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Online services in the digital space, where is the taxation line drawn?

Adequate mechanisms are currently not in place to allow for taxes to be imposed and recovered on online services

South Africa's online industry is under significant pressure as it battles against global digital giants for revenue in the local market place. This is evident in a number of industries where revenues generated by foreign suppliers are currently not captured by South Africa's existing tax legislation, thereby affording the foreign suppliers an advantage over South African companies.

Affected industries could include network services, IT related services and online advertising services, which all are expecting rapid growth over the next five years. Online advertising services revenue in the South African market alone is expected to grow from R1.3 billion in 2013 to R4.4 billion by 2018. A large portion of the growth is expected to come from offshore suppliers. Such growth forecast for the future coupled with the absence of an effective taxation framework create substantial revenue risks, high compliance costs and trade distortion. These challengers raise the question whether National Treasury should expand the current tax legislation to tax these types of services supplied into the South African market place from abroad and address the continuously evolving digital economy.

This debate is further complicated by the distinction between Business to Business (B2B) and Business to Consumer (B2C) transactions which differentiate the taxation of certain services on the basis of whom those services are being supplied to. In South Africa, this distinction has effectively become the line in the sand in the online services landscape with amendments to the electronic services provisions in the Value-Added Tax (VAT) Act aimed at taxing B2C transactions only. Currently, electronic services which are subject to SA VAT are limited to online education services, games, internet-based auctions, e-books, audio visual content, still images, music and certain online subscription based services, which are predominately purchased by end-consumers and a number of foreign companies are compliant in this regard.

In the 2015 National Budget Speech, it was announced that the electronic services provisions would be amended to include the supply of software within its scope. Given the nature of software and its use outside of the purely consumer based sphere (as software licenses are often purchased by businesses), this announcement signals a departure from the strictly B2C focus and the first steps towards the taxation of online services in the B2B space.

"South African businesses are at a competitive disadvantage as players in this industry do not have a tax presence in South Africa and therefore cannot be taxed due to our current narrow legislation" says Charles de Wet, Head of Indirect Tax for PwC Africa. "In fact, limited mechanisms currently exist in the South African tax legislation to tax many online services provided by foreign suppliers. Where these mechanisms do exist a number of foreign companies are compliant and tax the VAT due in South Africa"

Typically, B2B services will net off from a VAT perspective as a business will be charged VAT on the service it receives but will ordinarily be entitled to claim an input VAT refund on the VAT paid on those services. In the competitive online market place, however, the requirement for local businesses to charge VAT while foreign businesses are not gives rise to the misnomer that the services of foreign service providers are cheaper. In the online environment, for example, the differences between local and foreign electronic services suppliers are becoming increasingly apparent to South African businesses as they switch to foreign suppliers.

"This creates a mismatch between the treatment of operational expenses and profits, and while foreign electronic service suppliers benefit substantially from supplies made to South Africa, local businesses fail to compete in the same markets due to the requirement to account for VAT and pay corporate income tax," adds de Wet.

Given that many online services are supplied from outside South Africa, serious consideration needs to be given to updating the current tax regime to ensure it remains relevant in the digital age and the rapidly developing online market place. The broadening of the current legislation to include software services as proposed by the Finance Minister represents a step to protect the South African tax base and to ensure that local businesses and foreign suppliers are being treated equally.

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