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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

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ABSTRACT

The aim of this dissertation is to provide a detailed analysis of the impact electronic-commerce (e-commerce) is having upon the tax base and revenue collection of Value-Added Tax (VAT) in South Africa.

This dissertation commences with a chapter that sets out the model for the treatment of VAT in an e-commerce environment.

Three chapters follow this, recording how South Africa legislates for VAT, how traditional (offline) and e-commerce (online) transactions are conducted. This is followed by a chapter that makes a comparison between online and offline commerce, identifying the differences and difficulties between the two forms.

Leading from this comparison is a chapter that makes suggested recommendations to overcome the identified VAT administrative difficulties.

The final chapter records how the three parties, namely, governments, commerce and consumers can work together, if the freedom afforded by e-commerce is allowed to continue.

The analysis shows that if certain recommendations are implemented, then the negative impact of e-commerce on the tax base and revenue collection of VAT in South Africa can be reduced.

DECLARATION

I hereby declare that this dissertation is entirely my own work.

S Budlender

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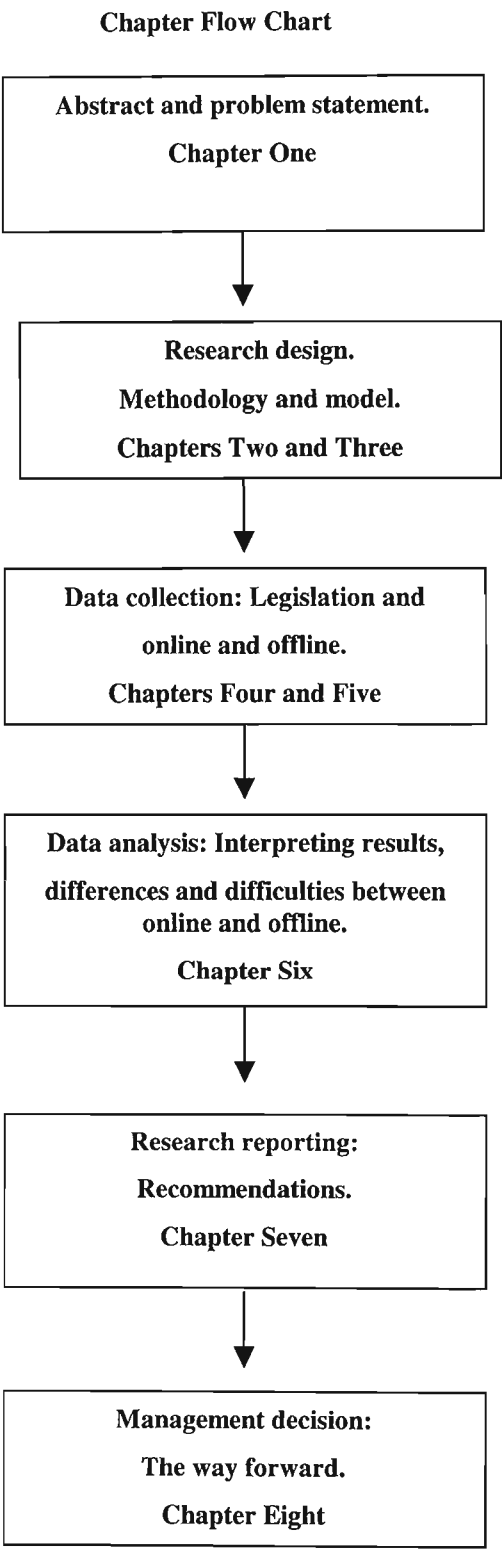
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Chapter 1

Introduction

Figure 1.1



Overview

This chapter gives a background to the dissertation, including the motivation and value of the research. It also includes a problem statement, objectives, and limitations. Considerations of ethical issues are also addressed.

Problem Statement

The growth in the use of the Internet for commercial purposes, in the form of electronic commerce (e-commerce), has seen the creation of a new economy wherein neither geographic location nor constraints of trading hours are a factor.¹ South African businesses are not confined to, nor inhibited by, trading across its national borders. This situation creates a problem of jurisdiction where business and transactions are conducted over the Internet.

Jurisdiction can be defined, in this context, as the power, authority and control in the territory where over taxation is exercised. Jurisdiction is a significant issue as this authority is generally confined to a particular geographical territory, while e-commerce, by its nature, is not. The lack of control, or clarity of jurisdiction in turn allows for decreased enforcement, with the possibility of a decrease in the level of Value-Added Tax (VAT) collection on transactions conducted over the Internet.

This situation creates the dilemma: The increase in the growth of e-commerce is creating a negative impact upon the VAT base and revenue collection of VAT.

The resulting questions are as follows:

- Has e-commerce, impacted upon the ability to define jurisdiction in the cyber world, creating problems of administration and enforcement, resulting in a shrinking VAT base and collection?
- And if so, how can the government overcome these challenges to safeguard its VAT base and level of fiscal revenue?

Research Objective

From the questions the research objective can be identified as providing direction to the fiscus of a particular country for further research into possible mechanisms, based on the following investigative questions, to ensure that the tax base and the VAT revenue do not shrink.

¹ Paul Richardson *Internet Marketing* (2001); Judy Strauss and Raymond Frost *E Marketing* 2 ed (2001).

The investigative questions needed to address the research objective are as follows:

- To identify those issues that define jurisdiction in terms of South African VAT law.
- To identify those issues that define, value, time of supply, and who is responsible for the supply and declaration, in terms of South African VAT law.
- To identify those issues that define, delivery of goods and services, from a VAT (or consumption tax) viewpoint.
- To identify how e-commerce (online commerce) differs from previously traditional commerce (offline commerce), specifically with regards to jurisdiction and delivery of goods and services.
- To identify how and why e-commerce is shrinking the tax base, and thereby reducing fiscal revenue of VAT.
- To identify what other countries or organizations are doing to address the challenges of a reducing tax base, declining VAT revenues and administration and enforcement problems.

These investigative questions are used to provide direction for further research into possible mechanisms of what can be done to counteract the effect of the differences between traditional commerce and e-commerce on VAT.

Limitations

Although a literature review of research performed in other countries has been conducted, this proposal is limited to the impact on South African residents trading over the Internet and the treatment of VAT in South Africa. There are many forms of fiscal revenue other than VAT, this proposal is, however, limited to VAT.

Only the impact that e-commerce is having on VAT is addressed and not other economic or social issues affected by e-commerce.

By its nature e-commerce, with its use of technology, is subject to incredible growth. This rapid change can render this research proposal to become dated before its completion.²

The Organisation of Economic Co-operation and Development (OECD) and other developed countries have recorded in detail the legal concerns with identifying certain core issues of

2 L M Applegate, F W McFarlan and J L McKenny *Corporate Information System Management* 5 ed (1999); 'Organisation of Economic Co-operation and Development (OECD) (April 2001) Consumption Tax Aspects of Electronic Commerce, a Report from Working Party 9 on Consumption Taxes to the Committee on Fiscal Affairs' see in this regard: <http://oecd.org/EN/d..0..EN-document-1001-nondirectorate-no-4-25844-29.00.htm>.

jurisdiction' and 'place of consumption'. As a result, this dissertation has not repeated these detailed legal concerns, but sets out to incorporate them in the dissertation as practical issues.

Background

Individuals through to large corporations for reasons both personal and commercial are using the Internet. It is based on a technology that is rapidly changing, affording all who use it the ability to communicate and trade beyond national borders in a seamless manner.³ Similar to those who use the Internet for commercial purposes, so too must governments respond rapidly to assess the impact this technology will have on its tax base and on its ability to govern. The use of e-commerce is one of the main contributing factors to globalisation, market liberalisation and increased cross-border activity, creating negative fiscal effect.⁴ Most of the existing legislation governing VAT was introduced and developed when the South African Revenue Services (SARS) could rely upon exchange controls, highly-regulated capital markets, and technological constraints to protect it from global activities conducted over the Internet.

In the traditional offline commerce environment the supply of goods were either

- confined within national borders, or
- required to be imported or exported through a designated port of entry and exit.

These ports were regulated and the collection of VAT was conducted based on documentation supplied at these ports.

The supply of services has always presented a problem to the SARS with regards the location, and resultant jurisdiction, of where the service was ultimately used by the recipient for VAT purposes.

The adoption of the Internet as a method of conducting commerce (online) has seen the ability of certain goods being able to be downloaded over the Internet thereby evading any designated port of entry or exit.

The ability to download goods over the Internet is referred to in this dissertation, as a service.⁵

3 Paul Richardson *Internet Marketing* (2001); Judy Strauss and Raymond Frost *E Marketing* 2 ed (2001).

4 David D Holmes 'A Sober View of Cyberspace' (29 March 2002) *OECD Centre for Tax Policy and Administration*; Department of Communications Republic of South Africa (1999) 'Green Paper on Electronic Commerce for South Africa', see in this regard <http://www.ecomm-debate.co.za/greenpaper/execsumm/>.

5 'Organisation for Economic Co-operation and Development' (December 2000) *Report by the Technology Technical Advisory Group (TAG)* see in this regard: <http://www.oecd.org/pdf/M000015000/M00015516.pdf>.

The lack of clarity of where the service is being provided is leading to the possibility where fiscal revenue in the form of VAT is not being collected when it is due.⁶ The use of the Internet for commercial purposes allows for the provision of goods and services supplied over the Internet to evade detection by the SARS, whether intentional or not.⁷

This dissertation is limited to dealing with the impact e-commerce is having on the importing and exporting from a South African perspective. Other aspects contained within the Value-Added Tax Act 89 of 1991 (the Act) may be recorded for appreciation of the greater picture. The Act distinguishes between the treatment of goods and services, with unique difficulties created by the provision of services rather than from goods.

A further distinction is identified in the Act, and that is between vendors and non-vendors:

- Transactions between vendors are normally conducted in a business-to-business (B2B) environment.
- Transactions with non-vendors conducted in a business-to-consumers (B2C) environment.

For this reason the layout of the dissertation distinguishes between

- import and exports,
- goods and services, and
- vendors (B2B) and to non-vendors (B2C).

This dissertation commences with a chapter that sets out the model for the treatment of VAT in an e-commerce environment.

- Three chapters follow this, recording how South Africa legislates for VAT. Then a chapter that records how traditional (offline) and e-commerce (online) are conducted. This is followed by a chapter that makes a comparison between online and offline commerce, identifying the differences and difficulties between the two forms. Leading from this comparison is a chapter that makes suggested recommendations to overcome the identified VAT administrative difficulties.
- The final chapter has been included to record how the three parties, namely, governments, commerce and consumers, can work together, if the existing freedom afforded by e-commerce is allowed to continue.

6 C G De Wet and R Du Plessis *Cyberlaw at SA* (Chapter 9) (1999); 'UK Inland Revenue' (1999) *Inland Revenue* see in this regard: <http://inlandrevenue.gov.uk/taxagenda/>.

7 'Department of Communications Republic of South Africa' (July 1999) *Discussion Paper on Electronic Commerce Policy*.

The growth and use of the Internet and telecommunications has been reported as follows:⁸

‘South Africa ranks 23rd in telecommunications development in the world. The country has approximately 4,9 million installed telephones and 4,3 million installed exchange lines. This represents 39% of the total lines installed in Africa. According to a new study released in 2002 by World Wide Worx, 2,89 m South Africans had access to the Internet at the end of 2001. This number will grow to around 3,1 million by the end of 2002. The Goldstuck Report: Internet Access in South Africa, 2002 reveals that 1 in 15 South Africans had access to the Internet at the end of last year. This figure is expected to grow to 11% by 2003. (Internet usage in Africa as a whole is estimated to be 3,11 m.)

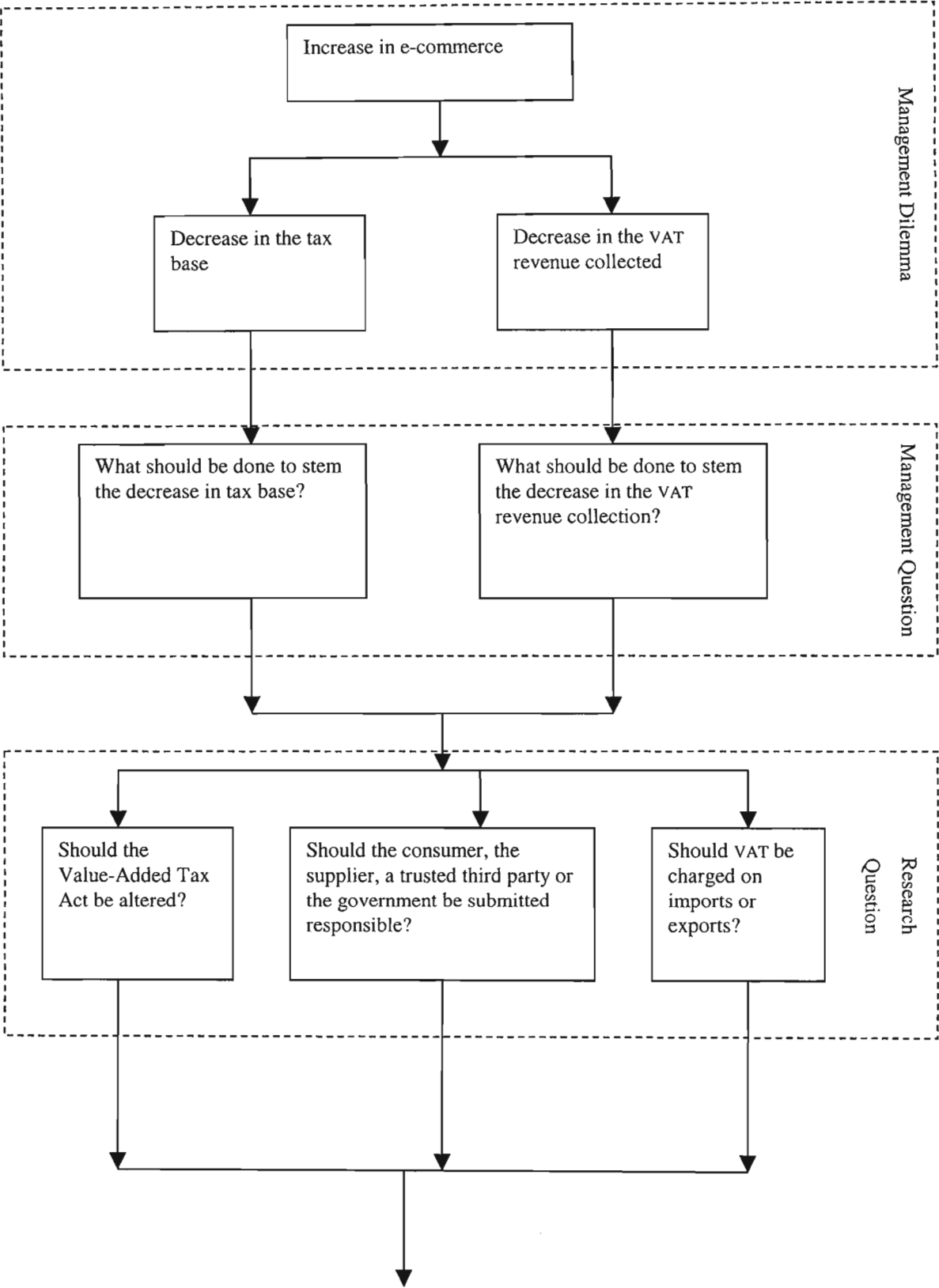
‘The Government is committed to make technological advances accessible for the South African public as a whole. This includes the installation of Public Information Terminals (PITs) in post offices, where a variety of Government services can be accessed electronically. Additionally, Multi-Purpose Community Centurms (MPCCs) are being established countrywide, where previously disadvantaged communities can access Government-related information, e.g. by using Internet facilities.’

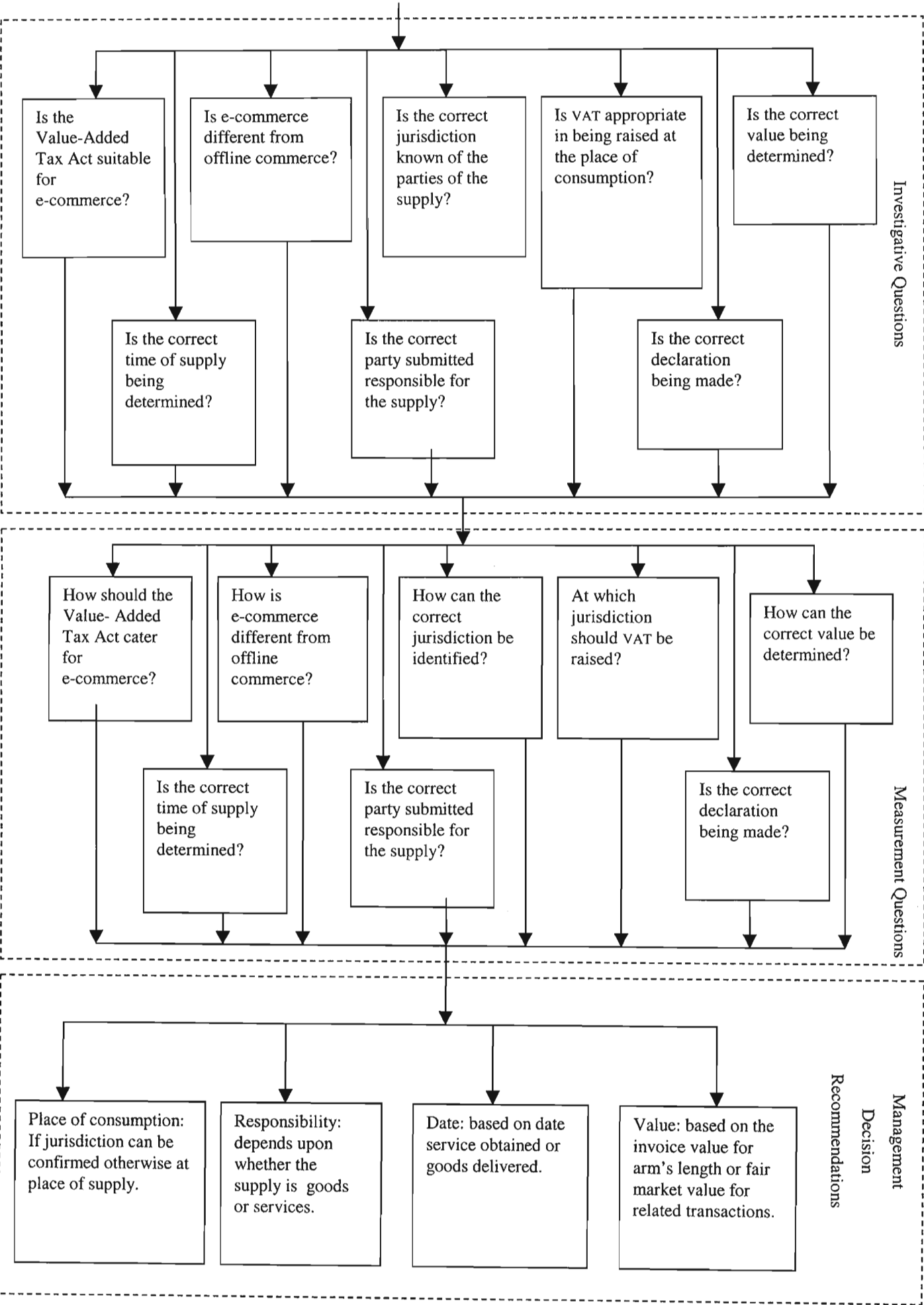
This extract highlights the growth rate and possibility for adoption of e-commerce in South Africa.

8 <http://www.SouthAfrica.info>.

Figure 1.2

Problem Statement Flow Chart





Chapter 2

Methodology

Between the abstract and the preceding chapter, entitled 'Introduction', the problem statement, the research objectives, and limitations were recorded. In this chapter a record of the methodology and approach of the dissertation is made.

Research Design

The design chosen is an exploratory study of the differences and difficulties created by e-commerce, with the objective of identifying those aspects that need to be subject to a more-formal study to find solutions to the differences created by e-commerce.

A qualitative technique of analysing the documents and procedures adopted by commerce, both online and offline, and the behaviour of the consumer to offline and online business, has been chosen.

Data Collection

A non-behavioural observation approach of data collecting, using secondary and primary data has been adopted.

The secondary data includes research of documentation listed by international bodies, including the OECD and the European Union (EU), and information supplied by various taxation authorities, including South Africa, the United Kingdom, Australia and America. All of these sources are considered to give reasonable assurance as to their credibility as authorities in what they report. This data has been analysed to identify areas that South Africa could adopt to assist in reducing the negative impact e-commerce is having upon the VAT base and VAT revenue collection.

Primary data has been collected from visits to web sites of online businesses, and from direct enquiry from offline businesses as to how they conduct themselves in an offline environment, pursuant to complying with the Act. The direct enquiry adopts a personal interview, and communication approach to data collection. So as to protect privacy, and honour ethical behaviour, the sources of the enquiry are not provided. This non-disclosure of source names, should not impact upon the credibility of the data, as the aim of the enquiry was purely to understand and record the general approach of business, and not to be an absolute record.

Purpose of the Study

The study is descriptive as it attempts to describe how online commerce differs from offline commerce for the collection of VAT in South Africa.

Research Environment

The study was undertaken under actual field conditions that businesses conduct themselves in.

Data Analysis and Interpretation

A written report is presented for consideration and discussion to

- government
- business, and
- consumers
- so that they can make an informed decision on the appropriate actions to take in addressing the dilemma.

Decision

A written report is for consideration and discussion to

- government,
- business, and
- consumers,

so that they can make an informed decision on the appropriate action to take in addressing the dilemma.

Chapter 3

Model

Introduction

In this chapter a review of the various legislation and papers governments and non-governmental bodies have conducted to address the impact of e-commerce is recorded. This record identifies the core issues that are creating differences and difficulties in enforcing VAT, resulting in a negative impact on the tax base and fiscal revenue.

Government and Non-Government

With the ever-increasing use of e-commerce, many countries have instituted investigations into the treatment of VAT (also known as consumption tax in an e-commerce environment). This is evidenced by the report in the '*Official Journal of the European Communities*', that records the Council Directive, dealing with a 'special scheme for non-established taxable persons supplying electronic services to non-taxable persons'.⁹ This rule establishes that EU suppliers will no longer be obliged to levy VAT when selling certain products on markets outside the EU. At the same time it rules that suppliers of digital products from outside the EU will have to charge VAT on sales to private consumers. The rule further states that a non-EU supplier will be required to register with a VAT authority in a member state of its choice, and to levy VAT at the rate applicable in the member state where the customer is resident.

This legislation identifies the EU as becoming the first significant tax jurisdiction to develop and implement a framework for consumption taxes on e-commerce in accordance with the principles agreed within the framework of the OECD.

Paragraph 7 of the report by the technology technical advisory group released in December 2000,¹⁰ highlighted the fact that end-to-end virtual transactions¹¹ are currently a very small part of e-commerce and a fractional non-factor in commerce overall. Paragraph 7 further provides that it is recognised that the potential for significant growth in this area, and that the complexity of the inherent

9 'European Union' (May 2002) *Council Directive 2002/38/EC*.

10 Organisation for Economic Co-operation and Development' (December 2000) Report by the *Technology Technical Advisory Group (TAG)*.

11 A definition is contained in the Glossary.

issues coupled with the pace of technological innovation and maturing business models, requires a more intense study to develop appropriate solutions in advance of significant growth in this area.

The exact value of virtual transactions or the supply of goods or services provided by electronic media is still unknown today. This is cause for concern. Until this method of conducting business is quantified, the exact extent of any potential negative impact upon the tax base and fiscal revenue, in the form of VAT will remain unknown.

Paragraph 7.1.2 of the *Australian Discussion Report* of the Australian Taxation Office Electronic Commerce Project 1997 states that ¹²

‘for taxation to be effective a tax administrator must be equipped with a number of fundamental requirements that apply, to some degree, to all historical, contemporary and theoretical types of taxation’.

The fundamental requirements are as follows:

- Jurisdiction, the power, authority and control in the territory over where the taxation authority is exercised. It is generally confined to a particular geographical territory.
- Identification of the taxpayers, the transactions allowing for identifying who is responsible for declaring and paying the tax.
- Information, including information concerning the transaction value and the nature of the transaction.
- Collection mechanisms, incorporating the efficiency as identified by the OECD (discussed below) and the ability to collect the tax thereby enforcing its right.

The United Kingdom Inland Revenue, included the following major principles for the taxation of e-commerce: ¹³

- Neutrality so that no particular form of commerce is advantaged or disadvantaged.
- Certainty and transparency rules should be clear and simple so that businesses can anticipate the tax consequences of a transaction.
- Effectiveness, risks from increased evasion and avoidance should be kept to a minimum, with the overriding aim that the correct amount of tax is paid at the correct time and in the correct country.
- Efficiency, keeping compliance costs of business and administration costs of governments to a minimum.

¹² ‘Australian Taxation Office Discussion Report of the ATO Electronic Commerce Project’ (August 1997) *Tax and the Internet*.

¹³ ‘United Kingdom Inland Revenue’ (6 October 1998) See in this regard: www.hmce.gov.uk.

The United States of America in a joint statement with the United Kingdom in January 1999, agreed to work together, supporting and endorsing the principles and policies of the OECD.¹⁴ The 1998 G8 summit in its conclusions record that it will work with and welcome the work of the OECD.¹⁵

The Republic of South Africa has enacted the Electronic Communications and Transactions Act 25 of 2002. Section 2 of this Act provides that its objectives are as follows:

‘... to enable and facilitate electronic communications and transactions in the public interest, and for that purpose to ... promote legal certainty and confidence in respect of electronic communications and transactions; ... promote technology neutrality in the application of legislation to electronic communications and transactions; ... ensure compliance with accepted International technical standards in the provision and development of electronic communications and transactions’.

As can be seen from the above, many developed nations have aligned themselves with the principles of the OECD. The SARS has stated the following:¹⁶

‘Although South Africa is not a member country of the OECD, the OECD Guidelines are acknowledged as an important, influential document that reflects unanimous agreement amongst the member countries, reached after an extensive process of consultation with industry and tax practitioners in many countries. The OECD Guidelines are also followed by many countries, which are not OECD members and are therefore becoming a globally accepted standard. South Africa is a member of the World Trade Organisation (WTO), which embodies the Multilateral Trading System (MTS), and this body is the only international body dealing with the rules of trade between nations.’

The OECD has stated that its objectives in the area of e-commerce and taxation for 2001-2003 are ¹⁷

‘to progress further the work towards the implementation of the taxation framework conditions and the strengthening of the international dialogue. The CFA has narrowed the focus of the main fields of further work to a number of key issues. These include, amongst others:

- ‘On direct tax issues, allocation of income.
- ‘On consumption tax issues, the role of technology-based systems in tax collection.
- ‘On tax administration issues, the means to address significant compliance challenges and to exploit taxpayer service opportunities.

In line with its working methods since Ottawa, the OECD Committee on Fiscal Affairs (CFA) intends to take forward this further work through its subsidiary bodies (Working Parties, etc.) with continued input from, and close working with, business, non-member economies and the European Commission. In January

14 *World Trade Organisation* See www.wto.org/anniv/ecom.htm.

15 *G8 Summit*, see in this regard: <http://birmingham.g8summit.gov.uk/forfin/joint.shtml>.

16 In its Practice Note 7 entitled ‘Determination of the Taxable Income of Certain Persons from International Transactions: Transfer Pricing’ in 7.31.

17 ‘Organisation for Economic Co-operation and Development’ (2001-2003) web site, see in this regard: <http://oecd.org/EN/OECD>.

2001, the CFA not only endorsed the elements of a work programme for 2001-03, but also approved proposals for a continuation and refinement of the TAG process.'

The site, goes on further to indicate that

'the CFA will continue to undertake its work on the taxation aspects of electronic commerce in an open and transparent manner with the express aim of continuing to strengthen the emerging international consensus on these issues. Working in partnership with the international business community, and with economies outside the OECD, remains central to building that international consensus and so providing the certainty and confidence that governments and business both seek.'

From this above quotation it can be seen that the international community has assumed responsibility through the OECD to address consumption tax issues using a technology-based systems in tax collection.

Pursuant to this commitment, the salient points, relevant to this dissertation are as follows: ¹⁸

- 'Neutrality, taxation should seek to be neutral and equitable forms of e-commerce and between conventional and e-commerce.
- 'Efficiency, compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.
- 'Certainty and simplicity, the tax rules should be clear and understood, including knowing where and how tax is to be accounted.
- 'Effectiveness and fairness, taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportional to the risks involved.
- 'Flexibility, the systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.'

The report, further indicated the following: ¹⁹

'In the field of consumption taxes the core elements of the Taxation Framework Conditions were developed as follows:

'Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where the consumption takes place and an international consensus should be sought on the circumstances under which supplies are submitted to be consumed in a jurisdiction.

'For the purposes of consumption taxes, the supply of digitised products should not be treated as a supply of goods.

18 'Organisation for Economic Co-operation and Development' (February 2001) Report from Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs.

19 'Organisation for Economic Co-operation and Development' (February 2001) Report from Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs.

‘Where businesses and other organisations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.

‘Countries should ensure that appropriate systems are developed in co-operation with the World Customs Organization (WCO) and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers.’

As can be seen from this extract from the report the following core elements are identified:

- Place of consumption.
- Jurisdiction.

The broad taxation principles cited above, identify the following issues:

- Enforcement, using words to ensure that administration costs are minimised.
- Responsibility, using words so that taxpayers can anticipate the tax consequences.
- Value, using words so that the correct amount is used.
- Date, using words so that the correct time is established.

In this dissertation, these core issues are the criteria in which the commercial transactions are assessed. Included in the paragraphs that follow is a review of the above report, as it pertains to these issues.

Jurisdiction

Jurisdiction is defined in the *Concise Oxford Dictionary* as ‘administration of justice (over or of); legal or other authority; extent of this, territory it extends over’. In this dissertation, jurisdiction is defined as the power, authority and control in the territory that taxation is exercised. Parties to a business transaction can be governed only within the jurisdiction where they transact. The report presented by the OECD recorded that the²⁰

‘challenge is to provide merchants with a mechanism that, inter alia, allows the jurisdiction of their consumers to be verified’.

20 ‘Organisation for Economic Co-operation and Development’ in para 11(December 2000) *Report by the Consumption Tax Technical Advisory Group (TAG)* see in this regard: <http://www.oecd.org/pdf/M000015000/M00015515.pdf>

E-commerce transactions that use an Internet content provider (ICP) for trading purposes require establishing where the physical presence of the ICP is so as to identify jurisdiction.

The use of a permanent establishment could assist the identification of the place of jurisdiction. The permanent establishments of both the supplier and consumer are required to be identified. Article 5(5) of the OECD Model Tax Treaty, provides

‘that where a person is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting state a authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that state’.

Article 5(10) goes on to record that

‘if the business of the enterprise is carried on mainly through automatic equipment then the location of this automatic equipment is the fixed place of business’.

Article 5(2) defines the term permanent establishment to include

- a place of management;
- a branch; and
- an office.

This definition assists in identifying the location of the jurisdiction of the supplier, but does not assist in identifying the whereabouts of the consumer and the place of consumption.

To establish jurisdiction in context of responsibility, it is necessary to distinguish between

- the owner of the host computer, and
- the owner of the content hosted on that computer.

The responsibility will vary according to the role assumed by the parties that can range from

- the owner of the host computer owning and controlling the data, to
- where the owner of the host computer has a minor role, like a host that hosts e-mails messages in mailboxes, with no further role.

Before responsibility can be established, the jurisdiction and the role, of both the host and the owner of the content, are required to be known.

The intermediation of an ICP is another situation where responsibility can be determined only once the jurisdiction and the role assumed by the content provider and the content owner have been established. If a foreign supplier has a physical presence in South Africa he may be required to register for VAT in South Africa.

Section 90 of the Electronic Communications and Transactions Act 25 of 2002, identifies that the jurisdiction of the courts is applicable to

- any offence committed in the Republic;
- where any result of the offence has had an effect in the Republic; or
- where the offence was committed by a South African citizen or by a person with a permanent residence in the Republic, or by a person carrying on business in the Republic.

The likely effect of this provision is that any offence that impacts or effects South Africa, is capable of being tried in a South African court.

Place of Consumption

The OECD Working Party 9 Report, in para 5 states the following:²¹

‘In the field of consumption taxes, the core elements of the Taxation Framework Conditions were developed as follows:

‘Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are submitted to be consumed in a jurisdiction.’

This statement addresses two of the core issues, namely, place of consumption and jurisdiction. The place of consumption is defined as the place where the customer actually consumes or uses the service. The basis of consumption tax, in South Africa being VAT, is at the place where the customer actually consumes or uses the service. *The South African Green Paper on Electronic Commerce* highlights as one of its more urgent tax issues, being of the place of consumption.²² *The Green Paper* goes on to record that the main difficulty that arises with the place of consumption is that the supplier may not be able to determine the location of the customer. This customer may then also be outside the fiscal jurisdiction of the authorities in the country where the consumption takes place. What is clear from these views is that VAT should be levied where the consumption took place, and not where the supply was rendered.

The United Kingdom Inland Revenue in its tax agenda states that²³

21 ‘Organisation for Economic Co-operation and Development’ (February 2001) Report from Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs.

22 ‘Department of Communications Republic of South Africa’ (1999) *The South African Green Paper on Electronic Commerce*, Theme 1 Legal and Regulatory Issues, para 4.3.2: Indirect (Consumption) Taxes.

23 United Kingdom Inland Revenue Tax Agenda Modernising VAT (accessed 2000-05-28) (Chapter 6) in para 6.22, see in this regard: <http://www.inlandrevenue.gov.uk/taxagenda/ecom6.htm> .

‘the emerging international view is that the definition of place of consumption for private consumers should be their usual place of residence. This would simplify decision making for suppliers, most of whom routinely collect this information for marketing purposes.’

Responsibility

Tax authorities are required to identify who is responsible for declaring VAT.

In a traditional offline transaction it is the supplier of the goods or services who is responsible for declaring VAT. The supplier can be easily identified. He is based in a specific tax jurisdiction, allowing for enforcement by the tax authorities.

The place of consumption of the goods or services cannot always be identified. Suppliers outside the jurisdiction of a country generally have not been liable for registration within that country even though they may supply goods or services for consumption in that country (the recent rule of the EU sees a change in this previous dispensation). The tax authorities have not in the past been able to enforce registration of foreign suppliers. They have used a reverse-charge mechanism, whereby the consumer of the goods is responsible for declaring and remitting VAT.

It can be seen that leading from responsibility is another core issue, and that is, declaration.

When discussing responsibility the issue of identification is relevant if identification of the party responsible for paying the VAT is fundamental to responsibility. *The South African Green Paper on Electronic Commerce* provides as follows:²⁴

‘The accurate identification of the party responsible for paying a particular tax is a fundamental requirement of any taxation system. Tracing the physical owner of a web site identified, can be a time-consuming process often with reliance having to be placed upon a third party. Conventional businesses are easier to keep track of as they operate from a physical and geographical location that can be visited. In addition, all conventional correspondence of Companies, Close Corporations and Trusts in South Africa require relevant registration number to be displayed. As there is to some extent a blurring of the mere advertising and the actual trading capabilities of an enterprise’s web site some attention ought to be given to drafting a minimum standard in respect of identification requirements.’

The Electronic Communications and Transactions Act 25 of 2002 identifies under the heading ‘legal requirements for data messages’ the requirements to ensure responsibility and non-repudiation of electronic transactions.²⁵ These provisions ensure responsibilities by the various parties who have been identified.

24 ‘Department of Communications Republic of South Africa’ (1999) *The South African Green Paper on Electronic Commerce* Electronic Commerce for South Africa – for Public Discussion, Theme 1 in para 4.5, under the heading ‘Identification’.

25 Electronic Communications and Transactions Act s 11 through to s 20 (August 2002) § 23.

The Australian Taxation Office provides that²⁶

‘the one key environmental difference between the Internet and the “real” world is the weakness of identity on the Internet, where the assumption of fictitious, multiple identities is by no means difficult’.

The ability, with certainty, to identify and assign responsibility is difficult in an e-commerce environment.

Declaration

For the tax authorities to determine the amount of VAT due and who the parties to the transaction are, it is necessary for the responsible party to the transaction to declare, in a pre-defined format, the required information. This generally creates the situation that the responsible party, so as to complete a declaration, must be within the jurisdiction of the tax authorities. The EU in its Council Directive 2002/38/EC, states that a non-EU supplier will be required to register with a VAT authority in a member state of its choice, and to levy VAT at the rate applicable in the member state where the customer is resident. The provisions in this circular sees parties outside of its jurisdiction being governed by that member state.

As can be seen from the above, the issues of

- place of consumption,
- jurisdiction,
- enforcement,
- responsibility, and
- declaration,

are inter-dependent upon each other.

Value

The amount of VAT is calculated from the value of the supply. It is therefore imperative to determine that the amount of VAT is based on ‘the correct amount’, in other words, the value. Value forms the basis that VAT is levied on.

The Australian Taxation Office²⁷ discusses transfer pricing and highlights that ‘difficulties in identifying that the transaction occurred between two associated parties’ may arise. Transfer pricing

²⁶ ‘Australian Taxation Office (ATO)’ (August 1997) *Discussion Report of the ATO Electronic Commerce Project* in para 8.2.1.

²⁷ ‘Australian Taxation Office (ATO)’ (August 1997) *Discussion Report of the ATO Electronic Commerce Project* in para 7.6.21 and 7.6.22.

refers to the situation where the profits are shifted offshore to a more-favourable tax rate (refer glossary for a more-detailed definition). In this regard the Australian Taxation Office states the following:

‘This could lead to increased difficulty in applying traditional transactional methods and require greater use of the profit split and profit comparison method in order to establish an arm’s length value.’

Many e-commerce sites derive revenue from advertising. They are therefore willing in an arm’s length situation to sell goods and services below a value compared to that in an offline environment.

The value paid for certain goods and services, online, can be lower than the open or fair market value for the same goods and services, offline. Section 3(2) of the Act defines ‘open market value’ as

‘the consideration in money that the supply of those goods or services would generally fetch if supplied in similar circumstances at that date in the Republic, being a supply freely offered and made between persons who are not connected persons’.

Of importance in determining value is the fact that the transaction should not only be arm’s length, but that the goods or supply need to be freely offered in the Republic (South Africa).

The ability to determine the fair and open market value of information stored in an electronic form on a computer disc, or downloaded over the Internet, can only reasonably be determined by the recipient of the information. The face value of the disc itself can be established, while the true value is the data stored on the disc. An example of this would be where a formula for a product or design, potentially worth millions of rands to the recipient could not be established while the data is encrypted. The Electronic Communications and Transactions Act 25 of 2002 requires cryptography providers to register with the Director-General. This registration will assist in potentially establishing the content of the data message to determine the value of the data stored on the disc.

The various forms of storing and supplying goods and services identify a situation where the true value or ‘the correct amount’ is extremely difficult to determine.

Date

The need to establish the ‘correct time’ is necessary to identify the date that VAT would be due to be remitted to the authorities. Knowledge of the correct time is required for VAT to be remitted in the correct tax period that the tax falls within.

Section 23 of the Electronic Communications and Transactions Act deals with the ‘time and place of communications, dispatch and receipt’ of a data message. It establishes that the date is when the data message is

‘used in the conclusion or performance of an agreement must be regarded as having been sent by the originator when it enters an information system outside the control of the originator or, if the originator and addressee are in the same information system, when it is capable of being retrieved by the addressee’.

Section 23(b) then provides that a data message

‘must be regarded as having been received by the addressee when the complete data message enters an information system designated or used for that purpose by the addressee and is capable of being retrieved and processed by the addressee’.

And then section 23(c) provides that a data message

‘must be regarded as having been sent from the originator’s usual place of business or residence and as having been received at the addressee’s usual place of business or residence’.

This provision establishes that the time of an electronic message, and the address to where the message is sent from and to, is to be regarded as the usual place of business or residence. This feature of ‘place of business and residence’ is important when trying to establish the place of consumption and the permanent establishment.

Enforcement

Recommendations of the OECD Task Group 9 are that efficiency should be ensured with

- compliance costs for taxpayers being minimised, and
- administrative costs for the tax authorities also being minimised as far as possible.

To minimise costs the tax authorities must be able to enforce legislation and compliance with a minimum degree of effort. Likewise the taxpayer must be supplied the necessary information from the consumer as to his place of consumption and jurisdiction.

To satisfactorily enforce legislation government must be able to access information. The Act sets out numerous ways where vendors must facilitate enforcement of the Act. Some examples are those provisions dealing with issues of

- record keeping,
- access to premises,
- inspection of records, and
- provision of information.

Summary

The increased use of e-commerce as a manner for trading has seen how the ability to efficiently enforce the collection of VAT has been negatively impacted. This chapter has highlighted how the international community is seeking solutions to the negative impact on the tax base and revenue of VAT, by the creation of various forums, seeking opinions from government, commerce and others who are involved in e-commerce. For VAT to be efficiently enforced certain criteria are needed to be addressed. These criteria, or core issues, have been identified above and are recorded below, as the basis upon which this dissertation analyses and approaches e-commerce:

- Jurisdiction.
- Place of consumption.
- Responsibility.
- Declaration.
- Value.
- Date.
- Enforcement.

For governments to collect VAT, sound rules for the enforcement and application of VAT need to be in place. This is achieved in South Africa by the Value-Added Tax Act. Its relevant provisions are discussed in the chapter that follow.

Chapter 4

VAT Legislation

Introduction

From its outset the Act has provided that one of its aims is to provide for taxation on the supply of goods and services and on the importation of goods.

This chapter commences with those issues that define the provision of, and supply of, goods and services, and the importing and exporting of goods and services. It provides how these issues are to be administered and enforced.

The chapter concludes with the identification of those issues addressed in the ensuing chapters that are impacting on the ability to administer and enforce the application of the Act, with regards to e-commerce and more specifically in the area of importing and exporting.

The Act applies to enterprises that carry on continuously or regularly in, or partly in, South Africa. This establishes that only enterprises within the jurisdiction of South Africa are governed by this Act, thereby not legislating for foreign enterprises.

The impact of not being in a position to legislate for enterprises outside of the South African jurisdiction is that they cannot be legally enforced. This hinders the enforcement or improvement in the collection of VAT.

A resident of the Republic is a person who is defined as resident in s 1 of the Income Tax Act.

Section 1 of the of the Income Tax Act defines a 'resident' as follows:

'(a) natural person who is–

(i) ordinarily resident in the Republic; or

(ii) not at any time during the year of assessment ordinarily resident in the Republic, if such person was physically present in the Republic–

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the three years of assessment preceding such year of assessment; and

(bb) for a period or periods exceeding 549 days in aggregate during such three preceding years of assessment:

Provided that–

- (A) for the purposes of items (aa) and (bb) a day shall include a part of a day; and
 - (B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; or
- (b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic (but excluding any international headquarter company);’

Any other person or any other company is deemed to be a resident of the Republic to the extent that he, or it, carries on in the Republic, any enterprise or other activity and has a fixed or permanent place in the Republic relating to that enterprise or other activity.

This dissertation is concerned with the negative impact e-commerce is having upon the tax base and fiscal revenue of VAT in South Africa. For this reason this chapter does not include a comprehensive record of the complete Act, but limits itself to highlighting those areas in the Act that are relevant to the importing and exporting of electronic goods and services over the Internet. In addition, in this dissertation, an online business is defined as not including a business that previously transacted offline and that now incorporates an online element, but it is a business that is primarily online.

Throughout this dissertation the following core issues are the criteria that commercial transactions are to be assessed against as it these areas that allow for administration and enforcement. These areas are later identified as being the area of differences between online and offline transactions. They are as follows:

- Jurisdiction.
- Place of consumption.
- Enforcement.
- Responsibility.
- Value.
- Date.

Imposition of VAT

Section 7(1) of the Act provides how VAT will be levied and paid. It provides as follows:

- On the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him.
- On the importation of any goods into the Republic by any person on or after the commencement date.
- On the supply of any imported services by any person on or after the commencement date, calculated at the rate of 14% on the value of the supply concerned or the importation, as the situation may be.

Section 7(2) provides that

- the tax payable in terms of s 7(1)(a) must be paid by the vendor (identifying responsibility) referred to in that provision,
- the tax payable in terms of s 7(1)(b) must be paid by the person referred to in that provision, and
- the tax payable in terms of s 7(1)(c) must be paid by the recipient of the imported services (identifying responsibility).

In this dissertation reference to the word ‘tax’ and the term ‘VAT’ are used interchangeably. The Republic of South Africa is referred to as both the ‘Republic’ and ‘South Africa’.

Registration

Section 23 of the Act indicates that every person who carries on any enterprise is liable to register, provided that the value of the supply is greater than a set threshold (currently R300 000) within a twelve-month period. This provision identifies who is liable to register. An enterprise can also apply for voluntary registration provided its turnover exceeds a set amount (currently R20 000) within a twelve-month period.

Section 23(3) provides as follows:

- ‘(3) Notwithstanding the provisions of subsections (1) and (2), every person who satisfies the Commissioner that, on or after the commencement date—
- (a) that person is carrying on any enterprise as contemplated in paragraph (b)(ii) or (iii) or (c) of the definition of “enterprise” in section 1; or
 - (b) that person is carrying on any enterprise other than as contemplated in paragraph (b)(ii) or (iii) or (c) of the definition of “enterprise” in section 1 and the total value of taxable supplies made by that person in the course of carrying on all enterprises in the preceding period of 12 months has exceeded R20 000; or

- (c) that person intends to carry on any enterprise from a specified date, where that enterprise will be supplied to him as a going concern and the total value of taxable supplies made by the supplier of the going concern from carrying on that enterprise or part of the enterprise which will be supplied has exceeded R20 000 in the preceding period of 12 months; or
- (d) that person is continuously and regularly carrying on an activity which, in consequence of the nature of that activity, can reasonably be expected to result in taxable supplies being made for a consideration only after a period of time and where the total value of taxable supplies to be made can reasonably be expected to exceed R20 000 in a period of 12 months,

may apply to the Commissioner in the approved form of registration under this Act and provide the Commissioner with such further particulars as the Commissioner may require for the purpose of registering that person.'

Section 1 of the Act defines an enterprise as

'in the case of any vendor . . . any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, . . . '.

The definition of an 'enterprise' includes two circumstances where, if persons outside the Republic engage in commercial activities within the Republic, are nevertheless deemed to be conducting an enterprise that is required to be registered in terms of the Act. These two circumstances are as follows:

- Telecommunication services set out in s 1(b)(iv) providing that the activities of any person who supplies telecommunication services, that are used in the Republic, are deemed to conduct an enterprise. He is also required to register and account for VAT on his supplies. This provision acknowledges that non-vendors (consumers) rarely account for the VAT due on imported services. It seeks to enforce compliance through registration of the foreign entity providing the service within South Africa.
- The activity underwriting insurance businesses as set out in the definition of an 'enterprise'. Proviso (vi) of this definition records that 'the activity of underwriting insurance business by Underwriting Members of Lloyds of London, to the extent that contracts of insurance are concluded in the Republic, shall be deemed to be the carrying on of an enterprise'.

This provision again demonstrates the intention of the legislature to capture the 'lost-value' associated with the importation of services into the Republic. It also facilitates the payment of VAT by consumers who would otherwise enjoy the benefit of these services without contributing to the fiscus.

Tax Invoices and Credit and Debit Notes

Having established who is responsible for registration as a vendor, the Act sets then out in s 20 and s 21 what details are required to be declared and recorded on the documentation supporting any transaction. This is dealt with in detail in s 20(4) (as recorded below). It ensures that jurisdiction, place of consumption, date and value, are all identified.

Invoice is defined in the Value-Added Tax Act to mean ‘a written obligation to make payment’, whilst a tax invoice is a formal document that is required to be issued by a vendor. It is also required by a recipient who intends claiming input tax credits. A vendor is required to account for output tax when a tax invoice is prepared. Often a written contract in law is tantamount to an invoice in an off-line environment. The same can be said about on-line transactions. That is, for example, terms, conditions, and payment details are set out when a person purchases items, that is a contract is entered into using electronic signature.

The use of the words ‘invoice’ and ‘tax invoice’ are used interchangeably in this dissertation and are to be treated as the same thing.

Section 20(4) provides that

‘except as the Commissioner may otherwise allow, and subject to this section, a tax invoice shall be in a currency of the Republic and shall contain the following particulars:

- (a) The words “tax invoice” in a prominent place;
- (b) the name, address and registration number of the supplier [identifying jurisdiction and responsibility];
- (c) the name and address of the recipient [identifying jurisdiction and place of consumption];
- (d) an individual serialized number and the date upon which the tax invoice is issued [identifying date];
- (e) a description of the goods or services supplied;
- (f) the quantity or volume of the goods or services supplied;
- (g) either ...

the value of the supply, the amount of tax charged and the consideration for the supply [identifying value]] or ... where the amount of tax charged is calculated by applying the tax fraction to the consideration, the consideration for the supply and either the amount of the tax charged, or a statement that it includes a charge in respect of the tax and the rate at which the tax was charged.

‘Provided that the requirement that the consideration or the value of the supply, as the case may be, shall be in the currency of the Republic shall not apply to a supply that is charged with tax under section 11 [this includes exports that are zero rated].’

Section 20(5) caters for where supplies are below a certain amount. Under this provision less information is required on the tax invoices. There is a proviso in s 20(5) stating that supplies at a ‘zero rate’ (for the purposes of this dissertation being limited to exports), must still record all the details as set out above.

Section 21(3) deals with credit or debit notes. They are to be issued after a tax invoice has been provided and should contain the following particulars:

- ‘ (i) the words “credit note” or “debit note” in a prominent place;
- (ii) the name, address and registration number of the vendor;
- (iii) the name and address of the recipient,
- (iv) the date on which the credit/debit note was issued;
- (v) either the amount by which the value of the said supply shown on the tax invoice has been reduced and the amount of the excess tax; or . . . where the tax charged in respect of the supply is calculated by applying the tax fraction to the consideration, the amount by which the consideration has been reduced and either the amount of the excess tax or a statement that the reduction includes an amount of tax and the rate of the tax included;
- (vi) a brief explanation of the circumstances giving rise to the issuing of the credit/debit note;
- (vii) information sufficient to identify the transaction to which the credit/debit note refers.’

Records

Section 55 deals with the information that has to be declared. It relates to how vendors must keep books of account and other records to enable the Commissioner to satisfy himself that the vendor has observed the requirements.

Section 55 includes the following provisions that are pertinent to this dissertation:

‘A record of all goods and services supplied by or to the vendor showing the goods and services, the rate of tax applicable to the supply and the suppliers or their agents, in sufficient detail to enable the goods and services, the rate of tax, the suppliers or the agents to be readily identified by the Commissioner, and all invoices, tax invoices, credit notes, debit notes ...

‘A record of all importations of goods and documents relating thereto ...

‘Any documentary proof required to be obtained and retained in accordance with s 11(3) [dealing with exports].’

National Goods and Services

The fact that the vendor is responsible for the payment for the supply of both goods and services in s 7(1)(a) is as a result of this supply being conducted by an enterprise.

An enterprise is defined to be any enterprise or activity that is carried on continuously or regularly by any person in the Republic or partly in the Republic.

A vendor is defined to be any person who is carrying on an enterprise.

Therefore a vendor would be an enterprise conducted in the Republic, or partly in the Republic. This situation would place the jurisdiction of the vendor in the Republic. The ability of the SARS to administer and enforce legislation in terms of this Act in the geographic region of the Republic should thereby be facilitated.

The Act makes a clear distinction between the supply of goods and the supply of services, and for this reason, these aspects are dealt with separately. The paragraphs that follow are applicable to both goods and services. They are dealt with under the 'international' heading and not specifically under either goods or services.

International

Section 16 establishes that a vendor is entitled to claim the tax paid on imported goods and services as an input tax deduction. Goods or services imported for home consumption do not form part of a vendor's enterprise and do not qualify for an input deduction.

Section 31(1) provides that where any person fails to furnish any declaration, the Commissioner may make an assessment of the amount of tax payable. This establishes that where goods or services are imported and no tax is paid, the Commissioner can then calculate the amount.

Section 75 establishes the potential for agreements with the government of any other country to prevent, mitigate or discontinue double tax. This may assist persons importing goods or services from not having to pay tax in more than one country.

Importation of Goods

Section 7(1)(b) provides that

‘on the importation of any goods into the Republic by any person’

tax will be levied and paid. And then s 7(2) provides that

‘the tax payable in terms of paragraph (b) of that subsection shall be paid by the person referred to in that paragraph’.

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 into the Republic. This is known as a reverse-charge mechanism because the customer is required to account for the VAT. The reason why it is not the vendor who is responsible is because the vendor is not in the geographic region of the Republic, and in terms of South African legislation is not governed by the Act, nor is he within its jurisdiction.

Establishing that the goods have been imported into the Republic identifies the place of consumption to be in South Africa.

All goods must enter South Africa through an official port of entry where customs and excise agents are present. These customs and excise agents are empowered, in terms of the Customs and Excise Act, to collect VAT. Ports of entry include, ports, post offices and airports where ease of enforcement is evident.

Section 54(2A) deals with goods imported into the Republic by an agent, who is acting on behalf of another person (the principal) for the purposes of that importation. Depending upon the circumstances, the importation of the goods is deemed to have been made by either the agent or the principal.

Section 8(20) indicates that where an importation of goods is deemed to have been made by an agent in the circumstances contemplated in s 54(2A)(b), the agent is deemed to make a supply of goods to the recipient of the supply and not the principal. These two provisions result in at least one party being responsible for the imposition and payment of tax for imported goods where an agent and principal relationship exists. This mechanism employs the concept of ‘leverage’ where a third party is leveraged to perform the task of either the consumer or the government.

Section 13 establishes both the date of importation and the value of the goods. The value is based on the same value used for customs duty purposes. Section 13(4) goes on to hold that the importer of the goods must furnish a declaration in the prescribed form. He must also calculate and pay the tax to the Commissioner, based on the value. When importing goods an additional 10% of the value is added to the base cost to determine the value for VAT. Section 14 establishes both the date of importation and the value of services. It is noted that the value of services does not have an extra 10% added to the base cost.

Section 13(1) provides as follows:

‘For the purposes of this Act goods shall be deemed to be imported into the Republic on the date on which the goods are in terms of section 10 of the Customs and Excise Act deemed to be imported: Provided that:

- (i) goods which are entered for home consumption in terms of the Customs and Excise Act, shall be deemed to have been imported on the date on which they are so entered;
- (ii) where any goods have been imported and entered into a licensed Customs and Excise warehouse but have not been entered for home consumption, any supply of such goods before they are entered for home consumption shall be disregarded for the purposes of this Act;
- (iii) goods imported from Botswana, Lesotho, Swaziland and Namibia shall be declared and tax paid to an officer designated by the Commissioner for Customs and Excise on entry into the Republic in accordance with such procedures and at such place as the said Commissioner may prescribe by rule.'

Section 13(2) then provides as follows:

'For the purposes of this Act the value to be placed on the importation of goods into the Republic shall be deemed to be:

- (a) where such goods are entered or are required to be entered for home consumption in terms of the Customs and Excise Act, the value thereof for customs duty purposes, plus any duty levied in terms of the said Act in respect of the importation of such goods, plus 10 per cent of the said value; or
- (b) where such goods are not required to be so entered, the amount of the value which would have been used for customs duty purposes had they been subject to customs duty:

'Provided that where the Minister has made a regulation determining the value of such goods for the purposes of this section, the greater of such determined value or the value declared on importation shall be used instead of the value for customs purposes.'

The importation of goods identifies the person who imported the goods into the Republic as the person who is responsible for the collection of, and declaration of, VAT. The goods being imported places the jurisdiction and the place of consumption in the Republic. The date and value is dealt with under s 13 of the Act.

Importation of Services

Section 1 of the Act defines 'imported services' to mean

'a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that the services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies'.

In view of this definition any service imported by a vendor would not be subject to VAT, resulting in the detail recorded below only pertaining to a non-vendor. In this regard *Cyberlaw at SA* reads as follows:²⁸

28 C G De Wet and R Du Plessis *Cyberlaw at SA* (Chapter 9) (1999).

‘Where the business consumer intends utilising or consuming the particular services for the purposes of making taxable supplies and would consequently be entitled to claim an input tax deduction in respect of the services rendered by the non-resident, it follows that the business consumer would thus not incur VAT and would not be liable to account for VAT.’

Imported services are

- a supply of services,
- made by a supplier who is not a resident of the Republic or who carries on business outside the Republic,
- to a recipient who is a resident of the Republic,
- to the extent that the services are utilized or consumed in the Republic otherwise than for making taxable supplies.

This definition implies that VAT need be paid only on services that are imported by a person who

- is not registered as a vendor; or
- is a vendor but using the services wholly or partially for exempt supplies; or
- is a vendor using the services for private purposes, that is not for taxable supplies.

Section 7(1)(c) provides that

‘on the supply of any imported services by any person calculated on the value of the supply concerned or the importation, as the case may be’

tax will be levied and paid.

Section 7(2) then provides that

‘the tax payable in terms of paragraph (c) of that subsection shall be paid by the recipient of the imported services’.

This creates the situation where it is neither the vendor nor the person who imported the service into the Republic who is responsible for the declaration of the tax, but the recipient of the imported service.

The reason why it is not the vendor who is responsible is considered to be because the vendor, similar to the importation for goods, is not in the geographic region of the Republic, and in terms of South African legislation not governed by the Act or within its jurisdiction.

The place of consumption is nevertheless considered to be in the Republic as the service is imported. Services are not of a tangible nature, and in accordance with this definition are not capable of being imported through an official port of entry, where customs and excise agents are present. It is for this reason that the recipient of the service is responsible for the tax being levied and paid. As there is no defined port of entry, this creates difficulty with enforcement.

Section 14(1) provides as follows:

‘Where tax is payable in terms of section 7(1)(c) in respect of the supply of imported services the recipient shall within 30 days of the date referred to in subsection (2);

(a) furnish the Commissioner with a declaration (in such form as the Commissioner may prescribe) containing such information as may be required;

and

(b) calculate the tax payable on the value of the imported services at the rate of tax in force on the date of supply of the imported services and pay such tax to the Commissioner.’

This provision establishes the date that VAT should be paid, the manner of the declaration, and the value of the service.

Section 14(2) then provides as follows:

‘For the purposes of this Act, a supply of imported services shall be deemed to take place at the time an invoice is issued by the supplier or recipient in respect of that supply or the time any payment is made by the recipient in respect of that supply, whichever time is the earlier.’

This provision connects the issuing of an invoice with the payment for the supply, establishing the time the service takes place.

And then s 14(3) provides as follows:

‘For the purposes of this Act, the value to be placed on the supply of imported services shall, save as otherwise provided in this section, be the value of the consideration for the supply, as determined in terms of section 10(3) or the open market value of the supply, whichever is the greater.’

Section 10(3) referred to in s 14(3) provides as follows:

‘For the purposes of this Act the value of any consideration referred to in this section shall be;

(a) to the extent that such consideration is a consideration in money, the amount of the money; and

(b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.’

The ability to establish the value of the consideration can be determined from the amount paid. The ability to establish the open market value is a matter for concern as many items downloaded from the Internet are done so at a value lower than the open market value. The consumer of the information can only determine the open market value of information stored on a disc. This creates difficulty for the tax authorities to establish the value, hindering enforcement. Section 10(1)(a) goes on to hold the recipient of the service is responsible to furnish a declaration, in the prescribed form, and to calculate and pay the tax to the Commissioner based on the value.

And then s 14(4) provides as follows:

‘Where a person carries on activities outside the Republic which do not form part of the activities of any enterprise carried on by him and in the course of such first-mentioned activities services are rendered for the purposes of such enterprise which, if rendered by anybody other than the said person, would be imported services, such services shall for the purposes of section 7(1)(c) be deemed to be imported services supplied and received by that person in respect of such enterprise.’

This is a specific anti-avoidance provision aimed at preventing non-registered vendors from setting up an operation outside the Republic and using the external activity to render services to the local enterprise free of VAT.

And then s 14(5) provides as follows:

‘The tax chargeable in terms of section 7(1)(c) shall not be payable in respect of;

(a) a supply which is chargeable with tax in terms of section 7(1)(a) at the rate provided in section 7; or

(b) a supply which, if made in the Republic, would be charged with tax at the rate of zero per cent applicable in terms of section 11 or would be exempt from tax in terms of section 12.’

This provision ensures that no VAT is payable

- if it has already attracted VAT by the vendor in terms of s 7(1)(a); or
- if the supply would have been charged at 0%, or be exempt from VAT.

The importing of services establishes that the jurisdiction and place of consumption is in the Republic. Section 14 deals with the date of the supply and the value of the supply. The recipient of the imported service is responsible for the declaration of the VAT.

Exporting of Goods and Services

Section 11 deals with the zero rating of tax on the supply of goods and services. The Act provides that goods and services exported are taxed at a rate of 0%. Section 11(1) deals with the supply of goods. It provides as follows:

‘Where, but for this section, a supply of goods would be charged with tax at the rate referred to in section 7(1), such supply of goods shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent.’

Section 11(2) deals with the supply of services. It provides as follows:

‘Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent.’

And then s 11(3) provides as follows:

‘Where a rate of zero per cent has been applied by any vendor under a provision of this section, the vendor shall obtain and retain such documentary proof substantiating the vendor's entitlement to apply the said rate under that provision as is acceptable to the Commissioner.’

These provisions place the responsibility of determining whether a zero rate of tax can be levied and the completion of any declaration, upon the vendor. The fact that the goods and services have been exported identifies the place of consumption to be outside the Republic. The issuing of a tax invoice as required by s 20 establishes both the date and the value of the supply.

The vendor being based in the Republic establishes that the jurisdiction is within South Africa and this allows for ease of enforcement. With VAT being at a rate of 0% the need to establish the date, value and declaration is unnecessary.

Summary

This chapter has identified that goods and services exported will be subject to VAT, but at the rate of 0%, while the importation of goods and services attract VAT. The supplier of goods and services imported into South Africa is not a resident of South Africa, nor governed by South African jurisdiction.

The responsibility of, accounting for, and the declaring of VAT, is placed on either the person who imported the goods or the recipient of the services.

An input tax deduction is available for goods imported by a vendor. This creates an incentive for the vendor to account for, and to declare, the VAT. The importation of services by a vendor is not subject to VAT reducing the enforcement burden of government.

Goods and services imported for private use, whether by a vendor or not, do not qualify for an input tax deduction. Yet they are subject to the imposition of VAT.

Services imported by a vendor, not for private use, are not subject to VAT.

Goods imported through a designated port of entry should have tax accounted for and declared by appointed agents of the Commissioner. Where goods bypass these designated ports of entry, for example, delivery directly to a home address, or where a service was received, then agents cannot collect the VAT. The importer of the goods or the recipient of the service is then responsible. In many instances the importer of the goods or the recipient of the services does not, for a variety of reasons, account for, or declare the VAT.

The focus of this dissertation is on this non-declaration of VAT on goods and services imported. With services being provided over the Internet, a situation could arise where the jurisdiction of the recipient of the service, or the place of consumption, is unknown. This situation creates a lack of clarity with regards to whether VAT at the zero rate should be levied or not. This situation is also, to a lesser extent, addressed in this dissertation.

The next chapter records how businesses in South Africa conduct themselves in an online and offline environment, pursuant to compliance with the Act.

Chapter 5

Business Practices

Introduction

The preceding chapter recorded how the Act governs and legislates who and what is liable for VAT. This chapter identifies how VAT has traditionally (offline) and in an e-commerce environment (online) been accounted for, declared, and paid over to the government. For enterprises in a B2B transaction, it is the vendor, his representative, or the recipient of the goods or services, who is responsible for complying with the Act.

Where goods or services are supplied by, or used by a non-vendor, in a B2C transaction they are nevertheless bound by the Act. This situation is likely to cause a high degree of ignorance of the Act, resulting in a high level of non-compliance.

The process of buying goods and services follows an established pattern that can be identified by three main steps. These steps are

- the pre-purchase,
- followed by the purchase,
- and thereafter the payment for the purchase.

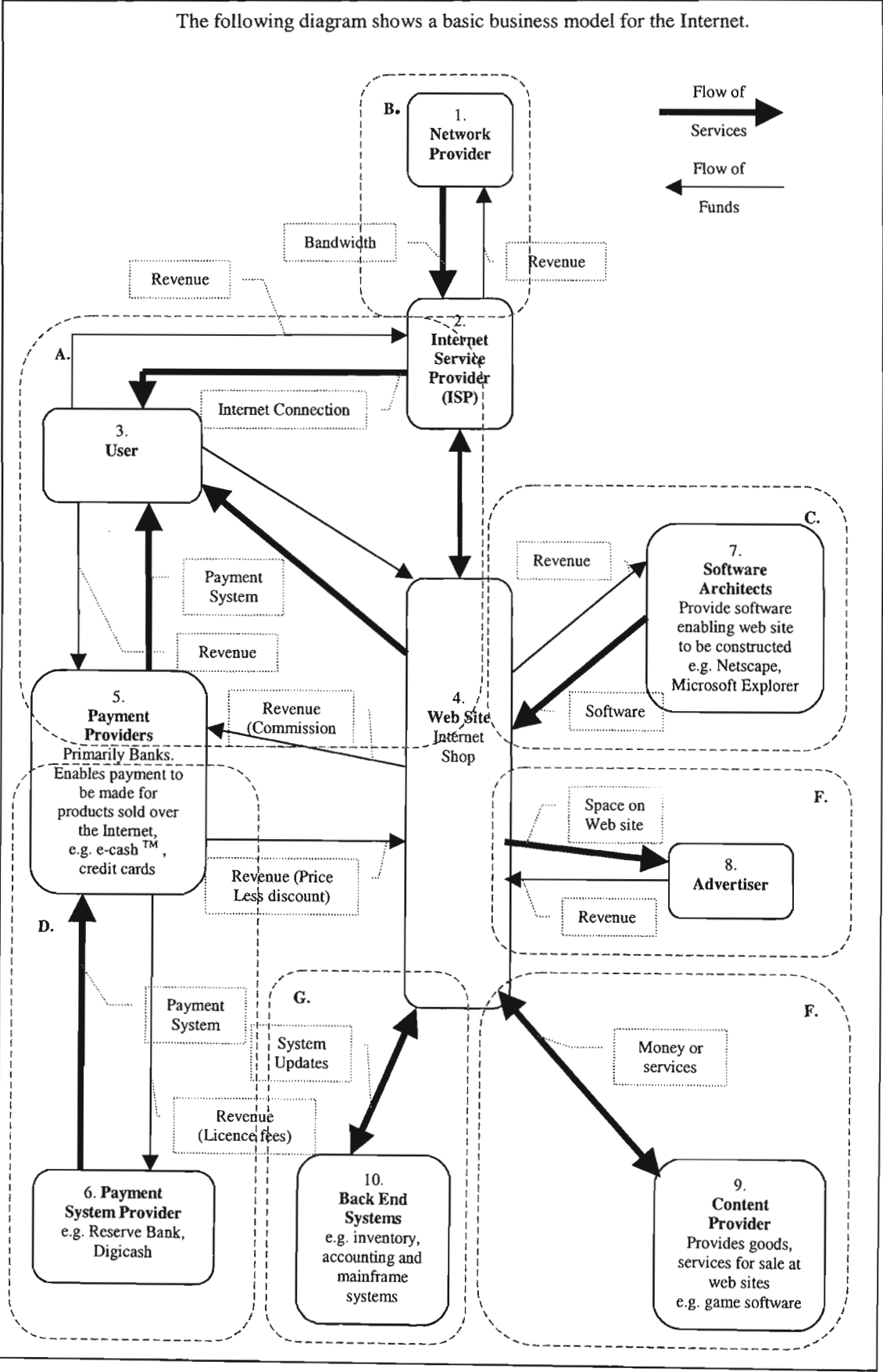
These steps have been adopted when recording the business process for buying and selling below.

The Act refers to the word 'supply'. A purchase represents a supply by one party and the receipt of a supply by the other party. A supply can therefore be viewed from both sides of a transaction.

The Australian tax office issued a paper that includes a diagram that records a basic business model for the Internet.²⁹ An extract of this diagram together with an explanation of the various transaction groups is set out below. It explains the basic mechanisms of e-commerce.

29 'Australian Taxation Office Discussion Report of the ATO Electronic Commerce Project', Diagram 3.6.2, (August 1997) *Tax and the Internet*.

Figure 5.1 **Diagram of a basic business model for the Internet**



‘Transaction Group A

‘The user, or potential “Internet shop” customer, pays a fee to the Internet service provider (ISP) who supplies an Internet connection. This gives the user access to various Internet services. The user visits a web site or ‘Internet shop’ and decides to purchase goods and or services. To pay for items, the user obtains a payment system from a financial institution (the payment provider). The payment provider’s also provide various services related to the system, such as settlement, authorisation. The Internet shop purchases a permanent Internet connection or space on the ISP’s computers from the ISP.

‘Transaction Group B

‘To provide the user with access to the Internet, the ISP purchases a set amount of bandwidth from a network provider.

‘Transaction Group C

‘Software architects supply the Internet shop with the software required to enable connection to an ISP and to allow customers to browse the shop.

‘Transaction Group D

‘Payment system providers supply the underlying technology and expertise required to run the payment providers computer systems. Payment providers pay license fees for this service.

‘Transaction Group E

‘The Internet shop purchases goods and services from a content provider. The Internet shop may purchase the rights to a product or may be one of many shops offering a product.

‘Transaction Group F

‘Advertisers purchase space on web sites through the Internet shop. Advertisers’ fees are negotiated on a fixed or ‘fee per click’ basis, depending on the popularity of the site.

‘Transaction Group G

‘The Internet shop maintains its back end systems through system updates. This automates the process of updating inventory, accounting and mainframe systems.’

As can be seen from the above diagram and explanations, there are many parties or groups involved in an e-commerce transaction. With an appreciation of these various parties and the roles each play, an understanding can emerge as to the possible complications, with regards to the location of jurisdiction and the allocation of responsibility. In a later chapter entitled 'Recommendations' the possible roles certain of these groups could assist in enforcing VAT compliance on the Internet is raised.

National Goods and Services

In the context of the heading 'National', goods and services are neither imported nor exported, placing the supply within the jurisdiction and the legislation of the government. This facilitates the SARS to administer and enforce the Act, with an element of ease. It also establishes that the place of consumption is within the South African jurisdiction. Fraudulent declaration or non-payment of VAT is not the subject of this dissertation. All goods and services supplied nationally by a vendor are subject to VAT. Section 20 and s 21 of the Act deal with the manner that VAT is to be raised, collected, and paid over to the SARS. In view of this, national goods and services should not impact on the fiscal revenue or tax base.

International

At the time of the pre-purchase, there is no difference between a vendor and a non-vendor, when goods or services are imported. Contact is made with the foreign supplier of the goods and services, where for commercial reasons it is likely that many of the details included in s 20 of the Act, would be established. They would probably include the following:

- The name and address of the supplier (establishes an external jurisdiction).
- The name and address of the recipient (establishes the jurisdiction as being within South Africa, but does not necessarily identify the place of consumption).
- An individual serialized number and the date the invoice is issued (establishes date).
- A description of the goods or services supplied.
- The quantity or volume of the goods supplied.
- The value of the supply (establishes value).

The supplier, not being governed by the Act, would not necessarily supply the following details required by s 20 of the Act:

- A VAT registration number.
- The fact that it is a tax invoice.

- The amount of tax charged.

E-commerce has caused many manual tasks previously conducted over the telephone or in writing, now to take place over the Internet. These include the placing of orders, establishing credit-worthy criteria, the manner of delivery, and payment. Regardless of whether goods or services are ordered online or offline, the process of buying goods continues to follow the established pattern of the pre-purchase, followed by the purchase, and thereafter the payment for the purchase.

This dissertation is not focused on the situation where goods or services continue to be transacted from traditional suppliers who have a presence on the Internet. The method the goods or services are supplied does not change from the offline circumstances. Under these circumstances the only major change from offline to online, are efficiencies created by the use of e-commerce for ordering the goods, tracking their movement, and paying for them. This dissertation is, however, focused on those organisations that primarily transact through the medium of the Internet, and were not previously offline.

Importation of Goods

In this dissertation, goods refers to movable goods, and not the downloading of data over the Internet. Goods can vary in size and nature. Depending on this feature, the means of transportation is determined. The main and accepted forms of delivery of goods are sea, rail, road, air, postal to a post office or direct to a postal address, and door-to-door courier. The form of transport dictates the manner that goods can enter the country, and the port of entry.

It is now far easier for non-vendors to order goods in an online environment, compared to previously, in the offline environment.

The importer of the goods and the end user may not be one and the same person. They may not even be the same person who ordered the goods over the Internet. A practical example of this would be where a head office orders a commodity for a branch, based in another jurisdiction, for temporary location or safe keeping, until it is required for consumption by yet another branch.

The supplier of goods is not concerned with these details. He enters into transactions solely for commercial gain. He does not identify who the recipient of the goods is, or where the place of consumption is.

Section 7 of the Act places the responsibility of accounting for VAT on the importation of goods upon the importer of the goods (known as self assessment at the place of consumption). If this cannot be established, who then is responsible for declaring the VAT? This is of concern where the goods are

small enough to avoid detection by customs for the imposition of tax, thereby creating enforcement problems.

Where the goods enter the Republic through a designated port of entry, then the ability to enforce and declare VAT does not differ from an offline transaction.

Pre-Purchase Offline

The supplier of the goods needs to establish the means of transport and at what stage the goods are to be paid for. Once the customer has made a decision concerning the products to be ordered, he would communicate this with the supplier. The supplier may accept an order verbally, but generally a written request evidenced by a signature of acceptance will be needed to ensure non-repudiation of the order. The supplier in turn would generally issue a written acceptance of the order. At this stage the negotiation of dates of delivery, means of transport, payment, and at what stage responsibility for the goods is transferred, then takes place.

The supplier of the goods may request who the recipient of the goods is, and who ultimately will be the end user of the goods, to ascertain who warranties or guarantees are to be issued to. These issues collectively establish that

- the jurisdiction is outside of South Africa (by the fact that the goods are being imported),
- with the importer or agent the person held responsible for the declaration of any VAT,
- establishing the date of receipt of the goods, and
- the value to be placed upon the goods.

Pre-Purchase Online

The main difference between online and offline commerce at the pre-purchase stage is that the customer has the ability to establish many questions at the time of being online (referred to as 'in real time'). For example, the price, the product details, the means of delivery, are all available on the web site. The ordering of goods takes place by the use of what is known as a 'shopping trolley' (there are a variety of names that can be assigned by an individual web site) where the goods are placed into a virtual shopping trolley. At this stage the commitment or intention is revocable. This procedure effectively identifies the goods the customer wants and places them in a separate location. The customer will then supply delivery and payment details. The customer is then given an opportunity to confirm the goods ordered and details supplied, thereby issuing an irrevocable commitment. The customer has an opportunity up to this last stage of shopping to remove products out of the shopping trolley.

Purchase Offline

The size and nature of the goods ordinarily dictates the means of transport and the date the goods are required. Goods sent by ship, rail, road or to large post offices, have customs officials present at the port of entry, and therefore the means to conduct customs official business, including the collection of VAT. This also establishes the place of consumption to be within a South African jurisdiction. The presence of these officials facilitates the enforcement of VAT collection.

Goods that are sent direct to postal addresses or that are delivered door-to-door often bypass customs officials. If a courier service is used, the courier is given the responsibility for ensuring that VAT is declared.

The Postmaster-General is held responsible for collecting VAT on goods sent through the post. For small goods sent directly to postal addresses, these can, and often do, avoid the detection of the Postmaster, thereby avoiding declaration for VAT purposes. Small goods do not facilitate identifying the place of consumption as no one is able to monitor the movement of these goods into the country.

The recipient of the goods, or his agent, is responsible for the completion of a bill of entry form (DA500). This satisfies the requirement for compliance with the details needed for declaration referred to in s 13. The fact that the supplier of the goods is not within the jurisdiction of the Republic enables the supplier not to have to comply with the requirements of the Act, however, the bill of entry contains all the necessary details needed for compliance with the declaration requirements of the Act. The responsibility for the completion of the bill of entry form is therefore placed upon the importer or agent of the goods. This method of accounting for VAT is known as self-assessment where the VAT is accounted for at the place of consumption.

The bill of entry records the date the goods were received, the value for VAT purposes, and evidences that VAT has been paid. The value is dependent upon whether the goods were imported for home consumption, to a non-vendor (B2C) or to a vendor (B2B). The bill of entry form therefore needs to establish the use of the goods.

For B2B transactions vendors can claim an input tax deduction, as long as they comply with s 16 of the Act. It requires evidence of the completed declaration referred to in s 13, namely, the bill of entry form.

Section 13(2) distinguishes between the value of goods imported for a vendor and a non-vendor. For goods imported by non-vendors in a B2C transaction, these consumers are not eligible for an input tax deduction and are possibly ignorant of the law. This can result in goods bypassing a designated port of entry with a bill of entry form not being completed, resulting in no VAT being paid. This allows non-vendors to not accept their responsibility of declaring VAT, hindering enforcement by the SARS.

Purchase Online

Whether goods are acquired online or offline, being physical in nature they will enter the country in the same manner. The main difference would be that an official packing list might not be available from the supplier. In these instances the customer would need to accept responsibility for those records required by the customs officials. It is therefore likely that the supplier would, under pressure from the customer, supply the same details as required in an offline purchase.

Payment Offline

In terms of the South African Reserve Bank (Reserve Bank) requirements, moneys cannot be remitted out of South Africa without the approval of, or notification to, the Reserve Bank. Requests for approval need to be applied for upon evidence that goods have been imported. Permission to remit money to a foreign entity is completed on an application to 'Remit/Transfer Foreign Exchange' also known as a 'Balance of Payment (BOP) Reporting' form. This form does not record any details pertaining to VAT. This form is, however, submitted to the bank together with the bill of entry form. The bank, if it were requested to do so, could compare that the value on the form is the same as the bill of entry form and that VAT has been paid over, in accordance with this value. It is also submitted that both the non-vendor and vendor are less likely not to declare VAT, knowing that their details have been supplied on the Reserve Bank form.

The method of delivery and the value of the goods dictate the form of payment. Large amounts are normally paid for by the establishment of letters of credit, telegraphic transfers, or foreign bills for collection (FBC). These methods establish that the supplier will be paid either upon receipt of the goods, or at some pre-arranged date. These details are established with the recipient's bank that is governed by the Reserve Bank.

Where small amounts are due and the supplier has not secured payment through a banker, then other form of payments, including direct electronic transfers or the supplying of credit card details could take place. With the relaxation in foreign exchange approval, Reserve Bank approval is not obtained, thereby impeding the ability to facilitate enforcement of the Act.

Payment for the goods can take place after the goods have entered the country. This can result in the value not being established at the time the goods entered a port of entry but at the time of payment.

Payment Online

Payment is made online at the web site at the time the goods are ordered. As mentioned under the heading 'pre-purchase' above, the goods are placed in a shopping trolley until the order process is complete. The customer is then taken through a series of questions that require a conscious action on his behalf, confirming

- the goods ordered,
- supplying the place of delivery (that possibly establishes the place of consumption),
- the means of transport, and
- the means of payment.

There are two types of payment systems, namely, accounted and unaccounted:

- An accounted system requires payment to be effected through a third party, independent of the payer and the recipient. Examples are cheque and credit card payments. The key feature of the accounted system is that it generates a record, linked to a person that can be produced if necessary for tax or other audit purposes.
- An unaccounted system allows value to be transferred without the involvement of an independent third party. Examples are cash and electronic payment systems including stored value cards (SVC). A key feature is that there is no independent record and the parties to the transaction need not be identified.

With the maturity in technology and the increase in security provided by protocols including a secure electronic transaction (SET), greater use of the Internet as a means of purchasing is likely to occur.

In an online transaction the goods would normally have been paid for before they arrived at a port of entry into the country. This would allow for both the date and value to be established by the time the goods enter the port of entry.

Importation of Services

Section 1 of the Act, establishes that a vendor is not liable for VAT on imported services, as mentioned under the chapter entitled 'Legislation' above. The ability to impact upon the tax base and fiscal revenue can therefore occur only with the importation of services by a non-vendor.

The provision of services does not take place or pass through a designated port of entry. This allows for services to be provided and not to be controlled or detected by customs officials, with no clear indication of the place of consumption.

The South African Institute of Chartered Accountants (SAICA) records that³⁰

'a vendor importing goods also would be required to produce a bill of entry to claim the input tax deduction. In the case of imported services, there is no port of entry or control into South Africa. Thus, as noted above, the South African Revenue Services is relying on consumers to self-assess VAT, where the

30. Deloitte and Touche *E-commerce 822. Value-Added Tax*, South African Institute of Chartered Accountants (August 2000).

recipient of the service will not be utilising the services for the purpose of taxable supplies (e.g. non-vendors, banks, etc).’

This extract highlights how the importing of services allows for the lack of responsibility and non-declaration by the recipient of the services, and the likelihood of high-enforcement costs for the SARS when collecting VAT.

Pre-Purchase Offline

The pre-purchase terms, conditions and nature of services, are similar to that for the supply of goods recorded above and have therefore not been repeated here.

The supplier of the services may request who the recipient of the service is, and who the end user of the service ultimately will be (establishing place of consumption), to ascertain to whom recourse action can be given. These issues collectively establish that

- the jurisdiction is outside of the Republic (because the services are being imported),
- with the recipient of the service being the person who is responsible for the declaration of any VAT,
- the date of receipt, and
- the value to be placed upon the service.

Pre-Purchase Online

In this dissertation the downloading of data over the Internet is referred to as a supply of a service. With the ease of ‘surfing the web’, a large and ever-growing number of transactions are taking place in an e-commerce manner.

The steps followed at the pre-purchase stage for the importing of services in an online environment are similar to the importation of goods in an online environment. These steps are recorded above and have therefore not been repeated here.

Purchase Offline

The procedures adopted for compliance with the Act for the importation of services are the same as for goods. Section 7(2) of the Act establishes that it is the recipient of the service who is responsible for accounting for VAT and not the importer, as in the situation for goods. This is a logical requirement as it is the only reasonable manner that the legislature can identify who is responsible for the collection and the remitting of VAT.

Purchase Online

Services imported by a non-vendor are identified in s 7(2) of the Act, to be the responsibility of the recipient of the service and not the importer, as is the position for goods. Most pure-online enterprises

do not and cannot ascertain who the ultimate recipient of the supply of the service is, or the place of consumption. This situation is highlighted by the following example:

The person downloading the data over the Internet may store the data on one computer in one geographical region (jurisdiction), for use by another computer based in a completely different geographical region. The ability of the supplier to establish this information is virtually impossible and may not be known to the importer at the time of downloading.

A visit to a purely-online business identifies that no official invoice, that could be considered valid for s 20 purposes, is issued. With the supplier not residing within the geographical region of South Africa, he is not bound by South African jurisdiction, and he may not be aware of the procedures to adopt for declaration purposes. Often the only proof of purchase is the payment document. The value can be established only from the payment document.

Payment Offline

The terms and manner for payment should not differ materially from that for importing goods. The main difference and cause for concern would be that the value and date could not be easily established as it can with physical goods that pass through a designated port of entry.

Payment Online

The relaxation of foreign exchange controls in South Africa creates the ability for services to be paid online thereby bypassing the Reserve Bank requirements. Unlike goods, however, services will not be detected at a port of entry, and the payment would therefore be the only means of detecting that a transaction took place. The use of electronic money in the form of mechanisms like 'e-cash' allow anonymity of the parties to a transaction resulting in the opportunity of VAT not being raised on a transaction.

Exporting of Goods and Services

Vendors are responsible to raise VAT on all supplies. VAT is raised on exports at a rate of 0%, resulting in no VAT being paid. To apply a zero rate, vendors must ensure that the goods or the services leave the Republic, and ensure that the place of consumption is outside the Republic.

Where goods or services are provided by a non-vendor, in a C2B or C2C transaction, no VAT is raised. Non-vendors are not required to be registered in terms of the Act, and are therefore not responsible for complying with any requirements of the Act, including s 20 of the Act. This situation results in no invoice being raised that could provide a record of the date, value, recipient of the service and therefore the place of consumption. The jurisdiction would then be established as being outside the Republic. What is of concern with these transactions is whether the non-vendor should have in fact

been registered as a vendor and whether the goods or services were in fact supplied at a place of consumption outside of the Republic.

Where goods exit the Republic at a designated port of exit, customs officials are able to monitor and establish whether a non-vendor should possibly be registered as a vendor and that the goods are being sent to a place of consumption outside the Republic. This chapter does not deal with exports of non-vendors as these transactions do not impact on the tax base or on fiscal revenue.

Exporting of Goods – *Offline and Online*

Whether the goods are supplied in an offline or online manner does not create any impact on the VAT revenue as in both situations the vendor is responsible for ensuring that the goods are exported.

Exporting of Goods – *Pre-Purchase*

The supplier (vendor) of the goods is based in the Republic and therefore within the South African jurisdiction and governed by the Act. The details established by a supplier for the importing of goods is the same as required by the local vendor when exporting.

Exporting of Goods – *Purchase*

Where goods are to be delivered by the vendor out of the country, the vendor or his agent, are responsible for issuing an invoice and declaring information by completing a form, known as a bill of entry form for export (DA550). This form records

- the transport document number,
- the means of transport out of the country, including all the details required by s 20 of the Act.

The customs department, as authorised by the SARS, stamp the form as evidence that the goods have left the country. Both the form and the invoice record the

- date,
- value, and
- recipient of the goods and therefore the place of consumption.

The jurisdiction is established as being outside the Republic.

As a result of fraudulent behaviour and misrepresentation of the recipient of goods when goods are sent on round trips (that is, leaving the country, and then returning into the country), vendors exporting to countries on the African continent are responsible for the freight of the goods. They must also pay these charges in advance. This system has been established to ensure that the vendor is satisfied that the goods are exported out of the country. It has placed an added responsibility on the

vendor. The completion of both an invoice in compliance with s 20 and the bill of entry form for exports has facilitated enforcement.

Similar to importing, the nature and size of the goods determines the means of transport out of the country. Where goods are supplied to a customer who indicates that he is leaving with the goods, the goods are not delivered out of the country by the vendor. VAT at the standard rate will then apply, and not at the rate of 0%. The recipient of the goods is responsible for claiming the VAT back from customs or SARS at the various designated port of exits.

Vendors must comply with s 20 and provide all the details of a tax invoice. The invoice establishes, date, value, place of consumption, who is responsible for declaration (namely, the vendor, being the supplier of the service), and the place of jurisdiction. All these features facilitate ease of enforcement.

An enquiry directed at Kalahari.net resulted in the following reply to the question of how it determines whether a consumer is based within or outside of South Africa:³¹

‘What we do is this: If the profile of the buying customer is anything other than South Africa, the prices are updated on the BASKET page to exclude VAT. However, if the customer then changes the delivery address on the next page (DELIVERY), VAT is then again added to the prices on the PAYMENT page. The reverse is also true, in other words, if you are a SA customer sending items overseas (i.e. you change the delivery address to anything other than SA) the prices are reduced by VAT. So it all hinges around the Country field.’

In view of this it can be seen that goods exported should not create any difference or difficulty between online and offline transactions.

Exporting of Goods – *Payment*

Vendors are required to account for VAT on the invoice basis, establishing that VAT will be paid as determined by the date at the time of the purchase. Natural persons in limited circumstances may apply to account for VAT on the payment basis. VAT on the payment basis will be made only when the vendor receives payment.

Exporting of Services – *Offline*

The supply of a service cannot be regulated by a means of transport where enforcement and control of goods at a designated port of exit could take place. Services rely upon the responsibility of a vendor to establish, by means of the information provided on an invoice in terms of s 20 of the Act. The invoice records the date, value, recipient of the service and therefore the place of consumption. The jurisdiction is established as being outside the Republic.

31 From Jennifer Swarts, Kalahari Customer Services of Kalahari.net.

Vendors, being subject to scrutiny by the SARS, are likely to ensure that a zero rate of VAT is raised only where they are aware that the service is being provided to an entity outside the Republic. In an offline transaction vendors are generally aware with whom they are dealing and to where the service is being provided. Section 38 of the Customs Act provides that no bill of entry for export form is required to be completed for the supply of services.

Exporting of Services – Online

In an online environment the vendor may not be aware of many of the details of the consumer of the service, for example, the jurisdiction or the place of consumption. Section 43(1) of the Electronic Communications and Transactions Act 25 of 2002, places the responsibility of vendors to include the following:

‘A supplier offering goods or services for sale, for hire or for exchange by way of an electronic transaction must make the following information available to consumers on the web site where such goods or services are offered:

- ‘Its full name and legal status.
- ‘Its physical address and telephone number [establish jurisdiction of the supplier].
- ‘Its web site address and e-mail address.
- ‘Membership of any self-regulatory or accreditation bodies to which that supplier belongs or subscribes and the contact details of that body.
- ‘Any code of conduct to which that supplier subscribes and how the consumer may access that code of conduct electronically.
- ‘In the case of a legal person, its registration number, the names of its office bearers and its place of registration [establish jurisdiction of the supplier].
- ‘The physical address where that supplier will receive legal service of documents [establish jurisdiction of the supplier].
- ‘A sufficient description of the main characteristics of the goods or services offered by that supplier to enable a consumer to make an informed decision on the proposed electronic transaction [assist in establishing value].
- ‘The full price of the goods or services, including transport costs, taxes and any other fees or costs [establish value].
- ‘The manner of payment [establish time of supply].
- ‘Any terms of agreement, including any guarantees that will apply to the transaction and how those terms may be accessed, stored and reproduced electronically by consumers.
- ‘The time within which the goods will be despatched or delivered or within which the services will be rendered [establish time of supply].
- ‘The manner and period within which consumers can access and maintain a full record of the transaction.
- ‘The return, exchange and refund policy of that supplier.
- ‘Any alternative dispute resolution code to which that supplier subscribes and how the consumer may access the wording of that code electronically.
- ‘The security procedures and privacy policy of that supplier in respect of payment, payment information and personal information.
- ‘Where appropriate, the minimum duration of the agreement in the case of agreements for the supply of products or services to be performed on an ongoing basis or recurrently [establish time of supply].
- ‘The rights of consumers in terms of section 44, where applicable.’

These details go a long way to establishing some of the core issues of the jurisdiction, place of supply, and the time and value of supply. A core issue of where the goods or services are being provided, that would assist with establishing where the place of consumption is, is however, not requested. In the absence of this information the supplier will be responsible for raising VAT on online transactions, unless the consumer can confirm that the service is to be consumed at a place of consumption out of South Africa.

Summary

From a fiscal revenue viewpoint whether a vendor imports goods or services any VAT collected on the importation of the supply, is later claimed as an input deduction, resulting in a 'nil' revenue situation to the fiscus.

The actual movement of goods in and out of the Republic is more easily monitored allowing ease of enforcement. This is not the situation for the importation of services where detection is less likely. Likewise the supply of small goods can evade the detection and ability to enforce the imposition of VAT. In the situation of non-vendors this results in lost revenue to the fiscus.

The supply of both goods and services to a place of consumption out of the country for export is subject to VAT at the rate of 0%. Goods can be identified by SARS at the time of exit out of the country. But services cannot be monitored by SARS.

The responsibility for accounting for, and declaring that the correct rate of VAT is being levied, is placed upon the vendor. Non-vendors are not governed by the Act. They are therefore not responsible for the completion of an invoice. This situation results in no VAT being raised on the sale of goods or services by a non-vendor regardless of where consumption takes place.

In an offline environment the provider of, and the receiver of, goods or services are generally easily identified. Knowledge of where and to whom the goods or services are being provided and the place of consumption are also generally known.

The online environment imposes little impact upon VAT revenue with regards to both the supply of, and receipt of, goods. The main area of impact upon VAT revenue in an online environment is from the supply of and receipt of services. The supply of services being supplied by a registered vendor is nevertheless enforceable, where the vendor can establish the place of consumption. The importing of services by a non-vendor is less detectable and therefore unenforceable. The area of greatest impact on VAT revenue arises from the importation of services by a non-vendor who should account for VAT, but for a variety of reasons may not.

The next chapter deals with the administrative differences and difficulties created by the increase in use of e-commerce as a means of conducting commerce.

Chapter 6

Administrative Differences and Difficulties

Introduction

In the preceding chapters the manner that business transactions are conducted, and how in conducting themselves, vendors and non-vendors comply with VAT legislation have been discussed. In this chapter the differences and difficulties are

- first, highlighted as they were identified in the preceding chapter entitled ‘Business Practices’,
- thereafter, a critical analysis of the business processes, applying the framework of the core issues, is made.

When applying the core issues as the criteria for assessment, it is necessary to be aware that for any system to be effective and efficient, and to assist with compliance, the following requirements need to be in place:

- Identification of whom the parties to the transaction are, where the place of jurisdiction is, and the nature of the transaction, including the value and time of the transaction.
- Availability of the records and details of the transaction. These need to be accessible to the relevant authorities to confirm compliance.
- Understanding of the legislative requirements and an appreciation of the need for compliance of all the parties to a transaction. Otherwise how can compliance take place if knowledge of the legislation is unknown?

National Goods and Services

Regardless of whether the goods or services are supplied online or offline, being a national supply taking place from within the jurisdiction of South Africa, the vendor is obliged to account for both supplies in the identical manner. The onus is upon the vendor to establish that the customer is based within the jurisdiction of South Africa. The supply by a non-vendor of goods or services is not relevant to this dissertation as this supply is not subject to VAT.

Importation of Goods

There is little difference between goods imported in an online or offline environment because all goods should be imported through a designated port of entry. It would appear, however, that non-vendors importing small goods, whether in an online or offline environment, often do so without being detected by the Postmaster-General, thereby evading VAT. The reverse-charge mechanism for imports is used for both goods and services and whether online or offline.

In an online environment the suppliers do not concern themselves with the place of consumption, concerning themselves only with the place of delivery. This may not be the same place as the place of consumption.

In the online environment transactions take place in 'real time', where the complete purchasing process takes place at the web site at the time of connection.

With the relaxation of foreign exchange controls in South Africa and the ability to pay for goods directly over the Internet simply by supplying credit card details, creates the ability for goods to be paid for bypassing any Reserve Bank requirements. The ability to enforce compliance procedures is then reduced.

Importation of Services

In an online and offline environment the provision of services does not take place or need to pass through a designated port of entry. This allows for services to be provided without control or detection by customs officials. No clear indication of the place of consumption emerges. The fact that vendors are not liable for VAT on the importing of a service, in terms of s 1, and the ability of vendors to claim an input tax deduction reduces the difficulty that can arise with the importation of services. But this is not the position with non-vendors. The ever-increasing trend of downloading data by non-vendors over the Internet is cause for concern. The amount of services downloading over the Internet has not been quantified in monetary terms. Only after the successful accounting of VAT, will it be possible to determine this amount. What is clear, however, is that more and more people are using the Internet as a means of business. Most pure-online enterprises do not, and cannot, ascertain who the ultimate recipient of the supply of the service is, or where the place of consumption is. Online businesses do not issue invoices, with the only proof of purchase being the payment-confirmation document. The mechanism of reverse charging of VAT is possible where vendors are responsible, but as many non-vendors are less educated in the ways of VAT, they will find the reverse-charge mechanism a cost beyond any benefit.

The SARS will find it difficult to enforce and regulate compliance of the Act as far as the provision of services is concerned as these cannot be physically identified or controlled at a designated port of entry. The lack of ability of the SARS to identify the recipient of the service allows for a negative impact upon the tax base and fiscal revenue when non-vendors do not account for VAT. This situation would be the same for online and offline transactions.

Exporting of Goods and Services

It is the responsibility of the vendor to raise VAT at the standard rate on all supplies, unless they are exporting the goods or services, where VAT at a rate of 0% will apply. In view of this there will be limited differences between an online and offline environment when supplying goods.

When supplying a service the vendor may not be aware of the jurisdiction of the consumer. It is submitted that under these circumstances a vendor has a responsibility to raise VAT, that is until he is assured that the service is exported.

Core Issues Framework

Having recorded above the differences and difficulties encountered between an online and offline environment from a local, international, importing, exporting, vendor and non-vendor perspectives, these issues as they affect the core issues identified in the chapter entitled 'Model' are reviewed below.

Jurisdiction

With the consumer presence being established in cyberspace the ability to identify the jurisdiction of the consumer is limited. The consumer can be requested to supply this information. The ability to confirm these details could be burdensome to the supplier.

The following are some of the reasons why the required information is not obtained:

- The need to keep compliance costs of business and administration costs of governments to a minimum.
- The Internet affords taxpayers to be anonymous by concealing their identity, location and ultimate place of consumption. The use of encrypted documents also assists with concealment of the parties to a transaction. These can also be stored offshore.
- The ease of use and mobility of the users of the Internet creates the situation where the parties to a transaction can be moving from one jurisdiction to another throughout a transaction. The possibility also exists for the place of consumption to change from the time a transaction starts

to the time of its ultimate conclusion. This ease of mobility also assist taxpayers in relocating their business from a cyberspace perspective to jurisdictions with a lower tax base.

- The use of electronic money can take place in a manner that does not leave a readily identifiable paper trail, thereby avoiding detection and liability for VAT.

Place of Consumption

The downloading of data over the Internet does not facilitate the identification of the place of consumption. Similar to the issue of jurisdiction, the consumer could be requested to provide this information, but the same concerns would be relevant.

The OECD, South Africa and other international bodies, have focused and reported at length over the problem of ascertaining the place of consumption. With VAT being based upon the premise that it needs to arise from the place of consumption, this place of consumption is then of paramount importance. It is a pre-requisite to raising VAT. The place of consumption must therefore be identified.

Responsibility

In line with the OCED view that VAT should be accounted for at the place of consumption, and the fact that a supplier is not governed by the legislature of another country, a reverse-charge mechanism has been introduced to ensure that VAT is accounted for at the place of consumption. Where the place of consumption cannot be identified then this reverse-charge mechanism cannot be effectively enforced.

Declaration

It is unlikely that non-vendors would voluntarily declare VAT on the requisite forms after they have evaded detection at a port of entry. This is especially prevalent with the importing of services.

In the Australian Discussion Report under its executive summary it is recorded that the use of the Internet as a means to conduct business allows for³²

‘the removal of efficient tax collection points such as “middlemen” in the distribution chain from producer to consumer, in an effect known as “disintermediation” ’.

This situation allows for no-one party to accept responsibility for the declaration of VAT.

32 ‘Australian Taxation Office Discussion Report of the ATO Electronic Commerce Project’ (August 1997) *Tax and the Internet*.

Date

The date of services is established in s 14(2) of the Act as being deemed to take place

- at the time an invoice is issued by the supplier, or
- at the time any payment is made by the recipient,

whichever is the earlier.

This requires both the date of the invoice and the date of payment to be known. In many instances invoices are not issued allowing only the date of payment to be used.

Value

The value for services is established in s 14(3) of the Act as being

- the value of the consideration for the supply, as determined in s 10(3) of the Act, or
- the open market value of the supply,

whichever is the greater.

The establishing of an open market value is often difficult to determine because in many instances suppliers offer the downloading of data at below market value. An example of a reason why a supplier may offer a supply below the market value would be to attract people to its web site by a low value, with the hope that they view the advertisements on the site. These advertisements create an alternative source of revenue to the supplier.

Non-vendor purchases can go undetected with the use of the unaccounted payment system where payments are made directly over the Internet. This hinders the ability to determine the value of the supply.

Enforcement

If the jurisdiction and place of consumption cannot be identified, together with the establishing of the value, then the ability to enforce the payment of VAT is rendered almost impossible. For imports, foreign suppliers are not governed by South African legislation and are not willing participants in accounting for any onerous responsibility that may remotely reduce their chances of deriving revenue. In addition the government is not empowered and does not have the means to 'snoop' in cyberspace or dictate what information people outside of its jurisdiction must supply.

For imported services, it is only the non-vendor who is liable for VAT. The ability of the SARS to account for these transactions will be at a cost likely to be in excess of the benefits and revenue collected. This will defeat the aims of efficiency.

Vendor or Non-Vendor

Because vendors are eligible for an input tax deduction, there is little differences between an online and an offline business. The presence of non-vendors on the Internet is increasing and with it the ease to conduct e-commerce is similarly increasing.

When non-vendors conduct business with local vendors through traditional means, the tax base is maintained. Now that non-vendors trade more and more through e-commerce, conducting businesses across geographic borders, the likelihood is that the tax base will be reduced.

Summary

The importation of goods requires entry through a designated port of entry. This will occur for both online and offline transactions thereby reducing the differences created between online and offline transactions. Small goods can in both online and offline transactions by-pass the scrutiny of officials at a designated port of entry, thereby evading VAT.

Vendors are not liable for VAT on the importation of services, while non-vendors are. The increase in e-commerce adoption by non-vendors allows more and more goods and services of all sizes to be imported. This has facilitated the evading of VAT.

E-commerce has the ability to trade in cyberspace creating difficulties in identifying the jurisdiction and the place of consumption of the consumer. Responsibility for the declaration of VAT can reasonably be assigned only if the jurisdiction and place of consumption are known. E-commerce in its new and varied form has allowed the supply of goods and services at a value below the open market value. In addition the ability to encrypt data hinders the establishment of the value of the data. All these features create difficulties in enforcing VAT collection.

The next chapter makes recommendations to overcome the differences and difficulties created by the use of e-commerce.

Chapter 7

Recommendations

Introduction

This chapter records the recommendations of the OECD and the EU. It then evaluates the recommendations of the OECD and EU and the information recorded in the preceding chapters. Recommended courses of action are made within the framework of the core issues.

Previous chapters identified that the main area of impact of e-commerce on the tax base and fiscal revenue collection is from 'services' (including the supply of digital products) conducted with consumers who are not registered as vendors.

OECD and EU Recommendations

The OECD having established the need as identified in the chapter entitled 'Model', makes the following recommendations on consumption taxes in the context and rationale for a concerted approach:³³

'In the field of consumption taxes the core elements of the Taxation Framework Conditions were developed as follows:

- 'Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where the consumption takes place and an international consensus should be sought on the circumstances under which supplies are submitted to be consumed in a jurisdiction.
- 'For the purposes of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
- 'Where businesses and other organisations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.
- 'Countries should ensure that appropriate systems are developed in co-operation with the World Customs Organization (WCO) and in consultation with carriers and other

33. 'Organisation for Economic Co-operation and Development' in para 5 (2001) *Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs*.

interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers.'

The report recognises that there is a need to maintain efforts to simplify and streamline systems for importing goods. There is also a specific need in services and intangible property of the treatment of international cross-border trade. It recommends that the following three points need to be adopted when dealing with services and intangibles:³⁴

- A need for clarity in defining the place of consumption and identifying the collection mechanism that supports this principle.
- This principle should then be expressed in the guidelines on the definition of the 'place of consumption' for consumption taxation on cross-border services and intangible property.
- These guidelines should then define the 'place of consumption' (and so of taxation) by reference, for B2B transactions to the jurisdiction in which the recipient has located its business presence, and for B2C transactions by reference to the recipient's usual jurisdiction of residence.

There is a clear distinction between B2B and B2C transactions. The preceding chapters have highlighted that the major area for concern as far as the tax base and revenue collection is concerned is the B2C transactions specifically in the area of services.

The most viable collection methods that address the issues of responsibility and declaration are recommended in the report. They are the reverse-charge or self-assessment mechanism for B2B transactions³⁵

'and some form of registration-based mechanism for B2C transactions'.

A trusted third party mechanism should also be relied upon. These collection mechanisms are discussed below under the heading 'responsibility'.

The report recommends that a system of simplified registration for non-resident suppliers should be pursued.³⁶ This is similar to the EU Council Directive,³⁷ ruling that non-EU suppliers must register with a VAT authority in any one-member state of their choice and levy VAT at the rate applicable in the

34 'Organisation for Economic Co-operation and Development' in para 10 (2001) *Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs*.

35 'Organisation for Economic Co-operation and Development' in para 11 (2001) *Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs*.

36 'Organisation for Economic Co-operation and Development' in para 60 (2001) *Working Party 9 Consumption Taxes to the Committee on Fiscal Affairs*.

37 European Union' (May 2002) Council Directive 2002/38/EC.

member state where the customer is resident. The EU Council Directive also ruled that suppliers of digital products from outside the EU must charge VAT on sales to private consumers.

The distinction between the OECD and the EU is that the EU has issued a directive while the OCED has issued only recommendations.

Recommendations

It is recommended that the following decision process is applied when addressing the core issues.

Core Issues Decision Process

Place of Consumption and Jurisdiction

Should the place of consumption and jurisdiction be based on the place of consumption or the place of supply?

Responsibility

Who should account for the VAT?

- The supplier,
- the consumer,
- the government, or
- a trusted third party?

Declaration

Should there be a international minimum or a simplified requirement, to ensure adequate declaration?

Value

Is the value to be established on,

- the actual price paid for the service, or
- the fair and open market value of the service?

Date

Does the time of the supply take place when,

- the invoice is dated,
- when the transaction takes place, or
- the date the service is received?

Enforcement

If the above decision process is followed, it should go along way towards ensuring enforcement. Compliance costs for taxpayers and administrative costs for the tax authorities, should also be minimised as far as possible.

Place of Consumption and Jurisdiction

The OECD recommends as a ground rule that consumption tax should be based on the place of consumption. But why, why not at the place of supply?

If it was based on the place of supply then a government could collect VAT on what has been produced in its country. The importer would not be able to claim an input tax deduction. This will result in an increase in the costs of imported supplies, potentially providing an advantage to locally produced supplies.

The United Kingdom Inland Revenue has stated the following:³⁸

‘The emerging international view is that the definition of place of consumption for private consumers should be their usual place of residence. This would simplify decision making for suppliers, most of whom routinely collect this information for marketing purposes.’

A supply takes place from at least two perspectives, namely,

- at the place of the supply, and
- at the place of consumption.

The OECD has identified that it is fundamental to VAT (consumption tax) that it takes place in the jurisdiction where consumption takes place.

The table that follows compares the core issues of whether VAT took place, at the place of consumption, or at the place of supply.

38 ‘United Kingdom Inland Revenue Tax Agenda Modernising VAT’ in para 6.23, available at <http://www.inlandrevenue.gov.uk/taxagenda/ecom6.htm>.

Table 7.1

Table of Comparisons of Core Issues

<i>Core Issues</i>	<i>Place of Consumption</i>	<i>Place of Supply</i>
Jurisdiction	Unclear where consumption took place.	Know where supply was made.
Responsibility	Unclear who the consumer is.	Know who the supplier is.
Declaration	Relies on self-assessment where reliability of the resultant data is of concern. The consumer's lack of financial incentive to declare information requires a need to verify the data declared. Consumer education is required.	The supplier being a commercial enterprise is more likely to be declaring information that can be more readily relied upon. The supplier will not require the same degree of educating with regards to what information is required to be declared. The supplier is able to make a declaration at the time of supply.
Date	Date of payment.	Date of supply.
Enforcement	It is difficult to identify or locate the consumer.	It is easy to identify the supplier. A government can legislate over this supplier. The jurisdiction where the supply took place results in no VAT being lost on exports.
Tax base	It is currently being lost because consumers are not complying with, or educated in, their obligations.	There would be no change in the existing tax base as vendors are already registered.

The following two tables provide a comparison of VAT between a vendor and a non-vendor, dependent upon whether VAT is collected at the place of consumption or at the place of supply.

Table 7.2

Table of Comparison for a Vendor

<i>Details</i>	<i>Effect on Place of Supply (POS)</i>	<i>Effect on Place of Consumption (POC)</i>			
		<i>If VAT at POS</i>		<i>If VAT at POC</i>	
		<i>Value</i>	<i>Fiscal Renenue</i>	<i>Value</i>	<i>Fiscal Revenue</i>
Base supply price	100			100	
POS VAT at 10 %	10				
Cost to consumer	110	110			
POC VAT at 10 %			0		10
Add value adding process		50		50	
Selling Price		160		150	
VAT on selling price at 10 %		16	16	15	15
Input tax claim					-10
Final price to consumer		176	16	165	

The VAT collected at the place of consumption is R15 made up of the original R10 at purchase plus the R5 at sale. The R5 is determined from the output VAT of R15 less the input tax deduction of R10.

From this example it can be seen that assuming the VAT rate was the same in the country of supply, the fiscal revenue is increased at the place of supply.

The final price to the consumer is higher in the situation of the place of supply.

Table 7.3

Table of Comparison for a Non-Vendor

<i>Details</i>	<i>Effect on Place of Supply (POS)</i>	<i>Effect on Place of Consumption (POC)</i>			
		<i>If VAT at POS</i>		<i>If VAT at POC</i>	
		<i>Value</i>	<i>Fiscal Revenue</i>	<i>Value</i>	<i>Fiscal Revenue</i>
Base supply price	100			100	
POS VAT at 10 %	10				
Cost to consumer	110	110			
POC VAT at 10 %			0	10	10
There is no value adding process for a non-vendor		0		0	
No sale takes place					
Final price to consumer		110	0	110	

The VAT collected at the place of consumption is R10. No VAT is collected where the consumption takes place if VAT is raised at place of supply.

Many consumers are not remitting VAT at the place of consumption resulting in a loss in the tax base and revenue collection. This results in a lower final price to the consumer of R100.

If VAT was raised at the place of supply this would ensure that the consumer is not placed in the position where he, knowingly or ignorantly, does not comply with VAT.

Responsibility

There are many parties to a transaction including

- the supplier,
- the consumer,
- the government,
- the financial institutions,
- Internet service providers, and
- web hosts.

Recommendations are made below suggesting who of the various parties to a transaction should be held accountable and responsible for VAT. No matter what the suggestion or recommendation is sight must not be lost that based on current OECD recommendations and South African legislation, it is the consumer who is ultimately responsible for VAT.

The concept of leverage is often used as an efficient means of collecting revenue. An example of leverage is where an employer remits employees’ tax (PAYE) on behalf of his employees to the revenue authorities. This same concept can be applied to the declaring and remitting of VAT. It could (subject to infringement of a person’s rights and legal consideration) be extended to the supply of information by certain parties relating to transactions that are taking place.

An appropriate example for VAT is where financial institutions advise the revenue authorities of all remission of funds to a foreign entity that are in excess of a certain amount.

Limitations on the use of and disclosure of this information are required to be put in place. This would ensure that a ‘police state’ does not occur. The information should be used solely for determining the VAT liability.

Further examples of who could provide the identity of details of information and assist in the collection of VAT were made by the Australian Taxation Office. The following table has been adapted from para 8.7.7 of this report:³⁹

Table 7.4

Table of Responsibility

<i>Player</i>	<i>Identity</i>	<i>Information</i>	<i>Collection</i>
Network providers	Yes		
Internet service providers and Internet access providers	Yes		
Internet business	Yes	Yes	Yes
Software architects	Yes	Yes	Yes
Site designers	Yes	Yes	Yes
Bank, credit card and financial institutions	Yes	Yes	Yes

39 Australian Taxation Office, in para 8.7.7, (August 1997) *Discussion Report of the ATO Electronic Commerce Project*.

The OECD recommended the following collection models:⁴⁰

- ‘Self-assessment, under a self-assessment model, tax is collected directly from the consumer relying on a self-assessment process.
- ‘Registration of non-residents, under this option a non-resident supplier is required to register with the revenue authority in the consumer’s jurisdiction and collect and remit consumption taxes to that revenue authority.
- ‘Tax at source and transfer, under this option, a business would collect indirect taxes on exports to non-residents at the rate payable in the consumer’s jurisdiction.
- ‘Trusted third party (TTP), refers to any organisation that is performing a task for merchants, consumers or governments, for example, a financial institution. Under this option a TTP (other than a supplier) would have to rely on the supplier to classify its catalogue according to a standard classification system. After the supplier informs the TTP of the consumers jurisdiction, it remits the tax directly to the tax office of the consumer’s jurisdiction.
- ‘Withholding by financial institutions, this model is similar to the TTP model, where the supplier supplies information to the financial institution who then remit directly to the tax office where the consumer resides.’

40 ‘Organisation for Economic Co-operation and Development’ in Annex II para 1(December 2000),. *Report by the Consumption Tax Technical Advisory G (TAG)* see in this regard <http://www.oecd.org/pdf/M000015000/M00015515.pdf>.

The OECD report contains the following two tables. They are included in this dissertation for their valuable content in the assessment of the core issues.⁴¹

Table 7.5

Table of Analysis of Collection Models

<i>Tax Collection Option</i>	<i>Effectiveness</i>	<i>Effect on Consumers</i>	<i>Compliance Burden Vendor</i>	<i>Administrative Burden</i>	<i>Feasibility</i>
Self assessment	Difficult	Large burden	None	Large burden	Not accepted to revenue authorities
Registration of non-residents	Difficult	None	Large Burden	Large burden	No practical on a global scale
Tax at source and transfer	Good, as have to deal only with revenue authority in the business's home jurisdiction	Neutral	Small additional burden. One set of books	Small additional costs. No primary concerns	Yes, requires agreement among states and local governments. Throwback rule may discourage exports
Clearinghouse (trusted third party)	Good, as tax model is included in an end-to-end vendor system needed for cross-border business	Neutral	Start up costs exist, but future benefits due to efficiencies consolidation, automation, and minimisation of errors may yield substantial benefits	Start up costs exist, but future benefits due to efficiencies, consolidation, automation, and minimisation of errors may yield substantial benefits, offsetting costs	Yes, certain vendors are searching for integrated end-to-end facilities. Global teamwork required

⁴¹ 'Organisation for Economic Co-operation and Development' (December 2000) *Report by the Consumption Tax Technical Advisory Group (TAG)* (at 22), see in this regard <http://www.oecd.org/pdf/M000015000/M00015515.pdf>.

Table 7.6

Table of Collection Model's Roles and Responsibilities

<i>Module</i>	<i>Self-assessment</i>	<i>Registration of Non-Residents</i>	<i>Tax at Source and Transfer</i>	<i>Trusted Third Party</i>	<i>Hybrid</i>
Registration	Customer with approved registration and certification authority	Business with government approved registration and certification authority	Business with government approved registration process	Business with government approved registration process	Business with government approved registration process
Purchase request and classification of catalogue	Business	Business	Business	Business	Business
Customer identification	Based on approved information supplied by customer	Customer jurisdiction verified in purchase transaction	Customer jurisdiction verified in purchase transaction	Customer jurisdiction verified in purchase transaction	Customer jurisdiction verified in purchase transaction
Tax calculation	Data from business and global tax database (revenue authority required to maintain)	Data from business and global tax database (revenue authority required to maintain)	Data from business and global tax database (revenue authority required to maintain)	Data from business and global tax database (revenue authority required to maintain)	Data from business and global tax database (revenue authority required to maintain)
Collection or remittance	Customers remit to customer's jurisdiction	Collected by business for remittance to customer's jurisdiction	Collected by business's revenue authority for remittance to customer's jurisdiction	Collected by trusted third party for remittance to customer's jurisdiction	Collected by business's revenue authority for remittance to customer's jurisdiction

Government

In business, there are more than the two normal parties to a transaction, being the supplier and the consumer. Another party who does not play an active role, is the government.

This dissertation reviews the roles and responsibilities of who accounts for VAT. An additional option in terms of 'responsibility' is recommended. This recommendation is that the government should be held accountable and responsible as set out below.

The Australian tax office diagram as set out in the chapter entitled 'Business Practice', records a basic business model for the Internet.⁴² Using this diagram and applying the OECD recommendation that VAT should take place at the place of consumption, the following recommendation is made, under the heading 'Government Responsibility Mechanism'.

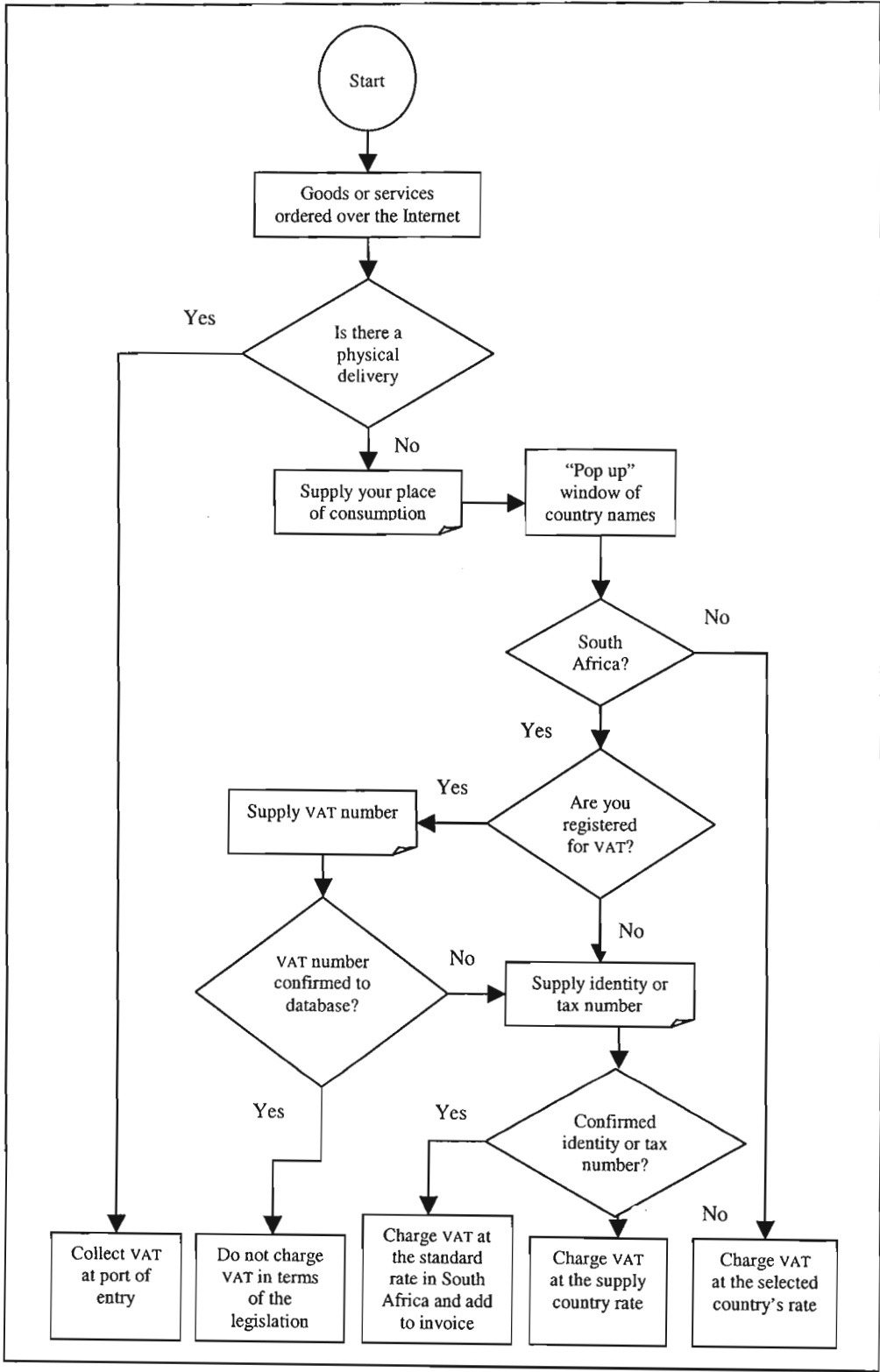
Government Responsibility Mechanism

The recommendation that government should be held accountable and responsible leads from the trusted third party mechanism where a trusted third party supplies and manages software implementing the flow-diagram decision tree below. The software would be required to account for and remit VAT to the appropriate authority. The reason for naming this mechanism the government responsibility mechanism is because it suggests that the government should be held responsible for the cost of implementing and maintaining of the software, based on some sound commercial basis, for example, on a percentage of the VAT collected and remitted.

42 'Australian Taxation Office Discussion Report of the ATO Electronic Commerce Project', in Diagram 3.6.2, (August 1997) *Tax and the Internet*.

Figure 7.1

VAT Collection System



The above flow diagram shows that VAT is collected for the supply of goods at the port of entry with VAT on the supply of a service, being collected at either

- the place of consumption, if this can be identified, or
- the place of supply, if the place of consumption cannot be corroborated.

Where the supply of the service is in South Africa to a registered VAT vendor then no VAT is raised.

Government is responsible for supplying or making available to the trusted third party its database of residents. For South Africa this would be its

- VAT registration number,
- tax reference number, or
- identity number.

The trusted third party, through the software programme, would be responsible for ensuring that a financial institution, when remitting money takes into account the payment to both

- the supplier, and
- the payment of VAT to the country of consumption.

Section 1 of the Act in the definition of 'imported services' identifies that any service imported by a vendor is not subject to VAT.⁴³ This is catered for in the above flow diagram. Imported goods are subject to VAT and with the use of the recommended government responsibility mechanism, there is no reason why VAT cannot be raised on the supply of services to vendors. The vendor would receive a valid tax invoice and be entitled to claim the VAT as an input tax deduction.

If the service is to be downloaded in one place for later transfer or use at another location, this subsequent transfer should attract a separate VAT action and charge. Abuse of this can take place with consumers recording a lower tax-rate jurisdiction as the place of consumption or by not charging VAT on the transfer from one jurisdiction to another. This would be especially true if the consumer is not a registered vendor.

The above recommendation does not employ the reverse charging mechanism, as it is the government concerned, through the use of the trusted third party who is responsible for collecting and remitting the VAT, and not the consumer.

43 Value Added Tax Act 89 of 1991 in s 1.

Financial Institutions

When an individual opens a bank accounts he is obliged to provide his personal details. This may assist a bank to identify the individual's place of 'permanent establishment'. The use of a permanent establishment could assist in the identification of the place of jurisdiction and the assumed place of consumption. With the knowledge of this information a bank, through the means of an international clearing bureau and specifically designed software, could provide the country of permanent establishment with a notification of the amount of the payment. It could also calculate and remit the VAT.

Consumer Education

If VAT is to be collected at the place of consumption then an education drive focused on the consumer, and more specifically the non-vendor consumer, is required to take place at the 'port of entry'. In e-commerce the port of entry is the web site. The first port of entry for a consumer is at the Internet service provider (ISP) site and can take place again when the consumer supplies the details to make payment. The United Kingdom Inland Revenue recommend the following:⁴⁴

'The Government believes that encouraging and assisting taxpayers is the most effective way of enabling them to comply with their tax obligations. This applies to those taxpayers engaged in e-commerce as it does to those trading by more traditional means. Taxpayers are more likely to comply if

- they understand and have confidence in the laws they have to observe;
- it is easy to comply; and
- 'compliance is a positive move giving certainty and reflecting good citizenship.'

It then makes the following further recommendation:⁴⁵

'Encouraging and improving compliance is achieved by respecting taxpayers' rights and helping them recognise their obligations under the law. Publicity, taxpayer education and support are all essential to achieving these goals.'

The local ISP could be requested to supply on its web site a VAT DA500 (Bill of Entry) form. The consumer can download this form for completion if a supply takes place.

A financial institution could be requested to host a place on its local ISP sites where the DA500 form could be completed. A 'secure' facility for the consumer to supply his credit card or personal details, to assist with effecting payment to the fiscus while online, could also be provided. This presence of the bank would provide not only a service to the fiscus and the consumer, but also promote the bank.

44 The United Kingdom Inland Revenue, in para 5.4, see in this regard <http://www.inlandrevenue.gov.uk/taxagenda/ecom5.htm>.

45 The United Kingdom Inland Revenue, in para 5.5, see in this regard <http://www.inlandrevenue.gov.uk/taxagenda/ecom5.htm>.

The concern of a consumer as far as maintaining his privacy is not considered valid, because the consumer would have just made a purchase online supplying personal details to facilitate payment for the supply. The use of Extensible Mark-Up Language (XML) as the means of completing the DA500 form enables the consumer to supply details including

- the method of payment,
- credit card details, and
- the amount of purchase.

The online form could then calculate the amount of VAT due and deduct this amount from the consumer's funds held by the bank, while simultaneously remitting the funds to the fiscus. This procedure is not seen as any different to the procedure in place for the purchase of a service.

This means of payment of VAT is seen as voluntary to the consumer. Consumer education would assist in allowing the consumer to make a more-informed decision, encouraging him to complete the form immediately, thereby reducing any inconvenience of having to complete the form at a later stage. The likelihood of compliance and collection by the fiscus should also be enhanced.

Declaration

It is recommended that a request to the international business community through the Multilateral Trading System (MTS) as embodied in the World Trade Organisation (WTO) and the OECD be made to issue an invoice (and for other e-commerce transactions) recording as a minimum the following issues:

- The name and address of the supplier (can also assist in recourse action).
- The name and address of the place of consumption (can be an Internet protocol (IP) address to ensure no 'pirating' of information).
- A description of the service (can also assist in recourse action).
- The value of the service provided, the VAT charged, and the country to which the VAT was remitted, giving the total consideration (can provide proof of payment and nature of service).
- An individual serialized number, the date of the invoice, and the date that the service is supplied (can provide a record to the government in the place of supply).

Most of the above details are provided in a normal business transaction. Yet they are not being provided for when downloading data.

The Green Paper on e-commerce for South Africa provides as follows:⁴⁶

‘The following information should be furnished on any commercial web site owned by a South African resident, company, close corporation or trust: trading name of business; the physical as well as postal address of the business; an e-mail address; telephone or other contact information and statutory registration number in respect of companies; close corporations and trusts.’

The Electronic Act provides that certain information must be supplied to protect a consumer⁴⁷ thereby placing the responsibility of vendors to include certain details. These are set out in s 43 of the Electronic Act. This provision does not request the details of the recipient of the supply. It therefore does not assist with identifying the place of consumption.

In addition to the above recommendations regarding the details to be declared, because fully-digital goods and services supplied online create difficulty in proving the place of consumption, the following additional information should also be provided and obtained by the supplier:

- The domain name of both the supplier and the consumer.
- The origin of the median of payment (for example, credit card) as the place of consumption. The consumer currently supplies details of his credit card number and the last three numbers on the back of it. He should therefore not be averse to supplying the place of origin of the credit card.
- An e-mail certification from the consumer that he is not a resident of South Africa.
- The name of the Internet service provider (ISP) of the consumer and his place of physical presence. In this regard the ISP should be requested to obtain personal information, including the place of physical presence from all its clients.

The overriding criterion to assist the collection mechanism for any form of declaration is that it must be simplified, and internationally unified, thereby encouraging user behaviour to adopt and apply.

These measures will ensure that the OECD’s concern for certainty, transparency, and efficiency are obtained.

Value

The need to establish the ‘correct value’ is important because the VAT rate is applied to this value. In an arm’s length transaction, if the consumer is able to take advantage of a price that is below the fair market value of a similar item, he should not be punished by the levying of VAT on a higher value. It

46 ‘The Green Paper on Electronic Commerce for South Africa’ (accessed 2000-12-18) *Public Discussion*, under the heading identification (theme 1 para 4.5).

47 The Electronic Act (August 2002) in s 43.

is submitted that the value paid for a supply in an arm's length transaction should be accepted as being the fair and open market value.

Local suppliers should not be protected at the expense of the consumer. Where the transaction is between connected persons then the fair and open market value is required to be determined. It is difficult to establish whether a transaction is taking place between connected persons at an arm's length price. Any legislation requesting details may infringe on the concept of efficiency.

As mentioned in a preceding chapter the establishment of a fair market value is an area of concern for the importation of goods and services.

Time

South African VAT legislation establishes that the time of supply is deemed to take place

- at the time an invoice is issued by the supplier or recipient for that supply, or
- the time any payment is made by the recipient for that supply,
- whichever is the earlier.

To account for VAT in the correct period, the time of the supply must therefore be established:

- If the supply is downloaded from the supplier to the place of consumption, the time of the downloading can be used as the time of the supply. An invoice should evidence this.
- Where, however, the service was not downloaded for use at the place of consumption, the ability to establish the time can take place only when the eventual place of consumption is identified.

Similar to the recommendation made under responsibility, it is submitted that the fact that a service is downloaded for later use at a different place of consumption gives rise to a further transaction. The VAT will, however, be charged at the time of the original download, being the earlier of time the invoice is issued or time payment is made for that supply. Any further transaction, such as downloading to a different place of consumption, would give rise to an additional VAT charge.

Enforcement

The recommendation that the government be responsible for ensuring that software be designed and maintained to collect VAT on its behalf is an incentive to it, and not a burden and a cost to the supplier. If the above recommendations taken together with those recommended by organisations including the OECD and the EU are implemented, enforcement will be improved.

Summary

VAT is currently based on the premise that cross-border trade should result in taxation in the jurisdiction where the consumption takes place. An international consensus should be sought on the circumstances under which supplies are consumed in a jurisdiction. Consideration should also be given that where the place of consumption cannot be identified or confirmed, that VAT should then be raised at the place of supply. This will ensure that VAT is raised in at least one jurisdiction, as opposed to the current situation of possibly no jurisdiction.

Services imported by a vendor are not be subject to VAT. Yet with the use of software by trusted third parties, there is no reason why services imported by vendors should not be subject to VAT. For this mechanism to operate efficiently VAT registration numbers must be supplied and VAT would have to be raised. It would also need to be supported by a government responsibility mechanism form of VAT. An input tax deduction would then be available for vendors.

The responsibility for declaring, enforcing and managing the collection of VAT must be borne by the government who receives the VAT. The government employing leverage on a foreign supplier will meet strong resistance for its potential lack of financial or commercial sense. The likelihood of non-vendor voluntary adoption is minimal without adequate consumer education or some form of cost, exceeding the benefit of evading VAT.

Value and time must be accepted in an arm's length transaction to be both the time and the value at the time the online transaction takes place.

Chapter 8

The Way Forward

This chapter looks at the research objectives, questions and research questions. It records the recommendations needed to answer these questions. This dissertation being an exploratory study concludes that a more-formal study of the recommendations be conducted to find solutions to the differences created by e-commerce.

For South Africa to continue participating competitively in the global economy it is necessary for it to

- keep pace with the technological advances of its trading partners;
- its government must ensure that its relevant legislation is clear and is understood by all parties; and
- this legislation should not place one concern at an advantage over another. The global nature of e-commerce dictates that no unfair disadvantage should exist between commercial enterprises. International rules that are both enforceable, and that are perceived to be fair, need to be introduced.

The chapter, entitled 'Model', included the following major principles for the taxation in e-commerce:

- Neutrality.
- Certainty.
- Effectiveness.
- Efficiency.
- Flexibility.

This chapter also indicated how the OECD is working towards the strengthening of international dialogue.

The questions can be answered as follows:

- E-commerce has impacted upon the ability to define jurisdiction in the cyber world creating problems of administration and enforcement.

- Government should perform a formal study on the impact of e-commerce on the VAT base and collection.

To assist in identifying what is recommended as ‘the way forward’, it is suggested that the research questions as recorded in the problem-statement flow chart in the introductory chapter should be used as the method to follow. These research questions are as follows:

- Should the legislation be altered?
- Should the consumer, the supplier, a trusted third party, or government be held responsible?
- Should VAT be charged on imports or exports?

This dissertation suggests that these three questions are answered as follows:

- The Act needs to be amended to record the various recommendations made in the chapter entitled ‘Recommendations’ dealing with the core issues as set out in the chapter entitled ‘Model’.
- Government should be held responsible using a ‘government responsibility mechanism’, with all three parties working together to assist in compliance.
- VAT should be charged on exports to overcome the difficulties of identifying place of consumption and jurisdiction.

International co-operation between global trading partners and governments is required to ensure the major principles as recorded above are met. To achieve international co-operation the following recommendations are made:

- More regular dialogue with business, members and non-members of the OECD, including governments needs to be held.
- Simplicity and uniformity of any proposed legislation needs to be assured.
- Similar to the EU implementation of its Council Directive,⁴⁸ legislation is needed to be introduced as soon as possible. It is only when legislation has been implemented that practical problems and difficulties can be identified. If an international standard was implemented then there should be less opportunity for prejudice to exist between the trading partners and governments.

The world-wide web, as its name implies, is an unstructured web of networks that is difficult to control. The random and perpetual occurrence of ‘viruses’ on the network is an example of how challenging it is to try and control this environment. Similar to international consensus on the practice

48 ‘European Union’ (May 2002) Council Directive 2002/38/EC.

of transfer pricing, VAT or indirect tax, must have international consensus on the treatment of the following core issues:

- Whether VAT should be raised on imports at the place of consumption or at the place of supply.
- Who is to be responsible for the completion of any declaration required for collection of and paying over of VAT.
- The establishment of the time of supply and the value of the transaction.
- Which jurisdiction is responsible for enforcement.

In conclusion whether it is VAT, or another form of global 'law and order', the international community needs to work together in the interests of all role players.

Glossary of Terms

In this dissertation the following operative definitions have been used:

From the Green Paper on e-commerce for South Africa (1999):

- **Authentication:** a mechanism of using information resources to verify the claimed identity of a party to a transaction or an entry involved in a transaction.
- **Browser:** software on the client's personal computer used to fetch or read documents from the web, displays them on-screen and prints them, jump to others via hypertext, view images and listen to audio files.
- **Certificate:** a certificate is a public key that has been digitally signed by a trusted authority to identify the user of the public key. Secure electronic transmission (SET) uses certificates to encrypt, for example, payment information.
- **Confidentiality:** reasonable assurance that online or stored data cannot be viewed and interpreted by any person other than an authorised one.
- **Cyberspace:** the Internet or electronic or digital environment.
- **Copyright:** the right to retain or sell the rights to an artistic work. Copyright is a form of protection to the authors or 'original works of authorship' including literary, dramatic, musical, artistic and certain other intellectual works.
- **Digital:** the representation of data by the bits and bytes of binary code. Vinyl records and cassette music tapes carry analogue media.
- **Domain name:** a unique name that represents each computer on the Internet.
- **E-commerce:** 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 between business and government. It is also described as the ability to exchange products, services, information and payments with the use of electronic networks.
- **Electronic fund transfer:** the electronic movement of money over secure private networks between banks' accounts.
- **Electronic money:** the retail payments executed over the Internet that leaves other traditional electronic payments outside of its scope. Alongside with most commonly used smart card, used

smart card, the term includes: e-cards, trade cards, traditional credit, debit and stored value cards, e-cash, digicash, digiwallet, e-credit, and e-loans.

- Electronic payments system: an array of institutions and mechanisms ensuring the cash flow through e-communications and timely provision of credit and settlements of debts at much less than traditional system could provide costs.
- Encrypting: the process of enabling information or data or knowledge to be coded in a way that it cannot be read without a decoding system or key.
- Hosting: the storage and maintenance of the data making up the content of web sites.
- Internet: the world-wide collection of networks communicating through common language and protocols. Also the basic infrastructure for the new economy where information can be transferred, transactions made and work done.
- Internet service provider: companies that specialise in linking organisations and individuals to the Internet and provide services to them.
- Internet protocol (IP) address: the address that all computers and web sites have to have on the Internet. (When a personal computer accesses the Internet through an Internet service provider it generally receives a temporary IP address.)
- Permanent establishment: a fixed place of business where the business of an enterprise is wholly or partly carried on.
- Repudiation: when a customer in a credit card transaction denies having been party to that transaction. (Can also extend to the denial of a business transaction.)
- Server: usually a computer hub of a network, fulfilling servers' functions to client computers connected to it, storing files and databases and running applications.
- Software: computer programming that gives the hardware its usefulness through various functions the software can perform.
- Virtual transactions: A virtual product as used in this dissertation includes all goods or services that are or can be provided completely over electronic media.
- Web site: pages of information linked to one another by hyperlinks (usually organised around a menu), with the main page (usually including the menu) bearing the domain address. These pages are on a web server and are accessible from any browser on the World-Wide Web.
- World-wide web: a collection of information located in many Internet servers that can be with a browser or by navigating via hyperlinks.

In terms of the South African Value-Added Tax Act:

- Export country: any country other than the Republic.
- Exported: any movable goods supplied by any vendor under a sale to the recipient at an address in an export country.
- Goods: corporeal movable things, fixed property and any real right.
- Imported service: a supply of services that is made by a supplier who is a resident or who carries on business outside the Republic to a recipient who is resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for purpose of making taxable supplies.
- Input tax: the tax charged to a vendor.
- Invoice: a document notifying an obligation to make payment.
- Open market value: the open market value as determined by the value for a similar supply.
- Output tax: the tax charged for a supply of goods or services by a vendor.
- Recipient: the person to whom the supply is made.
- Republic: the territory of the Republic of South Africa.
- Resident: any natural person who is ordinarily resident in the Republic or a person other than a natural person that has as its place of effective management in the Republic
- Sale: any transaction or act whereby ownership passes from one person to another.
- Services: anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods.
- Supplier: the person supplying the goods or services.
- Supply: performance in terms of a sale.
- Tax: the tax chargeable in terms of the Value-Added Tax Act.
- Taxable supply: any supply of goods or services that are chargeable with tax.
- Tax invoice: a document as required by s 20 of the Value-Added Tax Act.
- Vendor: any person who is or is required to be registered under the Value-Added Tax Act.

Other operative definitions:

- Access provider: a provider who provides users with access to the Internet
- Arm's length: The Commissioner for SARS, (6 August 1999), Practice note 7: Section 31 of the Income Tax Act, 1962 (the Act): Determination of the Taxable Income of Certain Persons from International Transactions: para 7.1: the transaction should have substantive financial characteristics of a transaction between independent parties, where each party will strive to get the utmost possible benefit from the transaction.
- Connected person: the situation where a relationship exists between the parties to the transaction. a relationship includes amongst a long list of others, a family member, a subsidiary or holding company.
- Extensible mark-up language (XML): a metalanguage, that is, a language for defining other languages. It is used to define text mark-up so the text can be used and interpreted by different applications. Unlike HTML (refer definition below), XML allows the developer to create new tags that describe the data.
- Globalisation: the trading of businesses around the world.
- Green Paper: a document issued by government for discussion or comment, before the application of a new legislation or in changes to existing legislation.
- Host: a host computer stores the data that can be accessed through the Internet by a user.
- Ill-defined: the inability, with confidence, to define an issue with clarity of a definition.
- Fiscal revenue: revenue that a government collect.
- Hyper text mark-up language (HTML): all documents on the web are created in HTML.
- Jurisdiction: the power, authority and control in the territory over where taxation authority is exercised.
- Secure electronic transaction (SET): a protocol aimed at providing an Internet payment mechanism that protects the stakes of every participant in the payment system.
- Source: the location of the transaction.
- Transfer price: where goods or services are acquired in terms of an agreement where connected persons transact and the goods or services are supplied or acquired at a price that is either less than the price that goods or services might have been expected to fetch if the parties to the transaction had been independent persons dealing at arm's length or greater than the arm's length price.

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