ECOMMERCE FORUM AFRICA

(EFA)

Submission to the Davis Tax Committee (DTC) on ecommerce and Indirect tax in South Africa.

The Ecommerce Forum Africa (EFA) much appreciates this opportunity to submit its views in response to the DTC's First Interim Report on Value-Added Tax for the Minister of Finance ('the Report'), specifically the DTC's discussion on electronic commerce in South Africa and recommendations on Value Added Tax.

What follows is an abstract of the more topical discussions within the EFA, in support of the two meetings with the Commission.

1. The cash flow impact of exempting B2B transactions in the South African VAT context

In the DTC First Interim Report on VAT, the DTC argues that there should no longer be a B2B exemption in South Africa (see footnote for the arguments given by the DTC).

However, we submit that the principal of neutrality does not consider the impact of the business cash flows. The principle of neutrality that each tax system should strive for is defined by the OECD as follows:

> Neutrality: Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

We would argue, therefore, that Neutrality seeks to ensure that similar levels of taxation are implemented by a system regardless of the type of transaction. The cash flow resulting from such a transaction is a business consideration, which should be motivated by economic rather than tax considerations. As long as taxpayers in similar situations carrying out similar transactions are subject to similar levels of taxation – then the principle of neutrality is achieved.

That having been said, it is not necessary for South Africa to adhere to each and everyone one of the OECD guidelines. If the design of our tax system does not suit an OECD recommendation, then that can be ignored.

In our opinion, from a business perspective, this issue warrants further investigation.

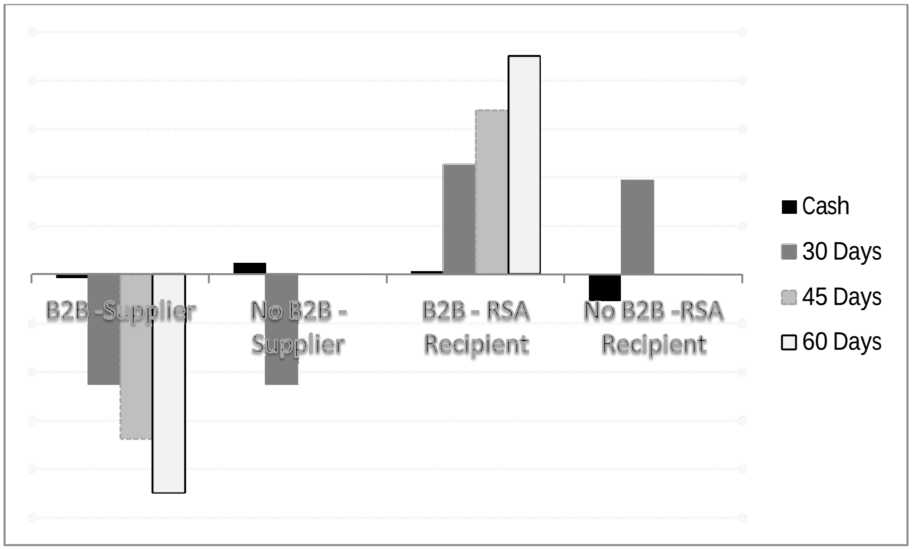
The following graph depicts the Net Present Value (NPV) of an R 100 transaction between two parties in two situations:

a. The transaction is zero rated (for whatever reason)
b. The truncation is standard rated (local, foreign supplier that is registered, etc.)

The NPV is calculated using a return rate of 5% (as an example - any rate can be used for demonstration purposes) and the payment of the service between the supplier and recipient takes place either immediately (cash) or at 30 days, 45 days or 60 days.

The VAT (if applied) is assumed to be paid across to SARS within 30 days – whereas the VAT that can be claimed is assumed to be claimed back from SARS at the outer limit of 60 days (although where a refund is created this could be significantly longer).

The chart below is a demonstration of what cash flow would reflect under simplistic conditions, a more complex model would perhaps achieve a better result more worthy of discussion.



Summary				
Cash	99.98493378	100.0459646	-99.98493378	-100.1088199
30 Days	99.54899934	99.54899934	-99.54899934	-99.61185467
45 Days	99.32426234	100	-99.32426234	-100
60 Days	99.10003269	100	-99.10003269	-100

If the transaction is cash: Tax neutral cash flow is only achieved in a cash transaction where B2B exemption exists. At this point, R 100 is paid and received and there are no irregular cash flows.

Only where a cash transaction attracts VAT is the recipient in a worse position, since the VAT is paid upfront and will in all likelihood only be claimed after 30 days (and in this assumption 60 days or perhaps even longer)

It should be noted that most overseas suppliers require cash or upfront payment, hence the analysis on the cash treatment is so important. It is noted that as suppliers provide longer terms the cash flow favours the South African recipient in a B2B exempt transaction.

2. How does one define Digital products/ e-services?

A consistent definition of what is considered goods, services and e-services is required. Ecommerce providers into South Africa require ready access to these definitions, as well as a detailed interpretation in order to foster trade. South African enterprises providing ecommerce services offshore also need assurance of what falls within and outside of e-services. In our view, the speed with which this area is developing necessitates constant review and updates, which in itself can create problems for certainty in tax systems.

Certain categories of supplies may create difficulties – such as goods that are supplied along with an e-service contract. Let us take for example a 3D printer that is imported from offshore into South Africa. The price of the printer itself is the equivalent of R100, which value is disclosed at the border when the goods enter South Africa and customs is paid on the ATV. However, the value of the total supply invoiced is ZAR150, because the electronic engineers will run some diagnostics and fine tune the printer once set-up – from offshore If no B2B exemption exists then how will this transaction be regulated, and is it fair to expect the supplier to register for a once-off service provided for the set-up of the goods?

On the topic of 3D printing – how would one define the printing of, for example, an artificial limb through the internet using a 3D printer in another jurisdiction? An American Prosthetist designs an artificial hand for a South Africa resident, that design is downloaded onto a South African 3D printer and printed for the RSA resident. Would this be a service? Again, how would one monitor and police these once-off transactions.

The categories and lists of e-services should be regularly (annually) reviewed and updated. The DTC in its Report proposes an annual review of categories, with a committee set up to do that. The EFA respectfully recommends that this committee also be used to review the lists of e-services.

There are items (such as bitcoins and other virtual currencies) which are not yet commonly used but which, when used regularly, would pose problems and would require evaluation sooner rather than later.

3. What is the purpose of a threshold

Jurisdictions should aim to implement a registration-based collection mechanism for supplies of services and intangibles by non-resident suppliers, without creating compliance and administrative burdens that are disproportionate to the revenues involved or to the objective of achieving neutrality between domestic and foreign suppliers.

A balance will need to be struck between minimising compliance burdens for non-resident suppliers and costs of tax administration while ensuring that resident businesses are not placed at a competitive disadvantage.

This balance is the R 1 m threshold for local suppliers. The question arises as to why the foreign supplier threshold is so very much lower (R 50,000) – considering that the tax compliance costs must be higher?

Within the ecommerce sphere, the largest risk of an imbalance is with the larger foreign ecommerce service providers. SMEs are within the primordial ooze of the ecommerce start-ups. The EFA is greatly concerned that by imposing a too low a threshold for foreign suppliers in South Africa, reciprocal action will be taken by foreign jurisdictions, and in doing so, our local start-ups would be prejudiced.

To take an example, an emerchant from Kenya sells R 70,000 worth of products into the RSA in the course of a year. The company will have to register itself with CIPR, this means that it will need an agent and/or an accountant in the RSA. The cost of this will probably be at least R 5,000 pa, plus once-off registration costs. The profit margin on the product it is selling is 5%, which means that it would be selling at a loss. Given the normal overheads that an emerchant faces (packaging, delivery costs, insurance …) it is unlikely that the emerchant would find the RSA a profitable market unless it sold at least R 350,000 worth of products. The government of that company is very likely to impose the same low threshold on SA emerchants, therefore closing that market to our SMEs.

The EFA would therefore propose that the threshold for foreign emerchants is increased to R 350,000 (in the EU the lowest threshold is 35,000€). Increasing the threshold will reduce the compliance costs, and increase the possibilities for SA companies in foreign market places.

4. Harmonisation

The OECD also refers to a group of countries bound by a common legal framework for a VAT system being able to apply relief and control measures between these countries – which would enhance the principles of neutrality.

The EFA considers that such a harmonised treatment would indeed encourage investment into a region or into those countries as *certainty* and *neutrality* will be enhanced and the ease of doing business in historically difficult regions would be improved.

Whilst it may not currently feature on any agenda, the expansion of the principles of the SADC (South African Development Community), OAU (organisation of African Unity), or AU (African Union) and the CMA (Common Monetary Area) are all bodies that speak to this.

Whilst it may not be within the mandate of DTC to comment on this, the EFA believe that the current hype and focus of all countries on the topic of VAT and taxation of e-services provides the best opportunity to make representation; identify African countries with VAT legal frameworks similar to South Africa, and to establish a common area for application of e-services rules within and between these African countries.

This will attract foreign investment in these areas, transfer skills and provided much needed certainty in times of change. Legislation which is too restrictive will only serve to alarm the big technologies. In our considered opinion, Africa is best suited to try to attract this new type of service industry.

5 Importation of Goods

Although we recognise that this issue falls outside the mandate of the DTC, we would greatly appreciate a mention in the Report. The main objective of the ETA is to encourage consumers to trust ecommerce, and therefore to buy products online. We are concerned that goods coming from abroad are often subjected to arbitrary valuations by customs officials. The buyer is therefore unsure what import “duty” s/he has to pay. This discourages trust and, in our view, can be relatively easily solved by adequate training of staff. Import duties, or VAT, should not be used as a tariff barrier. In the global digital economy that we have entered, tariff and non-tariff barriers can lead to trade wars, which benefit no one. As a member of the G20, the RSA supports an ordered, non-aggressive stance on international trade.

November 12, 2015

Footnote

@ Page 87, after the bullet points:

A point at issue is that to treat B2B and B2C transactions differently will be in contravention of the OECD principle of neutrality. That is, while the tax revenue is neutral the distinction arguably grants a cash flow benefit.

The difference between allowing for a distinction and not allowing for a distinction may be illustrated as follows:
A local SA VAT registered business acquires a service from a foreign supplier. The foreign supplier is not required to register for VAT as a B2B and B2C distinction has been made. The acquisition falls outside the definition of “imported services” as the recipient is acquiring the service in the course of his enterprise to make taxable supplies. As such, the service is acquired excluding 14% VAT.

In comparison, an SA VAT registered business acquires a service from a local SA supplier.
The local supplier is required to be registered for VAT and therefore, to impose VAT at 14% on the supply.
The recipient acquires the service including VAT at 14%. The recipient will then claim an input tax deduction in respect of the acquisition on its next VAT return. If the recipient's tax period is June / July and the service was acquired in June, the recipient will have to wait until the submission of its June/July VAT return in August in order to claim the input tax deduction.

As such, the SA customer will have a cash flow motivation to transact with a foreign supplier, as it will not have to wait up to 2 – 3 months to obtain the input tax deduction benefit.
One of the strongest arguments for allowing for a B2B and B2C distinction is that the B2B transactions will be VAT neutral, therefore, deeming VAT registration to be unnecessary.

However, in most cases concerning local / domestic B2B transactions, the transaction will also be tax neutral. Thus, it may be argued that if a foreign electronic service supplier may be excluded from registering for VAT in respect of B2B transactions, merely because the transaction is VAT neutral, then local suppliers of B2B transactions should be granted a similar benefit and not be required to register for VAT either. This would effectively mean a change in the core VAT system globally.

Furthermore, the OECD principle of neutrality should be adhered to, to ensure that taxpayers in similar situations are granted similar benefits. Thus, by granting a B2B concession in respect of cross-border transactions foreign suppliers are being permitted an advantage / benefit which is not afforded to local suppliers.
[Our emphasises]

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