The collection of value added tax on cross-border digital trade – part 2: VAT collection by banks*

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Abstract

The viability of Value Added Tax (VAT) as an effective source of revenue relies chiefly on the ability to enforce VAT rules and to collect VAT effectively on affected transactions. Existing VAT collection mechanisms are in dire need of modernisation, in that they are inefficient and increasingly burdensome on revenue authorities and suppliers. International trends show that tax collection by third party intermediaries is increasingly being introduced in countries where cross-border trade and employment are on the rise. Cross-border digital trade is a fully fledged electronic trading, and often automated, phenomenon. The execution of these transactions requires no or minimal human intervention. A withholding tax mechanism by financial institutions through the implementation of an automated split-payment system, offers the possibility of the execution of online cross-border transactions with no or minimal human intervention. Part 2 investigates VAT collection by financial institutions as a viable tax collection model for cross-border digital trade.

INTRODUCTION

The viability of Value Added Tax (VAT) as an effective source of revenue relies chiefly on the ability to enforce VAT rules and to collect VAT effectively on affected transactions. An ideal tax collection model ensures the elimination of tax fraud, tax avoidance, tax evasion, and over- or under-taxation at the least cost to the *fiscus* and without placing an additional cost or administrative burden on the taxable entity. This might be an illusionary ideal. Nevertheless, the registration and reverse-charge mechanisms as VAT

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collection models for cross-border digital trade are unsustainable in an online environment.

Existing VAT collection mechanisms are in dire need of modernisation, in that they are inefficient and increasingly burdensome on revenue authorities and suppliers. Some observers have proposed the use of financial institutions as VAT collectors and technology to facilitate their task. The OECD conclusion that VAT collection by financial institutions is not a viable option,[1] is based on resistance and objections raised by financial institutions coupled with the general international perception of the banker-customer relationship as regards customer privacy when the proposal was considered. Doernberg and Hinnekens argue that withholding taxes by financial institutions should be a method of last resort if the registration of non-resident vendors turns out to be an ineffective VAT accountability and collection tool.[2] We believe that this view (as with the concerns raised by financial institutions) is based on out-dated perceptions and the state of technology when it was formulated. Despite the fact that the registration mechanism has not yet given rise to serious cross-country coordination efforts, we believe it to be an ineffective cross-border collection mechanism in the absence of international cooperation. Recent technological advances, and a shift in VAT collection trends at local level, warrant further research into the viability of VAT collection by financial institutions in the case of cross-border digital trade.

In the present article (part II), we discuss VAT collection by financial institutions[3] as a viable tax collection model for cross-border digital trade. This will be achieved by first discussing the operation of this model, followed by a discussion of the benefits it offers as a VAT collection mechanism on a local level with international consequences. The main objections, concerns, and possible difficulties in implementing the model will also be considered.

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1 OECD *Report by the consumption tax technical advisory group* (2000) 24 http://www.oecd.org/tax/consumptiontax/1923240.pdf (last accessed 24 August 2012).

2 Doernberg & Hinnekens *Electronic commerce and international taxation* (1999) 352.

3 For the purpose of this article 'financial institution' will be interpreted in the narrow sense to denote banks, credit card companies, building societies or similar institutions which, as part of their ordinary duties, make payments from a customer's account to third parties on instruction of the customer.

VAT COLLECTION BY FINANCIAL INSTITUTIONS: HOW DOES IT WORK?

The basis of this model is to collect VAT on each transaction through an electronic payment system at the point at which it is traded – for example, a credit card system – based on the location of the customer and the VAT rules applicable in that jurisdiction.[4] In other words, the customer is immediately assessed when the transaction is entered into, and the VAT payable is transferred to the relevant revenue authority without delay. This is typically achieved when the supplier submits the customer's credit card or other payment details to the customer's bank or credit card company. The bank or company then identifies and locates the customer's place of residence or establishment. Details of the transaction – the purchase price and type of supply – are transmitted to the financial institution to enable it correctly to assess the transaction based on the VAT rules applicable in the jurisdiction where customer resides, is established, or has a permanent address. The amount payable by the customer is the final amount inclusive of VAT. A split-payment system separates the payment in two: the purchase price is transferred into the supplier's bank account while VAT is transferred to the relevant revenue authority.

Neither the supplier nor the customer is required to register with the relevant revenue authority. Involving financial institutions in the VAT collection process, is an attempt to move VAT closer to a return-free system through the increased use of electronic payment instruments.[5] Currently, two models exist: a blocked-VAT account system; and a real-time VAT system.

Blocked-VAT account system

The blocked-VAT account system was developed by Pricewaterhouse-Coopers,[6] and is essentially a split-payment system in terms of which the financial institution executing the payment, levies VAT on the transaction,

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4 Ligthart 'Consumption taxation in a digital world: a primer'(2004) *CentER Discussion Paper* no 2004–102 14 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=625044 (last accessed 28 November 2012); 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* 14–15.

5 Ainsworth & Madzharova 'Real-time collection of value added tax: some business and legal implications' 2012 *Boston Univ School of Law Working Paper no 12–51* 9 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2166316 (last accessed 18 December 2012).

6 *Id* at 8.

and then pays it into a blocked VAT account.[7] The blocked-VAT account can be used only for incoming and outgoing VAT payments, and for VAT settlements at the end of a VAT reporting period.[8] The financial institution merely acts as an intermediary burdened with the task of splitting the payment.[9] Since the VAT collected from the customer is not deposited into the supplier's private bank account, the risk of disappearing vendors is eliminated.[10] The supplier is still burdened with filing tax returns at the end of a VAT reporting period.[11] However, the supplier will receive a partially completed assessment form from the financial institution reflecting all the transactions effected by it for which VAT was paid into the blocked account.[12] Consequently, the greater the number of transactions executed through the blocked account, the lighter the supplier's burden in completing VAT returns.[13] VAT payments and refunds will be effected from and to the blocked account.[14] Despite the fact that VAT is collected in real-time, settlement with tax authorities is delayed until the supplier submits an assessment at the end of a reporting period.[15] This system remains to be tested. Until then, we do not wish to express a firm view for or against its implementation.

Real-time VAT

Real-time VAT (RT-VAT) collection corresponds most closely to the tax collection model by financial institutions. RT-VAT was put forward by Chris Williams, chairman of the RTpay® executive committee, a non-profit organisation the main aim of which is to promote RT-VAT as an alternative assessment method to the current registration and reverse-charge mechanisms.[16] RT-VAT is a real-time VAT collection system that operates

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7 PricewaterhouseCoopers *Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries* (2010) 11 at: ERLINK"http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/vat-study_en.pdf"http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/vat-study_en.pdf (last accessed 19 December 2012).

8 Ainsworth & Madzharova n 5 above at 8.

9 Ainsworth & Madzharova n 5 above at 9.

10 PricewaterhouseCoopers n 7 above at 11.

11 *Ibid*.

12 *Ibid*; Ainsworth & Madzharova n 5 above at 9.

13 *Ibid*.

14 *Ibid*.

15 *Id* at 8.

16 *Id* at 17; Jennings 'The EU VAT system-time for a new approach?' (2010) 21/4 *International VAT Monitor* 257.

on the existing card and payment platforms.[17] Once the supplier has submitted the customer's card details, purchase price, and transaction details to the financial institution, the financial institution identifies and locates the customer from its database, and levies VAT on the transaction based on the VAT rate applicable in the customer's jurisdiction of residence.[18] Payment is made directly from the customer's bank account and split into two separate payments. The purchase price is paid into the supplier's bank account, and VAT is paid to the relevant revenue authority.[19] Payment of VAT is effected once every 24 hours, as opposed to the delayed payment system under the post-transaction assessment model.[20] A dedicated server system – Tax Authority Settlement System ('TASS') – tracks every transaction to ensure that allowable input VAT claims in the case of Business-to-Business (B2B) transactions are paid automatically.[21] Lamensch argues that it is virtually impossible to keep track of every transaction concluded on the Internet.[22] It remains uncertain how TASS would ensure secure and adequate tracking. The RT-VAT system, too, is yet to be tested and again we reserve judgment on its implementation.

Benefits of VAT collection by financial institutions

Identification and location of the customer

In the case of cross-border digital trade where the supplier is required to levy VAT on the transaction based on the VAT rules applicable where the intangibles are consumed or where the customer resides or is established, the supplier is required to identify and locate the customer and/or locate the place of consumption. Verifying the customer's identity and location is difficult. Even where a combination of identification and location tools is applied, 100 per cent accuracy cannot be attained. It is trite that payment and credit card details in the hands of the supplier, do not reveal much about the customer. However, the financial institution executing the payment is able to access the customer's details from its database. In terms of the 'know-

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17 Ainsworth & Madzharova n 5 above at 17–18; Wohlfahrt 'The future of the European VAT system' *International VAT Monitor* (2011) 22/6 394; Ainsworth 'Technology can solve MTIC Fraud-VLN, RTvat, D-VAT certification' (2011) 22/3 *International VAT Monitor* 157; Jennings n 16 above at 257.

18 Williams *RTvat: a real-time solution for improving collection of VAT* (2012) 2 at: http://www.rtpay.org.php5-20.dfw1-2.websitetestlink.com/wp-content/uploads/2012/02/rtvathandoutv1.pdf (last accessed 18 December 2012).Wohlfahrt n 17 above at 394.

19 Williams n 18 above at 2.

20 *Ibid*.

21 *Ibid*.

22 Lamensch n 4 above at 12.

your-customer' principle, financial institutions are required to keep records of their customer's identification and place of residence.[23] Internationally, financial institutions are prohibited from keeping anonymous accounts, or accounts in fictitious names.[24] In South Africa, there is no specific legislation prohibiting such a practice. However, because of the duty of record keeping,[25] and the reporting duties[26] of accountable institutions[27] in terms of the Financial Intelligence Centre Act,[28] it is neither possible nor

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23 Financial Action Task Force *International standards on combating money laundering and the financing of terrorism and proliferation:the FATF recommendations* 2012 14 at: http://www.fatf-gafi.org/media/fatf/documents/recommendations/-pdfs/FATF%20Recommendations%20(approved%20February%202012)%20reprint%20May%202012%20web%20version.pdf (last accessed 20 December 2012); Lamensch 'Unsuitable EU VAT place of supply rules for electronic services-proposal for an alternative approach' (2012) 4/1 *World Tax Journal* 89; Baron 'VAT on electronic services: the European solution' (2002) 4/6 *Tax Planning International E-commerce* 4; Lamensch n 4 above at 13–14; Van Jaarsveld 'The end of bank secrecy? Some thoughts on the Financial Intelligence Centre Bill' (2001) 13/4 *SA Merc LJ* 580 584–587.

24 Financial Action Task Force n 23 above at 14.

25 Sections 21 and 22 of the Financial Intelligence Centre Act 38 of 2001, in terms of which accountable institutions are prohibited from establishing a business relationship or entering into a single transaction with a person or entity unless the financial institution has verified the identity and place of residence or establishment of such person or entity.

26 Sections 27 to 41 of the Financial Intelligence Centre Act 38 of 2001.

27 An 'accountable institution' means an attorney as defined in the Attorneys Act 53 of 1979; a board of executors; a trust company; or any other person who invests, keeps in safe custody, controls or administers trust property within the meaning of the Trust Property Control Act 57 of 1988; an estate agent as defined in the Estate Agents Act 112 of 1976; a financial instrument trader as defined in the Financial Markets Control Act 55 of 1989; a management company registered in terms of the Unit Trusts Control Act 54 of 1981; a person who carries on the 'business of a bank' as defined in the Banks Act 94 of 1990; a mutual bank as defined in the Mutual Banks Act 124 of 1993; a person who carries on a 'long-term insurance business' as defined in the Long-Term Insurance Act 52 of 1998, including an insurance broker and an agent of an insurer; a person who carries on a business in respect of which a gambling licence is required to be issued by a provincial licensing authority; a person who carries on the business of dealing in foreign exchange; a person who carries on the business of lending money against the security of securities; a person who carries on the business of rendering investment advice or investment broking services, including a public accountant as defined in the Public Accountants and Auditors Act 80 of 1991, who carries on such a business; a person who issues, sells or redeems travellers' cheques, money orders or similar instruments; the Postbank referred to in s 51 of the Postal Services Act 124 of 1998; a member of a stock exchange licenced under the Stock Exchanges Control Act 1 of 1985; the Ithala Development Finance Corporation Limited; a person who has been approved or who falls within a category of persons approved by the Registrar of Stock Exchanges in terms of s 4(1)(a) of the Stock Exchanges Control Act 1 of 1985; a person who has been approved or who falls within a category of persons approved by the Registrar of Financial Markets in terms of s 5(1)(a) of the Financial Markets Control Act 55 of 1989; and a person who carries on the business of a money remitter.

28 Act 38 of 2001.

legally tenable for South African banks to keep anonymous accounts. Consequently, financial institutions in South Africa are required to maintain a database of information of their customers' identity and location. Where a cross-border digital transaction payment is executed by a South African financial institution, that institution would, by mere fact that the customer's credit card or payment method was issued/executed by a South African financial institution, be able to identify the customer as a South African resident or entity established in South Africa. In addition, in many jurisdictions, including South Africa, financial institutions are already required to monitor and report the transfer of funds in terms of exchange control legislation.[29] It can, therefore, be concluded that as payment facilitators in the cross-border digital trade chain, financial institutions are best equipped to verify the customer's identification and location. Ligthart points out that the customer's identification cannot be ascertained if the credit card was issued by a bank in a country with bank secrecy laws.[30] But she is not entirely correct. While it is trite that in these countries the information in respect of the customer's identification and location cannot be divulged to third parties, the financial institution would still be able to ascertain the customer's identification and location despite secrecy provisions. Further, if the bank is authorised (or rather, compelled by legislation) to disclose the personal details of its customers, this will override the common law duty of confidentiality which a bank owes its customers. Lamensch suggests that customers should not be required to disclose their card or payment details to the supplier who will in turn disclose the information to the financial institution to identify and verify the customer's location and tax status.[31] Privacy, according to Lamensch, can be ensured by applying secure payment systems.[32] In terms of these systems, the customer is directed to a secure payment platform operated by the financial institution. The customer identifies himself by submitting his card details, and the financial institution can immediately recognise the customer based on the information stored on its database.[33] The financial institution only requires the value and nature of the supply from the supplier to levy the correct amount of VAT.

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29 Bentley 'A model for electronic tax collection (1999) 1/11 *Tax Planning International E-commerce* 24.

30 Ligthart n 4 above at 14.

31 Lamensch n 23 above at 89.

32 *Ibid*.

33 *Ibid*.

Destination and origin principle

VAT collection by financial institutions as a viable collection method is not restricted to cross-border transactions concluded under the destination principle.[34] Under the origin principle, the customer's bank would be required to identify the country of origin based on the information submitted by the supplier, levy VAT on the transaction in accordance with the rules applicable in the country of origin, and pay VAT to the relevant revenue authority.[35] The origin principle requires greater cooperation between financial institutions and various revenue authorities in different jurisdictions. It should, however, be noted that the origin of the supply (place where the supplier is established) cannot be determined with absolute certainty. The financial institution relies on information submitted by the supplier who can choose to accept payment in a low-VAT jurisdiction, while the actual supplies are delivered from a different location or in the cloud.

Under the destination principle, the financial institution is only required to cooperate with the revenue authority in the country where the customer is located. Consequently, VAT is collected based on a single set of VAT rules and paid to a single revenue authority. This is based on the premise that both the customer and the financial institution are located in the same jurisdiction. In the case of a federal system, greater cooperation might be required which could overburden financial institutions. Ligthart argues that a national clearing house could be set up under a federal system to assist financial institutions in transferring VAT payments to the relevant revenue authority.[36] While this proposal was in line with the requirements for a clearinghouse under the now abandoned 'definitive regime', a clearinghouse has never been set up. Basu points out that there is a greater likelihood of a legal nexus existing between the financial institution and the state for which taxes are being collected in a federal system, than would be the case where these taxes are collected by a supplier.[37] In other words, the system is compliant with both the Internet Tax Freedom Act[38] of the USA and the *Quill* judgment.[39] Basu further points out that existing debt and credit

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34 Ainsworth & Madzharova n 5 above at 18; Wohlfahrt n 17 above at 394.

35 Ainsworth & Madzharova n 5 above at 18.

36 Ligthart n 4 above at 15.

37 Basu 'Implementing e-commerce tax policy' *18th BILETA Conference: Controlling Information in an Online Environment* 2003 11 http://bileta.nsdesign7.net/content/files/conference%20papers/2003/Implementing%20E-commerce%20Tax%20Policy.pdf (last accessed 4 January 2013).

38 The Internet Tax Freedom Act, Amendment Act of 2007.

39 *Quill Corp v North Dakota* (91–0194), 504 US 298 (1992); Bentley n 29 above at 25.

collection mechanisms – including court procedures – as applied by the financial institution in the state of incorporation can be applied to collect taxes due on a transaction.[40] Such measures would, however, not be required. Under both the RT-VAT and Blocked-VAT systems, VAT is immediately levied on the transaction and recovered from the customer's bank account, leaving no opportunity for unpaid taxes that must be recovered by a debt collection process or court procedure. Where the bank has extended credit to a customer who has insufficient funds to cover both the purchase price and VAT, any subsequent action to recover such money would be a claim for outstanding and unpaid debt, not for outstanding and unpaid VAT.

Simplified VAT collection

In non-federal systems where the destination principle applies, financial institutions tasked with VAT collection, are only required to account for VAT in the jurisdiction where they are established. VAT collection is consequently simplified to the extent that the financial institution applies a single set of VAT rules. This should be contrasted against the registration method where suppliers, as VAT collectors, are required to register in multiple jurisdictions and are further required to apply multiple VAT rules. It should, however, be noted that it is possible for a customer to hold a bank account with a financial institution not established in the jurisdiction in which he resides.[41] In these cases, the financial institution would be required to apply a set of VAT rules that applies in the foreign country where the customer resides. This could place an additional administrative burden on the financial institution which must then cooperate with multiple tax authorities. This, according to Lamensch, should not pose any difficulty for these financial institutions.[42]

As VAT payments are automatically transferred to revenue authorities, financial institutions are not burdened with completing difficult VAT returns and manual payment systems.[43] The automated payment system under the RT-VAT system simplifies the collection and remittance process, creating a VAT collection mechanism that places the least administrative burden on the financial institution.

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40 Basu n 37 above at 11.

41 De Campos Amorim 'Electronic commerce taxation in the European Union' (2009) 55/9 *Tax Notes International* 779; Lamensch n 4 above at 15.

42 Lamensch n 4 above at 15–16.

43 Williams n 18 above at 1; Lamensch n 4 above at 15–16.

No delays in VAT remittance

Under the RT-VAT system, VAT is remitted automatically at 24-hour intervals [44] The transaction, VAT collection, and remittance, can effectively be completed on the same day. However, this is not the case under the Blocked-VAT account model, in terms of which VAT is collected immediately, but remitted to revenue authorities only at the end of a reporting period.[45] This is similar to the registration and reverse-charge models. Delays in VAT remittance negatively impact on the cashflow of revenue authorities, and increase opportunities for VAT fraud. From the vendor's perspective, however, delays in VAT remittance may temporarily aid cash flow; at the same time this poses a risk to the vendor that when VAT must be remitted, there may be insufficient cash on hand.

VAT fraud and unintended under-taxation eliminated

Generally, VAT fraud is associated with schemes that involve: the collection of VAT on taxable transactions and the failure of suppliers to remit VAT to revenue authorities; and artificially inflated input VAT deductions that exceed outputs.[46] Since VAT is automatically collected on transactions and automatically remitted to revenue authorities within a 24-hour cycle under the RT-VAT system, VAT fraud opportunities are virtually eliminated.[47] Similarly, in the case of a blocked-VAT account, VAT is not paid into private bank accounts which eliminates the chance of VAT fraud and simultaneously reducing the number of audits required.[48]

Under-reporting of output VAT is often associated with the failure to issue invoices or the lack of proper record keeping by suppliers. In the case of VAT collection by financial institutions, records of transactions are kept by third parties (financial institutions) which ensures that a sound audit trail is established, resulting in the elimination of opportunities for VAT fraud.[49]

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44 Williams n 18 above at 2; Wohlfahrt n 17 above at 394; Ainsworth n 17 above at 156; Jennings n 16 above at 257.

45 Ainsworth & Madzharova n 5 above at 8.

46 Ainsworth & Madzharova n 5 above at 2, 7.

47 Williams n 18 above at 1; Ligthart n 4 above at 14; Lamensch n 23 above at 90; Wohlfahrt n 17 above at 395; Lamensch n 4 above at 16.

48 Ainsworth & Madzharova n 5 above at 8–9.

49 *Id* at 9; Kleven, Kudsen, Kreiner, Pedersen & Saez 'Unwilling or unable to cheat? Evidence from a randomized tax audit experiment in Denmark' 2010 *NBER Working Paper Series no 15769* 20 at: http://www.nber.org/papers/w15769.pdf (last accessed 21 December 2012); Williams 'Technology can solve MTIC fraud-2' (2011) 22/4 *International VAT Monitor* 231; Ainsworth n 17 above at 157.

Reliability, respectability, and creditworthiness are essential elements in a successful third party VAT collection system.[50] This cannot be guaranteed by a reverse-charge or registration system. The principle of a fractionated VAT system operated by a reverse-charge mechanism, poses tremendous risks of non-payment in the case of insolvency.[51] VAT collection by financial institutions removes the risk of lost VAT in the case of businesses going bankrupt.[52] In jurisdictions that provide for special treatment of the *fiscus* as a statutory preferential creditor against the estate of the insolvent taxpayer, complete recovery of outstanding taxes cannot be guaranteed. Under the RT-VAT system, as VAT is collected by a third party and immediately remitted to the relevant tax authority, the possibility that the money can be embezzled by the supplier is eliminated. Furthermore, the trustee of the insolvent supplier cannot argue that the money falls into the insolvent estate, and that the revenue authority should submit a claim against the insolvent estate as a concurrent or statutory preferrent creditor. This is because the revenue authority's entitlement to the money vests as soon as the transaction has been concluded, and the money is collected on behalf of the revenue authority by the financial institution.

In the case of B2C cross-border digital trade where the reverse-charge mechanism applies, many transactions escape the VAT net simply because taxpayers are unaware of their statutory duty to report the transaction and remit VAT to the revenue authority.[53] A deferred payment system requires effective and regular internal audits and a higher degree of compliance by taxpayers to ensure constant VAT collection.[54] Under the RT-VAT and blocked-VAT account systems, B2C cross-border transactions can be detected and taxed effectively. As this happens during the transaction phase, the parties cannot escape VAT by failing to report the transaction.

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50 Basu n 37 above at 11.

51 Wohlfahrt n 17 above at 388.

52 Williams n 18 above at 1; Basu n 37 above at 11; Wohlfahrt n 17 above at 395.

53 OECD *Report by the technology technical advisory group* (2000) 52 http://www.oecd.org/tax/consumptiontax/1923248.pdf (last accessed 11 December 2012).

54 Cnossen 'Global trends and issues in value added tax' (1998) 5/3 *International Tax and Public Finance* 413 at: http://link.springer.com/article/10.1023%2FA%3A1008694529567?LI=true# (last accessed 4 January 2013).

Nevertheless, it should be noted that the RT-VAT and blocked-VAT systems cannot eliminate every form of VAT fraud.[55] Spending all resources to eliminate every form of VAT fraud is an unrealistic approach.[56] Goolsbee and Zittrain argue that VAT collection by financial institutions should be developed primarily to simplify VAT compliance and to make VAT fraud and evasion difficult to the extent that the problem can be limited.[57]

Can be applied to tangible and intangible transactions

Both the RT-VAT and the blocked-VAT account systems are not restricted to the application of cross-border trade in intangibles, but can be applied to any transaction where funds are transferred electronically.[58] Should these systems be applied to cross-border trade in tangibles, possible bottlenecks during peak import times could be avoided. Since import-VAT on tangibles is generally levied on the value of the goods , the purchase price, which must be disclosed to the financial institution, can be used to calculate and levy VAT. This will further eliminate valuation problems by customs where imported goods are not accompanied by invoices reflecting the purchase price or insured value. The cost of training custom officials, and further retaining expert and diligent officials in the system, could outweigh the revenue collected from small parcels. If the RT-VAT system were applied to both tangible and intangible cross-border supplies, fewer custom officials would be required, and expert or experienced officials could be deployed in fields where their expertise could better be applied. Kogels points out that the popularity of mail-order and online shopping portals will increase the flow of small parcels that cannot be checked adequately by customs, which could lead to distortions in competition for suppliers in local markets.[59] This could be avoided if an RT-VAT system is applied to both tangible and intangible cross-border supplies.

Records of the transaction and VAT collected thereon will be transmitted by the financial institution to the supplier as proof that VAT has been levied and duly paid. In the case of cross-border tangible sales, a print-out of the

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55 Goolsbee & Zittrain 'Evaluating the costs and benefits of taxing internet commerce' *The Berkman Center for Internet and Society Research* (1999) publication no 1999–03 5/1999 18 at: http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/1999-03.pdf (last accessed 3 January 2013); Lamensch n 4 above at 16.

56 *Ibid*.

57 *Ibid*.

58 Bentley n 29 above at 19.

59 Kogels 'VAT @ e-commerce' (1999) 8/2 *EC Tax Review* 122.

VAT record must be included in the package to prevent unintended double taxation at border posts.

It is recommended that an RT-VAT collection model must be applied to both cross-border tangible and intangible trade to offset the cost of implementation and to ensure its constant viability through periods where tangible trade is preferred to intangible trade and vice versa.

Objections and concerns

No data to process transaction

While it has been established above that financial institutions are better equipped (than suppliers) to identify and locate their customers when they facilitate payment in cross-border transactions, financial institutions are not equipped to tax the transaction in accordance with the local tax rules applicable to the transaction.[60] That said, because of technological advances, the gathering of information in order to tax a transaction is no longer limited to the supplier of the goods or services.[61] In jurisdictions where multiple VAT rates apply, the financial institution would require data reflecting the value of the supply, the type of supply, and the recipient's VAT status.[62]

Value of the supply

Determining the value of the supply would depend on the data received from the supplier. In the absence of a tax evasion scheme between connected persons, the purchase price would, generally, constitute the value of the supply. Since payment to the supplier is limited to the purchase price submitted to the financial institution, suppliers are likely to submit the actual amount they require to make the supply. The purchase price can be substantiated by means of an invoice.

Type of supply

In order to apply the correct VAT rate, a taxable entity is required to classify the type of supply correctly. This is an onerous task, especially in the absence of clear definitions.[63] Save for facilitating payment, financial

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60 Basu n 37 above at 12; Hinnekens 'An updated overview of the European VAT rules concerning electronic commerce' (2002) 11/2 *EC Tax Review* 71.

61 Lamensch n 23 above at 87.

62 Ligthart n 4 above at 15; Basu n 37 above at 12; Jenkins 'VAT and electronic commerce: the challenges and opportunities' (1999) 10/1 *International VAT Monitor* 5.

63 For a complete discussion see van Zyl *The collection of Value Added Tax on online cross-border trade in digital goods* (2013) (unpublished LLD thesis UNISA) paras 3.4.7 and 4.3.7.

institutions are not involved in the supply chain. Burdening financial institutions with the task of classifying the type of supply would require industry-specific data and expert knowledge of the VAT system applicable to the supply. In a highly competitive market, suppliers could submit false product descriptions to best suit the customer's needs as regards VAT rates. Neither financial institutions, nor revenue authorities, has the capacity to verify that the final supply and its description match. Such an investigation would require an extensive extraterritorial audit. Even in the absence of an underlying tax evasion scheme, financial institutions would find it difficult to classify the type of supply based purely on the product description submitted by the supplier. Furthermore, the financial institution cannot rely on the classification by the supplier, as the classification in the country of supply and the country of consumption could differ dramatically. Financial institutions, too, may for other reasons such as conflict of laws, be reluctant or unable to act against suppliers who fail to provide the necessary classification. Financial institutions could refuse to do further business with these suppliers – but that is not an ideal outcome for the either the bank or the supplier.

Basu suggests that an international uniform product classification should be developed.[64] But who would develop this uniform product classification data base, and would it be enforceable in all jurisdictions? Basu further suggests that the uniform product classification system should operate on a standardised coding formula.[65] Under this system all stakeholders in the supply chain, including revenue authorities, would apply a uniform standardised code assigned to products in accordance with their classification.[66] Should this system be applied, financial institutions would not be burdened with the task of classifying supplies.

> **Example 1:** X (a South African resident) orders an e-book from Y (an American supplier) and submits his credit card details to Y. Y submits the price and internationally unified code for electronic books to the credit card company to facilitate payment. The credit card company identifies X as a South African resident from the information available on their database. Based on the unified code submitted to it, the system further links the supply to the applicable VAT rate and duly debits X's account with the purchase price and South African VAT.

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64 Basu n 37 above at 4, 8–9.
65 *Ibid*.
66 Bentley n 29 above at 18.

In jurisdictions that apply multiple VAT rates, Basu's suggestion creates an opportunity for suppliers and customers to engage in tax evasion schemes. For example, where an e-book is taxed at 0 per cent in the customer's country of residence and computer software is taxed at twenty per cent, a supplier and customer can collude to submit the unified code for e-books when, in fact, computer software is being supplied. As with the self-assessment mechanism, the classification of goods by suppliers relies on the suppliers' good faith – although to a much lesser extent.[67] It should further be noted that the problem of tax evasion schemes similar to the one in this example, is not restricted to online transactions. There are no economic arguments that support nonsensical rate differentiation.

Moreover, the suggestion of a unified coding system requires greater international cooperation and sophisticated software or changes in the suppliers' and financial institutions' systems.[68] In cases where an international code has not been assigned to a particular product or service, but where the VAT rules in the country of consumption provide for the taxation of the transaction in question, additional changes to the payment system would be required to facilitate the transaction. This can be done by a dropdown list of classifications to which a country specific code has been assigned.[69] However, this system would constantly need to be adapted and amended to provide for new technologies, new services, and new categories of supply. This could negatively impact on its application.

Lamensch suggests that the financial institution should not be burdened with the task of classifying and taxing the transaction.[70] While this view should be supported, it should also be noted that revenue authorities would be far keener to burden banks (and not suppliers) with this duty. The main reason is that there are fewer banks which are easier to monitor, than millions of suppliers worldwide.[71] Lamensch further suggests that the supplier must submit both the value and the amount of tax to the financial institution.[72] The financial institution would, therefore, merely act as a tax collection agency. However, this suggestion raises certain issues. In order for the supplier to submit the value and the tax to the financial institution, it must be able to locate the supplier to calculate VAT at the rate applicable in the jurisdiction

67 Lamensch n 23 above at 90.
68 *Ibid*.
69 Bentley n 29 above at 19.
70 Lamensch n 23 above at 89.
71 Lamensch n 4 above at 16.
72 Lamensch n 23 above at 89.

of consumption. To establish the location with accuracy, the supplier would have to rely on the customer's location information as established by the financial institution. Disclosure of the customer's location to the supplier raises serious privacy issues in the hands of the financial institution, resulting in the suggestion being largely un-implementable.

Further issues that need to be resolved include whether the financial institution would be liable for penalties for incorrect taxation based on incorrect product classification;[73] whether a customer would have a right of recourse against the financial institution for incorrectly collecting VAT on the transaction;[74] and whether a customer would be entitled to a VAT refund on transactions incorrectly taxed.[75]

Recipient's VAT status

Based on the findings in the discussions in Part 1, it can be concluded that the majority of observers are of the view that cross-border B2B digital transactions should be exempted from VAT. This conforms to the international practice that VAT should be levied at consumption. However, this practice would require financial institutions (as VAT collectors) to determine the customer's VAT registration status to enable them to levy VAT at the correct rate. It could be argued that financial institutions can rely on the VAT status information supplied to them by the customer, or base their conclusion on the information available in their customer database. However, consumers can manipulate transactions to comply with their

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73 In terms of section 59(1)(*g*) of the VAT Act 89 of 1991, a person who knowingly issues any tax invoice, credit note, or debit note under the Act which is in any material respect erroneous or incomplete, commits an offence. Where the bank acts *bona fide* no penalties can be raised. It should, however, be noted that the different countries are free to provide for penalties in domestic VAT legislation.

74 Where a customer institutes the claim against the bank, the customer would likely succeed where the claim is based on delict or breach of contract, provided that the requirements for these claims are present and can be proved. See, eg, *Nedbank v Pestana* (142/08) [2008] ZASCA 140 (27 November 2008). The non-customer would base his or her claim on delict. In limited cases, provided that the requirements of the respective enrichment claims are present and can be proved, the non-customer would likely succeed in a claim for enrichment. To avoid unnecessary litigation, we suggest that a customer's right of recourse against the bank be limited or excluded.

75 Section 44(2)(*a*) of the VAT Act 89 of 1991 provides any person who has paid any amount of tax, additional tax, penalty, or interest in excess of the amount of tax, additional tax, penalty, or interest that should have been charged, may apply for a refund. Where the bank has charged VAT on the transaction incorrectly, either because of an incorrect product classification or any other reason, the recipient of the imported services may apply for a refund of the VAT incorrectly levied and collected. Also see Stiglingh (ed), Koekemoer, Van Schalkwyk, Wilcocks & De Swardt *Silke: South African income tax* (2013) at 1012.

taxing needs by submitting false VAT registration numbers (or using the VAT number of a registered VAT vendor) resulting in the avoidance of VAT. Even in cases where the VAT number can be verified by means of an integrated system linked to the revenue authority's taxpayer database, it would in some cases be difficult to verify if the vendor is who he claims to be. It could be argued that where the customer's personal information stored in a financial institution's database, and the personal information stored in a revenue authority's database differ, it can be assumed that the customer is not a registered VAT vendor. This would, however, not always be the case as the vendor could trade under one name for VAT purposes, but effect international payment under another name or from another account not linked to its business account.

Such an integrated system would require sophisticated software and a change in both systems. In addition, privacy issues would prevent revenue authorities from divulging the taxpayer's personal information to financial institutions.[76] Therefore, even in cases where the systems are fully integrated, the financial institution would, at best, be able to verify the existence of the VAT number supplied.

Under a credit system, financial institutions would not be required to verify the taxpayer's status. All transactions are taxed in real-time when payment is facilitated, irrespective of the customer's tax status. Where, because of the customer's tax status, the transaction qualifies for exemption or zero rating, the customer can claim VAT levied and paid in real-time as input credits. Under a credit system, VAT collection by financial institutions can be simplified, VAT fraud issues eliminated, and the taxpayer's privacy can be ensured.

Sophisticated software / change in systems required

A dominant concern associated with real-time tax collection by financial institutions, is that it would require sophisticated software and a change in banking systems that must be integrated or linked to other systems.[77] Developing and regularly updating the required software is costly.[78] Ainsworth points out that major technological advances in trade, spur the

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[76] In terms of section 6 of the VAT Act 89 of 1991 and sections 67 and 68 of the Tax Administration Act 28 of 2011, the disclosure of a taxpayer's tax or personal information is strictly prohibited.

[77] Ligthart n 4 above at 15; Basu n 37 above at 3–4.

[78] Ligthart n 4 above at 15; Basu n 37 above at 3–4.

need for technology-orientated reforms of VAT systems that are efficient and have revenue maximising potential.[79] A natural concomitant of technology-orientated tax collection systems is the development of sophisticated software. Consequently, a change in systems and the development of sophisticated software is an unavoidable requirement for the development of an efficient VAT collection mechanism for cross-border digital trade.

RTPay®, a non-profit organisation, constantly develops real-time VAT collection software for governments.[80] These systems are designed to offer the most efficient, cost effective, and fraud-proof methods of tax collection.[81] The system is swift and simple to implement, and requires minimal upfront capitalisation from revenue authorities.[82]

In the light of the availability of real-time VAT software systems, the argument that VAT collection by financial institutions would require the costly development of sophisticated software does not stand up to close scrutiny.

Additional costs involved

Under the registration and reverse-charge models, the taxable entity (the entity tasked to collect VAT) generally carries the administrative cost of collecting VAT on behalf of revenue authorities.[83] Where the taxable entity develops systems to simplify the VAT collection and remittance burden, the taxable entity bears the cost of development and implementation of these systems.[84] Some observers have proposed that this general practice cannot be applied in the case of VAT collection by financial institutions.[85] It is suggested that the cost of developing and implementing an integrated real-time collection system should be borne by revenue authorities as it is the *fiscus* that will ultimately benefit from the implementation.[86]

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79 Ainsworth & Madzharova n 5 above at 22.

80 http://www.rtpay.org/sample-page/ (last accessed 9 January 2013).

81 Williams n 18 above at 1–2.

82 *Ibid*.

83 Baron 'The OECD and consumption taxes: part 2' (2001) 3/10 *Tax Planning International E-commerce* 7.

84 *Ibid*.

85 Ligthart n 4 above at 14; Basu n 37 above at 18; Baron n 83 above at 7; Harley 'VAT and the digital economy: how can VAT evolve to meet the challenges of e-commerce' (1999) 1/10 *Tax Planning International E-commerce* 11.

86 Ligthart n 4 above at 14; Basu n 37 above at 18; Baron n 83 above at 7; Harley n 85 above at 11.

The collection of VAT necessarily involves additional administrative costs for financial institutions for which they would expect to be compensated.[87] Some observers suggest that financial institutions should be compensated for their services.[88] The proposed compensation rates should be negotiated and paid for on a 'per transaction' basis in the form of a transactional fee.[89] This could lead to a differentiation between taxable entities under a real-time VAT system, and taxable entities under the current registration and reverse-charge systems. Lighart points out that a real-time VAT system will not be viable if financial institutions are not compensated for their services.[90] We should not be surprised if the legislator simply burdens banks with the duty, without compensating them for the additional administrative burden. The banks, in turn, will undoubtedly recoup their costs from their customers by way of increased transaction fees and other bank charges.

It is trite that banks would be reluctant to assume a VAT collection duty voluntarily if there is no prospect of profit or compensation for their services. That said, the viability of a real-time VAT collection system is not dependent on the compensation and voluntary cooperation of financial institutions. Therefore, the absence of a compensation prospect only negatively affects the attractiveness of real-time VAT collection from the financial institutions' perspective. The cost of VAT collection under the registration and reverse-charge models is generally recovered from consumers by increasing profit margins or the implementation of an administration or convenience fee. In our view the viability or 'attractiveness' of a real-time VAT collection model lies not in the compensation for collection services as such, but in the right to recover collection and administrative costs. To avoid a differentiation between tax collectors under a real-time VAT collection model and the registration and reverse-charge models, we suggest that financial institutions should be permitted to charge customers a transaction or convenience fee for facilitating an international payment and processing, collection, and remittance of taxes due on the transaction. This would be in line with the current SARS practice of charging a valuation and transaction fee on imported goods. To avoid exorbitant fees, revenue authorities should

87 Lamensch n 4 above at 16.
88 Ligthart n 4 above at 14; Basu n 37 above at 18; Jennings n 16 above at 258.
89 Basu n 37 above at18; Jennings n 16 above at 259.
90 Ligthart n 4 above at 14.

develop a rate structure based on transaction values and frequencies. This rate structure should be legislated and reviewed annually.

Debt collection risk

The South African VAT Act[91] provides that where a VAT vendor has made a supply on credit on which VAT has been duly collected and remitted, and where the debt has subsequently become irrecoverable, the vendor may claim an input VAT deduction on that portion of the irrecoverable amount which constitutes VAT.[92] In order to claim an input VAT deduction, three requirements must be met:

- the vendor must have made a taxable supply for which payment in money is deferred to a future date payable either as a once off future payment or in instalments;
- VAT must have been levied on the supply and the vendor must have furnished a VAT return in respect of the tax period for which output VAT on the supply was payable, and have properly accounted for VAT on the supply;[93]
- the vendor must have written off the amount of the outstanding debt that has become irrecoverable.[94]

In the case of VAT collection by financial institutions, where the financial institution has extended credit (for example, overdraft facilities) to the customer in facilitating the payment, the financial institution can in principle finance the VAT it is required to levy on the value of the supply. Where the credit so extended has become irrecoverable, the financial institution would not be able to make an input VAT deduction under section 21 of the VAT Act for that part of the irrecoverable debt that constitutes VAT. This is chiefly because the financial institution did not make a supply in the ordinary course of business for which payment is deferred to a future date. The granting of credit to facilitate payment, even if the payment constitutes the payment of taxes, constitutes a financial service which is exempted from VAT.[95] The question arises whether the provision in section 21 should be extended to financial institutions that act as statutory VAT collection agents under a real-time VAT collection model?

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91 Act 89 of 1991.
92 Section 21(1) of the VAT Act 89 of 1991.
93 Section 21(1)(*b*) of the VAT Act 89 of 1991.
94 Section 21(1)(*c*) of the VAT Act 89 of 1991.
95 Section 12(*a*) read with the deeming provision in s 2(1)(*f*) of the VAT Act 89 of 1991.

Where a bank extends credit to a customer to enable the customer to pay personal taxes and the customer fails to repay the bank, the bank can only recover the amount outstanding from the customer (debtor) or its sureties. It is well established in common law that the outstanding debt cannot be recovered from the third party to whom the initial payment was made by the customer. The question is whether this should be distinguished from the position where the bank has collected taxes on behalf of the *fiscus* by extending credit to the customer and the customer has failed to repay this credit. Where credit is granted to enable the customer to pay personal taxes, the customer voluntarily wishes to use the loan/credit to settle outstanding taxes. This is no different from the case where the customer applies the loan to make payments to any other third party. In the case where credit is granted to facilitate an international payment of services for which the bank is obliged to collect VAT on the value of the supply, the customer does not voluntarily apply the funds to pay taxes. Yet, the customer can, after he has become aware of the fact that the bank will levy VAT on the transaction, decide to continue or abandon the transaction. The bank can, as where the customer voluntarily applies for credit to pay personal taxes, approve or reject the customer's application for credit. The bank, therefore, grants credit entirely at its own risk. In most cases the granting of credit to facilitate the payment of VAT will be clear from the transaction itself; but not invariably so. The system must, therefore, make provision for an 'alert' function to inform the financial institution when the overdraft or credit facility is being used to pay VAT on a transaction. The granting of credit to facilitate VAT payment under a real-time VAT model remains a financial service which is exempted from VAT. Despite a statutory duty (as proposed by the RT-VAT model) to collect VAT on the transaction, financial institutions may refuse to facilitate the payment of the supply in the case of insufficient funds to cover both the value of the supply and taxes. The argument that the risk of irrecoverable debt is shifted from the *fiscus* to the financial institution under a real-time VAT collection model, therefore, is without basis. A financial institution which extends credit to a customer to facilitate VAT payment under a real-time VAT collection model, should, in principle, not be entitled to recover VAT so collected as an input VAT credit where the debt has become irrecoverable.

Privacy

Global legislative trends show that the protection of personal data has become a basic human right which may only be infringed upon under exceptional circumstances. People generally place a high premium on their

personal information and privacy, and therefore require third parties and professionals who deal with their personal information do so in confidence.[96] The right to privacy is furthermore enshrined in the Constitution of the Republic of South Africa, 1996, which provides that:

> Everyone has the right to privacy, which includes the right not to have
> a. their person or home searched;
> b. their property searched;
> c. their possessions seized; or
> d. the privacy of their communications infringed.[97]

Banker-customer confidentiality

Banking services originated in temples during the Ancient Period and it was, in the main, performed by priests representing various deities.[98] This infused banking services with a holy and mystical aura.[99] It has become customary that one of the most important aspects of acting as a banker, is to maintain customer confidentiality.[100]

In South Africa, banking secrecy was first recognised in *Abrahams v Burns,*[101] and is traditionally protected by the contractual relationship between the banker and its customer.[102] In the case of breach of the banker-customer confidentiality relationship, the customer can seek recourse through delictual or contractual remedies.[103] As is the case in the United Kingdom, in South Africa the banker's duty to maintain secrecy is not a statutory duty but a customary duty that has found its way into the contract of mandate.[104] This duty of confidentiality forms part of the tacit *naturalia*

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96 Faul *Grondslae van die beskerming van die bankgeheim* (unpublished LLD thesis, Rand Afrikaans University (1991)) 1.

97 Section 14 of the Constitution of South Africa, 1996.

98 Faul n 96 above at 4; Faul *Bankgeheimnis: 'n regsvergelykende studie met die oog op die hervorming van die Suid-Afrikaanse reg* (1986) 6; Willis *Banking in South African law* (1981) 5.

99 Faul n 96 above at 4; Faul n 98 above at 6; also see the rise of the goldsmiths in Willis n 98 above at 8–9.

100 Faul n 96 above at 4; *Stevens and Others v Investec Bank Ltd and Others* (2012/32900) [2012] ZAGPJHC 226 (25 October 2012) par [10].

101 *Abrahams v Burns* 1914 CPD 452 456.

102 Faul n 96 above at 321; Faul n98 above at 314; Van Jaarsveld n 23 above at 587; Schulze 'Confidentiality and secrecy in the bank-client relationship' (2007) 15/3 *Juta's Business Law* 122; Willis n 98 above at 24, 39–41.

103 Faul n 96 above at 321; Faul n 98 above at 314; Willis n 98 above at 40.

104 Faul n 96 above at 321; Faul n 98 above at 314; Van Jaarsveld n 23 above.

of the contract between bank and customer.[105] The customer's right to have his personal affairs kept confidential, is, accordingly, not an absolute right.[106] Various incidences exist where a bank is (under certain circumstances) required by statute to furnish third parties with information relating to the transactions or other personal data of its customers.[107] In *Tournier v National Provincial & Union Bank of England,*[108] the court ruled that a number of exceptions exist in terms of which the banker's duty of secrecy cannot be relied upon. In these cases, the banker is relieved of its duty of secrecy and either has a duty, or is permitted, to disclose information about the affairs of its customer.[109] These exceptions can broadly be classified as:

- where the disclosure is required by law;
- where disclosure is in the public interest;[110]
- where the disclosure is in the interest of the bank;[111] and
- where the disclosure is made with the customer's express or implied consent.[112]

In *First Rand Bank Ltd v Chaucer Publications (Pty) Ltd and Others,*[113] it was held that for considerations of public policy, the relationship between a bank and its customer must be confidential.[114] Equally, for considerations of public policy, this duty is subject to the greater public interest.[115] Traverso DJP, made the important ruling that where information which merely confirms the existence of a customer's bank account at a certain bank, was obtained from a third party and not from the bank, there is no violation of the

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105 Schulze n 102 above at 122; *George Consultants and Investments (Pty) Ltd and Others v Datasys Ltd* 1988 (3) SA 726 (W) 736; *Densam (Pty) Ltd v Cywilnat (Pty) Ltd* 1991 (1) SA 100 (A) 109.

106 *Abrahams v Burns* n 101 above at 456; *Stevens and Others v Investec Bank Ltd and Others* (2012/32900) [2012] ZAGPJHC 226 (25 October 2012) par [11]; Van Jaarsveld n 23 above at 587; Willis n 98 above at 40–41.

107 *Stevens v Investec Bank* n 106 above at par [11].

108 *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461.

109 Schulze n 102 above at 122.

110 This would be the case where danger to the state or the public at large supersedes the duty of an agent to his principle. See *Stevens v Investec Bank* n 106 above.

111 This would be the case where the bank has instituted a legal claim against a defaulting customer and the disclosure relates to the outstanding debt. See *Densam v Cywilnat* n 105 above at 110–111; *George Consultants and Investments v Datasys* n 107 above at 737.

112 For example, in cases where a customer applies for credit at another institution and authorises the bank to disclose the information that is required in respect of the credit application.

113 *First Rand Bank Ltd v Chaucer Publications (Pty) Ltd* 2008 (2) SA 592 (C).

114 *Id* at par [20].

115 *Id* at par [20].

banker's duty of secrecy.[116] The mere publication of the fact that a person is a customer of a specific bank cannot infringe the right of privacy of either the bank or the customer, as envisaged in section 14 of the Constitution.[117] Schulze, however, points out that the banker-customer relationship, being an agreement of mandate, necessarily entails that the mandatory may well have a duty to protect the confidentiality of the affairs of the mandator.[118] On this basis, a bank would have legal standing to prevent third parties from publishing the fact that a certain person banks or deals with a certain bank.[119]

In recent years the legislature has passed various pieces of legislation that could potentially infringe on the banker's duty of confidentiality towards the customer. This is especially evident in respect of the collection of taxes. For purposes of this study, the discussion will be limited to cases where disclosure is required by law for VAT purposes.

Statutory duty to disclose information

The Commissioner, or any officer of SARS, may for the purposes of administering the VAT Act[120] in relation to any vendor, require the vendor or any other person to furnish such information, documents, or things as the Commissioner or officer may require.[121] Section 57A does not indicate who the 'any other person' is for purposes of the section, or whether such person must have a business or other relationship with the taxpayer. Therefore, given its ordinary meaning, a bank would qualify as 'any other person' for purposes of section 57A. The Commissioner can, as a result, require a bank to furnish him or her with any information held by the bank in respect of its customer that the Commissioner may find will assist him in administering the VAT Act. Section 57A has been repealed and, with effect from 1 October 2012, has been replaced by section 46(1) of the Tax Administration Act.[122] In terms of section 46(1), SARS may require any person to furnish it with information relating to a to a person identified in name or otherwise objectively identifiable taxpayer, which it may require.[123]

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116 *Id* at par [20].
117 *Id* at par [24].
118 Schulze n 102 above at 125.
119 *Ibid*.
120 Act 89 of 1991.
121 Section 57A of the VAT Act.
122 Act 28 of 2011.
123 Section 46 further provides that: '(1) A senior SARS official may require relevant material in terms of subsection (2) in respect of taxpayers in an objectively identifiable class of taxpayers. (3) A request by SARS for relevant material from a person other than the taxpayer is limited to the records maintained or that should reasonably be maintained

Croome opines that a citizen who embarks upon a business venture assumes certain obligations, one of which is to comply with the tax laws of the country.[124] The Commissioner has the responsibility of gathering taxes so that the government can function properly and finance social and welfare programmes.[125] Should the bank furnish the Commissioner with information in terms of section 57A of the VAT Act or section 46 of the Tax Administration Act, relating to transactions entered into by its customers, or in respect of any other personal information of the customer, the bank would not be in breach of its duty of secrecy.[126] It would merely be in compliance with national tax laws, the same laws to which the citizen, who started the business venture, is subject. Governments the world over take defensive steps to protect their revenue against the erosion of the tax base.[127] This is simply another price we have to pay for living in a complex society.

Statutory collection agent

Before the promulgation of the Tax Administration Act, the so-called 'agency appointment' provision in section 47 of the VAT Act provided that:

> The Commissioner may, if he thinks necessary, declare any person to be the agent of any other person, and the person so declared an agent shall for the purposes of this Act be the agent of such other person in respect of the payment of any amount of tax, additional tax, penalty or interest payable by such other person under this Act and may be required to make payment of

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by the person in relation to the taxpayer. (4) A person receiving from SARS a request for relevant material under this section must submit the relevant material to SARS at the place and within the time specified in the request. (5) SARS may extend the period within which the relevant material must be submitted on good cause shown. (6) Relevant material required by SARS under this section must be referred to in the request with reasonable specificity. (7) A senior SARS official may direct that relevant material be provided under oath or solemn declaration. (8) A senior SARS official may request relevant material that a person has available for purposes of revenue estimation.'

124 Croome *Taxpayer's rights in South Africa* (2010) 129.

125 *Ibid*.

126 Schulze argues that section 74A of the Income Tax Act (now repealed), cannot be applied to banks to compel them to disclose their customer's information upon request of the Commissioner. His statement is based on the fact that section 74A neither creates an express duty on banks to comply, nor does it require any objective basis of reasonable suspicion in order for the Commissioner to invoke section 74A. In essence, section 74A can easily be abused as a 'fishing expedition' into the affairs of the taxpayer. Similar objections can be raised against section 57A of the VAT Act and section 46 of the Tax Administration Act. It should, however, be noted that for the Commissioner to require information to compile an estimate assessment of the taxpayer's earnings, no evidence or basis of suspicion is required: see Schulze n 102 above at 122.

127 Cockfield 'Designing tax policy for the digital biosphere: how the internet is changing tax laws' (2002) 34/2 *Connecticut Law Review* 333.

> such amount from any moneys which may be held by him for or due by him to the person whose agent he has been declared to be: Provided that a person so declared an agent who, is unable to comply with the requirement of the notice of appointment as agent, must advise the Commissioner in writing of the reasons for not complying with that notice within the period specified in the notice.[128]

The collection of taxes by an appointed agent in terms of section 47 can only be done in respect of taxes, penalties, or interest due to SARS that exist at the time of appointment of the agent. Put simply, the taxpayer and the amounts due must be known to SARS before an agent can be appointed to collect such amounts. In addition, the agent must be appointed by way of written notice. A financial institution cannot be appointed to collect future taxes (on a per transaction basis similar to a real-time tax collection model) from its customer.

Section 47 has been repealed and replaced by section 179 of the Tax Administration Act[129] with effect from 1 October 2012. Section 179(1) provides that:

> A senior SARS official may by notice to a person who holds or owes or will hold or owe any money, including a pension, salary, wage or other remuneration, for or to a taxpayer, require the person to pay the money to SARS in satisfaction of the taxpayer's tax debt.

In contrast to the notice in terms of section 47 of the VAT Act, the notice in terms of section 179(1) of the Tax Administration Act may be delivered to the collection agent in electronic format accompanied by a statement reflecting the taxpayer's personal information, taxes due, and the amount required to be paid to SARS.[130]

Where the agent so appointed cannot collect the money in terms of the notice, it must inform the senior SARS official of its inability to comply with the notice (and reasons therefor) within the period specified in the notice.[131] The person (agent) who fails to pay the money in terms of the notice will be

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128 Section 99 of the Income Tax Act 58 of 1962 provides for similar provisions in respect of taxes, interest, and penalties owed to SARS in terms of the Income Tax Act.

129 Act 28 of 2011.

130 Le Roux & Van der Walt 'Third party appointments by SARS under the Tax Administration Act' (2013) 38 *Tax Talk* 16.

131 Section 179(2) of the Tax Administration Act.

held personally liable.[132] The collection of monies in terms of section 179(1) relates only to existing taxes, penalties, and interest owed to SARS. In contrast to the notice under section 47 of the VAT Act, the notice in terms of section 179(1) of the Tax Administration Act is not limited to the taxpayer's funds which the agent holds or to which he has access at the time of the issuing of the notice, but extends to future funds until the debt in terms of the notice has been settled.

Under both section 47 of the VAT Act and section 179 of the Tax Administration Act, the appointed agent is prevented from informing the taxpayer of the agent's obligation in terms of the notice to prevent the taxpayer from moving funds.[133] This secret withdrawal of funds and their subsequent remittance to SARS, would not be in breach of the bank's duty of secrecy, provided that it was carried out in terms of the financial institution's statutory obligation under the written notice. This was confirmed in *Hindry v Nedcor Ltd & Another*[134] where Wunsch J compared the application of section 99 of the Income Tax Act[135] to a garnishee order, and further ruled that a bank is in the same position as any other of the taxpayer's debtors.[136] Section 99 serves as a civil judgment against the taxpayer, and the bank, as is the case with any other debtor, is obliged to pay the monies demanded in terms of the order.[137] This is a duty that cannot be altered by the bank's duty of secrecy towards its customer.[138]

In *Nedbank v Pestana,*[139] the court was called upon to decide whether a bank may legally (or has a duty to) reverse an earlier transaction for the transfer of funds from a customer's bank account where a notice in terms of section 99 of the Income Tax Act has been issued on the bank. *In casu,* the customer instructed a branch of the main bank to transfer funds from his account. A few minutes earlier, a notice under section 99 of the Income Tax Act[140] in respect of the customer, had been issued on the bank at its head office. Nedbank contended that the instruction from the customer to transfer the funds was given with the intention of defrauding either SARS or the bank.

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132 Section 179(3) of the Tax Administration Act.
133 Le Roux & Van der Walt n 130 above at 16.
134 *Hindry v Nedcor Ltd and Another* 1999 (2) SA 757 (W).
135 Act 58 of 1962.
136 *Hindry v Nedcor* n 134 above at 773.
137 *Id* at 770; *Nedbank v Pestana* n 74 above at 140; *Nedbank v Pestana* 2009 (2) SA 189 (SCA) par [11].
138 Van Jaarsveld n 23 above at 592; Schulze n 102 above at 125.
139 *Nedbank v Pestana* n 74 above.
140 *Ibid*.

On this basis, Nedbank argued, it was legally entitled to reverse the transfer. The court held that the branch which had been instructed to make the transfer and which had no knowledge of the notice at the time, may not, and is not legally obliged to, reverse the previous transaction to fulfil its duties in terms of the section 99 notice.[141] Consequently, an instruction from a customer to transfer funds may only be reversed where the mandate to the bank has a decidedly suspicious ring to it,[142] or where it has been given in the furtherance of the commission of a crime.[143] A mere speculation on facts is not sufficient.[144] Schulze, however, opines that this does not mean that any other competent court may rule that in certain circumstances, a credit transfer can be reversed, and that a credit transfer is not generally an unconditional and final juristic act – especially where there has been fraud on the part of either the transferor or the transferee.[145]

Invasion of privacy by the financial institution

Financial institutions are concerned that a statutory duty to collect taxes on transactions entered into by their customers may result in an invasion of the customer's right to privacy. According to Ainsworth and Madzharova, it is unlikely that a real-time VAT collection model would comply with international privacy laws.[146] This is in part because the bank would be required to obtain information in respect of the transaction which the customer could consider private. However, the financial institution would generally be unaware of the exact particulars of the underlying transaction.[147] The bank would only have access to the limited information to enable it to identify the general type of transaction from the transaction code or description, the parties to the transaction, and the relevant revenue authority to which the payments are due.[148] Consequently, the intricacies of the transaction, or the relationship between the customer and the supplier,

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141 *Nedbank v Pestana* n 75 above at par [15].

142 Schulze is of the opinion that the available facts from the *Pestana* case have a decidedly suspicious ring to them, in that Mr Pestana instructed the transfer of the money from his account with the intention of defrauding SARS or Nedbank. See Schulze 'Electronic fund transfers and the bank's right to reverse a credit transfer: one big step (backwards) for banking law, one huge leap (forward) for potential fraud: *Pestana v Nedbank* (Act one, scene two)' (2008) 20/3 *SA Merc LJ* 296; Schulze 'A final curtain call, but perhaps not the last word on the reversal of credit transfers : *Nedbank Ltd v Pestana'* (2009) 21/3 *SA Merc LJ* 400.

143 *Nedbank v Pestana* n 74 above at par [10].

144 *Ibid*.

145 Schulze n 142 above at 401.

146 Ainsworth & Madzharova n 5 above.

147 Bentley n 29 above at 19; Ainsworth n 17 above at 232.

148 Bentley n 29 above at 19.

would remain private information. This is no different from any other transaction for which the financial institution facilitates payment on behalf of the customer. This can be illustrated by way of an example.

> **Example 2**: Where the customer uses a bank card as payment instrument at a supplier (both conventional or over the Internet), the supplier and the customer's identity, as well as a general description of the goods purchased or services rendered, would be revealed to the financial institution to enable it to execute the customer's order to make the payment effectively. The general product or service description is revealed to the financial institution for record keeping purposes. Without this information the financial institution would not be able to execute the customer's order to pay.

A real-time VAT collection model raises privacy concerns in respect of section 14(d) of the Constitution in so far as the customer's communication with the supplier is disclosed to the financial institution. Nevertheless, the information transmitted between the supplier and the financial institution, constitutes the necessary sharing of information in the ordinary course of businesses to enable the financial institution to make the payment as it was instructed to do by its customer. The transmission of information would be in line with what the customer consented to when it instructed the financial institution to make the payment – as in example 2 above.

In *Bernstein and Others v Bester and Others NNO*,[149] Ackermann J explained the meaning of 'privacy' as:

> ...an individual condition in life characterised by seclusion from public and publicity. This implies an absence of acquaintance with the individual or his personal affairs and this state. [ ] The unlawfulness of a (factual) infringement of privacy is adjudged in the light of contemporary *boni mores* and the general sense of justice of the community as perceived by the Court.[150]

Ackermann J further explained that:

> Privacy is acknowledged in the truly personal realm, but as a person moves into communal relations and activities such as business and social interaction, the scope of personal space shrinks accordingly.[151]

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149 *Bernstein and Others v Bester and Others NNO* 1996 (2) SA 751 (CC).
150 *Id* at par [68].
151 *Id* at par [67].

Where a person opens a bank account with a financial institution, and subsequently enters into a business transaction which requires the bank to make certain payments on his behalf, that person's right to privacy is limited in the interests of business efficacy. Similarly, where the financial institution transmits information pertaining to the transaction to SARS in terms of a statutory duty, the customer's right to privacy will not be infringed upon. This is chiefly because the customer, when he entered into the transaction, subjected himself, through the operation of law (although in many cases involuntarily), to the country's tax laws and therefore, in effect, consented through his conduct.

Multiple payment systems

Despite the popularity of credit cards as a payment method, various forms of digital cash or electronic money are increasingly being used as payment methods.[152] Since these payment methods are not executed through the financial institution with which the customer banks, they cannot be tracked and traced by the financial institution burdened with tax collection. However, at least some of these new methods do require a formal affiliation or relationship with a bank – for example, credit and debit transfers (including EFTs), and even electronic money in the form of an electronic wallet, can be traced to the original possessor of the wallet because these can at present (at least in South Africa) only be obtained through a bank. Further, one must have a bank account with a particular bank before it will issue an electronic wallet. Money-laundering considerations will prevent a bank from issuing electronic wallets on the payment of a cash sum by the applicant. In some jurisdictions it is possible to buy an electronic wallet from entities other than banks. This is not, at the time of writing, possible in South Africa. Thus, at present, all electronic wallets issued in South Africa are issued through the intervention of banks, which will inevitably involve the positive identification of the applicant for the card, as well as his address, details, et cetera. Subsequent payments made by that card can, therefore, be linked to the original applicant. Electronic wallets are, of course, freely transferable from the original applicant for the card to subsequent possessors of the card. This increases the potential for tax avoidance or jurisdiction shopping.[153]

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[152] For a discussion of the advent of digital cash and electronic money, see Volker *Essential guide to payments* (2013) 253–262.

[153] Bentley n 29 above at 20.

Two possibilities exist to overcome this issue. The electronic cash system could be linked to the RT-VAT system allowing it to identify and locate the customer, calculate the applicable VAT, and deduct it from the customer's electronic cash balance.[154] Alternatively, electronic cash can be taxed *ex ante* – as is done in the case of single-purpose vouchers as proposed by the European Commission.[155] To avoid double taxation, the tax status of the payment voucher should be revealed to the supplier. The issuer of the voucher or e-cash would be required to account for VAT in the jurisdiction where the customer resides. It should, however, be noted that the RT-VAT system is designed to cope with multi-purpose vouchers and e-cash, and it is likely to be more effective than the current (EU) system.[156]

Bentley suggests a third option. The electronic cash system could act as a mere notification tool that informs the customer's financial institution of the date, value, and type of transaction.[157] This would enable the financial institution to collect the applicable taxes from the customer's account *ex post facto*.[158] This would not be possible where the electronic wallet (to mention but one example) has been transferred from one person to another. The model further requires closer cooperation between the e-cash provider and the financial institution. The fraud potential, privacy issues, and cooperation requirements render this model infeasible. In addition, the financial institution could effectively be required to extend credit to the customer in the case of insufficient funds to collect and remit VAT.

Some form of electronic payment or payment method that leaves a transaction record is required for the RT-VAT system to be effective. Cash transactions would not be detected and taxed by the RT-VAT system.[159] Escaping the VAT net by means of cash payments and the failure to keep

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154 *Ibid*.

155 Soete & Ter Weel *Globalization, tax erosion and the internet* (1998) 24 at: http://arno.unimaas.nl/show.cgi?fid=331 (last accessed 19 February 2013). European Commission *Draft proposal a Council Directive Amending Directive 2006/112/EC on the Common System of Value Added Tax, as regards the treatment of vouchers* (2012) available at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/legislation_proposed/com(2012)206_en.pdf (last accessed on 11/11/2014); also see Van Zyl 'The VAT treatment of vouchers: a comparative study between South Africa and the European Union' (2013) XLVI/2 *CILSA* 245–250.

156 Jennings n 16 above at 258.

157 Bentley n 29 above at 20.

158 *Ibid*.

159 *Id* at 25; Ainsworth & Madzharova n 5 above at 22; Wohlfahrt n 17 above at 394; Jennings n 17 above at 258; Lamensch n 4 above at 15.

records of the transaction is not restricted to e-commerce transactions.[160] The parties can also enter into a barter agreement to escape the application of the RT-VAT system.[161] However, barter transactions and cash payments are rare in cross-border e-commerce.[162]

In South Africa, the use of credit cards and electronic fund transfers (EFTs)[163] are increasingly popular as payment methods to replace traditional cheque and cash payments.[164] Yet, the volume of credit card payments is relatively small compared to that of EFT transactions.[165] This could probably be attributed to strict credit extension regulations and a general perception that credit card transactions are unsafe and expensive.

Greater international cooperation required

The implementation of an international classification code system as discussed above, requires significant international consensus. In addition, international standards and licensing of financial institutions burdened with collecting VAT under a RT-VAT system must be established. Uniform software – such as the existing RT-VAT system – must be applied by all participating revenue authorities, financial institutions, and suppliers to ensure smooth and continuous operation. Bentley argues that it would only require a few large and influential countries to adopt an RT-VAT system that would set the standards and requirements for developing countries to follow.[166] That said, jurisdictions that fail to apply the uniform international standard would not be excluded from the market. The inefficiencies of traditional tax collection mechanisms and an increasing loss in revenue, could convince the majority of tax authorities to adopt a uniform standard under a RT-VAT system.

In some cases, additional bilateral or multilateral agreements between jurisdictions will have to be negotiated to avoid double taxation or unintended under-taxation.[167] This would be the case where one jurisdiction applies the origin-base taxation model, and the other jurisdiction applies the

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160 Williams n 50 above at 231; Ainsworth n 17 above at 232.
161 Bentley n 29 above at 25.
162 Lamensch n 4 above at 15.
163 The term includes the payment by electronic bank card, electronic transfers settled among banks but excludes credit card transactions and intrabank transactions.
164 South African Reserve Bank (2014) Mar 271 *Quarterly Bulletin* S–13.
165 *Ibid*.
166 Bentley n 29 above at 24.
167 Bentley n 29 above at 23.

destination-base taxation model. In most cases, these bilateral and multilateral agreements already exist between major trading jurisdictions in respect of tangible goods. The application of the agreements can merely be extended to include intangible goods. In practice, almost all the jurisdictions apply the destination principle for cross-border transactions.[168]

Unlike other tax collection models that require a regional or international clearing house, or confer extraterritorial powers on tax authorities, the RT-VAT system allows each jurisdiction to recover VAT within its borders and in accordance with domestic VAT rules.[169] Save for standardised international classification codes and licensing standards, the operation of the RT-VAT system requires minimal cooperation between revenue authorities in different jurisdictions.

CONCLUSION

International trends show that tax collection by third party intermediaries is increasingly being introduced in countries where cross-border trade and employment are on the increase.[170] This is particularly evident in Latin American countries which increasingly apply withholding tax mechanisms as a VAT collection tool.[171] The implementation of withholding tax mechanisms in terms of which a third party (financial institution) is burdened with the withholding duty, is a common modern taxing trend among developing countries. Similar trends have recently been introduced in South Africa.[172] However, collection by third party intermediaries will inevitably result in costs to banks. Banks will pass these on to their customers. In a country such as South Africa where there is a high percentage of 'unbanked' citizens, and where bank costs are already amongst the highest in the world, the affordability of burdening low income bank customers with even higher bank costs, must be questioned.

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168 Lamensch 'OECD draft guidelines on VAT/GST on cross-border services' (2010) 21/4 *International VAT Monitor* 272.

169 Bentley n 29 above at 25.

170 Ainsworth & Madzharova n 5 above at 11.

171 *Ibid*.

172 In terms of section 37I of the Income Tax Act 58 of 1962 any person who pays interest to or for the benefit of a foreign person must withhold the tax from that payment except in circumstances where the interest or the foreign person is exempted from tax. Section 37I came into operation on 1 July 2013. Similarly, in terms of section 49E, any person making payment of any royalty to or for the benefit of a foreign person must withhold 15 per cent tax from that payment. Section 49E came into operation on 1 July 2013.

VAT collection under an RT-VAT system complies with the OECD's principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. It affects only existing collection and reporting rules that already apply to all forms of commerce.[173]

The development of technology and software by RTpay®, eliminates most of the objections that were raised against VAT collection by financial institutions. The issue of privacy and the banker's duty of secrecy remain the chief objections to an RT-VAT system. This obstacle can be overcome by the development and implementation of a statutory duty on financial institutions to collect VAT on behalf of SARS through a withholding tax mechanism implemented by an RT-VAT system. However, since RTpay® remains to be tested, the successful integration of the software with that of financial institutions and revenue authorities is speculative.

Cross-border digital trade is a fully-fledged electronic trading, and often automated, phenomenon. The execution of these transactions requires no or minimal human intervention. It therefore follows that the taxation of cross-border digital transactions should preferably be effected electronically and with minimal human intervention. A withholding tax mechanism by financial institutions through the implementation of an RT-VAT system, offers this possibility. The implementation of the RT-VAT system should be considered as a matter of urgency in cases where the registration and reverse-charge mechanisms are found to be ineffective tax collection models.

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[173] Bentley n 29 above at 25.