Notes and comments

The OECD international VAT/GST guidelines on cross-border trade in digital goods – new developments since the Ottawa Conference (1998) on Restoring Tax Neutrality

1 Introduction

Taxation of e-commerce is a global issue that cannot be resolved by adopting Value Added Tax (VAT) rules with extra-territorial powers in the absence of international treaties. Furthermore, where jurisdictions modernise their VAT rules in isolation and without having regard to international trends and inter-jurisdictional relationships, the modernisation is set for failure. The Organisation for Economic Co-operation and Development (OECD) is an international body that concerns itself with the promotion of policies that will improve the social and economic well-being of people around the world. It provides a forum for governments to work together, share experiences, and seek solutions to common problems. One of its various areas of research is the taxation (more specifically consumer taxes) on cross-border trade in services and intangibles.

The OECD traditionally promotes tax reform in the international income arena through the implementation of and commentary on its model tax treaty.[1] Generally, apart from the Canada-USA treaty, no model treaty or bilateral agreement exists that covers VAT.[2] Since the rise of e-commerce in the late 1990s, a need for tax reform in the field of VAT has gained support among OECD members.[3] As a result, the OECD pursued its mandate to promote reform efforts for VAT. The OECD contributes to the efficient design and operation of VAT systems through policy analysis and advice.[4] It further

---

[1] Cockfield 'The rise of the OECD as informal world tax organization through national responses to e-commerce tax challenges' (2006) 8 *Yale Journal of law and Technology* 148.
[2] Cockfield n 1 above.
[3] Cockfield n 1 above.
[4] http://www.oecd.org/ctp/consumptiontax/articlesonvat.htm (accessed 28 November 2014).

develops international VAT/Sales tax guidelines as an international standard for cross-border trade to minimise the risk of double taxation or under-taxation.[5] These guidelines are based on the principles of a 'good tax' namely neutrality, efficiency, legal security, simplicity, equity, and flexibility.[6]

Following the Ottawa Conference on e-commerce in 1998, the OECD's Committee on Fiscal Affairs (CFA) adopted the *Guidelines on Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-commerce*[7] which was endorsed by the *Consumption Tax Guidance Series.*[8] It has, however, become clear that the problems associated with the application of VAT on the supply of intangible goods are, in the main, rooted in the remaining differing approaches in certain jurisdictions. This has exacerbated the possibility of double taxation and under-taxation.[9] As a result, in January 2006, the CFA adopted a set of basic principles for the development of the OECD *International VAT/GST guidelines*.[10] The development of the guidelines is a long-term project that aims to cover a broad spectrum of cross-border trade VAT issues.[11] At the second meeting of the Global VAT Forum,[12] chapters two and three of the *OECD International VAT/GST guidelines* were adopted as the first internationally agreed framework for applying national VAT rules to cross-border transactions.[13]

In the discussion that follows I critically discuss the *OECD International VAT/GST guidelines* with specific reference to the developments of the OECD proposals since the Ottawa Conference in 1998. This will be achieved by addressing the following issues –

- The neutrality of VAT/GST rules in the context of cross-border trade in intangibles.
- Determining the place of supply for purposes of computing VAT/GST on cross-border supply of services and intangibles.

---

[5]Note 4 above.
[6]Van der Merwe 'VAT and e-commerce' (2003) 15(3) *SA Merc LJ* 389.
[7]OECD *Guidelines on consumption taxation of cross-border services and intangible property in the context of e-commerce* (2001) http://www.oecd.org/tax/consumptiontax/5594831.pdf (accessed 12 November 2012).
[8]OECD *What are the OECD international VAT/GST guidelines?* (2010) 3 available at http://www.oecd.org/tax/consumptiontax/48077011.pdf (accessed 28 November 2014).
[9]Note 8 above.
[10]Note 8 above.
[11]Note 8 above 4.
[12]The second meeting of the Global Forum on VAT was held in Tokyo on 17-18 April 2014. OECD *Global forum on VAT* (2014) available at http://www.oecd.org/ctp/consumption/vat-global-forum.htm (accessed 26 November 2014).
[13]Note 11 above.

- Problem areas in respect of cross-border trade in intangible for which the OECD has not provided adequate guidance.

2 The neutrality of VAT/GST in the context of cross-border trade in intangibles

2.1 The concept of tax neutrality

The term 'tax neutrality' is a relatively modern concept. Most tax publications in discussing the canons of good taxation[14] often confuse the concept of 'equity' with 'tax neutrality'.[15] Tax neutrality, in the case of VAT, is a multi-dimensional concept. It includes, *inter alia,* the absence of discrimination in a tax environment based on impartiality, the elimination of undue tax burdens, and the eradication of an inappropriate compliance burden and cost.[16]

2.1.1 Guideline 2.1

In domestic trade, tax neutrality is generally achieved through the multi-stage payment system.[17] As VAT is a consumption tax, the consumer of goods and services must bear the ultimate tax burden. Guideline 2.1 echoes this principle in stating that the burden of VAT should not lie on taxable business except where explicitly provided for in legislation.[18] In other words, the business, as taxable entity, should be able to recover the taxes from its customers when it makes subsequent supplies for final home consumption. In the case of business-to-business (B2B) cross-border transactions, guideline 2.1 cannot be applied in the light of tax treaties which govern the type of supply. The result is that the business carries the VAT burden in that it cannot recover the VAT paid as an input deduction. Alternative measures are required to ensure tax neutrality.[19] The OECD, however, does not provide any guidelines on these alternative measures.

Circumstances under which legislation can specifically provide for the burden to be placed on the business include, but are not limited to –

---

[14]The canons of a good tax were first published by Adam Smith in 1776 in *An inquiry into the nature and causes of the wealth of nations.* According to Smith, a good tax must comply with the principles of equality, certainty, convenience, and economy.

[15]Groves 'Neutrality in taxation' (1948) 1 *National Tax Journal* 18.

[16]OECD *International VAT/GST guidelines* (2014) 10. joernaal is 2013

[17]Under the multi-stage payment system, each vendor pays VAT to its suppliers on its inputs and receives VAT from their customers on the output supplies. Neutrality is ensured by allowing each vendor to set-off against their output VAT liability, the input VAT paid. In that, the VAT liability is transferred to the consumer who ultimately bears the tax burden.

[18]OECD (2014) n 16 above 10.

[19]OECD *OECD international VAT/GST guidelines: Draft commentary on the international VAT neutrality guidelines* (2012) 4 and 7 available at http://www.oecd.org/ctp/consumptiontax /50667035_ENG.pdf (accessed 28 November 2014).

- Where the transactions made by the business are exempt because the tax base of the outputs is difficult to assess (in the case of financial services), or for policy reasons (in the case of health care and education or domestic passenger transport).[20] For example, where a supplier of financial services acquires computer software, it has to account for output VAT on the import in terms of the main rule, but would not be entitled to claim an input VAT deduction because the supply is not acquired to make taxable supplies.[21] The business would, furthermore, not be able to collect VAT from its customers as it makes exempt supplies. In other words, the business carries the VAT burden.
- Where the full input deduction is not allowed because of the nature of related transactions.[22] This would be the case where the related transactions fall outside the scope of VAT (no consideration paid), or where the supplies are not wholly applied in the furtherance of the taxable business activities.[23]
- Where input blocks are provided to balance the application of a lower VAT rate where goods can either be embedded in a product or bought separately at different rates.[24]
- Where input deductions are disallowed because explicit administrative requirements were not adhered to.[25] For example, where insufficient evidence is submitted to support the tax deduction.[26]

It should be noted that the VAT burden not only relates to the financial burden of carrying the cost of VAT, but the cost of recovering foreign VAT creates an additional burden on businesses.[27] While guideline 2.1 recognises that jurisdictions may legitimately place a VAT burden on vendors, legislation so providing should be clear, transparent, and the cost of compliance should be kept to the minimum.[28] Legislation providing for a tax burden on vendors should not only comply with guideline 2.1, but it should meet the requirements

---

[20] OECD (2014) n 16 above 10.

[21] In terms of the definition of 'imported services' in section 1 of the South African VAT Act 89 of 1991, the tax burden, in the case of imported services, lies with the importer (business or individual) insofar as the imported services are not utilised and consumed in the furtherance of an enterprise and in the making of taxable supplies.

[22] OECD (2014) n 16 above 11.

[23] OECD (2012) n 19 above 8.

[24] Note 23 above.

[25] OECD (2014) n 16 above 11.

[26] Note 25 above.

[27] Taxand *Taxand responds to OECD discussion draft on international VAT neutrality guidelines* (2012) available at http://www.taxand.com/files/u12/rality_Guidelines_-_26-9-2012_VMWT-1498-3309.pdf (accessed 28 November 2014).

[28] OECD (2014) n 16 above 16.

of all five guidelines on neutrality.[29] Absent that, the legislative provisions do not comply with the requirements of tax neutrality. Some observers recommend that the OECD develop further guidelines to minimise the additional burden on businesses.[30] Where the business customer would be entitled to recover output VAT for which it must account on imports in terms of the reverse-charge mechanism, the OECD recommends that jurisdictions should consider dispensing with the self-assessment method.[31] Simply put, where the business customer applies the imported intangibles in the course and furtherance of an enterprise (in the making of taxable supplies), it should not be required to account for output VAT upon import, and simultaneously recover VAT as inputs. The supplier will only account for output VAT when it makes further taxable supplies to consumers (from whom VAT will be collected) or where the supplies acquired are not applied to make further taxable supplies.

The VAT Act[32] provides that vendors can, subject to exceptions and exclusions, claim an input VAT deduction on supplies acquired in the course and furtherance of their enterprise.[33] In the case of imported services in terms of the use-and-consumption principle, the recipient vendor of imported services has to account for VAT only on the imported services that are not applied by it in the course and furtherance of an enterprise.[34] The use-and-consumption principle relies on the vendor's *bona fide* interpretation of what constitutes 'in the course and furtherance of an enterprise'. Non-disclosure of imported services that are not applied in the course and furtherance of an enterprise, cannot be detected and ultimately escape the VAT net.

In contrast, where the supplier accounts for VAT on every import and simultaneously claims an input VAT deduction, revenue authorities have better control and the risk of VAT fraud or under taxation is reduced. This can be detected if the amount of input VAT deductions significantly or continuously exceeds the amount of output VAT on sales.[35] To eliminate VAT fraud, the European Commission proposed that in the case of cross-border

---

[29]Note 28 above.
[30]Taxand n 27 above.
[31]OECD *International VAT/GST guidelines* (2006) http://www.oecd.org/ctp/36177871.pdf (accessed 24 August 2012).
[32]Act 89 of 1991.
[33]Section 16 read with ss 17 and 18 of the VAT Act 89 of 1991.
[34]Definition of 'imported services' in s 1 of the VAT Act 89 of 1991.
[35]Alfredo 'Applying VAT to international trade-the challenge of economic globalisation: The challenge for tax administrations' *First meeting of the OECD Global Forum on VAT* (2012) 54 http://www.oecd.org/ctp/consumptiontax/PptpresentationsessionmaterialGFonVAT.pdf (accessed 5 December 2012).

trade, the reverse-charge mechanism as currently applied in the Netherlands, should find general application.[36] Under this system, the recipient vendor of imported services must account for VAT on the supplies, irrespective of whether or not the supplies are applied in the furtherance of the enterprise.[37] The supplier will immediately be entitled to an input VAT deduction. Despite the additional administrative burden, VAT fraud and unintended mistakes can easily be detected.

However, in cases where the supplier for some or other reason cannot claim an input VAT deduction or cannot recoup the VAT from its customers, it will carry the burden of VAT and tax neutrality is distorted.

2.1.2 Guideline 2.2

Guideline 2.2 dictates that businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation.[38] The main aim behind this guideline is to achieve similar levels of taxation.[39] It should, however, be noted that this goal is recognised in respect of (a) businesses in similar situations that carries out (b) similar transactions.[40] In the absence of any one of these criteria, the guideline serves no purpose.

In determining the similar level of taxation, the final tax burden needs to be considered.[41] Businesses with the full right to deduct input tax should not bear the tax burden, irrespective if they acquired the intangibles in making taxable supplies internationally or domestically.[42] Furthermore, a business that does not have the full right to deduct input tax should be prevented from incurring irrecoverable tax in two or more jurisdictions.[43] A ‘similar situation’ does not necessarily equate to an evaluation of businesses within the same or similar industries but rather as an expression of the business’s right to deduction. For example, a bank that has limited rights to deduct input tax cannot be compared to a business that has a full right to claim input tax. Similarly, a business that applies intangibles in making taxable supplies cannot be compared to a business that applies the same intangibles in making exempt supplies.

---

[36]European Commission ‘Green paper on the future of VAT: Towards a simpler, more robust and efficient VAT system’ (2010) 695 final COM 8 available at http://eur-lex.europa.eu/Lex UriServ/LexUriServ.do?uri=COM:2010:0695:FIN:EN:PDF (accessed 21 January 2015).
[37]Note 36 above.
[38]OECD (2014) n 16 above 11.
[39]OECD (2014) n 16 above 17.
[40]Note 39 above.
[41]Note 39 above.
[42]Note 39 above.
[43]Note 39 above.

The test to determine 'similar transactions' is to determine the characterisation of the type of supply within a particular jurisdiction or jurisdictions.[44] It is well-known that some jurisdictions apply general characterisation rules to a broad spectrum of supplies while other jurisdictions provide a single tax treatment for a number of well-defined single characterisation supplies. For example, automated online education without any human intervention is characterised and taxed as electronically supplied services in the EU.[45] In contrast, in South Africa, online education is characterised and taxed as electronic services irrespective if the education so provided is automated or through human intervention.[46] The South African vendor that acquires online educational services from an institution registered in South Africa, and in the making of exempt supplies, will not pay VAT on the online educational supplies. This is because educational services are exempt.[47] On the other hand, the South African vendor that acquires online educational services from a foreign registered institution, and in the making of exempt supplies, will pay VAT on the online educational supplies. As the vendor makes exempt supplies, it cannot claim an input VAT deduction. Neutrality is, for that reason, not achieved.

2.1.3 Guideline 2.3

This guideline provides that VAT rules should be framed in such a way so as not to be the primary influence of business decisions.[48] It is well-known that various factors can influence business decisions. In a healthy economic environment, businesses should not make decisions primarily based on VAT rules. VAT consideration is not limited to rate consideration only. The administrative and cost burden of establishing in a foreign jurisdiction could be significant.[49] In many cases, the cost of compliance in the case of nominal value supplies would outweigh the benefit of international establishment.[50] Discrimination created by specific rules applicable to foreign vendors should, ideally, not be disguised as compliance with these specific rules.[51] To

---

[44]OECD (2014) n 16 above18.
[45]Annexure L to Council Directive 2002/38/EC.
[46]Regulations prescribing electronic services for the purpose of the definition of 'electronic services' in section 1 of the Value-Added Tax Act, 1991
[47]Section 12(*h*) of the VAT Act.
[48]OECD (2014) n 16 above 18.
[49]OECD *Report by the technology technical advisory group* (2000) 56 available at http://www.oecd.org/tax/consumptiontax/1923248.pdf (accessed 1 December 2014); Baron 'The OECD and consumption taxes: Part 2' (2001) 3(10) *Tax Planning International E-Commerce* 10.
[50]OECD (2000) n 49 above 56.
[51]Charlet and Buydens 'The OECD's draft guidelines on neutrality for value added taxes' (2011) 61(6) *Tax Notes International* 447.

further/comply with the neutrality principle, VAT rules should be accessible, clear, and consistent.[52] A case in point is the requirement of foreign suppliers of electronic services to register as VAT vendors in South Africa where the supplier supplies electronic services to a person resident in South Africa, or, where payment originates from a South African bank.[53] For these suppliers the administrative burden could pose significant. First, costly once-off changes in the invoicing system are required to reflect (a) the term 'tax invoice'; (b) the name, address, and VAT registration number of the vendor; (c) an individual serialised number and date on which the invoice is issued; (d) a description of the services supplied; and (e) the consideration of the supply and the amount of VAT expressed as fourteen per cent of the value of the supply.[54] Second, frequent filing of tax returns and the transfer of VAT from a foreign bank account to SARS's South African bank account will both be frustrating and costly.[55] Third, the foreign supplier has to identify the customer as a resident of South Africa or confirm that payment originates from a South African bank for it to levy South African VAT. Various methods of locating the customer's residence can be applied. However, studies have shown these to be ineffective and costly.[56] I have it on good authority that the registration requirements under the South African VAT Act that applies to foreign suppliers of electronic services has caused prominent international suppliers of digital goods to suspend services to South African residents. The registration requirements seemingly distort the market and neutrality is not achieved.

2.1.4 Guideline 2.4

With respect to the level of taxation, guideline 2.4 dictates that foreign businesses should not be disadvantaged or advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.[57]

---

[52]OECD (2014) n 16 above 11.

[53]Paragraph (vi) to the definition of 'enterprise' in s 1 of the VAT Act, 1991. In terms of s 95(1)(a) of the Revenue Amendment Act 43 of 2014, par (vi) will be amended, with effect 1 April 2015, to read:

> the supply of electronic services by a person from a place in an export country, where at least two of the following circumstances are present:
>
> (*aa*) The recipient of those electronic services is a resident of the Republic;
>
> (*bb*) any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No 94 of 1990);
>
> (*cc*) the recipient of those electronic services has a business address, residential address or postal address in the Republic.

[54]Schneider 'VAT registration of foreign e-commerce suppliers' (2013) 43 *TaxTalk* 29.

[55]Note 54 above.

[56]For a complete discussion on the different methods of customer location tools, see Van Zyl 'The collection of value added tax on cross-border digital trade-part1: Registration of foreign vendors' (2014) 47(2) *CILSA* 176-183.

[57]Van Zyl n 56 above 12.

Most VAT systems are based on the principle of consumption.[58] Since VAT is primarily characterised as an indirect tax on consumption, the destination-based system can be classified as an out and out VAT system. The destination base ensures greater tax neutrality in cross-border transactions.[59] This can be attributed to the fact that imported goods are taxed on par with domestic goods and services.[60] In the case of the origin base, imported goods are taxed in the country of origin. These goods often compete with domestic goods, especially where the foreign VAT rate is lower than the domestic rate. Tax neutrality is not achieved and market distortions occur frequently. Under the destination base, imports are fully taxed either at the border, or in terms of the 'deferred payment' or 'postponed accounting' method commonly referred to as a reverse-charge mechanism.[61] Here imports are taxed at the time of the importer's next periodic VAT return.[62] This allows for the tax free movement of goods and services across borders and international trade is not distorted.[63]

However desirable in theory, problems in applying and administering the destination principle unavoidably occur.[64] As a result, a foreign business may, in certain circumstances, incur a VAT liability in a jurisdiction where it is neither established nor registered. Guideline 2.4 aims to ensure that VAT systems do not encourage or discourage a business from investing or undertaking activities in a specific jurisdiction.[65] Put simply, VAT legislation – or the lack thereof – should neither discriminate nor favour foreign businesses as regards the taxation of transactions and their right to make deductions compared to domestic business.

Prior to the implementation of the registration rules that apply to foreign suppliers of electronic services,[66] foreign suppliers of digital goods to South

---

[58]Go, Kearney, Robinson and Thierfelder 'An analysis of South Africa's value added tax' (2005) *World Bank Policy Research Working Paper* No 3671 2; Doussy *The taxation of electronic commerce and the implications for current taxation practices in South Africa* (2001) 89; Botes 'South African VAT and non-resident business' (2011) 22(6) *International VAT Monitor* 396.
[59]Cnossen 'Design of the value added tax: Lessons from experiences' in Khalilzadeh-Shirazi and Shah (eds) *Tax policy in developing countries* (1991) 73; OECD *International VAT/GST guidelines on neutrality (*2011) 5 available at http://www.oecd.org/tax/consumptiontax/48331948.pdf (accessed 1 December 2014).
[60]Cnossen n 59 above 73.
[61]Ebrill, Keen, Bodin and Summers *The modern VAT* (2001) 177.
[62]Ebrill *et al* n 61 above.
[63]Ebrill *et al* n 61 above.
[64]Ebrill *et al* n 61 above 184.
[65]OECD (2014) n 16 above 12.
[66]Section 165(1) of the Taxation Laws Amendment Act 31 of 2013.

Africa were put at an advantage to domestic suppliers.[67] As the VAT Act[68] relied on the reverse-charge mechanism[69] to collect VAT on imported digital goods, foreign supplies were effectively fourteen per cent cheaper than domestic supplies. To level the playing field, from 1 April 2014, foreign suppliers of electronic services to a recipient resident in South Africa, or where payment was received from a South African bank, must register for South African VAT.[70] As I have pointed out above, the registration model does not seem to remove the market distortions. To the contrary, the differentiation in registration rules between domestic and foreign suppliers now discriminate against foreign suppliers as regards the taxation of transactions and their right to make deductions.[71] While the domestic market is now protected against cheaper imports, international trade is severely hampered by the strict VAT rules. For example, there currently exists no domestic supplier that makes available digital video files of international art-house films. International suppliers such as Amazon, Peccadillo, and Boll, who distribute these films no longer supply to recipients residing in South Africa. My personal account at Amazon has been suspended as a result of the legal requirements in the destination country. Relief mechanisms must be developed specifically for foreign suppliers in such a way that the disadvantage they are put at compared to domestic vendors is eliminated. At the same time, relief mechanisms should not advantage foreign suppliers to the extent that the domestic market is distorted.

2.1.5 Guideline 2.5

As I have mentioned above, while most jurisdictions follow the destination principle, the application of the destination principle does not always ensure

---

[67] SAPA 'Treasury publishes ESR for comments' (2014) *The Citizen* available at: http://citizen .co.za/119348/treasury-publishes-esr-comment/ (accessed 1 December 2014).

[68] Act 89 of 1991.

[69] 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 of 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 and Christian *The value added tax: Orthodoxy and new thinking* (1989) 257-258; Ebrill n 61 above 139-145.

[70] Section 165(1)(*d*) and (*e*) of the Taxation Laws Amendment Act 31 of 2013.

[71] In terms of s 178(1)(*b*) of the Taxation Laws Amendment Act 31 of 2013, foreign suppliers of electronic services must register for South African VAT if their taxable supplies to South Africa exceeds R50 000. In contrast, domestic suppliers are compelled to register for VAT only when their taxable supplies exceed R1 million. Furthermore, foreign suppliers of electronic services registered as such are not allowed to claim input VAT deductions. For a complete discussion see Van Zyl 'The collection of value added tax on cross-border digital trade-part 1: Registration of foreign vendors' (2014) 47(2) *CILSA* 154-186.

that businesses do not incur irrecoverable VAT. To prevent businesses from incurring irrecoverable VAT, guideline 2.5 provides a number of approaches to choose from. These include but are not limited to

- Making supplies free of VAT
- Allowing foreign businesses to obtain a refund through a special scheme
- Allowing foreign businesses to obtain a refund through domestic registration
- Shifting the VAT burden to domestic suppliers who are allowed to recover VAT from customers.
- Granting purchase exemptions certificates.[72]

Each approach has its own merits and a single approach is not preferred above another.[73] Inadequate and inappropriate VAT collection mechanisms in cross-border trade are the main contributors to VAT fraud and the erosion of the tax base.[74] While the OECD proposals on neutrality allow jurisdictions to protect their tax bases, the cost effectiveness of the protecting mechanisms must be taken into account. The objective is to strike a reasonable balance between the cost of processing VAT refunds and the amount of VAT involved.[75] Interestingly, the OECD recommends that a registration system that does not allow refunds – unless taxable supplies are made in the domestic jurisdiction by non-resident vendors – does not meet the neutrality requirement.[76]

Under the registration model that applies in the EU,[77] the non-established taxpayer would not be conducting a full scale enterprise in the EU; as a result, it would not be entitled to make any input VAT deduction in respect of the supplies it makes in terms of the special scheme.[78] Should the taxpayer be of the opinion that it is entitled to a deduction for input VAT, it can apply for a refund of the input VAT paid in accordance with the Thirteenth Directive refund procedure.[79] Bill and Kerrigan correctly point out that the supplier, who merely supplies electronically supplied services to EU consumers, would be

---

[72]OECD (2014) n 16 above 21.
[73]OECD (2014) n 16 above 21.
[74]Alfredo 'Applying VAT to international trade – the challenge of economic globalisation: The challenge for tax administrations' (2012) First *meeting of the OECD global forum on VAT* 54 available at http://www.oecd.org/ctp/consumptiontax/PptpresentationsessionmaterialGFonVAT .pdf (accessed 5 December 2014).
[75]OECD (2014) n 16 above 21.
[76]OECD (2014) n 16 above 21.
[77]See discussion below.
[78]Article 368 of Council Directive 2006/112/EC; art 368 of Council Directive 2008/8/EC.
[79]Article 368 of Council Directive 2006/112/EC; art 368 of Council Directive 2008/8/EC.

unlikely to incur any expenses in the EU in the making of the supplies.[80] The rules are silent on this, but it is presumed that any input deduction to which the supplier would be entitled, would be made in the tax return in the Member State of identification.[81] This could be a lengthy process, depending on the procedure and practice of the country from which the refund is being sought.[82] That said, any refund within the EU would be rare.[83] In contrast, the South African VAT Act does not prohibit a foreign supplier of electronic services from claiming an input VAT deduction where input VAT was incurred in the making of taxable supplies within the Republic.[84] Furthermore, the VAT Act does not prevent such vendors from claiming a VAT refund where inputs exceed outputs. As the foreign vendor is not established in South Africa, input VAT deductions would be limited to the VAT paid on fulfilling the order. VAT incurred in respect of operating the business must be claimed in the country of establishment. This ultimately results in a dual accounting system- one in the country of establishment, and one in South Africa where electronic services are supplied. The cost and administrative burden, as pointed out above, deter suppliers from doing business in South Africa.

2.1.6 Guideline 2.6

In order to protect the tax base it may be necessary for tax administrators to impose specific compliance rules that apply to different categories of business. Guideline 2.6 provides that where such administrative measures are imposed on foreign suppliers, these should not create disproportionate or inappropriate compliance burden on that foreign supplier.[85] Tax authorities should prevent disguising discrimination as mere compliance rules.[86]

As foreign suppliers do not have the same physical presence as domestic suppliers, there is an obvious risk on tax authorities in jurisdictions where

---

[80]Bill and Kerrigan 'Practical application of European value added tax to e-commerce' (2003) 38(1) *Georgia Law Review* 38 80.

[81]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* 1045.

[82]Minor n 81 above; Cervino 'VAT and e-commerce' (2007) 3 *International Tax law Review* 140-141; Fetzer 'Non-EU Businesses to collect VAT on electronic services' (2002) 4(7) *Tax Planning International E-Commerce* 9; De la Feria *The EU VAT system and the internal market* (2006) 110.

[83]Bill and Kerrigan n 80 above 80; Terra and Kajus *A guide to the European VAT directives* (2012) 1037.

[84]It should be noted that during the VAT Roundtable Discussion held on 23 August 2013 in Pretoria, Treasury proposed that foreign suppliers of 'electronic services' should be prohibited from claiming an input VAT deduction. The proposal was not included in the final amendments to the Act. The reason of which is unknown.

[85]OECD (2014) n 16 above 13.

[86]OECD (2014) n 16 above 13.

foreign suppliers operate without a physical presence. As a result, it may be necessary to impose specific compliance requirements where standard compliance measures do not provide adequate protection. Where these specific rules are imposed, the impact on neutrality must be minimised.[87] This can be achieved by developing a simplified registration regime for foreign vendors which includes electronic registration and declaration procedures.[88] Registration in organised regions can be simplified by allowing registration in one jurisdiction only, as applies in the EU.[89] 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 only. VAT should, however, be levied at the rate applicable in the Member State of consumption.[90] 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.[91] 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.[92] In contrast, while the South African VAT act provides for a simplified registration mechanism for foreign suppliers of electronic services, the burden of accounting for VAT and filing VAT returns is no different from

---

[87] OECD (2014) n 16 above 21.

[88] OECD (2012) n 19 above 17; Grandcolas 'VAT on the cross-border trade in services and intangibles' 2007 13(1) *Asia-Pacific Tax Bulletin* 41.

[89] OECD (2006) n 31 above 18.

[90] 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. Also see Minor n 76 above 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 (accessed 4 February 2014); Boullin 'B2C services: Liability for European VAT' (2003) 4(7) *World Internet Law Report* 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/ (accessed 5 Feb 2014); Brandt and Juul 'EU VAT rules on electronically supplied services' (2005) 7(10) *Tax Planning International: European Union Focus* 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* 773; Jackson 'EU VAT: Quo vadis?' (2011) 62(13) *Tax Notes International* 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* 312; 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* 7.

[91] Article 358(1) of Council Directive 2006/112/EC; art 358a(1) of Council Directive 2008/8/EC.

[92] Article 358(3) of Council Directive 2006/112/EC; art 358a(2) of Council Directive 2008/8/EC.

that of domestic suppliers. Furthermore, the slim-line registration in the EU effectively provides for a one-stop-shop in a region consisting of 28 tax jurisdictions.[93] Registration under the South African VAT Act grants the supplier access to South Africa only. In my view, the VAT Act fails to strike the balance between protecting the tax base and preventing unnecessary discrimination. In the absence of a true slim-line or regional registration process, the administrative burden, in most cases is not only costly, but near impossible to overcome. This is especially true for small and medium enterprises trying to establish themselves internationally.

3 Application of the OECD neutrality guidelines in international trade in intangibles: determining the place of supply

3.1 Neutrality ensured by the destination principle

At the 1998 OECD Ministerial Conference in Ottawa, the OECD ministers endorsed the proposal that VAT, being a consumption tax, should be levied in the jurisdiction of consumption.[94] Taxation at the place of consumption ensures tax neutrality and eliminates double taxation and unintended non-taxation of consumption.[95] As a result, the ministers proposed that, in the case of cross-border electronic commerce, VAT should be levied in the jurisdiction of consumption.[96] They further proposed that consensus should be sought on circumstances under which supplies are to be held to be consumed in a jurisdiction.[97]

It was soon realised that these broad criteria would be impossible to implement as each jurisdiction of consumption would have to be identified.[98] In most cases

---

[93] At the time of writing the 27 Member States consisted of Austria (1995); Belgium (founder); Bulgaria (2007); Croatia (2013); Cyprus (2004); Czech Republic (2004); Denmark (1973); Estonia (2004); Finland (1995); France (founder); Germany (founder); Greece (1981); Hungary (2004); Ireland (1973); Italy (founder); Latvia (2004); Lithuania (2004); Luxembourg (founder); Malta (2004); Netherlands (founder); Poland (2004); Portugal (1986); Romania (2007); Slovakia (2004); Slovenia (2004); Spain (1986); Sweden (1995); United Kingdom (1973).

[94] OECD *Electronic Commerce: Taxation framework conditions* (1998) 5 available at http://www.oecd.org/tax/consumptiontax/1923256.pdf (accessed 19 November 2014).

[95] Hellerstein 'Jurisdiction to tax income and consumption in the new economy: A theoretical and comparative perspective' (2003) 38 *Georgia Law Review* 16; Horner and Hardy 'The OECD work on taxation and e-commerce' (1998) Introductory issue *Tax Planning International E-Commerce* 27.

[96] OECD (1998) n 94 above 5.

[97] OECD (1998) n 94 above 5; Scheer 'Electronic commerce and VAT: The European view (1999) 10(3) *Journal of International Taxation* 17.

[98] OECD *Report by the Consumption Tax Technical Advisory Group* (2000) Annexe II 4 available at http://www.oecd.org/tax/consumptiontax/1923240.pdf (accessed 8 December 2014); Lamensch 'OECD draft guidelines on VAT/GST on cross-border services' (2010) 21(4) *International VAT Monitor* 272; Grandcolas n 83 above 40.

the place of consumption cannot be determined with absolute accuracy at the time of conclusion of the agreement, and the supplier would require insight into the consumer's ultimate use of the product to establish the place of consumption.[99] The Technical Advisory Group (TAG) team proposes a less accurate, but more workable, test to establish the place of consumption for each transaction.[100] These proposals are endorsed in the *International VAT /GST guidelines.* These guidelines have been developed to reflect the destination principle while at the same time ensuring that international neutrality is maintained, compliance rules are kept simple, clarity and certainty are provided for both businesses and revenue authorities, compliance and administration costs are minimised, and barriers to combat tax evasion and avoidance are firm.[101] In correctly applying the destination principle it is important to distinguish between business-to-business (B2B) and business to consumer (B2C) transactions. As a result, the guidelines discussed below are discussed with this distinction in mind.

3.1.1 Guideline 3.1

Guideline 3.1 is the quintessence of the destination principle. It provides that, for VAT/GST purposes, internationally traded services or intangibles should be taxed in accordance with the tax rules in the jurisdiction of consumption.[102] Determining the place of consumption is often difficult. For example, a consumer based in South Africa purchases software from a supplier in the Netherlands, he downloads the software from a location in Dubai and finally uses the software in India. In the absence of a close business-customer relationship or tracking service of some sort, it will be impossible for the supplier to determine the exact place of consumption.

Generally, in the B2B context the destination principle is fulfilled by shifting the taxing rights to the jurisdiction where the business is deemed to use the supply in making a taxable supply.[103] This ensures that the supply is taxed in the jurisdiction where the services or intangibles are consumed. The non-resident business recipient is identified as the taxable person in the jurisdiction of consumption, or the person or entity that is required to register for VAT under national laws, or is otherwise identified as a taxable person or entity.[104] The business presence is the establishment (headquarters, registered office, or branch) of the recipient to which the supply is made.[105]

---

[99]Hellerstein n 95 above 16; Lamensch n 93 above 272.
[100]OECD (2000) n 93 above.
[101]OECD (2014) n 16 above 23.
[102]OECD (2014) n 16 above 24.
[103]OECD (2014) n 16 above 24.
[104]OECD (2001) n 7 above 1.
[105]OECD (2001) n 7 above.

Determining the business customer's business presence or place of establishment in the absence of an established relationship between the supplier and the recipient, could prove difficult.[106] The TAG team proposes that existing contracts and normal commercial practices should be applied to locate the place of establishment.[107] In other words, the contract information or information gathering mechanisms applied in normal business practices should be used to locate the customer's place of establishment. This method relies on the honesty and the integrity of the customer to provide the correct information. Unlike the European system, the OECD proposal does not require the supplier to verify the VAT/GST registration status of the customer. Under the South African VAT Act, a foreign supplier of electronic services is not required to distinguish between business and non-business recipients. Put differently, the VAT registration status of the recipient need not be verified. However, locating the jurisdiction of consumption remains a challenge. In order to overcome difficulties, proxies may be developed to determine the jurisdiction of use.[108]

3.1.2 Guideline 3.2

To give effect to guideline 3.1 in respect of B2B transactions, the jurisdiction in which the business customer is located reserves the right to tax the transaction.[109] Generally, a business that orders intangibles from another jurisdiction uses the intangibles in the making of taxable supplies in the jurisdiction where it is located or established. When the business recipient makes subsequent supplies to the final consumer it is required to levy VAT. Consequently, when these supplies are consumed by final consumers, neutrality is restored. In the case of B2B transactions the OECD recommends that the tax burden be carried by the recipient business in terms of the reverse-charge mechanism.[110] Generally, in the case of B2B supplies, the recipient business is a registered VAT vendor in the country of consumption. In these cases the reverse-charge mechanism is more effective because authorities can verify and enforce compliance without difficulty.[111] That said, where the recipient business is not a registered vendor in the country of consumption, the reverse-charge mechanism relies on the integrity of the recipient to declare and

---

[106]Hellerstein n 95 above 51.

[107]OECD *Commentary on place of consumption for Business-to-Business supplies (Business Presence)* 3 available at http://www.oecd.org/tax/consumptiontax/5592717.pdf (accessed 10 December 2014); Lamensch n 98 above 273.

[108]OECD (2014) n 16 above 24.

[109]OECD (2014) n 16 above 25.

[110]OECD (2014) n 16 above 31.

[111]OECD (2006) n 31 above; OECD (2008) *Applying VAT/GST to cross-border trade in services and intangibles: Emerging concepts for defining place of consumption* at 7 http://www.oecd.org/tax/consumptiontax/39874228.pdf (accessed 5 December 2012).

pay VAT which could result in reduced effectiveness. Similarly, where the recipient business is a tax exempt entity (exempted from levying output VAT on the making of supplies), the reverse-charge mechanism is an ineffective tax collection model since it would mainly rely on the honesty and integrity of the tax exempt entity to complete tax returns. The tax exempt entity would still be required to account for VAT on the consumption of imported services and intangibles.

South Africa, Canada, and a few other countries apply the reverse-charge mechanism in both B2B and B2C transactions. In terms of the South African model, reporting is required on a transactional basis. Where the foreign supplier of electronic services is either not required to register for VAT or the transaction, for some reason, was not taxed adequately, the reverse-charge mechanism applies. Tax compliance under the reverse-charge mechanism in the case of B2C transactions is generally considered low. It is generally accepted that the self-assessment procedure is more effective in the case of imports by VAT vendors.[112] Statistics, nevertheless, show that tax compliance among individuals has increased since 1994.[113] It may be argued that this could be as a result of stricter income tax collection mechanisms and a general fear of SARS by individuals.[114] The fear of a tax audit with possible penalties and interest resulting from non-compliance is known to coerce taxpayers into submitting regular and timeous tax returns.[115] This fear is incited by the fact that SARS has certain mechanisms in place to cross check information supplied by taxpayers. For example, payments received by one taxpayer can be verified by information supplied by the issuer of the payment. However, these verifying mechanisms can seldom be applied in e-commerce transactions which are characterised by anonymity and a general lack of a paper trail such as invoicing. The coercion-theory is, as a result, ineffective in collecting VAT on cross-border e-commerce transactions. Taxpayers generally adopt the attitude that 'What SARS does not know about, SARS cannot tax'.[116] A relatively small number of taxpayers are diligent, and believe that they have a moral obligation towards the government they voted for and believe in.[117]

---

[112]Doernberg and Hinnekens *Electronic commerce and international taxation* (1999) 350-352.
[113]Charalambous *Magashule describes South Africa's Tax compliance trends* (2012) available at http://www.thesait.org.za/news/93631/Tax24.mobi-Daily-News-Magashule-Describes-South-African-Tax-Complian.htm (accessed 18 March 2013].
[114]Misra *The impact of taxpayer education on tax compliance in South Africa* (2004) MCom Thesis UKZN 9-11 available at http://researchspace.ukzn.ac.za/xmlui/bitstream/handle/10413/2505/Misra_Roshelle_2004.pdf?sequence=1 (accessed 18 March 2013).
[115]Misra n 114 above.
[116]Misra n 114 above.
[117]Misra n 114 above.

During the proposal stage in the amendment of the Japanese consumption tax laws to provide for the taxation of cross-border digital transactions, many observers pointed out that the inherent difficulties of implementing and enforcing a reverse-charge mechanism on B2C and B2B transactions where the business customer is a tax exempt entity, results in the reverse-charge mechanism being an ineffective tax collection model.[118] Nevertheless, the application of the reverse-charge mechanism in both B2B and B2C transactions cannot be summarily dismissed as an inappropriate and ineffective tax collection tool. The effectiveness thereof should continuously be assessed in the light of available and developing technology.

3.1.3 Guideline 3.3

As I have mentioned above, determining the customer's identity is onerous at best. Guideline 3.3 suggests that the customer's identity should be established by reference to the business agreement.[119]

In the case of high value transactions, the supplier is likely to have an established relationship with the customer and the VAT/GST registration status and location of the customer would be known to the supplier.[120] No additional verification of status or location should be required in these cases. Should the customer route the supplies to a location other than the location known to the supplier, the supplier should not be required to trace the supply to the actual place of consumption. In these cases the existing business agreement would be relied on to identify and locate the customer.[121] A business agreement is not restricted to a written legal contract between the parties, but includes general correspondence, service delivery agreements, invoices, purchase orders, payment instruments, and delivery notes.[122] It is, therefore, not desirable for jurisdictions to draw up a restrictive list of what should be included in a business agreement to safely rely on the information

---

[118]Uneki 'Proposed VAT amendments affecting software downloads' (2013) *International Law Office* available at http://www.internationallawoffice.com/Newsletters/Detail.aspx?g=e76d15bd-6c45-4e8d-a87b-5949e82687f8&utm_source=ILO+Newsletter&utm_medium=email&utm_campaign=Corporate+Tax+Newsletter&utm_content=Newsletter+2013-02-15 (accessed 18 February 2013).

[119]OECD (2014) n 16 above 31.

[120]OECD *Verification of customer status and jurisdiction* 2 available at http://www.oecd.org/ctp/consumptiontax/5574687.pdf (accessed December 2014); Buydens, Holmes and Owens 'Consumption taxation of e-commerce: 10 years after Ottawa' (2009) 54(1) *Tax Notes International* 62.

[121]OECD *OECD international VAT/GST guidelines: International trade in service and intangibles: Public consultation for on draft guidelines for consumer location* (2010) 8-9 available at http://www.oecd.org/ctp/consumptiontax/44559751.pdf (accessed 28 November 2014).

[122]OECD n 121 above 9.

obtained there as an identification and location tool.[123] Business agreements cannot be interpreted in isolation, and surrounding agreements, documents, or circumstances can also be consulted.[124]

Where no prior relationship exists, private customers (final consumers) may have a financial incentive if they declare that they are registered vendors or businesses.[125] In these cases customer declarations are not reliable.

The VAT Act does not provide any guidance or proxies to assist the foreign supplier of electronic services to determine the customer's location. A foreign vendor who incorrectly locates a customer and fails to levy South African VAT on the transaction could be subject to a severe understatement penalty.[126]

3.1.4 Guideline 3.4

Where the business customer has establishments in multiple jurisdictions, the taxing rights vests in the jurisdiction(s) where the establishment using the services or intangibles are located.[127] Revenue authorities the world over use different approaches to identify which of the customer's establishments is the entity that uses the internationally acquired intangibles in its business operations. The OECD has adopted three broad categories which will now be discussed.

Direct use

Under this approach the taxing rights are allocated in the jurisdiction where the customer establishment is regarded as using the supplies.[128] This approach relies on an existing business agreement where both the supplier and recipient are aware of where the intangibles will be applied to make taxable supplies. This method relies entirely on the honesty and the integrity of both the supplier and the recipient. '

Direct delivery

This approach attaches the taxing rights to the jurisdiction of the customer's

---

[123] OECD n 121 above.
[124] OECD n 121 above 9-10.
[125] OECD n 120 above 3.
[126] An understatement penalty may be imposed in terms of s 222 of the Tax Administration Act 28 of 2011 where SARS is prejudiced as a result of a default of rendering a return, an omission from a return, an incorrect statement on a return, or where no return is required, and the failure to pay the correct amount of tax.
[127] OECD (2014) n 16 above 27.
[128] OECD (2014) n 16 above 28.

establishment to which the supplies are directly delivered.[129] As is the case with the direct-use-approach, a special relationship must exist between the supplier and the recipient for the supplier to identify the customer's establishment of delivery and to locate that place of delivery. In the case of tangible supplies, the supplier may deem the address of delivery to be the location of use. However, in the case of intangibles, the supplier is entirely thrown on the information supplied by the customer. It is not clear whether or not the supplier would be required to verify the information so received.

Recharge method

This method requires the business establishment that ordered the intangibles from the international supplier to recharge the transaction on the establishment that applies the intangibles in making taxable supplies.[130] Put simply, the main branch that ordered the goods must treat the delivery to another branch-where that branch is not situated in the same jurisdiction as the main branch- as a taxable supply. In jurisdictions where the destination principle applies exports are generally zero-rated (or exempt from VAT). The recharge method, therefore, restores neutrality in that it ensures the jurisdiction in which the intangibles are applied in the making of taxable supplies acquires the taxing rights. As is the case with the direct-use and direct-delivery approaches, the recharge method relies on the honesty and integrity of the recipient customer. Nothing prevents the recipient customer to route orders to the branch that is established in a low tax jurisdiction and not to recharge the transaction when the intangibles are applied in the making of taxable supplies by other branches. Nevertheless, the recharge method is useful in cases where intangibles are used partially by the ordering branch and partially by other branches. In these cases the supplier relies on the business agreement and it is relieved from any additional duty to determine the exact location of use.[131] This approach should be adopted with caution. Clear and unambiguous rules must be adopted to ensure continued compliance and eliminate unintended over or under taxation. To achieve continued and accurate compliance often requires complex rules, the administrative burden of which could be cumbersome on business. For example, in some cases a clear and distinct separation of use cannot be established. This is especially the case where a unified marketing strategy is used to promote the business in different jurisdictions. In these cases tax authorities must allow calculation methods that include approximation formulas.[132] In terms of section 11(1)(i) read together with section 8(9) supplies to a branch located outside the Republic is zero-rated. Consequently,

---

[129]OECD (2014) n 16 above 28.
[130]OECD (2014) n 16 above 28.
[131]OECD (2014) n 16 above 29.
[132]OECD (2014) n 16 above 40.

the taxing authority in the jurisdiction where the foreign branch is situated acquires the right to tax the supply. The VAT Act, however, does not provide for approximation formulas where a distinct separation of use between a local and foreign branch of a business in respect of the same supply cannot be established.

3.2 Further comments on guideline 3.4

3.2.1 Intra-group supplies

It is common practice among multi-national businesses, to centralise procurement in a low tax jurisdiction from where internationally acquired goods, services, and intangibles are re-distributed to the associated businesses within the group which are established in different jurisdictions. The supplies between the procurement business and the associated businesses are governed by its own business agreements, and the transaction should be taxed under the reverse-charge mechanism in the jurisdiction where the associated business is established.[133] This intra-group supply does not concern or affect the tax treatment of the transaction between the initial supplier and the procurement business, irrespective of whether the associated business is situated in the same jurisdiction as the initial supplier or not.[134]

3.2.2 Subsequent supplies to third parties

Where the customer, in terms of a *bona fide* agreement, renders the services or intangibles acquired from the supplier to a third party, the customer remains the customer as identified in the principal business agreement, and it is this customer's location that determines the place of taxation.[135] The subsequent business agreement will determine the place of taxation for the transaction between the customer and the third party.

3.2.3 Supplier paid by third party

Businesses are often structured in such a way that different departments are situated in different jurisdictions. It can, therefore, happen that a transaction between the supplier and the customer is paid by a third party.

> **Example:** A concludes an agreement with B in terms of which B will supply intangibles to A in India where the intangibles will be applied in a manufacturing process. Payment is effected by C who acts as A's paymaster in terms of the company structure. C and B are both established in Canada.

---

[133] OECD (2010) n 121 above 13.
[134] OECD (2010) n 121 above 13.
[135] OECD (2010) n 121 above 13.

Payment flows in themselves do not create additional supplies, nor do they alter the supplies. They can also not reliably identify the customer or its location.[136] The supplier makes the supplies to the customer as identified in the business agreement irrespective of who makes the payment.[137] In the example above, the transaction will be taxed in the jurisdiction where A is established (India), irrespective of the fact that C, who made the payment, is located in the same jurisdiction as the supplier. One of the location proxies provided for in the VAT Act is where payment originates from a South African Bank. Measures to protect internet users from identity theft and banking fraud, make identifying the purchaser by tracing the payment path even more cumbersome than doing so by tracing the delivery path.[138] While credit cards contain an international country code, 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.[139] 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/consumption with absolute accuracy.[140] Relying on the payment information to locate the customer is, accordingly, flawed.

Where payment originates from a third party the OECD recommends that the transaction should not be taxed in the jurisdiction where payment originates from purely based on the fact that the paymaster is located there.[141] Rather the supplier should be allowed to make the supplies free of VAT. The recipient customer must account for VAT in the jurisdiction where it is established under the reverse-charge mechanism.

As mentioned above, a foreign supplier of electronic services must account for South African VAT where

> (aa) the recipient is a resident of the Republic;
> (bb) any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act 94 of 1990.[142]

---

[136]OECD (2010) n 121 above 14.
[137]OECD (2010) n 121 above 14.
[138]Bleuel and Stewen 'Value added taxes on electronic commerce: Obstacles to the EU Commission's approach (2000) July/August *Intereconomics* 158.
[139]Bleuel and Stewen n 138 above; Fridensköld 'VAT and the internet: The application of consumption taxes to e-commerce transactions' (2004) 13(2) *Information & Communications Technology Law* 185.
[140]Fairpo 'VAT in the European Union v– where are we now?' (1999) 1(9) *Tax Planning International E-Commerce* 19; Lamensch *International VAT Monitor* (2012) n 85 above 312; Lamensch M 'Unsuitable EU VAT place of supply rules for electronic services-proposal for an alternative approach' (2012) 4/1 *World Tax Journal* 171.
[141]OECD (2014) n 16 above 35.
[142]Paragraph (vi) to the definition of 'enterprise' in section 1.

Neither the words 'or' nor 'and' appears between subparagraph (aa) and (bb) of paragraph (iv) of the definition of 'enterprise'. Accordingly, it is not clear whether or not one or both requirements must be complied with for the supplier to be liable for South African VAT. Where both requirements must be fulfilled, payment by a third party will result in the transaction not being taxed by the foreign supplier. In such cases the reverse-charge mechanism will apply in accordance with the OECD proposal. In terms of section 95(1) of the Taxation Laws Amendment Act…., paragraph (vi) of the definition of 'enterprise' is amended to read as follows:

> the supply of electronic services by a person from a place in an export country, where at least two of the following circumstances are present:
>
> *(aa)* to a recipient of those electronic services that is a resident of the Republic; or
>
> *(bb)* where any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No 94 of1990);
>
> *(cc)* the recipient of those electronic services has a business address, residential address or postal address in the Republic:

The amendment will take effect 1 April 2015. The insertion of the phrase 'at least two of the following' resolves the confusion under the current definition. Consequently, where payment originates from a bank registered in South Africa, but the recipient is not a resident of South Africa, the foreign supplier is not required to levy South African VAT. Similarly, where the recipient is a resident of South Africa, but the payment originates from a foreign jurisdiction, the foreign supplier may make the supplies free of South African VAT. The recipient must account for VAT under the reverse-charge mechanism.

3.2.4 Guideline 3.5

In the case of B2B transactions the taxing rights of internationally traded services may be allocated by a proxy other than customer location where (i) the allocation of taxing rights by reference to location, in considering neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness, and fairness does not lead to an appropriate result; and (ii) a proxy other than customer location would lead to a meaningfully better result.[143] Such a special proxy can, for example, be the place of effective

---

[143]OECD (2014) n 16 above 41.

use or the location of immovable property. It is not the aim of guideline 3.5 to provide a list of supplies or instances for which special rules may be applied. Rather it is aimed at providing a general two-step test that must be complied with before a special rule or proxy is developed. The first step is to determine if the main rule (taxing the business customer in the jurisdiction where it is established) leads to suitable results having regard to neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness, and fairness.[144] If the main rule leads to suitable results, there is no need for a specific rule. However, where, upon analysis, it is indicative that the main rule will not lead to suitable results, a specific rule may be required and the second step must be followed. In the second step the specific rule must lead to suitable results having regard to neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness, and fairness.[145] The specific rule will be justified when the analysis indicates that the application of the special rule will lead to meaningfully better results.[146] As specific rules requires international co-operation through the implementation of tax treaties, a full evaluation from the perspective of both business and tax authorities must be undertaken before specific rules are implemented. An example of where a specific rule will lead to a significantly more appropriate right is where a vendor supplies services to a large number of customers in a short period of time and where the main rule would impose a significant administrative burden on the vendor. This would for example be where an international performer sells tickets to his concert to be held in Johannesburg. Where the tickets are sold at the gate, the main rule requires the vendor to identify the customer and determine his or her location. This could severely negatively impact efficiency of compliance. A specific rule that allows for the taxation of the transaction right there and then where the supply is utilised and consumed, leads to significantly better results than the main rule. The South African VAT Act endorses the 'utilised and consumed' principle as a specific rule in the case of imported services.[147] The 'utilised and consumed' principle under the VAT Act is broad and the interpretation thereof vague.[148] This is particularly evident where intangible products or services have been physically delivered outside the Republic, but where the benefit of the service or product

---

[144] OECD (2014) n 16 above 42.
[145] OECD (2014) n 16 above 42.
[146] OECD (2014) n 16 above 42.
[147] See the definition of 'imported services' in Section 1 of the VAT Act. Also see *Commissioner, South African Revenue Services v De Beers Consolidated Mines Ltd* 2012 SA 5 SA 344 (SCA); *Metropolitan Life Ltd v Commissioner, South African Revenue Services* 2009 3 SA 484 (C).
[148] *Commissioner, South African Revenue Services v De Beers Consolidated Mines Ltd* n 147 above; *Metropolitan Life Ltd v Commissioner, South African Revenue Services* n 147 above.

is experienced in the Republic. In these cases, proxies are appropriate.[149] However, save for the place-of-supply rules in respect of electronic services as provided for in the definition of 'enterprise', the VAT Act lacks the required proxies.

3.2.5 Guideline 3.6

Under certain circumstances guidelines 3.2 to 3.5 may not give effect to the main rule proposed in guideline 3.1. Under these circumstances specific rules may be developed to give effect to the main rule. Guideline 3.6 provides that where services or intangibles are supplied internationally in the B2B context, and where the supply is directly linked to immovable property, the jurisdiction in which the immovable property is located is awarded the taxing rights.[150] This specific rule is generally appropriate where the intangibles were supplied to one of the following categories:

- The transfer, sale, or lease or right to use, occupy, exploit, and/or enjoy immovable property
- Supplies of services physically provided to immovable property
- A close link exists between the supply of services and intangibles and immovable property.[151]

Guideline 3.6 should be applied in exceptional circumstances where the immovable property is clearly identifiable and where the close link between the supply and the immovable property is clear and obvious.[152] The connection between the supply and the immovable property must not be a mere link but it should be the heart of the supply or constitute the predominant nature of the supply.[153]

3.3 B2C transactions

In the case of a non-taxable person, or a person who is not liable to register for VAT/GST, the place of supply is deemed to be the jurisdiction in which the

---

[149] For a full discussion on the 'utilised and consumption principle' see Dendy *The VAT treatment of imported services: The zero-rating under the Value Added Tax Act 89 of 1991 of services performed outside South Africa by foreign non-vendors* (2012); Van Zyl 'Determining the place of supply or the place of use and consumption of imported services for value added tax purposes: Some lessons for South Africa from the European Union' (2013) 25(4) *SAMercLJ* 534; Van Zyl 'The place-of-supply rules in Value-Added Tax: *Commissioner, South African Revenue Services v De Beers Consolidated Mines Ltd* (2013) 25(2) *SAMercLJ* 255.

[150] OECD (2014) n 16 above 44.

[151] OECD (2014) n 16 above 44.

[152] OECD (2014) n 16 above 45.

[153] OECD (2014) n 16 above 45.

customer has his/her usual place of residence.[154] The OECD recognises that this proposal negates the consumption principle, since the place of residence and place of consumption do not always coincide.[155] Taxing the transaction at the location of consumption would place a significant compliance burden on suppliers.[156] Because of the mobility of communications, identifying the actual place of consumption would, in most cases and in the absence of practical evidence, be impossible.

In contrast to locating a business customer, a non-taxable person does not have a VAT/GST registration number that can be verified and used to locate its place of residence. Where no prior relationship exists, private customers (final consumers) may have a financial incentive if they declare that they are registered vendors or businesses.[157] In these cases customer declarations are not reliable. The Centre for Tax Policy and Administration recommends that tax authorities develop national guidelines to assist suppliers in locating the customer's place of residence.[158] These guidelines are yet to be endorsed by the *OECD International VAT/GST guidelines*.

4 Issues that must still be addressed by the OECD

It should be noted that the *OECD International VAT/GST Guidelines* is a work in progress document. As such, various issues that have been addressed by the subcommittees within the OECD have not been ratified by the OECD members.

In 1998, the OECD Ministers welcomed the proposal that the supply of intangible products, for consumption tax purposes, should not be treated as goods[159] – a principle that is endorsed in its *International VAT/GST guidelines* of 2006.[160] This proposal is rather vague and does not provide for specific guidelines as to whether the sale of intangible goods should be treated as services, royalties, or a separate category in its own right. Clearer guidelines on the classification of intangibles must be drafted.

The *VAT/GST Guidelines* do not provide any guidance as to the timing of a supply. At the time of writing, Chapter IV (Time of supply and Attribution

---

[154] OECD (2001) n 7 above.
[155] OECD (2001) n 7 above.
[156] OECD (2001) n 7 above.
[157] OECD n 92 above 3.
[158] OECD (2001) n 7 above 6. For a complete discussion on the verification of location tools see Van Zyl n 56 above 176-183.
[159] OECD (2001) n 7 above 1.
[160] OECD (2006) n 31 above.

rules) of the *International VAT/GST Guidelines* had not been finalised. At the First OECD Global Forum on VAT held on 7-8 November 2012 in Paris, it was concluded that an ambitious work programme should be followed to publish the final VAT/GST Guidelines by 2014.[161] Nevertheless, the Technological TAG team investigated the viability of the application of time stamping technology that could assist revenue authorities and suppliers in determining the exact time of supply.[162] It was, however, established that no real commercial purpose for such software exists, and that the cost were prohibitive for the majority of online transactions.[163] In the case of payment by way of vouchers, it is important to determine the time of supply as either when the voucher was issued and imported, or when the voucher is exchanged for goods or services.[164] Many e-commerce transactions are effected by vouchers, prepaid agreements, and third-party payment structures which have a direct effect on the timing of the supply. It is, therefore, essential that guidelines should be drafted on the determination of the time of supply where the timing is affected by the nature of the payment or other conditional issues in the agreement.

At the time of writing, chapter V (Value of Supply) of the *International VAT/GST guidelines*, too, had not been finalised. General inconsistency currently exists on the treatment of vouchers in respect of the value and timing of the supply for VAT purposes.[165] It has been suggested that the OECD develop guidelines that are in line with the current EU alignment on the treatment of vouchers.[166] Given the fact that many cross-border digital transactions include the provision of multiple supplies for which the determination of the value of the supply is often complicated, definitive guidelines are required.

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

---

[161] http://www.oecd.org/ctp/consumptiontax/conclusionsglobalforumvat.htm (accessed 29 November 2014).
[162] OECD (2000) n 98 above 91-93.
[163] OECD (2000) n 98 above 10.
[164] Van Zyl 'The VAT treatment of vouchers: A comparative study between South Africa and the European Union' (2013) 46(2) *CILSA* 235-256.
[165] Taxand n 27 above.
[166] Taxand n 27 above.

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. Alternative collection mechanisms should be explored and definitive guidelines should be developed accordingly.

5 Conclusion

The OECD has established itself as an international organisation with the principal aim of establishing tax guidelines to assist in the developing of clear tax rules, business certainty, reducing the risk of tax avoidance and tax evasion, but also ensuring flexibility so as to keep pace with technological advances and new business developments. Despite the fact that the OECD guidelines have no legal force, they include principles that can be followed by member countries.[167] In addition, these principles can be used as persuasive evidence in a court of law or other adjudicating body.

It has been established that the basic principles as laid down in the Ottawa Framework are the key steps to building VAT/GST systems based on neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. These key principles include that, in cross-border trade, VAT/GST should be levied at the jurisdiction of consumption; digital goods should not be treated as goods; and that the reverse-charge mechanism should be applied in the case of B2B transactions. South Africa applies the OECD principles with regard to electronically supplied services in respect of the place of taxation and the classification of electronic goods as services. South Africa opted for a registration model for both B2B and B2C transactions. The reverse-charge mechanism applies where a transaction could not be taxed appropriately under the registration model. The success of the registration model as applied in South Africa is yet to be tested.

At the first Global forum on VAT/GST, the OECD undertook to publish the complete and all-inclusive *VAT/GST Guidelines* by 2014. However, despite comprehensive efforts, the complete guidelines are not forthcoming. The issues regarding the time and value of supply rules, and the development of an effective tax collection model, are in dire need of international guidelines. Considering the rapid pace at which technology advances, and the global reach of digital trade, the slow pace at which the OECD has provided comprehensive guidelines since the Ottawa convention in 1998 is alarming. The lack of proper guidelines results in jurisdictions adopting separate and uncoordinated VAT rules, which in turn, cause market distortions. In most cases jurisdictions make hasty decisions to protect the tax base and to protect local market against an

---

[167] Charlet and Buydens n 51 above 447.

influx of cheaper imports. Instead, uncoordinated VAT rules ultimately results in a stagnation of international trade. The OECD guidelines on neutrality can be effective only when it provides comprehensive guidelines on all the issues associated with online cross-border trade.

SP van Zyl[*]
University of South Africa