Is tax coordination a solution of trade distortions in SACU? Possibilities for coordination of Value Added Tax in the Southern African Customs Union

Puseletso Letete[*]

Abstract

With the rise of regional integration and increasing globalisation, member countries to regional organisations and trading blocs, are under pressure to strengthen their economic integration. In view of this move, this paper explores the importance of extending this integration towards areas of Value Added Tax systems within the Southern African Customs Union. The paper argues that coordination of Value Added Tax within SACU will be beneficial for purposes of forging closer economic integration. This will also contribute towards fostering intra-regional trade between member states as well as in addressing issues of trade distortions which are caused by different VAT legal systems.

Introduction

There has been tremendous support from the African governments for regional integration and they have viewed regional integration as an important component of their development strategies.[1] Therefore, regional integration is an important aspect of economic development and economic integration for developing countries. Various studies have emphasised that tax harmonisation is a basic requirement for economic integration.[2]

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[*] Associate Professor: Department of Mercantile Law, Unisa.

[1] See Hartzenberg 'Regional integration in Africa' World Trade Organization Economic Research and Statistics Division: *Staff working Paper* ERSD–2011 14 October 2011 2.

[2] Petersen *et al Tax systems and tax harmonisation in the East African community* (2009) 3. See also Pfister 'Taxation for investment and development; an overview of policy challenges in Africa' Ministerial meeting and Expert Roundtable NEPAD-OECD Africa Investment Initiative 11–12 November 2009 5 at: http://www.o3de.org/dataoecd/44/43/43966821.pdf (last accessed on 15 March 2012). See also Velayos, Barreix & Villela 'Regional integration and tax harmonization: issues and recent experiences' in Tanzi *et al* (eds) *Taxation and Latin American integration*

According to some scholars, 'economic integration is the process through which economic relations and interdependence among areas are broadened and deepened'.[3] In this sense, there is a need to examine the extent to which tax coordination (and tax harmonisation) can contribute towards broadening and deepening economic relations.

The Southern African Customs Union (SACU) has played an important part in the economic and social development of the people of the member countries of this organisation.[4] SACU has also taken steps towards facilitation of trade and removal of trade barriers as a means to achieve economic integration within the sub-region. In a communiqué following the SACU's April 2010 summit, the leaders of the five states emphasised the role SACU must play in further integrating the region. Of the six points in their mission statement, one was 'to serve as a building block of an even closer community among the peoples of Southern Africa.'[5]

The European Union (EU) has also set an example of deepening integration in various economic areas as well as encouraging regionalism around the world.[6] This has extended to areas such as tax coordination of Value Added Tax (VAT).[7] In Africa, economic integration forms part of the final goal of political integration and unity.[8] The benefits of regional integration for developing countries are linked to the role that integration can play in fostering economic growth and development, specifically industrial development.[9] As a result, some writers have therefore argued that 'Customs

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(2008) 82.

3 See Velayos, Barreix & Villela n 2 above 79.

4 SACU is a customs union whose members are Botswana, Lesotho, Namibia, Swaziland and South Africa. See art 5 of the 2002 SACU agreement.

5 Final communique: the Heads of State and Government of meeting of the member states of the Southern African Customs Union (SACU): Windhoek Namibia 22 April 2010.

6 See Hancock 'What role of the EU in the Southern African Customs Union (SACU): advocate, cajoler, or bully?' prepared for the conference on the diffusion of regional integration, transformative power of Europe: Berlin 2010. See also Bilal 'Can the EU be a model of regional integration? risks and challenges for developing countries' paper presented at the CODESRIA-Globalisation Studies Network (GSN) Second International Conference on Globalisation: Overcoming Exclusion, Strengthening Inclusion (Dakar Senegal 29 August to 31 August 2005).

7 The EU is an economic and a political organisation, therefore this makes it different from SACU. In this sense, the EU is not discussed in any great detail in this paper.

8 See McCarthy 'The roadmap towards monetary union in Southern Africa – is the European experience commendable and replicable?' paper presented at the third GARNET Annual Conference (Bordeaux 2008) 2.

9 See McCarthy 'The Southern African Customs Union in transition' (2003) 102 *African Affairs* 605–630 607. This issue of tax fraud is discussed further in the parts which

unions are one of the deeper forms of regional economic integration, requiring members to create common external tariffs for non-members and to remove internal barriers to trade.'[10] In this context, hence the role played by SACU in removing barriers to trade is recognised and applauded.

The last century has seen a lot of countries, both developed and developing, moving towards the introduction of VAT to replace their single-stage sales taxes and turnover taxes.[11] The move to VAT has been for different reasons in each country. VAT was first introduced in developed countries[12] and was confined to a small proportion of countries until the late 1960s when it became the most popular form of tax on general consumption for governments.[13] Today VAT has spread over 140 countries covering nearly all parts of the world, with most countries in Europe, South America and Australia and the Pacific.[14] Within SACU, South Africa is the first country to introduce VAT in 1991.

This paper examines the possibility of tax coordination of VAT systems within SACU member countries in order to forge closer economic integration. SACU member countries form a closely integrated customs union and have an agreement which regulates their excise and customs duties, however, a similar agreement does not exist in respect of turnover taxes like VAT.[15] This fact tends to provide some loopholes for tax fraud. This point has also been acknowledged and expressed by some writers such as Flatters and Stern in the following way: 'there is little coordination of VAT and sales tax administration across SACU Member States... Separate border post administration by each Member and lack of basic information sharing provides obvious loopholes for tax fraud.'[16] It is also acknowledged

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follow.

10 Hancock n 6 above.

11 Under a VAT system, tax is only levied on the value added at each stage of the production process, but producers are allowed to claim their input tax on the materials used in the production of goods and services and can levy output tax on their products. VAT is charged on all goods and services for final consumption while at the same time it leaves out all intermediate goods.

12 France is the first country to introduce partial VAT in 1954 while Denmark is the first OECD country to introduce a comprehensive VAT in 1967, see OECD *Taxing consumption* (1988).

13 Owens 'The move to VAT' (1996) *Intertax* 45–52 45.

14 See Ebrill, Keen, Bodin & Summers *The modern VAT* (2001) xiv.

15 This agreement was originally concluded in 1969 and revised in 2002.

16 Flatters & Stern 'Implementing the SACU revenue-sharing formula: customs revenues' 2005 *Policy brief prepared for the South African National Treasury* 10 at:

that due to the more coordinated nature of the existing customs union, it would be easier and less challenging for SACU to explore other areas of coordination.

This paper discusses the possible issues which underlie the move towards coordination of VAT systems in order to address the issue of trade distortions which is caused by different VAT systems in the member states. It is also acknowledged that coordination of VAT systems in member states will contribute towards the improvement of the tax administration in the member states. This will also contribute towards the improvement of tax collection. On the same point, Kirk and Stern acknowledge that, given the extent of free trade within SACU and the fact that all member countries share common customs and excise tax rates, further tax harmonisation is possible and necessary.[17] Tax harmonisation in this context does include tax coordination. For purposes of this paper the concepts of tax harmonisation and tax coordination are regarded to be interrelated.

The paper commences with a historical background of SACU and how it operates. The paper goes on to briefly investigate the nature of the economies of the SACU member states. It also investigates the extent of SACU's integration of the excise and customs duties; and whether this can be extended to VAT. Furthermore the paper examines the aspect of tax coordination and its social and economic benefits within states in a customs union.

The paper also evaluates the existing VAT systems in the member states and the extent to which these systems can be coordinated and harmonised. The paper looks at the possible coordination mechanisms which can be adopted within SACU. Finally, the paper makes recommendations on how coordination of VAT regimes within SACU member states can be approached.

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http://pdf.usaid.gov/pdf_docs/PNADF156.pdft (last accessed 19 April 2013).

[17] Kirk & Stern 'The new Southern African Customs Union agreement' (2005) 28 *The World Economy* 169–190 188.

HISTORICAL BACKGROUND OF SACU

From 1969 Agreement to 2002 Agreement

SACU has been functioning since the late nineteenth century,[18] and this makes it the oldest customs union in the world.[19] One of the latest agreements was the one which was signed in 1969 between South Africa, Botswana, Lesotho and Swaziland which came into force on March 1, 1970.[20] Namibia joined SACU at independence on 10 July 1990.[21] This agreement has subsequently been renegotiated and replaced by the latest SACU Agreement of 2002, which came into force in 2004.[22]

The 2002 SACU Agreement[23]

The 2002 Agreement provides for greater institutional equality of the member states. It contains 51 articles. Its objectives are stated clearly as follows:[24]

- to promote the integration of the Members into the global economy;
- the facilitation of cross-border movement of goods between the Members;
- the establishment of effective, transparent and democratic institutions which will ensure equitable trade benefits to the members;

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18 On 22 April 2010, SACU celebrated its centenary at Windhoek Namibia under the theme 'Implementing a common agenda towards regional integration in Southern Africa'. See Ruppel 'SACU 100: reflections on the world's oldest customs union' (2010) 2 *Namibia Law Journal* 121 at 128 at: http://www.kas.de/upload/auslandshomepages/namibia/Namibia_Law_Journal/10-2/NLJ_section_7.pdf (last accessed 12 February 2013).

19 In 1910 the government of the then Union of South Africa and the territories of Basutoland, Swaziland and the Bechuanaland protectorate signed a customs agreement. This customs union has been in existence since then, with the revision of the custom's union's principles thereafter in subsequent agreements.

20 11 December 1969. For a detailed discussion of the 1969 Agreement, see Kumar 'Southern African Customs Union and BLS-countries (Botswana, Lesotho and Swaziland)' (1990) 24 *Journal of World Trade* 31–54 and Kumar 'Southern African Customs Union: lessons for the Southern African region' *Southern African perspectives – a working paper series* (1992)..

21 Kumar 'Southern African Customs Union: lessons for the Southern African region' n 20 above 1.

22 Southern African Customs Union 2002 'Agreement between the Governments of the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland' at: http://www.sacu.int/main.php?include=docs/legislation/2002-agreement/main.html (last accessed 28 March 2013). See the preamble of the 2002 SACU agreement.

23 The 2002 SACU agreement is at: http://www.sacu.int/main.php?id=468 (last accessed 28 March 2013).

24 Article 2 of the SACU agreement.

- to facilitate the equitable sharing of revenue from customs, excise and additional duties;[25]
- to promote fair competition, substantially increase investment and facilitate economic development; and
- to facilitate the development of common policies and strategies.

The SACU agreement is a customs union plan providing for free trade in goods and a common external tariff.[26] Free trade in this context means the elimination of tariff duties and quantitative restrictions on importation and exportation. SACU's main focus is on facilitation of trade and cross-border movement of goods by removal of trade barriers for the free movement of domestic products within the member states. This means that goods which are grown, produced or manufactured in the customs area, on importation from one member state to another member state, are free of customs duties and quantitative restrictions. This entitles the goods to move freely within the customs area without any restrictions. In contrast, goods which are imported from outside the customs area are subject to duties at the first point (country) of importation. This means that once the goods have entered the customs area they cannot be subject to additional duties when imported by one member state from another member state. The SACU agreement provides for unrestricted flow of goods produced within the customs union as well as free flow of imports and exports through South African territory to the other SACU states (all land-locked except Namibia).[27] The customs and excise duties collected in the SACU area are paid into a common revenue pool.[28] South Africa was appointed to manage the Common Revenue Pool into which all SACU customs, excise and additional duties collected are paid and from which payments to the member states are made.[29]

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25 Revenue which comes from the common revenue pool accounts for a large portion of government revenue in the BLNS countries. A new revenue formula in terms of art 34 was introduced. This formula takes into account the different levels of economic development of the various member states, and determines how revenue derived from customs and excise duties is to be shared.

26 See art 18 of the SACU agreement.

27 *Ibid*.

28 Article 32 of the SACU agreement.

29 In terms of art 33 of the SACU agreement, the common revenue pool will be managed by a member state or a SACU institution appointed by the Council of Ministers (established in accordance with art 8). In December 2010, the SACU Council signed a Memorandum of understanding (MOU) on the transitional arrangement for the management of the common revenue pool. The MOU formalises the current arrangement, where South Africa manages the common revenue pool on a transitional basis.

SACU is a supranational organisation with a Council of Ministers as the highest decision making authority and has an ad hoc tribunal, which settles disputes regarding the interpretation and application of the SACU 2002 agreement.[30] The agreement also created a permanent Secretariat to be based in Windhoek, Namibia.[31] The Agreement has also created a Customs Union Commission and the Tariff Board.[32] SACU also has the power to negotiate trade agreements with third countries (for example, the United States of America) on behalf of the member states and/or other free trade areas (such as the European Free Trade associations. SACU member states are also members of other trade organisations.[33]

The 2002 agreement in its present form does not contain anything that can permit coordination of VAT. Though this agreement has been hailed by writers for its significance in regional integration as it encompasses three main areas: governance and administration; economic policy and regulatory issues; and revenue sharing, it is disappointing in that the drafters of this agreement did not incorporate issues of tax coordination as a means to enhance regional integration.[34] It is therefore argued, that, SACU member states will have to consider amending the agreement to accommodate the proposed change of VAT coordination. This means that it would require the establishment of new laws and institutions for VAT coordination to be introduced in SACU.

KEY CHARACTERISTICS OF THE ECONOMIES OF SACU

The member states of SACU have close economic relations and ties dating back to the nineteenth century as indicated under historical background above. The SACU countries tend to differ in size and development, in that South Africa is a bigger country (both geographically and economically)

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[30] Article 7 of the SACU agreement. See also McCarthy n 9 above 622.

[31] Article 7 and art 3(2) of the SACU agreement.

[32] Article 7 of the SACU agreement. See also McCarthy n 9 above 623.

[33] All of the SACU member states are members of the Southern African Development Community (SADC) which is a free trade area. Swaziland is also a member of the Common Market for Eastern and Southern Africa (COMESA) which is a preferential trade area. The challenges of multiple memberships to various trade organisations have been extensively discussed by Saurombe 'Regional integration agenda for SADC, caught in the winds of change: problems and prospects' (2009) 4 *Journal of International Commercial Law and Technology* 100–106. See also Letete 'Harmonisation of value added taxes in the Southern African Development Community' (2011) 4/3 *International Journal of Private Law* 391–405.

[34] See Kirk & Stern n 17 above 176.

while the other members are smaller both in size and in the level of their development. The defining characteristic of SACU is the economic dominance of South Africa in contrast to the size of the other four members. Botswana, Lesotho, Namibia and Swaziland (commonly referred to as BLNS)[35] depend heavily on South Africa for a significant proportion of their trade, investment and to some extent migrant employment.[36] Four of these countries also form part of a monetary union.[37]

The early history of SACU shows that integration through a customs union was necessary to accommodate the flow of goods among territories that were locked into an integrated economy with separate political jurisdictions. South African companies dominate the business landscape in the BLNS countries.[38] The BLNS countries also source most of their imports from South Africa, although their exports are more geographically diverse.[39] Moreover, the commodity pattern of South Africa's exports to the BLNS differs significantly from its exports to the rest of the World. While South Africa continues to export predominantly resource-based goods, the BLNS represent a significant market for South African consumer goods and services.[40] The economic characteristics of the smaller members of SACU also tend to differ.

The high level of dependence of the smaller SACU member countries on South Africa is also reinforced by the revenue-sharing arrangement as provided for in the 2002 SACU Agreement.[41] The new revenue sharing formula deals with customs and excise revenues separately as two distinct components and provides for the establishment of a third development

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35 Hereinafter referred to as BLNS.
36 See Kirk & Stern n 17 above 171–172.
37 The common monetary area includes South Africa, Lesotho, Namibia and Swaziland – the monetary currencies of the smaller countries are pegged to South African rand. The common monetary agreement integrates three members of SACU, namely Lesotho, Namibia, and Swaziland into the South African money and capital market. The agreement provides for free transfers of funds between the member countries, free access to South African capital markets, and similar exchange controls for each member country. However, currently the South African currency, rand is legal tender in Lesotho and Namibia but not in Swaziland. For further reading on this topic, see McCarthy n 8 above 12.
38 See Kumar n 21 above 2. See also Kirk & Stern n 17 above 172.
39 Kirk & Stern n 17 above 188.
40 See McCarthy n 9 above 617.
41 *Id* at 616.

component.[42] SACU tariff revenues are distributed according to members' shares of intra-SACU trade and not according to their contributions to the revenue pool.[43] It is argued that, 'this practice is specifically applied in order to compensate the BLNS states for the cost raising impact of a tariff that has been designed primarily for the protection of industries in South Africa.'[44]

In terms of this agreement, the three poorer member states of SACU, which are Lesotho, Namibia and Swaziland, continue to receive more than a third of their total budget revenue through the revenue-sharing formula.[45] The introduction of a development component[46] has actually resulted in the increase of revenues in the BLNS states. This new component is designed to account for differences in member states' per capita income.[47] According to some writers, 'while the largest portion of the excise pool is distributed according to members' gross domestic products, some 15% is reserved for the developmental component, which reallocates revenues from the large member – South Africa – to the smaller and generally poorer BLNS states.'[48]

It is acknowledged by various writers that the BLNS states rely largely on receipts from the common revenue pool to finance their governments' expenditures.[49] This would mean that anytime that the revenues fall from the common pool, the receipts of these BLNS states will adversely be affected hence their funding of public sectors.[50] This problem can be addressed by ensuring that these countries shift their focus of revenue collection to other

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42 Article 34 of the SACU agreement. See also Kirk & Stern n 17 above 179.

43 Article 34 of the SACU agreement.

44 Flatters & Stern 'SACU revenue sharing: issues and options' policy brief Washington DC: United States Agency for International Development and Serbia economic growth activity' 2006 in Ruppel 'SACU 100: reflections on the world's oldest customs union' (2010) 2 *Namibia Law Journal* 121 123.

45 See Kirk & Stern n 17 above 184.

46 Article 34 par 5 of the SACU agreement.

47 *Ibid*.

48 See Flatters & Stern n 44 above 123. See also Jitsing & Stern 'VAT practices within SACU and possibilities for harmonisation' development network Africa *World bank regional integration project* 2008 7.

49 Fundira 'The state of regional trading arrangements in Southern Africa: options and considerations' in McCarthy *et al Supporting regional integration in East and Southern Africa – review of select issues* (2010) 140. See also Flatters & Stern n 16 above 1.

50 Mongardini, Benicio, Fontaine, Pastor & Verdier 'In the wake of the global economic crisis: adjusting to lower revenue of the Southern African Customs Union in Botswana, Lesotho, Namibia, and Swaziland' *IMF publications* 2011 at: http://www.imf.org/external/pubs/ft/dp/2011/afr1101.pdf (last accessed 26 January 2012).

mechanisms such as taxation, particularly VAT. This is why coordination of VAT is significant in this instance.

The differences in economic development between SACU member states are the highlighting factor of this customs union. The other significant factor is that three of the member states, which are Botswana, Lesotho and Swaziland, are landlocked countries and this tends to affect (to some extent) their trading powers (such as free access to trade markets).

TAX COORDINATION OF VAT IN SACU AND ITS ANTICIPATED BENEFITS

This paper argues that the debate towards deeper regional integration in SACU (and the review of the revenue sharing formula) needs to incorporate the debate on the role of tax coordination as a means towards deeper economic integration. The relevance of this debate is to examine the potential role of tax coordination in reducing distortions to cross-border trade and investment. According to Steenekamp 'closer economic integration between countries and regions sharing borders has become important in the last two to three decades.... Other major regional groupings are the South American Free Trade Association (MERCOSUR) and the Association of South East Asian Nations (ASEAN). The member states of the EU became borderless in 1992 with almost free intra-Union movement of goods, services, capital and labour. Several federal forms of government exhibit even higher levels of market integration, such as the United States of America, India, Argentina and Brazil.'[51] In this context coordination would also require 'free movement of goods, services, persons and capital'[52] which will result in further integration and hence economic growth in member states.

Tax coordination in this instance will prohibit any tax fraud which is likely to be caused by different tax bases[53] and tax systems. It is also argued that tax coordination within a group of states such as SACU will eliminate any tax competition practices between member states. Coordination of VAT in SACU countries will ensure that these countries monitor their imports and exports; and they keep detailed information of such cross border

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51 Steenekamp 'Value-added tax in a borderless SA-BLNS region' (2007) 75/2 *South African Journal of Economics* 236–257 236.

52 *Id* at 238.

53 This refers to the extent of the tax and whether it covers both goods and services.

transactions.[54] This will improve the administration and collection of taxes in member states.

Any regional integration or economic cooperation requires the member states to surrender a part of their economic sovereignty.[55] However, in practice countries are likely to be reluctant to adopt a uniform type of taxation[56] or rates[57] where their economies differ significantly**.** Therefore, it is crucial for member states to ensure that they reduce huge discrepancies in indirect tax rates to ensure that they do not interfere with free trade.[58] As a first step, member states have to identify where the differences and discrepancies exist and the problems that are caused by such discrepancies. From this analysis member states can therefore be able to identify possible areas of tax coordination. This debate becomes crucial for developing countries.

VAT DESIGN IN SACU COUNTRIES: LEGISLATIVE FRAMEWORK

South Africa, Botswana, Namibia and Lesotho all levy a broad-based consumption type VAT which covers both goods and services. These SACU member states have a VAT that applies the destination base principle (exports zero-rated and imports taxable) to international trade, determines tax liability using a tax credit (or invoice) method and exempts certain supplies such as financial, educational and medical services.[59] Botswana has the lowest standard rate of 12 per cent;[60] while Lesotho, South Africa and Swaziland have the standard rate of 14 per cent.[61] Namibia has the highest

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54 See Flatters & Stern n 16 above 10.

55 SACU has already surrendered part of their sovereignty under the 2002 agreement to the extent of common external tariffs and the revenue sharing mechanism.

56 In the context of VAT, VAT can either be on a destination basis or an origin basis. Destination base principle means that exports leave the country of jurisdiction tax free and imports are taxable at the importing country's rate. Origin base principle means that tax is levied on production.

57 There are different tax rates in VAT. These can be standard rate; reduced rate; and zero rate.

58 Leape 'Taxation and fiscal adjustment' in Jenkins *et al* (eds) *Gaining from trade in Southern Africa: complementary policies to underpin the SADC free trade area* (2000) 58–83 83.

59 See Jitsing & Stern n 48 above 8.

60 Section 6 Value Added Tax Act, chapter 50:03 2000 Act No 1 of 2001 of the Republic of Botswana.

61 See the Lesotho Value Added Regulations Legal Notice 95 of 2003 Regulation 6 (d) (enacted under Section 6 of the Value Added Tax Act 77 of 2001), the South African Value-Added Tax Act 89 of 1991, Section 7 (1) and the Swaziland Value Added Tax Act

standard rate of 15 per cent.[62] Lesotho is the only SACU member state which has positive multiple rates.[63] In addition to the standard rate of 14 per cent, a reduced rate of 5 per cent on electricity and telephone services and a higher rate of 15 per cent on alcohol and tobacco products are levied.[64] Multiple VAT rates tend to pose administrative complexity for both the taxpayers and the revenue administrators. In most cases, governments tend to use multiple VAT rates to eliminate the impact of the tax on the poor and the question is whether this is the appropriate approach in practice.[65] In view of this, multiple VAT rates result in a complicated tax system.[66]

Country	Date of introduction	Standard rate	Reduced rate
Botswana	2000	12	0
Lesotho	2003	14	5
Namibia	2003	15	0
South Africa	1991	14	0
Swaziland	2012	14	0

Table 1: VAT rates in SACU member states[67]

See 'Overview of general turnover taxes and tax rates' January 2014 *IBFD* and Letete 'The state of VAT harmonization in the SADC' (2014) 25 *International VAT Monitor* 85

Apart from zero-rating exports, a limited but similar range of goods and services are zero-rated in these countries, including a number of basic

of 2012.

62 Namibia Value Added Tax Act 10 (2000).

63 See the Lesotho Value Added Regulations Legal Notice 95 of 2003 Regulation 6 (d) (enacted under section 6 of the Value Added Tax Act 77 of 2001).

64 Glenday 'Assessment of the current state of VAT implementation in SADC member states' (report prepared for the SADC trade, industry, finance and investment directorate, 2004) at: http://fds.duke.edu/db/attachment/829 (last accessed 15th April, 2013).

65 Ebrill, Keen, Bodin & Summers n 14 above 82.

66 See Letete 'Between tax competition and tax harmonisation: coordination of value added taxes in SADC member states' (2012) 16 *Law, democracy and development* 119–138 129.

67 Cnossen 'Coordination of indirect taxes in the Southern African Development Community (SADC): lessons from European experience' (2011) 61 *Tax Notes International* 943. See also Steenekamp n 51 above 237.

foodstuffs, fuel and exports. For example, Botswana zero-rates goods or services for the personal or official use of the President or any dependent member of his family are zero-rated.[68] Botswana also zero-rates various foods, petrol, diesel and illuminating paraffin.[69] Lesotho zero-rates basic foods, farm inputs and fuel. Namibia zero-rates basic foods, farm inputs, water, electricity, fuel, building materials and telecommunication services to residential accounts.[70] On the other hand, South Africa zero-rates basic foods, farm inputs and fuel while Swaziland zero-rates basic foods, animal feeds and paraffin.[71] It seems that all the BLNS member states and South Africa zero-rate basic food items, farm inputs and fuel (Botswana does not zero-rate fuel but kerosene).[72] According to Steenekamp, 'on balance VAT in SA-BNL is levied on a similar (uniform) broad base with tax rates not deviating much from the unweighted average of 13,25 per cent'.[73] In respect to exemptions, Botswana exempts water, passenger transport, low-income housing;[74] Lesotho exempts medicines and passenger transport;[75] Namibia and South Africa exempt public (passenger – the latter) transport.[76] Swaziland exempts medical and dental services.

Some member countries of SACU have had a VAT system for a number of years. For example, South Africa introduced VAT in 1991, Namibia in 2000, Botswana in 2002, and Lesotho in 2003.[77] Swaziland is the latest member country to introduce VAT in 2012. In the area of VAT, each country has adopted its own VAT system, though it appears that the South African VAT

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68 Section 10, Botswana Value Added Tax Act, Chapter 50:03 2000 Act 1 (2001), provides that goods or services supplied for the personal or official use of the president or any dependent member of the president's family are subject to VAT at zero rate.

69 In terms of s 10, of the Botswana Value Added Tax Act, Chapter 50:03 2000 Act 1 (2001), the following goods and services are subject to VAT at zero rate: – goods and services exported from Botswana; international transport services; sale of a going between registered persons; sorghum or maize meal; goods or services supplied for the personal or official use of the president or any dependent member of the president's family; and petrol, diesel and illuminating paraffin. The Act is at: http://www.sadc.int/information-services/tax-database (last accessed 25 February 2013).

70 See Namibia Value Added Tax Act 10 of 2000.

71 South African Value-Added Tax Act 89 (1991), schedule 2 part B, section 11 (1) (J).

72 Cnossen n 67 above 946.

73 See Steenekamp n 51 above 237. At the time when Steenekamp wrote the article, Swaziland had not yet introduced VAT.

74 See s 11, Botswana, Value Added Tax Act, Chapter 50:03 2000 Act No 1, (2001).

75 See s 6 (as amended by s 4), Lesotho Value Added Tax Act 77 (2001) and Lesotho Value Added Regulations Legal Notice 95, (2003), Regulations 17, 18, 19 and 20.

76 Namibia Value Added Tax Act 10 (2000), s 10, and South African Value-Added Tax Act 89, (1991), s 12(g).

77 See Krever (ed) *VAT in Africa* (2008) 3–4.

system has influenced the VAT systems in the other member states.[78] It is also clear from the table that the VAT rates of all the member countries are within the range of 12 to 15 per cent standard rate.[79] These SACU countries maintain their border posts and the issue of VAT thus remains a matter for each individual country. However, with closer economic integration between countries, inter-jurisdictional issues regarding indirect taxation are becoming a concern. As a result member states will have to rethink their policies on VAT and how it affects cross-border trade within the region.

APPROACH TO TAX COORDINATION OF VAT IN SACU: VAT ON CROSS-BORDER TRANSACTIONS

The most important issues which need attention relate to the taxation of cross border transactions amongst member states. These are: – firstly, the treatment of zero-rated goods from one country to the other within the customs union area and to third countries (countries outside SACU). Most VAT systems zero-rate exports as well as other essential domestic products.[80] In the context of a customs union, exports from the customs union (which is SACU) to third countries will be zero-rated and also supplies of goods within the customs union (intra-SACU supplies) from one member state to a registered business entity in another member state will be zero-rated. In the two situations, this means that exporters of goods will have to be refunded.[81] The issue of refunds can be problematic if it is not closely monitored or if refunds are not dealt with timeously. Zero-rating of exports will require close monitoring of exports from each member state and accurate recording to ensure such exports are not reverted to circulate back in the country of export (to the member state where the goods originated from) without VAT being imposed (having been taxed) accordingly. Tax authorities will have to ensure that refunds are paid out to exporters within a reasonable time, as this can cause unnecessary costs for the traders.

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[78] It can be assumed that this is the case because South Africa is the first country in the customs union to introduce VAT, and it has the largest economy within the customs union.

[79] See Table 1.

[80] Countries tend to zero-rate different domestic products depending on their own social and economic needs.

[81] Exporters are enabled to recover their input VAT before the goods are exported, so that they can be charged VAT in the country of importation or destination. This will require that refunds are dealt with expeditiously and treated with care as this is crucial to ensure that the trading partners/business entities are refunded timeously to avoid incurring any further costs.

The other types of transactions within the member states relate to the treatment of supplies of goods from one member state to a consumer or an unregistered business entity within the customs union. The correct approach is that these kinds of supplies be treated in the same way that domestic supplies are treated. This means VAT is imposed on the transaction at the originating state. Therefore, the consumer or an unregistered business entity does not have to bear any further tax if consumption of such goods or services occurs in another state. However, the consumer or an unregistered business entity has to produce proof that tax has already been charged and paid.

Secondly, SACU member states will have to consider how to tax international transactions on the basis of two jurisdictional principles.[82] The two relevant principles are the origin base principle and the destination base principle. The origin base principle charges tax on a transaction in a state where the transaction originates or where the goods which are supplied under the transaction were produced. This principle requires that tax be imposed at the point of production and in principle everything that is produced domestically is taxed. In effect exports are taxed while imports are not and credit is given in importing country at the rate applied there.[83] This means that when the goods are exported they already bear the tax of the state of production and the goods have to be relieved from further tax in the importing state. This is done by 'giving credit in the importing country at the rate of tax applied there'.[84]This principle eliminates borders in the sense that there is no need for border tax adjustment as the tax is imposed purely on domestic value added.

On the other hand the destination base principle charges tax at the point of consumption. This principle requires that all goods and services that are domestically consumed are taxed in that state. Therefore the destination base principle zero-rates exports and imposes tax on imports. Ebrill describes the destination base principle in the following manner: – 'In order to be a tax on domestic consumption, the VAT must be levied by the destination principle.

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[82] These rules are important for the legal design of the place of supply rules as they are known for VAT purposes. See Miller 'Jurisdictional reach of VAT' in Krever (ed) *VAT in Africa* (2008) 175.

[83] See Tuahn Minh Le 'Value added taxation: mechanism, design, and policy issues' *Paper prepared for the World Bank course on practical issues of tax policy in developing countries* (Washington DC 28 April–1 May 2003) 20.

[84] *Ibid*.

This means that the total tax paid in relation to a commodity is determined by the rate levied in the jurisdiction of its final sale (as a proxy for the location of consumption); and, moreover, that all the revenue accrues to the government in the jurisdiction where that sale occurs.'[85] The taxation of imports as opposed to exports requires border tax adjustments as the VAT must be deducted (removed) from products leaving the state and then added upon entry in the importing state.[86] Exporters are therefore expected to declare their export values, so that they can be refunded their inputs on the goods. This principle works more effectively where there are border posts where customs officials can actually check and trace the movement of imported and exported goods.

In practice, most countries with a few exceptions, have adopted the destination base principle with respect to the implementation of VAT. For example, the SACU member states have also adopted the principle in their VAT systems.

SACU member states will have to consider which of the two principles they should adopt for their coordinated VAT system. This will determine their approach towards taxation of transactions between member states and transactions between member states and third countries. The inter-jurisdictional principles will also determine the taxation of distance selling transactions; electronic services and supply of services within the community (intra-SACU) and to parties outside the community. The most visible and viable way of ensuring the effectiveness of the coordination process in the context of SACU, will be in effect to tax all intra-SACU transactions on an origin base principle rather than destination base principle. This effectively means that all taxable transactions between member states are taxed in the country in which the transaction originates (or goods which are subject of the transaction originates) or where value is added. This will mean that there is no need to impose VAT in the member state where the goods are consumed, hence there will not be a need for any border checks (of imported goods) at SACU border crossings. If this position is adopted by SACU member states, the destination base principle can be adopted only when the goods are imported into or exported from SACU (customs union area). The effect of the destination basis taxation in this case, is that VAT will be imposed on goods that are imported into SACU

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85 Ebrill, Keen, Bodin & Summers n 14 above 176.
86 *Ibid*.

member states from third countries and when goods originating from SACU are exported to third countries. This effectively means, the terminology 'imported' and 'exported' only refers to transactions between SACU member states and third countries and does not make reference to intra-SACU trade transactions.[87]

Thirdly, the other important key factor to consider in coordination of VAT is the issue of revenue sharing amongst the member states. In the context of customs and excise, SACU has an agreed formula for distributing the revenues collected at outside borders; therefore the concept of revenue sharing already exists within SACU member states. The customs and excise duties collected in the SACU area are paid into a common pool. Customs revenue is allocated in proportion to (intra) SACU import shares, while 85 per cent of excise revenue is allocated according to each member's share in SACU's combined GDP and 15 per cent according to deviations from the combined GDP's average.[88] This concept and mechanism can be extended to the area of VAT.[89] It seems South Africa has done a remarkable job in managing the Common Revenue Pool as it exists presently and SACU can agree to continue to use its resources to manage the revenue pool relating to collection of VAT. The member countries of SACU will have to devise the principles which will regulate and govern the mechanisms relating to collection of VAT and managing the revenue pool in that respect.

Possible Coordination Mechanisms and Transition Mechanisms

In respect of the existing position in SACU member countries at present, the prevalent issue is whether there are possible coordination and transition mechanisms which can be recommended. Within SACU, some members (at a bilateral level) have already committed to work together in order to facilitate cross border trade within their jurisdictions. We can refer here to the Memorandum of Association which has been signed by the Lesotho Revenue Authority (LRA) and the South African Revenue Authority (SARS) in 2004 to regulate the collection of VAT on indirect exports from South Africa into Lesotho.[90] This arrangement between the two revenue authorities ensures that traders exporting goods from South Africa and importing them

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87 This effectively means that SACU member countries in this respect are regarded as 'one' jurisdiction as it is envisaged under a free trade area. See Easson 'Tax harmonisation in the EEC: the Commission's programme' 1981 *British Tax Review* 330.

88 See Kirk & Stern n 17 above 179.

89 See Flatters & Stern n 16 above 11.

90 Jitsing & Stern n 48 above 16.

into Lesotho, do not need to obtain a refund from SARS upon 'exportation of such goods' and subsequently pay VAT on the imports into Lesotho. This arrangement facilitates the submission of invoices and relevant documentation by the trader to the LRA (and in some cases also to SARS), and the revenue authorities deal with the issue of refunds between themselves.[91] This arrangement between the LRA and SARS has actually reduced long queues at the border posts for traders. This to some extent encourages cross border trade, particularly for traders in Lesotho who in most cases have to buy goods from South Africa, due to the geographical situation of Lesotho.[92]

It is possible for other SACU member countries to have similar arrangements particularly with South Africa in order to enhance cross border trade within the region. This can also facilitate VAT processes at the border posts of the member countries and reduce overcrowding and delay. There is no doubt that this can contribute to the efficiency of the border posts systems as well as tackling any tax avoidance schemes which are caused by cross border shopping and different VAT rates in member countries.

SACU member states can also enhance their information sharing as part of the coordination process. This will ensure that traders do not have to register in all the member countries, hence relieves the burden of compliance on the traders. Furthermore, in cases where traders have to be refunded by one member country, it will be easier to access the trader's tax information from the revenue authorities of another member country for verification.

LESSONS FOR SACU AND RECOMMENDATIONS

The SACU member states have already introduced VAT which extends through to the retail stage. The VAT systems extend to both goods and services and these two features are essential in assessing the tax incidence of VAT. On the same point, Robinson submits that any sales tax that does not extend through the retail sales level can cause administrative problems

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91 *Ibid*. The recently concluded agreements between the Government of South Africa and Lesotho and the Government of South Africa and Swaziland on mutual assistance and cooperation and the prevention of fiscal evasion with respect to value-added tax are significant developments in this area and will contribute towards effective cooperation in the area of VAT between these countries. These agreements have not yet entered into force.

92 Lesotho is a landlocked country and is surrounded by South Africa. Therefore, all goods that are imported into Lesotho have to pass through South Africa.

because if the actual sales price is used, competitive distortions are created in different channels of distribution.[93]

An important aspect of coordination of taxes is to result in increase of revenue and improvement of tax administration in member states. This will ensure that the structure of VAT is also improved. In practice the introduction of VAT is also associated with the reform of tax administration which extends to other types of indirect and direct taxes. This has been the position in some of the developing countries, that VAT has been used to improve the collection of other taxes and the administrative strategies and institutions on revenue collection.[94] Tax administration can also be improved, for example by considering establishing a large-taxpayers unit.

All SACU member countries have now introduced VAT as a means to move towards deeper cooperation in tax. Though VAT systems within a customs union may slightly differ, member states should adopt rules and policies of how goods and services which enter the area are treated (treatment of imported goods and services within the SACU customs area – intra-SACU). This relates to the taxation of transactions by business entities from the member states to third countries, as well as the taxation of transactions by the business entities or customers within the community and those from outside the customs union. The member states will have to decide which tax system is more suitable in SACU in those instances as discussed above. In the same way, SACU should also sort out the issue of exports (within the member states) and refunds to exporters. It is important that refunds to exporters are processed in time by the revenue authorities as this can distort trade. In most developing countries, the issue of refunds is a problem as it is not coordinated efficiently and as a result refunds are not paid out promptly to exporters.

It is also recommended as the first step, that SACU should adopt a legal framework which will be the basis of coordination of VAT within the

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[93] Robinson 'An overview of commodity tax reform in Southern Africa' (2004) 7 *SAJEMS NS* 387–426 405.

[94] For example, in some of the member states the introduction of VAT formed part of the general reforms of revenue administration mechanisms. This was seen in South Africa in 1991 when SARS was established as an initiative to improve revenue collection and administration. This was followed by the introduction of VAT. In the same way, Lesotho established a revenue authority (LRA) in 1993 in order to improve tax administration and revenue collection. Swaziland also established an independent revenue authority in 2006/07 and this was followed by the introduction of VAT in 2012.

customs union; or alternatively amend the existing 2002 Agreement to extend to coordination of other areas of indirect taxes such as VAT. Furthermore, the SACU member states should also aim to achieve sharing information that arises from the VAT systems.

In order to achieve complete harmonisation of VAT systems of member states, SACU at a later stage should aim towards the abolition of internal border controls in member states.[95] This will eliminate tax barriers and the administration of VAT within individual member states. However, this will require some kind of a central mechanism to oversee the border tax adjustments and its administration. This is not an easy aspect of full integration and harmonisation of a tax system to achieve. The existence of border controls is a way a government exercises its political control to regulate the movement of imported and exported goods in a country. The member states have to ensure that they are willing to give up their political control to the extent that the VAT system has to be fully implemented at the SACU level. It has been argued that cooperation and eventual harmonisation of VAT systems could contribute to the fiscal effectiveness of important revenue sources within SACU while also promoting intra-SACU trade.[96] When the member states of SACU eventually move towards the abolition of border controls, they will then have to consider moving away from the use of the destination base principle, since this principle does not work without border controls. This has proved to be the case in the EU.[97] The EU has adopted the Transitional VAT system with a mixed application of the destination and the origin base principles.[98]

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[95] See Glenday n 64 above 89.

[96] See Flatters & Stern n 16 above 13.

[97] See Schenk & Oldman *Value added tax a comparative approach* (2007) 361 note 11; Ebrill, Keen, Bodin & Summers n 14 above 184; Easson n 87 above 329.

[98] The destination theory is retained for transactions involving VAT-registered business entities in the member states. The origin theory is introduced for all cross-border supplies to persons outside the VAT system which includes final consumers and exempt business entities. The effect of the origin taxation rules is that cross-border purchases by private persons and final consumers are now taxed in the member state where the final purchase is made (this can either be the state of origin or an intermediate state where production was completed or further value was added to the product). Transactions with third countries continue to be taxed on a destination principle. The present requirement is that business entities should register for VAT in every member state in which they know that they will carry on business and engage in taxable transactions. This enables them to be able to reclaim input tax and refunds on exports. For a detailed discussion on the EU system, see Ebrill, Keen, Bodin & Summers n 14 above and Schenk & Oldman n 97 above.

The VAT systems which exist in member states tend to differ particularly in regard to their rates; the exemptions which they provide; and the provision of zero-rated items. To pave way for the coordination of a VAT system in the customs union, the member states will have to review these differences and align their policies in these regard to international practice. Issues of neutrality;[99] regressivity;[100] simplicity;[101] certainty[102] of the VAT system; administrative burden on the authorities and compliance burden on taxpayers have to be considered in engaging with issues of design of a coordinated VAT system. In this way, it is recommended that some of the exemptions and zero-rates will have to be removed and rather have them standard rated in order to broaden the base of the tax.

CONCLUSION

The objective of this article is to contribute towards the debate regarding the possibilities of coordinating VAT systems in SACU member states as a means to promote growth and development of the economies of the member states. Economic integration and globalisation tend to dictate the extent of how regional economic groupings approach the issue of free movement of goods and services within member states.

It is also noted that the purpose of tax coordination is to limit the ability of member countries to improve their positions at the expense of their regional partners through taxation. Therefore, SACU member states should be able to trust each other as all countries will benefit from the coordination. The most prevalent issue within SACU member states is that if the VAT systems are not coordinated the exporting country is exposed to increased risks of export fraud. This would result from the exploitation of the notion of zero-rating of 'exports'. Typically goods are zero rated and supposedly exported – but actually remain for domestic consumption. This phenomenon has already been observed with SACU where border controls have been weakened, but not eliminated, and cross-border shopping is prevalent, for

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99 In this sense taxation is used to ensure that the tax system as far as it is possible minimises interference in the process of allocation of resources.See footnote 94 above.

100 In this sense the tax system should not tax those with lower income more heavily rather, those with higher income should be taxed more. See also Tait 'Value-added tax: administrative and policy issues' *Occasional Paper* 88 International Monetary Fund (1991).

101 The tax system should be easy to understand and to comply with by the taxpayers. the language of the tax statute should also be simple and clear.

102 Certainty is created by the application of the VAT rules and regulations consistently.

example, between Lesotho and South Africa.[103] In the area of tax administration, there is very little coordination of VAT administration across SACU member states at present, as a result, 'separate border post administration by each member and lack of basic information sharing also provides loopholes for tax fraud'.[104] Therefore, in order to address such issues as well as to facilitate cross-border trade, it is argued that coordination of VAT within SACU member states should be on the agenda of this customs union in the near future.

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103 A separate study on the challenges brought by cross-border shopping on the VAT systems of Lesotho and South Africa is being undertaken.

104 Flatters & Stern n 16 above 10.