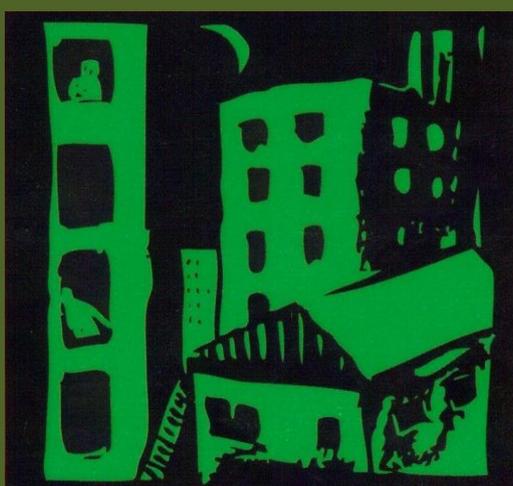


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**Between tax  
competition and tax  
harmonisation:  
Coordination of  
value added taxes in  
SADC member  
states\***

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**1 INTRODUCTION**

Regional integration is becoming a key feature of economic development and economic integration for developing countries in the global economy. Regional integration is important for countries with smaller economies to gain access to some of the benefits of more open policies: access to a larger market and hence opportunities for economies of scale, access to greater competition and hence opportunities for improving efficiency, and access to foreign capital and technology.<sup>1</sup>

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<sup>1</sup> Jenkins C, Leape J & Thomas L "Gaining from Trade in Southern Africa" in Jenkins C, Leape L & Thomas L (eds) *Gaining from Trade in Southern Africa: Complementary Policies to Underpin the SADC Free Trade Area* Great Britain: Macmillan Press Ltd (2000) at 9.

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In the southern part of Africa, the Southern African Development Community (SADC)<sup>2</sup> is playing an increasingly important role in the social and economic development of the people and the ongoing African economic integration process. For SADC to achieve effective economic integration, it has become imperative for the organisation to engage in an exhaustive process of identifying strategies which can contribute towards harmonisation of economic and business laws in a broader context within the community. Therefore, in this sense taxation is central to the current economic development agenda of SADC.

This paper examines strategies which can be adopted for achieving regional integration through the harmonisation of tax laws in Southern Africa, particularly value added tax (vat) laws. The research looks into the extent to which coordination of vat<sup>3</sup> policies in SADC member states can be used as one of the tools towards economic integration and development. This paper argues that tax harmonisation<sup>4</sup> is instrumental to economic integration.<sup>5</sup> Tax harmonisation is important in a regional grouping of states in the form of a customs union or a common market so far as it aims at ensuring that equal conditions for competitors are not distorted by discriminatory tax systems.<sup>6</sup>

The paper critically discusses the issue of tax competition in the broader context and how it impacts on economic activities of member countries in a regional grouping and their full integration process. The paper argues for harmonisation of vat policies to deal with the challenges of tax competition particularly in the context of SADC's economic integration. The paper argues that where vat policies of countries within an economic grouping (such as a customs union) are not harmonised, tax competition is likely to arise due to differences in the tax treatment of goods and services in these countries. As a result consumers are likely to bring goods from another member country where either such goods are zero rated or the rate of tax is lower than in their own country. Similarly, investors (who are exporters) as well are likely to invest in a country for example, where the procedures of vat refunds are simpler and refunds are dealt with efficiently. This scenario raises issues of tax competition and problematic tax practices which discourage investment and contributes to the problem of cross border shopping in member countries.

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<sup>2</sup> Hereinafter referred to as SADC. SADC is a regional organisation which is composed of 15 member countries which are:- Angola, Botswana, Democratic Republic of Congo Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. SADC was initially established in 1980 as SADCC (Southern African Development Coordination Conference) and it was transformed to SADC (Southern African Development Community) in 1992. For the historical background see <http://www.sadc.int> (accessed 10 May 2012).

<sup>3</sup> Vat is also called Goods and Services Tax (GST) in some jurisdictions such as Australia, Canada, New Zealand and South Asia.

<sup>4</sup> The terms tax harmonisation and tax coordination are used interchangeably in this research paper.

<sup>5</sup> See Velayos F, Barreix A & Villela L "Regional Integration and Tax Harmonization: Issues and Recent Experiences" in Tanzi V, Barreix A & Villela L (eds) *Taxation and Latin American Integration* Wahington D.C.: Inter-American Development Bank (2008) at 82.

<sup>6</sup> Jenkins, Leape & Thomas (n 1 above) at 15.

Vat as a net turnover tax on all production stages avoids the so-called cascade<sup>7</sup> effects and is also neutral regarding national competition. Because the final consumption price easily and clearly expresses the whole effective tax burden, the vat makes the border equalisation easy and controllable and is especially suitable for the promotion of trade within an economic union.<sup>8</sup> Deeper integration which SADC wants to achieve, means increased exposure to the consequences of the removal of barriers to trade and factor movements.<sup>9</sup>

Section 1 lays out a broad outline of issues which are dealt with in this paper. Section 2 deals with issues which are raised by tax competition and the relevance of tax harmonisation in that context. Section 3 examines the existing legal framework which underpins regional integration and economic integration in SADC. The section also discusses the Memorandum of Taxation which has been adopted by SADC member states as the basis for tax harmonisation. Section 4 looks at the status of vat implementation and systems in SADC member states. Section 5 provides an analysis of how tax (vat) coordination can be approached in SADC and it also highlights some challenges towards vat coordination. Section 6 provides some recommendations of what should be done in SADC to engage in vat harmonisation and section 7 provides some concluding remarks.

## 2 ISSUES OF TAX HARMONISATION AND TAX COMPETITION

### 2.1 Tax harmonisation

When reference is made to tax harmonization,<sup>10</sup> the tax bases or even the tax rates of two jurisdictions are harmonised. Tax harmonisation would entail the following two most important steps: - (1) transparent tax bases and (2) a certain convergence in the tax rates.<sup>11</sup> Both measures simplify administration and cross border trade, alleviate border controls and reduce inefficient waiting times at the borders and diminish incentives for purely tax avoiding cross border shopping activities.<sup>12</sup> The most important reason is that by harmonising to an agreed regional standard, countries give up the ability to structure their tax system to their own individual preferences.<sup>13</sup> The tax systems are structured in accordance with the policies agreed upon at the regional level. This will ensure uniformity to a certain extent and eliminate any aspects of tax

<sup>7</sup> Levying tax on products which already bear tax from the previous stages of production. See Leape J "Taxation and fiscal adjustment" in Jenkins C, Leape J & Thomas L (eds) *Gaining from Trade in Southern Africa: Complementary Policies to Underpin the SADC Free Trade Area* Great Britain: Macmillan Press Ltd (2000) at 79.

<sup>8</sup> Petersen H "Tax Systems and Tax Harmonisation in the East African Community" (2009), available at <http://www.eacgermany.org/index.php/eac-giz.../tax-harmonisation> (accessed 3 May 2011) at 23.

<sup>9</sup> The Regional Indicative Strategic Development Plan of 2003 (RISP of 2003) which SADC adopted outlines the integration plan which the organisation wishes to achieve.

<sup>10</sup> This can also apply to the concept of tax coordination.

<sup>11</sup> Petersen (n 8 above) at 29.

<sup>12</sup> Ibid.

<sup>13</sup> See Leape (n 7 above) at 83.

competition practices which are caused by different tax policies and systems. However, on the other hand, it is noted that countries are likely to be reluctant to agree to uniform taxation in areas where their economies differ.<sup>14</sup>

Strengthening and modernising the national tax authorities is a prerequisite for a successful harmonisation strategy of vat in SADC.<sup>15</sup> In this area seven of the fifteen SADC member states<sup>16</sup> have established semi-autonomous revenue authorities to administer taxes.<sup>17</sup> Where revenue authorities are not in place yet, taxes are administered by departments of the Ministry of Finance and the tax officials are civil servants.

The vat<sup>18</sup> system is known for its broad base with value being added in each production stage while the businesses can be able to recover their input against tax paid on outputs. The most attractive feature of vat is the fact that it is a multi-stage tax which ensures that tax is charged at all stages of production<sup>19</sup> with the provision of some mechanism enabling business entities to offset the tax they have paid on their own purchases of goods and services against the tax they charge on their sales of goods and services.<sup>20</sup> This mechanism entitles the business entities to recover their input tax which they have incurred previously against the output tax which is finally charged on the item.<sup>21</sup> This means that vat can be reclaimed in the next link in the trading chain until the final consumer is reached.<sup>22</sup> This mechanism of vat ensures that there is equal treatment of all goods across the board and this eliminates the existence of tax competition in favour of certain type of goods over others.

Harmonising can also extend to the procedures for the input tax deduction within a community of states in the context of SADC.<sup>23</sup> This would ensure that the member countries have harmonised and consolidated procedures and guidelines relating to input tax deduction and treatment of refunds to exporters.

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<sup>14</sup>Ibid.

<sup>15</sup> Petersen (n 8 above) at 98.

<sup>16</sup> These are Botswana (2010), Lesotho (2001), Malawi (1999), South Africa (1997), Tanzania (1996), Zambia (1993) and Zimbabwe (2001).

<sup>17</sup> See Leape (n 7 above) at 73.

<sup>18</sup> Some other countries choose to call a VAT by some other name, such as a general sales tax or a goods and services tax. However, the different names do not have any economic importance per se. See Bird RM & Gendron PP *The VAT in Developing and Transitional Countries* Cambridge University Press: New York (2007) at 10.

<sup>19</sup> See Terra B *Sales Taxation: The Case of Value Added Tax in the European Community* Norwell: Kluwer Law and Taxation Publishers (1988) at 5-6.

<sup>20</sup> Ibid. See also Ebrill L, Keen M, Bodin JP & Summers V *The Modern VAT* Washington D.C.: International Monetary Fund (2001) at 1-4.

<sup>21</sup> Petersen (n 8 above) at 23.

<sup>22</sup> Owens J "The Move to VAT" (1996) 2 *Intertax* 45-52. See also Krever R "Designing and Drafting VAT Laws for Africa" in Krever R (ed) *VAT in Africa* South Africa: Pretoria University Law Press (2008) at 10-11.

<sup>23</sup> Petersen (n 8 above) at 97.

## 2.2 Tax competition

The question which undermines the issue of tax competition in developing countries is to what extent should “market forces” be allowed to influence the levels of taxation in different countries?<sup>24</sup> A country that reduces tax rates to attract foreign producers (or consumers) fails to take into account the cost of its actions – in terms of lost revenue – to the original destination or home countries.<sup>25</sup>

Tax competition can be defined as a governmental strategy of attracting capital and high value human resources by minimising the overall taxation level.<sup>26</sup> By tax competition, sovereign countries lower their tax rates on income earned by foreigners within their borders, so as to attract direct investment from such parties.<sup>27</sup> It is argued that tax competition becomes a problem when governments attempt to attract investors or consumers through lower tax rates and this result in low levels of revenues.<sup>28</sup>

Tax competition therefore threatens to undermine the various types of taxes that remain major sources of revenue such as income taxes and consumption taxes for states.<sup>29</sup> This means that tax competition threatens indirect taxes such as vat and threatens its efficiency and administration. Countries can use the various vat rates as a way to attract foreign investors, for example, by treating various goods and services as zero-rated to ensure that the investor effectively does not pay any vat, but is able to claim his input tax credits from the revenue administrators. In effect tax competition results in trade distortions between a community of states in a customs union and this tends to undermine the objectives of a free trade area. The different treatment of goods and services and the different vat rates across borders create distortions that in turn induce spill-overs or externalities such as cross border shopping.<sup>30</sup> In such cases, there is a potential for business entities and consumers to purchase their goods from a country which has low tax rates. This means, for example, that if countries in an economic grouping tax transactions within the member states under the origin principle, all the tax which is chargeable accrues to the country where the goods are produced or purchased.

The problem of cross border shopping has proved to be true in some member countries within SADC particularly in the case of Lesotho and South Africa where there is increased cross border shopping due to different vat rates which apply to some

<sup>24</sup> Leape (n 7 above) at 86.

<sup>25</sup> Ibid.

<sup>26</sup> Vondra K “Between Tax Competition and Harmonisation: A Survey on Tax Coordination” (2006) Discussion Paper Nr.18, available at <http://ssrn.com/abstract=1138639> (accessed 13 January 2011) at 3.

<sup>27</sup> See Avi-Yohan R S “Globalization and Tax Competition: Implications for Developing Countries” in Tanzi V, Barreix A & Villela L (eds) *Taxation and Latin American Integration* Washington D.C.: Inter-American Development Bank (2008) at 173.

<sup>28</sup> Vondra (n 26 above) at 4.

<sup>29</sup> Avi-Yohan (n 27 above) at 173.

<sup>30</sup> Robinson Z “An Overview of Commodity Tax Reform in Southern Africa” (2004) 7 *South African Journal of Economic and Management Sciences* 387-426. In the context of studies of cross-border shopping in the European Union, see Bygura S “The road to the Single European Market as seen through the Danish retail trade: Cross-border shopping between Denmark and Germany” (1998) 8 *The International Review of Retail, Distribution and Consumer Research* 147-164 at 148.

goods.<sup>31</sup> For example, though the standard rate of vat in Lesotho and South Africa is 14 per cent,<sup>32</sup> there are differences in zero-rated items. For example, some items such as rice, cooking oil, fruits and vegetables are zero-rated in South Africa while they are taxed at the standard vat rate in Lesotho.<sup>33</sup> The different treatment of these basic goods does lead to consumers bringing such items from South Africa as opposed to buying them in Lesotho.

### 2.2.1 *What can be done about tax competition?*

It is clear from various studies that the tax competition problem, therefore, is essentially a problem of coordination and trust. Each jurisdiction would prefer to tax investors from abroad to gain the revenue, but it fears that doing so would drive the investors to other jurisdictions that do not tax them.<sup>34</sup> If there were a way to coordinate actions among the relevant jurisdictions, they all could gain added revenues without running the risk of losing the investment.

The inefficiencies which are caused by tax competition create opportunities for cooperation or tax coordination, which can include policies such as tax rate harmonisation and minimum tax rates.<sup>35</sup> On the other hand, where tax competition takes place within a community of states (in a regional grouping), the consequences thereof can be harmful to intra-regional trade and investment by third parties. It is therefore argued that harmonisation of vat policies at a regional level such as SADC, can be beneficial for member states to ensure that the problem of tax competition does not affect their trading relations. The purpose of coordination as well in trying to curb tax competition within a community of states is to limit the ability of member countries to improve their individual positions at the expense of their regional partners via taxation.<sup>36</sup> It is therefore clear that, “[T]he differentiations within the tax base and the rate systems then cause the need within common markets and economic unions to coordinate the vat system so that just acceptable differentiations remain, which do not impair the fair rules of systems’ competition.”<sup>37</sup>

## **3 STRATEGIES TOWARDS REGIONAL INTEGRATION IN SADC**

The SADC institutional and legal framework is enshrined in a treaty and a wide range of protocols, memoranda of understanding, charters, declarations, regulations and guidelines. Apart from these fundamental instruments, SADC has also adopted three

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<sup>31</sup> The issue of different vat rates is not the only factor which contributes to cross border shopping between Lesotho and South Africa. There are other factors which are not necessarily tax related.

<sup>32</sup> 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) and the South African Value-Added Tax Act 89 of 1991, Section 7 (1)

<sup>33</sup> South African Value-Added Tax Act 89 of 1991 Schedule 2 Part B, Section 11 (1) (j).

<sup>34</sup> Avi-Yohan (n 27 above) at 183-184.

<sup>35</sup> See Kanbur R & Keen M “Tax Competition and Tax Coordination When Countries Differ in Size” (1991) Working Papers: the World Bank.

<sup>36</sup> Leape (n 7 above) at 86.

<sup>37</sup> Petersen (n 8 above) at 34.

major strategic documents, which are: - the Regional Indicative Strategic Development Plan (RISDP), the blueprint for development, and the Strategic Indicative Plan for the Organ on Politics, Defence and Security Cooperation (SIPO).<sup>38</sup> This legal framework acts as the basis for harmonisation of different trade laws of SADC member countries.

SADC has laid out its plan to achieve full regional integration and harmonisation of trade laws (and other related laws thereof). This plan was to begin with the creation of a Free Trade Area (FTA)<sup>39</sup> in 2008 which was planned to be followed by a Customs Union in 2010,<sup>40</sup> a Common Market in 2015, a Monetary Union in 2016 and a single currency in 2018.<sup>41</sup> However, this integration plan and agenda was regarded as unrealistic by the private sector which preferred that SADC should not introduce a Customs Union until the FTA has been fully and successfully implemented.<sup>42</sup>

The different stages of economic integration and tax coordination as laid out in SADC's plan indicate the extent of integration between member countries and also have different consequences.<sup>43</sup> The agreement by SADC member states to move towards a customs union (and a common market); and to gain the full benefit of freer trade within the region will increase pressure to relax internal border controls on trade between member states.<sup>44</sup> The consequence of this move requires examination of all the relevant components to free trade such as taxation policies and laws; and other business and economic laws. This provides SADC with a major agenda in the years to come.

In practice the issues of taxation are no longer confined to national territories and jurisdiction only as significant changes to the economic environment in recent years have brought international tax issues to the forefront. Globalisation has increased world trade and increased the mobility of capital and labour.<sup>45</sup> The cross border trade of services through the use of e-commerce has also brought new challenges to taxation of cross border transactions.<sup>46</sup> These changes have highlighted weaknesses in the current tax systems of member states and to the potential weaknesses of the free trade area. In

<sup>38</sup> [http://www.tralac.org/cgi-bin/giga.cgi?cmd=cause\\_dir\\_news\\_item&news\\_id=45318&cause\\_id=1694](http://www.tralac.org/cgi-bin/giga.cgi?cmd=cause_dir_news_item&news_id=45318&cause_id=1694) and <http://www.sadc.int/> (accessed 10 February 2011).

<sup>39</sup> Hereinafter referred to as FTA. An FTA is where member countries agree to eliminate tariffs, quotas and preferences on most goods and services which are traded between them. Implementation of the SADC FTA began in 2000 following the signing of the SADC Trade Protocol in 1996. See <http://www.sadc.int> (accessed on 25 May 2012).

<sup>40</sup> In 2009 SADC agreed to postpone the 2010 target for establishing a customs union and rather focus on the implementation of the FTA.

<sup>41</sup> The Regional Indicative Strategic Development Plan of 2003 (RISP of 2003). The RISDP on the other hand stems from the objective of regional integration that the treaty seeks to achieve. As a result the RISDP seeks, among others, to remove barriers that prevent economic relationships between countries in the Region and to harmonise the regulatory and legal environments across Member States.

<sup>42</sup> Saurombe A "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.

<sup>43</sup> This discussion only deals with stages of economic integration in the context of SADC as detailed out in the Plan.

<sup>44</sup> Glenday G "Assessment of the Current State of VAT Implementation in SADC Member States" (2004) A report prepared for the SADC Trade, Industry, Finance and Investment (TIFI) Directorate at 10.

<sup>45</sup> Zee H "World Trends in Tax Policy: An Economic Perspective" (2004) 32 *INTERTAX* 352-364 at 352.

<sup>46</sup> See Ebrill et al (n 20 above) at 178.

an international context, there is a fundamental question over where taxation should take place, for example, in the country in which consumption takes place (the destination principle) or in the country of production (the origin principle).<sup>47</sup> In view of these challenges, the case for tax coordination and harmonisation in member countries in a regional grouping has been strengthened.

“It is argued that tax coordination like tax policy, should proceed from the assumption that the market achieves optimal allocation of resources. Accordingly, the tax systems of member countries of a customs union or a common market should also be designed and coordinated that they interfere as little as possible with this premise.”<sup>48</sup>

In order to eliminate tax competition in an integrated system of either a customs union or a common market, the member countries should not be allowed to tax goods, services, labour and capital from other countries more heavily than their own goods, services, labour or capital.<sup>49</sup> The argument is that there should be no discrimination of treatment of goods and services within the member countries in order to eliminate tax competition within a regional group of states. The reason behind this argument is that since member countries are governed by similar trade rules, they should also deal with any trade distortions which lead to tax competition in a coordinated and similar manner.

The SADC tax coordination and harmonisation agenda is reflected in the SADC Memorandum of Understanding on Cooperation in Taxation and Related Matters of 2002<sup>50</sup> (the Memorandum). The Memorandum in its Article 6 highlights the need for SADC member states to take explicit steps to achieve effective coordination and harmonisation in the administration of indirect taxes. In the areas of vat, member states will identify and explore areas of possible cooperation in the formulation of policy and the administration of vat and sales tax. Member states also undertake to take steps to harmonise their vat regimes and in particular; set minimum standard rates; harmonise the application of zero-rating and vat exemption of goods and services; and establish a SADC forum for collectively dealing with vat matters.

The Memorandum is relevant to SADC's policies and is intended to pursue the objectives set out in the SADC Treaty. The Memorandum can be regarded as the basis towards harmonisation of vat systems of member states in SADC. With the intention of SADC to become a customs union (and later a common market), this requires discriminatory border taxes to be abolished and the adoption of uniform and common tax systems, particularly a vat system. Therefore, the implementation of the Memorandum will be the first step towards achieving a harmonised vat system in SADC.

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<sup>47</sup> A detailed discussion of these principles appears in section 5 of this paper. For the discussion of these principles, see Cnossen S “Global Trends and Issues in Value Added Taxation” (1998) 5 *International Tax and Public Finance* 399-428 at 411.

<sup>48</sup> Cnossen S “Coordination of Indirect Taxes in the Southern African Development Community (SADC): Lessons from European Experience” (2011) 61 *Tax notes international* 943-949 at 944.

<sup>49</sup> See Cnossen (n 47 above) at 5.

<sup>50</sup> Hereinafter referred to as the Memorandum. This memorandum was signed in August 2002. See <http://www.sadc.int/index/> (accessed 20/10/2011).

It is therefore important for SADC member states to actually agree on a plan of how to implement this Memorandum.

The intention of SADC to harmonise vat regimes within the community is to ensure uniformity in the treatment of goods and services and to eliminate trade distortions between member states. Harmonisation of vat systems will also eliminate any trade competition between member states.

The areas of tax laws which need to be harmonised can be identified from the various legal instruments adopted by SADC. It is important that when developing a strategy for harmonisation of these laws, a realistic framework for the harmonisation process should be developed. This will require cooperation of member states and coordination of the processes at the national and regional level and involvement of all relevant sectors.

#### 4 VAT IN SADC MEMBER STATES

There has been incredible progress within SADC in regard to the implementation of vat. Of the fifteen (15) SADC member states, eleven (11) have introduced vat, three of these countries have done so since 2001.<sup>51</sup> Four other countries without vat<sup>52</sup> have alternative domestic indirect tax systems. Angola has a manufacturers' sales tax, Democratic Republic of Congo<sup>53</sup> has a turnover tax, Seychelles a manufacturers' sales tax and a services tax, while Swaziland has a manufacturers' sales tax.<sup>54</sup> It is clear that there is significant vat experience within the region, but many countries are still in the early stages of implementation. SADC member states are switching over to a destination-based vat credit system. The application of the destination principle<sup>55</sup> ensures that taxation takes place in the importing country where consumption will take place.

The other crucial aspect of a vat system is the issue of rates. Some writers<sup>56</sup> tend to support the use of a single vat rate as opposed to multiple rates, though in practice some countries do have more than one vat rate.<sup>57</sup> Within the SADC region vat rates tend to vary. Standard vat rates range from 12 per cent in Botswana<sup>58</sup> to 20 per cent in Madagascar. When vat was first introduced in Tanzania, the standard rate was 20 per

<sup>51</sup> These countries are Botswana which introduced vat in 2002; Lesotho where vat was introduced in 2003 and Zimbabwe which introduced vat in 2004. See Krever R (ed) *VAT in Africa* South Africa: Pretoria University Law Press (2008) at 3-4.

<sup>52</sup> These are Angola, Democratic Republic of Congo, Seychelles and Swaziland. Swaziland is in the process of introducing vat.

<sup>53</sup> Hereinafter referred to as Congo DR.

<sup>54</sup> See SADC Tax Database available at: <http://www.sadc.int/tifi/tax> (last accessed on 10 May 2012).

<sup>55</sup> A detailed discussion on the destination principle and its consequences appear in section 5 of this paper.

<sup>56</sup> See Ebrill et al (n 20 above) at 82.

<sup>57</sup> Some countries have a standard rate, reduced rate, zero rate and a higher rate on luxurious goods. For example, other African countries with a VAT have more than one vat rate. See Krever (n 22 above) at 3-4.

<sup>58</sup> Section 6 Value Added Tax Act, Chapter 50:03 2000 Act No 1 of 2001 of the Republic of Botswana.

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cent.<sup>59</sup> This rate was reduced to 18 percent in 2009. On the other hand, Mozambique introduced vat in 1999 with only a single positive rate of 17 per cent.<sup>60</sup> Table 1 below represents the various rates of vat in SADC member states and also indicates the dates when vat was introduced in the member states.

Table 1: VAT rates in SADC countries

Country	Date vat introduced	Current standard rate	Other rates
Botswana	July 2002	12	0
Lesotho	July 2003	14	5; 15
Madagascar	September 1994	20	-
Malawi	May 1989	16.5	-
Mauritius	September 1998	15	0
Mozambique	June 1999	17	-
Namibia	November 2000	15	0
South Africa	September 1991	14	0
Tanzania	July 1998	18	0
Zambia	July 1995	16	0
Zimbabwe	January 2004	15	0

Source: SADC Tax Database available at: <http://www.sadc.int/tifi/tax> (accessed on 10 May 2012) and the International Monetary Fund (IMF) VAT Database.

The table captures the tax rates of SADC member states with vat only. SADC member states without a vat have tax rates which range from 10 per cent in Angola to 14 per cent in Swaziland (Congo DR has 13 per cent and Seychelles 12 and 15 per cent).<sup>61</sup> As it is seen from the table, Lesotho has a reduced rate of 5 percent which applies to supplies of electricity and telephone calls while other countries have a zero per cent as their reduced rate.<sup>62</sup> Madagascar, Malawi and Mozambique do not have a reduced rate.<sup>63</sup> Lesotho further has a higher rate of 15 percent which applies to the import and/or supply of alcoholic beverages and tobacco. In this case, Lesotho uses vat to try to discourage the use of certain goods which are regarded as harmful for public use.

<sup>59</sup> Due J "Two New African Value Added Taxes - Tanzania and Mozambique" (1999) 10 *International VAT Monitor* 117-123 at 118. See also the United Republic of Tanzania Value Added Tax Act Chapter 148 of 2006, section 8.

<sup>60</sup> Ibid at 121.

<sup>61</sup> See SADC Tax Database available at: <http://www.sadc.int/tifi/tax> (accessed on 10 May 2012). Angola has a reduced rate of 2 per cent and higher rates of 20 and 30 per cent, while Congo DR has reduced rates of 3 and 6 per cent and a higher rate of 18 per cent.

<sup>62</sup> 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).

<sup>63</sup> See for example Malawi's Value Added Tax No.7 of 2005, sections 6 and 8. See also Mozambique's Value Added Tax Code of 2007.

The vat systems in SADC countries differ on which goods and items are taxed at standard rates,<sup>64</sup> most of these countries zero rate basic food products (Mauritius in particular zero rate sugar);<sup>65</sup> farm inputs and fuel (or kerosene); machinery; water; electricity; books; medicines; building materials; and telecommunications other than exports.<sup>66</sup> For those countries without a vat, Congo DR zero rate basic necessities<sup>67</sup> while Seychelles<sup>68</sup> zero rate electricity and soft drinks.<sup>69</sup> It is clear that SADC countries provide for various forms of zero rates whose effect is to erode the base of the tax system. It can be argued that some of the zero rates are not justifiable therefore, in order to broaden the base of vat in some of these countries with the aim to increase revenue, some of the zero rates will have to be reconsidered.

In most developing countries, multiple rates have been adopted in an effort to mitigate the regressivity<sup>70</sup> of vat. However, this approach has been criticised in the sense that, multiple rates tend to complicate the tax system and increase both administration costs and compliance costs on the part of taxpayers.<sup>71</sup> According to Leape, “the effectiveness of the indirect tax system can be further enhanced if governments currently using multiple tax rates under the general sales tax or VAT work, over time, towards a simplified two-rate structure (or even, where possible, a single uniform rate)”.<sup>72</sup> Furthermore, tax compliance is generally correlated with tax rates,<sup>73</sup> in the sense that when there are fewer and lower tax rates, compliance is likely to improve.

Apart from the provision of zero rated goods, SADC member states with a vat also make provision for exemptions.<sup>74</sup> Apart from the standard exemptions (of public transport, financial services, public sector activities and education services), SADC member states provide for the following exemptions: - medicines; water; low-income housing; fabrics; basic food products (such as rice, tea and coffee); electricity; farm

<sup>64</sup> See SADC Tax Database available at: <http://www.sadc.int/tifi/tax> (accessed on 10 May 2012).

<sup>65</sup> See also the United Republic of Tanzania Value Added Tax Act Chapter 148 of 2006 Section 9 (First Schedule).

<sup>66</sup> Cnossen (n 48 above) table 9.

<sup>67</sup> See <http://www.sadc.int/tifi/tax/chapter/2/country/drc> (accessed on 14 May 2012).

<sup>68</sup> See <http://www.sadc.int/tifi/tax/chapter/2/country/seychells> (accessed on 14 May 2012).

<sup>69</sup> Angola and Swaziland do not have a zero rate.

<sup>70</sup> The effect of a tax which falls more harshly on poorer people than the wealthy. See a detailed discussion on ‘regressivity’ in Krever (fn 22 above) 18-20. See also Fourie F C v N & Owen A “Value-Added Tax and Regressivity in South Africa” (1993) 61 *South African Journal of Economics* 308-319. See also Tait A A (ed) *Value-Added Tax: Administrative and Policy Issues* (1991) Occasional paper No. 88 International Monetary Fund at 5.

<sup>71</sup> See Ebrill *et al* (n 20 above) at 78.

<sup>72</sup> Leape (n 13 above) at 78.

<sup>73</sup> de Mooij & Keen M “Fiscal Devaluation and Fiscal Consolidation: The VAT in Troubled Times” IMF Working Paper WP/12/85 (2012) at 12, available at <http://www.imf.org/external/pubs/ft/wp/2012/wp1285.pdf> (accessed on 25 May 2012).

<sup>74</sup> The SADC member countries without a vat tend to zero rate basic necessities, electricity and soft drinks. They also exempt certain items such as farm products, handicrafts, transport, building materials, capital equipment and retail sales. According to Williams, “by definition, exempt supplies are not taxable supplies” – see Williams D “Value-Added Tax” in Thuronyi V *Tax Law Design and Drafting* Washington D.C.: International Monetary Fund (1998) 202.

products and inputs.<sup>75</sup> On the other hand, countries without vat exempt farm products; handicrafts; retail sales; print; transport; building materials and capital equipment.<sup>76</sup> The extent of the exemptions provided by SADC member states is questionable as it differs from international practice.<sup>77</sup>

The vat systems in SADC member states can be characterised as broad based to the extent that they tax both goods and services indiscriminately. According to Leape, “broad-based general consumption taxes are increasingly the backbone of tax systems world-wide, as they can be an effective, fair and buoyant source of revenue.”<sup>78</sup> However, the vat systems of most of the SADC states also tend to provide for too many unnecessary zero rated goods and exemptions whose effect results in a complex vat system with high administration and compliance costs. These zero ratings and exemptions increase the threats of tax fraud in member states and also tend to affect the neutrality of the tax.<sup>79</sup> These kinds of vat systems tend to leave most goods and services out of the tax net. In view of this, it is necessary for SADC member states to revisit their vat systems and particularly to re-examine the various exemptions and zero rates in order to ensure that they do not interfere with free trade.<sup>80</sup> It is argued that, “a ‘good’ vat should tax the broadest possible range of goods and services which are ultimately used by or benefit consumers.”<sup>81</sup>

## 5 APPROACHES TO COORDINATION OF VAT IN SADC

Coordination of vat in SADC member states is important in order to achieve the objectives of the Memorandum on Taxation. If member countries want to eliminate distortions resulting from tax competition and differences in tax policies within a customs union or a common market, they should not be allowed to use their internal indirect taxes such as vat to discriminate against products from other member countries.<sup>82</sup> In view of the intention to harmonise vat systems, this section highlights key areas and principles which are relevant for the treatment of cross border transactions within member states either in a customs union or a common market to achieve that purpose.

There is a need to determine how supplies of goods from one member state to the other will be treated, as well as supplies involving exports from member states to other countries (third countries which are outside the SADC community of states). It is therefore imperative to examine the principles of zero-rating and exemption which are relevant. Zero-rating applies where the rate of tax charged to sales is zero but credit is given to the supplier for taxes paid on inputs. This means the zero rated business entity

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<sup>75</sup> See Due (n 59 above) at 118 & 121.

<sup>76</sup> See Cnossen (n 48 above) at table 9.

<sup>77</sup> See section 5 below.

<sup>78</sup> Leape (n 13 above) at 78.

<sup>79</sup> See Tait (n 70 above) at 1.

<sup>80</sup> See Leape (n 7 above) at 78-79.

<sup>81</sup> Cnossen (n 47 above) at 403.

<sup>82</sup> Cnossen (n 48 above) at 15.

is entitled to a full refund of taxes paid on inputs. Therefore, this makes a zero rated business entity a part of the vat system.<sup>83</sup> In vat system designed to tax domestic consumption only, exports are zero rated<sup>84</sup> as well as other essential domestic products.<sup>85</sup> In the context of a customs union, exports from a community of states (in this case SADC) to third countries will be zero rated and also supplies of goods within the community (intra-SADC supplies) from one member state to a registered business<sup>86</sup> entity in another member state will be zero rated. This means that exporters will have to be refunded. The importance of paying refunds to exporters within a reasonable period is an important aspect of the vat system and this ensures that exporters do not incur any interest charges which will then affect the neutrality of the tax.

Zero-rating can be contrasted with exemption, which is provided for in most vat systems.<sup>87</sup> Exemption is a concept which applies where tax is not charged on outputs, but tax on inputs cannot be reclaimed.<sup>88</sup> The effect of exemption<sup>89</sup> is that it does not provide complete relief from tax in the sense that tax on intermediate transactions remains unrecovered therefore, the business entity that is making an exempt supply would have had to pay vat on the value of the supply or part of it. This means the business entity will have to pass some of the vat to the buyer as part of its price in a taxable supply. A business entity which is exempt from paying tax is not required to charge vat on its outputs. To the extent that exempt inputs are used in the production or distribution chain, this has the effect of turning vat into a cascade tax.<sup>90</sup> Exemption<sup>91</sup> tends to be applied to financial services, education services, agricultural activities and other public sector activities, for example, transportation services and quasi-governmental activities.<sup>92</sup> These sectors are regarded as difficult to tax on administrative grounds.<sup>93</sup>

In order to pave the way to a harmonised system of vat, SADC countries will have to review some of their exemptions which tend to have no basis and rather make the vat

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<sup>83</sup> Knatz T "Value Added Tax: Practice and Planning" (1970) *British Tax Review* 292. The rationale behind zero-rating is to avoid extending the scope of vat to include certain essential goods and services. In practice most countries zero-rate exports (including other international supplies) and allow zero-rating of domestic supplies of certain goods.

<sup>84</sup> This means that exports leave the country free of any domestic vat.

<sup>85</sup> See Section 4 on VAT in SADC member states.

<sup>86</sup> Vat requires that businesses above a certain threshold should be registered and this is regulated accordingly in each member country.

<sup>87</sup> Williams (n 74 above) at 202-203.

<sup>88</sup> Ebrill *et al* (n 20 above) at 90-91. See also Schenk A & Oldman O *Value Added Tax: A Comparative Approach* Cambridge: Cambridge University Press (2007) at 268.

<sup>89</sup> Exemptions tend to violate the basic logic of the vat, which is taxing output and crediting input tax and zero rating.

<sup>90</sup> Ogley A *Principles of Value Added Tax: A European Perspective* United Kingdom (1988) at 9. See also footnote 7 above.

<sup>91</sup> Ebrill *et al* (n 20 above) at 83-84. See also the European Community (EC) Sixth VAT Directive of 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – common system of value-added tax, available at <http://europa.eu> (accessed on 20 April, 2012).

<sup>92</sup> Exemption may also relate to the exclusion of small traders from the vat system through the use of a registration threshold (this means setting a registration threshold which will exclude small traders).

<sup>93</sup> Cnossen (n 47 above) at 405.

burden distribution regressive. This issue will need to be investigated and it can be proposed that some of the exemptions should be made subject to the standard vat rate to eliminate different treatment of some goods and services. Some of the exemptions also tend to compromise the destination principle for internationally traded goods in the sense that if an exporter uses exempted goods as inputs, that exporter's zero-rated exports will embody vat from earlier in the production chain and this in a way violates the idea of the vat.

Two inter-jurisdictional principles which are also relevant in the context of vat for the taxation of cross border transactions are: - the origin principle and the destination principle. The origin 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.<sup>94</sup> 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."<sup>95</sup> 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.

In contrast the destination 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 principle zero rates exports and imposes tax on imports, with the result that total tax paid in relation to a commodity is determined by the rate levied in, and revenue accruing to, the jurisdiction of its final sale. 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.<sup>96</sup> Exporters are therefore expected to declare their export values, so that they can be refunded their inputs on the goods. In most cases this does not create any problems since, "generally exporters have no incentives to under-declare their export values, and similarly importers have no incentives to overvalue their imports."<sup>97</sup> In this sense, it is argued that the destination principle favours the net-importing members whilst the origin principle benefits the net-exporters.<sup>98</sup> The destination-based vat therefore guarantees a greater degree of neutrality and uniformity.<sup>99</sup>

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<sup>94</sup> See Tuan Minh Le "Value Added Taxation: Mechanism, Design, and Policy Issues" (2003) *Paper prepared for the World Bank course on Practical Issues of Tax Policy in Developing Countries* Washington D.C., April 28-May 1 at 20.

<sup>95</sup> *Ibid.*

<sup>96</sup> Implementing the destination principle by zero-rating exports requires some mechanism for identifying the movements of goods and services across borders. Recent trends toward regional integration and the development of the Internet have complicated this. See Robinson (fn 28) 413.

<sup>97</sup> Cnossen (n 47 above) at 399-428.

<sup>98</sup> Petersen (n 8 above) at 22.

<sup>99</sup> Robinson (n 30 above) at 128.

Most countries in practice with a few exceptions, have adopted the destination principle with respect to the implementation of vat. For example, the European Union (EU)<sup>100</sup> member countries have adopted the destination principle under the transitional system<sup>101</sup> and other countries within SADC such as South Africa, Lesotho, Botswana Namibia and Zambia have also adopted the principle. The issues of cross-border taxation between member countries are important for the success of the harmonised system. Therefore, SADC will need to formulate rules on how to tax transactions between member states and transactions between member states and third countries.

## 6 CHALLENGES TOWARDS HARMONISATION OF VAT IN SADC

It is acknowledged that there are some underlying challenges towards harmonisation of vat in SADC member states which needs to be highlighted. The different levels of economic development in the member states do pose a challenge towards the move towards harmonisation. Since member states are at different levels of development, they have different institutions and approaches towards tax administration in their respective jurisdictions. It will therefore be a great challenge to try to harmonise such institutions or even to adopt similar models of administering taxes. In view of this, there will be a need for capacity building of tax institutions in some of the member states, which may not be the case in some other member states.

The other challenge relates to the fact that since SADC has not yet achieved any deeper economic integration in areas of trade and related aspects, the issue of tax harmonisation of vat may not be successful. The argument is that, for harmonisation of vat to succeed, there is need for SADC member states to achieve deeper economic integration in broader areas of free trade and other related areas which can impact on tax harmonisation.

Another area of concern relates to the political will of member states to engage in tax harmonisation. There is no doubt that it is extremely important for member states and their governments to fully support the move towards harmonisation. This involves resources, in the form of financial resources and skilled personnel to oversee the process of harmonisation. In this sense, for tax harmonisation to succeed, there is need for the member states to be committed and support this process in their different spheres.

The other challenge towards harmonisation of vat laws and the completion of the SADC customs union is the multiple (and overlapping) memberships of its member states to different regional trade areas.<sup>102</sup> SADC members belong to one or more of the existing regional trade areas within the African continent.<sup>103</sup> This issue has been

<sup>100</sup> Hereinafter referred to as EU.

<sup>101</sup> Ebrill *et al* (n 20 above) at 178. See also Easson AJ "Tax Harmonisation in the EEC: The Commission's Programme" (1981) *British Tax Review* at 329.

<sup>102</sup> Mozambique is the only country in SADC which does not belong to other regional trade areas.

<sup>103</sup> Some of SADC member states belong to the Southern African Customs Union (SACU – these are Botswana, Lesotho, Namibia, South Africa and Swaziland); others to the Common Market for Eastern and Southern Africa (COMESA – these are Congo DR, Madagascar, Malawi, Mauritius, Seychelles, Swaziland,

discussed extensively in different publications.<sup>104</sup> This is one of the issues which SADC needs to attend to in the near future to avoid any duplication of policies.

## 7 RECOMMENDATIONS

From the above discussion, it is clear that in order to deal with issues of tax competition which are likely to arise and those which already exist within SADC, harmonisation of vat policies is inevitable. Most SADC states with vat already have taxes extending through the retail stage.<sup>105</sup> This is an important aspect since these types of vat systems can already provide correct border tax adjustments within cross border transactions in member states.

In view of the arguments in this discussion, this paper makes the following recommendations and proposals to form part of the future debate and mechanisms in moving towards coordination of vat in SADC member states: - Firstly, it is proposed that universal adoption of vat in SADC should be the first issue to be dealt with, as it is a prerequisite for the formation of a customs union and a common market in terms of the organisation's plan. The SADC countries without vat can refer to the experiences of the other member states' with a vat.

Secondly, it is proposed that a collecting mechanism or an institution or a member state oversees the issue of tax administration for the whole group of states (whole community) to deal with revenue sharing and refunds. This will ensure that there exists a central office or institution whose main task is to ensure the efficiency of the vat system at the regional level and oversees the issue of collection of invoices, tax returns, refunds for exporters and other registered vat entities. This type of a collecting mechanism can also extend to the establishment of an inter-community equalisation system in order to guarantee a fair distribution of the vat.<sup>106</sup> This might be in the form of a regional fund or a common pool where all the revenue which is collected is administered and distributed amongst member states as agreed.

Thirdly, since member states still maintain their fiscal border controls, which means each country has established facilities and offices which oversee the administration and collection of vat internally; moves towards coordination of vat collection can utilise these facilities which already exist. This way there is no need to develop entirely new structures and this is important for saving costs from the perspective of member states.

Fourthly, at a later stage, it is recommended that SADC can consider abolishing economic border controls and shift the border tax adjustments of vat under a deferred

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Zambia and Zimbabwe); one other member, Tanzania belong to the East African Community (EAC) while one other member state Angola belong to the Economic Community of Central Africa States (ECCAS).

<sup>104</sup> For example, see Saurombe (n 42 above).

<sup>105</sup> The importance of having a vat that extends through to the retail stage is discussed by Cnossen (n 47 above) at 401-402. See also Robinson (n 30 above) at 405.

<sup>106</sup> For further reading see Robinson (n 30 above) at 413.

payment system.<sup>107</sup> The effect of this system is that importers are supposed to declare their imports, compute the vat that would be due and take credit for that vat, all in the same return. In this way, “the effect is that vat is collected on imports only when they are resold or incorporated in goods sold by the importing firm.”<sup>108</sup>

Lastly, in practice SADC is making reference to the EU model as its basis for further integration. Therefore there is a high likelihood that SADC will make reference to the EU vat system as its basis for vat harmonisation within its member states. The EU vat system does not form part of the discussions in this research paper. However, the EU vat system has been discussed in various publications.<sup>109</sup> The issue as to whether SADC is ever going to have its own unique model of vat harmonisation without imitating models from other regional organisations is one which needs to be addressed. Due to the different trading areas and patterns which exist in SADC, it can be argued that there is a possibility to develop a unique model of vat harmonisation within SADC which is influenced by the existing cross border transactions rather than to copy models of tax (vat) harmonisation from other regions.

## 8 CONCLUSION

It is acknowledged that developing countries such as SADC member states have to choose a tax system that promotes growth and development within the region and the economies of the member states. It is also noted that the purpose of tax harmonisation and coordination is to limit the ability of member countries to improve their positions at the expense of their regional partners through taxation. The objective of this paper is to highlight the importance of harmonising vat laws within SADC member states while addressing the issue of tax competition which exists between these countries. This paper also highlights the importance of regulating tax harmonisation and coordination through legislation and policies adopted at the regional level as it is the objective of SADC’s Memorandum on Taxation in this regard. This approach highlights the importance of adopting strategies to achieve the objective of harmonising and coordinating tax laws within SADC member states. The challenges which presently exist in SADC are also pointed out in order to pave the way for the task of harmonisation and coordination. However, it is argued that there are more positive aspects of harmonisation of vat systems which tend to outweigh the challenges.

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<sup>107</sup> The system involves deferring payment of vat until a later stage when all the invoices have been collected and checked internally by the relevant revenue department.

<sup>108</sup> Bird RM & Gendron PP “Dual VATs and Cross-Border Trade: Two Problems, One Solution?” (1997) International Centre for Tax Studies University of Toronto at 5.

<sup>109</sup> For example, Ebrill *et al* (n 20 above); Ogley (fn 90 above); Terra (n 19 above) Schenk & Oldman (n 88 above) Cnossen (n 48 above) ; Easson (n 101 above)

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