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ISSUES IN THE REGULATION AND POLICY SURROUNDING E-COMMERCE IN SOUTH AFRICA

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Abstract

Online retail enhances the scope for suppliers and retailers internationally to access consumers in vastly different geographic contexts, including across national borders. This has a consequent effect on a range of policies including competition policy, taxation, industrial policy, trade, data protection and the protection of intellectual property. Complexity is added by the fact that decisions and policies in one policy sphere could potentially shape and impact on developments and trajectories in other areas. Countries are grappling with challenges in terms of regulating e-commerce. On the one hand, it provides opportunities for opening-up retail markets for smaller suppliers, reducing their costs to reach customers and providing rich data on customer preferences. On the other hand, the interplay of e-commerce with data as well as the underlying economies of scale can lead to dominance by larger providers, and reinforce trade patterns that favour companies and countries that were earlier adopters and innovators in the tech space. E-commerce also could potentially provide means by which companies avoid taxation and regulation, undermining local producers who are compliant. It raises important questions about the nature of the 'regulatory state' required, in terms of laws, regulations and institutions. This paper assesses key regulatory challenges that have arisen as a result of e-commerce, and approaches taken in South Africa and internationally with a focus on the regulation of market power, trade and taxation.

JEL classification: F1, L4, L5, O38

Keywords: e-commerce, regulation, competition, tax, trade, market power, digital platforms

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1 Introduction

E-Commerce, described broadly as the purchase of items over the internet, is changing the structure and value chain of retail industry. It can enhance efficiencies, increase the breadth and variety of products available to customers and allow for more transparent comparisons between products and providers. It provides the opportunity for small domestic suppliers to directly access customers and thereby bypass the high barriers to entry characteristic of traditional routes-to-market. It also has the potential to allow customers in rural and outlying areas to access a broader range of products, ultimately increasing the size of the market. At the same time, the widening of the market to all internet users means that e-commerce and online retail provides a route to markets beyond physical geographic borders.

As online retail enhances the scope for suppliers and retailers internationally to access consumers in different geographic contexts, implications arise in terms of the effect on policy. In particular, the cross-border nature of e-commerce has implications for taxation, industrial policy, trade negotiations, data protection and the protection of intellectual property. Furthermore, numerous policy areas determine the shape and trajectory of e-commerce within a country. Decisions and policies in one sphere could potentially shape and impact on developments and in other areas. There are various types of policies that impact on e-commerce. First, there are policies that facilitate e-commerce provision and uptake such as supportive telecommunications and postal policy, regulation of payment systems, digital promotion policies and e-commerce industrial development policies. Second, there are policies that determine the international implications and competitiveness of e-commerce for local industries and government including the tax and trade implications of cross-border e-commerce. Third, there are policies that prevent consumer exploitation such as digital competition policy and policies related to consumer protection such as data privacy and fraud protection in payment systems.

Although e-commerce at the moment forms a small proportion of overall sales in South Africa (1%), advances in internet speed, payment system security and mobile shopping means that it is rising significantly. With improvement in the postal system, reductions in delivery costs and in data prices, e-commerce has the potential to grow even further. Furthermore, the international dimension of e-commerce makes it imperative that the government has a clear understanding of the issues at hand in order to develop its policy stance in international forums. As such a pre-emptive and integrated approach needs to be taken to ensure that South Africa is able to benefit from the opportunities the sector presents whilst limiting the negative impacts particularly to employment and trade in the country.

In this paper we begin the process of unpacking key issues and debates relevant to building a regulatory framework. We start by focusing on three specific areas of regulation, namely competition, trade and taxation.

- First, we summarise some of the issues that have emerged from the intersection of e-commerce and *competition policy* with a discussion of different models of regulation being used internationally.
- Second, we assess some of the key issues being raised in relation to e-commerce from a *trade* perspective.
- Third, we assess concerns over the potential for e-commerce to allow companies to bypass regulation ultimately impacting on the efficacy of certain policies. Specifically,

we assess concerns over how e-commerce interacts with *tax policy* to influence competition and how this has been dealt with internationally and in South Africa.

2 Methodology

E-commerce has a range of definitions. At its widest it encompasses the sale or purchase of goods or services over computer-mediated networks. A narrower definition is the sale or purchase of goods or services using internet (OECD 2002). This has over time grown to encompass a broad range of industries that may include services such as online educational courses, financial services and the sale of digitised products such as online games, video and music. Whereas in most of the IDTT e-commerce study we have used an even narrower definition of e-commerce and focus specifically on online retail which is the sale of physical products over the internet, in this paper we use a more expansive definition that also encompasses the range of electronically transmitted data flows that are currently sold.

The study used a combination of qualitative and quantitative data. Primary data was collected from stakeholders in the value chain on the basis of a semi-structured questionnaire in face-to-face, telephonic and Skype interviews. 18 interviews were carried out comprising interviewees with expertise and experience in online sales, logistics and online payments in South Africa as well as regulators. Secondary data was collated from a range of sources. This was triangulated with a review of academic literature, policy documents and news articles.

3 E-Commerce and regulating market power

Concern has been raised over the power of platforms from an e-commerce perspective.³ This is partly due to the confluence of traditional market power enjoyed by companies with high market shares, and a new form of power that derives from access to data and the associated network effects, discussed below. Several key themes relating to this market power on different levels of the market including: (i) the role of platforms in routes to market; (ii) the impact on retailers who use platform marketplaces; and, (iii) as a result of platform power and use of user data. Countries have attempted to intervene using differing institutions and regulations. For example, the EU has primarily approached this through competition law, while other countries such as India have used a regulatory approach. In this section we outline some of the key issues in relation to market power and platforms in e-commerce and how they have been approached by authorities before drawing out lessons for South Africa.

At the outset it is important to note the relationship between data and dominance that pervades much of the discussion. The ability to collect and rapidly analyse large data sets ('big data') provides substantial advantages to sophisticated technology companies with access to large datasets. Online providers can collect information on consumer behaviour by tracking users' internet activities including searching/browsing and social media activity. Data, including a range of demographic data (often requested when signing up for a service) can also be collected through voluntary means. Details such as age, gender, details of individual's choices and behaviour such as dietary habits, purchasing history, search history, browsing in online stores, composition of household, and locational data can all be analysed to predict likely consumer preferences. This can be used to market products on a personalized basis, to

³See, for example, The Economist, "How to tame the tech titans". 18 January 2018, available at <https://www.economist.com/news/leaders/21735021-dominance-google-facebook-and-amazon-bad-consumers-and-competition-how-tame>. Lagarde 19 April 2018.

forecast trends and demand on a macro level and to incentivise certain behaviour (OECD, 2016). Sites that sell advertising such as Facebook and Google use this information to enhance personalisation. Shopping sites assess this data for a range of outcomes including optimizing pricing and determining when mark-downs should occur.⁴ This is increasingly done through machine learning and artificial intelligence and as these become more sophisticated data needs will rise. Scale economies exist in data. The more people that use the platform, the more data you have, the better the information and predictive value or value of advert/ the better the search results or targeting.⁵ In reality, this has manifested in market power both at advertising and retail level.

3.1 Platform power and routes to market

As noted in other papers in this series, a key aspect of competitive performance in online retail involves successful marketing through online search and social media platforms.⁶ Platforms with a measure of market power such as Google and Facebook have been highlighted by numerous South African companies that we interviewed to be important tools to build online trial. However, these platforms have themselves been subject to scrutiny over abusive practices internationally. As participants in two-sided markets concerns have arisen that dominance in consumer-facing markets (search and social media) is translating into abuse in the market for advertising. There is also concern that dominance in routes to market and the subsequent increases in costs could potentially raise barriers to entry for new entrants and smaller participants.

The EC has primarily investigated and attempted to remedy abuse by platforms using competition law. For example, in terms of route to market or advertising the EC has fined Google for abusing their dominance in search in which they have a market share over 70%. Firstly, the European Commission penalized Google €2.4bn for abusing its position in comparator shopping, promoting its own comparison shopping service in its search results, and demoting those of competitors thereby preventing them from growing and competing.⁷ Secondly, the EC has fined Google an additional €1.49bn for restrictive clauses that blocked rival online search advertisers from advertising on 3rd party sites in which Google provided their “AdSense for search” product. These clauses include exclusivity, premium placement of Google search ads and a right to authorise competing ads.⁸

Market power in online platforms is also being *facilitated by access to data*. Larger platforms with many users have access to large datasets which allow them to personalise advertising.

⁴ Marr, B, “Big Data: A game changer in the retail sector.” 10 November 2015, Forbes. Available at <https://www.forbes.com/sites/bernardmarr/2015/11/10/big-data-a-game-changer-in-the-retail-sector/3/#1e6428fe3e22>

⁵ Autorite de la Concurrence and Bundeskartellamt, “Competition Law and Data”. 10 May 2016, available at https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Berichte/Big%20Data%20Papier.pdf;jsessionid=D49470E80279FCA4A61DB9FF56516942.2_cid378?__blob=publicationFile&v=2

⁶ Goga, S., Paelo, A., and Nyamwena, J. (2019) Online Retailing in South Africa: An Overview. *IDTT Project Paper*; Goga, S and Paelo, A. (2019). Strategies for adapting to online entry: the case of retailers in South Africa. *IDTT Project Paper*.

⁷ European Commission Press Release, “Antitrust: Commission fines Google Euro 2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping services”, Brussels, 27 July 2017.

⁸ European Commission Press Release, “Antitrust: Commission fines Google Euro 1.49 for abusive practices in online advertising”, Brussels, 20 March 2019.

The level of data possessed through dominance in adjacent markets, namely search and social networking) provides them with power in the market for online advertising by allowing for very targeted adverts.

This aspect of market power has been investigated and found to be an exploitative abuse by the German Bundeskartellamt in a recent decision on Facebook, a social networking company that is dominant (with a market share of over 95% in Germany).⁹ Prior to the ruling Facebook combined data from a range of 3rd party websites including (i) other services owned by Facebook such as Instagram and WhatsApp, (ii) third party websites with embedded 'like' or 'share' buttons and (iii) websites which use Facebook Analytics services. Consenting to data collection from other sites was a prerequisite for using any part of the Facebook social network. The data was used to create very detailed user profiles that were combined into a user's individual Facebook profile without user consent and used to sell personalised advertising services. The Bundeskartellamt considered this an exploitative practice that violated data protection requirements as well as a "*manifestation of Facebook's market power*" with the two causally linked. While acknowledging the efficiencies of a data-driven business model they also noted that this level of data processing was inappropriate and abusive. They also noted that this conduct would impede competitors and increase market entry barriers, further increasing Facebook's market power and dominance. Facebook has disagreed with them.¹⁰

It can be noted that India is also considering issues in relation to dominance in social media and search engines and its impact on advertising and barriers to entry for smaller enterprises in their policy framework. India's Draft National Ecommerce Policy notes that smaller companies and start-ups are facing increased prices in advertising and that this is likely to increase barriers to entry. While the document does not go into great detail it states that "*advertising charges in e-commerce must be regulated, especially for small enterprises and start-ups*".¹¹

Our interviews with South African e-commerce and traditional retailers, as well as smaller platforms and marketplaces have highlighted the importance of advertising on dominant social media platforms (Facebook) and search engines (Google). The patterns experienced in other countries in which dominance in social media and search that translates into market power in advertising appears to be evident in the South African market too. Traditional retailers in the e-commerce space that we interviewed noted that they do not consider channels outside of Facebook and Google for online advertisement placement. Since Google and Facebook are likely to be dominant in search and social media in South Africa and are clearly essential as a route to market it is important to consider the implications of their dominance and how best to regulate distortions it may create. The Competition Commission, for example, should strongly consider whether the types of abuse investigated and fined in the EC in search and social

⁹ Bundeskartellamt, "Facebook, Exploitative business terms pursuant to Section 19(1) GWB for inadequate data processing" B6-22/16, 6 February 2019.

¹⁰ Facebook Newsroom, "Why we disagree with the Bundeskartellamt", 7 February 2019, available <https://newsroom.fb.com/news/2019/02/bundeskartellamt-order/>

¹¹ "Electronic Commerce in India: Draft National Policy Framework", available from <https://www.medianama.com/wp-content/uploads/Draft-National-E-commerce-Policy.pdf>

media or similar patterns of behaviour that may impact on local markets are relevant within this context and to remedy it if this is occurring.

Furthermore, it can be noted that in addition to distortions that are caused, abuse of dominance, concentration in routes to market due to dominance in search and social media is creating barriers to entry for smaller companies. One interviewee who owned a small marketplace stated that they “*burnt through money*” trying to compete with bigger marketplaces for Google advertising. As such, it is important that authorities also monitor the impact of this market power on barriers to entry for smaller participants in e-commerce.

Potential abuses due to dual roles as marketplaces and online retailers

Online platforms exhibit the characteristics of a network market. Their substantial first-mover advantages, economies of scale and scope and network effects mean that markets can tip to dominant firms. Network effects mean that people want to join the platform with the largest membership. In addition, there can be many different ‘sides’ or groups of users which reinforce these effects. In the case of online retail, the sellers are more likely to supply platforms which have many buyers signed up and vice versa. If the arrangements are not exclusive, namely, sellers are not tied to a single platform, then the effect should, in principle, be much weaker. However, this depends on the arrangements governing suppliers (such as payment terms and good positioning on the site) which may orient them to one platform. Consumers can also get tied into one site through direct and indirect inducements.¹² In addition, the data collation which comes from observing transactions and search on a platform can place the platform owner in a privileged position to analyse market developments and use analytical tools to benefit over rivals. By integrating the different functions and bringing together suppliers and customers search and transactions costs are lowered. However, it also can lead to enhancement of dominance.

The largest online platforms in the world (such as Amazon and Alibaba, as well as Takealot in South Africa) play dual roles. They act as online retailers purchasing and reselling products at a market. At the same time, they operate marketplaces in which third-party sellers list and utilise their marketing and fulfilment services. As such, in some instances they compete directly with third-party sellers that they host and therefore are in both a vertical and horizontal relationship with its resellers. This dual role has raised competition concerns relating to abuse of dominance and has been the target of regulatory focus in numerous jurisdictions. Furthermore, as technology changes there is the concern that further automation by platforms will cement this dominance by creating further control over routes to market and reducing the likelihood of multihoming (where consumers use multiple websites to shop from). For example, the use of specialized or automated (generally voice controlled) assistants such as Amazon’s Alexa¹³ which currently prioritise Amazon-owned brands (such as Amazon Basics) for staple product orders may impact on competitors’ route to market.¹⁴

¹² Candeub, A. (2014). “Behavioural Economics, Internet Search and Antitrust”, Michigan State University College of Law, 2014

¹³ According to a recent study almost a quarter of people surveyed in the US had an in-home voice-controlled devices and another 20% were planning to purchase one, see Walker Sands, “Future of Retail: 2017”, available at <https://www.walkersands.com/Thank-You-for-Downloading-Future-of-Retail-2017-The-Connected-Consumer-and-the-Changing-Face-of-Commerce>

¹⁴ Cision PR Newswire, “Voice Shopping Set to Jump to \$40 Billion By 2022, Rising From \$2 Billion Today” 28 February 2018, available at

Intervention to limit the harm from the vertical relationships combined with horizontal competition has occurred in many jurisdictions. This ranges from competition investigations in the EC and Germany to regulatory approaches in India and China. Numerous countries have also been developing standalone e-commerce policies. These policies often cover a range of issues including IP protection and data protection but also include clauses that focus on competition.

1. Abuse of dominance and the role for competition law

In September 2018, the European Commission begun a preliminary investigation of Amazon with a focus on its collection and use of transaction data.¹⁵ In particular, they are concerned that Amazon is collating data from smaller merchants via its marketplace and potentially utilising the data to enhance its own retail offerings. An example would be Amazon collating and processing data on trending products sold by third parties to inform its own strategy on what new products to source and introduce as products sold directly by Amazon. At this early stage requests for information have been sent include data of merchants made available to Amazon, and whether they are relevant for positioning.¹⁶

Similarly, the German Bundeskartellamt has initiated an abuse proceeding and is investigating the role and market power of Amazon with particular regard to its dual business.¹⁷ Amazon is the largest online retailer in Germany and serves as a gatekeeper for customers for many retailers and manufacturers that use its marketplace. The Bundeskartellamt stated that they have received many complaints about Amazon abusing its market position to the detriment of sellers in the market. It is therefore looking at its business practices and restrictions that impact sellers in the German marketplace. As such, they see this investigation as supplementary to the broader EC investigation.

2. FDI regulation

Certain countries have tried to prevent the growth of multinational e-commerce platforms using FDI regulation. This is often motivated by a need to control access to information and to protect infant industries.¹⁸ However, India is also using FDI regulation as tool to remedy e-commerce platform power in retail competition.

<https://www.prnewswire.com/news-releases/voice-shopping-set-to-jump-to-40-billion-by-2022-rising-from-2-billion-today-300605596.html>

¹⁵ Financial Times, "EU opens probe into Amazon use of data about merchant." 19 September 2018, available at <https://www.ft.com/content/a8c78888-bc0f-11e8-8274-55b72926558f>

¹⁶ Hoppner, T and Westerhoff, P, "The EU's investigation into Amazon Marketplace", 30 November 2018, Kluwer Competition Law Blog, available at <http://competitionlawblog.kluwercompetitionlaw.com/2018/11/30/the-eus-competition-investigation-into-amazon-marketplace/>

¹⁷ Bundeskartellamt, "Press release: Bundeskartellamt initiates abuse proceeding against Amazon." 29 November 2018, available at https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Pressemitteilungen/2018/29_11_2018_Verfahrenseinleitung_Amazon.pdf?__blob=publicationFile&v=2

¹⁸ China, for example, historically limited cross-border e-commerce into China through an investment cap on foreign ownership on value added telecoms services. This, combined with limitations on internet access to foreign websites (popularly termed the "Great Firewall of China"), led to the development of large local platforms in social media, search and e-commerce with significant scale economies and entrenchment in the local market. However, they have since slowly been liberalising their FDI requirements.

In December 2018, India passed rules that ultimately regulate e-commerce by foreign platforms, using their foreign direct investment law.¹⁹ The new regulations have several implications and severely limit the business model of foreign owned e-commerce marketplaces and firms.

Firstly, they *prevent foreign e-commerce companies from selling directly*. E-commerce platforms operate on various levels, (i) as marketplaces on which sellers can list products (often providing warehousing, payment, fulfilment and delivery services) and (ii) as retailers who purchase or manufacture products for sale to consumers. In terms of the new FDI regulations foreign companies are not allowed to compete on the basis of an “inventory based” model of e-commerce in which inventory of goods and services is owned by the e-commerce entity and sold directly to consumers. Instead they are only allowed to compete on a “marketplace model” where a network acts as a facilitator between buyer and seller or provides services such as logistics, payment and fulfilment. In effect this meant that companies such as Amazon and Flipkart (owned by Walmart) are now not able to sell their private label items (such as Amazon Basics) and can only provide the platform and services for third party sellers to sell through the website. Secondly, the rules prevent e-commerce entities from selling products from vendors in which they *hold an equity stake*, preventing vertical relationships.²⁰ Thirdly, there are restrictions on e-commerce entities directly or indirectly influencing the sale price of goods. The regulations also specify non-discrimination across vendors. Fourthly, e-commerce entities are prohibited from mandating contracts which require online retailers to sell exclusively on their platforms.²¹

This intervention is largely an industrial policy intervention that has been undertaken to protect bricks and mortar companies as well as Indian e-commerce companies from the large multinational e-commerce companies who have made inroads into the Indian market. However, it directly eliminates industry structures which allow vertical e-commerce providers to directly compete with retailers and regulates other potential competition issues (such as exclusivity and vertical arrangements) preventing some of the issues mentioned previously.

3. *E-commerce policy*

A third way in which countries are approaching concerns over dominance in e-commerce is to include competition considerations in their specific e-commerce frameworks or regulations.

China implemented a specific e-commerce law in January 2019. The law covers three types of operators, platform operators, operators on platforms (third party merchants or retailers) and online sellers that sell directly or through other channels (such as social media). While the policy is broad and covers a range of areas such as protection of personal information and IP protection, it also has particular sections that focus on unfair competition. For example, Article 22 relates to abuse of dominance and focuses on the prevention of exclusionary behaviour stating:

¹⁹ Government of India, Press Information Bureau, Review of policy on Foreign Direct Investment in e-commerce, 26 December 2018, available at <http://pib.nic.in/newsite/PrintRelease.aspx?relid=186804>

²⁰ If more than 25% of the purchases of a vendor are from a particular marketplace they are considered controlled by that company

²¹ <https://www.bbc.com/news/business-47083972>

“Where an e-commerce business operator has a dominant market position due to its technological advantage, number of users, and control of relevant industries, other business operators’ reliance on it in trading, or any other factor, the e-commerce business operator shall not abuse its dominant market position to eliminate or restrict competition”

Article 35 which focuses on unreasonable trading conditions and fees states: *“E-commerce platform business operators must not use platform service agreements, trading rules, technologies or other methods to impose unreasonable restrictions or requirements on on-platform businesses’ transactions, trading prices, or transactions with other businesses, or collect unreasonable fees from on-platform businesses.”*

This ultimately could be used to regulate some of the vertical arrangements by e-commerce platforms and their retailers.

Likewise, India has also developed an e-commerce policy (still in draft form) which covers e-commerce specific issues (such as anti-counterfeit and anti-piracy measures, authentic rating and review requirements, mechanisms for tracking etc), and regulatory issues (such as data, taxation, payment, consumer protection etc). However, it specifically notes the impact of network effects that arise from data and highlights the need to consider data and network effects in the assessments of mergers and anti-trust etc.

3.2 Conclusions on competition

It is increasingly accepted in a range of countries around the world that while e-commerce could expand markets and provide a route to entry for smaller businesses, given economies of scope and scale, e-commerce has the potential to consolidate power in the hands of a few large e-commerce companies. Furthermore, dominance in adjacent areas such as search and social media provides large digital platforms (particularly Facebook and Google) the ability to leverage into other markets, and control routes to market and customers which also impacts on competitive dynamics.

A range of countries are attempting to remedy this. While different models of regulation are being taken depending on the institutional framework of the country involved there is an overall understanding that platforms lend themselves to dominance and there is a need to guard against abuses of this dominance, particularly with respect to its impact on routes to market and resellers. At this stage there have been cases related to dominance in search and social media that have highlighted the distortions that can be caused by platform power that impact on e-commerce by controlling and distorting routes to market and by controlling data. However, investigations, regulations and policies *relating to e-commerce* directly are still in their infancy and cases relating to abuses by *e-commerce platforms* (Amazon in particular) have not been tried and concluded. It is thus not clear whether an ex-ante approach (similar to that being undertaken indirectly by India) or an ex-post approach such as that taken in the European Union is more effective.

In our discussions with South African companies it has emerged that the e-commerce market is still in its infancy and there is currently no e-commerce platform or marketplace with a dominant position in terms of South African Competition Law or that in effect has strong power over third party resellers. Furthermore, unlike India, there are no large foreign marketplaces (such as Amazon or Alibaba) that are active in the country and that sell the products of local third-party retailers. As such, we face a different set of circumstance and need to be wary of regulating inappropriately before the domestic market has grown and developed. However, it

is possible that as the market develops domestic platforms may grow dominant or large international e-commerce platforms enter. It is thus important that in addition to search and social media, e-commerce platforms remain on the radar of competition authorities and that any overall e-commerce policy takes cognisance of the potential for abuses in the e-commerce market and incorporates competition and market power considerations. Furthermore, where there is established international precedent for preventing certain anticompetitive contractual arrangements (such as Most Favoured Nation clauses which prohibit companies from requiring suppliers not to offer products at lower prices to other platforms and customers) these should be investigated in a South African context and enforcement action taken.

In terms of adjacent markets and routes to market with relevance to e-commerce, such as search and advertising, our interviews have emphasised the power of Google and Facebook in providing routes to customers and markets in South Africa and the lack of local competitors. As such, it is essential that competition authorities carefully consider the extent to which patterns apparent in jurisdictions such as the EC are relevant to our context and address it.

In terms of broader regulation, South Africa should consider the development of an e-commerce policy to align the different sectoral regulators when assessing e-commerce related regulation and policy. This is discussed further in the final conclusion

4 E-commerce and international trade

Digital transformation and the introduction of cross-border e-commerce has various implications for international trade negotiations. As such, e-commerce has been discussed in the WTO as early as 1998 in which a Declaration on Global Electronic Commerce was adopted to establish a work programme on trade-related issues in global e-commerce. This programme includes four major areas, trade in services, trade in goods, intellectual property rights, and trade and development. At subsequent trade conferences Ministers have thus far instructed that the work programme on e-commerce continue. In addition, they have routinely agreed the practice of not imposing customs duties on electronic transmissions until the next session.²² However, outside of the WTO multilateral framework e-commerce is increasingly being considered with several regional trade agreements incorporating e-commerce provisions, notably the Trans-Pacific Partnership which has various clauses related to e-commerce now collectively known as the Digital 2 Dozen.²³ Though the US pulled out of the TPP, the clauses on e-commerce that they primarily developed remain.

On the one hand, some countries believe that the benefits of free trade should translate favourably into the digital sphere, providing companies with wider markets and consumers with a wider range of products and associated competitive benefits. Various countries have therefore been pushing for new rules on e-commerce with 76 countries including the US and

²² World Trade Organisation, Electronic Commerce, https://www.wto.org/English/tratop_E/ecom_e/ecom_e.htm

²³ The Trans-Pacific Partnership (TPP) clauses related to e-commerce are aimed at promoting the digital economy through a free and open internet and commerce across borders which have come to be known as the Digital 2 Dozen. The Digital 2 Dozen advocate for, among other things, free internet, free flows of data, protection of source codes and levelling the playing field for international digital companies.

China engaging in talks on e-commerce.²⁴ However, there is a strong divergence with the views of other countries who wish to hold out on incorporating these issues into the WTO agenda at this stage of technological development. Large developing countries such as India, and Argentina (as well as South Africa) have therefore not joined the talks. A key aspect of the contention arises from the impact that proposed clauses will have on a country's ability to regulate and localise data flows, and the impact on industrial policy and nascent industries going forward.

In this section we outline some of the key issues for which there is contention in relation to e-commerce.

4.1 Tariffs on e-commerce goods

At the outset it is useful to outline the different types of goods and products retailed over e-commerce channels.

1. Tangible products ordered via online retail. These need to be physically transported and in the case of cross-border e-commerce, needs to pass a physical border.
2. Online services. These are services that are provided electronically and do not pass borders.
3. E-products: This includes music, video games and e-books that historically would have been physical products but are now streamed using data.
4. Remote additive manufacturing or 3D printing: Digital files that are sold and transmitted electronically but that can be used to create objects through 3D printing techniques in another location.

It can be noted that while the first type of product sold via e-commerce passes through a physical border and tariffs and taxes can be applied to it, the other three types of products are entirely virtual, even though they compete with physical goods and services (such as physical services in the country, physical books and music and products manufactured through other technologies or through 3D designs developed in-country).

One of the key features of digital trade negotiations at the WTO thus far is a moratorium on tariffs on electronic transmissions. However, the proportion of traded products comprised of electronic transmissions, and their future uses is changing as consumers switch from physical to digital products (such as books and music) and 3D printing becomes more cost-effective and common. A moratorium on tariffs applied to electronically transmitted products therefore potentially impacts on the total tariff revenue collected as well as the opportunity to utilise industrial policy in markets for these products. Countries such as India have raised concern that *"with more and more products traded digitally in the era of additive manufacturing and digital printing, the GATT schedule of countries will erode and will vanish ultimately."* They go on to raise concerns that more and more goods will be traded at zero duties and that protection for nascent industries in India will disappear.²⁵

²⁴ European Union, "Press Release: Goods and services- 76 countries launch WTO talks on e-commerce", 25 January 2019.

²⁵ Government of India, Draft National e-Commerce Policy: India's Data for India's Development, available at https://dipp.gov.in/sites/default/files/DraftNational_e-commerce_Policy_23February2019.pdf

In addition to the moratorium on tariffs on digital transmissions at the WTO, tariffs on digital transmissions have been totally prohibited in some bilateral trade agreements including the TPP.

4.2 Data localisation and data sovereignty

Data is a core resource in digital trade. It allows companies to make decisions, allows for personalisation and is the basis on which AI and machine learning functions. However, data also includes information which can be personal or sensitive for other reasons. Ownership of data and regulation of cross-border flows of data is therefore becoming increasingly contentious.

Data localization refers to policies by national governments that restrict the flow of data across countries (WTO, 2018). The Digital Trade Estimates index estimates that there were 84 data localization measures put in place by 64 countries covered. This represented a substantial increase from its 1960 or even 1990 levels. Data localization measures differ in terms of the level of restriction and focus. This ranges from requirements on local or processing of data which requires firms to construct local data centres storage (with or without allowing a copy of the data to be moved off-shore) to conditional measures such as restricting data flows for particular sectors (such as health and financial data in the case of China, and geospatial and mapping data in South Korea) or requiring use of particular technologies or procedures to store or process data (such as the European General Data Protection Regulation).²⁶ National governments may also institute a complete ban on transferring data out of the country (WTO, 2018). Data localisation is closely associated with the concept of data sovereignty. At present, South Africa has conditional requirements on data. The Protection of Personal Information Act (POPI) in South Africa allows data transfers to third countries on a conditional basis (such as consent, the recipient being subject to a law that upholds similar conditions to those contained in POPI etc). This to some extent mitigates the data protection needs for data localisation.

Various countries believe that data localisation policies should be prohibited or restricted to allow international technology companies to access data that would improve their services. Several clauses in the Digital 2 Dozen in the TPP agreement deal with data. For example, it requires parties to the agreement to allow the transfer of data across the border. It also prohibits rules on data localisation which requires companies to “localise data” or host it on servers within the country.

Data localisation policies have been instituted for various reasons. The main arguments relate to data privacy and protection of the individuals. Some countries believe that they are better able to regulate and control use of data if the data is localised and they have jurisdiction. Data localisation measures are also used to promote national security and cybersecurity (though critics also point to it allowing for government surveillance). There are also some digital industrial policy arguments, namely that data localisation encourages foreign companies to make use of local skills, labour and resources which would create jobs. This could occur

²⁶ European Commission, Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016R0679>

directly through investment in data centres, or indirectly as a prohibition on data transfer makes it more feasible to have integrated systems within the country.

However, data localisation is contentious for various reasons. First, the costs involved. Data localisation may require duplication of data centres which may raise costs, and act as a disincentive for investment. Even for local companies, the costs of using local storage may exceed that of international cloud computing services. Second, it is argued that it may impact on innovation as companies would have limited access to cross-border data. This could impact on the ability for companies that operate across borders to integrate their functions (for example, in e-commerce it would prevent websites from integrating their data with manufactures offshore). Third, some opponents argue that there is little evidence for the purported benefits, that security is not better and that employment does not rise (as these centres are largely automated) and that costs rise as a result (Cory, 2017; WTO, 2018).

At this stage the costs of additional data centres as opposed to the benefits of innovation from a free flow of data has not been determined and much of the debate is still to some extent theoretical. However, there are widely diverging views on this.

Related, but slightly different to data localisation are issues related to data sovereignty and data ownership. Data is generated by individuals on a daily basis. However, this data gains value when combined with that of other people or with other types of data which allow inferences to be made or patterns to be established. For example, individual mobile credit or payment data can be combined to create credit profiles that benefit individuals in allowing access to credit as well as reducing risk in the financial system, while healthcare data may allow insurance companies to assess individual risk. Data on traffic movements could potentially be used to optimise traffic flows in urban planning. At present, much data is collected (openly or covertly), processed and utilised as a resource by private companies. Those who provide the data are generally not compensated, and the dataset becomes a private good. Governments often have limited access to this data to aid in policymaking or regulation. As such, questions have been raised as to the extent to which citizens should have access to their data and the extent to which governments should act as trustees of general data that could have social or national benefit.²⁷

While there are different types of data including personal and commercial data, there are arguments that some data is collective. Data on geo-mapping, health, traffic flows, or the natural environment can be argued to have significant value as a public good that would allow for the application of technology to optimise policy. Thus, a question is whether certain categories of data should be owned by the country itself as trustees for the people. Some countries are developing policies that claim to ownership of certain data. For example, Rwanda has a policy on national data sovereignty in which they retain exclusive sovereign rights over 'national data'. This is still in the early stages, however. Europe and India have both discussed access to data in the development of APIs on a fair, reasonable and non-discriminatory basis. The European Union is discussing ways in which data generated by the Internet of Things can be shared (such as open data, data monetarisation through a data

²⁷ See for example, Jeet-Singh, P, Digital Industrialisation in Developing Countries- A review of the Business and Policy Landscape.

marketplace and data exchange) and by which private sector data could be used to support public bodies.²⁸

For this, it is important that public data ownership is placed on the agenda of trade negotiations and is considered in discussions related to the free flow of data so that onerous conditions preventing any form of localisation are not agreed to.

4.3 Disclosure of source code

Another contentious area relates to source code. Source codes refer to “*the list of programming commands necessary to understand and modify how software works*” (WTO, 2018). Recent WTO E-Commerce proposals and the TPP include clauses that disallow countries from including such provisions as terms for a firm’s entry into their markets, except in particular narrow circumstances such as software used for critical infrastructure (WTO, 2018). This is seen as important by some countries in preventing piracy of products through the leakage of software code.

However, this is also controversial and may have far-reaching implications beyond trade. This is because source code is in certain instances essential to evaluating outcomes. In particular, source code is often required to assess regulatory compliance of software or devices, particularly of ‘smart products’ which operate based on code. Examples include the following: to assess environmental compliance (such as in evaluating cars emissions), health safety (ensuring that medical devices are safe and not vulnerable to hacking), evaluating prudential financial regulation, as part of a patent application or in resolving IP disputes, and court proceedings (such as competition cases that may increasingly require code to understand collusion) etc. Source code may also be an important component of technology transfer, which would aid development. As such prohibitions on requirements on source code may have far reaching consequences for regulation as well as industrial development.

4.4 Trade facilitating measures

There are also certain laws that would facilitate trade and e-commerce that have been mooted. This includes frameworks for consumer protection and privacy, support for e-payments and e-signatures, customs clearance processes on low value shipments etc.

Some of these changes would potentially change the nature of online retail in South Africa. At present South Africa is inadvertently protected from e-commerce originating in countries such as China by the long processing times and lack of transparency on tariffs for inward bound imports. As such, laws that facilitate e-commerce may result in greater external competition. However, if these laws apply to other countries in sub-Saharan Africa, interviewees in the logistics sector believe that South Africa is well-poised to become an e-commerce storage and distribution hub in the region. As such, this may generate growth in other areas.

4.5 Conclusions on trade

It can be noted that the US which has a large internet economy and hosts many large digital businesses, as well as China that has a strong focus on outward oriented e-commerce, are pushing for various clauses in trade agreements that enhance the openness of countries with

²⁸ European Union, “Commission Staff Working Document: Guidance on sharing private sector data in the European data economy”, SWD(2018) 125 Final, Brussels, 25 April 2018.

respect to digital trade, and the flow of goods and data. These policies would, for the most part, promote the international operation and expansion of technology companies such as Google, Facebook, Amazon and Alibaba. In response, there are strong arguments being made for a level of digital protectionism, particularly, in developing country markets. In particular, India who historically maintained protection for designated infant industries is taking a more interventionist approach in order to protect digital industries, encourage local investment, and protect local sectors threatened by e-commerce (such as retail). This includes a suite of regulations including a focus on data localisation, an unbundling of platforms from retail with a limitation on foreign entry on retail and lobbying for tariffs on electronic transmissions. The example of China, which had a firewall and ultimately grew its own tech giants as a result, is sometimes raised as an example of the benefits of protectionism. However, it can be noted that both India and China have extremely large domestic populations that allow for internal scale economies to be achieved and lower costs.

In terms of industrial policy countries such as South Africa, with smaller populations, will not be able to achieve the same scale economies as countries like India or China and therefore may benefit from a more open economy, as long as it is developed with sufficient consumer protection. For example, local companies may benefit better from access to cheap cloud computing facilities for data processing and storage hosted in other markets that compete vigorously with each other, as opposed to a local data storage monopoly. In addition, an advantage of the technological revolution is the ability to access services internationally. Interviews with South African businesses have shown that at present certain complex e-commerce programming and analytic services that are not available locally are procured internationally.²⁹ Concerns over a shortage of skills within South Africa in STEM means that laws on data that are too restrictive may therefore have unintended consequences for local industry.

As such, we would argue that data flows should not be unduly limited subject to (i) adequate data protection and (ii) localisation or ownership required for certain categories of data where deemed necessary for regulatory or security reasons (such as financial services and healthcare).

However, there are also problematic aspects to overtly liberalised digital trade on regulation and the country. Restrictions on data flows, technology transfer and source code that are too onerous should be avoided. In terms of source-code we would argue that any trade negotiations that the government signs clearly allows them to request source code in certain instances to allow for regulation of products and services that relies on algorithms or code. Likewise, data that is of public benefit should be treated carefully and overtly onerous concessions on the free flow of data should not be agreed to, in order to allow space for future regulation and use of this data. Consideration should be given to how best to define and regulate ownership over public data. Furthermore, South Africa should side with those countries that oppose agreements banning tariffs on any electronically transmitted product, (including, but not limited to 3D printing) as this is likely to increasingly impact on trade and industrial policy. These issues require further research and analysis.

An awareness of the impact of trade policy is important in developing industrial development strategies for e-commerce. At present South African e-commerce companies have been

²⁹ Interviews with a large electronics and clothing retailer and interviews with supermarket groups.

largely protected from e-commerce through non-tariff barriers such as the registration procedures associated with receiving items purchased from outside the country which provide an inadvertent barrier to trade. This could change if trade rules regarding aspects like customs clearance and taxation are smoothed significantly. In this case, there may be impacts on local industry, particularly if there is an increase in imports. At the same time, this may lead to increased opportunity for South Africa to develop as a regional e-commerce logistics and warehousing hub to serve neighbouring countries, which at present according to logistics and retailers interviewed is more challenging to enter due to custom clearance and tax procedures.

5 E-commerce and taxation

E-commerce decouples shopping and payment from the geographic location of the supplier. While this enhances the reach for companies, and the range available for customers, the decoupling of physical presence from the point of sale has important implications for various aspects of regulation. One important area that is affected is taxation. Concerns have arisen in policy circles over the potential for e-commerce to allow for tax avoidance, thereby distorting comparative advantages and reducing tax income for a country. This section discusses the key areas in which e-commerce impacts on taxation and discusses developments in the taxation of e-commerce internationally.

The cross-border nature of e-commerce has important implications for tax authorities on two fronts, the levying of corporate income tax and of VAT.

5.1 Corporate tax

E-commerce can impact on corporate taxation through several mechanisms. This includes the fact that an absence of physical presence of a retailer can be used to avoid tax in a country in which it sells. It also can result from the fact that e-commerce has intangible value derived from its platform economies which are of great value but not monetised in a traditional manner.

a) Physical presence

Prior to the internet and growth of e-commerce, the jurisdiction of tax authorities was within geographical borders. The “source principle” gave the state the authority to tax income obtained within its borders (Bardopoulos, 2015). In the case of international businesses with operations in different countries, the concept of Permanent Establishment (PE) was used to determine which country had the right to tax business profits (The Davis Tax Committee, 2016). Conventions developed tools such as a ‘substantial physical presence’, and ‘the operation of agents’ to determine tax liability (OECD, 2017)³⁰. However, with the development of the internet, companies are able to operate across several countries and jurisdictions without a physical presence.

This has resulted in companies using the lack of a physical presence to evade tax, for example, by situating their headquarters in tax havens. Examples in the tech sector are fairly common. For example, in 2016, the European Commission (EC), ordered Apple to pay €13 bn in back taxes to Ireland (Farrell and McDonald, 2016). The EC found that a deal Apple had orchestrated with the Irish government which required Apple to pay a mere 1% in corporate tax compared to the standard Irish corporate rate of tax of 25%, was illegal. Google has also been accused of tax avoidance in a manoeuvre that entailed shifting profits to subsidiaries in

³⁰ The concept of PE as defined in article 5 of the OECD model tax convention.

various jurisdictions)³¹ which saved them about US\$3.6bn in 2015 alone (Wood, 2016). While Apple and Google are not online retailers of physical products at this time, similar concerns have arisen from international online retailers. Amazon was ordered to repay €250 million to Luxembourg for “undue tax advantages” under the EU’s state aid rules. EC Commissioner Margrethe Vestager noted that these benefits allowed almost three quarters of Amazon’s profits to go untaxed allowing them to pay four times less tax than other local companies.³²

Tax avoidance using a lack of physical presence is particularly relevant where platforms provide the technology to intermediate between buyers and sellers and hold this IP in subsidiary a tax haven. The ultimate impact of this is that tax revenue to a country decreases. Companies that do not pay corporate taxes due to these structures are advantaged relative to local suppliers that pay full corporate tax. A second issue of concern is that the anonymous nature of e-commerce also brings particular challenges such as difficulties in the identification of taxpayers, in the identification of taxable transactions and the ability to establish a link between the two.³³ Within a South African context this has been considered in some detail by the Davis Tax Commission and recommendations have been made in the context of international treaties.

b) The value of data

As discussed previously, with the rise of the internet and e-commerce, value in the digital economy, is created from a combination of algorithms, user behavioural data, sales functions and knowledge. Online e-commerce companies are increasingly relying on intangible assets and data to produce income. By sharing reviews, search behaviour or preferences on a platform, the user shares data with the platform that can later be used and monetised for targeted advertising. While a company may not be physically present in a country it may have a significant digital presence from which it derives the value described above at a substantial margin. However, under the present rules, profits are generally taxed in the country where the algorithms have been developed and not where the user and viewer of the adverts are located. Intangible items such as intellectual property critical to the formation of key goods are often registered to companies in tax friendly locations as is the case with Google as discussed above (Tracy, 2016). This means that while the input (user data) is “produced” in one country, it is given no value. All profits are seen to derive from intellectual property and no value is received by the country whose population provided the raw data.

c) Profit neutrality and taxation

Another issue that has arisen is that some of the larger international technology companies have been foregoing profits in order to expand, often with strong investment support. While this is often a pragmatic investment decision, there have been allegations that Amazon in particular has been foregoing profits to maintain artificially thin margins in order to establish dominance (Khan, 2017). From a tax perspective this means that companies are often

³¹ This manoeuvre entailed Google transferring a portion of its profits to a subsidiary in Ireland with a lower corporate tax. The revenue was then transferred to a subsidiary in Netherlands from which it was once again transferred to another Irish subsidiary whose registered headquarters are in Bermuda, a zero-rated tax country (Tracy, 2016).

³² European Commission, “Press release: State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million”, Brussels, 4 October 2017, available at http://europa.eu/rapid/press-release_IP-17-3701_en.htm

³³ Davis Tax Commission, Interim Report on Action Plan 1, Digital Economy, 2014.

unprofitable and therefore not eligible for corporate tax. This provides an advantage relative to companies that pay corporate tax.

5.2 Conclusions on corporate taxation

Residency rules and guidelines do not fully account for the digital economy. As outlined earlier, with the growth of e-commerce, a company does not have to be physically present in South Africa in order to derive substantial profits either through the sale of physical goods or non-physical goods (such as e-books, movies or digital designs) on platforms such as Amazon or intangible value through the use of algorithms and consumer data for advertising. While current OECD Guidelines on e-commerce have revised the concept of physical establishment from simply a physical presence to the presence of a server, companies may still derive profits from a country (potentially displacing local providers) even without the presence of a server. For example, Google does not have servers in South Africa despite maintaining a significant digital presence with numerous users.

Recognising the disconnect, there is global move towards reforms that allow tax authorities to tax companies that derive significant portions of their income from a particular country regardless of whether or not they have a physical presence in that country, provided they have a substantial digital presence. For instance, the European Commission has a proposal in which EU Member States would be able to tax profits that have been generated in their territory should the company have a significant digital presence, even if it does not have a physical presence³⁴ (European Commission, 2017). The proposals have been submitted to the Council for adoption and to the European Parliament for consultation.³⁵

Other countries are developing national versions of taxes. The UK for example, has announced a new Digital Services tax, which is a 2% tax levy on sales made by large digital companies in the UK that meet a revenue threshold (Pratley, 2018). These proposals aim to address the lack of physical presence, as well as the intangible benefit of users who do not purchase a product but interact on a platform.

However, while there is much discussion over these issues internationally, it has not been definitively addressed and implemented as yet in any tax jurisdiction to our knowledge. This is in part due to the complex nature of international taxation treaties. While it was assessed in some detail by the Davis Tax Commission and SARS and the National Treasury are engaging in discussions about these issues in international fora it is still being assessed and considered. There are however, strong arguments for developing new source rules that consider where consumption takes place similar to the ones being contemplated in the UK and European Union.

³⁴ A company or digital platform will be considered to have a taxable 'digital presence' or a virtual permanent establishment in a Member State if it adheres to one of the criteria related to a revenue threshold, user threshold and number of contracts generated as follows: it exceeds a threshold of €7 million in annual revenues in a Member State, it has more than 100,000 users in a Member State in a taxable year or over 3000 business contracts for digital services are created between the company and business users in a taxable year.

³⁵ http://europa.eu/rapid/press-release_IP-18-6732_en.pdf

5.3 Consumption tax issues

Another key tax issue lies in the ability of tax authorities to levy consumption taxes on goods and services traded over an e-commerce platform. Consumption taxes, generally in the form of Value Added Tax (VAT) or sales tax, can be levied regardless of where in the world they are purchased from or where the company is registered, provided they are consumed in that country (OECD, 2001). However, while local suppliers within a country are liable for VAT, there is concern that foreign suppliers are at times able to supply VAT-free goods and services, giving them a distinct advantage (European Commission, 2016). This is due to the fact that most laws developed have not been designed to deal with cross-border flows of this nature. The transfer and consumption of digital products and services (such as ebooks or music) which are not easily traceable were not envisioned. Furthermore, historically in many jurisdictions, import tax was only required for products over a certain amount.

With the introduction of e-commerce an increase in direct imports of low value products that would previously been imported in large consignments (thereby meeting the threshold for tax) or purchased locally, small products purchased through e-commerce channels may not always be liable for tax and may not always be assessed. The lack of awareness of different country rules and an international standard for charging, collecting and remitting tax to tax authorities increases non-compliance particularly for small and medium enterprises. This has meant that government tax revenue is lost, and the competitive dynamics between local and foreign companies are impacted as suppliers of products purchased via e-commerce can be advantaged relative to local suppliers that pay sales tax. However, there are attempts being made to address these issues both in South Africa and in other jurisdictions.

International experience

Internationally countries are adapting to the changing environment by reforming relevant consumption tax structures to ensure that local and foreign products are taxed on a fair and equal basis. In 2017 the Australian government introduced a number of reforms that affected the e-commerce industry.³⁶ The rationale behind changes were to ensure that Australian and foreign products were subject to the same tax regime. The Act focuses on taxation of two types of products, low-value imported goods and digital products and services. Similar laws are being developed and discussed in other jurisdictions. New Zealand intends to introduce similar laws to those in Australia in late 2019. In the European Union, a full set of rules will enter into force in 2021. There have also been narrower rulings and amendments in other jurisdictions. Overall, there are three key areas that are being reformed:

The taxation of intangible goods: Countries are creating amendments to tax intangible goods (such as imported services and digital products). Australia for example, requires that merchants that sell imported services or digital products to Australian consumers as well as operators of an electronic distribution platform or market place are liable to register with tax authorities if they meet a turnover threshold within a 12 month period (ATO, 2018).³⁷ As is discussed in the next section, South Africa has already addressed this.

³⁶ This was introduced through the Treasury Laws Amendment (GST Low Value Goods) Act of 2017

³⁷ Specifically, companies that supply imported services or digital services, run an enterprise and have a GST turnover from sales connected to Australia that meet or exceed A\$75,000 (about US\$ 54,559) in a 12 month period or A\$150,000 (about US\$ 109,000) for a non-profit must register to pay returns in Australia with the Australian Taxation Office.

Taxation of Low value products: In Australia amendments are being made to ensure that all imported goods worth less than a certain amount be liable for a 10% sales tax. Previously taxes were only charged on goods with a value above A\$1000 (US\$ 727). Sales tax on goods over this threshold (or a consignment that meets the threshold) will still be charged at the border. Non-resident suppliers of low value goods can access a simplified registration and reporting system. The law allows for a 75% administrative penalty on offenders (Avalara VATlive, 2018). Similarly, in the EU the current exemption on VAT for low value consignments from outside of the EU will be removed and replaced with a new scheme (European Commission, no date).

The joint liability of electronic suppliers or platforms: In Australia, operators of platforms and marketplaces are liable for tax in certain cases. In instances in which goods are purchased through a platform and brought into the country with the assistance of supplier or operator the electronic distribution platform will be treated as the supplier (including those sold by foreign online retailers such as Amazon and those that use a drop shipment model). In the EU, all services and sales of goods supplied to persons within the region will be subject to VAT. Online platforms will be made liable for collecting VAT on distance sales that it facilitates (Council of the EU, 2017). In the UK and Germany draft laws makes the operators of electronic marketplaces responsible for unpaid sales tax during transactions on their platforms even sooner (Chazan, 2018). This requires them to collect data on sellers and ensure that they are registered to pay sales tax.

Another issue is the e-commerce implications on regional taxes. In the US, a recent ruling *South Dakota vs Wayfair, Inc.*(2018) enables US States to impose a sales tax on goods sold by online retailers despite their physical location. Previously, 'out of state' merchants did not have to collect sales tax in states where they did not have a physical presence i.e. property or employees (Chalamish, 2018). While this is less relevant to countries such as South Africa which does not have the same regional tax structure, it does have implications for sellers into those jurisdictions, increasing compliance costs significantly.

International platforms have responded differently to these changes in taxation. For example, in response to Australian law Amazon has set up a more limited and expensive website to service Australian customers (Zhou, 2018). eBay has taken the opposite approach and invested significantly in systems to administer and collect taxes from customers to pay to the government (Kaye and Westbrook, 2018). In New Zealand there has been some resistance by large platforms who argue that there are costs to compliance (Shaw, 2018). In the US there are also concerns about the difficulty in complying with a wide range of state taxes (Karsten and West, 2018). We discuss this further after outlining the South African experience

5.4 Taxation of e-commerce in South Africa

Though there have been policy concerns that e-commerce currently provides a route to avoid taxation in South Africa, and that this disadvantages local competitors, this is not a true reflection of present status quo as South Africa has various laws and procedures in place to tax e-commerce companies. This can be divided into two categories, digital products and physical products. We discuss each in turn.

5.4.1 Digital products

South Africa has been particularly progressive and innovative when it comes to the taxation of intangible digital products. In 2014, amendments were made to the South African Value-

Added Tax (VAT) Act, No. 89 of 1991 that made South Africa the second country to introduce tax legislation targeting e-commerce, making it a pioneer in taxation of digital products. The Act requires all Foreign Electronic Service Entities to register for VAT in South Africa where the total value of electronic services they supply into the country exceeds R50 000 (about US\$ 3454). Section 1(1) of the VAT Act specified that taxes should be levied in the following instances:

- Where the recipient of the electronic services is a *resident of South Africa*
- Where payment to the foreign entity *originates from a South African bank*
- Where the recipient of the electronic services has a *business, residential or postal address in South Africa*

While the law levels the playing field by levying taxes on foreign vendors thus upholding the OECD taxation principle of neutrality, some objections have been raised concerning the discrepancy between taxes charged to foreign as compared to local vendors e.g. the low tax threshold for foreign suppliers in comparison to local suppliers and the levying of tax on business to business customers where this does not occur locally.³⁸ Since the introduction of the amendments about 200 international companies have registered for tax including Amazon and Alibaba. The National Treasury and SARS are now looking at expanding regulations to include third party platforms such as eBay to make them jointly liable to collect taxes, creating a clause that allows for a definition of an intermediary³⁹ to be taxed.⁴⁰ Expanded regulations are expected to be adopted in 2019.

While the legal framework exists, at present there are no real mechanisms that allow tax authorities to monitor purchases of digital products and services. As such, SARS currently relies on companies to voluntarily register and comply. While large international companies have registered it is less likely that small and medium enterprises abroad will be fully aware of the registration requirements.

5.4.2 Physical products

In terms of physical products, import VAT is levied at the point of entry (whether by air, road or sea). As such, it has been less of a focus from a policy perspective. In contrast to other jurisdictions where retailers have complained that e-commerce suppliers pay less tax and as a result have cheaper products, in South Africa e-commerce products are subject to higher levels of sales tax than local products as they are often subject to duties and additional taxes (such as 10% upliftment value on “up-market” goods). The duty regime protects local manufacturers from e-commerce imports in the same way that it protects them from wholesale imports of goods manufactured elsewhere. All goods coming in are inspected and taxed so e-

³⁸ One of the major concerns is the low threshold of company turnover for VAT registration of R50 000 in a 12 month period especially when one compares it to the local requirement of R1 000 000 for local vendors (Grimm, 2018). The amendments also do not distinguish between Business to Business (B2B) customers and Business to Consumer (B2C) customers. B2B customers who generally makeup about 90% of e-commerce transactions are liable for VAT on intermediate goods that they use to provide products or services. The Davis Tax Commission had in fact recommended that there be distinctions between the two such that B2B customers are not charged VAT while B2C become liable for VAT (The Davis Tax Committee, 2018).

³⁹ “‘**intermediary**’ means a person who facilitates the supply of electronic services supplied by the electronic services supplier and who is responsible for issuing the invoices and collecting payment for the supply;”

⁴⁰ Interview conducted with National Treasury, 16 August 2018.

commerce imports face the same duties and taxes that a container of wholesale goods would face.

As discussed in the previous working papers⁴¹, South African retailers interviewed have noted that one of the reasons that internationally inbound e-commerce is less of a threat in South Africa is that a lack of clarity over the level of duties and import VAT resulting in uncertainty of the final price often makes products less attractive to consumers than purchasing a product at the marked price locally. As such, it is possible that the concerns over the impact of low value e-commerce products on local retail has been muted in South Africa relative to other countries due to the taxation framework. Unlike other countries with a relatively high threshold under which low value imports were free (for example, Australia had a threshold of A\$1000 which is generally over R10 000), South Africa had a far lower threshold of R500 (Aramex, 2018). Goods below this threshold still pay a flat fee on value of 20% but are VAT exempt. As such, products entering South Africa are charged taxes and duties.

However, the policies and procedures for import duty were not specifically designed for small consignment low value e-commerce goods but rather designed for wholesale bulk imports. As such processes have not adapted yet and there are arguments that the regulations and processes should be reassessed within the context of increased e-commerce volumes to enhance efficiencies and consumer welfare. In addition, under-invoicing is also a concern.

SARS clearance requires that customs duty and import VAT is paid on physical products that enter South Africa. Most e-commerce products are either shipped via the postal services or through courier companies. There are various processes in place aimed at streamlining the process for courier companies. For example, there is a single administrative document which captures information and the documentation can be submitted electronically. However, in practice the process does not appear to be working as intended and the consequence is long delays in getting products through as well as variability and a lack of certainty over the duty to be paid.

In addition, there are specific issues that logistics companies believe are damaging to e-commerce.

1. *Legal requirements on registration as importers:* South African Customs regulations require that a customer who import goods worth more than R50 000 per consignment or more than thrice a year are required to register as an importer. Should the item be less than R50 000, the customer may import the product in their personal capacity. However only a company and not an individual may register as an importer. This requires that the “importer” completes forms and physically presents them at particular SARS offices with a range of documents⁴² However, this is cumbersome and most individuals who simply wish to purchase a few products from the internet are unaware of this, and unlikely to comply, resulting in them inadvertently breaking the law. Some

⁴¹ Goga, S., Paelo, A., and Nyamwena, J. (2019) Online Retailing in South Africa: An Overview. *IDTT Project Paper*; Goga, S and Paelo, A. (2019). Strategies for adapting to online entry: the case of retailers in South Africa. *IDTT Project Paper*.

⁴² Proof of address, certified copy of identity document, a certified copy of either a Close Corporation or Company registration; certified copies of VAT, Income Tax (IT), Pay as You Earn (PAYE), Skills Development Levy (SDL), Unemployed Insurance Fund (UIF) letters from SARS to confirm revenue registration details; proof of permanent address in South Africa and proof of banking details).<http://www.sars.gov.za/ClientSegments/Customs-Excise/Processing/Pages/Importers.aspx>

consumers circumvent this by registering with a local company that already has an importer's code but this raises the costs of using e-commerce services to acquire items.

2. *Custom duty Charges:* There are also a range of duties paid on products. These duties are not readily accessible and difficult to estimate. This creates opaqueness in terms of what a customer is due to pay and leads to high levels of uncertainty as to the cost of items as this is only assessed at the border.

Concerns over delays at the border due to customs and excise as well as uncertainty over taxation appears to be hindering inbound e-commerce and potentially reducing cross-border trade and the resultant tax income that would be derived from it. Some companies have worked around it. Amazon, for example, estimates total taxes for South Africa and refunds the customer if it is less, while absorbing the additional expense if it is more. However, while products are being taxed and the playing field between international e-commerce suppliers and local suppliers is not being distorted as a result of e-commerce it is clear that the processes to ensure fair taxation are hindering efficiency. In addition, where small businesses wish to purchase products internationally to circumvent higher local prices they are effectively being prevented from doing so.

5.5 Conclusion on taxation

South Africa has laws and regulations to govern the taxation of physical as well as digital e-commerce. In particular, it has been a pioneer in developing a legal framework for the taxation of digital and intangible products. While monitoring of digital products is difficult, the fact that the largest tech and e-commerce companies have registered and are paying tax is a promising start. Given the growing concentration in the market, the registration of companies such as Apple and Amazon are likely to increasingly make up a high proportion of taxes. In terms of income tax it is less likely that South Africa will be able to unilaterally make changes given the complexity of international tax treaties. However, it is important that the country continues to engage in these processes. Turnover taxation as is being introduced in the EU may also be an alternate means of ensuring that South Africa derives taxation income from the use of data that comes from the country.

In terms of physical products less innovation has occurred. While tax is paid on physical products it has been argued that the current system of taxation is not streamlined, discourages e-commerce, and reduces any efficiencies related to it. It is not clear whether these barriers to e-commerce are intentional as part of an industrial strategy or inadvertent. However, if the consumer benefits of cross-border trade such as improved range are to be realised measures to simplify the customs processes for e-commerce imports should be investigated and considered. There are several policy considerations. For example, holding platforms jointly liable for sales tax (such as in Australia and the EU) may increase compliance. It would also allow for expedited delivery at the border and potentially increase efficiencies. A simple online registration process for suppliers that allows for online payment of VAT and duties or allows customers to do so online will also expedite delivery and provide the consumer benefits while reducing the burden on border officials. As such, it is important that policy consideration is given to a more effective means of taxing small value e-commerce consignments.

6 Discussion and recommendations

E-commerce is shaped by the intersection of a range of policies including competition, trade and tax, as discussed in this paper, as well as data, payment systems, intellectual property and telecommunications policy which we have not discussed in detail. As such, there is a confluence of regulatory regimes that impact on the development of e-commerce. Furthermore, many of these regimes (such as taxation and trade) depend on international treaties and negotiations and are thus not entirely independent.

There are a range of issues that require serious policy consideration, research and intervention where relevant.

- In competition policy: We need to consider the role of data, vertical integration and multi-sided markets in platforms in creating distortions within online markets. This includes ascertaining whether platforms that operate in South Africa (such as Google and Facebook) which are likely dominant are distorting markets or abusing their dominance in the manner that has occurred in other jurisdictions. Furthermore, we should consider whether they are creating barriers to entry in online markets. The role of data and its impact on competition should be carefully considered in the South African context. In addition, the appropriate balance of competition enforcement as opposed to regulation needs to be debated.
- In trade policy: In trade policy we need to consider how to manage the tension between allowing flows of data that allow South Africans to benefit from the efficiencies of the internet economy while maintaining autonomy over use of data and source-code for regulatory and public policy purposes. In addition, strategies should be developed to future-proof local industry against changes in non-tariff barriers that may lead to increases in incoming international e-commerce. Furthermore, a trade negotiation strategy that maintains protection where appropriate for 3D printing and certain electronic transmissions should be developed.
- In tax policy: South Africa should continue to consider and engage in international discussions over tax avoidance by technology platforms. Serious consideration should be given to instituting turnover taxes as per the European model, holding platforms jointly liable for tax and enhancing efficiencies in the collection of duties on e-commerce.

Going forward it is important to develop a unified strategy for e-commerce incorporating the views of stakeholders and policymakers. Various arms of government, regulators and private sector companies are engaging deeply with issues related to e-commerce. However, there appears to be limited understanding of what streams of work are being undertaken and limited interaction between them. At the outside it is essential that better communication and alignment across regulators and policymakers occurs.

Internationally various approaches to the regulation of e-commerce have been taken. Some countries (such as India) have developed an e-commerce policy that sets out an overarching vision and principles as well as sub-sections that relate to particular components. Others have continued to use existing regulatory frameworks where appropriate and introduce specific laws to address policy gaps, such as the European Union which has continued to use its existing competition law to regulate aspects of e-commerce while creating new laws to regulate data

protection. The UK has approached these questions by establishing a Digital Competition Expert Panel to consider potential opportunities and challenges from the emerging digital economy.

South Africa currently has well-developed laws in a range of areas including competition and data protection and data sharing. Instead of creating parallel and overlapping laws a policy framework that can be agreed upon and that is used to guide policymaking in these areas, with supplementary laws or regulations developed where there are gaps would seem more beneficial than a standalone legal framework. However, it requires considerable input and buy-in from the full range of ministries and regulators involved. This co-ordination may require leadership from a single entity such as an expert panel or commission, or a unifying process such as the development of a national e-commerce policy.

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List of interviewees

	Company	Name of interviewee(s)	Position at company	Date of interview
1	Aramex	Denton Haridass	National Customs Compliance Manager	20 August 2018
2	Aramex	Mark Mahoney	Manager E-commerce Services	02 August 2018
3	Brownsense	Mzuzukile Soni	CEO	14 August 2018
4	DHL South Africa	Wayne van Rensburg; Carla Ferreira	Commercial Director; Relationship Channel Manager	16 July 2018
5	DHL Southern Africa	Hennie Heymans	CEO	06 August 2018
6	FNB	Bafana Mabasa	Operations Manager Foreign Exchange	14 August 2018
7	Hello Pretty	Samantha Marx; Scott Hadfield	Founders	07 August 2018
8	JD Group	Deitz Meiring	Chief Digital Officer	10 September 2018
9	National Treasury	Aneesa Baig	Director Indirect Tax	16 August 2018
10	Nedbank	Dayalan Govender	Managing Executive - Nedbank Card and Payments	17 September 2018
11	Pick n Pay	Richard van Rensburg; David North	Deputy CEO; Group Executive- Strategy and Corporate Affairs	24 July 2018
12	Pricecheck	Kevin Tucker	CEO	24 July 2018
13	South African Revenue Services (SARS)	Adrienne Veary	Specialist: Legislative Research and development	18 August 2018
14	The Foschini Group	Brent Curry	Chief Information Officer	09 October 2018
15	The Payments Association of South Africa (PASA)	Walter Volker	CEO	20 July 2018
16	Uafrica/Bidorbuy	Andy Higgins	Managing Director	18 July 2018
17	Wantital/Parcel Ninja	Justin Drennan	Chief Executive Officer (CEO)	23 July 2018
18	Woolworths	Ralph Buddle	Director, Strategy and business development	18 July 2018