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14 July 2014

Mr Mpho Logote
Senior Economist
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Republic of South Africa
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Via email: mpho@treasury.gov.za

Subject: VAT and Foreign-Based Supplies of Electronic Services

Dear Mr Logote:

Amendments to the definition of "electronic services" in section 1(1) of the Value-Added Tax Act 1991 (act No. 89 of 1991) ("VATA 1991") went into effect 1 June 2014. The new rules will significantly change the current treatment of these supplies and will present challenges for both businesses and the South African Revenue Service ("SARS"). Tax Executives Institute ("TEI" or the "Institute") welcomes the publication of regulations and Binding General Rulings and, in particular, the Electronic Services Regulations R.221 published on 28 March 2014. This guidance clarified the scope of the digital products and services covered by the definition of "electronic services" and postponed the implementation of the new provisions until 1 June 2014. We remain concerned, however, that significant uncertainty and complexity still surrounds the practical implementation of the rules, which will adversely affect businesses using their best efforts to comply. This letter identifies areas where further guidance would assist businesses and SARS.

Founded in 1944 to serve the professional needs of business tax professionals, TEI is the preeminent association of in-house tax professionals worldwide. The Institute's 7,000 professionals manage the tax affairs of over 3,000 of the leading companies across all industry sectors around the world. TEI members are accountants, lawyers, and other corporate and business employees responsible for the tax affairs of their employers in an executive, administrative, or managerial capacity.

Many of these companies are involved in the sale, distribution, and purchase of digital products and services on a global basis. TEI members working for those companies, and other businesses, constantly monitor VAT developments around the world, including in

South Africa. In respect of those rules, TEI espouses organizational values and goals that include integrity, effectiveness and efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators alike.

TEI believes it is critical to maintain a dialogue between businesses and revenue authorities to ensure release of necessary guidance on VAT rule changes before their effective dates. That guidance should focus on practical implementation and clearly describe how the rules should be applied. This ensures that businesses and SARS are interpreting the legislation in a similar fashion, thereby facilitating compliance, collection, and enforcement of the tax.

Recently, the European Union ("EU") developed systems and rules governing the VAT treatment of electronically delivered goods and services. Many of those rules will go into effect on 1 January 2015. TEI worked extensively with the European Commission on guidance interpreting amendments to the law that will make it easier for businesses to comply with the new rules and for EU Member States to administer them.

TEI's work with the European Commission was informed by experience with other jurisdictions in which TEI members already comply with similar rules. In particular, since 1 July 2011 Norway has been taxing sales of electronic services made by foreign (non-established) vendors to Norwegian customers through a simplified registration and collection system. The Norwegian system has generally been viewed as satisfying the demands of both the Norwegian tax administration and businesses. Unlike the EU, the Norwegian system was devised to deal with a single country, rather than a trading block, and it was even recommended as a model for taxing digital sales to final consumers during a plenary session of the OECD Global Forum on VAT held in Tokyo this past April.

References to the EU and Norwegian rules should not be read as inferring South Africa should simply duplicate regulations that have been designed for other countries with different legal frameworks, customs, and backgrounds. Our comments focus on the practical implementation of these rules, as we expect all countries will have common objectives of fair taxation, maintaining (or achieving) a level playing field between domestic and foreign vendors, as well as efficient collection and enforcement of their tax systems. In the specific context of electronic commerce, it is in the interest of all parties to ensure a consistent global approach in line with OECD principles and guidelines.

Our comments focus on the following areas:

1) Differentiating between Business-to-Business ("B2B") and Business-to-Final Consumer ("B2C") Supplies
2) Identification of Customer Residence
3) Identification of the Origin of the Payment
4) Issuance of Invoices
5) Retention of Data and Records
6) Intermediaries and Chain Transactions

1) Differentiating between B2B and B2C Supplies:

Prior to 1 June 2014, local suppliers were required to charge South African VAT to their South African customers while foreign suppliers had no such requirement. Customers purchasing electronic services from foreign suppliers had to self-assess South African VAT (whether B2B or B2C). The National Treasury's press release of 28 March 2014 noted that concerns about non-compliance with those rules was a major reason for amending the VATA 1991 to require foreign suppliers of electronically delivered services to register with SARS and collect South African VAT.

The amended VATA 1991 and associated guidance do not differentiate between B2B and B2C supplies. Generally, however, non-compliance in this area occurs with B2C supplies where the VAT is a cost, rather than at the B2B level where VAT is rarely a cost (except for exempt or input-taxed businesses). Requiring collection of VAT on B2B supplies by foreign suppliers, rather than by their domestic customers through the reverse-charge mechanism, creates a new administrative burden without enhancing compliance with, or collection of, South African VAT. Thus, we urge SARS to exclude B2B sales from the new rules. Doing so would make the VAT collection process more efficient for the government and for businesses alike, while still achieving the goal noted in the 28 March 2014 press release of "level[ing] the playing field between local suppliers of e-services and foreign suppliers."

Differentiating between customers could be accomplished via a simple test, such as the collection of a South African VAT number. TEI suggests excluding from South African VAT transactions with customers that provide a South African VAT number, whether by way of a new regulation or Binding General Ruling.

2) Identification of Customer Residence:

The guidance published by the government to date does not address the proxies that would be acceptable as evidence to support the decision to charge (or not charge) South African VAT. This absence of authority will undoubtedly lead to varying approaches by businesses for determining place of supply and difficult audits where the interpretation of existing place of supply rules will differ between businesses and SARS auditors. These administrative inefficiencies will be costly to businesses and the government.

The European Commission has done significant work on this issue. On 2 April 2014, after much consultation with business groups (including TEI), the European Commission published its "Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015" (the "Explanatory Notes").[1] The Explanatory Notes are not prescriptive. Rather, they provide a

[1] The latest and final version of the EU guidelines (EU Explanatory Notes) can be found at: http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm#explanatory_notes

or directly at:

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/explanatory_notes_2015_en.pdf

framework within which all suppliers of e-services can find the compliance logic that best suits their business model, their systems, etc. to achieve a reasonable tax result. Large international suppliers of e-services are already designing their systems in line with these EU rules, including identifying the types of documentation and logic to best assess the location of their customers for determining the place of supply.

Adopting a similar approach in South Africa would benefit SARS by providing a solid foundation for building its compliance and audit programs. Also, SARS and businesses could leverage the work already being done by businesses to adopt systems that comply with the EU rules. This would give all parties comfort that foreign vendors' systems would be tested and audited elsewhere, which would further increase compliance.

3) Identification of the Origin of the Payment:

The Electronic Services Regulations provide, at regulation 2(2)(b), that South African VAT is due "where any payment originates from a bank registered or authorised in terms of the Banks Act 1990 (Act No. 94 of 1990)." Looking at the complex supply chains leading to the delivery of electronic services (which we describe in more detail in Section 6 below), this information is unlikely to be available to suppliers of electronic services. For example, payments made using an e-wallet like Paypal or Google Wallet would not provide any information to the supplier as to how the customer actually added the necessary funds to the e-wallet, which could have been by bank transfer or credit card. Similarly, whilst it would be possible to determine the country of the financial entity issuing a credit card, it would not be possible to determine the bank account actually used by the customer to settle his / her credit card liability. Finally, where payments are made through a premium SMS (or "shortcode"), one cannot expect that the telephone companies would share the banking details of their own customers with the electronic services supplier.

TEI fears that, in many cases, compliance with the requirement from the regulations will be impossible. Even when feasible, it would create a level of uncertainty that would be detrimental to both businesses and SARS, as it would be extremely difficult to apply or verify on a consistent basis. In most cases, we expect that customers resident in South Africa would use a form of payment that is also connected with South Africa. For example, they would use a debit card or credit card issued by a financial institution registered in South Africa or would have registered an e-wallet with their South African address. Looking at the work done in the EU, this information, which could be accessed by electronic services suppliers in most cases, could form part of the evidence used by the suppliers to determine the location of their customers, where this fits with their systems and business model.

TEI urges SARS to withdraw regulation 2(2)(b) from the Electronic Services Regulations.

4) Issuance of Invoices:

The draft Binding General Ruling on Electronic Services relating to tax invoices and advertised or quoted prices requires, at paragraph 2.1, that an electronic services supplier issue a tax invoice containing, among other elements, the following information:

- The value-added tax (VAT) registration number of the supplier.

- An individual number with a distinct indicator for a supply made to an electronic services recipient (for example, ZAR).

- If the consideration is reflected in the currency of South Africa, the amount of the tax charged or a statement that it includes a charge for the tax and the rate at which the tax was charged.

- If the consideration is reflected in the currency of any country other than South Africa, the amount of the tax charged in the currency of South Africa or a separate document issued by the electronic services supplier to the electronic services recipient reflecting the amount of the tax charged in the currency of South Africa.

Many of the businesses affected by the amendments to the VATA 1991 sell electronic services that are designed only to be used by final consumers (*i.e.*, B2C supplies). Their systems have been designed to deal efficiently with the high volume, low value transactions that dominate this market. The key to a successful business in this field is the ability to deliver content to consumers in real time with no delays; consumers today expect instant access to their purchased content and do not want or expect to receive an invoice each time they make a low value purchase. Moreover, the number of computer files that would be generated – and need to be retained – would be huge given the volume of transactions in this marketplace. The costs of adapting systems to comply with such a requirement should not be underestimated.

From our experience, insistence on the provision of tax invoices, such as those required under the draft Binding General Ruling, to all customers is an administrative measure imposed to address the lack of an audit trail for cash transactions. For the services covered by the Electronic Services Regulations, however, there is no opportunity to pay with cash; other means of payment are used (*e.g.*, credit cards, vouchers, premium rate SMS). Even in situations where customers pay cash for vouchers later used to purchase electronic services, the retailer selling the voucher generally produces an invoice (usually a till receipt) for the customer at the time of purchase. Also, because the transactions at issue are high volume, low value, and heavily automated, there is no opportunity for a person to intervene in the supply chain to divert VAT. A systems process audit will reveal quickly that all transactions are captured and relevant tax declared.

In theory, the concept of a threshold over which a tax invoice is required could work in practice. Regrettably, however, the current proposal of ZAR50 is too low. Also, it is not industry practice to issue a tax invoice for e-services. In many cases, an automatic receipt or confirmation of the purchase is issued (generally by e-mail or text), but the formats may vary, and the electronic documents rarely satisfy tax invoice requirements. In some cases, the electronic document is actually issued by an intermediary (*e.g.*, a virtual marketplace like the Apple App Store), and the supplier is only notified of its sales by the intermediary at the end of an agreed reporting period (reporting periods can be monthly or quarterly).

There would be significant technological challenges and costs involved to design and implement a system that issues valid tax invoices for e-services, and there does not appear to be any real benefit associated with them. For example:

a) Ultimately, B2C customers cannot reclaim VAT charged to them, so issuing a proper VAT invoice is not relevant for VAT purposes.

b) E-transactions are rarely in cash. They are generally paid by electronic means that leave some sort of audit trail or evidence, meaning that there is no requirement of an invoice to combat the black market.

c) For B2B customers, they should be accounting for South African VAT under the reverse-charge mechanism to ensure they reclaim VAT charged to them (see our recommendation above in Section 1 of this letter regarding differentiating between B2B and B2C supplies).

Accordingly, TEI urges SARS to amend the Binding General Ruling on tax invoices in the context of electronic services to include language clarifying that there should not be a requirement that businesses issue tax receipts for transactions with final consumers. Possible language could include the following:

The requirement to issue tax invoices does not apply to the supply of electronic services delivered via an information technology route where the following requirements are met:

- *the customers are not taxable persons or legal entities, and*
- *payment does not take place in cash.*

5) Retention of Data and Records:

Government Notice No. 787 of 1 October 2012 provides that records retained in an electronic form must be kept and maintained at a place physically located in South Africa. Most multinational businesses store their data at the place where they are established or some other data centre, determined by reference to their business needs and corporate structure. Creating systems to extract and store data specific to South African sales on servers located in South Africa that comply with South African data protection requirements would require significant investments of capital and information technology resources with no associated benefit inuring to the administration of the South African VAT system. Currently, foreign suppliers can provide data in support of their VAT charges electronically and on demand in the event of a request by SARS in the course of an audit. It appears that the requirements of the Notice were established with taxpayers established in South Africa in mind, rather than the non-established foreign electronic services suppliers that are now being brought into the South African VAT system. TEI urges SARS to issue a Binding General Ruling eliminating the requirement for foreign suppliers to store their data in South Africa where the data collection and retention policies of the foreign suppliers meet minimum industry standards.

6) Intermediaries and Chain Transactions:

The guidance published to date does not address the determination of the person responsible for the collection and remittance of the South African VAT in cases of complex distribution chains involving intermediaries, such as a virtual marketplace like an app store. The number of links in the distribution chain for electronic services between producer and final customer varies widely. In some instances, the transaction occurs directly between the owner of the electronic content and the ultimate consumer (*e.g.*, an individual purchases a song directly from an independent artist on the artist's website). Other situations involve transactions between multiple intermediaries playing varying roles, ranging from simply acting as introduction agents to being closely involved in the delivery of the supply. For example, in the case of a ringtone, the content owner may enter into a licensing agreement with an aggregator of ring tones that enters into agreements with mobile telecommunications providers that sell the ringtones to their mobile customers. Similar arrangements exist with app stores where app creators contract with, for example, Apple's App Store or the Google Play platform, and customers purchase the apps they download by paying Apple or Google.

In the case of a marketplace, for example, SARS could explore permitting the operators of app stores and/or the carriers involved to collect and remit the tax. Many of the suppliers of apps, subscriptions, etc. that sell through this type of marketplace are small operations that would likely be exempt from the registration and compliance system under a small-seller registration threshold. Having larger, established businesses manage the compliance for those transactions would reduce the number of registrations SARS would need to administer and avoid placing heavy burdens on small business.

TEI urges SARS to provide clarification on this issue to ensure that all parties in the distribution chain know the identity of the person responsible for collection of South African VAT. Certainty on this issue would reduce the risk of double taxation and non-taxation. Significant work has been carried out by the EU on this matter (Article 9a of Implementing Regulation (EU) No 282/2011), and other countries (*e.g.*, Norway[2]) have adopted similar positions. TEI would be pleased to work with SARS on developing guidance that would assist all stakeholders in this area.

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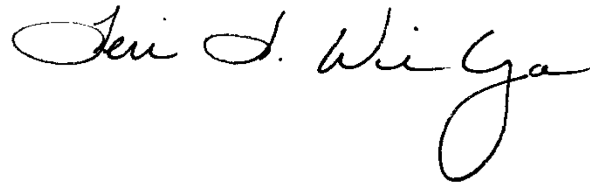
[2] http://www.voesnorway.com/Legal-Information/

TEI welcomes the opportunity to meet with National Treasury and SARS representatives to discuss these comments and other issues relating to the administration of the South African VAT. Such a dialogue would ensure that the system operates in the most practical, effective, and efficient manner to the benefit of both the government and the business community.

TEI's comments were prepared by the Institute's European Indirect Tax Committee, whose chair is Jean-Francois Turgeon. If you have any questions about TEI's comments, please contact Mr Turgeon at +41 228 494 342 Turgeon_Jean-Francois@cat.com, or Daniel B. De Jong of the Institute's legal staff at +1 202 638 5601 or ddejong@tei.org.

Respectfully submitted,
Tax Executives Institute, Inc.



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