

Jurisdiction to Tax Corporate Income in the Digital Economy: A South African Perspective

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OECD (2016) defines the digital economy as
“a broad range of economic activities that include using digitised information and knowledge as the key factor of production, modern information networks as an important activity space, and the effective use of information and communication technology as an important driver of productivity growth and economic structural optimization.”

Introduction

South Africa has jurisdiction to tax the corporate income of its residents on a worldwide basis and the corporate income of non-residents that is from a South African source. This study analyses the challenges that the digital economy poses to South Africa's jurisdiction to tax corporate income. In proposing suitable recommendations for South Africa, the study evaluates the viability of adopting the various measures for taxing the digital economy, such as: unilateral tax measures (like the digital services tax), Article 12B of the United Nations Model Tax Convention, and the Organisation for Economic Co-operation and Development (OECD)'s Pillar One Amount A as potential solutions to the challenges identified.

Impact of the digital economy on South African Jurisdiction to tax rules

Residence basis of taxation

- The “incorporation test” is easy to manipulate as it does not require substance
- The “place of effective management test” is easy to circumvent because of digitalisation
- Controlled foreign company rules have not kept pace with digital economy business models

Source basis of taxation

- The concept of “place” is rendered useless in the digital economy
- No withholding taxes on services or the provision of digital goods or services
- The “permanent establishment test” relies heavily on “physical presence” which can be avoided in the digital economy

Identification of taxpayers and their transactions

- Identification difficulties because of the anonymity of the internet
- Current tax measures are outdated because they were not tailored to the digital economy

Characterisation of income and issues regarding data

- Difficulty in distinguishing between different categories of income
- Need for new characters of income that captures the digital economy
- Uncertainty regarding the classification and tax treatment of data

Viability of potential solutions to address challenges posed by the digital economy

Unilateral measures

- Uncoordinated, potential trade wars, potential double taxation, conflict with other international obligations, passing on of tax incidence, call to withdraw DSTs and other similar measures

Article 12B of the UN MTC

- Limited scope
- Limitations of the buy-in of other contracting parties

OECD Pillar One Amount A

- Taking time and may not proceed because of the withdrawal of the USA
- Focus on taxing large MNEs (revenue above 20 billion euros and profit margin above 10%)
- Complex

Interim recommendations

- Strengthen source rules and consider significant economic presence provisions
- Consider a standardised DST based on the ATAF guidelines
- Modernise tax rules
- Invest in capacity building for SARS to enable it to audit taxpayers in the digital economy
- Include a modified Article 12B in double tax treaties

Conclusion

The study finds that the digital economy has impacted South Africa's jurisdiction to tax corporate income, making the current rules inadequate in taxing corporate income in the digital economy. Accordingly, South Africa faces a pressing need to adapt its jurisdiction to tax rules to the realities of the digital economy.

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