

**EVALUATING THE INTERNATIONAL TAXATION OF DIGITAL SERVICES IN
RELATION TO SOUTH AFRICA**

by

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ABSTRACT

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Background

The digital economy affects nearly all aspects of everyday human life and is becoming more and more entrenched in a wide variety of economic sectors. According to the Davis Tax Committee, this entrenchment has made it increasingly difficult to differentiate the digital economy from traditional economic trade for purposes of taxation.

The digital economy exacerbates certain base erosion and profit shifting tax risks and, as a result of a lack of international consensus to tax the digital economy, taxing authorities worldwide have begun implementing different methods in order to tax the digital economy.

Main purpose of study

This study will focus on evaluating methods applied internationally in taxing the digital economy and will aim to examine whether South Africa's current approach in taxing the digital economy should be adapted to ensure that the most effective mechanism for taxing the digital economy is used.

Method

This study will be conducted as qualitative research based on the multi-sited, global research method. It will also contain comparative studies where the taxation method applied by South Africa (in relation to the digital economy) will be compared to the

methods applied by other developed countries in order to establish whether South Africa's taxation is in line with international guidance.

Results

It was found that South Africa complies with the OECD VAT guidelines as well as the recommendations made by the Davis Tax Committee in relation to taxing the digital economy.

It was also found that taxing the digital economy both by way of direct and indirect taxing methods could be an effective, temporary solution to address the tax risks posed by the digital economy.

Conclusions

Although South Africa's current VAT legislation should serve as an effective mechanism to tax the digital economy, South Africa could consider adapting and enhancing its legislation to further improve the effectiveness of its VAT legislation by adopting certain taxing mechanisms implemented in the UK.

South Africa should strongly consider implementing a digital services tax that could provide a temporary solution to tax the digital economy by way of a direct tax.

Keywords

- Digital Economy
- Digital Services Tax
- Organisation for Economic Co-operation and Development ('**OECD**')
- Base Erosion and Profit Shifting ('**BEPS**')
- South Africa

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GLOSSARY

2013 TLAA	The Taxation Laws Amendment Act No. 31 of 2013
2018 TLAA	The Taxation Laws Amendment Act No. 23 of 2018
Action 1 Report	The OECD's 2015 BEPS Action 1 Report on "Addressing the Tax Challenges of the Digital Economy"
B2B	Business-to-business
B2C	Business-to-consumer
BEPS	Base Erosion and Profit Shifting
Brexit	The UK's exit from the EU
CFC	Controlled Foreign Company
CGT	Capital Gains Tax
Dependent Agent	In the context of a PE, means a person who is acting in the jurisdiction of an entity's "fixed place of business" and who concludes – or is continually involved in the conclusion of – contracts on such entity's behalf
DST	Digital Services Tax
DTC	Davis Tax Committee
E & M	Entertainment and Media
E-commerce	Electronic commerce
E-mail	Electronic mail
EU	The European Union
G7	Major developed economies listed by the UN, including Canada, France, Germany, Italy, Japan, the UK and the United States
GBP	British Pound, the official currency of the UK
GDP	Gross Domestic Product
GN 429	Government Notice No. 429, published in <i>Government Gazette</i> No. 42316 on 18 March 2019
HMRC	Her Majesty's Revenue and Customs
MNE	Multinational Enterprise
MTC	OECD Model Tax Convention
NETP	Non-established taxable person
OECD	Organisation for Economic Co-operation and Development
OECD CFA	The OECD Committee on Fiscal Affairs
OECD VAT Guidelines	The OECD International VAT/GST Guidelines, published in 2017
OMP	Online Marketplace
PE	Permanent Establishment
POS	Place of Supply
Second Report	DTC: Second Interim Report on BEPS in South Africa

Standard rate	The standard rate at which VAT is levied in South Africa, which is 15% as at the date of this mini-dissertation
Subparagraph (b)(vi)	Subparagraph (b)(vi) of the definition of an enterprise as contained in section 1 of the VAT Act
TFDE	Task Force on the Digital Economy
The Minister	The Minister of Finance of South Africa
The Regulations	The regulations prescribing electronic services for the purpose of the definition contained in section 1 of the VAT Act, as published in Government Notice No. R. 221 on 28 March 2014
Ubiquitous	"Seeming to be everywhere" ¹
UK	United Kingdom
UK VAT Act	The Value Added Tax Act 1994, c.23. of the UK
UN	United Nations
UP	University of Pretoria
USD	United States Dollar, the official currency of the United States of America
VAT	Value-Added Tax
VAT Act	The Value-Added Tax Act, No. 89 of 1991
Zero rate	The applicable rate at which VAT is levied in South Africa on qualifying supplies, such rate being 0%

¹ Cambridge Dictionary. n.d.-b. ubiquitous. *Cambridge Advanced Learner's Dictionary & Thesaurus*: Cambridge University Press. [Online] Available from: <https://dictionary.cambridge.org/dictionary/english/ubiquitous> [Accessed: 21 July 2021].

EVALUATING THE INTERNATIONAL TAXATION OF DIGITAL SERVICES IN RELATION TO SOUTH AFRICA

CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION

The way in which human beings interact with one another has evolved drastically over the years (Wardynski, 2019). While factors such as politics and economics are considered some of the most influential factors on human interaction, technology is one of the primary driving forces which affect the way in which humans interact today (Deloitte, n.d.-b). Although this study does not focus on the impact that technology has on human interactions, it is important to understand these changes in light of the research question this study seeks to address.

From printing presses used for printing written communications during the 15th and 16th century, to the incorporation of electricity in communication channels during the 19th century (which gave rise to the term ‘telecommunications’), these advancements show that as humans evolve and improve on the technologies of their era, so do the means by which they communicate and collaborate (Novak, 2019).

With the inception of the internet *circa* 1983, the ways in which humans interact rapidly changed (Andrews, 2013). Human interaction in the 21st century is no longer bound by geographical locations and time zones with communication tools such as electronic mail (**‘e-mail’**), video conferencing software (such as Skype[®]), mobile messaging applications (such as WhatsApp[®]) and a variety of social media platforms (such as Facebook[®] and Instagram[®]) (Allen, 2019; Burgess, 2020).

This change in human interaction not only means that we are now able to communicate electronically via the internet with ease, but also greatly affects the way in which humans participate in the economy, with the adoption of electronic commerce (**‘e-commerce’**) (Zwass, 2019). E-commerce can be described as the provision of goods and services through an online platform which connects businesses and their customers (Bloomenthal, 2020). Some argue that the digital economy (which is a term used to capture the impact of

digital technology on economic trade, i.e. e-commerce) is growing so rapidly that the digital economy is in fact becoming the economy itself (Davis Tax Committee, 2016).

According to the World Bank Group (2020), over the past 15 years the global digital economy has grown at a rate which is two and a half times faster than the global gross domestic product ('GDP') growth. It is estimated that the digital economy worldwide was worth USD 11.5 trillion (15.5 per cent of global GDP) in 2016, which is expected to increase to USD 23 trillion (24.3 per cent of global GDP) by 2025 (Oxford Economics & Huawei, 2016). This increase is expected as a result of an increased demand for e-commerce which has enabled companies to provide their goods and services to a much wider consumer base since e-commerce is typically less bound by geographical confines in comparison to traditional economic trade (Abarche, 2018). Additionally, the recent outbreak of the novel SARS-CoV-2, commonly referred to as the Coronavirus, is expected to accelerate the digitisation of the economy as a result of the measures taken by global governments to curb the spread of the Coronavirus (which have typically encouraged consumers to remain inside their residences and avoid public interaction) that has resulted in a spike in the demand for e-commerce (Bloomberg Intelligence, 2020).

The increased earning potential of corporate entities has caught the attention of taxing authorities worldwide as well as the Organisation for Economic Co-operation and Development ('OECD') (KPMG, 2021b). Digital transformation is affecting global economic trade and has seen companies implementing unconventional methods in conducting their economic trade, which only serves to spark the authorities' and the OECD's interest even more (Deloitte, n.d.-b). The following statement made by Goodwin (2015) puts some of these unconventional methods into perspective: "Uber, the world's largest taxi company, owns no vehicles. Facebook, the world's most popular media owner, creates no content. Alibaba, the most valuable retailer, has no inventory. And Airbnb, the world's largest accommodation provider, owns no real estate. Something interesting is happening."

It is therefore evident that the digital economy, while providing great opportunities for economic and value-chain growth, also poses various unprecedented challenges and threats in relation to the fair allocation of taxing rights, which will briefly be discussed in the following section.

1.2. BACKGROUND/RATIONALE FOR THE STUDY

The digital economy affects nearly all aspects of everyday human life. From buying groceries and clothing, to streaming media content or finding a dating partner – the digital economy is becoming more and more entrenched in a wide variety of economic sectors (Mühleisen, 2018). According to the Davis Tax Committee (2016) ('**DTC**'), this entrenchment has made it increasingly difficult to differentiate the digital economy from traditional economic trade for purposes of taxation.

One of the major concerns globally is the erosion of a country's tax base as a result of companies "artificially shifting" income and profits to low-tax jurisdictions through elaborate tax planning strategies which exploit "gaps" or mismatches in different jurisdictions' tax legislation (OECD, n.d.). This is commonly referred to as Base Erosion and Profit Shifting ('**BEPS**'). It is estimated that BEPS practices annually lead to a loss in tax revenue of between USD 100 – 240 billion, which more severely affects developing countries, such as South Africa, since they are typically more reliant on the income generated from corporate income tax (OECD, n.d.).

The diminished tax base and loss in revenue has led to the OECD developing its BEPS project, which aims to provide domestic and international guidance in curbing tax avoidance. These tools provide countries with the means to ensure that profits are taxed in jurisdictions where the economic activities, which generate value, are undertaken (OECD, n.d.).

One such tool is the OECD Model Tax Convention ('**MTC**') which provides, *inter alia*:

- a basis for determining tax residence of an entity; and
- guidance on the taxing rights of a jurisdiction where an entity is performing and earning income from economic activities performed in such jurisdiction but found to be exclusively tax resident in another jurisdiction. In such circumstances, without guidance from the MTC, any taxing rights of the jurisdiction from which economic value is extracted could potentially be removed (Kobetsky, 2011).

Enter the concept of a "permanent establishment" ('**PE**') (Kobetsky, 2011).

A PE is defined in Article 5 of the OECD MTC as a “fixed place of business through which the business of an enterprise is wholly or partly carried on”. This definition specifically includes a building site or construction/installation project which lasts for a period exceeding 12 months as well as a “dependent agent” who is acting in the jurisdiction of such “fixed place of business” and who concludes – or is continually involved in the conclusion of – contracts on such entity’s behalf (**‘dependent agent’**) (OECD, 2017c). Since corporate entities are no longer bound by geographical confines due to such entities being able to provide their services via the internet to consumers of another country (without the need for any fixed infrastructure, buildings or services of a dependent agent), the OECD’s definition of a PE is facing obsolescence. The effectiveness of using this concept of a PE as a means to ensure fair distribution of taxing rights is less efficient in the context of the digital economy (Vosloo, 2016). This effectively means that the current approach to taxing the digital economy should be reviewed to ensure that taxing rights are fairly distributed to the jurisdictions from which economic value is extracted (OECD, 2013).

The OECD has published guidance on the subject, although, as of the date of this study, they have not been able to find a consensus-based approach. Based on the lack of consensus, taxing authorities worldwide have begun implementing different methods in order to tax the digital economy. These methods are broadly referred to as “direct” and “indirect” taxing methods. Some taxing authorities have implemented both a direct and indirect taxing approach to tax the digital economy (such as France and the United Kingdom) and other taxing authorities have elected to tax the digital economy only by way of an indirect taxing method (such as Germany) (KPMG, 2021b; Mekgoe & Hassam, 2020). This study will focus on evaluating methods applied internationally in taxing the digital economy and will aim to examine whether South Africa’s current approach in taxing the digital economy should be adapted to ensure that the most effective mechanism for taxing the digital economy in South Africa is used.

1.3. RESEARCH PROBLEM

Action 1 of the OECD’s BEPS project seeks to address and provide guidance on the taxation of the digital economy (Gianni, 2018). In a report released by the OECD on Action 1 of the BEPS project, the OECD determined that even though the digital economy may

not create issues which are unique to BEPS, some of its key features may impose increased BEPS risks (Mekgoe & Hassam, 2020). The OECD has therefore developed a two-pillar approach which seeks to find a consensus-based solution to the challenges that the digital economy presents in respect of taxation (Mekgoe & Hassam, 2020). However, since there have been delays in the OECD's finalisation of Pillar One and Two of the BEPS Action Plan, several countries have begun implementing solutions in order to tax the digital economy in an attempt to ensure they do not miss out on any potential tax revenue (Gough, Polacco, Dorin, Turrado, Bongaerts & Sikora, 2019). One of the most notable proposals are the directives published by the European Commission which could have an impact on the taxation of the digital economy for the entire European Union (van der Gulik, 2018).

South Africa has opted to wait for the OECD to find a global solution to tax the digital economy and is currently only collecting tax revenue from the digital economy by way of its indirect tax regime through the imposition of Value-Added Tax ('VAT') on electronic services (KPMG, 2021a; Mekgoe & Hassam, 2020). With the delivery of South Africa's annual budget review speech on 24 February 2021, it was noted that South Africa's budget deficit for the 2020/21 fiscal year equalled 14 per cent of GDP, which is the country's largest budget deficit ever recorded (Bloomberg, 2021). This highlights the importance of ensuring that the South African government maximises its collection of tax revenue from the sources available to it and that an analysis should be conducted in order to establish the most effective method for taxing the digital economy in South Africa.

1.4. RESEARCH QUESTION

What are the weaknesses in South Africa's approach to taxing the digital economy and what is the potential impact of levying taxes on digital services by way of a direct tax?

1.5. RESEARCH OBJECTIVES

- To determine the key differences between direct taxes and indirect taxes and their application in taxing the digital economy in a selected developed country;

- To compare South Africa’s approach to taxing the digital economy to the guidelines developed by the OECD and the taxing methods applied by a selected developed country;
- To determine the effectiveness of South Africa’s taxation of the digital economy through its VAT legislation; and
- To determine the reasons why other countries have implemented a digital services tax and to determine whether South Africa should follow suit.

1.6. RESEARCH DESIGN AND METHODOLOGY

RESEARCH METHOD AND DESIGN

Qualitative research can briefly be described as the collection and analysis of non-numerical data. Qualitative research is typically used by researchers to gain insight into a research problem in order to enable the researcher to understand concepts, opinions, or experiences (Bhandari, 2020). Advantages of qualitative research methods include:

- Flexibility – the data collection process/method can be adapted as and when necessary;
- New ideas – qualitative research typically leads to open-ended responses which can lead to the generation of new ideas; and
- Natural, meaningful data and insights – the data is generally collected in “real world contexts” which provide detailed descriptions of other people’s experiences, which can be used to improve systems or products (Bhandari, 2020).

“Multi-sited, global research” is a qualitative research method which has been developed as a result of the changes brought about by globalisation. This method shares many of the tools and assumptions of “Institutional Ethnography”, which allows researchers to start their investigation with a core “group” and then move on to further investigate the factors/activities that impact such “group”. Multi-sited, global research removes geographical confines and allows researchers to analyse and investigate the link and connections of the relevant activities between different parts of the world (Taylor, Bogdan & DeVault, 2015).

In light of the requirements of this study, it is evident that an analysis and investigation of international data is required in order to effectively address the research question posed. Therefore, this study will be conducted as qualitative research based on the multi-sited, global research method. It will also contain comparative studies where the taxation method applied by South Africa (in relation to the digital economy) will be compared to the methods applied by other developed countries in order to establish whether South Africa's taxation is in line with international guidance.

SAMPLING

When sampling data, researchers typically consider two sampling methods, i.e. probability sampling and non-probability sampling.

In short, probability sampling means that the sample of data is collected at random, and non-probability sampling means the sample is selected based on convenience (i.e. ease of access). The sample of data collected for this study will be collected on a non-probability basis, since information relating to specific topics and countries is required (McCombes, 2019).

Furthermore, there are four different methods which can be applied when conducting sampling on a non-probability basis. These methods can be briefly explained as follows:

1. Convenience sampling – means the information which is most easily accessible to the researcher is used. This method, however, does not guarantee that the sample collected is representative of the population.
2. Voluntary response sampling – relies on people volunteering to supply information to the researcher. This study will not require the collection of information in the form required for this sampling method.
3. Purposive sampling – requires the researcher to determine the sample most suitable for purposes of their study. This type of sampling method is usually employed when the researcher is seeking to gain detailed knowledge about a specific topic or phenomenon.
4. Snowball sampling – typically used when the population is difficult to access. This method requires that the researcher recruit participants through other participants.

This method can be a time-consuming process since the data collected depends on the number of people the researcher has contacted (McCombes, 2019).

Therefore, purposive sampling will be done on a non-probability basis in order to gather data on information available in an international as well as a South African context in relation to the research topic and question.

DATA COLLECTION

The data collection method will be based on “secondary research”, which means that existing data (in the form of texts, images, video or audio) will be collected by way of a general internet search via either Google Scholar or the library site of the University of Pretoria (**UP**) using pre-selected keywords relevant to the topic. This is due to the nature of the research topic being a study of the international taxation of the digital economy, and obtaining data from multiple local (South African) as well as international sources through these pre-selected keywords would be beneficial to reach any conclusion on the research topic.

DATA ANALYSIS

Data will be analysed in the form of a literature review, analysing information freely available to the general public; however, preference will be given to academic articles or articles published by reputable corporate entities involved in the field of tax law.

TRUSTWORTHINESS

As mentioned above, data will be collected utilising Google Scholar or the UP library website in order to obtain reputable and verifiable sources. Where data is collected from other sources, these sources will be thoroughly analysed to ensure that the data is collected from reputable, reliable and trustworthy publishers.

ETHICAL CONSIDERATIONS

There should be no conflict with regard to ethical standards since all data sources should be widely available and due reference will be provided to each source where applicable.

1.7. STRUCTURE OF THE MINI-DISSERTATION

The main outcomes of the present study are presented in the form of a mini-dissertation. The basic structure and outline of this mini-dissertation is summarised below:

CHAPTER 1: INTRODUCTION

In this chapter the purpose, aim and reason for conducting the specific study will be discussed. This chapter will aim to provide a brief history of the digital economy and the reader will be presented with background information in order to provide a high-level understanding of the context of the study.

CHAPTER 2: THE OECD'S GUIDELINES IN RESPECT OF THE TAXATION OF THE DIGITAL ECONOMY

This chapter will provide an overview of the challenges posed by the digital economy to international tax collection. Under this section, an analysis will be performed of the guidelines developed by the OECD in order to address taxation concerns in relation to the digital economy to establish whether South Africa's current approach is in line with these guidelines and to provide an overview of the different methods that could be applied in order to tax the digital economy.

CHAPTER 3: SOUTH AFRICA'S APPROACH TO TAXING THE DIGITAL ECONOMY

This chapter will provide an overview of the taxing method applied by South Africa in order to collect tax revenue from the digital economy and the factors that played a role in South Africa's decision for implementing said method.

CHAPTER 4: ANALYSIS OF THE METHODS APPLIED IN TAXING THE DIGITAL ECONOMY IN OTHER COUNTRIES

This chapter will look at the taxing methods applied by a selected developed country to be able to compare their taxing method to that of South Africa. A brief discussion regarding the method for choosing the country will be provided in order to establish the relevance to this study.

CHAPTER 5: ANALYSIS OF SOUTH AFRICA'S LEGISLATIVE INFRASTRUCTURE

This chapter aims to analyse the South African tax legislation and some case law in order to determine whether or not South Africa's current legislative infrastructure is sufficient to encompass the taxation of the digital economy and determine the effectiveness of South Africa's legislation in taxing the digital economy.

CHAPTER 6: COMPARATIVE ANALYSIS

This chapter aims to summarise the findings of this study and to analyse South Africa's compliance with the OECD guidelines as well as provide recommendations based on the taxing methods applied in the UK.

CHAPTER 7: CONCLUSION

In this chapter, a conclusion that is based on the findings of the research conducted in this study will be formed in order to theoretically answer the research question and provide proposals which National Treasury and SARS could implement in order to improve the current method of taxing the digital economy.

CHAPTER 2: THE OECD'S GUIDELINES IN RESPECT OF THE TAXATION OF THE DIGITAL ECONOMY

2. INTRODUCTION

As discussed in chapter 0 above, the use of the traditional concept of the “permanent establishment” in determining taxing rights between two countries needs to be reassessed in light of the digital economy and the challenges it poses (Vosloo, 2016). Furthermore, it was recognised in the OECD's 2015 report on “Addressing the Tax Challenges of the Digital Economy” that, as a result of the increasingly ubiquitous nature of the digitalisation of the economy, it would be challenging to separately identify the digital economy from the rest of the economy for tax purposes (OECD, 2015).

As a result, the OECD has developed certain guidelines in its 2015 BEPS Action 1 Report on “Addressing the Tax Challenges of the Digital Economy” (**Action 1 Report**) regarding the taxation of the digital economy, which have been provided in respect of direct and indirect taxes on the digital economy. These guidelines are discussed below.

2.1. THE OECD'S GUIDELINES IN RESPECT OF DIRECT TAXES

“Direct tax” is a term defined in the *Oxford Learner's Dictionary* as “a tax that is collected directly from the person who pays it” (Oxford Learner's Dictionary, n.d.-a). Direct taxes are typically levied based on the taxpayer's income earned and take into consideration the taxpayer's ability to pay taxes (Corporate Finance Institute, n.d.; Kagan, 2021a). Prime examples of direct taxes in South Africa include *inter alia* income tax and donations tax (De Wet, 2013).

According to the OECD (2015), the challenges raised by the digital economy in relation to direct tax policy can be categorised as follows:

- Nexus;
- Data; and
- Characterisation.

“Nexus” is a term which is used in tax law to describe the relationship or link between taxpayers, the income they earn and the source of that income (typically the country from which such income is earned) (Murray, 2020). With regard to nexus (similar to the challenges and threats posed to the concept of a PE), the continuous development of digital technologies and reduced need for companies to have an extensive physical presence in a jurisdiction to conduct their business activities have raised questions on whether the rules currently applied in determining nexus with a jurisdiction for tax purposes are appropriate and effective (OECD, 2015).

“Data” in this context is used to describe the gathering and representation of information which can be used by other persons for purposes of communication, interpretation or processing (UNECE, 2000). The OECD has found that a company’s ability to gather and use information across borders raises issues in relation to the attribution of value created from the generation of data as a by-product of digital goods and services, as well as in relation to the characterisation thereof (i.e. should this data constitute (i) the supply of goods, (ii) barter transactions or (iii) any other classification?) (OECD, 2015). In other words, it has become increasingly difficult to determine the value of “data” (which may include information such as personal information, for example gender of consumers, or engagement data such as the manner in which consumers interact with a company’s chosen trading platform, etc.) which is generated in the ordinary course of a company’s business operations, especially in the international context (Freedman, 2020).

“Characterisation” is defined as the way something is described or classified based on the qualities thereof (Cambridge Dictionary, n.d.-a). Since the digital economy is continuously evolving and companies are implementing more unconventional methods of conducting their business activities, uncertainties arise in relation to the characterisation of payments made to suppliers in respect of newly developed business models (OECD, 2015).

The G20/OECD Task Force on the Digital Economy (**‘TFDE’**) determined that, in view of the substantial overlap between the challenges discussed above, it would be preferable to come up with a possible solution to address the two main considerations in relation to the digital economy, which include:

- the ability of businesses to earn income from a country without the need for a physical presence in such country; and

- the ability of businesses to utilise and sell data which is collected due to users participating in the businesses' value chain. This sale of data includes *inter alia* the sale of data to third parties, advertising campaigns which target specific consumers and the sale of the business itself (i.e. the “physical” sale of the business) (OECD, 2015).

There have been several proposals in order to address the issues above; however, this section is limited to an analysis of the proposal in respect of the imposition of a withholding tax on digital transactions (i.e. a digital services tax or '**DST**'). This study seeks to compare the effectiveness of the imposition of a DST as opposed to an indirect tax in developed countries and to compare the results with South Africa's approach to taxing the digital economy.

In this regard, the TFDE has considered a DST on payments made by residents and PEs of a country in respect of goods and services acquired online from providers who are non-residents of that country. This approach raised technical issues in relation to the scope of transactions to be included within the ambit of the proposed DST, as well as the method of collecting the DST (OECD, 2015).

2.1.1. THE SCOPE OF TRANSACTIONS COVERED

The TFDE found that the best method of determining the scope of transactions covered within the ambit of the proposed DST is to apply a general definition of “transactions”. This was determined on the grounds that a general definition may provide flexibility, result in less disputes over the character of income and provide tax neutrality in relation to identical ways of doing business (OECD, 2015).

2.1.2. COLLECTION OF THE TAX

Generally, where transactions fall within the ambit of any withholding tax regime, the payor may be held liable for the withholding of amounts of tax on behalf of the taxing authorities (Snyckers & Visser, 2015). In a business-to-business ('**B2B**') context, this does not pose much of an issue since it is typically expected of resident companies to comply with tax withholding obligations. However, in a business-to-consumer ('**B2C**') context, the

withholding of amounts by a large number of individual taxpayers (and the subsequent collection of the typically smaller amounts of withholding taxes by the taxing authorities) would prove challenging (Kagan, 2021b). It is therefore proposed that the liability to withhold an amount of tax is shifted to a local collecting agent or intermediaries involved in the processing of payments, although this still poses challenges of its own (OECD, 2015).

2.2. THE OECD'S GUIDELINES IN RESPECT OF INDIRECT TAXES

“Indirect tax” is a term defined in the *Oxford Learner's Dictionary* as “a tax that is paid as an amount added to the price of goods and services and not paid directly to the government” (Oxford Learner's Dictionary, n.d.-b). Indirect taxes are generally collected by one entity, for example a supplier of goods or services, but is paid for by the ultimate end-user of the product or service acquired (Kagan, 2020). A prime example of an indirect tax in South Africa is VAT, currently levied at a flat rate of 15 per cent (PricewaterhouseCoopers, n.d.).

Global taxing authorities have found it increasingly difficult to collect tax revenue via VAT on goods, services and intangibles that are traded between two different jurisdictions, particularly where such trade is conducted between private individuals and foreign suppliers (van Zyl & Schulze, 2014). Since businesses have an increased capability to provide their goods and/or services to customers globally without requiring any significant presence in their customers' jurisdictions, the challenges faced by taxing authorities have been amplified (OECD, 2015).

According to Action 1 of the report on “Addressing the Tax Challenges of the Digital Economy” of the OECD (2015), there are two main challenges that are imposed by the digital economy in relation to VAT:

1. Where low value parcels are imported via online sales into certain jurisdictions and are treated as exempt for VAT purposes; and
2. The growing trade of providing services and intangibles to consumers, especially individuals, which are often not subject to an adequate amount of VAT or not subject to VAT at all.

These challenges are examined in more detail below.

2.2.1. IMPORTS OF LOW VALUE GOODS WHICH ARE EXEMPT FROM VAT

Many countries collect VAT on the import of goods by employing customs collection mechanisms (World Bank Group, n.d.). However, many jurisdictions apply an exemption from VAT for low value parcels since the VAT revenue collected on such parcels does not (or is unlikely to) justify the costs of collecting such VAT revenue (OECD, 2015). This VAT exemption has led to a significant growth of low value parcel-imports in various jurisdictions as well as business restructures which allow businesses to take advantage of such VAT exemption (WTS Global, 2021). The challenge faced by taxing authorities therefore lies in finding the balance between ensuring appropriate collection of VAT revenue on digital sales and avoiding any adverse effects on the competitiveness of a country's domestic suppliers (OECD, 2015).

To address this challenge, the OECD prepared a report which:

- outlined the approaches that may be followed to increase the efficiency of collecting VAT on low value imports which would allow jurisdictions to lower their VAT exemption thresholds; and
- identified four models for collecting VAT on low value imports. In short, these models are:
 - the traditional collection model, where low value imports are assessed individually for VAT purposes at the border;
 - the purchaser collection model, where the purchaser is required to self-assess and pay the relevant VAT on its low value imports;
 - the vendor collection model, where non-resident vendors are required to ensure that the VAT is collected and remitted in the country of importation; and
 - the intermediary collection model, where intermediaries are required to collect and remit the VAT on low value imports on behalf of non-resident vendors (OECD, 2015).

The OECD found that jurisdictions could implement one or a combination of the models mentioned above which should allow the respective jurisdictions to lower (or even remove) the VAT exemption thresholds and result in an increased efficiency in collecting VAT on low value imports (OECD, 2015).

2.2.2. CROSS-BORDER SUPPLIES OF DIGITAL SERVICES

The second challenge relates to the increased capability of companies to provide their digital services to a global customer base without having direct or indirect physical presence in the jurisdiction in which such customers are situated (OECD, 2015). These transactions often result in low VAT (or no VAT at all) being collected and exacerbates the competitive pressure local suppliers may experience, as discussed in 2.2.1.

Broadly speaking, international taxing authorities have been implementing two different approaches when imposing VAT on cross-border transactions:

1. The first approach allocates taxing rights to the country in which the supplier is resident (referred to as the '**origin principle**').
2. The second approach allocates taxing rights to the country in which the customer is resident (referred to as the '**destination principle**')(OECD, 2015).

Where the origin principle is applied, it is possible that the supplier is situated in a jurisdiction that does not impose VAT or imposes an inappropriate rate in respect of VAT, which results therein that no VAT revenue accrues to the jurisdiction in which the supplies are consumed (OECD, 2015).

Where the destination principle is applied, taxing authorities find it challenging to ensure effective collection of the applicable VAT from the consumers, particularly where private individuals are involved (OECD, 2015). Certain jurisdictions have implemented requirements on private consumers to remit or "self-assess" the applicable VAT in the jurisdiction where they are resident; however, this approach has proven largely inefficient (OECD, 2015). The OECD therefore recommended in their E-commerce Guidelines of 2003 that taxing authorities should implement mechanisms that require non-resident suppliers to register for VAT purposes and to collect and remit the applicable VAT in the jurisdiction in which their consumers are resident (OECD, 2015). This proposed approach is dependent on the non-resident suppliers' compliance with the recommendations, which may prove inefficient if the jurisdiction's taxing authorities have not implemented an effective mechanism for ensuring the collection of the taxes that the non-resident suppliers are required to collect and remit (OECD, 2015). Furthermore, this has incentivised

domestic suppliers to restructure their operations in such a manner that their supplies of services and intangibles are effectively made from an offshore jurisdiction, which leads to a further depletion of VAT revenue (OECD, 2015).

It is evident that both of these approaches are flawed and are not as efficient for collecting VAT revenue as the taxing authorities had hoped. In this regard, the OECD published updated international VAT/GST guidelines ('**OECD VAT Guidelines**') in 2017 which provide internationally agreed methods for the treatment of VAT, with a particular focus on cross-border trade in services and intangibles as well as digital products (OECD, 2017a). These guidelines will be further examined below.

2.2.2.1. OECD VAT GUIDELINES: GENERAL

The OECD VAT Guidelines were established with the aim of furthering two main objectives:

1. Improving neutrality of VAT in the context of international trade; and
2. Assisting in the determination of the place of taxation for international supplies of services and intangibles (OECD, 2017a).

With regard to neutrality, it was determined in the OECD VAT Guidelines that the staged collection process of VAT (i.e. the process of charging VAT each time value is added in the supply chain and allowing all participants in the supply chain to deduct the respective VAT they have paid on purchases) gives VAT its essential characteristic of being economically neutral since the VAT essentially "flows through the businesses" and is ultimately paid by the consumer of the supply (OECD, 2017a). Furthermore, it was determined that the destination principle places all firms competing in a given jurisdiction on equal grounds by giving taxing rights to the jurisdiction in which the supply is consumed. Therefore, this principle is recommended by the OECD and is sanctioned by the World Trade Organisation (OECD, 2017a).

It was, however, highlighted in the OECD VAT Guidelines that the implementation of the destination principle in respect of international trade differs when the trade relates to the supply of goods versus the supply of services and intangibles (OECD, 2017a). Goods are generally subjected to a jurisdiction's border controls where VAT can be imposed on the

goods being imported, whereas services and intangibles are typically not subject to border controls in the same manner (OECD, 2017a). This necessitates special guidelines in respect of the collection of VAT revenue in the context of international trade in services and intangibles. These guidelines are discussed below.

2.2.2.2. OECD VAT GUIDELINES: THE TAXATION OF INTERNATIONALLY TRADED SERVICES AND INTANGIBLES

Although it was clearly stated that it is not advisable for jurisdictions to develop and implement different rules for supplies made in a B2B versus a B2C context, the OECD, in light of the different objectives of the different supplies, published separate guidelines in respect of B2B and B2C supplies (OECD, 2017a). These are as follows:

In a B2B context, taxing rights in respect of internationally traded services or intangibles should be given to the jurisdiction in which the customer is located (OECD, 2017a). The general rule in this regard is that the jurisdiction in which the customer has located its “permanent business presence” should be construed as the jurisdiction of consumption and that the supplier should be afforded the right to make the supply free of VAT in its jurisdiction and to claim the VAT paid in the process of making such supply (OECD, 2017a). This general rule should apply in all situations in the context of B2B supplies, except in extraordinary circumstances clearly specified in OECD VAT Guidelines 3.7 and 3.8 (OECD, 2017a).

In a B2C context, the OECD has recommended two general rules in relation to B2C supplies of services and intangibles:

- In terms of OECD VAT guideline 3.5, the place of taxation rule should be based on the place of performance in cases where supplies are performed and consumed at the same time and place and in the presence of both parties, i.e. the supplier and the consumer; and
- In all other cases, OECD VAT guideline 3.6 provides that the place of taxation rule should be based on the consumer’s usual residence (OECD, 2017a).

2.2.3. OECD RECOMMENDATION

Based on the discussions above, the OECD CFA recommended that all OECD members and other jurisdictions who intend to adhere to the OECD VAT Guidelines should particularly focus on:

- Implementing the principle of neutrality as well as the principles of the “destination principle” in their VAT legislation; and
- Using the OECD VAT Guidelines as a source of reference to ensure the facilitation of a coherent application of national VAT legislation in international trade (OECD, 2017a).

CHAPTER 3: SOUTH AFRICA'S APPROACH TO TAXING THE DIGITAL ECONOMY

3. INTRODUCTION

As stated in the "Research Problem" section (chapter 1.3) of this document, South Africa has opted to collect tax revenue on the digital economy by bringing digital services within the ambit of its VAT legislation (Mekgoe & Hassam, 2020).

3.1. BRIEF HISTORY

South Africa first introduced tax measures to ensure that tax is collected from the consumption of commercial activities in the digital economy effectively in 2014, which is estimated to have raised over R2 billion in additional tax revenue within the first three years of introducing such measures (Jantjies, 2020). However, it was realised that the tax measures were not as effective at collecting tax revenue from the digital economy and that further tax measures were required (Jantjies, 2020). Therefore, on 18 March 2019, National Treasury published Government Notice No. 429, in which National Treasury determined that "electronic services" as defined in section 1 of the Value-Added Tax Act, No. 89 of 1991 ('**VAT Act**') includes a supply by means of "an electronic agent, electronic communication or the internet for any consideration..." (National Treasury, 2019). This amendment has resulted therein that, with effect from 1 April 2019, the requirements to register as a VAT vendor have been broadened so as to include foreign electronic service suppliers who are making taxable supplies (through their own business activities or those of an intermediary or agent in relation to such supplier) in excess of R1 million within the Republic in any 12-month period (PricewaterhouseCoopers, 2019).

This follows the OECD guidelines of imposing VAT on the "destination basis" as well as the "place of consumption" rules of the OECD which determine that VAT should be imposed based on the location of the recipient of the services as opposed to the location of the supplier of such services (Deloitte, n.d.-a).

3.2. DAVIS TAX COMMITTEE REPORT ON ACTION 1 OF THE OECD BEPS PROJECT

In their second (and final) interim report on BEPS in South Africa (**'Second Report'**) the DTC stated that, as a result of the rapid expansion of the digital economy, it would be nearly impossible to separate the digital economy from the rest of the economy for tax purposes (Davis Tax Committee, 2016). It is further stated that the digital economy has accelerated the implementation of global value chains by Multinational Enterprises (**'MNEs'**) to integrate their global business operations (Davis Tax Committee, 2016). The DTC expects that the solutions that were proposed by the OECD in the BEPS Project should substantially address the BEPS issues that are exacerbated by the digital economy, and these proposed solutions can be summarised as follows:

In relation to direct taxes:

- The list of exceptions to the definition of a PE should be amended to ensure that the exceptions only apply to activities of a “preparatory or auxiliary” nature and to prevent closely related enterprises from benefitting from the exceptions by fragmenting their business activities among the different enterprises.
- The definition of a PE should be amended to prevent abuse of the “dependent agent” exception. For example, where a local subsidiary of a company selling goods or services online habitually plays the principal role in concluding contracts with large customers for those goods or services and those contracts are frequently concluded without any significant changes being implemented by the parent company, such activities should result in a PE for the parent company.
- Following an update to its transfer pricing guidance, the OECD made it clear that the group companies performing vital activities, contributing essential assets and managing significant economic risks should be entitled to an appropriate portion of the return generated from the exploitation of intangibles.
- Controlled Foreign Company (**'CFC'**) rules should be amended to ensure that income that is typically earned from participation in the digital economy is subject to taxation in the jurisdiction of the ultimate parent company (Davis Tax Committee, 2016).

In relation to indirect taxes:

- The OECD recommends that countries apply the principles of the OECD VAT Guidelines as discussed in chapter 2.2.2.1 on page 20 and consider introducing the collection mechanisms included therein (Davis Tax Committee, 2016).

3.3. DTC RECOMMENDATIONS ON DIRECT TAXES FOR THE DIGITAL ECONOMY IN SOUTH AFRICA

Given the international nature of the challenges faced by South Africa in relation to taxing the digital economy, the DTC recommended that South Africa should adopt the OECD recommendations, while taking note of specific recommendations set out by the DTC (Davis Tax Committee, 2016).

CHAPTER 4: ANALYSIS OF THE METHODS APPLIED IN TAXING THE DIGITAL ECONOMY IN OTHER COUNTRIES

4. INTRODUCTION

Having established the recommendations on taxing the digital economy by the OECD and the DTC in chapters 2 and 3 of this study, this chapter will focus on analysing the taxing methods applied in a developed country in order to compare their methods to the method currently applied by South Africa and to determine whether South Africa should consider adopting measures taken in such developed country in order to ensure effective and sufficient tax collection from the digital economy in South Africa.

4.1. SELECTION OF COUNTRY FOR PURPOSES OF THIS STUDY

According to the United Nations (2020), South Africa is classified as a country with a “developing economy” when comparing its economic conditions to the economic conditions in countries such as *inter alia* Australia, France, the Netherlands and the United Kingdom (**‘UK’**). Therefore, given its “developing economy” status, it is advisable that South Africa should observe the practices of countries classified as “developed economies” since the administration and implementation of certain practices of these countries have arguably been proven to be effective. It is further noted that the United Nations (**‘UN’**) has listed seven countries as “major developed economies” (**‘G7 countries’**) which includes Canada, France, Germany, Italy, Japan, the UK and the United States (United Nations, 2020). Therefore, the countries selected for purposes of this study will be limited to G7 countries, given their further distinction from the other “developed economies”. This narrows the selection of countries down considerably; however, other criteria must be applied to further reduce the list of countries, which are discussed below.

As stated in chapters 1.3 and 3 (page 4 and 23) of this study, South Africa currently imposes tax on the digital economy only by way of its VAT legislation, i.e. an indirect tax (Mekgoe & Hassam, 2020). Therefore, in light of the research question this study aims to address, the country selected for purposes of this study will be limited to a country currently taxing the digital economy by way of direct and indirect taxes in order to:

- compare the indirect taxing methods applied by the relevant country to South Africa's approach;
- analyse the impact of imposing a direct tax on the digital economy; and
- determine the benefits and drawbacks of implementing direct taxes on the digital economy.

The G7 countries that are currently implementing direct and indirect taxing methods in respect of the digital economy are:

1. France;
2. Italy; and
3. The UK (KPMG, 2021b; United Nations, 2020).

The common law of South Africa has its roots in Roman-Dutch law, which is the legal system brought to South Africa by European settlers who began arriving on South African soil during the mid-sixteenth century (Schreiner, 1967). However, according to Schreiner (1967), the contributions of English law to South Africa's common law is undeniable, since South African legislation is heavily influenced by English law and English case law has been widely used in South African courts in deciding cases where no binding precedent had been established in terms of the South African common law (Schreiner, 1967). Therefore, given the English law's strong influence on the South African common law, the country that will be analysed in this chapter will be the UK.

4.2. TAXATION OF THE DIGITAL ECONOMY IN THE UK

According to a report by KPMG (2021b), the UK government and Her Majesty's Revenue and Customs ('**HMRC**') has enacted legislation with the aim of taxing the digital economy by way of direct and indirect taxes. Since South Africa is only implementing indirect taxing methods, the indirect taxing method applied by the UK will be analysed below in order to compare their method to the method applied in South Africa and to make recommendations that could improve South Africa's indirect taxing method. An in-depth analysis of the UK's direct taxing method will also be conducted below in order to determine the reasons why the UK has adopted their direct taxing method as well as the effectiveness thereof.

4.2.1. INDIRECT TAX

The UK government, along with the HMRC, have over the years adopted developments in order to tax the digital economy by way of its indirect tax legislation (KPMG, 2021a). These mechanisms are summarised in the table below. For purposes of the discussions in this chapter (chapter 4), any reference made to “resident” is a reference made to a tax resident of the UK and any reference made to “foreign supplier” is a reference made to a supplier that is resident in a country other than the UK.

Table 1: The UK's indirect taxing mechanisms aimed at the digital economy

Date of development	Status of development	Description of the development
13 March 2018	Enacted	Effective from 15 March 2018, an obligation to act was placed on operators of a platform who knew or “ought to have known” that a foreign supplier using its platform was not accounting for VAT. If such platform operator does not act, they will be treated as jointly and severally liable for any underdeclaration of VAT (KPMG, 2021a).
8 December 2020	Enacted	For imports valued at less than GBP 135, the supply is no longer subject to import VAT, but is now subject to UK domestic VAT / Sales VAT instead. Where such supplies are made by an online marketplace (‘OMP’), the OMP must charge and remit the VAT to the HMRC. In all other cases, the foreign seller is required to register for VAT in the UK. However, where the recipient is a UK VAT-registered business and supplies the foreign seller with a valid GB VAT registration number, such supply would be subject to the reverse charge in the UK and the recipient would be liable to declare and pay the applicable VAT to the HMRC (Gilbert-Smith, 2021).

9 October 2019	Announced	If the UK exits the European Union (' Brexit '), non-UK resident vendors will be liable to register for VAT purposes in the UK, irrespective of whether they are registered for the EU Mini One Stop Shop-scheme (KPMG, 2021a).
11 March 2020	Enacted	The VAT rate applicable to digital publications will be zero-rated effective 1 May 2020. All digital publications prior to 1 May 2020 are subject to VAT at the standard rate (KPMG, 2021a).
15 January 2021	Enacted	Clarified that resident businesses providing digital services to EU consumers must register for the applicable VAT scheme post-Brexit (KPMG, 2021a).

Source: (KPMG, 2021a) (Own adaptation)

It is clear from the summary above that the UK has generally opted to tax the digital economy by requiring that non-resident suppliers register for VAT purposes in the UK. However, the UK also uses a reverse charge which requires residents of the UK to declare and pay the applicable VAT to the HMRC in certain circumstances (Gilbert-Smith, 2021). The UK's reverse charge and requirements to register for VAT are therefore discussed below.

In order to meet one of the objectives of this study (which is to compare the taxing methods applied in relation to the taxation of the digital economy in a developed country to the methods currently applied in South Africa), the discussion below will be limited to the methods applied in the UK to address the taxation of "digital services", since South Africa is focused on taxing digital services as is evident in chapter 3.1 above (National Treasury, 2019).

4.2.1.1. THE UK'S REVERSE CHARGE

The reverse charge in the UK essentially requires that the recipient of the services must act as both the supplier and the recipient in respect of the services (HMRC, 2020c). The effect of the reverse charge is that, where the recipient of the service is, or is deemed to

be, the final consumer of the service, such person will be liable to pay the applicable VAT on such supply. However, if the recipient uses such supply to make taxable supplies, such person would be entitled to claim the input tax on such supply and would be in a VAT-neutral position (HMRC, 2020c). This is in accordance with the OECD's principle of neutrality and the general objective of VAT being a tax charged on the final consumption of the supply, as set out in chapter 2 above. The requirements for the reverse charge to apply are discussed below.

In terms of VAT Notice 741A, updated and published by the HMRC on 31 December 2020, the reverse charge applies if:

- the “place of supply” (**‘POS’**) is found to be the UK;
- the supply is made to a UK resident by a foreign supplier;
- the supply is not exempt for UK VAT purposes; and
- in specific circumstances, the UK resident is a registered VAT vendor (HMRC, 2020c).

There are general rules for determining the POS in respect of B2B and B2C supplies of services and these are contained in section 7A of the Value Added Tax Act 1994, ch. 23 (**‘the UK VAT Act’**) (23/1994). The general rules provide that:

- In a B2B context, the POS is deemed to be in the country in which the recipient “belongs”; or
- In a B2C context, the POS is deemed to be in the country in which the supplier “belongs” (HMRC, 2020e).

Briefly, a person is deemed to “belong” in the UK if such person has a business establishment or fixed establishment in the UK making the relevant supplies or that person’s usual place of residence is in the UK (HMRC, 2020e).

Based on the general POS rules, it is found that the reverse charge would not apply where services are supplied in a B2C context, for the following reasons:

1. The reverse charge only applies in situations where a supply is made by a foreign supplier to a UK resident and where the POS is in the UK (HMRC, 2020c).

2. When one considers the general POS rules and the factors determining where a person “belongs” for UK tax purposes, the POS is deemed to be in the country in which the supplier is found to have its business establishment or has its usual place of residence (HMRC, 2020c).
3. Therefore, it is highly unlikely that a foreign service provider (i.e. a supplier that does not “belong” in the UK) makes a supply that has its POS in the UK in a B2C context.

Although there are specific POS rules in respect of the supply of digital services, it has typically been found that “reverse charge mechanisms” are not viable collection mechanisms in respect of B2C supplies (OECD, 2017b).

It therefore follows that, in light of the growing demand for digital services (especially in a B2C context) and the fact that the reverse charge is typically more effective at taxing B2B supplies of services, the UK adopted a different approach to tax, *inter alia*, B2C supplies of digital services (Hajro, Hjartar, Jenkins & Vieira, 2021). This approach requires foreign suppliers of digital services to register for UK VAT purposes, and this approach is discussed below.

4.2.1.2. UK VAT REGISTRATION AND LIABILITY FOR VAT

VAT is levied in the UK in terms of section 1 of the UK VAT Act on the “supply of goods or services in the United Kingdom ... and on the importation of goods ... into the United Kingdom.”

Section 4 of the UK VAT Act provides that VAT must be charged in respect of a taxable supply of goods or services made by a taxable person in the UK and in the course or furtherance of any business carried on by him. From this section it is clear that VAT must be levied where a supply constitutes:

- a taxable supply;
- made by a taxable person;
- in the UK; and
- in the course or furtherance of such person’s business.

A “taxable supply”, in short, is any supply made in the UK which is not exempt from VAT, and all supplies that are not exempt constitute taxable supplies, whether the supplier is registered for VAT or not (HMRC, 2021). A “taxable person” in terms of section 3 of the UK VAT Act means a person that is, or is required to be, registered under the UK VAT Act. The UK VAT registration requirements are therefore discussed below.

In terms of VAT Notice 700/1 read with the relevant supplement, both updated by the HMRC on 9 June 2021, a person is required to register for VAT purposes if the total value of taxable supplies made by such person exceeds GBP 85 000 (HMRC, 2021). It is, however, stated that in respect of a “non-established taxable person” (**NETP**), the registration threshold does not apply and therefore the NETP becomes liable to register and account for VAT if they make *any* taxable supplies in the UK (HMRC, 2021). The HMRC has defined an NETP as any person “who is not normally resident in the UK, does not have a UK establishment and, in the case of a company, is not incorporated in the UK” (HMRC, 2021).

This has the potential of discouraging foreign suppliers from conducting business in the UK, given that they would be liable to register and account for VAT as soon as they start making taxable supplies in the UK, whereas a UK supplier of similar services would not have to register nor account for VAT on taxable supplies less than GBP 85 000. Nevertheless, the POS rules in respect of digital services are considered below to determine when supplies are deemed to be made in the UK.

Given the reverse charge’s effective taxation of B2B supplies of digital services, this discussion will focus on determining when B2C supplies of digital services are deemed to have been made in the UK. Furthermore, notwithstanding the general POS rules in respect of B2C supplies as discussed in chapter 4.2.1.1 above, there are specific POS rules in respect of the supply of cross-border digital services in a B2C context (HMRC, 2020d). These rules are referred to as “the specific POS rules” in this chapter and are set out below.

As a starting point, the HMRC defines “digital services” in order to provide guidance as to which supplies are subject to the specific POS rules (HMRC, 2020d). Digital services are defined to include radio and television broadcasting services, telecommunications services

and electronically supplied services (HMRC, 2020d). The HMRC further defines “electronically supplied” to mean supplies which are delivered over the internet with minimal or no human intervention (HMRC, 2020d). Having established what constitutes digital services for UK VAT purposes, the specific POS rules provide that the POS in respect of cross-border digital services is the customer’s location, which is typically determined by where the consumer usually lives (HMRC, 2020d). This is in accordance with the OECD’s principle of imposing VAT on the “destination basis” as discussed in chapter 0 above.

The wide definition of “digital services” read with the specific POS rules should ensure that the majority of foreign suppliers of digital services would be required to register and account for VAT in the UK. This would therefore prove to be an effective mechanism for collecting VAT on the digital economy. To enforce compliance, the UK has adopted legislation that requires operators of an OMP to “act” when a foreign supplier using its platform is not accounting for VAT (KPMG, 2021a). This will be briefly discussed below.

4.2.1.3. OPERATORS OF OMP JOINTLY AND SEVERALLY LIABLE FOR VAT

The HMRC has certain powers to treat the operator of an OMP as jointly and severally liable for any unpaid VAT where such operator knew, or should have known, that a foreign supplier using its platform should have registered and accounted for VAT (HMRC, 2020a). The HMRC requires the operator to prevent the foreign supplier from offering goods via the operator’s platform until the foreign supplier has settled their VAT obligations (HMRC, 2020a). Until such time, the operator will be jointly and severally liable for any unpaid VAT (HMRC, 2020a). The HMRC provides guidance in relation to the “checks” that operators have to perform which should provide them with enough knowledge to determine whether a foreign supplier should register and account for VAT (HMRC, 2020a). Although the provisions may seem unfair to the operators of the OMP, these provisions should effectively enforce compliance with the registration requirements and provide assurance to the HMRC that they will collect any VAT amounts rightly due to it.

4.2.2. DIRECT TAX

On 22 July 2020, the UK government and the HMRC introduced legislation imposing a 2% tax (referred to as “the DST” in this chapter) on revenues earned in respect of certain “online services” provided to UK-based customers (Alliston & Harrison, 2020). The DST is retroactively effective from 1 April 2020. The DST is analysed in detail below.

4.2.2.1. BRIEF BACKGROUND

According to the HMRC, the UK government believes that the most sustainable, long-term solution to tax the digital economy is by reforming the international corporate tax rules (HMRC, 2020b). It therefore strongly supports the OECD discussions on the topic and have committed to remove the DST once international consensus has been reached in this regard (HMRC, 2020b). However, the HMRC has stated that the current corporate tax rules do not ensure that businesses operating in the digital economy are taxed in the jurisdiction from where they derive economic value (HMRC, 2020b).

Former UK finance minister Philip Hammond has stated that “[t]he UK has been leading attempts to deliver international corporate tax reform for the digital age. A new global agreement is the best long-term solution. But progress is painfully slow. We cannot simply talk forever.” (Holton & Young, 2018). The UK therefore decided to take proactive action and to implement its DST, albeit temporarily, while the OECD continues working toward international consensus on the matter. The anticipated impacts of the DST are discussed below.

4.2.2.2. ANTICIPATED IMPACT

The DST is expected to not only impact the total revenues earned by the HMRC but also the administrative burden placed on taxpayers, who will also have to carry certain costs in order to effectively comply with the new tax (HMRC, 2020b). The impact on revenue and the administrative burden will be discussed below.

Total additional revenue expected from implementing the DST

The total additional revenue that the HMRC expects to earn from the DST, as certified by the Office for Budget Responsibility, is set out in the table below (HMRC, 2020b).

Table 2: Total revenue earned by the UK DST

Relevant tax period	Additional Revenue (GBP million)
2019 – 2020	70
2020 – 2021	280
2021 – 2022	390
2022 – 2023	425
2023 – 2024	465
2024 – 2025	515

Source: (HMRC, 2020b) (Own design)

Impact on taxpayer’s administrative burden

It is expected that there will be an increased administrative burden on taxpayers affected by the DST; however, this is not unusual when new legislation is introduced. The HMRC has committed to providing clear and targeted guidance to ensure that businesses are supported in managing the increased administrative burden (HMRC, 2020b). Additional costs that the businesses are likely to incur include one-off costs to familiarise themselves with the rules and workings of the DST legislation and certain ongoing costs in respect of recording revenue earned from UK users and paying the applicable DST to the HMRC (HMRC, 2020b).

4.2.2.3. APPLICATION OF THE DST

Businesses subject to DST

The DST is aimed at large businesses or MNEs that earn revenue from providing services in relation to social media, a search engine or an OMP (**‘Online Services’**) to users in the UK (HMRC, 2020b). Where a business’ worldwide revenue from digital services exceeds GBP 500 million and at least GBP 25 million of that revenue is attributable to sales to UK users, the DST will apply to such revenue earned from UK users (HMRC, 2020b). The lower threshold effectively means that the first GBP 25 million of a business’ revenue earned from UK users is exempt from the DST (HMRC, 2020b).

If a business operates with low profit margins or is in a loss-making position, such business will be allowed to calculate their DST liability based on the operating margins of the group's relevant activities (HMRC, 2020b). This means that it is possible that no UK DST liability arises in the case of groups where their operating margins are low or negative. This provides that the DST should not have adverse effects on the long-term sustainability of businesses operating in the digital economy (HMRC, 2020b).

Revenue deemed to have been earned from UK users

Revenues are deemed to be earned from UK users if the recipient of the relevant service is a person that is normally located in the UK or is established in the UK (HMRC, 2020b). Although some concerns have been raised regarding the difficulty in determining whether a user is normally located or established in the UK, the HMRC appears to be relatively relaxed regarding the method used to determine the user's location, and therefore businesses should not be too concerned regarding the methods they apply, provided that such methods are reasonable and justifiable (Alliston & Harrison, 2020).

Services subject to the DST

The DST applies to Online Services and includes any online advertising service associated with such Online Services, but the OMPs of financial service providers are exempt (HMRC, 2020b). Below are some examples of services that are subject to the DST:

- When an advertisement is viewed or deemed to be consumed by a UK user;
- When a UK user is a party to a transaction on an OMP, all of the revenues arising from such transaction; and
- Accommodation, land or buildings situated in the UK or if accommodation, land or buildings situated outside the UK are supplied to a UK user (HMRC, 2020b).

Prevention/reduction of double taxation

If a transaction which is subject to the DST is supplied to a user via an OMP and such user is normally located in a country operating a similar tax to the DST, the revenues earned from such supply will be reduced by 50% (HMRC, 2020b).

Reporting

A group of companies is allowed to nominate an entity that is responsible to ensure that the entire group's DST liability is reported to the HMRC (HMRC, 2020b). However, if no entity is nominated, the ultimate parent of the group will be obligated to carry out such responsibilities (HMRC, 2020b).

Liability and payment of the DST

For large MNEs, the DST liability is calculated at a group level (based on the financial statements of the group), but each individual entity in the group will be required to pay their portion of the DST.

The DST will be payable and reportable on an annual basis (HMRC, 2020b).

Monitoring of the DST

The HMRC has indicated that the DST will be reviewed before the end of 2025 (HMRC, 2020b).

CHAPTER 5: ANALYSIS OF SOUTH AFRICA'S LEGISLATIVE INFRASTRUCTURE

5. INTRODUCTION

This chapter will analyse South Africa's legislation which was enacted with the aim of taxing the digital economy and to identify any weaknesses which may have a negative impact on the legislation's effectiveness in meeting its objectives. For purpose of the discussion under this chapter (chapter 5), any reference made to "the Act" means the South African VAT Act.

5.1. VAT IN SOUTH AFRICA

In South Africa, VAT is levied on the use or consumption of goods and services and is generally charged, collected and remitted to SARS by registered VAT vendors (PwC, n.d.). The tax has been designed as a tax on the final consumption of goods or services (i.e. the "ultimate" or final consumer of the supply is taxed) and most business transactions are subject to VAT, either at a rate of 15% ('**standard rate**') or 0% ('**zero rate**') (PwC, n.d.).

5.2. THE REVERSE-CHARGE MECHANISM

Before special provisions of the Act were introduced that impose VAT on foreign electronic services, VAT would be collected in respect of imported services only if local consumers complied with the so-called "reverse-charge mechanism" in terms of section 7(1)(c) of the Act. In short, the reverse-charge mechanism requires consumers to self-assess the VAT on an "imported service" and to then declare such imported service and the respective VAT to SARS (Gopal, 2017). "Imported services" are defined in section 1 of the Act as "a supply of services that is made by a supplier who is resident or carries on business outside the Republic [of South Africa] to a recipient who is a resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies". It follows from this definition that the reverse-charge mechanism only applies where the recipient of the imported service is, or is deemed to be, the final consumer of such supply, which is in accordance with one of the objectives of VAT (i.e. to constitute a tax on the final consumption of a supply) (PwC, n.d.). It is noted that this reverse-charge mechanism complies with the OECD guidelines of imposing VAT based on the "destination principle"; however, this has proven to present risks with regard

to the collection of the relevant tax in respect of imported services, especially in a B2C context where the recipient of the service is not a registered VAT vendor (Deloitte, n.d.-a).

Based on the final section of the definition of “imported services” in section 1 of the Act, which essentially requires that the imported service should be consumed for purposes other than making taxable supplies, the reverse-charge mechanism would not apply in a B2B context where the company importing the service is a registered vendor and will use such service in making taxable supplies (Coetzee & Meiring, 2017). Although no VAT is collected on the supply of the service imported, it should be noted that the company (being a registered VAT vendor in these circumstances) would likely have been entitled to claim the VAT paid in respect of the supply in terms of section 16(3) of the Act had the imported service been subject to VAT. The company is liable to levy output VAT on the subsequent supplies it makes (as part of which the company had been consuming the imported service) in terms of section 7(1) of the Act. Therefore, based on these findings, there is no prejudice to the fiscus and no loss of tax revenue should arise under these circumstances.

In a B2C context, however, the recipients of imported services are typically not VAT vendors and therefore, in most cases, the consumers are unaware of their liability to collect and remit the applicable VAT to SARS, which results in inadvertent non-compliance with the reverse-charge mechanism (Coetzee & Meiring, 2017). Given that the demand for electronic services such as *inter alia* video and music streaming services has increased dramatically over the past couple of years, especially during the period when South African citizens were confined to their living spaces during the strict lockdown protocols implemented by the South African government in 2020, it is expected that the non-compliance (and subsequent loss of tax revenue as a result thereof) with the reverse-charge mechanism in a B2C context will only increase (Ahmed, 2020; BDO USA, 2020). It is therefore evident that the reverse-charge mechanism is ineffective in collecting VAT revenue in the context of B2C supplies and, consequently, the Act was amended in 2013 to require foreign suppliers of electronic services to register for VAT in an attempt to address this loss of VAT revenue (Coetzee & Meiring, 2017). These amendments are analysed in detail below.

5.3. REGISTRATION AND LIABILITY FOR VAT

As stated in chapter 5.1 above, only registered VAT vendors are generally required to charge, collect and remit VAT in South Africa. However, in certain instances, another person (such as an agent, intermediary or the consumer of the supply as discussed in chapter 5.2 above) may become liable to ensure the appropriate VAT treatment of transactions (PwC, n.d.). The requirements to register for VAT purposes in South Africa are, therefore, examined below.

Section 23 of the Act contains the requirements and criteria that must be met in order for a person to be required to register for VAT purposes. This section of the Act essentially provides that every person who carries on an “enterprise” will become liable to register as a VAT vendor at the end of the month where the total value of taxable supplies made by that person in a consecutive 12-month period exceeds R1 million. A critical element to the requirement to register for is that the person should be carrying on an enterprise as defined in the Act.

Paragraph (a) of the definition of an “enterprise” in section 1 of the Act states that an enterprise essentially means any activity which is continuously or regularly carried on by any person in South Africa in the course or furtherance of an enterprise in exchange for consideration. Based purely on this part of the definition, foreign suppliers would not be required to register for VAT in terms of section 23(1) of the Act if none of the activities of the foreign supplier are “continuously or regularly” being physically rendered within South Africa. This highlights the South African tax risks imposed by the increased ability of foreign entities to provide cross-border electronic services without the need for a physical presence in the country, as discussed in detail in chapter 2 of this study.

To address this tax risk, the Taxation Laws Amendment Act No. 31 of 2013 (31/2013) (**2013 TLAA**) added section 23(1A) of the Act (89/1991), subparagraph (b)(vi) to the definition of an enterprise (**subparagraph (b)(vi)**) in section 1 of the Act (89/1991) as well as a definition of “electronic services” in section 1 of the Act (89/1991). The additions were aimed at ensuring that foreign suppliers of electronic services were required to register for VAT purposes. However, it became evident that the additions were not as successful in achieving their objectives and therefore section 23(1A) of the Act and subparagraph (b)(vi) were

subsequently amended by the Taxation Laws Amendment Act No. 23 of 2018 (23/2018) (**'2018 TLAA'**) to address these inefficiencies (Moodaley, 2020). The amended requirements for foreign suppliers of electronic services to register for VAT purposes are discussed below.

Section 23(1A) of the Act provides that “[e]very person who carries on any enterprise as contemplated in paragraph (b)(vi) or (vii) of the definition of an ‘enterprise’ in section 1 and is not registered becomes liable to be registered at the end of any month where the total value of taxable supplies made by that person has exceeded R1 million in any consecutive 12-month period”. Subparagraph (b)(vi) of the definition of an enterprise in section 1 of the Act provides that an enterprise means “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” (own emphasis) –

- i. The recipient of such services is a South African tax resident;
- ii. The payment in respect of such services is made from a South African registered bank;
or
- iii. The recipient of such services has an official registered address in South Africa, whether it be a business, residential or postal address.

It is evident from the legislation quoted above that, in order to determine whether a liability to register for VAT purposes exists, foreign suppliers of electronic services would first need to establish whether their business activities constitute the supply of “electronic services” as defined in section 1 of the Act. This definition is analysed below.

“Electronic services” are defined in section 1 of the Act to mean services which are electronic services as prescribed by the Minister of Finance (**'the Minister'**). The regulations published by the Minister in this regard (Government Notice No. R. 221, **'the Regulations'**) were amended by Government Notice No. 429 (**'GN 429'**), which was published on 18 March 2019 and which provides that electronic services means “any services supplied by means of an electronic agent, electronic communication or the internet for any consideration, other than –

- (a) educational services supplied from a place in an export country and regulated by an educational authority in terms of the laws of that export country; or
- (b) telecommunications services; or

- (c) services supplied from a place in an export country by a company that is not a resident of the Republic to a company that is a resident of the Republic if –
- (i) both those companies form part of the same group of companies; and
 - (ii) the company that is not a resident of the Republic itself supplies those services exclusively for the purposes of consumption of those services by the company that is a resident of the Republic” (Own emphasis) (National Treasury, 2019).

The definitions of “electronic agent”, “electronic communication” and “internet” in section 1 of the Electronic Communications and Transactions Act (25/2002) (**ECT Act**) have a wide application and according to Moodaley (2020), the effect is that “virtually all services that are supplied by way of electronic means” are now considered “electronic services” for purposes of the Act. SARS has, however, explained that the intention of the policy is to impose taxes on services that can be provided by systems requiring minimal human intervention (Marais, Hare, Williams & Bouwer, 2019). To assist foreign suppliers and to provide some clarity and guidance on the topic, SARS has published a document that provides some guidance in respect of the registration requirements of foreign suppliers of electronic services (South African Revenue Service, 2019). In this document, SARS provides guidance on what constitutes “electronic services” and states that “[i]n simple terms, ‘electronic services’ refers to electronic or digital content that is supplied by electronic means, for example, via the internet, or other telecommunications service” and that such services would constitute electronic services even if such services were supplied via an intermediary (South African Revenue Service, 2019). It is evident that the wide ambit of the definition of electronic services should prove beneficial to the objectives of collecting tax revenue on the supply of electronic services and imposing a registration requirement on foreign suppliers of electronic services.

5.4. EFFECTIVENESS OF SOUTH AFRICA’S CURRENT APPROACH

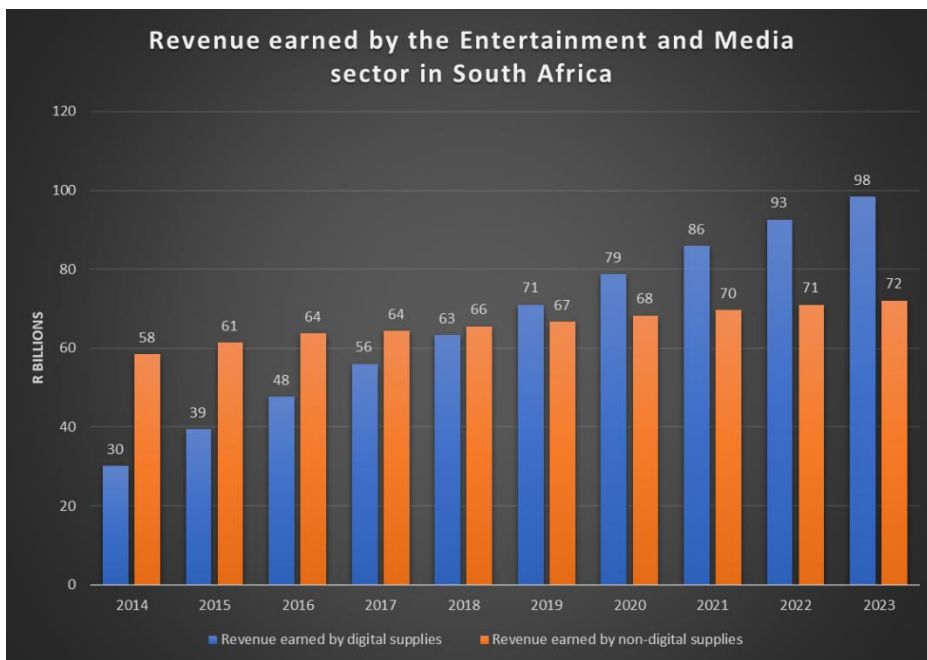
As stated in chapter 3.1 above, it is estimated by the South African Parliamentary Budget Office that within three years, South Africa raised over R2 billion in additional tax revenue from the digital economy since it first introduced the relevant tax measures effectively from 2014 (Jantjies, 2020). However, according to the OECD Secretary-General Tax Report to the G20 Finance Ministers and Central Bank Governors published in April 2021, it is estimated that the total revenue raised by the current VAT legislation in South Africa has

raised R8.4 billion in the first six years (OECD, 2021). This shows that the VAT legislation in its current form can serve as an effective mechanism for collecting additional tax revenues, given that the revenue earned from the digital economy is increasing exponentially when comparing the R2 billion earned during the first three years and the R8.4 billion estimated to have been earned by April 2021. This effectively means that the total VAT revenue earned by SARS from the digital economy increased by 320% since 2017.

It is worth noting, however, that although this increase in tax revenue is impressive, the global digital economy is growing at a rapid rate and one would have to consider the estimated growth of the digital economy in South Africa to accurately determine the effectiveness of South Africa's VAT legislation in taxing the digital economy (Oxford Economics & Huawei, 2016).

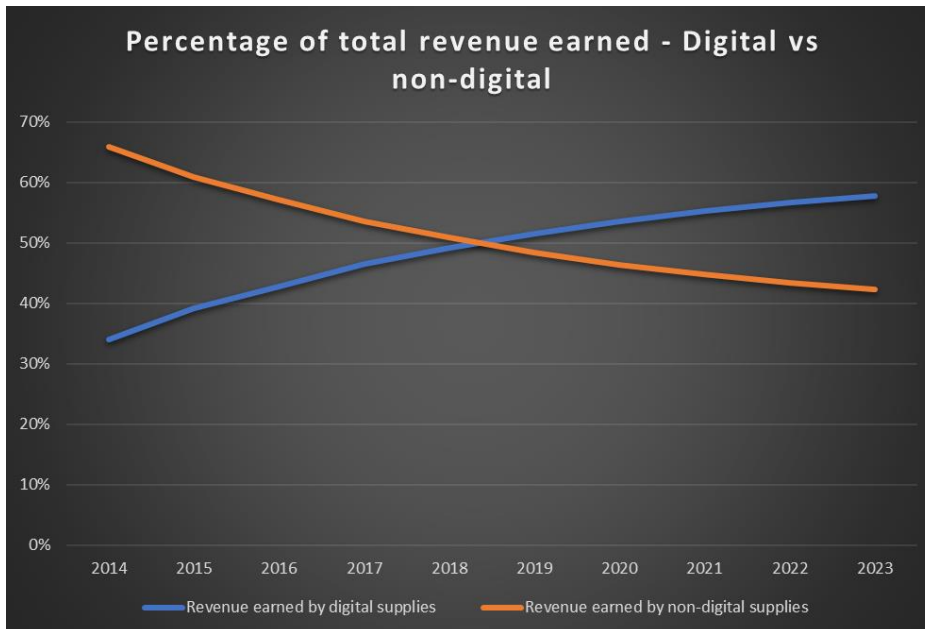
To place the growth of the digital economy in South Africa in perspective, the following charts set out the revenue earned by, and forecasted for, the entertainment and media sector in South Africa from 2014 to 2023 (PwC, 2019):

Figure 1: Comparison of the revenue earned by the entertainment and media sector in South Africa by way of digital vs non-digital supplies



Source: (PwC, 2019) (Own adaptation)

Figure 2: Comparison of the percentage of total revenue earned in South Africa by way of digital vs non-digital supplies in the entertainment and media sector



Source: (PwC, 2019) (Own adaptation)

It is clear from **Error! Reference source not found.** and Figure 2 above that, in the context of the South African entertainment and media ('E & M') sector, digital supplies of E & M have experienced immense growth in comparison to non-digital supplies. In 2014, the total revenue earned by way of digital E & M supplies was equal to approximately 34% of the total revenue earned by the E & M sector in South Africa (PwC, 2019). However, in 2019 this percentage increased to approximately 52% and it is anticipated that by 2023 the total revenue earned by digital E & M supplies would constitute nearly 60% of the total revenue earned by the E & M sector in South Africa (PwC, 2019). This might explain why the DTC and the OECD have stated that the digital economy is arguably becoming the economy itself, given this increase in the proportion of digital supplies of E & M in South Africa (Davis Tax Committee, 2016; OECD, 2015). These findings highlight the importance of ensuring that South Africa's approach to taxing the digital economy is closely monitored and adapted as necessary, in order to ensure that there is no inadvertent loss of tax revenue due to ineffective tax mechanisms. The effectiveness of South Africa's current taxing approach is, therefore, analysed further below.

As stated previously, South Africa imposes tax on the digital economy only by way of VAT (Mekgoe & Hassam, 2020). Therefore, the total estimated revenue collected by way of its VAT legislation during the period 2014 to 2021 (in respect of all economic sectors relevant to the digital economy) will be compared to the total revenue it could potentially have earned on digital E & M supplies in South Africa in order to determine the effectiveness of South Africa’s current taxing method. The reason why these amounts are compared is simply to place into perspective the effectiveness of South Africa’s approach to taxing the digital economy. The following table illustrates the findings in this regard:

Figure 3: VAT collected from the digital economy vs Potential VAT revenue on digital E & M supplies in SA

Period	Total revenue earned ² (R Billion)	Potential VAT revenue ³ (R Billion)	VAT revenue collected during period (R Billion)	% of total potential income ⁴
2014 - 2016	117,3 ⁵	17,6	2,0 ⁶	11,4%
2017 - 2021	190,4 ⁵	28,6	6,4 ⁷	22,4%

Source: (Refer to footnotes) (Own design)

It is clear from Figure 3 that, although South Africa’s collection of VAT revenue in respect of the digital economy seems to be improving quite significantly, the percentages calculated above are indicative that South Africa’s current approach to taxing the digital economy could be improved or adapted to ensure that not only a higher amount of VAT be collected from the digital economy, but that a greater amount of tax (such as *inter alia* income tax) could be collected from the digital economy in South Africa. Recommendations for improving South Africa’s VAT legislation will be discussed in chapter 6.3 of this document.

² By way of digital E & M supplies in South Africa.

³ Given the wide definition of “electronic services”, these amounts have been calculated as if all supplies constitute taxable supplies which would be subject to VAT in South Africa. These amounts have been calculated by applying the standard rate to the total revenue earned by digital E & M supplies in South Africa.

⁴ The estimated total VAT revenue collected as a percentage of the total potential VAT revenue that may have been collected from digital E & M supplies in South Africa.

⁵ (PwC, 2019).

⁶ (Jantjies, 2020).

⁷ This amount was calculated by deducting the estimated R2 billion revenue earned during 2014 – 2016 from the total estimated revenue earned of R8.4 billion by 2021 (OECD, 2021).

CHAPTER 6: COMPARATIVE ANALYSIS

6. INTRODUCTION

After the analysis conducted in the chapters above, this chapter seeks to summarise the findings of the chapters as well as meeting the objective of comparing South Africa's approach to taxing the digital economy to the guidelines provided by the OECD and the DTC and the methods applied in the UK.

6.1. SOUTH AFRICA'S COMPLIANCE WITH THE OECD GUIDELINES AND DTC RECOMMENDATIONS IN RESPECT OF VAT

The table below sets out the relevant recommendations of the OECD and South Africa's compliance with such recommendations, as discussed in the relevant chapters of this study.

Table 3: South Africa's compliance with the OECD recommendations

OECD's recommendation	South Africa's compliance
The burden of VAT should not lie on taxable businesses.	South Africa's VAT legislation provides for businesses to claim the relevant input VAT paid and only the final consumer of a supply is not allowed to claim such input tax. Refer to chapters 3 and 5 above for more detail in this regard. South Africa therefore complies with this recommendation.
Businesses involved in similar business activities should be subject to similar taxation.	The VAT registration threshold in South Africa is the same for both domestic suppliers and foreign suppliers, i.e. R1 million (PricewaterhouseCoopers, n.d.). South Africa therefore complies with this

	recommendation.
Foreign businesses should be on a level playing field with domestic businesses with regard to the level of taxation.	<p>The VAT registration threshold in South Africa is the same for both domestic suppliers and foreign suppliers, i.e. R1 million (PricewaterhouseCoopers, n.d.).</p> <p>South Africa therefore complies with this recommendation.</p>
Internationally traded services should be taxed on the “destination basis”.	<p>Foreign supplies of electronic services are only subject to VAT in South Africa if:</p> <ul style="list-style-type: none"> i. the recipient of such services is a South African tax resident; ii. the payment in respect of such services is made from a South African registered bank; or iii. the recipient of such services has an official registered address in South Africa, whether it be a business, residential or postal address, <p>in terms of section 23(1) of the VAT Act (89/1991).</p> <p>South Africa therefore complies with this recommendation.</p>
In a B2B context, the jurisdiction of the location of the customer should have taxing rights	<p>B2B supplies are generally subject to VAT in South Africa if such supplies are made in South Africa or if the reverse-charge mechanism applies, where the customer is a resident charging and paying the applicable VAT in respect of imported services. Refer to chapters 3 and 5 above for more detail in this regard.</p>

	South Africa therefore complies with this recommendation.
<p>In a B2C context, two rules apply in determining the place of taxation:</p> <ul style="list-style-type: none"> • where services are physically rendered and consumed at the same time and place, the jurisdiction in which the supply is performed has taxing rights; and • in any other case, the jurisdiction where the customer has its usual residence must have taxing rights. 	<p>Supplies are subject to VAT in South Africa if such supplies are made in South Africa or if the supply meets the requirements of electronic services as set out above, which essentially requires that the customer is a South African resident. Refer to chapters 3 and 5 above for more detail in this regard.</p> <p>South Africa therefore complies with this recommendation.</p>
<p>There should not be separate rules for supplies made in a B2B versus a B2C context.</p>	<p>Although South Africa's legislation may contain specific rules in relation to certain supplies, generally South Africa does not have separate rules for B2B supplies and B2C supplies. Refer to chapters 3 and 5 above for more detail in this regard.</p> <p>South Africa therefore complies with this recommendation.</p>

Source: (Own design)

Based on the table above, it seems that South Africa currently complies with the OECD VAT guidelines.

As discussed in chapter 3.3 above, the DTC recommended that South Africa should follow the recommendations of the OECD and therefore, based on the finding that South Africa complies with the OECD's recommendations, South Africa is currently also in compliance with the DTC's recommendations.

6.2. COMPARISON BETWEEN SOUTH AFRICA AND THE UK

Table 4: Comparing South Africa's approach to the UK

Element / requirement	South African reverse-charge mechanism	South Africa's newly enacted legislation	UK's reverse-charge mechanism	UK's VAT legislation ⁸
Definition of electronically supplied services or similar	No	Yes, prescribed by the Minister of Finance in a published regulation	No	Yes
Method of collection	Reverse charge	Registration of foreign suppliers of "electronic services"	Reverse charge	Registration of foreign suppliers of any taxable supplies in the UK
Responsibility to declare and pay	Recipient of the service	Supplier of the service	Recipient of the service	Supplier of the service and operators of OMP ⁹
Applies to B2B or B2C supplies	Both, but more effective in relation to B2B supplies	Both	B2B	Both
Registration threshold	Exemptions for transactions	R1 million	None	GBP 85 000 for domestic

⁸ Excluding the provisions relating to the UK's reverse charge.

⁹ Only in certain circumstances when the operator of the OMP should have known that the foreign supplier had to register and account for VAT.

	less than R100 ¹⁰			suppliers, GBP 0 for foreign suppliers ¹¹
Place of supply rules	No	No	Yes	Yes

Source: (Coetzee & Meiring, 2017) (Own adaptation)

From the table above it is clear that the indirect taxing methods applied in the UK and South Africa, respectively, do not differ greatly. The following are some of the most notable differences:

1. The UK VAT Act (23/1994) contains place of supply rules, while South Africa does not have place of supply rules in its VAT legislation.
2. The UK has no VAT registration threshold that applies to foreign suppliers of taxable supplies in the UK, while South Africa's VAT registration threshold is the same for domestic and foreign suppliers.
3. The UK's legislation is not aimed specifically at suppliers of electronic services, but rather at all foreign suppliers of taxable supplies in the UK. South Africa's legislation only requires foreign suppliers of electronic services to register and account for VAT in South Africa.

Although the methods applied in these two countries are somewhat similar, some of the mechanisms applied in the UK could certainly prove useful if they were to be implemented in South Africa and, therefore, recommendations are made in the remainder of this chapter.

6.3. RECOMMENDATIONS FOR SOUTH AFRICA

The recommendations contained in this section are divided between recommendations relating to indirect taxes and direct taxes. The indirect tax recommendations are discussed first, followed by recommendations relating to direct taxes.

¹⁰ (Coetzee & Meiring, 2017).

¹¹ Refer to chapter 4 above for more detail.

6.3.1. RECOMMENDATIONS FOR SOUTH AFRICA: INDIRECT TAXES

Based on the findings of chapter 4.2.1 above, it is recommended that South Africa investigate the benefit of adopting the following recommendations to improve its current indirect taxing method in relation to the digital economy. These recommendations are:

Adopting general place of supply rules

It was established in chapter 4.2.1 above that the UK's current VAT legislation, read with its place of supply rules, are quite effective at taxing the digital economy. However, one should be cautious not to "over-engineer" such place of supply rules, since taxpayers in the UK have, in certain instances, found that the different place of supply rules are complicated and difficult to understand (Thexton, 2020). Therefore, general (and simple) place of supply rules should prove more effective in guiding taxpayers to determine the relevant place of a supply.

As discussed in chapter 5.1, in South Africa supplies are generally only subject to VAT if such supplies are made in the course or furtherance of an enterprise as defined in section 1 of the VAT Act. The first section of this definition requires that supplies must be "continuously or regularly" made in South Africa. A general place of supply rule providing guidance on when supplies are made in South Africa could assist taxpayers in (i) determining whether they should register for VAT, (ii) clarifying the place of supply and (iii) reducing uncertainty as to the VAT treatment of certain transactions. If it is found that there is general uncertainty with regard to determining the place of supply rules in respect of specific transactions, SARS could provide guidance in respect of such transactions or infer place of supply rules in its legislation as it has in subparagraph (b)(vi) of the definition of an enterprise. These inferred place of supply rules are discussed below.

Subparagraph (b)(vi) of the definition of an enterprise can be seen to infer place of supply rules in respect of foreign supplies of electronic services, given that such supplies are only subject to VAT if at least two of the following requirements are met:

- (i) the recipient is a resident of South Africa;
- (ii) payment originates from a bank in South Africa; or
- (iii) the recipient has a registered address in South Africa.

This is in accordance with the OECD's guidance in determining the place of taxation in respect of both B2B and B2C supplies (OECD, 2017a). This subparagraph, although not specifically addressing the place of supply in respect of electronic services, provides clear guidance as to when such foreign electronic services are subject to VAT. It is therefore recommended that South Africa should adopt general place of supply rules which apply to a wide variety of transactions and that further guidance could be provided in respect of transactions where the VAT treatment thereof is generally uncertain.

Adopt similar approach as the UK to deem operators of OMPs jointly liable for a foreign supplier's VAT liability

The OECD has established that the effectiveness of requiring foreign suppliers to register for VAT purposes relies on the compliance of the foreign suppliers, which poses a significant risk on the country imposing such requirements. The following recommendation is therefore discussed below.

It is recommended that South Africa imposes legislation which deems operators of an OMP to be jointly and severally liable in respect of the VAT liability of a foreign supplier using such OMP to make taxable supplies in South Africa. This should enforce compliance with the local registration requirements and should ensure that South Africa is in a favourable position with regard to tax revenue collection. The government could provide specific guidance to operators of OMPs in respect of determining when such liability arises, as was done in the UK.

6.3.2. RECOMMENDATIONS FOR SOUTH AFRICA: DIRECT TAXES

Based on the discussion in chapter 4.2.2, it is clear that imposing a DST could serve as an effective mechanism of collecting additional tax revenue in relation to the digital economy. The recommendations in this regard are discussed below.

It was found that South Africa has decided against implementing direct taxing mechanisms to tax the digital economy in anticipation of the OECD providing a unilateral approach. However, the progress made by the OECD in this regard has been stated as being "painfully

slow” and, therefore, various countries have started implementing a DST to tax the digital economy (Holton & Young, 2018).

At least 4 of the G7 countries have either implemented a DST or published draft legislation to enact a DST. Japan has also established a panel of international tax experts to evaluate *inter alia* the imposition of a DST (KPMG, 2021a). It is therefore clear that the developed countries are not waiting around for international consensus and, therefore, it is recommended that South Africa strongly considers the possibility of implementing a DST in order to ensure that it collects its fair share of tax revenues from the digital economy.

Understandably, South Africa would not want to jeopardise its relationship with the OECD. Therefore, if South Africa were to adopt a DST, it could, as is the case in the UK, commit to remove the DST once international consensus on the matter has been reached, thereby reducing any adverse impacts on its relationship with the OECD.

It is furthermore recommended that, if South Africa were to consider implementing a DST, the DST should be based on a formula similar to the mineral royalty formula contained in the Mineral and Petroleum Resources Royalty Act, No. 28 of 2008. In short, this formula provides that a minimum rate of 0.5% up to a maximum rate of 5% applies to the gross sales value of minerals being transferred, depending on the profitability of the company making the sales (Van der Zwan, 2013). This would ensure that the level of taxation of different companies remains fair and that the DST should not have adverse effects on the long-term sustainability of businesses involved in the digital economy.

CHAPTER 7: CONCLUSION

7. INTRODUCTION

Before the conclusion of this study is reached, the research question and objectives of the study will be examined in order to determine whether this study has been successful in meeting its objectives and addressing the research question. These are therefore repeated for the purposes of the discussions below.

7.1. RESEARCH QUESTION

What are the weaknesses in South Africa's approach to taxing the digital economy and what is the potential impact of levying taxes on digital services by way of a direct tax?

Weaknesses in South Africa's approach

As discussed in chapter 6 above, it was found that, although South Africa's current VAT legislation should serve as an effective mechanism to tax the digital economy, South Africa could consider adapting and enhancing its legislation to further improve the effectiveness of its VAT legislation¹². It was therefore recommended that South Africa should consider some of the mechanisms used in the UK to achieve this goal. Further research should be conducted to determine the potential impact of implementing such recommendations.

This study also found that South Africa does not currently impose any taxes on the digital economy by way of direct taxes. Given the challenges the digital economy poses in relation to the current international corporate income tax framework, it was recommended that South Africa should strongly consider implementing a DST that could provide a temporary solution to tax the digital economy. Other recommendations were made to ensure that the DST would not result in unfair taxation of companies, by taking into consideration a company's profitability when determining the applicable rate of the DST. Further research should be conducted to determine the impact of implementing a DST based on the recommendations made in this study.

¹² In taxing the digital economy.

Impact of imposing direct taxes

It was found that imposing a direct tax such as a DST has the potential of earning substantial additional tax revenue. Although some challenges are posed with regard to the administration thereof, this should be manageable if the taxing authorities are able to provide clear and targeted guidance to assist and support taxpayers in dealing with the added challenges.

7.2. RESEARCH OBJECTIVES

To determine the key differences between direct taxes and indirect taxes and their application in taxing the digital economy in a selected developed country

The direct and indirect taxing methods applied to tax the digital economy in the UK were analysed in chapter 4. It was found that both the direct and indirect methods applied by the UK should serve as effective mechanisms to tax the digital economy.

To compare South Africa's approach to taxing the digital economy to the guidelines developed by the OECD and the taxing methods applied by a selected developed country

South Africa's compliance with the guidelines developed by the OECD was discussed in chapter 6.1 above and it was found that South Africa's current taxing mechanisms comply with the guidelines of the OECD.

In chapter 6.2 above, South Africa's approach was compared to the indirect taxing method applied in the UK and it was found that, although these methods were largely similar, South Africa could implement certain mechanisms adopted in the UK to further improve its VAT legislation in relation to the digital economy.

To determine the effectiveness of South Africa's taxation of the digital economy through its VAT legislation

South Africa's VAT legislation that is aimed at taxing the digital economy was discussed in chapter 5 above and it was found that South Africa's current legislation should serve as an effective mechanism to tax the digital economy. However, as discussed above, the effectiveness of South Africa's VAT legislation¹³ can be improved by implementing certain mechanisms applied in the UK.

To determine the reasons why other countries have implemented a digital services tax and to determine whether South Africa should follow suit

It was found that most developed countries forming part of the G7 have enacted a DST, published draft legislation to enact a DST or is seriously considering implementing a DST. It seems that the main cause of this movement to implement a DST is the lack of progress made by the OECD in reaching international consensus in taxing the digital economy.

It was recommended that South Africa should consider implementing a DST to ensure that South Africa earns a fair amount of tax revenue from the digital economy, which should assist in addressing the large budget deficit as mentioned in chapter 1.3.

It follows from the discussions above that this study has addressed the research question posed as well as met its objectives. However, it is clear that further research should be conducted in order to study the impact of the findings and recommendations of this study.

¹³ In taxing the digital economy.

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ANNEXURE A: PLAGIARISM DECLARATION



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DEPARTMENT OF TAXATION

Declaration Regarding Plagiarism

The Department of Taxation emphasises integrity and ethical behaviour with regard to the preparation of all written assignments. Although the lecturer will provide you with information regarding reference techniques, as well as ways to avoid plagiarism (see the "Guidelines on Referencing" document), you also have a responsibility to fulfil in this regard. Should you at any time feel unsure about the requirements, you must consult the lecturer concerned before submitting an assignment.

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For the period that you are a student at the Department of Taxation, the following declaration must accompany all written work that is submitted for evaluation. No written work will be accepted unless the declaration has been completed and is included in the particular assignment.

	Student
I (full names & surname):	Dean van den Berg
Student number:	19365820

Declare the following:

1. I understand what plagiarism entails and am aware of the University's policy in this regard.
2. I declare that this assignment is my own, original work. Where someone else's work was used (whether from a printed source, the Internet or any other source) due acknowledgement was given and reference was made according to departmental requirements.
3. I did not copy and paste any information directly from an electronic source (e.g., a web page, electronic journal article or CD ROM) into this document.
4. I did not make use of another student's previous work and submitted it as my own.
5. I did not allow and will not allow anyone to copy my work with the intention of presenting it as his/her own work.

Dean van den Berg

Signature