stopping countries from raising much needed tax revenues. The concerns about the impact of the transformation of the economic activities operating in a digitalised environment requires a better coordination of a macroeconomic approach within a regulatory framework governing technology.

### **3.1. Technology Advancement and Digital economy**

A single common or agreed global definition of the concept of a ‘digital economy’ is currently lacking. One conventional understanding of this concept is of a digital transformation of the

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<sup>11</sup>National Treasury & SARS 2020/21 Annual Performance Plans; with Minister & Deputy Minister, Finance Standing Committee, 05 May 2020, <https://pmg.org.za/committee-meeting/30136/>

interrelated activities of production and consumption of goods and services within given sectors or states within a region or the global community. These interrelated activities and process are intended to determine the distribution of assets and other resources within a given society, state or global setting. The interrelated activities of production and the consumption of goods and services further determines the level of economic growth and reproduction of factors of production.

With digital technology, interrelated processes connected to the production and consumption of goods and services have been radically transformed over the decades. This transformation has been in part due to advancement of technology and innovations. Over the decades, this transformation has been classified into four revolutions, popularly known as the first, second, third and fourth industrial (4IR) revolution. Since the initial (1<sup>st</sup>) industrial revolution, governments across the world have developed (and continue to update) economic and regulatory frameworks and rules to guide and direct the production and consumptions of goods and services. One example of these structures include a system for distributing the economic benefits derived across society, which touches upon taxation rights within economies. Hence, unilateral, bilateral, plurilateral and multilateral economic and legislative frameworks have emerged to guide the societies and economies over the decades.

The goals or objectives of unilateral, bilateral, plurilateral and multilateral economic regulatory and frameworks thus serve to ensure that the benefits derived economic performances are fairly and equitably distributed to societies. However, the history of the WTO and the trade agreements between developed and developing countries shows that these goals have not been realised. Nevertheless, the level of economic and human development varies between countries, entailing that the advancement of economic regulatory and legislative are also seen and experienced differently. For examples, the least developed countries are concerned that international taxation rules that may have benefited developed countries fail to take into account their own development objectives.<sup>12</sup>

The advancement of technology has led to the digitalisation of significant parts of activities and processes in the production and consumption of goods and services. A full account of the digitalisation of economic activities could be categorised into; i) digitalisation and integration of supply chains, ii) designing rapid prototyping and customisation, iii) advanced

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<sup>12</sup>United Nations Economic Commission for Africa - Investment Policies and Bilateral Investment Treaties in Africa: Implications for the Regional Integration (2016) Addis Ababa

manufacturing and automation and iv) e-commerce online search and social media platforms.<sup>13</sup> As digitalisation continues across many economic sectors, there is also a need to ensure that economic policies and legislative frameworks keep abreast of technological advances together with the effects of technology on society and economies. For example, taxation policy, reform to ensure that societies continue to share the benefits of the production and consumption of goods and services.

### **3.2. Digital data and economy**

The expansion and digitalisation of economies has largely been driven by the growth and availability of digital data,<sup>14</sup> parallel to the capacity and availability of processes to monitor the digital data.<sup>15</sup> However, it is debatable as to which came first, digital data or economic activities, in the accumulation of such data. Nonetheless, the capacity and availability of evermore digital platforms to collect and analyse data digitally to provide products or services for consumption in an economy has led to further digitalisation of economies the world over.

Within this context of the digitalisation of economies, we should underline that digital data involves a variety of raw or partly processed information from either consumers, intermediaries or producers. The usefulness of digital data may also be dependent on whether or not it is i) personal or non-personal data, ii) for commercial use or government purposes, iii) collected from volunteers or through observation, or bought or referenced, iv) includes confidential or non-confidential data. There is also the question of whether or not the digital data is collected through structured or unstructured methods, as an unstructured approach makes it far more complex to collect data reliably and reach a common understanding about value creation.

### **3.3. Global Narrative and Perspectives**

Discourses about technological advancement continue in a global context and how such development is affecting societies and economic development. These global discussions have taken place on various multilateral platforms and organisations including the World Trade Organisations (WTO), World Economic Forum, UNCTAD, Organization for Economic Co-operation and Development (OECD), the African Union (AU) and other platforms.

The outbreak of Covid19 has also accelerated discussions about the advancement of technology and its use thereof to enhance the efficiency of societies and raise economic development.

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<sup>13</sup>Industrial Development Think Tank, (2019) Towards a Digital Industrial Policy for South Africa: A review of the Issues

<sup>14</sup>Digital data: data that represents other forms of data using specific machine language systems that can be interpreted by various technologies. The most fundamental of these systems is a binary system, which simply stores complex audio, video or text information in a series of binary characters, traditionally ones and zeros, or "on" and "off" values,

<sup>15</sup>UNCTAD 2019 digital data report,

Debates around technological advancement are dependent on the conceptual context used to frame discourse according to the discursive categories of i) the fourth industry revolution, ii) artificial intelligence and data analytics, iii) the internet of things, iv) the gig economy, v) automation and robotics, vi) cloud computing, vii) blockchain technologies and so on. One common feature to these discourses is how these technology advancements are disrupting societal and economic development across the globe. For example, there is the question of whether or not they produce additional poverty and income inequality, increase unemployment and lead to the loss of governments' ability to regulate them.

There is an international consensus that the global traffic of digital data has grown significantly over the past three decades and is expected to grow faster in the near future. The ability to convert the collect-store-analyse-transform data process into market intelligence constitutes a major source of value creation within the digitalised economies. However, many developing countries lack capacity in terms of technical skills, infrastructure and institutions to create value from digital data. The corresponding concern is that the lack of such capacities could lead to economic inequalities being further exacerbated globally to delay human and economic development. As a result of this concern, multilateral institutions like the UNCTAD have supported economic policies or proposed legislative frameworks to ensure that advances in economic digitalisation are to the benefit of both developing and developed countries. One such policy is a need to reform international taxation rules to make them suitable for digitalised economies.

The extent of the digitalisation of economic activities has always been considered in terms of the extent to which the production of goods and service and the consumption is digitalised. By 2019, digitalised economic activities had come to account for broadly 15.5 per cent of the global economy (GDP), while the principal large-scale digital economic activities were concentrated in United States of America (USA) and China. A study of cross-border transactions on trade activities,<sup>16</sup> shows that cross border electronic trade has increased over time. This research compares the physical trade in goods and services with those tradable online or digitally. The findings are that rapid growth in the digitalisation of cross-border trade, formerly taking a physical form, has led to the failure to reach a global consensus on proper international and domestic taxation frameworks and could result in huge fiscal losses.

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<sup>16</sup>UNCTAD 2019 digital data report

## 4. Digital Economy and Taxation

Governments throughout the world have seen a decline in taxable revenues since the 2008 GFC. These experiences have elevated global discussion about closing the gaps abused by MNEs in international taxation frameworks. The G20 and OECD took an initiative and formed the Base Erosion and Profit Shifting (BEPS) Committee to reform international tax measures and deal with BEPS. The BEPS Committee then proposed mechanisms that would lead to reform of the key international taxation frameworks - BEPS 15 Action Plan Reports. One of the BEPS 15 reports deals with base erosion and profit shifting due to digitalisation of economic transactions.<sup>17</sup>

Given the effects produced by the digitalisation of economies and due to concerns that the BEPS Action 1 report is not exhaustive in addressing the concerns of developing countries, deliberations on the taxation of digitalised economic activities continue to seek reforms to international and domestic taxation frameworks. There is a particularly strong argument for multilateral and unilateral approaches deliberately developing approaches and measure to make sure that the income and profits of the digital economy are distributed fairly and equitably. The allocation of taxation rights over the income or profits of the digital economy should address economic inequalities and ensure that developing countries receive revenues similar to those enjoyed by counterparts from advanced economies. Over and above fair and equitable distribution of these income and profits, there is a need for multilateral rules consensus about the protection of ownership and control of digital data collected used by MNEs.

### 4.1. Incompatible International Tax Rules

Currently, there is a lack of consensus in terms of the anticipated human and economic repercussion of the continued digitalisation of economic activities. However, there are some indications that many economies have been disrupted leading to loss of jobs and loss of government revenues. There is a great need to ensure that economic policies and state regulation keep up with the rapid digital transformation of economies. The reform of income tax laws should also tackle the current difficulties experienced in enforcing the current laws and regulations in relation to cross-border digital goods and services.

The income tax policies used to determine taxing rights have also come under scrutiny. The question is whether the current taxation model conventions are effective in raising revenue given the continued rapid growth in the digitalisation of economic activities.<sup>18</sup> The incidence of deliberate economic lockdowns due to Covid19 has also accelerated the growth in digitalisation

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<sup>17</sup>OECD/G20 BEPS, 2015 Addressing the Tax Challenges of the Digital Economy, ACTION 1: 2015 Final Report

<sup>18</sup>Taxation model conversion: is a multilateral framework from which international taxation laws are based

of economic activities in South Africa as well as internationally. Concerns about the effectiveness of current international taxation measures for a digitalised economy are similar to those raised by the League of Nations, which intended to develop fairer international taxation rules. It is clear that the international taxation rules have worked to a certain extent, even given continued abuse of the system. However, for many countries the digitisation of the economy in the current economic climate continues to pose further challenges in raising much needed tax revenue.

#### 4.2. Value Creation and Taxing Rights

International taxation rules are intended to allocate taxation rights fairly for income generated cross-border transactions for different jurisdictions, while also eliminating double taxation and non-taxation. For example, allocation of the taxing rights could be based on *residence* or the *source bases principle*. In essence, countries choose either to use either residence base or source base to levy taxes on income generated from international economic activities. *Residence base* means that taxation rights are allocated based on the status of the taxpayer either being resident or not. Residents (corporate and individual taxpayers) are taxed on all their worldwide income regardless where such income is generated.

On the other hand, *source base* refers to taxing of income based on sources or the place where the income is generated. These taxing rights allocation bases use a legal form (jurisdiction chosen by taxpayer as their residence) of the taxpayer as opposed to an economic form (jurisdiction of economic activities). In a digital economy, legal formation may differ substantially with economic form, in that MNE may generate income from many jurisdictions without necessarily being resident.<sup>19</sup> Therefore, the current international tax principles may fail to prevent tax avoidance of abuse MNEs operating in multiple jurisdictions. Certainly, in terms of allocating taxing rights between various jurisdictions, commercial activities in newly digitalised economies expose the weaknesses in the current international taxation rules.

Moreover, the tax system lacks guidance in determining the correct jurisdiction for value creation in cross border digitalised economic activity. As a result of this weakness, allocating taxing rights accurately and fairly has become complex for many jurisdictions. For example, a MNE that operates within a digital economic activity or digital platform (*based in a particular jurisdiction*) and global users (from various jurisdictions) can create value (generate income, say *advertising revenue*) from the digital platform while their residence jurisdiction is different from

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<sup>19</sup>Du Plessis, (2007), the principles of source and residence taxation of electronic commerce transactions in South Africa

those where value is created. At times, digital transactions are initiated and executed in more than two jurisdictions making it difficult to agree or determine where exactly value is created and where precisely the proportional ratio allocates the taxation rights amongst multiple jurisdictions.

The largest MNEs dominating global digital economic activities are residents of developed countries with subsidiaries all over the world, e.g. Google, Amazon, Apple, Facebook, Uber and Air BnB headquartered in USA. In some cases, these MNEs have been accused of BEPS because while many developing countries have limited human technicians, technical institutions and other resources they attempt to pursue MNEs to contribute their fair share of tax, which proves to be a costlier process than in developed countries. At the same time, the subsidiaries of the MNEs operating in developing countries are able to shift profits as they would expense, like management fees or royalties or service charges and others, so eroding tax bases.

In essence, the current international taxation rules are unable to provide a reliable guide to many jurisdictions to determine the correct framework for value creation. Moreover, this lack hinders the process of allocating taxing rights accurately from digitalised economic activities. The fact is that the foundation of international tax rules is mainly residence and source based. These are the challenges and concerns that have seen many jurisdiction pushing for reforming international taxation rules to account for digitalised economic activities. In turn, OECD countries and observing states are taking the initiative to focus on reforming the international taxation rules in an attempt to develop a multilateral consensus on dealing with taxation of digitalised economic activities. The OECD initiative has not stopped many countries from initiated their own unilateral approaches to develop domestic taxation rule for taxing digitalised economies.

#### **4.3. Unitary Taxation Principle**

The broader debate about the current international taxation rules concerns the extent to which the current OECD and UN taxation conversion models are still fit for purpose.<sup>20</sup> It is given that international tax rules have fundamentally remained the same regardless of changes in global economies activities insofar as these models were developed as early as post-World War One. Hence, the current economic, social and political climate may be completely different from their post-war equivalents.

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<sup>20</sup>Taxation model convention: a framework from which international taxation laws are developed.



As indicated earlier in the brief, today's international taxation models are largely based on the principle of legal form over that of economic form or substance, where taxing rights are based on economic activities or where value is created. Therefore, the current international debate on how to transform the international tax rules should account for the rapid growth of the digitalisation of economies globally as a basis for reform. Being that value creation is significant in allocating fair taxing rights, the main issue at the centre of the debate on reforming international tax rules is reaching a consensus on the jurisdiction of value creation. Value creation here should be seen as an economic form rather than the legal form, while the principles set out in current international tax defines value creation from legal rather than economic parameters.

One approach to addressing the value creation challenge present in the research literature but otherwise disregarded relates to the recognition of the global income of MNE for income tax purposes (together with subsidiaries in various jurisdictions). This approach is known as unitary taxation,<sup>21</sup> where global income and profit are determined first and only then are taxing rights allocated to various jurisdiction based on a formula that recognises the economic activities that led to value creation. The economic activities sought to determine the unitary taxing rights include the sales and advertising sector, labour, assets and many other economic activities. The unitary taxing approach is thus intended to eliminate the erosion of the tax base and the ability to shift profits. This unitary tax was initially proposed by UN research under the hypothesis that current tax rules recognise MNEs and their subsidiaries (from different jurisdictions) as separated entities perpetuating BEPS. They perform this manoeuvre by shifting profits from subsidiaries in jurisdiction with a higher tax rate to those with lower tax rate. Recognition of unitary taxation has thus given various jurisdictions the right to levy a tax on income despite such profits having been shifted to other jurisdictions.

The OECD-led initiative drafted an Inclusive Framework based on unitary tax principles, where MNEs are recognised as global taxpayers so allowing for reallocation of profits for tax purposes. The acknowledgment of the unitary tax principle by the OECD is seen as a progressive development towards reforming the international tax system. This reform would fundamentally shift the way in which international tax rules recognise global income and profit generated by MNEs. This approach also allows for the reallocation of income or profit considered to have been shifted from jurisdictions that create value. As proposed in the OECD inclusive framework,

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<sup>21</sup>Sol Picciotto, (2012) Towards Unitary Taxation of Transnational Corporations, Tax Justice Network [http://www.taxjustice.net/cms/upload/pdf/Towards\\_Unitary\\_Taxation\\_1-1.pdf](http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf)

the recognition of the unitary approach may, if adopted at multilateral level, empower many developing countries to recover eroded tax bases and further strengthen international tax system predictability and cooperation.

## **5. South Africa and Digital Economy Taxation**

Until recently, the portrayal of the digital economy deliberations in South Africa has been dominated by academic spaces over the years, but now President Cyril Ramaphosa and some Ministers have established technology and related advisory committees.<sup>22</sup> However, the debate on the digital economy has yet to lead to more significant changes in government policies, such as tax laws.

Certainly, South Africa has adopted a consumption tax for digitalised economic activities. A digital tax on the consumption of digital economic activities was introduced in 2013 which came into effect in 2014, largely in response to growing concerns that there was a sufficient base for digital economic activities. Doubtlessly, there are other visible instances of where cross-border goods and services dominate some of the domestic markets, e.g. online advertising, software, video games, online movies and music and others. However, it is unclear as to whether current digital taxation on the consumption of digital goods and service is broad enough to include other digital economic activities created by data-driven activities like social media platforms.

South Africa is yet to initiate a process to develop tax rules that will specifically focus on taxing income or profits generated from digitalised economies activities. However, South Africa has largely benefited from observing the OECD international tax guidelines and the government is currently awaiting finalisation of the OECD inclusive framework. The OECD process is intended to finalise international taxation approaches in digitalised economies. This is considered to be plurilateral and to be adopted multilaterally. The completion of the OECD process was planned for the end of 2020, while it is worth mentioning that the targeted completion date (end of 2020) was set before the outbreak of Covid19. It is therefore to be expected that the OECD inclusive framework process will be delayed, being that more countries have shifted their focus to dealing with the virus' impact on economies, societies and the taxation system.

The drafted OECD Inclusive Framework has been criticised for being more interested in protecting the tax base of their member states, as some of the economic sectors provisions are excluded from the approach, like the finance sector, mining and extractive the industry, airlines and the shipping industry. The OECD inclusive framework approach has also set high income

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<sup>22</sup>E.G. 4IR Commission at Presidency

thresholds (EURO 750 million) to be considered for taxation. In retrospect, many OECD member states have benefitted from the current international taxation system. There is consequently a lack of trust amongst some of the non-member states as to whether this OECD-driven solution would benefit everyone.

The concern for non-OECD member states, including South Africa and other African countries, should be how much influence they have upon reform of these international taxation rules. Having some level of influence of the process would ensure that the reform process reflects upon how digitalisation of economic activities affects the economic targets of developing countries. In particular, income tax revenue contributes significantly towards government revenues in developing countries, with international income tax contributing more than 10 percent on average.<sup>23</sup> Beside the OECD process, other multilateral processes taking place at UNCTAD within the UN have intended to support international taxation rules reform processes, yet the UN process itself has not been able to determine deadlines.

### 5.1. Digital Economy and Consumption Taxation

South Africa was one of the first countries<sup>24</sup> to implement a consumption tax on the digitalisation of economic transactions.<sup>25</sup> The government's consumption tax on digitalised economic activities was introduced by amending the then taxation law to include e-services in the definition of supplies in consumption taxation. Within three years of introducing the taxation on the consumption of digitalisation of goods and services in 2014, an associated additional R 2 billion of tax revenue was raised by 2017. In addition, more than two-hundred new foreign taxpayers were registered in the same period. The taxation rules on the consumption of digital goods and services did not distinguish between the business to business (B2B) and business to consumer (B2C) economic activities. Distinguishing between B2B and B2C allows the tax system to target consumption, although this can be complex in cross-border transactions. During the introduction of the consumption tax on digital economy there were concerns that B2B transaction should be treated differently or be subject to a different tax regime.<sup>26</sup>

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<sup>23</sup>Martin Herson,(2017) Developing Countries' Role in International Tax Cooperation

<sup>24</sup>Norway was one of the first countries to introduce consumption taxation of digitalization activities,

<sup>25</sup>Deloitte, (2019) VAT in a digital economy Driving co-operation across borders,  
<https://www2.deloitte.com/za/en/pages/tax/articles/vat-in-digital-economy.html#>

<sup>26</sup>Deloitte, (2019) VAT in a digital economy Driving co-operation across borders,  
<https://www2.deloitte.com/za/en/pages/tax/articles/vat-in-digital-economy.html#>

## 5.2. Digital Economy and Income Taxation

South Africa's green paper on electronic commerce was published in the year 2000.<sup>27</sup> It raised concerns around the progress of digital technology in business when a proper tax mechanism was lacking to ensure tax revenue was generated from electronic economic activities, so shrinking the income tax base. The green paper cited inherent limitations related to defining jurisdictions within digital economies, as well as challenges around administration and enforcement of tax laws within the digital economy.

There have continued to be complaints and concerns over the past few years from both online and non-online industries in South Africa<sup>28</sup> that they continue to be taxed while their global counterparts operating in the Republic escape or contribute lower taxes locally.<sup>29</sup> Many South African corporate taxpayers argue that the lack of tax reform for digital economic activities constitutes an unfair advantage with digital MNEs operating domestically to enjoy over local business, one example is MultiChoice calling for Netflix to be regulated.<sup>30</sup>

In essence, digital economy MNEs retains a large proportion of their income generated within the Republic. However, it is worth noting that businesses operating within the digital economy in South Africa continue to benefit from lack of targeted digital taxes regardless of their residential status. In 2016, Price Waterhouse Coopers (PWC) estimated that the revenue that Google and Facebook made in advertising in South Africa would reach about R 70 billion by 2021.<sup>31</sup> Therefore, lack of income tax rules targeted at digitalised economic income or profits means the fiscus is losing out. It is therefore worrying that local competitors are negatively affected because of the ability of digital MNEs to advertise their products and take away a bigger market share while failing to contribute their fair share in local taxes.<sup>32</sup>

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<sup>27</sup> Department of Communications Republic of South Africa, (200) A green paper on electronic commerce for South Africa

<sup>28</sup> Industries include: network services, IT related services and online advertising services

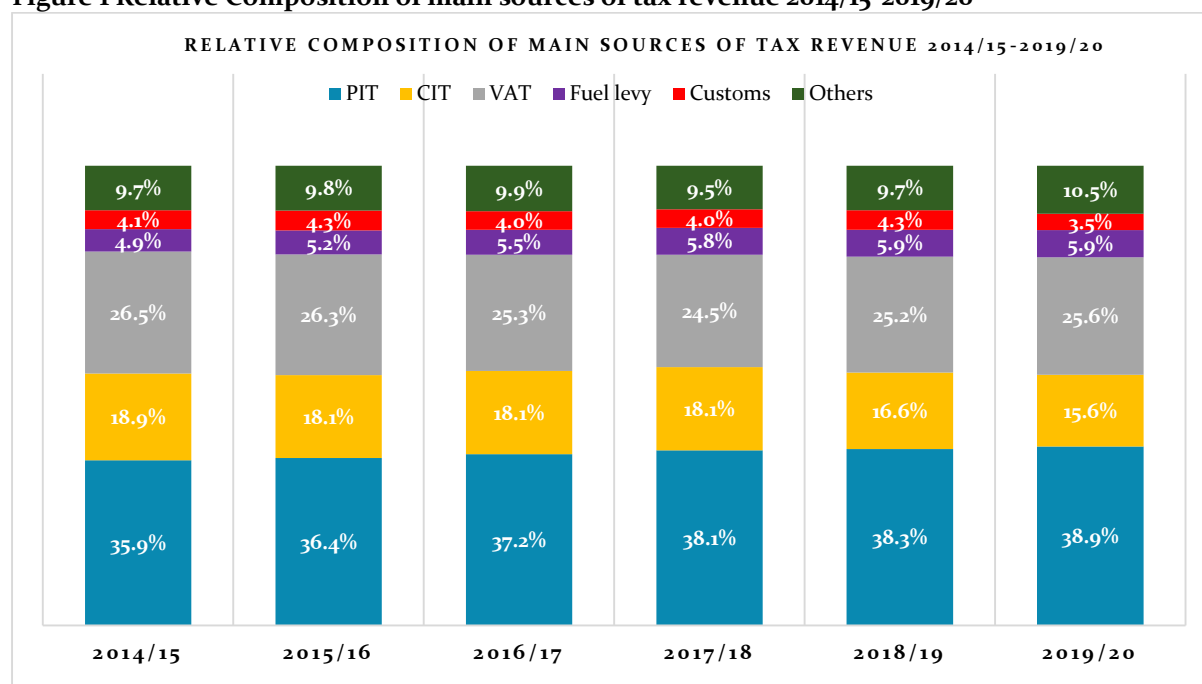
<sup>29</sup> <https://www.pwc.co.za/en/press-room/broadband-tax.html>

<sup>30</sup> Business Day, (2018), MultiChoice calls for Netflix to be regulated, <https://www.businesslive.co.za/bd/companies/2018-07-12-multichoice-calls-for-netflix-to-be-regulated/>

<sup>31</sup> Tax Consulting SA, (2016) Tech Giants' Tax Avoidance hurts South African Media; <https://www.taxconsulting.co.za/tech-giants-tax-avoidance-hurts-south-africas-media/>

<sup>32</sup> Accountancy, (2019) The digital Economy is Booming- Where do we draw the tax line? <https://www.accountancysa.org.za/the-digital-economy-is-booming-where-do-we-draw-the-tax-lines/>

**Figure 1 Relative Composition of main sources of tax revenue 2014/15-2019/20**



Data source: Tax Stats 2020, (PIT-Personal Income Tax, CIT- Corporate Income Tax an VAT- Value Added Tax)

South Africa is similar to many other developing countries that rely on income taxes as one of a major source of government revenue, as shown in Table 2.<sup>33</sup> It is also important to note that income tax is considered more progressive than consumption tax. In contrast, many developed countries rely more on consumption tax or an equal balance between income and consumption tax for revenues. Therefore, given that South African corporate tax revenue as a share of revenue has declined over the years and that more businesses have become more digitalised, it is necessary to consider taxation measures that enable revenue to be raised from digital economic activities income.

By applying this approach, South Africa would be following recent international trends, which would not only guarantee additional needed revenue but also ensure that all business activities contribute their fair share into the fiscus. As mentioned earlier, South Africa's approach to international taxation has always been to await guidelines provided by the OECD to ensure global tax predictability and cooperation is maintained. However, given the current economic climate, waiting for a multilateral approach might not provide much needed revenues.<sup>34</sup>

<sup>33</sup>PBO Brief on 2018 Rates & Monetary Amounts Bill Rates Bill – VAT Increase Focus – Finance Committees- May 2018

<sup>34</sup>OECD, (2020), Tax Challenges Arising from the Digitalisation of the Economy- Update On the Economic Analysis and Impact Assessment

**Table 2 Tax Rates Mix Comparison South Africa and other regions**

Region /Countries	2016			2017			2018		
	PIT	CIT	VAT*	PIT	CIT	VAT*	PIT	CIT	VAT*
ASIA- Average	28.9%	21.9%	12.3%	27.7%	21.0%	12.2%	27.9%	21.2%	11.7%
OCEANIA- Average	32.7%	26.0%	11.8%	33.4%	28.4%	11.9%	33.4%	28.4%	12.3%
LATIN AMERICA- Average	30.8%	27.3%	13.2%	32.4%	28.0%	12.9%	32.5%	28.0%	13.1%
NORTH AMERICA- Average	36%	33.3%	5%	36.3%	33.3%	5.0%	35.0%	26.8%	5.0%
AFRICA-Average	33.3%	27.5%	15.3%	31.9%	28.2%	15.4%	32.0%	28.3%	15.5%
<b>South Africa</b>	<b>41%</b>	<b>28%</b>	<b>14%</b>	<b>45.0%</b>	<b>28%</b>	<b>14.0%</b>	<b>45%</b>	<b>28.0%</b>	<b>14.0%</b>
EUROPE- Average	37.2%	20.5%	20.1%	32.8%	19.5%	20.1%	32.5%	19.5%	20.1%
EU-Average	38%	22%	22%	38.5%	21.3%	21.5%	38.2%	21.3%	21.5%
OECD- Average	42.2%	24.8%	19.2%	42.3%	24.0%	19.2%	42.0%	23.5%	19.2%
BRICS-Average	32%	28.3%	17%	33.2%	28.3%	16.4%	33.3%	28.4%	17.0%

Data source: prepared by PBO, 2018

In order to develop unilateral policy on the taxation of digital economic activities, South Africa may require additional human technical knowledge capacity and institutional information technology capacity for both policy and administration purposes. These capacity challenges should be used as an opportunity to strengthen the state' capacity in planning, monitoring and evaluation, auditing and technical knowledge in the rapidly transforming digitalised economic world.

South Africa could also take advantage of being part of the various multilateral bodies like UN and related bodies like WTO and UNCTAD, IMF, World Bank and AU and others as areas to identify much-needed capacity to strengthen their own capacity. South Africa can also learn from countries that are already considering a unilateral approach to digital economy taxation policies, some of which are already in the implementation stages, as shown in Table 2.

### 5.3. E-Commerce Moratorium and Custom tax revenue

Apart from a digital tax on consumption and income generated by digital economic activities, South Africa could also generate additional revenue from custom duties on cross border digital economic activities. The current tax regime makes provision for custom duties for non-digital cross border products and services. In 1998, the WTO and its member states agreed on the declaration of a moratorium (E-Commerce Moratorium on Digital Transmissions), arguing for a consensus on many issues including common understanding between electronic transmission of goods, services or intellectual property, the revenue loss implication of the moratorium and the technological feasibility of imposing taxes on electronically transmitted goods and services.<sup>3536</sup>

Initially the moratorium was agreed for two years in 1998, but it was never lifted, continued to be renewed and is still in place. The implication for the moratorium is that WTO member states

<sup>35</sup>A.Kwa, F. Rosales and P. Lunenburg, (2020) COVID-19 and WTO: Debunking Developed Countries' Narratives on Trade Measures, Policy Brief No. 77 South Centre,

<sup>36</sup>WTO, (1998) Declaration on Global Electronic Commerce, May 1998, [https://www.wto.org/english/tratop\\_e/ecom\\_e/ecom\\_e.htm](https://www.wto.org/english/tratop_e/ecom_e/ecom_e.htm)

(including South Africa) are barred from imposing custom duties on cross border electronic transmitted goods and service over the period of moratorium which has been more twenty-two years now. Using the list of thirty-eight digitisable products identified by UNCTAD in 2000<sup>37</sup> (these are conservative estimates), Table 3 shows that revenue for the MNEs operating with digitisable electronically transmissible cross border goods and service grew between 2010-2017. These growth rates are a further indication that online global imports and exports have grown faster than physical imports over the years.

**Table 3 Growth rates of global revenues of some of the providers of ET**

ET-Digitalisable products /Companies	Global Average Annual Revenue Growth-2010-2017
Netflix (films) <sup>38</sup>	37%
Music streaming <sup>39</sup>	50%
E-books	44%
Video games <sup>40</sup>	10%
Microsoft <sup>41</sup>	10%
Amazon <sup>42</sup>	28%

Data source: PBO, based on various source see reference list

The growth in the global revenue made by MNEs on cross border digitisable electronic transmission of goods and services entails that more physical products imports are being replaced by digitisable products. Given the WTO 1998 Moratorium declaration on customs duties on imports, this means that the custom revenue base will continue to decline if the moratorium remains. Using the 2017 global statistics, a study by UNCTAD<sup>43</sup> of potential custom duties revenue loss due to the WTO Moratorium shows that as a result of the WTO Moratorium, government revenue losses in developing countries range between \$5 and \$10 billion (R90 billion and R180 billion).

The revenue losses of Sub-Saharan Africa are expected to range between \$ 600 million and \$ 2.6 billion (R10.8 billion and R46.8 billion) annually in potential custom duties due to the WTO Moratorium. South Africa is estimated to have lost between \$25 million (R475 million) and \$37 million (R700 million) in potential custom duties revenue as a result of the WTO Moratorium. Unsurprisingly, South Africa and India<sup>44</sup> have raised concerns about the fiscal impact of the 1998

<sup>37</sup>The list is expected to have increased significantly due to the rapid expansion of products having been digitalised since the declaration of the moratorium in 1998.

<sup>38</sup> <https://www.macrotrends.net/stocks/charts/NFLX/netflix/revenue>

<sup>39</sup> <https://www.statista.com/statistics/587216/music-streaming-revenue/>

<sup>40</sup> <https://lpsports.com/e-sports-news/the-video-games-industry-is-bigger-than-hollywood>

<sup>41</sup> <https://www.macrotrends.net/stocks/charts/MSFT/microsoft/revenue>

<sup>42</sup> <https://www.buchmesse.de/files/media/pdf/whitepaper-the-business-of-books-frankfurter-buchmesse.pdf>

<sup>43</sup>Growing Trade in Electronic Transmissions: Implications for the South

<sup>44</sup><https://economictimes.indiatimes.com/tech/internet/e-commerce-moratorium-proposal-worries-india/articleshow/75039086.cms>

WTO Moratorium over the years, and the duo submitted a proposal to end the WTO Moratorium in March 2020.<sup>45</sup>

## 6. International Experience- Digital Economy and Taxation

The urgent requirement to reform international tax rules is a matter that has been debated by many countries across the world, while the debate has escalated following the 2008 GFC. Before, the debate was more about how to go about reforming the international tax system and led to the Ministers of Finance of G20 countries working with the OECD in 2014 to create the BEPS project to reform international taxation rules. It was an OECD-led initiative that drafted an Inclusive Framework to reform international tax rules to address the taxation of cross border digitalised economic activities. The drafted OECD Inclusive Framework proposes a two-pillar approach to taxing income or profit generated from digital economy by MNEs. Pillar One<sup>46</sup> has a focus on re-allocation of taxing rights where the tax base is eroded, or profit is unfairly shifted, while Pillar Two<sup>47</sup> focuses on a global anti-base erosion mechanism.

Pillar One: known as the unified approach, this is intended to give countries the right to tax the profits of MNEs, regardless of whether they have a base in the country. The allocation of taxing rights through revised profit allocation rules and revised nexus rule then goes beyond the arm's length principle, including the use of significant economic presence against the physical presence test, with 3 proposals for allocating taxing rights: i) user participation, ii) marketing intangibles (customer list, customer relations and customer data) iii) significant economic presence. Pillar One has the following provisions:

- A new right for jurisdictions to tax part of the profits of MNE in reference to the income generated in that jurisdiction, irrespective of whether the MNE has physical presence in that territory (also known as Amount A);
- A standardised return for certain baseline marketing and distribution activities (also known as Amount B);
- Additional taxation rights given to a jurisdiction (Amount C) where the activity in that jurisdiction exceeds the assumed baseline under Amount B.

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<sup>45</sup>Amiti Sem, (2020) Customs duty on e-transmissions: India, South Africa make new submission at WTO, <https://www.thehindubusinessline.com/economy/customs-duty-on-e-transmissions-india-south-africa-make-new-submission-at-wto/article31074449.ece#>

<sup>46</sup>Pillar one, business presence and activities without physical presence, where tax should be paid and on what basis, portion of profits could or should be taxed in the jurisdictions where customers and/or users are located

<sup>47</sup>Pillar two, stop the shifting of profits to low or no tax jurisdiction, minimum level of tax is paid MNEs, normalize the playing field between digital and non-digital business



Pillar One is intended to exclude the following entirely or in part: i) business to business activities, ii) the extractive and mining industry, iii) the financial services sector, iv) the airline and shipping industry and professional services.

Pillar Two strives to counter profit-shifting by MNEs subject to low or zero taxation by imposing a global minimum tax, applied at the level of the taxpayer rather than the level of the country. The drafted OECD Inclusive Framework is still under consideration, although there is already criticism of its conceptual complexity which makes it virtually implausible to implement in current form. The USA is one of the countries that opted not to support the current draft OECD Inclusive Framework, rendering the proposal potentially less effective in addressing digital economy taxation given that most of the MNEs are based in the USA.

As a result of the weakness of the current international tax rules in taxing income derived from digitalised economic activities, many countries have broken away from relying only on the multilateral tax rule in taxing income from digitalised economic activities.<sup>48</sup> There have also been more developed countries seeking to break away from OECD processes on the taxation of the digital economy including France, United Kingdom, Spain, Italy and others. Table 4 provides details of the various countries taking a unilateral approach to taxing digitalised economic activities.

**Table 4: Countries with taxation on digital economy**

	Country	Taxation proposed or in place		Country name	Taxation proposed or in place
1	Italy	3% of revenue - Jan 2020	17	Taiwan	Tax on revenue
2	Austria	5% of revenue - Jan 2020	18	Uruguay	Tax on revenue
3	Belgium	1.5% of revenue - July 2019	19	Hungary	7.5% Revenue- Jan 2020
4	Czech Republic	7% of revenue – Dec 2019	20	India	1% -01 October 2020
5	France	3% of revenue - July 2019	21	Vietnam	Tax on revenue
6	Turkey	7.5% of revenue – March 2020	22	Pakistan	5% of revenues – 01 July 2018
7	Indonesia	25% revenue tax	23	Zimbabwe	5% on revenue
8	Kenya	Tax on revenue-	24	Singapore	Revenue tax on online services
9	Malaysia	Tax on revenue	25	Israel	3%-5% Revenue- May 2019
10	Mexico	Tax on revenue	26	Norway	2.5% June 2019, await OECD process
11	Poland	1.5% revenue- April 2020	27	Tunisia	3% of Revenue- Jan 2020
12	Canada	3% of revenue -October 2019	28	United Kingdom	2% of revenue -April 2020
13	Thailand	5% on revenue- May 2019	29	Spain	3% of revenue- Jan 2019
14	Chile	10% of revenue- proposal	30	Latvia	3% on revenue- Dec 2019
15	Maryland-USA state	2.5%-10% tax on revenue on specific sales- Jan 2020	31	New York-USA State	5% on revenue – Jan 2020
16	Nebraska-USA State	5.5% -on revenue- Jan 2020	32	New Zealand	2.5% June 2019, await OECD process

Data Sources: individual countries data sources,<sup>49</sup>

<sup>48</sup>Tim Bradshaw, (2019) Countries vow to press ahead with digital taxes despite US threat, FT, <https://www.ft.com/content/6529014c-169a-11ea-9ee4-11f260415385>

<sup>49</sup>V. Grondona, A. M., Chowdhary and D Uribe, (2020), National Measures on Taxing the Digital Economy Research Paper, South Centre

Most of these countries are running deficits in their budgets, largely due to self-imposed fiscal consolidations and austerity budgets, are therefore in need of more revenue sources. The potential fiscal impact of Covid19 may now have motivated many countries to pursue innovative measures to raise additional government revenues, so taxing income derived from digital economic activities provides this opportunity. Examples of countries with a unilateral approach to taxing income from digital economy show that, due to the complexities of determining jurisdiction for value creation accurately, many opted for imposing a flat tax rate on revenue instead of taxing profits.

The taxing of profits is in line with current international tax principles of revenue less expenses. According to the countries surveyed in Table 4, which is a mixture of developing and developed countries, the tax rate is imposed on revenues from the digital economy ranging from 1 to 10 per cent. Some of the considerations about unilateral measures taken by these countries include-

- **Many OECD countries are at the forefront of adopting unilateral taxation measures in relation to digital economy:** Countries such as the US, Canada, Israel and EU-members, are taking unilateral approach, much to the disappointment and panic of the OECD. Despite the Two-Pillar approach favouring OECD countries, they seem dissatisfied with the proposal. Notwithstanding their acknowledged and belief in multilateralism and a “rules-based international order”, there seem to be a contrary set of actions.
- **Potential delay in reaching multilateral consensus:** Many countries are concerned that it has taken so long to achieve an initial consensus to reform current international tax rules to address the loss of revenue. As a result, there has been growing doubt on the part of many countries as to whether a global agreement would be reached by the end on 2020, as was set out by the OECD led inclusive group. There are further concerns that the technical complexity in the current draft OECD Inclusive framework may delay the process further, whilst many countries continue to miss an opportunity to raise additional revenue.
- **Digital tax targeting research engines, social media platforms, marketplaces derive, e-commerce, online advertising, gaming, sale of digital content, sale of digital data:** Many countries have identified and targeted specific digital economic activities for additional tax revenue within digitalised economic activities. As a consequence, many digital tax policies explicitly specify targeted economic activities for tax purposes.
- **Withholding tax for non-residence and facilitated by financial institutions:** Having opted for a unilateral approach to taxing digital economies, some countries are choosing to

withhold tax for non-residence MNEs and legislating the role of financial institutions to support the process by identifying and providing remittance for withholding taxes.

- **Reassessment on international agreements and cooperation:** Adopting a unilateral approach has the potential to affect existing international agreements on tax, investment and other cooperation. Therefore, unilateral tax rules on digital economic activities may require a review to double taxation treaties (DTT) or investment agreements (BITs) and other cooperation to include reformed taxation on digitalised economic activities.
- **Significant Economic Presence (SEP):** Many countries opting for unilateral approach included the use of significant economic presence test to determine taxing rights over income or profits of cross border digital economic activities.<sup>50</sup> SEP go beyond the conventional approach that uses availability of fixed place of business in a jurisdiction taxing rights purposes. Inclusion of SEP is recognition that digital economy business operates without fixed place of business.

## 7. Considerations for Oversight

South Africa was one of the first countries to introduce taxation measures to generate revenue from consumption of commercial activities in the digital economy, which raised additional government revenue since 2014. However, like many other developing countries South Africa has continued to lose tax revenue in the absence of specific tax measures that enable taxes to be imposed on income raised by digitalised economic activities.

The OECD is currently driving a global effort to reform international taxation laws via a drafted Inclusive Framework to ensure that digital economic activities are taxed. Yet many developing countries doubt that it would address their concerns, even though, past experience that having multilateral consensus on international tax principles generally ensure predictability and cooperation between jurisdictions in collecting tax revenue. As a results, many countries have opted for unilateral policy measures.

Multiple international experiences on the part of both developed and developing countries having been proposed, while others have implemented unilateral taxation policy measures to enable the taxing of cross border digital economic activities. In conclusion, South Africa can learn from these countries when considering a unilateral approach to taxing digitalised commercial activity within the national economy.

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<sup>50</sup>V. Grondona, A. M., Chowdhary and D Uribe, (2020), National Measures on Taxing the Digital Economy Research Paper, South Centre