VAT ON DIGITAL SERVICE IMPORTS, A SHIFT OF ONUS FROM THE CONSUMER TO FOREIGN COMPANIES

Category: Commercial Law
written by Gugulethu Majija | March 5, 2014

As it stands there are no regulatory measures in place regarding the levy and collection of tax on digital service imported from foreign companies who are not resident in South Africa. This article serves to discuss the newly proposed regulations which aim to bring digital services, obtained from foreign companies for South African consumers, fully within the ambit of the South African VAT regime.

In terms of the Value Added Tax Act 89 of 1998 ("**the Act**"), VAT is an indirect tax on the consumption of goods and services in the economy. Revenue is raised for government by requiring certain businesses to register and to charge VAT on the taxable supplies of goods and services. These businesses become vendors that act as the agent for government in collecting the VAT. VAT is also levied on the importation of certain goods and services into South Africa and is levied at the standard rate of 14%.

With regard to foreign companies, the Act levies VAT on the importation of goods in respect of which, for example border posts or the post office serve as collecting agents for the South African Revenue Service ("**SARS**"). What then in the process followed for the collection of VAT with the importation from foreign companies of services and more specifically, digital services who are not present within the Republic?

In theory, the onus is on the recipient to declare and pay such VAT to the SARS where such services are to be used for purposes other than the making of taxable supplies. There is however nothing compelling consumers to do the above and practically the result is that local consumers can buy imported digital goods or services without any VAT implications. For the local economy this means that local suppliers of similar digital services are at a competitive disadvantage.

It has therefore been proposed by the Finance Minister that all foreign companies supplying e-books, music and other digital goods and services in South Africa be required to register as VAT vendors in South Africa. The purpose of which would be "to bring cross-border e-commerce, specifically the digital economy – into the VAT regime" as stated by the Minister. This will now shift the obligation from the consumer to the foreign companies that do not have a presence in South Africa but do business here.

His proposal has become a reality in the form of the Electronic Services Regulations ("**Regulations**") prescribing VAT for Electronic Services, as defined in Section 1 of the Act. These Regulations aim to put South Africa's VAT regime in line with existing international standards and trends which require such foreign suppliers to register for VAT in the country their consumers reside. An example in which similar regulations have been adopted is the European Union. The purpose of these Regulations is to "prescribe those services that are electronic services as defined" and "apply VAT to the supply of electronic services in the course and furtherance of an enterprise carried on by a person from a place in an export country:

(a) to a recipient that is a resident of the Republic; or

(b) where a payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990. (Act No. 94 of 1990)."

The services to which this will apply are listed in the different Regulations. These include; Educational services such as distance teaching programmes, internet based education programmes or webinars, only if the person making the supply of the educational services is not regulated by an educational authority in that export country; games and games of chance are included which include internet based or interactive games, the provision of any information system services, the supply of any internet-based auction service facility; maintenance services such as the administration, maintenance and technical support of or in relation to things such as blogs, databases, information system services or websites.

In addition, miscellaneous services such as e-books, film, images, music and software including application software, system software and any update to any software listed in the Regulation will be subject to VAT. Finally subscription services are included and these could relate to any blog, newspaper, magazine, webcast, webinar, website, social networking service to name a few.

The decision to levy tax on e-commerce products which are bought from foreign companies which have no physical presence in South Africa will have the effect of increasing tax revenue attributed to VAT in a fiscal year. According to the National Treasury, legislation will provide a way in which SARS would be able to tax the digital economy, an economy which is growing and which for the most part has managed to escape any kind of taxing locally. In addition, the competitive playing field will be made level as this will address the competitive disadvantage that local suppliers have faced because South African consumers were able to import digital products without any VAT implications felt.

These regulations are however not without any controversy and there are challenges which may arise. Currently it is unknown as to how the Treasury will enforce this requirement on foreign companies. It would appear that Treasury will have to investigate other jurisdictions across the globe in order to seek guidance on how this requirement should be implemented. The introduction of this levy is however definitely a reality and the Electronic Services Regulations are set to come into operation on 1 April 2014.