



# **VAT Practices within SACU and possibilities for harmonisation**

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**List of Acronyms**

BLNS	Botswana, Lesotho, Namibia and Swaziland
BLN	Botswana, Lesotho and Namibia
BNS	Botswana, Lesotho and Swaziland
EDI	Electronic Document Interchange
GDP	Gross Domestic Product
GST	General Sales Tax
HMRC	Her Majesty's Revenue and Customs
SACU	Southern African Customs Union
SARS	South African Revenue Services
VAT	Value Added Taxation
VIES	VAT information exchange system
VRA	VAT Refund Administrator

## 1. INTRODUCTION

Since the development of value added taxation in the early 1960s, this form of taxation has spread rapidly throughout both the developed world and developing world. The popularity of VAT is partly based on economic argument, but equally if not more important are the administrative efficiencies associated with VAT relative to its predecessors. The early adoption of VAT by the EU and the endorsement of this form of taxation by international agencies such as the IMF (Bird, 2005) has also contributed to its use elsewhere.

As of 2006, over 140 countries worldwide had adopted a VAT system (PWC, 2006). Africa has been slow to implement VAT and within the South African Customs Union, South Africa was the first country to introduce a VAT system in 1991. It was followed almost a decade later by Namibia, Botswana and Lesotho. Swaziland still administers a general sales tax (GST). But despite the known advantages of VAT, it too can cause costs and administrative problems, particularly in dealing with cross-border transactions. This has been a point of contention in SACU.

The purpose of this study is to investigate how VAT is levied on goods and services traded within SACU, identify costs and bottlenecks, and to make recommendations on how VAT administration can be improved and harmonised to facilitate intra-regional trade. This study is part of a broader World Bank research programme to promote regional trade capacity and to assist the Southern African region to integrate into global markets.

This paper is structured as follows:

- Section 2 introduces the concept of value added taxation and its characteristics.
- Section 3 provides an overview of the importance of VAT in the SACU member states' economies and discusses the regulatory framework.
- Section 4 describes the VAT related processes involved in cross border trade.
- Section 5 identifies cross cutting problems and country specific issues within the current system of cross border trade.
- Section 6 contains recommendations on how to facilitate cross border trade and address the problems identified in the previous section.
- Section 7 concludes this paper.

## 2. VAT CONCEPTS AND PRINCIPLES

### 2.1. Overview

Value added taxation was developed to overcome some of the disadvantages associated with general sales taxation (GST). Under a general sales taxation system, taxes are charged in full at each stage of the production process with no opportunity for recovery (Oliveria, 2001). The longer the production chains the higher the taxation liability. GST can therefore raise prices, distort market signals and influence production decisions.

Under a VAT system, tax is only levied on the value added at each stage of the production process. Producers levy output VAT at the designated rate on their products and are allowed to claim input VAT on the materials used in the production of their goods and services.

There are two main methods of accounting for VAT – the subtraction method (direct) and the credit based method (indirect). The type of method used in accounting for VAT used determines the compliance obligations (and therefore the costs) for the taxpayer.

Under the subtraction method, the taxpayer determines the amount of value added by his production process in order to calculate a VAT liability. Under the credit method, the taxpayer offsets the output VAT charged on invoices against the input VAT claimed on purchases to determine the VAT liability (Oliveria, 2001 and Watanabe, 2007). As the credit method is the easiest to implement, it has become the most popular way of accounting for VAT.

## 2.2. Principles

Overall, the VAT system has certain desirable principles, which include neutrality, efficiency, certainty, simplicity, effectiveness and fairness (Grandcolas, 2008). These principles, although often tested in cross border trade situations, should guide the design of any harmonised system.

### *Neutrality*

As a consumption tax, VAT is neutral in respect of the inter-temporal decisions of households (Boeters *et al*, 2006) and the production decisions of businesses. It is also neutral in terms of exports and imports. See Box 1 below.

#### **VAT and the destination principle**

VAT is based on the destination principle in that it is levied at the place where consumption occurs. This means that all goods and services consumed locally are liable to attract VAT whereas goods produced locally for foreign consumption are exempt from VAT. The destination principle reduces market distortions by taxing imports and zero rating exports. By levying a consumption tax on imports, the VAT system therefore creates parity between the price of locally produced goods and imports.

#### **Box 1 VAT as a destination based tax**

### *Efficiency*

The efficiency of any form of taxation lies in its ability to maximise the revenue raising ability of government while minimising the costs associated with tax collection. Moreover, any taxation system should minimise the cost of compliance. For low to middle income countries with a limited income tax base, VAT provides them with a relatively broad and easy away to raise revenues. This can be particularly important during periods of trade liberalisation. VAT can serve to mitigate the loss of government revenue arising the reduction or elimination of tariffs by imposing a tax on all imports. Finally, because the VAT system allows taxpayers to self-assess, it has a generally low compliance cost.

### *Effectiveness*

The principle of 'self enforcement' embedded within all VAT regimes is the cornerstone of the system's attractiveness. Under a value added system of taxation, the onus is on taxpayers to offset their value added tax deductions and input claims against their value added tax liabilities (Hillman, 2003). The economic cost of collecting revenue therefore declines as the VAT base increases.

The extent of administration and operational effectiveness within a country however depends also on the effectiveness of VAT administration at the border. Where borders are porous and where roundtripping occurs frequently, the chain of taxes and credits created by the VAT regime breaks down. In such cases a credit based VAT system can distort market signals by implicitly taxing exporters (through long delays in refunds) and supporting importers who bypass the system.

### *Fairness*

All forms of taxation have a redistributive effect on society. VAT is perceived as a regressive form of taxation – taking up a higher share of income of lower income households. In order to shift the incidence of VAT taxation away from low income to higher income groups, most governments choose to zero-rate specific goods. Although within SACU there are similarities there are also some differences in terms of which goods are zero-rated. There are also some differences in VAT rates across some sectors. For example, Lesotho applies a higher rate of 15 per cent on alcoholic beverages and a lower rate of 5 % on electricity. The differences in rates and exemptions between countries can lead to and foster cross border fraud.

In many countries financial services, telecommunications and medical services are exempt from VAT. This is because it is difficult to assess the value added at each stage of the production of these services. However, with improved information systems and better tax administration capacity, there are moves by governments to remove the blanket exemption from these sectors and require the standard rating of certain financial services. In SACU, Lesotho and Namibia have a blanket exempt provision on financial services, whereas South Africa applies a partial exemption.

#### *Simplicity and certainty*

The great value of a value added taxation system lies in its simplicity and certainty. Under a VAT system, all taxpayers should be able to easily understand the tax rules so that they can anticipate the tax consequences of any transaction and account for their tax liability correctly (Grandcolas, 2007). Applying VAT rules and regulations consistently creates certainty for taxpayers.

### **3. OVERVIEW OF VAT IN SACU COUNTRIES**

The Government sector and hence government revenues play a particularly important role in the economies of SACU member states. With the exception of South Africa and to a lesser extent Botswana, SACU economies are generally small and very vulnerable to revenue shocks. They also have a limited number of revenue instruments at their disposal. This section assesses the contribution of different revenue sources within SACU member states and explains the regulatory framework that governs the levying of value added taxation/general sales tax in these countries.

#### **3.1. Revenue**

The Government's of Botswana, Lesotho, Namibia and Swaziland (commonly termed the 'BLNS') are heavily dependent on customs and excise duties. Within the BLNS, trade taxes account for between 10% and 30% of GDP; and between 27% and 65% of Government revenue. Most of this revenue is sourced externally, as a transfer from the SACU Revenue Pool, and almost all of this transfer is derived from tariffs on imports into South Africa. This situation is worrying from two perspectives: not only are tariff duties a volatile and declining source of revenue; but the BLNS have little or no authority over the level of SACU tariff duties and the underlying trade on which these duties are charged.

Examining the contribution of other taxes to government revenue merely serves to re-emphasise the high dependency of all BLNS countries on customs and excise taxes (i.e. the SACU payment). With the exception of South Africa, income taxes contribute a relatively small amount to total government revenue and indirect taxes such as GST/VAT account for even less - averaging 5.6 per cent of total GDP in the BLNS.

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Indicators	Botswana	Namibia	Lesotho	Swaziland	South Africa
Tax Revenue as % of GDP	23.7%	33.4%	48.3%	35.2%	27.1%
Government Revenue as % of GDP (includes non tax revenue)	37.1%	35.9%	53.0%	36.2%	27.7%
Income taxes as % of GDP	9.7%	10%	8.7%	7.9%*	16%
GST/VAT as % of GDP	3.5%	6.5%	6.7%	3.7%*	7.8%
Trade taxes as % of GDP	10.2%	16.0%	31.8%	23.6%	1.1%

**Table 1 Key indicators within SACU member states**

Source: IMF Article IV Consultation Reports, SACU member countries documentation and author's own calculations

\* Based on authors' own calculations

### 3.2. Regulatory and Legislative framework

Four of the five SACU member states have adopted a credit based (indirect) value added taxation regime. South Africa was the first country to adopt a VAT system, in 1991. The others followed much later: Namibia and Botswana in 2000, and Lesotho in 2001. The common characteristics amongst the VAT regimes in these SACU member countries can be summarised as follows:

- *Rates:* SACU countries have at least two rates – a standard rate and a zero rate, which apply to the majority of goods and services produced or traded. Some SACU members have created additional rates to cover extraordinary items such as 'sin' products and intangible goods.
- *Tax periods:* Botswana, South African and Namibia allow their taxpayers up to 25 days after month-end to file their tax returns. Lesotho requires taxpayers to file their returns after 20 days.
- *Zero rating:* Zero rating is generally used to provide relief to the poor by removing VAT on the sale and import of basic foodstuffs. Exports are also zero rated in line with the destination principle.
- *Exempt supplies:* All SACU member states have identified exempt supplies, which do not fall into the definition of a taxable supply. Those service industries where the value added in production cannot be easily assessed, are exempted as per international practice. Exempt supplies are listed in the Annexures to VAT legislation in all member states.
- *Registration thresholds:* All revenue authorities in SACU member countries have voluntary and compulsory registration thresholds.
- *Time of supply:* All VAT regimes have similar time of supply rules which recognise that the time of supply takes place when either an invoice is issued or a payment is made – whichever is earlier.
- *Value of supply:* The value of supply is generally calculated as the value of the good as paid to the seller or the fair value of the good in an open market. In the case of



imports, member countries have established different rules to assess the taxable value (refer to Table 2).

Swaziland is the only SACU member state that still operates a general sales tax system. Under the GST system, taxation is charged on the first sale of goods imported or manufactured in Swaziland. A number of imported goods are exempted from GST for trade policy or social reasons. Such goods are listed in Schedule 2 of the Sales Tax Act.

Description	Botswana	Lesotho	Namibia	Swaziland	South Africa
VAT/GST Rate	10 % (Standard Rate)	Variable rates 14 % (Standard Rate) 15 % for tobacco and alcoholic beverages 5 % on electricity and telephone calls	15 % (Standard Rate) 30 % on certain high value and 'sin' goods such as alcohol, motor vehicles listed in Schedule 2 of the VAT act.	Multiple rates listed in Schedule 1 of the ST Act 14 % General Sales Tax (Standard Rate) 25% on alcoholic beverages and cigarettes 12% on services	14 % (Standard Rate)
Legislation	Value Added Tax Act 2000	Value Added Tax Act 2001	Value Added Tax Act of 2000	The Sales tax Act of 1983	Value Added Tax Act of 1991
Administering Authority	The Botswana Unified Revenue Service	Lesotho Revenue Service	Inland Revenue Authority of Ministry of Finance	Swaziland Ministry of Finance	South African Revenue Services
Taxation Principle on Goods	Credit Based Destination Principle VAT regime	Credit Based Destination Principle VAT regime	Credit Based Destination Principle VAT regime	GST on final goods. Intermediate goods and inputs are exempt from GST.	Credit Based Destination Principle VAT regime However in South Africa – exports are classified into two categories (1) direct exports are automatically zero rated whereas (2) indirect exports attract a standard rate of taxation.
Taxation Principle on Services	Services imported for the purpose of making taxable supplies are liable for VAT but can be claimed back as input tax.  Services imported for the purposes of making exempt supplies (e.g financial services) are liable for VAT.  All exports of services are zero rated	Services imported for the purpose of making taxable supplies are liable for VAT but can be claimed back as input tax.  Services imported for the purposes of making exempt supplies are liable for VAT but cannot be claimed back as an input tax.  All exports of services are zero rated	Services imported for the purpose of making taxable supplies are liable for VAT but can be claimed back as input tax.  Services imported for the purposes of making exempt supplies are liable for VAT but cannot be claimed back as an input tax.  All exports of services are zero rated	GST is levied on imported services specified in schedule 4 of the Sales Tax Act.	Services imported for the purpose of making taxable supplies are liable for VAT but can be claimed back as input tax.  Services imported for the purposes of making exempt supplies are liable for VAT but cannot be claimed back as an input tax.  All exports of services are zero rated.
Taxable value of goods imported from	The taxable value is the sum	The taxable value is the sum	The taxable value is the sum	The taxable value is the sum	The taxable value is the sum of:

Description	Botswana	Lesotho	Namibia	Swaziland	South Africa
within SACU	<p>of: The customs value of the goods (FOB) plus the cost of insurance and freight</p> <p>If the cost of insurance and freight is not shown on the invoice, then an upliftment factor of 5 % is added to the value of the goods.</p>	<p>of: The customs value of the goods (FOB) plus the cost of insurance and freight</p>	<p>of: The customs value of the goods (FOB) plus the cost of insurance and freight</p> <p>Or if the cost of insurance and freight is not known, then The FOB value of the goods plus an upliftment factor of 10% Or The open market value of the import.</p>	<p>of: The customs value of the goods (FOB) plus the cost of insurance and freight</p>	<p>The customs value of the goods (FOB) plus the cost of insurance and freight</p>
Taxable value of goods imported from the Rest of the World	<p>The taxable value is the sum of: The custom value of the goods plus the cost of insurance and freight plus the amount of duties payable.</p> <p>If the cost of insurance and freight is not shown on the invoice, then an upliftment factor of 5 % is added to the value of the goods.</p>	<p>The taxable value is the sum of: The customs value of the goods imported plus the value of any services related to the imports plus any duties payable.</p>	<p>The taxable value is the sum of: The value of the goods for customs purposes, plus a 10% upliftment factor, plus the amount of any duties payable plus the value of any services related to the import.</p>	<p>The taxable value is the sum of: Customs value plus the duties payable plus 10 % of the sum of the customs value and duties.</p>	<p>The taxable value is the sum of: The customs value plus an upliftment factor of 10 % plus any duties payable.</p>

**Table 2 A summary of the VAT regulatory framework in SACU member states**

*Sources: Interviews with country officials, Pricewaterhouse Coopers (2007), VAT acts of SACU member states, Practice Notes*

## **4. VAT ON CROSS BORDER TRANSACTIONS**

### **4.1. Imports**

All imports entering South Africa, Botswana, Lesotho and Namibia attract VAT whilst goods entering Swaziland are subject to Sales Tax. For all SACU member countries, excluding Swaziland, the amount of VAT payable depends on the way in which the taxable value of the good is defined and calculated. This in turn depends on the origin of the goods in question.

Cross border trade poses challenges for any VAT system: there is usually a trade-off between the potential efficiency gains from destination based tax collection and the prevention of tax avoidance and fraud. To understand how this trade-off may play out within SACU, it is first important to understand how cross border trade is administered in the customs union and between different member states.

#### **4.1.1.Import control**

In order to clear goods across a SACU border, all traders must complete a standardised and single administration document: the SAD 500 form. The SAD 500 requires the importer to: disclose his contact and registration details; describe the content of the shipment; and declare the customs value, insurance and freight and any other supplementary costs related to the import.

Botswana, Namibia, South Africa and Lesotho – despite operating different customs clearing systems - allow traders to submit their SAD 500 forms electronically and prior to the import and export of goods. In addition, traders must make and carry copies of the SAD 500 across each border post through which they pass and attach supporting documentation such as invoices.

Based on the information provided, customs officials at the border posts of the recipient country calculate the VAT/GST liability. In Namibia, Botswana, Lesotho and South Africa, the revenue authorities offer some traders a 20 to 25 day deferment period by which time they must pay their VAT liability. Depending on the risk profile of the importer and the volume of trade, the revenue authorities may require security against this deferment facility, usually in the form of a bank guarantee (Hoskins, 2008). Should the importer not be registered as a VAT vendor in the recipient country, cash payment of the VAT liability will be required at the border post before the goods are cleared. The importer can then claim input VAT if the imported good is used in the production of taxable supplies.

In Swaziland the process is slightly different. GST is payable on the first import of goods into Swaziland unless the good is specifically exempt under Schedule 2. Schedule 2 exempts a number of imports including basic foodstuffs, goods imported as inputs into the manufacturing process, goods imported temporarily for repair, goods imported for farming and forestry and goods imported for use by the King. All traders are required to fill out the SAD 500 form, attach invoices and declare the goods at customs. In the case of goods imported for industrial purposes, written permission from the Commissioner of Revenue in Swaziland should be attached to the documentation in order for the exemption to apply.

#### **4.1.2. Temporary imports**

In certain instances, an import may enter a country temporarily for repairs. The revenue authorities do allow for such goods to be zero-rated provided that proof of re-export is

submitted to the port of entry within 30 days. The revenue authorities may insist on the payment of provisional VAT on the good. For goods entering South Africa temporarily from the BLNS countries, traders are required to fill out a SAD 500 along with a VAT 266 form. With temporary trade, imports must be registered with the revenue authorities of both countries at the ports of entry and exit.

## 4.2. Exports

In line with the destination principle, all exports from Botswana, Lesotho and Namibia zero are zero-rated for VAT purposes. In Swaziland, exports do not attract any general sales tax. South Africa however distinguishes between direct and indirect exports – depending on who has substantive control over the transportation of goods outside of the country (Republic of South Africa, 1998). This dual system is not uncommon amongst revenue authorities. For example, HMRC in the United Kingdom only allows producers to zero-rate supplies to other EC member states if they can prove that they have:

- a valid EC VAT registration from the purchaser;
- commercial evidence that the goods have been removed from the UK; and
- evidence of transportation out of the UK (HMRC, 2007).

### How it works in the EU

With the advent of a single market within the EU came the abolition of borders between countries. Although great step forward in terms of trade facilitation and liberalisation, it has created widespread difficulties in the collection of VAT for revenue authorities. The initial approach suggested by the EU commission was to move to an origin-based system whereby VAT would be collected in the country where the supplier is based. However, this approach was not feasible due to the differing regimes and capacities of member states. Instead, the EU has adopted a transitional system, which combines both origin and destination based principles and allows member states to decide on the VAT rates subject to certain guidelines.

For the purposes of cross border trade within the EU, goods traded are treated as arrivals and dispatches. The terms imports and exports are then only used to label goods traded between the EU and Rest of the World. The VAT registration status of the recipient of supply within the EC will influence the way VAT is accounted for. VAT is zero rated on goods dispatched to another EU member states if the recipient is registered as a VAT vendor and their VAT number has been verified using the VAT Information Exchange System (VIES). VAT is then payable on an arrival or intra community acquisition at the VAT rate of the receiving member state. If a supply is made to a non-registered purchaser, then the origin principle is applied. That is the individual or company pays VAT in the country of sale. In both cases, where either the origin or destination principle is applied, the recipient is entitled to claim input tax if the good is used in the production of taxation supplies.

There are numerous problems associated with VAT administration within the EU, with the biggest problem being carousel fraud. Carousel fraud occurs when a trader registers as a VAT vendor in one EU member state and uses it to purchase zero rated goods from another business in a differing member state. The trader then sells the goods at a VAT inclusive price to a second business in his own country, disappearing with the VAT. The second trader claims input VAT from the revenue authorities (Grandcolas, 2008).

### Box 2 VAT in the EU

*Source: HMRC (2007) and Europa Website*

#### 4.2.1. Direct Exports

The general rule on all intra-SACU trade was that all exports are zero-rated. However, with increasing VAT related fraud in cross border trade transactions, the South African revenue authorities have removed the blanket zero-rating on exports and has instead placed the onus on the exporter to prove and ensure that goods exit the country in order

to claim zero-rated status. Within SACU, South Africa is the only country that has adopted this approach.

A direct export is defined as a situation where the supply vendor is in control of the export and ensures that the movable goods are exported from the Republic (SARS, 2006). In practice, this means that where the South African supplier delivers the goods abroad by paying for the cost of transport, then the export can be zero-rated. This includes those situations where an exporter delivers an export good to a listed international airport or harbour (within South Africa). Specifically, for an export to be classified as a direct export, the supplier must:

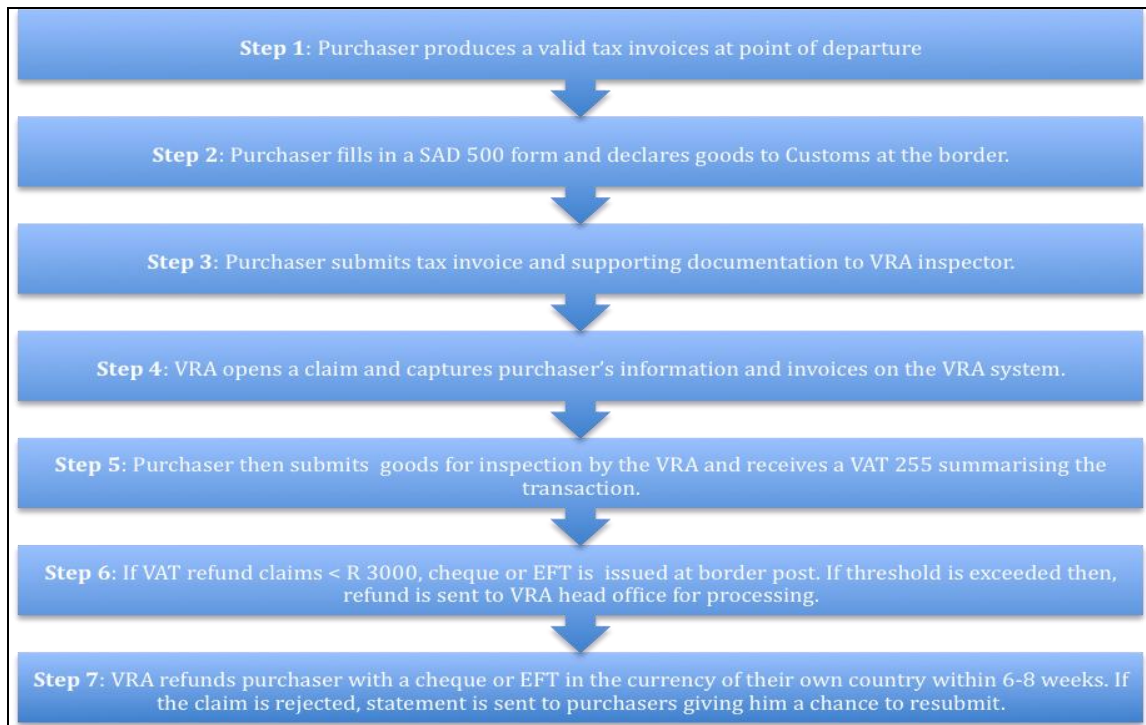
1. ensure that the goods are exported within two months of the tax invoice being issued and;
2. obtain and retain the following documentary proof:
  - i. Purchase order or contract between the importer and exporter.
  - ii. Official documentation of export as prescribed by the Customs and Excise Act.
  - iii. Commercial documentation issued by freight forwarders and clearing agents such as tax invoices, bill of lading etc.
  - iv. Proof that movable goods have been received by the importer in the foreign country.
  - v. Proof of payment.

The border clearing process is similar to that of imports. Traders complete the SAD 500 and submit it along with supporting documents electronically and/or in hard copies to the border posts. In the case of direct exports, SARS allows for pre-clearance to be completed so that goods can travel mostly unhindered across borders.

#### **4.2.2. Indirect Exports**

The process becomes more complex in the case of indirect exports. An indirect export is defined as a situation where the importer collects or arranges for the collection of movable goods for export from the South African supplier (SARS, 2006). In this case, the supplier in South Africa would be required to charge the standard VAT rate on the export. The onus is then on the foreign purchaser to claim a VAT refund at the port of exit. Upon arrival at the border post, the purchaser would complete a SAD 500 form and submit the goods for clearance to the Customs Officer. Once the goods are cleared by customs, the purchaser can claim a VAT refund from the VAT refund administrator. To do so, the purchaser is required to present the following documentation:

1. The stamped copies of the customs clearance documents (SAD 500) or a release order.
2. Valid tax invoices that comply with the Export Incentive Scheme.
3. A copy of the passport of the purchaser or alternatively a copy of the enterprise's trading license.



**Figure 1 VAT refund process**

Figure 1 shows the 'front office' process for obtaining VAT refunds at designated border posts where VRA officials are physically present. At border posts, where the VRA is not present, customs officials are responsible for collecting the VAT claim and sending it to the VRA Head Office for processing.

In 1998 SARS separated the front- and back-office functions of the VAT refund process and the VRA operates as a private company. This separation of roles was designed to promote specialisation and improved operational efficiency. Once the VRA head office receives the refund claims, the 'back office' processing starts. The VRA rechecks claims, verifies the documentation, batches them together and sends them to SARS for auditing. Upon receipt of a batch of refund claims, SARS pays 80 per cent of the value of the batch upfront to the VRA. The remaining 20% is paid out once the audit process is complete. If SARS rejects a claim that has already been paid out at the border post, then the VRA incurs the financial loss related to the claim. The VRA charges traders an administrative fee at a rate of 1.5 per cent of the VAT inclusive value of the claim with a minimum charge of R10 and maximum of R250 per claim.

SARS is currently reviewing the role of the VRA with the possibility of internalising the front-office functions of the VRA back into the revenue authority.

**SARS-LRA Bilateral agreement**

Lesotho introduced Value Added Taxation in 2003 at a rate of 14 %. A year later, the Lesotho Revenue Authority (LRA) and the South African Revenue Services (SARS) signed a memorandum of association that governs the collection of VAT on indirect exports from South Africa into Lesotho. This arrangement aims to facilitate cross border trade by removing the need for the trader to pay VAT on imports entering Lesotho and then obtain a refund from SARS. Instead, the trader simply submits his invoices and forms to the LRA (and in some cases also to SARS) and the revenue authorities then settle all refunds between themselves.

In practice, the LRA batches the invoices received from traders at the border and submits these to the VRA. The VRA verifies the invoices and then sends them on as a claim to SARS for auditing. SARS pays the refund claim to the VRA, which in turn pays the LRA. The VRA charges the LRA a flat rate of R20 per successful claim refunded. On average, the LRA receives 80 per cent of the value of claims submitted under this method after accounting for administration charges and rejections. Based on the efficiency gains from this system, the LRA is negotiating with SARS and the VRA to apply similar provisions to goods purchased in Lesotho and imported into South Africa. The Government of Lesotho hopes that this might encourage nearby residents of South Africa to purchase more from within Lesotho.

**Box 3 The SARS-LRA bilateral agreement**

*Source: SARS (2008) and interviews with LRA officials*

**4.3. Transit**

Three of the five SACU member countries are landlocked countries. They are all much smaller than South Africa in economic terms. Most of the trade between the BLNS and the rest of the world therefore passes through South Africa as the geographic and economic hub of the region. The rules and processes relating to transit trade are clearly important for the BLNS.

Generally, when goods enter South Africa for re-export to the BLNS, a declaration will be made on the SAD502 to remove the goods in bond. The goods will consequently not attract any VAT upon entry into South Africa. The trader then has 30 days within which to produce evidence of export (acquittal documentation) to the port of entry. Should the trader not be able to produce the acquittal documentation within 30 days, SARS is entitled to levy penalties and raise a VAT liability on the exporter. Upon arrival at their final destination in the BLNS, customs officials are required to clear the goods and calculate the customs duties and VAT/GST liability payable by the importer.

**4.4. Services**

Trade in services has traditionally been a problematic area for value added taxation. Based on the destination principle, the VAT should be levied where consumption occurs. However, enforcing the collection of VAT on services trade poses practical difficulties, as there is no physical customs clearing process involved. For this reason, it is generally accepted that the recipient of a foreign service should be required to declare and pay over VAT on service imports.

Self-declaration only applies when services are imported for purposes *other* than making taxable supplies. Thus, if a recipient imports a service for the purpose of making taxable supplies, VAT is not payable. For example, assume that a factory in Botswana imports the services of a South African engineering company to repair machinery, which is in turn used in the production of goods. The recipient of such a service will not be required to make a self-declaration as the service is a direct input for the production of taxable supplies. However, if the services of the engineering firm were imported to advise on the construction of a new factory, then the self declaration requirement would apply and VAT would be payable.



Under the reserve charge rule, the recipient of the service is obliged to calculate the tax payable and pay it over to the revenue authorities. The reserve charge rule can be found in the legislation of all SACU member states that have adopted a VAT system. In South Africa, SARS requires the recipient of services to complete a VAT 215 form. Moreover, there is additional capture clause within all VAT legislation. If the value of services provided by a foreign enterprise exceeds the VAT registration threshold in the recipient's country, then the authorities will require to the foreign enterprise to register domestically as a VAT vendor. The registration thresholds for VAT in Botswana, Lesotho, Namibia and South Africa are P250 000, M 500 000, N\$ 200 000 and ZAR 1000 000 respectively. The South African threshold was only increased from ZAR 300 000 to ZAR 1000 000 in 2008.

## **5. PROBLEMS AND ISSUES**

The previous section outlined how VAT is intended to work in SACU. In this section, we highlight some of the cross cutting and country specific problems that arise from this system, as described to us in interviews with regional revenue authorities and traders. The root cause of many of these problems is the usual tension that exists between promoting intra-regional while preventing cross-border fraud and tax revenue losses. Rules and regulations that effectively reduce the risk of fraud and under-collection have in some cases created double taxation and uncertainty, thereby negating the neutrality of the VAT system.

### **5.1. Cross cutting problems**

#### **5.1.1. Working capital costs**

A VAT system imposes certain costs on traders. Generally, two economic costs can be identified for businesses:

- opportunity costs of not using the outlay used to cover the VAT liability for productive purposes; and
- working capital costs associated with financing the VAT liability until a refund is made.

The higher the rate of VAT and the longer it takes to get refunds back, the larger are these costs. But are they substantial within SACU?

Although it is difficult to quantify the opportunity costs to businesses, it is possible to estimate working capital costs using the prevailing interest rate on a bank overdraft as a proxy. Working capital costs for SACU traders can arise from two separate sources: firstly, the cost of financing the VAT liability payable to the revenue authority of the importing country; and secondly, the cost of financing the VAT liability charged by the exporting country (indirect exports). Together, these costs constitute the total financing costs for traders.

Botswana, Namibia and Lesotho all have a VAT deferment facility in place, which provides a credit facility to qualifying businesses and enables them to defer VAT payable on imports for a period of time. Interviewees within each of these countries have noted that the time taken to process a VAT input tax claim by their revenue authorities varies between 2-3 months in the BLN countries. The longer it takes to process a VAT claim, the higher the financing costs for traders. This is likely to impact negatively on small to medium businesses.

In the case of indirect exports from South Africa to the BNS, the Export Incentive Scheme prescribes the time period for a VAT refund as a maximum of 8 weeks (56 days). During interviews, many traders from Botswana, Namibia and Swaziland raised concerns about the time taken to receive VAT refunds from the VRA, claiming that this can take frequently between three to six months. In order to reduce their working costs, they are therefore forced to maintain very low levels of imported inventories. Financing a business' VAT liability can be costly for a trader.

### 5.1.2. VRA tax refunds and administration charges

There seems to be a lack of understanding around the issue of administrative charges, the relationship between the VRA and SARS and how claims are approved and/or rejected. Traders, although aware of the cap of R250 per border crossing, add that if their imports came through in five different consignments, they can incur up to R1 250 in administration fees. The traders also claim that in cases where they import dissimilar items grouped together, they are charged administrative charges for each groupage instead of one border crossing. For low value and high volume goods such as bulk packaging and certain retail items, these administration charges can therefore reduce their margins substantially.

#### VAT Refund – the different models.

Most revenue authorities have recognised that separating the front and back office functions in processing VAT refunds leads to an efficient outcome. There are a number of different variations in terms of how this is done. In South Africa, the VRA administrator is operated by a private company and can be found at certain land border posts and the main international airports. The VRA is responsible for capturing the claim, processing it, obtaining approval for the claim from SARS and then paying it out to the trader or tourist.

In Singapore, the Tourist Refund Scheme (TRS) allows travellers to claim refunds. Under this arrangement, the traveller will present themselves at the Immigration and Checkpoints Authority (ICA) to obtain a customs endorsement on their declaration forms. Once this is done, the traveller will then proceed to the counter of the Central Refund Agency. The Central Refund Agency will process the claim and then refund the traveller within three months of departure. The Central Refund Agencies found through Singapore are operated by two companies – the Global Refund Singapore (Pte) Ltd and the Premier Tax Free (Pte) Ltd. The TRS scheme only applies to purchases by non-residents for export. All other commercial exports are GST Free.

In the EU, most member states have different processes for VAT refunds. Although traders can apply to the relevant Revenue Authorities for a VAT refund, dealing with different bureaucracies can be cumbersome. A number of private VAT refund companies have therefore emerged, which will submit the claim on behalf of the trader. These specialist VAT refund companies charge an administration fee for the services rendered. The main difference between this model and the SA variant is that the EU regulations have created a competitive market with a number of VAT refund firms capturing the claims whereas in South Africa, the revenue authorities appoint one service provider to capture and process all VAT refunds.

*Source: Inland Revenue Authority of Singapore*

Another cross cutting issue raised by traders is the documentary requirement for VAT refunds. Collecting the documents and getting the appropriate endorsements from customs officials on both sides of the borders can be difficult and costly. One interviewee noted an instance where SARS required a trading license from the BLNS importer. Unfortunately, this specific country does not issue trading licenses. The refund was refused on the basis of inadequate supporting documentation.

**Real life example: The cost of a stamp**

A BLNS based trucking company makes weekly deliveries to its clients. The truck driver with his load arrives at the border post at 18h30 and declares the 25 different consignments for different clients. The customs official captures the information, checks the goods but misses out stamping a SAD 500 in the rush to close off for the day. The VRA official endorses all the forms and inspects the consignments before releasing the truck. The trucker brings the forms back to the freight forwarder who collates the documents and submits it to the client who will request the VAT refund by post. The client notices that one of his SAD 500 forms is not stamped. To rectify this error, the client is required to send his own employee, with a letter authorising him to obtain the stamp, to the border post. The cost of this exercise, which is reportedly not uncommon, can be estimated as follows:

	Unit	Price (Rands)	Quantity	Total (Rand)
Fuel and Wear and Tear (AA rates)	KM	4.12	130	535.6
Driver Costs	Day	140.00	1	140.00
Daily allowance	Day	50	1	50.00
<b>TOTAL COST OF COLLECTING AN ENDORSEMENT PER TRIP</b>				<b>725.6</b>

**Box 4 The cost of a stamp**

*Source: Interviews*

The most substantive complaint by traders is the amount of money they lose if and when their VAT refund claim is rejected. One trader interviewed estimated that he had lost on average 10 per cent of the value of the claims submitted to the VRA. He noted that although he has tried to make arrangements with South African exporters to zero rate the goods, they were unwilling to do so as the volumes ordered did not warrant the additional risk. Because the VRA funds itself through administrative fees, there is an incentive for them to process every claim regardless of its merit. But there is also an incentive for the VRA to adopt a conservative approach to refunds and not to assume the risk on potentially wrongful claims.

The validity of these complaints is difficult to verify without obtaining further information on the value of claims put forward by traders per annum and the number of claims rejected. In order to assess the impact of border administration on VAT refunds, one could compare the per cent of the claims rejected in Botswana, Namibia and Swaziland to the per cent rejected in Lesotho (where the administrative requirements have been largely removed). Interviewees from the revenue authorities suggest that the bilateral arrangement between the LRA and SARS has led to a dramatic increase in the collection rate of VAT on imports since its implementation in 2004. This data was requested from SARS but was not made available to the researchers prior to the completion of this study.

**5.1.3. Border processes**

The lack of uniformity at border posts can have either adverse or favourable effects on cross border trade in SACU. Specifically, because the VRA is only present at designated border posts, VAT processes are more mature at these borders. Thus, whereas importers might choose to import through designated borders in order to obtain immediate refunds, some exporters might favour non-designated posts. See Box 6 below. VAT refunds submitted at non-designated posts are likely to take longer to process and obtain.

**Tax avoidance through border post shopping**

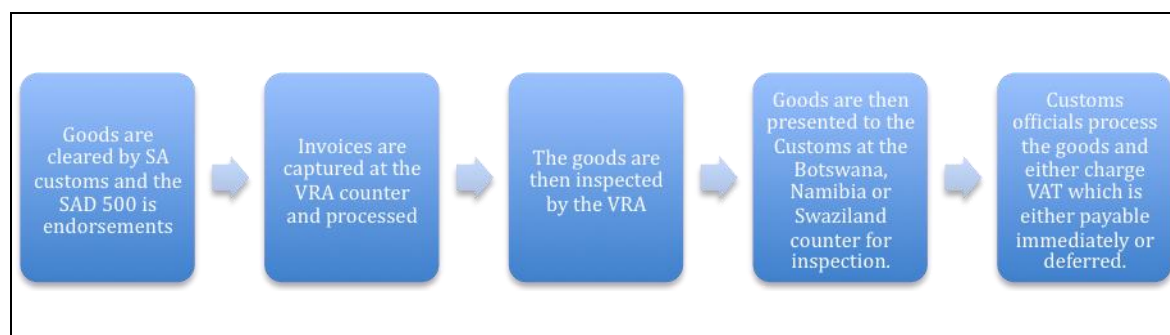
A BLNS based transport company interviewed highlighted the benefits of border shopping. The company which is also registered as a clearing agent noted that in transporting goods for temporary export into South Africa, the payment of provisional VAT could be avoided depending on which border post the goods passed through. Therefore, the transport

company opted to haul the goods an additional 160 kilometres (following an agreement with the client) to avoid the cost of paying provisional tax and tying up their working capital.

### Box 5 Tax avoidance through border shopping

Source: Interviews

One of the main advantages of the SARS-LRA agreement comes from the reduction in congestion and delays at border posts between South Africa and Lesotho. Figure 2 and Figure 3 shows the processes at the border posts between SA and the BLNS. For traders entering Botswana, Namibia and Swaziland, the process is longer as they have to clear goods with SA customs, present goods to the VRA and then declare goods for VAT purposes to the customs authorities of Botswana, Swaziland and Namibia (See Figure 2). During interviews, traders indicated that delays tended to occur in clearing goods for VAT with the local custom authorities: IT systems are often down or officials demand immediate payment of the VAT, which requires traders to either present the cash or send a bank guaranteed cheque to the border.



**Figure 2 VAT processes at borders between South Africa and Botswana, Swaziland and Namibia**

Traders importing goods into Lesotho face a smoother and shorter process. Most traders will clear goods with the South African customs office, present goods to the VRA and then hand over their invoices and forms to the LRA as they leave the border post. The LRA is then responsible for submitting the claim to the VRA on behalf of the trader. This process has many of the benefits of the 'walk through' concept of a one-stop border post.



**Figure 3 VAT processes at borders between South Africa and Lesotho**

#### 5.1.4. Additional costs related to the VAT system

SARS (2006) interpretation note no. 30 requires all cross-border transporters to be registered in terms of the VAT Act. For BLNS based companies, this means that they must either establish a physical address in South Africa or must appoint a local agent. A BLNS based company interviewed noted that they have established offices in South Africa just so that they could be appointed as a registered transport contractor.

This requirement does offer advantages to both the revenue authority and the transporter. For SARS, this enables them to hold a single and South African-registered entity accountable for VAT on cross-border transactions. For transporters, it enables them to zero-rate South African exports and offer seamless collection, warehousing and

nodal distribution functions in the importing country. But this practice is costly – the transporter interviewed estimated that the additional operating costs, as a result of this requirement, is about R1.2 million per year. These costs relate mainly to the operational costs of having a presence in South Africa such as leasing and maintaining premises and paying South African staff.

Additional documentary requirements are also set out for road transporters and freight forwarders in the SARS practice note no. 30 when zero rating goods: These include:

- The recipient's order
- Proof that the supplying vendor (exporter) has paid the transport costs
- Evidence that the transport contractor has taken possession of the goods or road manifest
- Proof of delivery in the recipient's country (importer)
- Export documentation in terms of the Customs and Excise Act (SAD 500 or release documents)
- Proof of payment

Obtaining the proof of delivery in the recipient's country and export documentation is often the hardest and most tedious part of the process. In order to comply with these requirements and obtain evidence of acquittal, transport contractors increasingly have to invest in maintaining staff at SACU borders to expedite the process of clearing goods. This is still necessary despite the introduction of the Electronic Document Interchange System in South Africa and ASYCUDA system in Botswana and Namibia, which are used to apply for customs clearance online. This raises questions around the efficiency of the current border processes, which are, unfortunately, not the main focus of this paper.

### **5.1.5. Grey areas**

#### *Repairs*

Many BLNS-based companies send their machinery and other assets to South Africa for repairs and SARS allows for the temporary movement of machinery into and out of South Africa, with not VAT payable, as long as this period does not exceed 30 days. A problem therefore arises when this maximum period allowed for repairs is not sufficient. Information gathered during the interviews suggests that there are inconsistencies in practice across borders. Traders in Namibia claim that after the expiration of the 30-day period, they are fined R1 000 by SARS. Traders in Botswana however indicate that they are able to negotiate an extension for a further 30 days.

#### *Second hand motor vehicles*

The problem associated with VAT and second hand motor vehicles illustrates a more general principle that applies to the cross border trade in all second hand goods. When a non-vendor sells a second hand good to a registered vendor, the full cost price of the good plus the output tax payable is cascaded upwards until it gets to the end consumer. This means that the final consumer pays higher taxes than he would have otherwise paid if the VAT chain had not been broken. To counteract this situation, domestic VAT legislation introduces the concept of a notional input tax credit, which allows the registered vendor to claim back a 'notional' input tax credit. However, if the second-hand good is then exported by the registered vendor, the VAT chain is once again broken and the exporter must pay back the 'notional' input tax credit.

This complex chain of events is perhaps best illustrated by way of an example. A registered vendor (a second-hand car dealership) in South Africa purchases a car from a non-registered vendor (an individual) in the same country for R 114 000. The registered vendor can claim a notional input tax credit of R14 000 from SARS on a VAT 264 form. The registered vendor resells the vehicle for the net purchase price of R100 000 plus a profit margin and plus VAT of 14% on the final price. But if the registered vendor sells the car to a BLNS trader, he is required to add back the notional input tax claim to his selling price otherwise he makes a loss of R 14,000. Effectively, the second hand dealership 'pays' back the notional input tax deduction to SARS but can zero rate his profit margin as it reflects the value added by the dealership.

<b>Purchase from non registered vendor</b>	<b>Price (Rands)</b>
Purchase price	114,000
Less: Notional input tax credit @14%	14,000
<i>Net purchase price</i>	<i>100,000</i>
<b>Domestic sale</b>	
Profit margin (50%)	50,000
VAT on selling price (14% of R150,000)	21,000
<i>Gross selling price</i>	<i>171,000</i>
<b>Export sale</b>	
<i>Net purchase price</i>	<i>100,000</i>
<i>Profit Margin (50%)</i>	<i>50,000</i>
<i>Add back the notional tax credit</i>	<i>14,000</i>
<i>Gross selling price</i>	<i>164,000</i>

**Table 3 How notional input tax credit work**

*Source: SARS (2006)*

The second hand car dealership should ideally invoice the BLNS for R 164,000 but in practice BLNS traders generally pay the 'window' price of the motor vehicle. Based on the notional tax rule, SARS will only refund the trader the difference between VAT paid and the notional tax credit. The trader therefore receives R 7000 or his VAT back on the profit margin of the dealership (14% of R 50 000).

This concept of notional input tax credit is widely misunderstood amongst BLNS traders and even the revenue authorities. Their main complaint is that they are being under refunded and should be able to claim back the VAT on the gross selling price. Allowing notional input tax credits on exports would mean that the South African fiscus subsidises exporters of second hand goods negating the principle of neutrality. With regard to the above example, SARS would lose R 35 000 in tax revenues on exports. Much can be done to educate SACU traders on the import of second hand motor vehicles.

#### *Empty containers*

There is some uncertainty around the treatment of empty containers returned by the importer to the supplying vendor. In terms of the 'sale agreement' between the exporter and 'importer' the contents of the container are sold while the container remains the property of the exporter or his agent. For example, a Swaziland manufacturer imports yarn spun around bobbins from a supplier in South Africa. It is only the yarn that is imported and the condition of sale agreement states that the bobbins must be returned to the exporter. Technically, the value of the bobbins is not part of the sale. And VAT is only levied when a sale transaction occurs.

We use an example to illustrate this. The manufacturer imports 10 bobbins of yarn at R1 00 each from a South African Supplier. VAT of R140 is paid at the border on the taxable

value of the invoice. When the empty bobbins are returned, the transaction is treated as an export sale and the manufacturer is required to pay VAT on the value of the empty bobbins. Further guidance is needed from all revenue authorities on this issue.

#### *Market power influences*

The relative size of the South African market and the importance of South African buyers in the region raises additional challenges for smaller suppliers and traders in the BLNS. In particular, within the agriculture sector where phytosanitary requirements are high, BLNS companies are often required to assume full responsibility for clearing the goods and paying for VAT along with a host of other charges related to the export. For small to medium size companies, this can be difficult and costly. For example, the company may have to raise working capital to cover VAT, clearing charges, transport costs and phytosanitary clearing requirements. Although the charges themselves are eventually recouped on final sale to the importer in South Africa, the cost of financing this arrangement is borne by the BLNS trader. The opposite tends to apply in the case of importers from the BLNS, who usually have to assume the full costs in importing from the dominant suppliers in South Africa. In other words, being small in itself imposes costs and constraints on exporters and importers in the BLNS.

#### *Calculation of guarantee for the deferment account*

The use of a deferment account facility is fairly new amongst SACU member countries. The cost of holding a deferment account for a trader includes bank charges payable for the issuing the guarantee and the interest costs of holding the amount. Most traders interviewed did not understand the basis on which their guarantee/security amounts were calculated.

#### *Services*

Interviewees suggest that the under-collection of VAT on imported services is a pervasive problem across all SACU member countries. The reasons for this are three fold:

- Most companies are well aware of the VAT mechanism involved in cross border trade in goods but did not understand the VAT prescriptions in respect of imported services.
- Revenue authorities are not doing enough to enforce compliance in respect of self declaration.
- The poor coordination between SACU member states on VAT hinders the sharing of information on imports and exports of services.

Within SACU countries, there are two main areas where under-collection is large and common: the use of foreign consultants by government departments; and the use of imported professional engineering services on major construction projects.

Interviews with VAT practitioners reveal other problems – for example, in certain SACU countries, the costs and administrative burden involved in registering for VAT in order to export services, can be substantial. These include legal requirements, such as registering as a company, leasing premises, appointing auditors, as well as the payment of professional fees. Moreover, there are sometimes difficulties associated with deregistering a company once a contract has been completed.

**The demand for tax practitioners**

As cross-border trade in services has grown, so has the demand for tax practitioners. One example presented to us involved the export of consulting services to a BLNS country from South Africa. The legislation simply notes that VAT is payable where the service is consumed. However, whereas most of the exported consulting services took place in the BLNS country, representatives from the client also travelled to South Africa to participate in meetings and training activities. Professional tax practitioners were subsequently hired to determine the correct allocation of VAT between the two revenue authorities. The total cost of this assessment amounted to approximately 15% of the total invoice.

**5.1.6. The total cost of VAT: Scenario Analysis**

The previous sections describe a number of problems experienced by exporters and importers in trading across SACU borders. In order to assess the validity and potential scale of these claims, we have calculated the potential costs associated with these working capital and administrative constraints and developed a worst-case scenario.

Table 4 shows the key timeframes for VAT deferments, payments and refunds for the BLNS that are used in this analysis. The information on the VAT deferment period and VRA refund is taken from legislation. Information on input tax claim refunds is the consensus value agreed upon by traders in each country during interviews. For example, traders interviewed in Namibia noted that they waited on average three months (90 days) to receive their VAT input tax claims from the revenue authority.

Country	VAT deferment period (Days)	Input tax claim payment (Days)	Refund from VRA (Days)
Botswana	25	60	56
Lesotho	20	60	56
Namibia	25	90	56
Swaziland			56

**Table 4 Important timeframes within the VAT system**

Source: VAT legislation, VAT in Africa (PWC, 2007) interviews with traders and Export Incentive Scheme (1998).

We also make a number of additional and simplifying assumptions:

- The goods are imported from South Africa at a purchase price of R1 million.
- The traders are based in the BLNS and are responsible for the purchase and import of the goods. The sale is therefore classified by SARS as an indirect export and VAT is payable in South Africa. The VAT refundable exceeds R 3000 and is therefore not refunded at the border.
- The purchase is one container of grouped goods and treated as a single border crossing.
- The prime interest rate is 15.5% per cent compounded daily.
- The goods are not exempt and attract a standard rate of VAT/GST in all countries.
- Traders in Botswana hold accounts in SA rands and purchase goods in this currency. Namibia, Lesotho and Swaziland are part of the common monetary areas and allow traders to hold dual currencies.
- The goods purchased are intermediate products, to be used in a production process, and therefore are not sold as final goods in the domestic market.
- The production process period exceeds the VAT refund period from the BLNS revenue authorities and SARS.



The total amount of VAT/GST payable in each country on this single import transaction is then as follows:

Purchase price	SA VAT on indirect exports	Botswana VAT	Lesotho VAT	Namibia VAT	Swaziland GST
R1,000,000	R140,000	R100,000	R140,000	R150,000	R140,000

**Table 5 VAT liability in SACU member states on a purchase of R 1 million**

*Source: Own calculations*

The following analysis recognises that the presence of a deferment facility may reduce the working capital costs of traders in Namibia and Botswana. The deferment facility is generally available for all VAT registered vendors however there might be occasions when it is not used. For example, the trader might not want to or be able to put forward a bank guarantee if the volumes imported or the frequency of imports do not justify the cost. Alternatively, the revenue authority may decline the deferment account facility on the basis of the risk profile of the importer. We therefore calculate the total working capital costs in the case where the deferment facility is used and also where it is not. Traders also incur VRA administration charges, capped at R 250 per border crossing.

Table 6 shows the total interest costs borne by traders in financing VAT. We estimate that the total finance charges together with the administrative charges amount to between 0.5% - 1% of the total value of the goods imported. We also find that for both countries the financing costs associated with the SA VAT paid on indirect exports account for a large portion of these interest costs.

We compare the situation in Botswana and Namibia to the situation in Swaziland and Lesotho in Table 7. In Swaziland, the trader incurs interest costs on the South African VAT liability and pays GST to the revenue authority in Swaziland once the goods cross the border. The GST paid on the import is only recoverable once the trader sells the final goods onto his customers. Assuming, in this example, that the production time prior to the sale of the goods is 1 month, then the total finance and administration costs amount to about 0.5% of the goods imported.

Based on the processes described in Box 3, we note that the harmonised system at the South African-Lesotho border clearly reduces VAT financing costs. Since VAT paid to SARS is credited against his liability at the LRA, the trader incurs no further interest costs upon entering Lesotho nor does he pay the VRA administration fee. The trader will however need to finance the VAT payable in South Africa until he receives his input tax claim from the LRA.

Country	Interest with no deferment facility	SA VAT financing costs (%)	Interest with Deferment facility	SA VAT financing costs (%)	VRA administration charges	Total cost without deferment	Total cost with deferment
Botswana	5,946.62	57%	4,863.58	69%	250	6,196.62	5,113.58
Namibia	9,209.07	37%	7,563.67	45%	250	9,459.07	7,813.67

**Table 6 Financing the costs of the VAT liability for Botswana and Namibian traders**

	Interest on VAT paid in SA	SA VAT financing costs (%)	Interest on GST/VAT paid until recovered/refunded	VRA Administration charges	Total cost to trader
--	----------------------------	----------------------------	---	----------------------------	----------------------

Swaziland	3,367.49	65%	1,793.59	250.00	5,411.08
Lesotho	0	0%	3,611.18	0.00	3,611.18

**Table 7 Financing the costs of the VAT liability in Swaziland and Lesotho**

*Source: Own calculations*

We recalculate the interest costs taking into account the claims of traders that VRA refunds can take between three to six months. In the table below, we show the increased interest cost paid by traders as a result of a 90-day delay from the VRA. Namibian traders incur the highest costs as their VAT refunds and VAT input tax claims would now both take 3 months. For Botswana traders, the proportion of total financing costs attributable to SA VAT increases from 69% to 78% given the additional 34-day delay when the deferment facility is used.

A change in the number of days taken for the VAT refund has no impact on traders in Lesotho because of the bilateral agreement. Thus, we can summarise that in cross border trade, the time taken to obtain refunds on indirect exports contributes substantively to the working capital costs of traders.

Country	Interest with no deferment facility	SA VAT financing costs (%)	Interest with Deferment facility	SA VAT financing costs (%)	VAT administration charges	Total Cost without deferment	Total Cost with deferment
Botswana	8,031.20	68%	6,948.15	78%	250	8,281.20	7,198.15
Namibia	11,293.64	48%	9,648.25	57%	250	11,543.64	9,898.25

**Table 8 Financing the costs of the VAT liability for Botswana and Namibian traders**

	Interest on VAT paid in SA	SA VAT financing costs (%)	Interest on GST/VAT paid until recovered/refunded	Administration charges	Total cost to trader
Swaziland	5,452.07	75%	1,793.59	250.00	7,495.66
Lesotho			3,611.18	250.00	3,861.18

**Table 9 Financing the costs of the VAT liability for Swaziland and Lesotho traders.**

#### *Building a worst-case scenario*

What is the worst-case scenario for traders in the BLNS and how much could VAT cost them? In this sub section, we illustrate the additional costs that BLNS traders could possibly face in cross border trade with South Africa. We start by assuming that traders have access to a deferment facility and that a single administrative charge is levied by the VRA to construct a baseline scenario.

We then build in some common problems and issues raised by traders during the interview, including:

1. The traders from BLNS countries have exceeded their deferment limit and have to pay VAT in South Africa and the imported country immediately. This occurs because traders do not have real time electronic payment facilities and have to wait until their payment is processed by the BLNS revenue authority.
2. The imports are grouped in distinct pellets and the VRA charges the same trader for 4 different border crossing (that is an additional charge of R750).

3. The traders have to send a company employee to obtain a customs stamp before submitting a postal VAT refund.
4. The possibility that 10 per cent of the claims of the traders are rejected.

This exercise demonstrates that inefficient processes can increase the net cost of VAT within SACU to well over 2 per cent of the transaction. It also serves to highlight how well the SARS-LRA agreement works within the context of cross border trade. Lesotho traders are unlikely to incur any of the additional costs experienced by Botswana, Namibia and Swaziland.

Cost	Botswana	Lesotho	Namibia	Swaziland
Interest costs with Deferment	4,864	3,611	7,564	5,161
Administrative Charges	250		250	250
<b>BASELINE</b>	<b>5,114</b>	<b>3,611</b>	<b>7,814</b>	<b>5,411</b>
Additional interest costs if no deferment	1,083		1,645	0
Additional administrative charges for groupage	750		750	750
Additional clearing and documentation costs	726		726	726
Loss from rejected VRA claim	10,000		15,000	14,000
<b>WORST CASE</b>				
<b>Total Cost</b>	<b>17,673</b>	<b>3,611</b>	<b>25,935</b>	<b>20,887</b>
% of value of import	1.8%	0.4%	2.6%	2.1%

**Table 10 A worst-case scenario.**

## 5.2. Botswana

During interviews in Botswana, traders noted that they receive their refunds from the VRA in Pula and that the exchange rate is not indicated anywhere on their VAT 255 form. Although Section 1.5 of the Export Incentive Scheme provides specifically for the Botswana refunds to be done in the currency of that country, it does not specify the date at which the conversion should be done nor the type of exchange rates used (i.e. spot, interbank or daily average). Similarly, no explanation is given by SARS for the rates that it publishes daily on its own website. This practice gives rise to unnecessary uncertainty and exchange rate risk.

Botswana has no exchange controls and traders are permitted to hold rand accounts at a domestic bank of their choice. One possible solution to this problem would be to refund Botswana traders in the same way as the rest of the world is refunded unless there is an identifiable risk of fraud or exchange control issues from the South African side.

## 5.3. Namibia

### *VAT on imports of services*

South Africa is a net exporter of services to Namibia. Some of these services fall within the exempted supply category. This means that since the service is imported in order to

produce a non taxable supply, the importer should be liable for VAT. For example, a private educational institution operating in Namibia imports the services of a South African lecturer to carry out classes for a week. Education is an exempt supply according to the Namibian VAT legislation and the South African lecturer zero rates his invoice. The onus though is on the Namibian educational institution to pay the VAT on this service using the reverse charge method. This is generally not done and substantial VAT revenue may be lost as a result.

#### *Fraudulent declarations at the border*

The Namibian authorities have noted that there have been cases of fraudulent declarations at the border. Traders attempt to escape the payment of the 15 per cent in VAT or alternatively to avoid the payment of VAT on goods that are zero rated in South Africa but not in Namibia. Traders will usually submit the correct invoices to the SA side and claim their VAT refund but then under-declare the value of their goods by producing false invoices on the Namibian side. This happens because of the inadequate cooperation related to the exchange of customs and trade information between the countries.

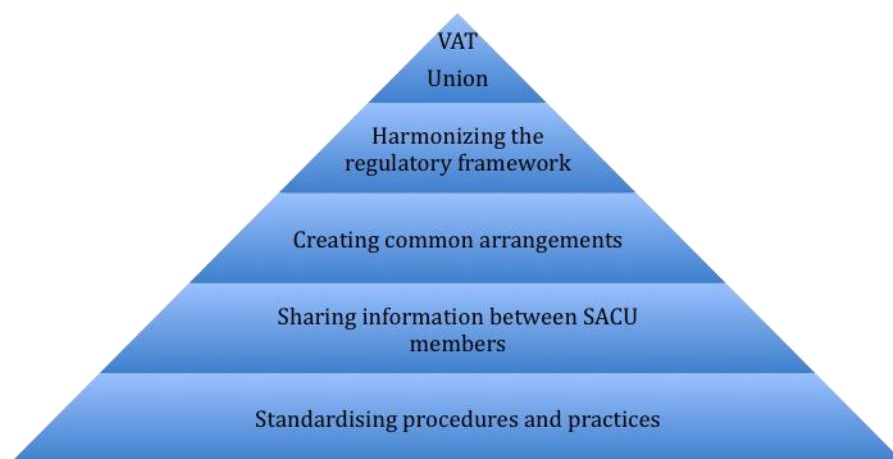
### **5.4. Lesotho**

The bilateral agreement between South Africa and Lesotho has eliminated a number of problems arising from administering VAT within a cross border trader environment. One of the few remaining issues is that of smuggling in zero rated supplies from South Africa into Lesotho. This problem arises as the zero rated lists are different between countries in SACU. It might not be practical to harmonise lists, as the zero rated lists reflect a country's basic foodstuff preferences, which in turn are dictated by cultural, political and economic factors.

## **6. RECOMMENDATIONS**

The importance of VAT as a source of revenue in SACU member countries is expected to grow as the BLNS countries attempt to reduce their reliance on customs and excise duties. Harmonising VAT regimes across SACU, will improve the efficiency of tax collection as well as facilitate cross border trade.

The pyramid below illustrates the key stages of maturity in the VAT harmonisation process. The extent to which the SACU VAT regime can be fully harmonised and a VAT union achieved will depend largely on member country's political commitment to deeper regional integration. It would also require the establishment of new laws and institutions. This is unlikely to transpire in the short or even medium term. However, there are a number of immediate steps towards greater VAT efficiency and harmonisation that can be taken with relative ease. For this reason, our recommendations focus on the first three steps of the triangle.



**Figure 4 Stages of maturity in the harmonisation process**

Steps one and two involve strengthening existing in country-capacities and improving cooperation and coordination within SACU member countries. SACU has made partial progress towards the achievement of these foundation levels.

Level three involves creating common institutional and systemic arrangements to improve the effectiveness of VAT in cross border transactions and address the structural shortcomings within the current system. The existing agreement between the LRA and SARS is a good example of this form of cooperation.

Harmonising the regulatory framework requires much deeper political commitment. At this stage, SACU member states could decide on common VAT legislation and implementation strategies. The final stage involves moving towards a VAT union where place of supply rules apply.

*Recommendation 1: Standardising procedures and practices*

Many of the problems and complaints identified within SACU stem from inconsistent border processes. Although, a discussion of problems related to the border processing within SACU are beyond the scope of this paper, there are numerous ways of improving the efficiency of VAT administration at borders.

A first step would be to standardise the processes at the border relating to the identified 'grey areas'. This includes temporary imports/exports, second hand cars, empty container returns etc. In order to achieve this, better coordination between the inland revenue and customs departments of the various revenue authorities is needed. Common practice notes and regulations can be issued to provide guidance on these issues by revenue authorities in respective countries.

*Recommendation 2: Sharing information*

The improved sharing of information between SACU member states can help to reduce round tripping and fraud and also improve the efficiency of cross border procedures. Within SACU, there are already structures designed to review issues related to border and customs processes. There does however seem to be insufficient consultation and information sharing on VAT issues. This paper recommends that VAT Harmonisation be placed as a key agenda item at the relevant SACU forum. Possible area for discussion could include trade data, the treatment and identification of zero rated goods, and the possible development of a VAT information exchange system within SACU – where customs officials could verify the VAT numbers and the tax clearance status of registered VAT vendors.

### *Recommendation 3: Creating common arrangements*

Based on the success of the bilateral agreement between South Africa and Lesotho, this paper suggests the adoption of a SACU-wide multilateral agreement that allows for a common VRA to perform front office functions across all SACU borders while back office functions remain with the relevant revenue authorities. There are numerous advantages for SACU members emanating from this arrangement, including:

- Improving the amount of VAT collected. Lesotho reported a substantive increase in VAT revenues on imports following the implementation of the agreement.
- Preventing of round tripping and cross border fraud.
- Reducing congestion at border posts by reducing the time required to deal with VAT issues.
- Aligning VAT to the concept of a 'one stop' border post.
- Neutralising the distinction between direct and indirect exports.

Although the harmonisation of rates would simplify the task of a SACU VRA, this is not necessary for the arrangement to work. Differences in rates could be accounted for at the border – maintaining some of the administrative burden of dual regimes but greatly reducing the financing cost and the incentive for fraud.

The establishment of a SACU-wide VRA would however require extensive cooperation between SACU member countries. There would also need to be some agreement on the funding of the arrangement. The new entity could be based on the existing LRA-SARS model. We think that an independent SACU-wide VRA might have the following advantages:

- The front office functions of the VRA will be run by an (or potentially more than one) independent, private sector operator. All revenue authorities can thus negotiate and enter into separate contracts with the VRA.
- The bulk administration fees paid to the VRA by the revenue authorities will be lower than those paid by individual traders.
- The VRA will be able to report regularly on the VAT collected on imports, improving the ability of revenue authorities to monitor this critical source of revenue.
- A SACU-wide VRA is likely to increase the revenue from VAT on imports for Botswana, Namibia and Lesotho by improving efficiencies in revenue collections.
- A SACU-wide VRA will reduce congestion and delays at borders.

It will however be important to ensure that any fees charged by the VRA are sufficient to incentivise it to do its job, efficiently and correctly, but not too burdensome for traders.

Table 11 shows how a VRA might work within SACU under two possible scenarios: trade originating from South Africa; and trade destined for South Africa.

Country	Trade originating from South Africa	Trade destined for South Africa
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Botswana	<b>VAT registered vendors</b>  In the case of a VAT registered Vendor in Botswana, the claim will be submitted to the SACU VRA. The VRA will process the claim. Once the claims are approved by SARS, the VRA will pay it over to the BURS against the VAT account number of the trader. The BURS will credit the 4% difference in VAT to the account of the registered vendor	<b>VAT registered vendors</b>  Exports from Botswana are zero rated and hence no claims will be submitted to the VRA
	<b>Non registered vendors</b>  Non-registered vendors (Botswana Residents) will submit their claim to the VRA. The VRA will then process the claim. Once the claim is approved by SARS, the VRA will pay it over to the BURS, including the details of the taxpayer. The BURS will issue an EFT or cheque to the taxpayer refunding the difference of 4 %.	<b>Non registered vendors</b>  A non-registered vendor will submit their claim to the VRA. The VRA will collect the claim and the difference of 4%. It will process the claim and submit to the BURS. Once the BURS approves the claim, the VRA will collate the payment and transfer it to SARS. If the BURS do not approve the claim, the 4% difference is paid back to the BURS and the reason for the rejection is forwarded to SARS.
Namibia	<b>VAT registered vendors</b>  In the case of a VAT registered vendor in Namibia, the claim will be submitted to the SACU VRA. The VRA will process the claim. Once the claims are approved by SARS, the VRA will pay it over to the Namibian MoF against the VAT account number of the trader. The Namibian MOF will debit the 1% difference in VAT to the account of the registered vendor.	<b>VAT registered vendors</b>  Exports from Namibia are zero rated and hence no claims will be submitted to the VRA.
	<b>Non registered vendors</b>  Non-registered vendors (Namibian Residents) will submit their claim to the VRA along with the difference of 1%. The VRA will process the claim and	<b>Non registered vendors</b>  A non-registered vendor will submit his claim to the VRA. The VRA will collect the claim, process it and forward details of the taxpayer to the Namibian

	submit to SARS. Once the claim is approved by SARS the VRA will pay it over to the Namibian MOF, including the details of the taxpayer.	MoF. Once the Namibian MOF approves the claim, it will pay the VRA the 14 % of VAT, which will be, transferred to SARS. The MoF will pay the remaining 1% back to the taxpayer.
Swaziland	As Swaziland operates a GST system with a similar rate to that of South Africa, the trader simply submits the invoice to the VRA. The VRA processes the claim and submits it to SARS. Upon approval, the VRA pays the Ministry of Finance in Swaziland.	Swaziland zero rates all its exports. Moreover, there is no GST refund on goods purchased by tourists and exported from Swaziland.

**Table 11 How a SACU Wide VRA might work**

## 7. CONCLUSION

The objective of this research paper was to investigate the impediments to cross border trade emanating from the differing VAT/GST regimes in place. The research found that the working capital and administrative requirements of cross-border taxation are generally low, but could potentially rise to around 2% of total trade. Given the fact that almost all imports into the BLNS pass through South Africa; the absolute value of this additional 'tax' might be very high.

The largest component of this cost is explained by delays in VAT refunds – generally from South Africa – and delays in processing input tax claims by the relevant revenue authorities in the BLNS. Because only South Africa differentiates between direct and indirect trade, most of this cost is borne by BLNS importers. Weak or inconsistent administration at some border posts further adds to the compliance cost associated with VAT.

Although this paper recognises that closer VAT harmonisation is linked to political goals, it adopts a progressive approach toward achieving this. Reducing costs associated with cross border trade can be done through standardising processes, improving coordination between SACU member states and creating common arrangements. The fact that this has already been achieved between South Africa and Lesotho, with the desired effect, only serves to confirm that this can and should be done across all of SACU. The region-wide efficiency gains from a common and single SACU VAT refund administrator could be substantial.



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## List of forms

SAD 500 – Single Administration Document

SAD 502 – Single Administration Document: Cross Border Trade

VAT 215 – Declaration in respect of ‘imported services’

VAT 263 – Surety for the payment of VAT

VAT 264 – Declaration in respect of the acquisition of second hand goods

LRA VAT refund forms

## Annexure One

### List of interviewees

#### Botswana

Name	Designation	Organisation/Company
Mr. Segolo Lekau	Commissioner for internal revenue	Botswana unified revenue service
Mr. Koane Molapo	General Manager income tax and VAT	Botswana unified revenue service
Miss. Boutle Lesedi	Revenue Manager: Technical Services	Botswana unified revenue service
Mr. Brian Mosenene	Export promotion manager	Botswana Export Development and Investment Agency
Mr. Norman Moleele	Deputy Executive Director	Botswana Confederation of Commerce, Industry and Manpower
Mr. A Rosenkhan	Director	Impex Fasteners and Tools
Mr. Reuben R. Tsatsi	Director	Massyn Moves
Mr. David Ditsebe	Director	T.Z Freight services
Mr. Peter Mabeo	Director	Mabeo Furniture
Mr. Hugo Ross	Director	Pie City

#### Lesotho

Mr. Charles Jenkins	Commissioner General Lesotho	Lesotho Revenue Authority
Mr. Retselisitsoe Motsoeneng	Director: Performance Analysis	Lesotho Revenue Authority
Mr. Thabo Moleko Mr. Mamawala Pitso Miss. Makhehleng Tsosane Mr. Phillip Lebia Mr. Samonyane Ntsekele Mrs. Mannana Sethobane	Various Roles	Lesotho Revenue Authority
Mrs. Joyce Johnson	Director	Meta Cash – Maseru

Mr. Micheal Brown	Financial Director	Lesotho Breweries
Mr. E. Qhashele	Financial Accountant	Lesotho Breweries

**Namibia**

Mr. I Murangi	Chief Customs and Excise Officer	Ministry of Finance – Namibia
Mr. Victor Kamtuka	Senior Officer: Customs and Excise	Ministry of Finance Namibia
Ms. Nadine Du Preez	Inland Revenue Officer	Ministry of Finance Namibia
	Director and Clearing Team	Etosha Transport
	Director	BJ Couriers CC

**Swaziland**

Name	Designation	Company/organisation
Miss Zodwa Mabuza	CEO	The Federation of Swaziland Employees and Chamber of Commerce
Mr. Muzikayise Dube	Director	The Federation of Swaziland Employees and Chamber of Commerce
Mr. Veli Dlamini	Director	Interfreight (Pty) Ltd
Mrs. Delories Littler	Managing Director	All Stationary Shop
Mr. Robert Atwell	Financial Manager	Fashion International (Pty) Ltd
Miss Thabsile Sukati Mrs Olga Kitson Mr. Prius Dlamini Vusumuzi Mkhonta	Various roles	Spintex Textile Manufacturers (Pty) Ltd

**South Africa**

Name	Designation	Company/Organisation
Mr. Mohammed Desai	Inland Revenue - Audit	South African Revenue Services
Mr. Russell Allison	Customs	South African Revenue Services

Mr. Ian Anderson	Senior Manager	South African Revenue Services
Mr. Peter Franck	Independent Consultant	Peter Franck Cc.
Mr. Gerard Soverrall	Tax Director	Pricewaterhouse Coopers
Mike Goch	Managing Director	VAT refund administrator
Christopher Richards	Executive Officer	South African Association of Freight Forwarders