Taxation of Electronic Commerce in South Africa

1. Background

The challenges of the taxation of e-commerce form part of the broader challenges of the digitalisation of the economy. These challenges arise primarily when transactions between client and supplier cross international borders. When both the client and the supplier are in South Africa, the normal tax rules apply and can be enforced. When the client is in South Africa but the supplier is not, the fact that the supplier may do business without a physical presence in South Africa creates both conceptual and practical difficulties.

Conceptually, the right to subject foreign businesses to income tax in terms of double taxation agreements (DTAs) requires a particular degree of physical presence or nexus with South Africa. This is the so-called permanent establishment (PE) threshold. Practically, when a supplier is based outside South Africa, it becomes more difficult to enforce tax laws since the supplier is outside SARS' jurisdiction. Recovery of tax, prosecution of non-compliance and other enforcement action become more complex or even impossible. This follows from the so-called revenue rule, which essentially provides that the courts of one jurisdiction will not enforce the tax laws of another jurisdiction. The revenue rule can only be overcome by way of treaty, as was the case when the England and Wales Court of Appeal ruled in favour of Her Majesty's Revenue and Customs pursuit of a tax debt owing to SARS, based on the assistance in collection article that had been inserted in the DTA between the United Kingdom and South Africa. (Ben Nevis (Holdings) Ltd & Anor v HM Revenue & Customs [2013] EWCA Civ 578)

2. Domestic e-Commerce

SARS' treatment of domestic e-commerce is no different from any other form of commerce. Indeed, businesses may maintain both "bricks and mortar" and e-commerce operations, which would make differential treatment on the basis of e-commerce alone difficult. As an example, several retail businesses with store footprints across South Africa, such as Checkers, Clicks, Makro and Pick n Pay, offer e-commerce platforms that allow clients to order goods for delivery or collection, either at stores or at pick up points.

Domestic businesses with e-commerce operations file their returns, make payments, are subject to risk rules for auditing, are audited, etc. just like any other business.

3. Cross-Border e-Commerce

The challenges of the taxation of cross-border e-commerce will be considered in three categories, being customs and excise, income tax and value-added tax (VAT).

3.1. Customs and Excise

Customs and excise duties on physical goods are levied on import. The imports are generally handled by a clearing agent, courier company or the Post Office, which pay the customs and excise duties due over to SARS on their clients' behalf.

Customs and excise duties are not levied on imported services.

3.2. Income Tax

As mentioned in the background, the difficulty in subjecting foreign businesses to income tax is that DTAs require that the PE threshold must be met. Once that is done, the question then becomes how much income can be attributed to the PE.

These issues were the subject of the Organisation for Economic Cooperation (OECD)/G20 Base Erosion and Profit Shifting (BEPS) project that commenced in 2013 and was largely completed by October 2015. One of the outcomes of the BEPS Project was the Action 1: 2015 Final Report on Addressing the Tax Challenges of the Digital Economy. The Executive Summary of the report is attached as Annexure B and the full report is available at https://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm.

Four key findings emerged from this report:

- The digital economy was increasingly integrated with the economy as a whole, so it would not be feasible to ring-fence it for tax purposes.
- Other proposed BEPS actions with respect to lowering the PE threshold and improved controlled foreign company (CFC) rules would assist in mitigating the risks associated with the digitalisation of the economy.
- It was possible to introduce rules and collection mechanisms for the efficient collection of VAT in the country of the client; and
- Further work would need to be done as no consensus could be reached on other options that were considered.

3.2.1. PE Threshold

Other BEPS Actions

Changes to the PE threshold in existing DTAs would normally require the renegotiation of each DTA, which would be a long and difficult task. In order to address this the Action 15: 2015 Final Report on Developing a Multilateral Instrument to Modify Bilateral Tax Treaties analysed the situation and set out an agreement on the development of a multilateral instrument (the MLI) capable of incorporating the treaty related BEPS outcomes into the existing network of bilateral treaties, rather than attempting to renegotiate them individually. South Africa was one of over 100 jurisdictions (including other African countries, such as Kenya and Nigeria) that worked together to develop the MLI.

South Africa was one of the 67 countries to first sign the MLI on 6 July 2017 and it is anticipated that the MLI will be placed before Parliament later this year for ratification. It should be borne in mind, however, that the MLI does not automatically change all affected articles of a DTA. Reservations are possible outside of certain minimum standards. As a result, if one country has a reservation on a change to an article, the change will not take effect between that country and other countries. Reservations may be withdrawn but cannot be made after ratification so the number of changed articles will increase over time.

Compliance Work

SARS does not simply accept foreign businesses' assertions that they do not have a PE in South Africa. Where a risk in this regard is identified, SARS performs appropriate audit or other compliance work to determine whether there is a PE in South Africa or not. While not directly related to e-commerce, SARS was successful in arguing in the tax court that the extended provision of technical services to a client in South Africa and use of the client's boardroom gave rise to a PE in South Africa and thus to taxable income of R64 million. IT 13276 [2015]. In order to assist in identifying future risks in this regard, a reporting obligation was created under the reportable arrangements provisions of the Tax Administration Act, 2011. The recipients of such technical services are required to report them if the supplier is physically present in South Africa and the total fee is or is anticipated to be in excess of R10 million. These cases are risk profiled to determine whether there is a risk that an undisclosed PE has been created and referred to audit as appropriate.

SARS is currently in the process of auditing well-known e-commerce players with a physical presence in South Africa. One of the issues being considered is whether a PE exists in South Africa or not.

3.2.2. Improved CFC Rules

South Africa's CFC rules were introduced in 1997 and are regularly reviewed for effectiveness. They are specifically mentioned, together with those of the United Kingdom and the United States of America (USA), in the Action 3: 2015 Final Report on Designing Effective CFC Rules as examples of options to be considered in the design of CFC rules.

3.2.3. Efficient Collection of VAT

See 3.3. below for a discussion in this regard.

3.2.4. Further Work

The Action 1: 2015 Final Report on Addressing the Tax Challenges of the Digital Economy indicated that a further report could be expected by 2020.

Interim Report

In March 2018, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) released an interim report, which notes that; "The proliferation of unilateral approaches is likely to have adverse impacts on investment and growth, and risks increasing double taxation and complexity for taxpayers and tax authorities alike. However, the tax issues raised by digitalisation are technically complex, and this interim report identifies the different views among countries on whether and to what extent the features of highly digitalised business models and digitalisation more generally should result in changes to the international tax rules. Overall, there is support for undertaking a coherent and concurrent review of two key aspects of the existing tax framework, nexus and profit allocation rules that would consider the impacts of digitalisation."

The report also notes that; "There is no consensus on the merits of, or need for, interim measures, and therefore this report does not make a recommendation for their introduction." The members of the Inclusive Framework undertook to work towards a consensus-based solution by 2020.

Policy Note

In January 2019, the Inclusive Framework released a policy note setting out agreed policy options to be explored on a "without prejudice" basis. The options are grouped under two pillars. Pillar One focusses on a re-examination of the threshold or nexus to subject a multinational enterprise to tax in a jurisdiction and the basis for allocating profits (or losses) to that jurisdiction. Pillar Two aims to resolve remaining BEPS issues relating to amounts that are not subject to a minimum level of taxation. A public consultation document setting out further details and public consultations followed. In May 2019, the Inclusive Framework released a programme of work aimed at arriving at a consensus based outcome by the end of 2020.

OECD Secretariat Proposals

In view of the competing options under Pillar One, in October 2019, the OECD Secretariat published its attempt at a unified proposal that draws on common elements of the three options. Public consultations followed. In November 2019, the OECD Secretariat published a public consultation document on Pillar Two and public consultation followed. The proposals contain a number of elements that have each become the subject of debate between countries, depending on their circumstances.

Recent Developments

In January 2020, the Inclusive Framework reaffirmed its commitment to reaching a consensus-based long-term solution to the tax challenges arising from the digitalisation of the economy and to working towards an agreement by the end of 2020.

The USA has signalled that it will impose tariffs on countries that impose unilateral digital taxes. This was demonstrated in reporting on the January 2020 World Economic Forum meeting in Davos, where the USA agreed to suspend planned tariffs on US$2.4 billion of French goods and France agreed to suspend collection of its digital tax due in April 2020, pending the conclusion of the Inclusive Framework's work in 2020.

Unfortunately, the COVID-19 pandemic has made advancing the work more difficult, with the Inclusive Framework meeting scheduled for July 2020 being postponed. Agreement on key policy features is now anticipated by October 2020.

The intention is still to arrive at a consensus based outcome by the end of 2020.

3.3. VAT

VAT on physical goods is levied on import on much the same basis as for customs and excise duties.

VAT has always been due on imported services, through the reverse charge mechanism, where the client is not a wholly taxable business for VAT purposes. The reverse charge mechanism requires that clients charge themselves VAT and pay it over to SARS. Private individuals, however, did not generally comply with this collection mechanism.

2013 Budget

In 2013, the Budget Review proposed that "all foreign businesses supplying e-books, music and other digital goods and services be required to register as VAT vendors… in line with international trends, such as the regulations adopted by the European Union requiring such suppliers to register for VAT in the country where the consumer resides." Suppliers were preparing their systems to comply with such legislation. While they might decide to ignore a small market imposing such a requirement on its own, once a critical mass of implementing countries had been reached it would be relatively easy to add one more market. Work in this area was also foreshadowed in Action 1 of the BEPS Action Plan released in July 2013.

The proposal was taken up in the Taxation Laws Amendment Act, 2013, and the necessary regulations issued for it to take effect on 1 April 2014. The electronic services covered by the initial regulations were fairly narrowly drawn, as South Africa was an early adopter and to focus on those services that were used by consumers and most commonly taxed internationally.

OECD Reports

In 2015, the Action 1: 2015 Final Report on Addressing the Tax Challenges of the Digital Economy confirmed the approach of requiring foreign businesses to register for and pay over VAT in the country where the client resides. A number of approaches to simplify such registration and thus encourage voluntary compliance where enforcement options were limited were also proposed.

SARS had already implemented many of these proposals, such as simplified electronic registration, electronic returns and electronic payment. SARS also adjusted its risk detection rules to customise them for the risks posed by foreign businesses. SARS conducted initial outreach through the Business and Industry Advisory Committee to the OECD. Where significant foreign businesses had not registered, although it appeared that they should have, SARS made contact to determine what the reasons were and to encourage them to do so if they fell within the regulations, with positive results. The outcome of these interactions also fed into the process of revising the regulations discussed under the next heading.

The 2018 interim report mentioned in 3.2. above notes that “The early data on the impact of these measures is very promising. This is the case, for example, in South Africa where the revenue collected through the application of the recommended principles and collection mechanisms amounted to ZAR 585 million for 2016/2017.”

The revenue collected had grown to R1 billion in 2018/19.

2018 Budget

In February 2018, revised draft regulations were published, which substantially expanded the range of electronic services covered. In line with the primary legislation passed in 2013, the revised draft regulations did not draw a distinction between business-to-consumer and business-to-business transactions, so foreign suppliers would not need to add complexity to their processes or systems to draw the distinction. It was also proposed that the Value-Added Tax Act, 1991, be amended to increase the 2013 registration threshold of supplies of R50 000 a year to R1 000 000 a year, in recognition of the expanded range of electronic services covered, for consistency with the domestic compulsory registration threshold and to reduce compliance costs for both small business and SARS in line with international best practice. Following a public consultation process, the revised regulations were promulgated and took effect from 1 April 2019.

Preliminary figures indicate that the revenue collected grew to R5.4 billion in 2019/20. SARS is in the process of reviewing the outcomes to determine the need for further outreach and adjustments to its risk rules.

4. Conclusion

As set out above, South Africa, National Treasury and SARS have closely followed, and in some cases been in the forefront of, developments in the taxation of e-commerce within the constraints faced by a small open economy.

South Africa has contributed to the work of the OECD/G20 BEPS project and the Inclusive Framework at many levels, from early signature of the MLI by the Minister of Finance, to participation in the Steering Groups of the BEPS Project and the Inclusive Framework, to facilitating public consultation on the Pillar One and Pillar Two proposals by the African Tax Administration Forum.

While the fundamental policy challenges around income tax and the digitalisation of the economy remain matters for further negotiation and consensus building, progress in this area has been made through aspects of the BEPS Project. Work that has been done with respect to indirect taxes and e-commerce is further advanced and has delivered substantial amounts of revenue.