TECHNOLOGICAL ADVANCES IN THE MUSIC INDUSTRY MAY CAUSE SOME CONSUMER TAX PROBLEMS IN SOUTH AFRICA

by

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The music industry has seen a memorable technological advancement from the vinyl to magnetic tape to CD and now it has become completely digital in the format of MP3 and MP4 files that can be played by many devices. These digital files are virtually intangible as transfer from one device to another can be done by merely connecting to the internet or using infrared or Bluetooth technology which are all wireless connections.

VAT as a consumer tax in South Africa is levied in terms section 7(1)(a) of the Value Added Tax Act 89 of 1991, "subject to exemptions and exceptions", on all supplies of goods and services rendered by a VAT vendor in the furtherance of his enterprise. Section 7(1)(b) states that VAT will be levied on any person who imports goods to South Africa. Section 7(1)(c) imposes VAT on any person who imports services to South Africa.

This article will discuss how new digital music technology has influenced The South African Revenue Services' (hereinafter referred to as SARS) ability to levy VAT on the sale of digital music and the importation thereof. The article will also discuss possible solutions and its feasibility.

KEYWORDS

Digital goods, digital imports, e-commerce, European Union, Internet, MP3, OECD, South Africa, tax compliance, value added tax

1. WHAT IS MP3 AND MP4 TECHNOLOGY?

MP3 or MPEG-1 layer 3 file format refers to audio encoding using data compression.[1] It uses lossy compression algorithms to record audio at 1/10th of

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[1] See http://www.wikipedia.org/wiki/MP3 visited on 12/06/2008

the size of a normal audio file.[2] Because of the size of the file it can easily be transferred at 128kbits per second which makes internet transfer of audio files fast and cheap.[3] MP4 file format or also known as MPEG-4 Part 14 uses the same compression technology as MP3 file format but can also store digital video streams over and above audio streams.[4] The user of MP3 and MP4 files would typically need software in the form of an MP3 or MP4 player that will be able to decompress the files and play the audio and or video streams.[5] Besides MP3 and MP4 technology other competing technologies that uses the same compression and decompression of files are also available such as mp3PRO, AAC, DivX, Matroska, NUT, Ogg, ratDVD and VOB. This list is not exhaustive. All of these technologies enable the user to easily transfer audio and video streams from one device to another at a very fast transfer rate. These devices are often situated in different parts of the world and one only needs an internet connection of some sort to transfer these files. Most of these devices are also freely available from the internet.

1.1. TRADITIONAL MUSIC TRADE VS MODERN MUSIC TRADE

Traditionally if one was interested in owning a copy of a particular piece of music one would visit a record store and purchase a CD, Tape, Vinyl or similar object on which the music was stored. The stored music would then be played on a device that decodes the music from the CD, tape or similar item. MP3 and MP4 technology has changed this traditional method of owning music to a more intangible form. One no longer needs to physically enter a record store and purchase an item on which the music is stored. It is furthermore not necessary to purchase the music online and then wait for the CD or storage device to be sent to you via mail or door to door delivery to be enjoyed. Record stores all over the world are now selling music in MP3 or MP4 format and can be purchased per song or per track.[6] This allows the user to create his/her compilation of music. It furthermore allows the user to purchase the music online, download it on a device that can decode the file and immediately enjoy listening to the music once downloading is complete-no waiting period.

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2 Ibid.

3 Ibid.

4 See http://www.wikipedia.org/wiki/MPEG-4_Part_14 visited on 12/06/2008

5 Ibid.

6 See http:// www.napster.com, http://www.freenapster.com visited on 18/06/2008

2. CURRENT SOUTH AFRICAN VAT POSITION: SUPPLIES FROM VAT VENDOR.

Section 7(1) of the VAT Act 89 of 1991 states:

> *"(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax-*
>
> *(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;*
>
> *(b) on the importation of any goods into the Republic by any person on or after the commencement date; and*
>
> *(c) on the supply of any imported services by any person on or after the commencement date,*
>
> *calculated at the rate of 14 per cent on the value of the supply concerned or the importation, as the case may be."*

Where a vendor supplies goods or services as contemplated in section 7(1)(a) the vendor will levy VAT on the goods and services on behalf of SARS.[7] This will only be the case if the vendor is a registered VAT vendor in terms of section 23(1)(a) and where the vendor's taxable supplies in a year exceeds or is likely to exceed R300 000. The minister of finance announced in his 2008/2009 budget speech that the VAT registration threshold will be increased to R1 million. Although the increase was meant to be implemented on 1 March 2008 SARS announced that implementation will be deferred to some time during 2009 during the implementation of small business tax amendments.[8]

A South African vendor would thus levy VAT on behalf of SARS on all the supplies of goods and services to users within the Republic. Typically a record store, which is a registered VAT vendor, will levy VAT on CDs supplied to its customers. Furthermore a record store who imports CDs on behalf of its customers will also have to account for VAT on the import of that supply.

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7 Section 7(2).

8 Practitioners newsletter *VAT reg increase* issued by SARS on 26 May 2008 (Notice 16/2008). The effect of the small/micro business tax transition will mean that vendors with a turnover of less than R1 million may opt to register as a micro business pay a fixed amount of income tax per year irrespective of it having made a loss or profit. Micro businesses will also be deregistered as VAT vendors and will have no obligation to levy or account for VAT.

2.1. WHEN IS REGISTRATION AS A VAT VENDOR COMPULSORY?

In terms of section 23 (1):

> *"Every person who, on or after the commencement date, carries on any enterprise and is not registered, becomes liable to be registered ….where the total taxable supplies made by that person in the period of 12 months ending at the end of that month in the course of carrying on all enterprises has exceeded R300 000 [R1 000 000]."*

> An enterprise means:

> *" in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course of furtherance of which goods or services are supplied to any person for consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club."*

It is clear that a vendor must be carrying on his enterprise wholly or partially within the Republic. Registration as a VAT vendor furthermore only becomes compulsory if the making of "taxable supplies" within the Republic exceeds the threshold. Taxable supplies should not be confused with turnover. An enterprise's turnover can comprise of taxable supplies (both zero rated and standard rated supplies) and exempt supplies (ie exports). From the definition of an enterprise it is clear that the enterprise need not physically be present (fixed or permanent establishment) within the Republic as long as it makes taxable supplies in South Africa.[9] Section 23(1) however does not specify whether the taxable supplies only refer to those rendered in the Republic or worldwide supplies. Supplies that are exported are still regarded as taxable supplies but at a zero rate in terms of section 11(1)(a)(i) and (ii). This creates a serious compliance problem for example: X has an enterprise situated outside the Republic but makes taxable supplies (both standard and zero rated supplies) to South African users and non-South African users exceeding R1 000 000 per annum.[10] Although he does not have a fixed permanent establishment in the Republic his total taxable

[9] Buys *Cyberlaw @ SA II* (2004) 283; Van der Merwe "VAT and E-commerce" 15 *SAMercLJ* (2003) 385.

[10] Buys 283.

supplies may oblige him to register as a South African VAT vendor because section 23(1) does not state whether only taxable supplies rendered within the Republic are considered. Common sense would hopefully prevail that foreign suppliers without a fixed permanent establishment in South Africa should be regarded as foreign enterprises and only their taxable supplies that are rendered within South Africa should be considered to determine compulsory registration. Where a foreign company has a fixed permanent establishment in South Africa all taxable supplies rendered from the fixed establishment in and outside the Republic should be considered to determine compulsory registration. The question arises then whether an enterprise situated outside the Republic who makes supplies in the form of MP3 and MP4 files ie digital supplies, should register as a VAT vendor in South Africa? In order to answer this question it first needs to be determined if the supply of MP3 and MP4 files are taxable supplies in terms of section 7(1).

2.1.1. IS THE SUPPLY OF MP3 AND MP4 GOODS OR SERVICES?

In terms of section 1 of the VAT act goods are defined as "corporeal movable things, fixed property and any real right in any such thing or fixed property…" but excluding money, rights under a mortgage bond or stamp or alike that has a monitory value. As indicated above MP3 and MP4 files are digital files that are completely intangible and incorporeal unless it is physically stored on a tangible corporeal storage device such as a flash disc, CD or MP player. MP3 and MP4 files can therefore not qualify as goods in terms of the VAT Act.[11] Services are defined in section 1 as "anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods money or any stamp, form or card…" MP 3 and MP 4 files as such will not qualify as a service unless the right to a MP3 and MP4 file is granted, surrendered or made available to a consumer. Services clearly entail the "supply" of a right or intangible incorporeal thing.

Since the supply of MP3 and MP4 files can collectively be classified as the supply of services (when the right to its use is transferred to the consumer) it can therefore be seen as a taxable supply in terms of section 7(1)(a).[12] Where an enterprise, although situated outside the Republic, wholly or partially supply MP3 and MP4 files within the Republic exceeding R300 000 [R1 000 000] per annum it should register as a VAT vendor in South Africa in terms of section 23(1). This will ensure that the "foreign" vendor has to collect VAT on behalf of SARS on every supply of a MP3 or MP4 file to a

[11] Van der Merwe (2003) 380.

[12] Buys 278; Van der Merwe (2003) 378.

South African within the Republic. The same vendor might also be liable to collect VAT on behalf of SARS in terms of section 7(1)(c) being the importation of digital goods.

2.1.2. IMPORTATION OF MP3 AND MP4 FILES: A NON VENDOR

Where MP3 and MP4 files are supplied by an enterprise that needs not register as a VAT vendor in terms of section 23(1) because its taxable supplies does not exceed R300 000 [R1 000 000] there is no duty on that enterprise to levy VAT on the supply or to collect VAT on behalf of SARS in terms of section 7(1)(a). The same enterprise will also not be obliged to collect VAT in terms of section 7(1)(c) purely because the enterprise is not a registered VAT vendor. This however does not mean that the consumer can import digital goods VAT free. In case of the supply of tangible goods the levying of VAT is much simpler. Section 13(1)(i) states that imported goods are taxable for VAT purposes as soon as it has entered the Republic for home consumption. The collection of VAT will be done by either an officer as appointed by the Commissioner (section 13(5)(i)) or by the managing director of the South African Post Office (section 13(5)(ii)). Therefore tangible goods can be taxed at any point of entry (border posts, airports etc) to South Africa.[13] Goods purchased via the internet or postal service will have to enter South Africa at the South African Post Office's International Post office at O.R Thambo International airport. Therefore imported tangible goods can hardly be smuggled into the Republic without it being taxed. South Africa has however a small parcel exemption of R100 in respect of books and other printed material.[14]

In terms of section 14 where services (ie MP3 and MP4 files) are imported to South Africa the recipient thereof must, within 30 days after having received the invoice or having made payment for the service (whichever took place first), calculate the value on the imported services and pay the necessary VAT to the Commissioner.[15] The value of the supply is deemed to be the consideration in terms of section 10(3) as being the amount in money paid for it or the open market value.[16] The burden thus rests on the consumer to pay VAT to SARS each and every time he or she has downloaded a MP3 or MP4 file from a foreign non-vendor supplier.[17] It is highly unlikely that any consumer will declare digital imports and pay VAT to SARS.

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[13] Buys 284; Van der Merwe (2003) 382

[14] Section 13(3) and section 2 of Schedule 1.

[15] Section 14(1)(*b*) and (2); Buys 280; Van der Merwe (2003) 377

[16] Section 14(3); Buys 281

[17] Buys 287

It is furthermore not always clear if the payment for downloading music files constitutes a purchase price or royalties.[18] It is however suggested that the payment constitutes a purchase price inclusive of royalties to simplify taxation issues.

2.1.3. IMPORTATION OF DIGITAL GOODS: VAT VENDORS

Where a VAT vendor imports digital goods in order to make taxable supplies as contemplated in section 7(1)(a) such a vendor need not account for VAT on the import thereof.[19] The vendor will however account for output VAT on the supply of the digital goods as part of his taxable supplies or in the making of other taxable supplies to consumers or other non-vendors. VAT is also not payable where the imports would have been a zero rated or an exempt supply if the supply was rendered in South Africa.[20] It is thus clear that the import of digital goods by a South African VAT vendor hardly creates any VAT compliance issues.

2.1.4 . LOCATION OF THE CONSUMPTION

It is clear from sections 7(1)(a),(b) and (c); 11(1)(a)(i)(ii), (g),(h),(i) and (l) that VAT in South Africa as a consumer tax is levied at the place of consumption being within the Republic. When section 7(1)(c) is read together with the definition of "imported services" and section 14(1) some confusion arises. Imported services are defined as "a supply of services that is made by a supplier who is resident or carries on business outside the Republic 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." From section 7(1)(c) and section 14(1) one can conclude that any person who imports services to be consumed within the Republic will have to account for VAT on the import in South Africa (location of consumption) save where it is imported to make taxable supplies. The definition of imported services only refers to consumption within the Republic by residents to the Republic. Resident for VAT purposes is defined in section 1 of the Income Tax Act 58 of 1962.[21]

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[18] Van der Merwe (2003) 379

[19] Section 14(5)(*a*); Van der Merwe (2003) 377

[20] Section 14(5)(*b*)

[21] Resident is defined as:

"(a) natural person who is-

(I) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic-

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

This result in non-residents who import services to the Republic, and who consume these services in the Republic not being liable for VAT. Surely a non-resident will also consume these services within the Republic? It is trite that non-residents are only temporarily within the Republic and chances are good that these imported services will again be exported by the non-resident when he or she returns to his or her country of origin. But what if the service is completely consumed within the Republic and cannot be exported? For example a digital file that is used on a computer for a specific task (to enable the user to connect to a server or stop South African spam etc) and is rendered useless after its application? Surely such an import should be taxed in the hands of the non-resident just as other consumables like food and drinks that are consumed in the Republic by the non-resident is taxed? I therefore agree with Van der Merwe that place of consumption rules will be difficult to monitor.[22]

Another compliance problem is created by section 14(2). The time of supply in order to comply with the 30 days compliance rule in section 14(1) is deemed to be the date of issue of an invoice or when payment took place whichever is the earlier of the two. What if the resident is physically present in a foreign country and downloads software (or MP3 and MP4 files for that matter) onto a mobile device and pays for it there and then. The resident will only return to the Republic in 90 days (for example's sake) he or she would then fail to comply with section 14(1) as he would be unable to make the necessary declaration at a SARS office. Surely the time of import for purposes of compliance to section 14(1) should be the date on which the services commence or when the service enters the country. Again it is highly unlikely that a South African resident who has purchased digital goods in a foreign country and who installed the software on a device (which he has exported to the foreign country) will upon his arrival back in the Republic report the import to SARS. It is also virtually impossible for SARS to control these kinds of imports unless any device using digital software is scanned upon exiting the country and again scanned upon entry to determine a change or upgrade in software and I seriously doubt if SARS would have the manpower and willpower to conduct these scans.

3. IMPACT ON REVENUE

From the above it is clear that SARS relies on the honesty of importers of digital goods to declare the service and pay the necessary VAT within the 30

(bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment…"

22 Van der Merwe (2003) 377

day compliance period. This self-assessment approach is not very effective as most private individuals are unaware of the legislation and even if they are will hardly ever comply. It is all fair and well to criticize the self assessment approach but before any drastic measures are taken a rough estimate of the loss of revenue created by digital imports and the subsequent non-compliance by consumers should be considered. As this study mostly focuses on digital music in the form of MP3 and MP4 files only revenue losses in the music industry will be discussed. In a recent article in Business Day[23] the reasons for the decline in CD sales were discussed. Figures released from the Recording Industry of South Africa (RISA) have shown that CD sales from local musicians have dropped from R456million in 2006 to R443-million in 2007. However, other figures released from RISA all show an increase in music sales (which comprise of CD's, DVD's, record tapes and digital music) to R1.02billion in 2007.[24] Although CD sales have dropped there was a significant increase in the sale of music.[25] According to David du Plessis from RISA the digital market in South Africa is still in its infant's shoes standing at approximately R60million per annum.[26] The figures released by RISA only represents controlled imports and sales through music dealers and or record companies that are all VAT vendors. It is not clear from du Plessis whether the R60million in digital sales are locally downloaded music from a VAT vendor or privately downloaded music from international websites. If we assume that digital music was purchased from foreign non-vendors (this assumption is made because none of the major music retailers support digital sales)[27] SARS will have a revenue loss of roughly R7.36million per annum. This is quite a lot of money and if du Plessis is correct that digital sales are still in its infant's shoes, SARS is set to lose a huge chunk of its revenue from music sales let alone other digital imports such as computer software, games etc. If these amounts are considered the criticism against the self assessment approach by SARS is valid and some solution should be found.

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23 Sibongakonke Shoba "Poor CD sales not because of piracy" *Businessday* 10 April 2008 http://mybroadband.co.za/news visited on 16/10/2008.

24 Christelle du toit "Cassettes retard digital music market http://www.itweb.co.za/sections/internet/2008/0804071044.asp?S=e-Business&A=EBU&O=google visted on 16/10/2008

25 Ibid.

26 Ibid.

27 http://www.musica.co.za; http://www.lookandlisten.co.za visited on 16/10/2008. Except for http://www.samp3.co.za and http://www.rythmrecords.co.za that supply local mp3 files. Visited on 1/11/2008.

4. SOME SOLUTIONS

4.1. THE OECD MODEL LAW

In its guidelines on VAT and GST issued in February 2006 the OECD proposed certain guidelines to ease the taxation of cross border sales of digital/ intangible goods or as they propose services.[28] The basic proposals are that:

Services or digital goods should be taxed in the jurisdiction where it is used or consumed.[29]

The place of consumption is the jurisdiction where the recipient resides or spends most of his time in the case of multiple jurisdictions.[30]

Businesses borne with compliance liabilities should not be burdened with irrecoverable VAT payments.[31]

Digital goods should not be treated as goods for VAT purposes.[32]

The self assessment approach should be followed where businesses acquire digital goods from non-resident suppliers (foreign non vendors).[33]

As it is clear that most jurisdictions have adopted the OECD model[34] that the place of taxation is the place of consumption this discussion will focus on compliance problems only.

The OECD realised that Business to Consumer (B2C) transactions are the most problematic.[35] In case of Business to Business (B2B) transactions the South African Business (vendor) would anyway be liable for output VAT when the digital goods are sold and would therefore easily comply with import VAT compliance.[36] I can therefore agree with the proposal that self-assessment should remain the appropriate compliance option for B2B transactions. It should however be continuously reviewed as technology advances.[37] Where the consumer or non-vendor is the importer he or she would be under no obligation to register as an importer or VAT vendor unless he or she is obliged to do so in terms of section 23 (or the country of import's regulations). The self-assessment process as imposed by revenue ser-

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28 OECD *International VAT/GST guidelines* (2006) http://www.oecd.org/dataoecd/16/36/36177871.pdf visited on 17/10/2008

29 OECD (2006) 7; Van der Merwe (2003) 375

30 OECD *Consumption Tax Aspects of Electronic Commerce* (2001) 12-13 http://www.oecd.org/dataoecd/37/19/2673667.pdf; visited on 17/10/2008. Van der Merwe (2003) 375

31 OECD (2006) 7

32 Ibid.

33 Ibid.

34 Van der Merwe (2003) 387. South Africa as a non-OECD member have also opted for the OECD model.

35 Van der Merwe (2003) 373

36 Van der Merwe (2003) 373

37 OECD Report by The Consumtion Tax Technical Advisory Group (TAG) (2000) 5 and 16. http://www.oecd.org/dataoecd/46/1/1923240.pdf visited on 17/10/2008.

vices worldwide is ineffective in this case since virtually none of the consumers complies with the self assessment criteria.[38] It is also not worth prosecuting an individual for failing to comply with self assessment especially if it was a once of import and the VAT amounted to a couple of Rands. The OECD TAG team however feels that self assessment for individuals should still be explored as other technological compliance methods may pose privacy and security risks for individuals.[39] Although TAG initially in 2000 were against registration of non-resident vendors[40] the OECD made the following proposals regarding non-resident vendor registrations in 2006:

Foreign vendors who regularly supply digital goods to consumers should be obliged to register as vendors in the country of import even if they do not qualify as vendors in terms of the country's VAT vendor regulations.

Registration of non-resident VAT vendors should however be done electronically with less administrative burdens than those imposed on resident VAT vendors.

Compliance to VAT collection should also be made electronic with little or no administrative burdens.

Registration thresholds for non-resident vendors should be non-discriminatory and compliance rules should be adapted to enhance better global tax administration.[41]

The problem with non-resident vendor registrations is two fold. Firstly these vendors will be registered in multiple jurisdictions (even in more than 10 jurisdictions which can lead to costly VAT administration. Secondly if the supplier does not have a proper compliance system it will be difficult to collect VAT at the different jurisdictional rates within the short "online" time. Some guidelines to combat these problems include:

An online tax processor (probably a central system) will calculate the tax payable on the transaction upon receipt of the buyer's credit card details as opposed to an email ID which can mislead the supplier on the place of consumption.[42]

The online tax processor will determine the tax jurisdiction and rates or exemptions from the credit card details.

The full amount including taxes is deducted from the credit card account upon shipment.

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38 OECD (2000) 5 and 16; Van der Merwe (2003) 384
39 OECD (2000) 5 and 16; Van der Merwe (2003) 384
40 Ibid.
41 OECD (2006) 13
42 Van der Merwe (2003) 377

The purchase price goes to the seller and VAT to the tax processor who will complete the tax return on behalf of the seller and pay the necessary taxes to the authorities.[43]

TAG also considered third party collections for VAT compliance for example credit card companies and banks but found the solution completely unrealistic.[44] Third party collections are discussed below. Technology can greatly assist in the collection of taxes in the future. TAG considered the use of smart cards where certain countries have already replaced their driver's licence and ID books with smart cards.[45] Smart card technology contains a microchip with the individual's personal and governmental status information (example: Address, next of kin, allergies, tax number, pensioner status, outstanding traffic fines etc.) When an individual purchases digital goods online the operator may prompt for a smart card number. When the card number is used it will automatically calculate VAT on the transaction and record it as "outstanding tax" on the smart card. This might cause fraud issues as anyone can enter a different person's smart card number. Another solution might be smart card readers. When the transaction takes place the operator may prompt the user to insert his or her smart card in the reader and then record the transaction and calculate the VAT payable. When no card is available the transaction will be terminated. Smart cards can also be used as a prepaid card where the user has to prepay VAT on future transactions.[46] TAG proposes that the supplier will need to complete the necessary tax calculations once the correct smart card details have been entered.[47] It is however debatable whether suppliers will have the diligence to correctly complete the tax calculations. It would be better if the smart cards are preprogrammed to automatically calculate the VAT payable on the total amount of the purchase according to the particular jurisdiction's VAT rules.

Although smart card technology seems like a brilliant idea it will take years (if not decades) to implement its use worldwide. Not all internet users will have access to card readers. New computers should be fitted with standard card readers which can increase the cost thereof. Considering the staggering amounts in revenue loss and the anticipated revenue loss in future it might be advisable for revenue authorities to invest in a smart card system and reap the benefits combating revenue loss.

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[43] OECD (2000) op cit p25 obtained from Hardesty, David (2000) "United States Sales Tax and E-Commerce—Part II," Tax Planning International E-commerce, pp. 11-13, June.

[44] OECD (2000) 5; Van der Merwe (2003) 382.

[45] OECD (2000) 17

[46] Ibid.

[47] Ibid.

5. THE EUROPEAN UNION

As it has been established that B2B transactions poses no real threat to SARS's revenue capacity, only B2C transactions will be discussed. Before the EU council amendments[48] digital goods or the then defined services were taxed in the jurisdiction of origin and not in the jurisdiction of consumption.[49] The amendments included inter alia a definition of electronic services/goods and a change in supply rules:

"Electronically supplied services include services such as cultural, artistic, sporting, scientific, educational, entertainment, information and similar services as well as software, video games and computer services generally. The result is that:

for specified electronically delivered services, when supplied by a non-EU operator to an EU customer, the place of taxation is within the EU and accordingly they are subject to VAT;

when these services are provided by an EU operator to a non-EU customer, the place of taxation is where the customer is located and they are not subject to EU VAT;

when an EU operator provides these services to a business in another Member State, the place of supply is the place where the business customer is established;

where the EU operator provides these services to a private individual in the EU or to a taxable person in the same Member State, the place of supply continues to be where the supplier is located."[50]

These amendments shifted the VAT obligation from the jurisdiction of origin to the jurisdiction of consumption.[51] The place of consumption is also regarded as the place where the consumer usually resides or where he/she is established or has a fixed address irrespective of where the goods are consumed.[52] Prior to the amendments[53] non eu member vendors were allowed to supply digital goods VAT free allowing them an economic advantage over EU registered vendors whose prices were more expensive due to the added VAT.[54] Non-EU member vendors are now required to register as EU VAT vendors when they make taxable supplies to customers/final con-

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48 Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC

49 European Union (2002) VAT: special arrangements applicable to services supplied electronically http://europa.eu/scadplus/leg/en/lvb/l31044.htm visited on 22/10/2008

50 Ibid.

51 Van der Merwe "VAT in the European Union and Electronically Supplied Services to Final Consumers" (2004) 16 *SAmercLJ* 580; Van der Merwe (2003) 375

52 Van der Merwe (2004) 581

53 Directive 2002/38/EC and Regulation 792/2002

54 Van der Merwe (2004) 579

sumers within the EU.[55] These vendors can opt for a slimline VAT registration within the EU to a fixed EU member state to simplify VAT compliance.[56] Compliance or VAT returns are completed every three months in the member state of choice of registration. The fiscal authority of the member state of choice will allocate the revenue to the member state where the consumer resides.[57] From a compliance point of view these rules would make perfect sense and revenue losses can be kept to the minimum. Technology can be used to combat tax evaders and tax fraud. In a developed world such as the EU compulsory registration for non-EU member vendors will be effective and easily enforceable. From an economic point of view compulsory registration might not be the best solution. The EU is a sought after offset point for any manufacturer/dealer and small barriers such as VAT compliance can easily be overcome to distribute goods or services in the EU. However third world or developing countries are not very attractive offset destinations and a supplier will rather opt not to supply its goods to such a country if it has to register as a VAT vendor in that country especially if administrative costs are involved. Such a supplier will rather supply its goods to more fixed/reliable markets and spend administrative costs on the reliable market than a developing market that can collapse at any given point in time. In a volatile market such as South Africa's where it has to compete heavily against European countries for foreign investment, harsh import regulations/VAT compliance rules, such as non-resident vendor registration might scare investors and would not be advisable.

6. LET'S MAKE IT A BANKING PROBLEM?

Although the OECD has investigated the possibility of using third party or credit card company involvement in VAT compliance and found the result completely unrealistic (see above) it is still worth while discussing as technological advances may make third party involvement a viable option.

It is trite that online transactions are mostly paid for via credit cards. Credit card companies will be in possession of the user's personal details including country of residence irrespective of the country where the credit card was issued. When a user uses his or her credit card the transaction itself is recorded when the user's credit card details are entered to complete the sale. It is suggested that credit card companies should withhold VAT on behalf of the relevant revenue authorities and place the burden of no VAT or exemptions on the consumer. This means the credit card company will

[55] European Union (2002); Van der Merwe (2004) 582

[56] Ibid.; Van der Merwe (2003) 385

[57] European Union (2002); Van der Merwe (2004) 582

automatically levy VAT on the purchase price according to the user's recorded jurisdiction's rate (the permanent address as supplied by the user when the credit card was issued). If no VAT was payable or at a lower rate for any reason at all, the user should by means of an objection liaise with the revenue authorities to claim a refund.

Objections at this option include:

It is difficult for credit card companies to determine the VAT rate if the credit card was not issued in the user's country of residence.

Banks and credit card companies will be overburdened with VAT compliance administration which can be costly which will increase transaction fees.

The reverse onus of prove will be costly and consumer unfriendly for ordinary consumers. (The current reverse onus on physical imports at ports of entry is already experienced as costly and burdensome).

Irrespective of the above objections a withholding tax system collected by credit card companies will be more effective than self assessment. VAT return rules can be globalised to ease the burden on the banks for example: VAT returns should be done every three months. As payment of the original purchase is made electronically it should not be difficult for a credit card company to instantly determine the country of consumption (ie country of chosen residence), calculate VAT at the relevant rate and levy it. Current payment software can easily be adapted to enable the credit card company to instantly and online calculate VAT and display the total amount (VAT inclusive) to the user. Credit card companies will only incur administration cost during filing season. Revenue authorities can refund credit card companies for administration cost as an incentive for collecting VAT on their behalf. The administration cost refund will most probably be miniscule in relation to the amounts of revenue collected. The reverse onus is currently already in use with physical import of goods. The revenue authorities at points of entry place a value they deem fit on goods that are imported and VAT is levied on the spot. The user may only redeem the goods once VAT and custom and excise duties have been paid. If the consumer is unhappy with the assessment he or she may object to it by using the formal objection process in terms of sections 81-88 of the Income Tax Act 58 of 1962. Although the formal objection process is experienced as burdensome for consumers it can just as well be extended to online digital sale transactions.

7. GLOBALISED VAT COLLECTIONS?

Another option could be an adaptation of the EU model where non-resident vendors may register in one jurisdiction and the relevant tax authority will transfer VAT to the jurisdiction entitled to the VAT. This system can be sim-

plified with a central worldwide revenue authority that can collect VAT on behalf of all the jurisdictions and transfer funds to the relevant tax authority. All online suppliers of digital goods should register at the central fiscal authority as vendors. A uniform rate for digital goods can be agreed on. Suppliers will collect VAT at the uniform rate and include information regarding the user's place of consumption when filing tax returns. This can be done electronically where the supplier's system automatically pays VAT to the centralised VAT collection authority together with a country code to identify the jurisdiction that is entitled to the VAT. Audits can be done on the automatic transfers every three to six months to test its effectiveness. Suppliers will have low cost administration. VAT compliance is ensured. Revenue losses will be limited. All jurisdictions can contribute towards administration costs of the central revenue collection authority calculated as a percentage of the total revenue collected. This will ensure fair contribution.

This seemingly blissful option is also not without problems. Getting the whole world to agree to a centralised VAT collection authority based on the OECD place of consumption rules can be an unmanly task to fulfil. Agreeing to a uniform VAT rate for digital goods won't be easier either. Some countries will not be willing to accept a lower rate as their current rates are exceptionally high. Consumers in low rate countries will be negatively affected by a uniform higher rate. One could make provision for the collection of VAT at the individual rate by the central VAT authority but then the administrative burden becomes virtually impossible as with the non-resident vendor registration option. It would be impossible without proper technology for suppliers to determine the correct VAT rate and or exemptions. This can only be done if the consumer uses a country code assigned to his/her jurisdiction when contracting online. The online payment systems can then calculate VAT at the particular rate, pay it to the centralised VAT collection authority to which the supplier must be registered. Again the centralised VAT authority will distribute the VAT collected to the relevant authorities.

7. CONCLUSION

It is clear from the above that traditional means of obtaining music and other computerised products have changed dramatically and that delivery of these items will in future be intangible. Due to its intangible nature revenue authorities will have less control over its imports and is set to lose millions in revenue if the current self assessment method continues to be operational for non-vendor end-user consumers. Consumers will not declare their imports of digital music to pay VAT and be VAT compliant. From the OECD

and EU models some basic rules regarding digital imports should be applied worldwide:

1. The supply of digital goods should be regarded as the supply of services and not goods.

2. The place of supply of services is the place of consumption or where the consumer is a resident.

3. VAT will then be payable in the jurisdiction of consumption.

This approach seems to be the least troublesome in VAT calculations and the final VAT compliance. Interestingly section 104(1) (c) of the Revenue Laws amendment bill 80 of 2008 proposes to insert the supply of electricity under the definition of goods in terms of the VAT Act 89 of 1991. Electricity is intangible and can rather be classified as services. Inserting the supply of intangible goods such as electricity in the definition of goods may open the door for digital goods to be classified as goods for purposes of VAT and subsequently change the calculation of VAT on the import thereof. For example the value of imported goods for VAT purposes are significantly higher than services.[58] Section 13(2)(a) calculates the value of imported goods as the value for custom purposes with an added 10% before VAT will be levied. No such provision exists for services. It should therefore be noted that the OECD and EU model should be adopted at all times to classify the imports of digital goods and imported services to simplify the VAT calculation. I therefore disagree with Van der Merwe that the distinction between goods and services should be reconsidered.[59]

The OECD and EU compliance proposals should be considered with caution. Registration of non-resident vendors in jurisdictions of consumption won’t be a wise move from an economic point of view. Most suppliers will rather spend money to be VAT compliant in bigger fixed and more reliant markets than volatile smaller markets depriving consumers of possible services. To further complicate this matter SARS introduced a new VAT registration process effective from 10 November 2008.[60] This process involves the applicant to apply for VAT registration in person, to supply verification (according to FICA) by means of a valid ID document and Telkom or electricity bill and a physical inspection of trade by a SARS official before a registration number will be issued.[61] Existing VAT vendors will also be sub-

58 Van der Merwe (2003) 378

59 Van der Merwe (2003) 381

60 New simplified VAT registration rules http://www.sars.gov.za/home.asp?pid=194 visited 17/11/08; PricewaterhouseCoopers “New VAT registration Process” Taxtalk Newsletter November week 2 http://www.etaxes.co.za/index.asp?articleid=2436 visited on 17/11/08

61 New simplified VAT registration rules http://www.sars.gov.za/home.asp?pid=194 visited 17/11/08; PricewaterhouseCoopers “New VAT registration Process” Taxtalk Newsletter November week 2 http://www.etaxes.co.za/index.asp?articleid=2436 visited on 17/11/08

ject to inspection and verification.[62] These rules are in direct conflict with the definition of enterprise and the registration requirements in terms of section 23. A physical place of business is not needed to qualify as an enterprise yet the new rules require a physical inspection before registration will take place. These rules can hardly be called "simplified registration rules" as it will frustrate the current process even more. These rules are also in contravention of the OECD and EU proposals that promotes simplified VAT registrations for non-resident vendors. It is clear that the new rules are aimed at combating VAT fraud and false registrations but can rather be seen as step backwards to the dark ages than a step forward. We are moving towards an electronic era. If business can be conducted electronically so should taxing the business.

Although the OECD has found third party involvement unrealistic I am of the opinion that credit card companies can in the interim be called upon to assist revenue authorities to ensure VAT compliance and combat revenue losses until a centralised VAT compliance authority has been established to collect VAT on behalf of all jurisdictions. So-called under developed or non-developed software excuses are becoming lame. The OECD and EU should long gone have invested in the upgrading and creation of VAT compliance software to enable credit card companies or a centralised VAT collection authority to collect VAT on behalf of the jurisdiction concerned. It is sure that none of these options will go without major planning, co-operation of all nations and its subsequent headaches. One thing is for certain, the world is turning digital making it a global village. Countries' revenue authorities will have to co-operate in finding a uniform solution to ensure VAT compliance and combat revenue losses.

62 Ibid.