The collection of value added tax on cross-border digital trade – part 1: registration of foreign vendors

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Abstract

The principal deficiency in modern VAT systems is their inability to levy VAT on affected transactions through a simplified collection mechanism that does not overburden taxable entities charged with VAT collection, or is not inefficient from an economic point of view. VAT systems that do not specifically provide for, or which have not been adapted to cope with, technology-driven advances, generally do not provide for the adequate levying and collection of VAT on cross-border digital trade. The South African VAT system is no exception. Part 1 of this two-part article, investigates the feasibility of compulsory registration of foreign suppliers as VAT vendors as a VAT collection mechanism for the collection of South African VAT on cross-border digital trade.

INTRODUCTION

Since its inception, the Internet has continued to expand in use, size, reach, and impact. This has reached the point where we can no longer imagine an existence without the Internet.[1] It is estimated that the world's Internet population will increase to three billion users by 2016.[2] This growing phenomenon is not restricted to developed countries. Developing G-20 countries already have 800 million Internet users. 80 per cent of whom use the Internet to access social networks.[3] The introduction of mobile devices such as smart phones, tablets, and notebooks will dramatically influence the expansion of the Internet in developing countries.[4] Retailers, service

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1 Dean *et al The internet economy in the G-20* (2012) available at: https://www.bcgperspectives.com/content/articles/media_entertainment_strategic_planing_4_2_trillion_opportunity_internet_economy_g20/ (last accessed 27 January 2014).

2 *Ibid.*

3 *Ibid.*

4 *Ibid.*

providers, and governments cannot afford to ignore the rapid impact the use of Internet applications has on society.

Technological advances have had a major impact on traditional retail shopping changing it from a physical undertaking to a completely digitised experience where consumers buy digital media online. In a society where digital media is readily available, it is trite that consumer behaviour will ultimately adapt to a digitised world. Digital files are entirely intangible, and the transfer of these files from one device to another can be effected through the Internet or Bluetooth technology. No physical presence or physical form of delivery is required.

Value Added Tax (VAT) systems were designed in an era pre-dating digital technology and the Internet. In addition, VAT systems operate based on tax policy, tax administration, and the law. If any of these are inadequate, difficult technical issues will not be manageable. As a result, VAT systems that do not specifically provide for, or which have not been adapted to cope with, technology-driven advances, generally do not provide for the adequate levying and collection of VAT on cross-border digital trade. The South African VAT system is no exception.

The principal deficiency in modern VAT systems is their inability to levy VAT on affected transactions through a simplified collection mechanism that does not overburden taxable entities charged with VAT collection, or is not inefficient from an economic point of view. In the Taxation Laws Amendment Bill, 2013, Treasury proposes that foreign suppliers who supply digital products to South African residents, must, for VAT purposes, register as VAT vendors under the VAT Act.[5]

In Part 1 of this two-part series, I critically examine the registration of non-resident suppliers of digital products as a VAT collection model for the collection of VAT on cross-border digital trade. In Part 2,[6] we examine third party VAT collection by financial institutions as a viable VAT collection model for the collection of VAT on cross-border digital trade specific to South Africa.

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5 Act 89 of 1991.

6 Part 2 is authored by van SP van Zyl and WG Schulze.

REGISTRATION OF FOREIGN SUPPLIERS UNDER THE CURRENT VAT ACT

In a VAT system based on consumption, the burden of VAT must be carried by the person or entity that ultimately uses or consumes the supply. To require consumers (non-vendors) to account for VAT on each and every purchase in terms of a reverse-charge mechanism,[7] is nonsensical from both an administrative and an economic point of view. VAT systems, therefore, provide for deemed taxable entities to collect VAT on behalf of revenue authorities. Unless otherwise indicated in the Act, the VAT Act primarily provides for the following taxable entities:

a) In the case of the supply of goods and services by a registered VAT vendor, the VAT vendor making the supplies must collect VAT as the deemed taxable entity.[8]
b) In the case of imported goods, the person who imports such goods shall be deemed the taxable entity charged with the burden of collecting tax.[9] In practice, VAT will be levied and collected by customs officials or agents appointed by customs. The person who imported the goods is only burdened with the payment of VAT to customs or to the appointed agent.
c) In the case of imported services, the recipient of the service must collect and pay VAT thereon in terms of section 14(1).[10]

Determining the taxable entity is fairly straightforward under the deeming provisions. However, in the case of imported services it is often difficult to establish whether the recipient of the goods or services must account for VAT in terms of the reverse-charge mechanism, or whether the foreign supplier is required to register as a VAT vendor in the Republic, and collect VAT on the supplies as if they constituted a domestic supply in terms of section 7(1)(*a*) read with section 7(2).

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7 In terms of a reverse-charge mechanism, the recipient taxpayer is required to self-invoice and levy VAT on the transaction. This is declared to the revenue authority concerned and VAT is paid to the revenue authority on the basis of the self-declaration. In terms s 14(1) the recipient of imported services must furnish the Commissioner with a VAT return within 30 days of the earliest of the issuing of an invoice or any payment. For further reading on the reverse-charge mechanism see Lovell *Understanding VAT* (1990) 54–56; Weidenbaum, Raboy & Christian *The value added tax: orthodoxy and new thinking* (1989) at 257–258; Ebrill *et al The modern VAT* (2001) at 139–145.

8 Section 7(2) of the VAT Act 89 of 1991.

9 *Ibid*.

10 *Ibid*.

The requirements for registration

Every person who carries on an enterprise, and who makes taxable supplies that exceed, or are likely to exceed, R1 million in a twelve month period, is required to register as a VAT vendor.[11]

In terms of the definition of 'enterprise', the following elements must be present before it can be concluded that a person is carrying on an enterprise:

i) a continuous or regular activity;
ii) carried on within the Republic;
iii) for the supply of goods and/or services;
iv) for consideration.

It is a given fact that a foreign supplier would supply either goods or services to a resident recipient against payment. For this reason, the elements of 'supply' and 'consideration' will not be discussed.

A continuous or regular activity

The concept 'continuous or regular' is not defined and has not been judicially considered in the context of VAT.[12] A continuous activity is an activity that is prolonged over a period of time without interruption.[13] SARS interprets a 'continuous' activity as an on-going activity (ie the duration of the activity has neither ceased in a permanent sense, nor has it been interrupted in a substantial way), or a progression of separate and continuous steps to bring an activity to conclusion.[14] A regular activity is an activity that is carried on at periodic or frequent intervals.[15] Once-off imports, or imports that take place infrequently, would therefore not qualify as a continuous or regular activity for purposes of vendor registration. It is not clear how the term 'regular' should be interpreted, or whether an activity that is performed three or four times annually would qualify as a regular activity.

De Koker and Kruger state that where a person comes to South Africa regularly to procure wool, despite that person not being resident in the

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11 Section 23(1)(*a*) of the VAT Act 89 of 1991.

12 Botes 'South African VAT and non-resident business' (2011) 22/6 *International VAT Monitor* 397.

13 *Collins English dictionary* (6ed 2004) Soanes & Stevenson (eds) *Concise Oxford English dictionary* (2008).

14 SARS *Guide for Fixed Property and Construction* (VAT409) (2011) at 9; Stiglingh (ed) *et al Silke: South African income tax* (2013) at 1019.

15 *Collins English dictionary* n 12 above; Soanes and Stevenson n 12 above.

Republic, he in part carries on an enterprise as defined.[16] SARS interprets 'regular' as an activity that takes place repeatedly at reasonably fixed intervals.[17] The term 'regular', therefore, excludes a transaction or transactions that happen by chance, and should be construed to mean something that happens more than once, and is likely to happen again.

Carried on within the Republic

The South African VAT system is not restricted to the supply of goods and services rendered in South Africa.[18] Exported goods and services are zero-rated.[19] Although zero-rated supplies are often confused with non-taxable supplies, attention should be drawn to the fact that zero-rated supplies are, in principle, taxable supplies.[20] This means that a supply that is made from South Africa to any place in the world, is, in principle, subject to VAT.[21] It is often unclear to what extent a foreigner's business activities in South Africa constitute conducting an enterprise wholly or partly in South Africa.[22] Silver and Beneke suggest that the mere export of goods and services to South African customers from any foreign country by a foreign supplier, does not constitute an enterprise carried on wholly or partially in the Republic.[23] Wagley J, however, is of the opinion that where such services are regularly supplied to South Africans, the foreign supplier could be deemed to be carrying on an enterprise in South Africa, and should register here as a VAT vendor.[24]

As there are no definitive place-of-supply rules in the Act, this issue cannot be finally resolved.[25] Furthermore, the position adopted by SARS as to what

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16 De Koker & Kruger *Value added tax in South Africa: commentary* (2013 update) at par 12.2.

17 SARS n 13 above at 9; Stiglingh *et al* n 13 above at 1019.

18 Silver & Beneke *VAT handbook* (2012) 25; De Koker & Kruger n 15 above at par 12.2.

19 Section 11(1)(*a*) of the VAT Act 89 of 1991.

20 A vendor is entitled to claim input VAT on the goods and services acquired in its enterprise in so far as the goods and services are acquired to make taxable supplies. Where the vendor makes exempt supplies only, it will not be entitled to claim input VAT credits. It can, therefore, be deduced that zero-rated supplies are taxable supplies. The supplies are taxed at zero per cent.

21 Silver & Beneke n 17 above at 25; De Koker & Kruger n 15 above at par 12.2.

22 Silver & Beneke n 17 above at 25.

23 *Ibid*.

24 *ITC* 1812 SATC 207 at par 14; Dendy *The VAT treatment of 'imported services'* (2012) at 34.

25 Steyn 'VAT and e-commerce: still looking for answers?'2010 22/2 *SA Merc LJ* at 244; Bagraim 'Another taxing task' (2003) 9/3 *Juta's Business Law* 110; De Swardt & Oberholzer 'Digitised products: how compliant is South African Value Added

does and does not constitute an 'enterprise', often changes, or is not implemented consistently.[26] In recent years, SARS has indicated that a foreigner would be deemed to be carrying on an enterprise in the Republic if:

- the foreigner leases goods to a resident and receives regular rental income in exchange;[27]
- the foreigner grants the use or licence to a resident in respect of any patent, trademark, copyright, know-how, trade secret, or similar intellectual property right and as a result receives royalties from a person in South Africa;[28]
- the foreigner supplies telecommunication services to be used by a South African resident and as a result receives consideration.[29]

This confusion is exacerbated by the fact that SARS has not yet implemented section 23(1)(*e*) of the Taxation Laws Amendment Act[30] requiring foreign suppliers of telecommunication services to register as vendors in the Republic. In addition, SARS has withdrawn its position on foreign suppliers of intellectual property issued in 1999. SARS has recently announced its intention to review its initial position and re-implement it.[31] A survey by De Swardt and Oberholzer, reveals that this hedged approach by SARS has caused confusion among tax practitioners.[32] Half of the respondents believed that a foreign supplier of digital goods is conducting an enterprise in the Republic, while the other half believed the opposite.[33] Furthermore, should these amendments be promulgated, additional multi-lateral treaties would have to be negotiated to afford SARS extra-territorial powers to enforce these provisions. This could prove impossible.

Tax?'(2006) 14/1 *Meditari Accountancy Research* at 20.

26 Silver & Beneke n 18 above at 26.

27 *Id* at 25.

28 VAT News 13 December 1999 available at: http://www.sars.gov.za/tools/Printbody.asp?pid=47320 (last accessed 27 January 2014); also see De Koker & Kruger n 15 above at par 8.10; Bagraim n 24 above at 112.

29 Section 23(1)(*e*) of the Taxation Laws Amendment Act 27 of 1997.

30 Act 27 of 1997.

31 *VAT News* 37–February 2011 available at: http://www.sars.gov.za/home.asp?pid=4&cx=009878640050894574201%3Aku-b t v 5 0 z y m & c o f = F O R I D % 3 A 1 0 % 3 B N B % 3 A 1 & i e = U T F - 8&q=VAT+royalties&sa=%3CIMG+alt%3D%22Click+here+to+begin+your+search%22+src%3D%22images%2FsearchButtonBackground.gif%22%3E&siteurl=http%3A%2F%2Fwww.sars.gov.za%2F (last accessed 27 January 2014).

32 De Swardt & Oberholzer n 24 above at 20.

33 *Ibid*.

In terms of the amendment of the definition of 'enterprise' by section 165(1)(*e*) of the Taxation Laws Amendment Act 31 of 2013, foreign suppliers of electronic services[34] to a recipient that is a resident of the Republic, or where payment for the services originates from a bank registered in the Republic, are required to register as VAT vendors in South Africa. The implementation date has since been postponed to 1 June 2014 and will apply to electronic services supplied after that date.[35] Registration of foreign suppliers is discussed below.

Duty to register under the current Act?

Every person who conducts an enterprise becomes liable to register as a VAT vendor:

a) At the end of any month where the total value of taxable supplies made by that person in the period of 12 months ending at the end of that month in the course of carrying on all enterprises has exceeded R1 million;

b) at the commencement of any month where there are reasonable grounds for believing that the total value of the taxable supplies to be made by that person in the period of 12 months reckoned from the commencement of the said month will exceed the abovementioned amount.[36]

Where a person becomes liable to register as a vendor in terms of section 23(1), he must apply for registration no later than 21 days after having become liable to register.[37]

The words 'every person' in section 23(1), and 'persons' in the heading of section 23, clearly indicate that residency is not a requirement to register as a VAT vendor, provided that supplies were made in the course and furtherance of an enterprise. This said, section 23(2) requires a non-resident to furnish the Commissioner with the particulars of a representative vendor in South Africa. In addition, particulars of the non-resident person's bank account at a bank registered as such in terms of the Banks Act,[38] must also be submitted.[39] In other words, the non-resident person must have a South African bank account. Failure to submit the required particulars or

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34 As defined by the Minister by regulation in terms of the Act.
35 Section 165(5) of the Taxation Laws Amendment Act 31 of 2013.
36 Section 23(1) of the VAT Act 89 of 1991.
37 *Ibid*.
38 Act 94 of 1990.
39 Section 23(2)(ii)(*bb*) of the VAT Act 89 of 1991.

documentation could see the Commissioner deeming that the person as not having applied for registration.[40] Although the requirements in section 23(2)(ii) do not demand that the non-resident applicant have a fixed abode or establishment in South Africa, the only inference that can be drawn is that he should have some sort of physical presence in the Republic.[41] This physical presence can either be through a representing vendor, or by an establishment of some sort. Botes opines that the fact that a non-resident business does not have a fixed establishment in South Africa for income tax purposes, does not necessarily mean that it does not carry on an enterprise in South Africa for VAT purposes.[42]

It is not clear whether a person must have a physical presence before he is required to register, or, because the person is required to register, he is required to have a physical presence. This confusion stems from the inconsistent position taken by SARS with regard to the meaning of a 'regular and continuous activity carried on within the Republic' as set out above. I am of the view that once it has been established that the non-resident person is carrying on a regular activity in the Republic and is then required to register as a vendor, he should have a physical presence in the Republic as a result of this registration requirement. Bagraim notes that there is no requirement that a vendor must have a fixed or permanent establishment to conclude that it is conducting an enterprise.[43] This view is supported by Van der Merwe.[44]

It is clear that the physical presence requirement serves as no more than an administrative aid to the Commissioner. The lack of a physical presence does not mean that the non-resident person has not carried on regular activity in the Republic. Steyn states that the mere fact that a non-resident supplier does not have a fixed place of business in the Republic, does not mean that he is relieved of the obligation to register as a South African VAT vendor.[45] Section 23(3)(*d*) provides for voluntary vendor registration where:

> that person is continuously and regularly carrying on an activity which, in consequence of the nature of that activity, can reasonably be expected to

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40 Section 23(2)(ii) of the VAT Act 89 of 1991.
41 Naicker 'The VAT implications of e-commerce' 2010 *Taxtalk* January/February at 9.
42 Botes n 11 above at 397.
43 Bagraim n 24 above at 110.
44 Van der Merwe 'VAT and e-commerce' (2003) 15/3 *SA Merc LJ* at 385.
45 Steyn n 24 above at 244.

> 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 R50 000 in a period of 12 months.

The Commissioner may refuse or cancel the applicant's registration where the applicant:

i) does not have a fixed place of business or abode;[46]
ii) does not keep proper accounting records relating to the enterprise;[47]
iii) has not opened a bank account for purposes of the enterprise;[48]
iv) has previously registered as a VAT vendor in terms of the VAT Act 89 of 1991, or as enterprise under the General Sales Tax Act 103 of 1978, and has failed to perform his duties in terms of either of the Acts.[49]

In the case of voluntary vendor registration, the vendor is required to have a fixed place of business or abode in the Republic. A mere physical presence of some sort, as is required by compulsory registration, is not sufficient. Still, if one considers the other requirements in section 23(7), the impression is created that the requirements were introduced as an administrative tool to assist the Commissioner in combating VAT fraud. This position is further emphasised by the practice as regards registration applied by SARS officials since 2009. In terms of this procedure, interviews are held with applicant vendors (voluntary and compulsory registrations) or representative vendors.[50] The procedure was implemented to guarantee that applicant registrants have a genuine place of business from which an enterprise is conducted.[51] The self-assessment and reverse-charge mechanisms open the South African VAT system to VAT fraud. It is common practice to register a fictitious enterprise as a VAT vendor and then claim input VAT based on false and irregular tax invoices. To further eliminate fraud, SARS officials are also entitled to inspect the business premises or establishment to confirm that an actual enterprise is being conducted, or to require vendors to undergo biometric tests, such as fingerprint verification.[52] This is in line with international best practice to eliminate VAT fraud.[53] As a result of the VAT

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46 Section 23(7)(*a*) of the VAT Act 89 of 1991.
47 Section 23(7)(*b*) of the VAT Act 89 of 1991.
48 Section 23(7)(*c*) of the VAT Act 89 of 1991.
49 Section 23(7)(*d*) of the VAT Act 89 of 1991.
50 Steyn n 24 above at 245; Anon 'SARS Act to Protect Taxpayers from VAT Abuse' 2008 *The Professional Accountant* at 31.
51 *Ibid.*
52 Anon n 50 above at 31.
53 *Ibid*.

registration clean-up process, VAT vendor registration has declined by 0,89 per cent since 2009.[54] In addition to the registration requirements provided for in the VAT Act, section 22(3) of the Tax Administration Act[55] provides that SARS may require the applicant registrant to produce biometric evidence if it is required to identify him or to combat fraud. Where the taxpayer is obliged to register as a VAT vendor under the VAT Act but has failed to do so, SARS may register the taxpayer as such unilaterally where it is found to be appropriate.[56]

E-commerce is characterised by anonymity and the convenience that a fixed place of business or physical establishment provides is not required. In the case of electronically ordered and physically delivered goods, the supplier can operate its enterprise from a server located anywhere in the world. Essentially, no physical presence – in the form of a shop, warehouse, or office – is required. Orders can be executed by instructing a third party to collect the items ordered from its warehouse and dispatch them to the recipient. The third party then acts as dispatch agent on behalf of the supplier.

This virtual or non-physical existence is even more prevalent in the case of electronically ordered and delivered goods. Digitised products can be stored on multiple servers open to remote access. Orders are executed by connecting the recipient's device to the nearest server and starting to download. The enterprise can be operated from these multiple servers or from a portable device. Save for the initial setup of servers, and the occasional upload of merchandise on the server, no human intervention is required in conducting the actual transactions.

Where it has been established that the e-commerce supplier 'regularly and continuously' makes taxable supplies to recipients in the Republic in excess of R1 million, the supplier is required to register as a VAT vendor in terms of section 23(1). The supplier should, consequently, in compliance with the requirement to register as a VAT vendor, open a South African bank account, appoint a representative vendor, or establish some sort of physical presence in South Africa. These requirements will frustrate e-commerce

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54 National Treasury and SARS *2011 Tax Statistics* (2012) available at: http://www.treasury.gov.za/publications/tax%20statistics/2011/2011%20Tax%20Statistics.pdf (last accessed 27 January 2013).

55 Tax Administration Act 28 of 2011. This Act came into force on 1 October 2012.

56 Section 22(5) of the Tax Administration Act 28 of 2011.

suppliers and eliminate the convenience of virtual trade. Foreign suppliers could terminate trade with South African residents which could result in market distortions. Silver and Beneke's opinion that the mere export of goods and services to South Africa does not amount to the carrying on of an enterprise, should be more closely considered.[57] Where the foreign supplier *exports*[58] goods and services to South Africa, he acts as mere dispatcher of the goods, and does not actively take part in any business-like activities in the Republic. This should be contrasted with a person who imports goods and services to be distributed for home consumption. The importer actively engages in activities in the Republic that resemble the conducting of trade. According to Bargraim, where the supplier's server, or one of its servers, is located in South Africa, or where the supplier has a warehouse in South Africa from which supplies are dispatched, the supplier is conducting an enterprise in South Africa and should register as a vendor.[59] She further holds the position that some form of physical presence is required before it can be said that the supplier is carrying on an enterprise in the Republic.[60] It could, therefore, be argued that where digitised products are ordered by South African residents from a foreign supplier, the delivery (by export to South Africa) of the products does not amount to the making of a supply in the hands of the foreign supplier. The supplier would not be carrying on an enterprise in the Republic. The recipient importer, so it could be argued, carries the burden of collecting VAT. Due to a lack of clear rules or policy statements from SARS, the supplier is likely to make an incorrect tax decision.[61]

The non-resident non-vendor importer as taxable entity

De Swardt and Oberholzer pose the question whether a foreign supplier of digitised products should levy South African VAT on the supplies, irrespective of whether the supplier is registered or ought to be registered as a VAT vendor.[62] This would be the case where it is found that the supplier is carrying on an enterprise within the Republic.[63] In such an eventuality, the supplier would have to verify the residency status of the recipient before it

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57 Silver & Beneke n 17 above at 25.
58 My emphasis.
59 Bagraim n 25 above at 110.
60 *Ibid*.
61 De Swardt & Oberholzer n 25 above at 21; Botes n 11 above at 399.
62 De Swardt & Oberholzer n 25 above at 20.
63 *Id* at 21.

could levy South African VAT on the transaction.[64] De Swardt and Oberholzer opine that the complex residency rules applied in South Africa place an enormous compliance burden on such vendors.[65] This would, however, be no different for resident suppliers who are registered as VAT vendors and who supply digital products. They, too, must determine the residency status (or at least the location where the recipient finds himself at the time of supply) of the recipient to determine if VAT should be levied at the standard rate (in the case of domestic supplies), or at the zero rate (in the case of exported supplies). Furthermore, there is no indication in the VAT Act[66] that a foreign vendor whose taxable supplies do not reach the R1 million threshold, is obliged to register as a VAT vendor in South Africa. Since non-vendors do not levy VAT on supplies, the non-vendor supplier is deemed to be the final consumer of the goods supplied. In other words, the VAT paid by the non-vendor supplier cannot be recovered from its customers. Similarly, where a foreign supplier is not registered as a VAT vendor in South Africa, it cannot collect (nor is it required to collect) VAT from its customers. In this case, however, the foreign supplier cannot be deemed to be the final consumer as it never paid VAT. In this case, the burden to account for VAT shifts to the person who imported the digitised products (services).[67] The importer recipient is, accordingly, construed to be the taxable entity in terms of the reverse-charge mechanism.

This poses the question of whether a non-resident person who imports digitised products to South Africa while he is physically present in the Republic, should account for VAT on the importation thereof? In terms of the definition of 'imported services', imports by non-residents for their own consumption while physically present in the Republic, do not amount to imported services. The non-resident importer will, therefore, not be a taxable entity in so far as the digitised products so imported are not utilised and consumed by a resident.

REGISTRATION UNDER THE TAXATION LAWS AMENDMENT ACT 31 OF 2013

As I have mentioned, reliance on the reverse-charge mechanism as a means of enforcing VAT on imported services is impractical. This is mainly

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64 *Ibid*.
65 *Ibid*.
66 Act 89 of 1991.
67 Section 7(1)(*c*) of the VAT Act 89 of 1991.

because compliance, especially in the case of e-commerce, is low.[68] The lack of compliance can mainly be attributable to two main factors: some taxpayers do not comply out of utter ignorance; or other taxpayers perceive VAT on imported electronically supplied services as voluntary.[69] As a result of the lack of compliance and the inability of SARS to enforce compliance, domestic suppliers of electronically supplied services are put at a disadvantage to foreign suppliers.[70]

Instead of providing for specific place-of-supply rules in the case of electronically supplied services, Treasury, in the Draft Taxation Laws Amendment Bill, 2013, attempted to achieve the incorporation of deemed place-of-supply rules by the insertion of the definition of 'e-commerce services' and the amendment of the definition of 'enterprise'. The term 'e-commerce services' was defined in the draft proposal as 'the supply of any services where the placing of an order and delivery of those services is made electronically'.[71]

It was further proposed that the definition of 'enterprise' should be amended by the insertion of the following proposed subparagraph following subparagraph (v) of the current definition:

> (vi) the supply of e-commerce services by a person that is not a resident of the Republic–
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> (*aa*) to a recipient that is a resident of the Republic; or
>
> (*bb*) where one or more payments to that person originates from a bank registered in terms of the Banks Act, 1994 (Act No 94 of 1994).[72]

Based on these proposals, it is clear that a foreign supplier of e-commerce services to a recipient that is resident to South Africa, or where payment originates from a bank registered in South Africa, must register as VAT vendor under the VAT Act. However, this would only be the case where the

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68 National Treasury *Explanatory memorandum on the taxation laws amendment bill,2013* (2013) at par 6.6.

69 *Ibid.*

70 SAPA 'Treasury publishes ESR for comments' 2014 *The Citizen* available at: http://citizen.co.za/119348/treasury-publishes-esr-comment/ (last accessed 31 January 2014).

71 Section 174(1)(*d*) of the Draft Taxation Laws Amendment Bill 2013.

72 Section 174(1)(*e*) of the Draft Taxation Laws Amendment Bill 2013.

taxable supplies – that is the supply of electronic services to South African residents – exceeds the annual threshold of R50 000.[73]

However, it was found that the term 'e-commerce services', despite the specific definition attached to it in the proposal, is confusing.[74] It was further found that the words 'the placing of an order' in the proposed definition of 'e-commerce services' could be interpreted to mean that VAT must be levied on the placing of an order of 'e-commerce services' irrespective of whether or not a supply was made.[75] In other words, under the proposed definition, VAT must be levied upon the making of an offer by the purchaser irrespective if the offer was rejected or if a counter offer was made. This is in direct conflict with charging provision in section 7 of the Act in terms of which VAT is levied on the actual supply of either goods or services. As a result, the term 'e-commerce services' was replaced by the term 'electronic services' in the Taxation Laws Amendment Bill[76] and the current Taxation Laws Amendment Act.[77] Currently, the term 'electronic services' is defined to mean 'those electronic services prescribed by the Minister by regulation in terms of this Act'.[78]

As technology develops faster than the ability of legislation to keep up, it was found that an annual list of electronic services as prescribed by the Minister by way of a regulation would be more effective than a definitive definition with limited scope.[79] The draft regulations prescribing electronic services for purposes of the definition of 'electronic services' was published for public comment on 31January 2014.[80] While the list of electronic services, at face value, includes the majority of known types of digital goods or services

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73 Section 172(1)(*c*) of the Draft Taxation Laws Amendment Bill 2013; See also Schneider 'VAT registration of foreign e-commerce suppliers' (2013) 43 *TaxTalk* 29.

74 VAT Roundtable Discussion held on 23 August 2013 at Pretoria.

75 *Ibid*.

76 Section 165(1)(*d*) of the Taxation Laws Amendment Bill 39 of 2013.

77 Section 165(1)(*e*) of the Taxation Laws Amendment Act 31 of 2013.

78 Section 165(1)(*d*) of the Taxation Laws Amendment Act 31 of 2013.

79 VAT Roundtable Discussion n 74 above.

80 National Treasury *Regulations prescribing electronic services for purposes of the definition of 'electronic services' in section 1 of the value-added tax act, 1991* (2014) available at: http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2014-02%20-%20Draft%20Regulations%20Electronic%20Communication%20Services%20VAT.pdf (last accessed 4 February 2014); Also see Legalbrief 'Draft VAT regulations published for e-commerce' *Legalbrief Today* 31 January 2014.

capable of being supplied online, new technology (not listed as such) can be developed to escape the VAT net.

As the lack in the current VAT rules adequately to levy and collect VAT on imported digital goods negatively affects domestic suppliers of digital products, the proposed registration of foreign suppliers of electronic services is aimed, not only at raising revenue, but also to protect the domestic market.[81] However, it remains uncertain whether registration as a VAT collection mechanism would serve this purpose without overburdening taxable entities charged with VAT collection, or is not inefficient from an economic point of view.

FEASIBILITY OF REGISTRATION AS A VAT COLLECTION MECHANISM IN CROSS-BORDER DIGITAL TRADE

Under the registration mechanism, the non-resident supplier is required to register as a VAT vendor in the foreign jurisdiction where it makes supplies which are taxable under the VAT rules of that jurisdiction.[82] Depending on the tax dispensation, the non-resident supplier either pays VAT on the transaction to revenue authorities, or collects VAT from consumers and remits it to the tax authority.[83] The OECD recommends that registration should, generally, not be required in the case of transactions between businesses (B2B transactions). In the case of B2B transactions, the business customer would, under domestic laws, be required to register for VAT in the country of establishment, and VAT collection on imported intangibles or services can be effected through the reverse-charge mechanism. Requiring the non-resident supplier of B2B supplies of intangibles or services to register in the foreign jurisdiction of supply creates an unnecessary compliance burden for the supplier while alternative, as effective but less burdensome, collection mechanisms can be applied.

Where jurisdictions face major market distortions or the potential risk of significant revenue losses when dealing with B2B transactions, a registration system consistent with the national consumption tax system of that jurisdiction should be considered.[84] The administrative and cost burden to

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81 VAT Roundtable Discussion n 74 above.

82 OECD *International VAT/GST Guidelines* (2006) available at: http://www.oecd.org/ctp/36177871.pdf (last accessed 27 January 2014).

83 *Ibid.*

84 *Ibid*.

suppliers could be significant.[85] In many cases, the cost of compliance in the case of nominal value supplies, would outweigh the benefit of international establishment.[86] Where registration of non-resident vendors is required, the burden on these vendors should be minimised.[87] Discrimination created by specific rules applicable to foreign vendors should therefore not be disguised as compliance with these specific rules.[88] This can be achieved by developing a simplified registration regime for foreign vendors which includes electronic registration and declaration procedures.[89] Registration in organised regions can be simplified by allowing registration in one jurisdiction only, as applies in the EU.[90] In terms of the special scheme for non-EU suppliers who make electronically supplied services available to EU customers, the supplier can choose to register under the scheme in the member state of identification and account for VAT in that member state. VAT should, however, be levied at the rate applicable in the member state of consumption.[91] The supplier vendor must be a foreign vendor who does

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85 OECD *Report by the Technology Technical Advisory Group* (2000) 56 available at: http://www.oecd.org/tax/consumptiontax/1923248.pdf (last accessed 27January 2014); Baron 'The OECD and consumption taxes: part 2' (2001) 3/10 *Tax Planning International E-commerce* 10; Lamensch 'Are "reverse-charging" and the "one-stop-scheme" efficient ways to collect VAT on digital supplies?' (2012) 1/1 *World Journal of VAT/GST Law* at 7.

86 OECD n 85 above at 56; Baron 'VAT on electronic services: the European solution'(2002) 4/6 *Tax Planning International: E-commerce* 5.

87 OECD n 82 above; also see Zubeldia 'Administrative burdens on cross-border B2B services under EU VAT' (2011) 22/4 *International VAT Monitor* 221.

88 Charlet & Buydens 'The OECD's draft guidelines on neutrality for value added taxes' (2011) 61/6*Tax Notes International* at 447.

89 OECD n 82 above; OECD *OECD International VAT/GST Guidelines: Draft Commentary on the International VAT Neutrality Guidelines* (2012) at 17 available at: http://www.oecd.org/ctp/consumptiontax/50667035_ENG.pdf (last accessed 27 January 2014); Grandcolas 'VAT on the cross-border trade in services and Intangibles' (2007) 13/1 *Asia-Pacific Tax Bulletin* at 41.

90 OECD n 85 above at 18.

91 Articles 358–369 of Council Directive 2006/112/EC which applies until 31 December 2014. From From 1 January 2015 the special scheme shall also apply to suppliers of broadcasting and telecommunication services. Also see Minor 'A primer on the 'one-stop shop' VAT compliance scheme for non-EU suppliers of e-commerce services' (2011) 62/13 *Tax Notes International* 1043–1057. Parrilli 'Electronically supplied services and Value Added Tax: the European perspective' (2009) 14/2 *Journal of Internet Banking and Commerce* available at: http://www.arraydev.com/commerce/jibc/2009-08/RI_Davide%20Maria%20Parrilli.pdf (last accessed 4 February 2014); Boullin 'B2C services: liability for European VAT' (2003) 4/7 *World Internet Law Report* at 10; Borec *EU: 2015 VAT changes to eservices – the "keep it simple" edition* 2013 available at: http://ebiz.pwc.com/2013/01/eu-2015-vat-changes-to-eservices-the-keep-it-simple-edition/ (last accessed 5 Feb 2014); Brandt & Juul 'EU VAT Rules on Electronically Supplied Services' (2005) 7/10 *Tax Planning International: European Union Focus* at

not have a fixed establishment or is not otherwise required to be established in the EU.[92] No physical presence in the EU is required. Any supplier who makes electronically supplied services available to EU consumers (who are not taxable persons) qualifies as a taxable person for purposes of the special scheme. The supplier can choose the member state of identification in which it wishes to register under the scheme, and to which it will submit its VAT returns.[93]

The effectiveness of a registration system is greatly affected by the design and application of a threshold system.[94] To further minimise the burden on small and micro businesses, thresholds that apply to resident vendors should be applied equally to non-resident suppliers.[95] In other words, the simplified registration dispensation should not create alternative registration thresholds for non-resident suppliers. This, however, is not the case under the amendments to the South African VAT Act. A differentiation is created between non-resident and resident suppliers of electronic services. Resident suppliers of electronic services may voluntarily register for VAT if their annual taxable supplies exceed R50 000, and must register for VAT if their annual taxable supplies exceed or is likely to exceed R1 million.[96] Non-resident suppliers of electronic services must, in terms of the proposed amendment, register for VAT if their annual taxable supplies of electronic services to South African residents exceed R50 000.[97]

12–13; Butler 'Place of supply of services: new VAT Rules applying in the European Union' (2010) Sept/Oct *International Tax Journal* 13–14; De Campos Amorim 'Electronic commerce taxation in the European Union (2009) 55/9 *Tax Notes International* at 773; Jackson 'EU VAT: quo vadis?' (2011) 62/13 *Tax Notes International* at 999; Jennings 'The EU VAT system – time for a new approach?' (2010) 21/4 *International VAT Monitor* 257; Lamensch 'Proposal for implementing the EU one-stop-shop scheme from 2015' (2012) 23/5 *International VAT Monitor* at 312; Lamensch n 85 above at 1–20.

92 Article 358(1) of Council Directive 2006/112/EC; article 358a(1) of Council Directive 2008/8/EC.

93 Article 358(3) of Council Directive 2006/112/EC; article 358a(2) of Council Directive 2008/8/EC.

94 Oka 'Specific challenges for tax administrations in applying VAT in international trade' *First Meeting of the OECD Global Forum on VAT (*2012) 81 available at: http://www.oecd.org/ctp/consumptiontax/PptpresentationsessionmaterialGFonVAT.pdf (last accessed 5 December 2013). In terms of art 9(1) read with Title XI of Council Directive 2006/112/EC, any supplier of electronically supplied services who is established in the EU and who renders the supplies at any place (inside or outside of the EU) is, as a general rule, obliged to register for VAT.

95 OECD n 82 above.

96 Section 23 of the Value-Added Tax Act 89 of 1991.

97 Section 178(1)(*b*) of the Taxation Laws Amendment Act 21 of 2013.

When registration is considered, jurisdictions should take cognisance of the need for greater international cooperation.[98] Existing tax, trade, and development treaties should be considered to develop an enforceable registration regime that would not lead to market distortions. The purpose of the proposed lower threshold that will apply to non-resident suppliers of electronic services is to protect resident suppliers of electronic services against market distortions.[99]

Simplified registration process

Generally, a requirement for registration is that the supplier must have a physical presence or fixed establishment in the jurisdiction where it makes taxable supplies. In the case of cross-border supplies of intangibles, the nature of the supply allows the supplier to make cross-border supplies without having a physical presence or fixed establishment in the jurisdiction where it makes the supplies. As a result, suppliers would increasingly find themselves with VAT/GST liabilities in countries in which they have no physical presence or fixed establishment.[100] Where these suppliers are required to register in the countries where they make taxable supplies, to require a physical presence or fixed establishment would be counterproductive to the virtual nature of e-commerce establishments. In terms of the special scheme for non-EU suppliers who make electronically supplied services available to EU customers, the supplier can choose to register under the scheme in the member state of identification and account for VAT in that member state. VAT should, however, be levied at the rate applicable in the member state of consumption.[101]

The supplier vendor must be a foreign vendor who does not have a fixed establishment or is not otherwise required to be established in the EU.[102] No physical presence in the EU is required. Any supplier who makes electronically supplied services available to EU consumers (who are not

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98 OECD n 82 above; Baron n 85 above at 10; Schenk & Oldman *Value added tax: a comparative approach* (2007) 218.

99 National Treasury n 68 above at par 6.6.

100 OECD *Consumption tax guidance series: simplified registration guidance* (2003) at 12 available at: http://www.oecd.org/ctp/consumptiontax/17851117.pdf (last accessed 6 December 2013).

101 Articles 358–369 of Council Directive 2006/112/EC which applies until 31 December 2014. From 1 January 2015 the special scheme shall also apply to suppliers of broadcasting and telecommunication services.

102 Article 358(1) of Council Directive 2006/112/EC; article 358a(1) of Council Directive 2008/8/EC.

taxable persons) qualifies as a taxable person for purposes of the special scheme. The supplier can choose the member state of identification in which it wishes to register under the scheme, and to which it will submit its VAT returns.[103] In the UK, registration can be completed online.[104]

The OECD also recommends that the simplified registration regime for the cross-border supply of intangibles should not require the supplier to have a physical presence or fixed establishment in the country of supply.[105]

Applicants should be allowed to complete an online registration application form that is accessible from the revenue authority's home page.[106] The application form should further be available in the official language of the applicable country's major trading partners.[107] In addition, the form should be standardised and the information requested should be limited to:

i) the registered name of the business and trading name;
ii) name and contact details of the person responsible for tax administration;
iii) postal/registered address of the business and name of contact person;
iv) telephone number of contact person;
v) electronic address of contact person;
vi) website URL of business; and
vii) the national tax number in the jurisdiction of establishment.[108]

Confirmation of receipt of the application, and the final registration number should be communicated to the supplier by electronic means.[109]

The South African VAT registration system does not provide for a simplified registration process for suppliers of cross-border intangibles. Vendors must, amongst other requirements, have a fixed establishment with a physical presence in the Republic.[110] The current vendor registration

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103 Article 358(3) of Council Directive 2006/112/EC; article 358a(2) of Council Directive 2008/8/EC.

104 Cass & Mason 'Recent changes to EU VAT for services supplied electronically' (2003) 4/11 *World Internet Law Report* at 14.

105 OECD n 100 above at 12.

106 *Ibid*.

107 *Ibid*.

108 OECD n 89 above at 13.

109 *Ibid*.

110 In addition to the registration requirements provided for in the VAT Act, section 22(3) of the Tax Administration Act 28 of 2011 provides that SARS may require the applicant

regime is inconsistent with the simplified registration proposal. It is known that the strict VAT registration regime in South Africa serves as a tax administration tool to combat VAT fraud and false VAT registrations.[111] Charlet and Buydens suggest that OECD member countries should take advantage of information exchange treaties as mutual assistance and debt recovery tools, as opposed to implementing stricter registration requirements.[112] This way business can be relieved from burdensome compliance procedures.[113] The amendments in respect of electronic supplies do not provide for a simple registration system for non-resident suppliers of electronic services.

Assessment under simplified registration regime

In addition to a simplified registration process, a simplified electronic self-assessment procedure should be available to non-resident suppliers of cross-border intangibles.[114] VAT declarations in the various jurisdictions vary in format, filing periods, and filing methods. This could adversely affect business.

Compliance under the EU special scheme is not necessarily less burdensome or less complicated than that established in each member state of consumption.[115] Not only must the supplier comply with the requirements in the member state of identification, it also must comply with any existing relevant rules applicable in the member state of consumption.[116] In other words, the supplier must study the national VAT rules of all the member states of consumption. Van der Merwe points out that non-EU sellers should be allowed to follow a single set of rules for all EU sales.[117]

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registrant to produce biometric evidence if it is required to identify him or to combat fraud.

111 In terms of registration procedure that was implemented in 2009, interviews are held with applicant vendors (voluntary and compulsory registrations) or representative vendors. The procedure was implemented to guarantee that applicant registrants have a genuine place of business from which an enterprise is conducted. To further eliminate fraud, SARS officials are also entitled to inspect the business premises or establishment to confirm that an actual enterprise is being conducted, or to require vendors to undergo biometric tests, such as fingerprint verification.

112 Charlet & Buydens n 88 above at 447.

113 *Ibid*.

114 OECD n 89 above at 13.

115 Lamensch n 85 above at 7.

116 Van der Merwe 'VAT in the European Union and electronically supplied services to final consumers' (2004) 16/4 *SA Merc LJ* at 584; García & Cuello 'Electronic commerce and indirect taxation in Spain' (2011) 51/4 *European Taxation* at 142.

117 Van der Merwe n 116 above at 584.

The OECD recommends that a standardised international declaration form and process should be developed for vendors who are registered under the simplified registration regime.[118] The VAT/GST declaration form should strike a balance between the need for simplicity, and the need for tax authorities to verify whether the tax obligations have been fulfilled.[119] The OECD suggests that further guidance should be given on the frequency of tax returns.[120]

Record keeping under a simplified registration regime

Registered vendors are generally required to keep records of transactions to enable tax authorities to review the data to ensure that VAT/GST has been correctly levied and paid to the relevant tax authority. Jurisdictions are free to prescribe the method of record keeping required by vendors. That said, the different record keeping requirements in the different jurisdictions, of which some prohibit the electronic storage of documents, could have an adverse effect on business. Baron opines that the administrative burden of record keeping under the EU simplified registration scheme cancels out the simplicity envisaged and brought about by the scheme.[121] The OECD proposes that an international standard for record keeping in the case of cross-border traders should be developed.[122] In developing record keeping guidelines that can ensure reliable and verifiable records that can be trusted to contain a full and accurate account of the electronic transaction concerned, cognisance should be taken of existing acceptable business practices.[123]

It could be argued that the strict requirements for electronic record keeping in terms of section 29 of the South African Tax Administration Act, place an additional administrative burden on non-resident suppliers which is not in line with the OECD guidelines. In terms of the OECD guidelines, record keeping in jurisdictions other than the jurisdiction in which the documents are created, should not pose an adverse risk to tax authorities if a standardised record keeping format (as is required in the jurisdiction of

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118 *Ibid*.
119 *Ibid*.
120 *Ibid*.
121 Baron n 85 above at 5.
122 OECD n 94 above at 14.
123 *Ibid*; OECD *Record keeping guidance* 17 available at: http://www.oecd.org/tax/taxadministration/31663114.pdf (last accessed 30 January 2014).

establishment) is maintained and can be guaranteed.[124] Record keeping in a place other than the Republic of South Africa is, generally, prohibited unless strict requirements are adhered to. In contrast, the EU Directive allows for record keeping in the cloud, provided that online access can be guaranteed. Record keeping under the EU model is less restrictive than under the South African model.

Enforceability of compliance / administrative burden

Enforceability of registration remains the chief challenge. In the absence of definitive rules and international cooperation, tax collection from non-compliant offshore suppliers would be difficult to enforce.[125] In addition, transparency in cases where registration can be enforced, would be difficult to achieve.[126] For example, would revenue authorities have extra-territorial powers to conduct audits on non-resident suppliers to ensure the accuracy of tax returns? Furthermore, would revenue authorities be able to enforce penalties, interest, or other punitive measures against non-compliance in foreign jurisdictions? Ecker opines that arbitration or similar forms of alternative dispute resolution, should be considered to enforce extra-territorial compliance.[127] The negotiation of multilateral treaties, as opposed to bilateral treaties, must be undertaken to ensure greater international and regional cooperation.[128]

From an economic perspective, compliance under a registration dispensation would create an additional burden on business. The administrative burden is, in most cases, costly and could deter foreign vendors from making supplies in a particular jurisdiction. Under the amendments to the South African VAT act, a non-resident supplier of electronic services will face various compliance challenges. First, costly once-off changes in its invoicing system is required to ensure that invoices reflect a) the term 'tax invoice'; b) the name, address, and VAT registration number of the supplier; c) an individual serialized number and date on which the invoice is issued; d) a description of the services supplied; and e) the consideration of the supply

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124 *Id* at 14.

125 Oka n 94 above at 81.

126 *Ibid*.

127 Ecker 'Considering the future: a VAT Model Tax Treaty?' *First meeting of the OECD Global Forum on VAT* (2012) at 119 available at: http://www.oecd.org/ctp/consumptiontax/PptpresentationsessionmaterialGFonVAT.pdf (last accessed 5 December 2013).

128 *Id* at 120.

and the amount of VAT expressed as fourteen per cent of the value of the supply.[129] Second, registration in the absence of a streamlined process will be both difficult and expensive.[130] Third, the frequency of the filing of returns and the actual transfer of VAT from a foreign bank account to SARS's South African Bank account will be frustrating and counterproductive.[131] If the non-resident supplier operates from a jurisdiction that applies strict exchange control measures, the transfer of funds could result in a long process. This could further result in late payments and additional penalties or interest being levied on the late payment.

To advance international trade, registration thresholds could be applied in the case of small to medium cross-border enterprises. However, striking a balance between a reduced administrative burden and the protection of the tax base would be difficult to accomplish.[132]

Determining the place of supply

The levying and collection of VAT by non-resident suppliers of electronic supplies under both a proxy system and a system based on the 'utilised and consumed' principle presupposes that the supplier can identify the customer's location. Place-of-supply proxies are founded on the premise that the supplier is able to determine the place where the consumer is established, or has a fixed address, or resides. In the case of tangible goods, the address of delivery is fairly indicative of the place of consumption.[133] In the absence of guidelines, determining the place of supply/consumption for digital deliveries is cumbersome.[134] Various methods of locating the customer's place of residence can be applied. These will now be discussed.

Customer self-declaration

The supplier could rely on the information supplied by the customer, but then runs the risk of incurring penalties or recourse being taken against it,

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129 Schneider n 73 above at 29.

130 *Ibid*.

131 *Ibid*.

132 Oka n 94 above at 83.

133 Fridensköld 'VAT and the Internet: the application of consumption taxes to e-commerce transactions' (2004) 13/2 *Information & Communications Technology Law* at 185; Directorate-General for Internal Policies *Simplifying and modernising in the digital single market* (2012) at 11 available at: http://www.europarl.europa.eu/document/activities/cont/201209/20120924ATT52130/20120924ATT52130EN.pdf (last accessed 5 February 2014).

134 Minor 'The European Comission's VAT Regulation project for supplies of electronic services' (2012) 67/3 *Tax Notes International* at 242.

for under- or over-taxing a customer as a result of false information obtained.[135] Most suppliers are not equipped to verify the customer's self-declared information and should, as a matter of principle, not be burdened with the obligation of verifying this information.[136] In the absence of physical contact between the parties, and given the speed and anonymity at which e-commerce is traded, the customer status and location would be difficult to determine.[137] Potential customers are likely to abandon the transaction where the supplier requests personal information, as this is often perceived as an invasion of privacy.[138] Bleuel and Stewen suggest that two methods of identifying the customer exist: tracing the delivery path of the supply, or tracing the path of payment.[139]

Tracing the path of supply relies on the IP address of the computer or device to which the digital products will be delivered. It is so that every computer is assigned an unambiguous address consisting of either four digits, or a corresponding sequence of signs.[140] Tracing the path of delivery using the sequence method, is indicative of the place where the customer finds himself when making the purchase.[141] This place could be very different from the customer's place of residence. For example, where the customer resides in Germany, but purchases digital products from his work computer in Switzerland, the places of purchase and consumption differ. Article 24 of Regulations 282/2011, provides that, as from January 2013, priority should be given to the place that best ensures taxation at the actual place of consumption. This puts an even greater burden on suppliers not only to determine the place of supply, but also to distinguish this from the actual place of consumption. Lamensch opines that the Regulations, just like the 1998 OECD guidelines on which they are modelled, are unconvincing.[142]

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135 Lamensch 'Unsuitable EU VAT Place of Supply Rules for Electronic Services-Proposal for an Alternative Approach' (2012) 4/1 *World Tax Journal* 81; Hardesty 'European VAT on digital sales' (2002) 4/3 *Tax Planning International E-commerce* at 4; Ivanson 'Overstepping the boundary-how the EU got it wrong on e-commerce' (2003) October *International Tax Report* at 9; Lamensch n 90 above at 315.

136 Lamensch 'New Implementing Regulation 282/2011 for the 2006 VAT Directive' (2011) 20/4 *EC Tax Review* at 171.

137 Lamensch n 135 above at 81.

138 Fridensköld n 133 above at 185; Baron n 85 above at 4; Baron 'The OECD and consumption taxes part 1' (2001) 3/9 *Tax Planning International E-commerce* at 5.

139 Bleuel & Stewen 'Value added taxes on electronic commerce: obstacles to the EU Commission's approach' (2000) July/August *Intereconomics* at 158.

140 *Ibid.*

141 *Ibid*.

142 Lamensch n 135 above at 81.

Unless the digital products emit signals to the supplier every time they are accessed/used/enjoyed the supplier will have no control over where or when the customer consumes the supplies.

Furthermore, where the destination computer is connected to an international service provider, such as Compuserve or AOL, the IP address attached to the computer could be shared on a limited network.[143] As the system can assign the same number to different computers at different times, it would not be possible correctly to identify the location of the computer.[144] Digital products are also often delivered at one IP address (remote server in a low-tax jurisdiction) from where they are later further downloaded anywhere in the world.[145] It should further be noted that where a resident of Belgium uses a portable device, such as an i-phone, across the border in Luxembourg, a different IP address is assigned to the device. The Belgian resident can therefore download a large volume of digital media while he is in Luxembourg and pay VAT at fifteen per cent on the downloads, as opposed to the 21 per cent Belgian VAT that should apply as he resides in Belgium.[146] Baron notes that suppliers acting in good faith, should be allowed to assume that the location as determined at the time of purchase is a good enough proxy for the place of residence.[147]

While complex technology can in some cases be applied to trace the origin (however uncertain) of the computer used to make the purchases, it should be noted that it is not widely available and often expensive to acquire and apply. In addition, software exists that can obscure the transaction/delivery path, or even hack the IP address of another computer and display it as the purchaser's computer address. Lamensch points out that it would be unfair to require suppliers to obtain this expensive software to collect taxes on behalf of the *fiscus,* especially where the supplier receives no incentive for tax collection.[148]

Measures to protect internet users from identity theft and banking fraud, make identifying the purchaser by tracing the payment path even more

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143 Bleuel & Stewen n 139 above at 158.
144 *Ibid*.
145 Directorate-General for Internal Policies n 133 above at 11.
146 *Id* at 44.
147 Baron n 85 above at 4; Baron n 138 above at 7.
148 Lamensch n 135 above at 87.

cumbersome than doing so by tracing the delivery path.[149] Credit cards contain an international country code in the card number that can easily identify the country where the card was issued.[150] This information can be verified against information supplied in the customer's self-declaration.[151] That said, credit card payments are increasingly completed under a secure electronic transaction protocol which hides the purchaser's identity and credit card number from the supplier.[152] Other payment methods such as Paypal or Digicash, are completely anonymous and there is no way that the supplier can identify the customer's country of residence.[153] Furthermore, credit card holders are not necessarily resident in the jurisdiction where the card is issued, nor can it be guaranteed that consumption will take place in the country of issue of the card.[154] It is common for consumers who, for business purposes, temporarily reside in a different jurisdiction, to retain credit cards issued in the country of their former residence.[155] In border regions, customers often acquire cross-border cards in jurisdictions where lower card fees or better deals are available.[156]

The EU Council Directives do not provide a safe harbour to help vendors determine the residence of individual customers.[157] The vendor would not be protected in the case of discrepancies where inaccurate information is *bona fide* obtained.[158] Penalties can be imposed on suppliers for failing to establish the correct location of the customer and the subsequent failure to apply the appropriate VAT rate.[159] The European Commission is, however, engaged on a project to address the issue before the implementation of the 2015 amendments.[160] Lamensch opines that the 2015 provisions are not

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149 Bleuel & Stewen n 139 above at 158.

150 *Ibid*.

151 Hobbs & Christie 'Cloud computing and VAT' (2011) 62/11 *Tax Notes International* at 899.

152 Bleuel & Stewen n 139 above at 158; Fridensköld n 133 above at 186.

153 Fairpo 'VAT in the European Union – where are we now' (1999) 1/9 *Tax Planning International E-Commerce* at 19; Lamensch n 90 above at 315; Lamensch n 135 above at 171.

154 *Id* at 46; Arthur 'International perspectives on e-commerce taxation' (2000) 2/12 *Tax Planning International E-Commerce* 18.

155 OECD n 85 above at 46.

156 *Ibid.*

157 Fitzgerald 'US companies' sales to EU consumers subject to VAT on digital downloads' (2002) June *The Tax Adviser* at 382.

158 *Ibid*.

159 Ivanson 'Why the EU VAT and E-commerce Directive does not work' (2003) 14/9 *International Tax Review* at 28; Ivanson n 135 above at 9.

160 Directorate-General for Internal Policies n 133 above at 43.

implementable at all.[161] This is because no official and verifiable elements of identification are available regarding private consumers.[162] Ultimately it is a question of good faith. Where the supplier has verified that the customer has provided a consistent set of information with a valid credit card, billing address, and IP address, all indicating the same address as residence, it can be said that the supplier has acquitted itself of its duty to determine the customer's location.[163]

Billing information

In cases where a billing address is required, a correlation between the customer's jurisdiction of residence and billing is likely to exist.[164] The billing address supplied for payment purposes could thus be used to verify the information supplied in the self-declaration. Where a mismatch between the billing address and the self-declaration exists, additional verification measures should be applied. The supplier could alert the customer that a mismatch exists and that he is required to review and correct the information. Where the addresses differ, but are both in the same jurisdiction, it would lead to the same tax result and the mismatch can be negated. Suppliers could, in cases where the addresses are located in different jurisdictions, cancel the transaction in cases where the customer fails to review and correct the information or fails to submit adequate reasons for the mismatch.

Tracking/Geo-location software

Various information resources can be applied to identify the customer's location through its IP address by utilising geo-location software.[165] When a customer types an IP address (URL) in the browser's URL bar, the browser sends a connection request to the IP address which in turn sends a location request to the geo-location provider.[166] The geo-location provider sends the customer's location information, based on the IP address on its database, to the supplier's or requested website's server.[167] Svantesson refers to the

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161 Lamensch n 135 above at 84.

162 *Ibid;* Lamensch n 136 above at 171.

163 Directorate-General for Internal Policies n 133 above at 61.

164 OECD n 114 above at 7.

165 *Ibid*.

166 Svantesson 'How does the accuracy of geo-location technologies affect the law?' (2008) 2/1 Masaryk University Journal of Law and Technology 12 available at: http://mujlt.law.muni.cz/storage/1234798550_sb_02_svantesson.pdf (last accessed 26 January 2013).

167 *Ibid.*

location identification by the geo-location provider as an educated guess.[168] The accuracy of geo-location technology is difficult to assess.[169] A disparity exists between the accuracy levels proclaimed by software developers, and the testimony by expert witnesses in court. Geo-location provider, Digital Element, claims that it has 99,9 per cent accuracy in respect of country location, and 95 per cent accuracy in respect of city location.[170] In *La Ligue Contre Racisme et L'Antisemitisme v Yahoo Inc*,[171] the panel of experts testified that around 70 per cent of IP addresses assigned to French Internet users can be accurately matched to persons resident in France.[172] The finding was based on numerous exceptions, for example, where Internet users subscribe to international or private service providers.[173] In *Nitke v Ashcroft*,[174] expert witness Ben Laurie testified that geo-location software has a maximum of 70 per cent accuracy on state level.[175] In most cases, the geo-location software can accurately identify the location of customer's Internet Service Provider, but the actual location of the machine/device used by the customer cannot be established accurately.[176] In addition, geo-location software is dependent on information already available in its data-base.[177] Consequently, geo-location software operates as a verification process in terms of which the IP address submitted by the customer's device or service provider, are compared to information that was submitted by or to the customer's service provider when the customer's IP address was issued or assigned. Where the information submitted during this initial phase is false or incorrect, geo-location software would be unable to verify its authenticity.

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168 *Ibid.*

169 Svantesson n 166 above at 13; Lamensch n 85 above at 10.

170 Digital element *Our technology* available at: http://www.digitalelement.com/our_technology/our_technology.html (last accessed on 26 January 2013).

171 *La Ligue Contre Racisme et L'Antisemitisme v Yahoo, Inc* Tribunal de Grande Instance de Paris No RG 00/05308 (November 20,2000).

172 Akdenis 'Case analysis of *League Against Racism and Antisemitism (LICRA), French Union of Jewish Students v Yahoo Inc (USA), Yahoo France* Tribunal de Grande Instance de Paris (The County Court of Paris), Interim Court Order, 20 November, 2000' (2001) 1/3 *Electronic Business Law Reports* vol 1 issue 3 at 111 available at: http://www.cyber-rights.org/documents/yahoo_ya.pdf (last accessed 26 January 2014).

173 *Ibid*.

174 *Nitke v Ashcroft* 253 F.Supp 2d 587 (SDNY Mar 24, 2003) (NO 01 CIV 11476 (RMB).

175 Laurie *Nitke v Ashcroft: geolocation of web users* (2005) 10 available at: http://www.apache-ssl.org/nitke.pdf (last accessed 26 November 2013).

176 *Id* at 6–10.

177 Svantesson n 166 above at 11; Lamensch n 85 above at 11.

Circumvention software can be applied to hide the customer's IP address from geo-location software or submit another machine/device's IP address to the geo-location provider.[178] It is commonly known that sophisticated circumvention technology is expensive and not readily available to the general public.[179] That said, anonymising technology, although less advanced than most circumvention software, is inexpensive and commonly used to hide or obscure the customer's IP address from geo-location software.[180] Anonymising software can assign an IP address located in a jurisdiction best suited to the customer's needs.[181] Yet, anonymising software is limited, and the number of countries that can be used as a smoke screen location is further limited.[182] These limitations do not prevent customers from choosing a location in a low-tax jurisdiction to reap the benefits of a lower tax rate or to avoid consumption tax altogether. The Technological TAG team, however, opines that it is unlikely that attempts to avoid consumption taxes would attract significant numbers of customers to anonymisers.[183]

Svantesson states that where the IP address and port number of a proxy server located in a jurisdiction best suited to the customer's needs are known to the customer, the customer's location can be hidden or obscured by changing the proxy server information on the customer's web browser.[184]

Geo-location software cannot be used in isolation to determine the customer's location. The OECD proposes that geo-location software should be used to verify the information submitted in the customer's self-declaration.[185] While geo-location software cannot guarantee accuracy in itself, where it is used as a secondary tool to verify the information in the self-declaration, suppliers can achieve greater accuracy. The CTPA suggests that jurisdictions should develop an acceptable protocol in cases where a mismatch exists between the geo-location results and the self-declaration.[186] The CTPA, however, fails to indicate or suggest an acceptable protocol.

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178 Svantesson n 166 above at 16; Baron n 85 above at 7.
179 Svantesson n 166 above at 16.
180 Akdenis n 172 above at 111.
181 Svantesson n 166 above at 17.
182 *Ibid.*
183 OECD n 85 above at 30.
184 Svantesson n 166 above at 17.
185 OECD n 114 above at 7.
186 *Ibid.*

Nature of supply

In some cases the nature of supply can be applied as an indicator of the customer's location. This includes a combination of factors such as language, content, and the currency in which the transaction is completed.[187] It should be noted that these factors are only indicative and should not be applied as the predominant test to avoid incorrect assessments.[188] For example, where a resident of Spain orders a popular novel in Dutch (in order to improve his language skills), the language and currency could indicate that the customer is located in the Netherlands while he, in fact, resides in Spain.

Digital certificates

It is well known that digital certificates offer the most accurate solution to identifying and locating the customer. However, digital certificates are not often issued by revenue authorities.[189] In addition, the use of digital certificates is less common among individuals.[190]

CONCLUSION

It has been established that it would generally be onerous, if not impossible, to determine the actual place of consumption for tax purposes in the absence of a close relationship between the supplier and the non-taxable customer. The proposal to deem the place of consumption to be the customer's normal place of residence (in the case of individuals), or place of establishment (in the case of businesses), could have an adverse effect on the destination principle. This is even more so in the case of individuals who are more mobile than businesses. Individuals often consume supplies in a jurisdiction different from the place of residence. That said, the impracticality of a pure consumption test warrants the proposal that the place of residence or establishment is deemed to be the place of consumption. Greve points out that even this rough proxy becomes difficult to apply in cases where the customer principally exists in cyberspace.[191] A constant review of identification and location proxies is required to keep pace with technology.[192] Lamensch opines that the OECD guidelines are outdated and that the current inefficiencies have been ignored by the OECD.[193] Baron

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187 *Ibid*.
188 Baron n 85 above at 8.
189 OECD n 114 above at 7; Baron n 85 above at 6.
190 *Ibid.*
191 Greve *Sell globally, tax locally: sales tax reform for the new economy* (2003) at 8–9.
192 *Id* at 9.
193 Lamensch n 135 above at 86.

proposes that businesses should only be required to make limited efforts to establish a customer's location.[194] Once two or three tests have been laid down, any business which applies them should be treated as having fulfilled its obligations in locating the customer.[195] It should further be noted that the tests should not irritate customers, or significantly slow down the transaction process.[196]

Ligthart opines that substantial international cooperation would be required to prevent countries from adopting and implementing mutually inconsistent tax policies that would lead to double taxation or unintended under or non-taxation.[197] Consequently, the destination principle should be adopted globally in respect of electronically supplied services or intangibles. The OECD guidelines are considered soft-law and can merely serve as persuasive guidelines to jurisdictions in reforming national VAT/GST legislation.[198] Enforcing international cooperation, and moreover enforcing the OECD's place-of-supply proposals, would be impossible in the absence of sanctions or penalties against defaulting countries.

Inadequate and inappropriate VAT collection mechanisms in cross-border trade are the main contributors to VAT fraud and the erosion of the tax base.[199] The OECD recognises four essential VAT collection mechanisms: registration; collection through a reverse-charge mechanism; taxing at source and remittance; and collection by collecting agents.[200] Since registration and the reverse-charge mechanism are commonly applied in most jurisdictions, the OECD suggests that, as an interim approach, it should be adapted (where required) and applied as the collection mechanism of choice in the case of cross-border trade in intangibles.[201] Despite the rise of modern technology that can be applied to develop collection mechanisms, member countries are

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194 Baron n 85 above at 8.

195 *Ibid*.

196 *Ibid*.

197 Ligthart 'Consumption Taxation in a Digital World: A Primer' 2004 *CentER Discussion Paper no 2004-102* at 12 available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=625044 (last accessed 28 November 2013).

198 Charlet 'VAT focus: Draft OECD VAT/GST Guidelines' (2010) March *Tax Journal* at 22 available at: http://www.oecd.org/tax/consumptiontax/45274124.pdf (last accessed 29 November 2013).

199 Alfredo 'Applying VAT to international trade – the vhallenge of economic globalisation: the challenge for tax administrations' 2012 *First Meeting of the OECD Global Forum on VAT* at 54 available at: http://www.oecd.org/ctp/consumptiontax/PptpresentationsessionmaterialGFonVAT.pdf (last accessed 5 December 2013).

200 OECD n 82 above; OECD n 85 above at 5.

201 OECD n 82 above; Schenk & Oldman n 98 above at 217.

of the opinion that the traditional collection mechanisms remain the most effective.[202]

Enforceability of registration remains the chief challenge. In the absence of definitive rules and international cooperation, tax collection from non–compliant offshore suppliers would be difficult to enforce.[203] In addition, transparency in cases where registration can be enforced, would be difficult to achieve.[204] For example, would revenue authorities have extra-territorial powers to conduct audits on non-resident suppliers to ensure the accuracy of tax returns? Furthermore, would revenue authorities be able to enforce penalties, interest, or other punitive measures against non-compliance in foreign jurisdictions? Ecker opines that arbitration or similar forms of alternative dispute resolution, should be considered to enforce extra-territorial compliance.[205] The negotiation of multilateral treaties, as opposed to bilateral treaties, must be undertaken to ensure greater international and regional cooperation.[206] Current registration systems are heavily reliant on voluntary compliance.[207] From a neutrality and competition perspective, it is questionable whether a system based on voluntary compliance will be acceptable in the long term.[208] However, Bill and Kerrigan, in an unsubstantiated statement, are of the opinion that businesses will want to be compliant.[209] Jenkins believes that because of the legal certainty created by clear and unambiguous Directives, suppliers willing to expand are more likely to comply.[210] However, given the fact that non-compliance cannot be traced or adequately penalised, I (perhaps cynically) fail to see any reason why businesses would be compliant.

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202 OECD n 82 above.

203 Oka n 94 above at 81; Bleuel & Stewen n 139 above at 159; K Wasch as quoted in Basu 'European VAT on digital sales' (2002) 3 *Journal of Information, Law and Technology* available at: http://elj.warwick.ac.uk/jilt/02-3/basu.html (last accessed 5 October 2013); Ivanson n 159 above at 31.

204 Oka n 94 above at 81.

205 Ecker n 127 above at 119.

206 *Id* at 120.

207 European Commission 'Green Paper on the future of VAT: towards a simpler, more robust and efficient VAT system' *COM* (2010) 695 final at 12 available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0695:FIN:EN:PDF (last accessed 21 January 2014); Fetzer 'Digital sales and the European Union: taxing times imminent' (2003) 5/4 *Tax Planning International E-commerce* at 7; Lambourne & Llewellyn 'Does EU VAT extension catch you?' (2002) 4/11 *Tax Planning International E-commerce* 4 at 5; Lejeune, Korf & Grünauer 'New E-commerce directives: a move towards e-Europe?' (2003) 17/4 *Journal of International Taxation* at 22–23.

208 European Commission n 207 above at 12.

209 Bill & Kerrigan 'Practical application of European Value Added Tax to E-commerce' (2003) 38/1 *Georgia Law Review* at 81.

210 Jenkins 'The EU proposals for the effective application of VAT in the Internet age' (2001) 2/12 *Tax Planning International E-commerce* at 7.

From an economic perspective, compliance under a registration dispensation would create an additional burden on business. The administrative burden is, in most cases, costly and could deter foreign vendors from making supplies in a particular jurisdiction. To advance international trade, registration thresholds could be applied in the case of small to medium cross-border enterprises. However, striking a balance between a reduced administrative burden and the protection of the tax base would be difficult to accomplish.[211]

Tax collection models should ideally ensure the most efficient tax collection through the elimination of tax evasion and avoidance, and unintended over and under-taxation without over burdening the taxable entity, and at the lowest administrative cost to the revenue authority. The interim solution proposed by the OECD, namely registration for B2C transactions, and self-assessment for B2B transactions, favours revenue authorities in that it places the burden of tax collection and the burden of administrative costs on the taxable entity. In addition, efficiency cannot be guaranteed as it is not clear to what extent revenue authorities will be granted extra-territorial powers to enforce cross-border VAT collection.

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[211] Oka n 94 above at 83.