KS Thabane & MJ Dednam

Tax laws harmonisation between Lesotho and the Republic of South Africa

Summary

Lesotho is geographically landlocked within the Republic of South Africa. Research has been done at border gates where Basotho shoppers are able to claim and gain reimbursement of the value-added tax amounts paid against shopping in South Africa. Basotho have to pay 10% general sales tax due on sales at the Lesotho side of the border. This arrangement is administratively difficult to implement and has therefore led to massive losses of sales tax revenue for Lesotho. Also, having acquired their trading stock free of value-added tax, branches of South African businesses are liable to commodity tax in Lesotho. Research has however revealed contrary practices as indicated. It is submitted that the existence of different laws governing economic activities in countries that cannot avoid interacting with one another leads to skewed distribution of resources amongst these countries. It remains unclear whether the provisions of the Lesotho value-added tax law will address the widespread abuse of the system as well as the glaring evasion of the tax being experienced by Lesotho today. It is in the light of the above-mentioned that the hypothesis of this article was formulated: that the efficient collection of tax revenue, the decline in the abuse of the tax system and the evasion of sales tax, will all occur to some significant extent if, amongst others, the Lesotho value-added tax legislation is in harmony with its South African equivalent. In conclusion the harmonisation of the tax rates provided for by statutes of the two countries is recommended.
1. Introduction

Lesotho is geographically landlocked within the Republic of South Africa. Situated on the Eastern part of the latter country, it has both formal and not so formal entry points all around it. Formal border gates are situated near most of the major towns of Lesotho. For purposes of this paper focus is on four border gates, namely, Maseru, Maputsoe, Caledonsoort, and Van Rooyenshek. These are four of the five border gates whereat Basotho shoppers are able to claim and gain reimbursement of the value-added tax amounts paid against shopping in South Africa.\(^1\)

The problem with the system of value-added tax refund by the South African Revenue Services to Basotho exporters is that the amounts claimed at the South African side of the border affect the revenue sharing arrangement which forms part of the Southern African Customs Union Agreement. To minimise the diminishing effect that the arrangement has created for Lesotho, Basotho have to pay 10% general sales tax due on sales at the Lesotho side of the border.\(^2\) It is submitted that this arrangement is administratively difficult to implement and has therefore led to massive losses of sales tax revenue for Lesotho.

The Kingdom of Lesotho is a politically independent sovereign state, having attained its independence from Great Britain in 1966. She is however heavily dependent on the Republic of South Africa economically.\(^3\) It has also been a matter of great concern to Lesotho that over a decade or so 54% of all revenue arose from the Customs Agreement share. This source accounts for 78% of the Lesotho Government’s recurrent expenditure.\(^4\)

Being situated in the same part of the world usually leads to several cooperation agreements amongst countries. Lesotho and South Africa are part of some such establishments, including the Southern African Development Community (SADC), the Southern African Customs Union (SACU) and the Rand Monetary Area. These establishments are a clear indication of the unavoidable interdependence amongst countries of a region. The degree of dependence upon each other differs in accordance with the different degrees of each country’s level of economic development.

It is submitted that the existence of different laws governing economic activities in countries that cannot avoid interacting with one another leads to skewed distribution of resources amongst these countries. This is the case between Lesotho and South Africa. Although somewhat slow in keeping up pace with South Africa, Lesotho has from time immemorial been aware of

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1. In terms of RSA VAT Practice Note No. 2 of 1998:4 Par 5.6.
3. It is estimated by the Lesotho Bureau of Statistics Report 1999:4 that 80% of all Lesotho imports are of South African origin. Exports to South Africa from Lesotho comprise largely of the Highland waters and migrant labour.
this. It is for this reason that several statutes of Lesotho are exact replicas of the statutes of South Africa.5

Historically, much of the law applicable to the Cape of Good Hope was made applicable to Lesotho6 by virtue of Proclamation 2(b) of 1884,7 as amended. In terms of the amendment it was open for Lesotho to adopt any of the statutes promulgated in South Africa, following its own process of law. This has been the case, especially with regards to commercial law. This being what it may, one cannot turn a blind eye to the slowness of the pace that Lesotho has adopted in keeping up with developments in laws adopted by its neighbour South Africa.8 This slow pace has in some instances led to losses in revenue on the part of Lesotho. The laws on sales taxes are one case in point.

Following the replacement of a general sales tax system by one of value-added tax in 1991 by South Africa, the Lesotho Government considered doing the same in 1993.9 At that stage the decision to make the change depended on there being some guarantee that a value-added tax system would improve revenue collection in Lesotho,10 and that it would resolve the widespread problem of abuse of the system and prevalent tax evasion.11

A Value-Added Tax Bill 2000 is presently under discussion in Lesotho. This bill may well be an indication that Lesotho is in the process of effecting a change-over from the general sales tax system to a value-added tax one. What remains questionable though, are the guarantees that the proposed new legislation brings for Lesotho in so far as the improved revenue collection capacity is concerned. It also remains unclear whether the provisions of the Lesotho value-added tax law will indeed address the widespread abuse of the system as well as the glaring tax evasion being experienced by Lesotho today.

5 For instance, Lesotho’s Insolvency Proclamation of 1957 is a replica of South Africa’s Insolvency Act of 1936; Lesotho’s Companies Act of 1967 is a replica of South Africa’s Companies Act of 1948; and Lesotho’s Hire Purchase Act of 1974 is equivalent to South Africa’s Hire Purchase Act of 1942. In some instances the South African equivalent has since been repealed and replaced.
6 Lesotho was then known as Basutoland.
7 Section 2 of the General Law Proclamation 2(b) of 1884 which came into effect on 29th May 1884 read partly as follows: “In all suits, actions or proceedings, civil or criminal, the law to be administered shall, as nearly as circumstances of this country will permit, be the same as the law for the time being in force in the Colony of the Cape of Good Hope”.
8 For example: Lesotho’s General Sales Tax Act of 1982, as amended, is a replica of South Africa’s Sales Tax Act of 1978. The latter statute has since been repealed and replaced by the Value-Added Tax Act of 1991, while Lesotho still operates under its 1982 statute.
The disparity in the size of economic muscle and the geographic proximity of the two countries have both created a dilemma for Lesotho in deciding upon appropriate rates for a value-added tax. The effects that these two factors have on revenue collection in Lesotho have to be balanced with the country's desire and indeed need to achieve optimum levels in this regard. Due consideration of the weak position of Lesotho with regards to trade competitiveness led to Lesotho proposing the introduction of VAT at 10% standard rate, with virtually no zero-rated exceptions, 15% on alcohol and cigarettes, and 5% on amenities such as electricity and telephones.12

It is in the light of the above-mentioned that the hypothesis of this article was formulated: that the efficient collection of tax revenue, the decline in the abuse of the tax system and the evasion of sales tax, will all occur to some significant extent if, amongst others, the Lesotho value-added tax legislation is in harmony with its South African equivalent.

To test the hypothesis, library research, observation, questionnaires and interviews have all been employed. Problems were encountered in conducting the research. Not all questionnaires were returned. In some cases interviewees were either too ignorant or laboured under a fear of disclosing too much, thus being in breach of their oath to official secrecy. These factors slowed down the pace of work as more questionnaires were distributed and fresh interviews arranged.

2. Reforming tax systems

The need for national economic growth and the desire for increasing levels of revenue have been major driving forces behind tax reforms in most countries. Ancillary to this, but of no lesser importance, are the objectives of redistribution of wealth, tax simplification, and a more efficient allocation of resources.14 These reforms have in recent times assumed a movement away from direct taxation towards the adoption of more indirect taxation.15 This has been the international trend. Southern African countries have not been exceptions in this regard.

The rationale for this movement is that high income taxes are a disincentive to work and they encourage tax evasion.16 Where tax rates in personal and corporate income taxes have reached such high levels that they cannot for this reason be effectively increased, maintaining them at constant levels has necessitated increases in taxes on commodities to meet the ever increasing revenue demands.17 Indirect taxes are so called because they are effectively levied indirectly on incomes and specifically on

expenditures. Included under this category are, amongst others, general sales tax, value-added tax and customs and excise duties, to name but a few. While the levying of customs and excise duties in Southern Africa dates back to colonial times, further efforts to expand tax bases in this region came with the introduction of a general sales tax system.

General sales tax is a single stage collection system. It is charged at the point of sale by the retailer. In terms of this system, business pays tax on capital goods purchased as well as on intermediary costs such as advertising; otherwise the general principle of the general sales tax is that no tax is paid on the purchases of trading stock and raw materials. Taxes paid on capital goods are as a general principle in business recovered by the trader through increases in product prices. That is, they are recouped by transferring the tax burden to the final consumer. Higher product prices in turn lead to even higher taxes or tax on tax. The tax on capital goods is taxed again on the price of the commodity. This is known as cascading.

Globalisation demands competitiveness. It is therefore necessary that a country participating in international markets adopt a commodity tax regime that also enhances its ability to compete. Price levels must be seen to compare with those of other countries. For this and other reasons perhaps, it has been necessary for countries of the world to follow, as much as possible, the introduction of relatively similar commodity tax regimes.

Hailed as the Mata Hari of the tax world value-added tax is a relatively better system than general sales tax. Value-added tax is collected at each one of the lines of distribution. It is a tax on the “value added” at each stage. The vendor under this system is allowed an input tax deduction against the output tax through set-off. The difference between output tax and input tax is what gets paid to the revenue authorities. Input tax is the amount paid on purchases while output tax is collected on sales.

A value added tax system has the advantage of being a multiple stage tax, the result of which gives government more agents in the collection process. The multiplicity of the collection points in turn creates a clearer audit trial that is easier to trace by the revenue departments. Conversely, under the general sales tax regime collection is effected only at the final distribution stage: the retailer’s. Failure on the part of the retailer to submit tax collected results in a loss by the revenue department of government. The latter system therefore provides a perfect incubator for tax fraud and tax evasion. Furthermore, the cascading effect built into this system acts as a hindrance against competitiveness in global markets.

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21 According to an IMF survey published on May 8, 2000, in 1999 around 75% of all the countries in the world had VAT in place.
22 Tait 1993:5.
A recent survey by the International Monetary Fund’s (IMF) Fiscal Affairs Department looking into the pros and cons of changing to VAT,\textsuperscript{24} concluded that while it is true that value-added tax can be applied just about anywhere, there are still unanswered questions in relation to small open island countries. Several factors need to be taken into consideration here before a value-added tax system is adopted.

In the first place, it is important to embark upon a tax administration reform exercise before a country can successfully change over to a value-added tax system. Putting these administrative reforms into place is a difficult and time-consuming\textsuperscript{25} exercise. A good tax administration is the major ingredient of tax collection performance, the latter being determined by a country’s level of development\textsuperscript{26} generally. Characteristics of a good tax administration system are simplicity and cost effectiveness.

Secondly, it is important to measure the degree of dependence on imports for consumption of the country. This factor is of significance in the case of the small island economies. An island economy whose size of domestic production is insignificant would not benefit from a value-added tax system. In such a situation tariffs would achieve the same results as a VAT system.\textsuperscript{27}

Thirdly, to be politically correct a tax system must take into consideration equity principles. A broad based tax on goods and services is undoubtedly regressive. To address the regressiveness of a value-added tax system two techniques are usually applied. One is a system of exemptions, and the other of zero-rating. Exempt tax units do not levy VAT and do not claim refunds for VAT paid against purchases. Under the zero-rating mechanism a tax unit files returns to the tax authorities and may claim refunds in respect of VAT paid on purchases while it pays zero rate on sales.

A closer look\textsuperscript{28} at the two techniques reveals that exemptions muck up a value-added tax system. It leads to cascading, which is the very evil in a general sales tax system, thus putting it in a comparatively disadvantageous position relative to value-added tax. Zero-rating on the other hand involves putting into place a refund system. This too is not without practical problems. First of all, it has been observed\textsuperscript{29} that countries with fiscal problems are reluctant to part with cash already in hand. Secondly, where fraud is rife, the authorities may not be confident about their ability to identify genuine claims. Regional efforts at integration of economies which leads to laxity or total disregard of border controls also frustrate the enforcement of zero-rating of exports. This is confirmed by an observation by the IMF survey that progress

\textsuperscript{24} International Monetary Fund Publication, Vol. 29, No. 9, dated May 8, 2000. The survey also looked at the problems encountered in the process of changing to a VAT system.
\textsuperscript{25} International Monetary Fund Publication 2000:5.
\textsuperscript{26} Black \textit{et al} 1999:145.
\textsuperscript{27} International Monetary Fund Publication 2000:7.
\textsuperscript{28} International Monetary Fund Publication 2000:7.
\textsuperscript{29} International Monetary Fund Publication 2000:7.
on VAT within Europe has come to a halt as a result of the establishment of the European Union and developments incidental thereto.30

3. Commodity taxes in the Republic of South Africa and Lesotho: a brief historical perspective

During 1970 to 1971 Lesotho and South Africa were both parties to the Customs Union Agreement. Under this agreement, customs, excise and sales duties are pooled and shared in accordance with an agreed formula.31 Revenue derived from customs, excise, and sales taxes in Lesotho during this period accounted for 67% of the country’s total revenue. In comparison these sources together with stamp duty and marketable securities tax formed 30% of the total revenue of South Africa.32

With the passage of time the proportionate contribution of indirect taxes to total revenue started to decline. The Governments’ revenue demands on the other hand were on the increase. The need to broaden the tax base could not be ignored for much longer. Consequently South Africa introduced a sales tax system in 1978.33 This tax partly replaced the sales duty, leaving only a few items still subject to this regime.

Initially South Africa levied sales tax at the rate of 4%.34 As the demands for more revenue increased, the rates of sales tax also increased from the initial rate to 7% in 1984, rising to 13% in 1989. When the threshold for the tax rate went beyond 10% a multiplicity of problems related to high taxes originated. To address these problems a new and better system had to be found. A commission of enquiry chaired by Margo J35 was set up to look into the problems then connected to a system of sales tax. In 1988 the South African Government announced its intention to introduce a destination based, invoice type value-added tax system. A single and low rate was then envisaged. Eventually the Value-Added Tax Act was promulgated in 1991.36 This was a dramatic step that demanded deeper reflection on the part of Lesotho. A question emerged then: given her circumstances, would Lesotho cope with the demands of a value-added tax system?

30 International Monetary Fund Publication 2000:7.
31 The Southern African Customs Union Agreement between governments of South Africa, Botswana, Lesotho and Swaziland was concluded on the 11th December 1969 and came into operation on the 1st March 1970. Until the envisaged review of the Agreement is effected, the formula is determined in accordance with the provisions of section 14 of the current Agreement. See also Parmena 1973.
A review of the position with regards to the levying of a sales duty by South Africa for other SACU members showed that they too had to follow suit, by virtue of this form of tax being a common tax. To this end Lesotho announced her plan to introduce sales tax for the first time in 1980.\textsuperscript{37} The Lesotho \textit{Sales Tax Act} was eventually promulgated in 1982.\textsuperscript{38} Lesotho kept pace with the changes and developments effected onto the South African statute and the two statutes were at all material times in harmony. This was the position until 1991 when the two countries’ sales tax rate was set at 13% and South Africa suddenly changed over to a new and more sophisticated regime, the value-added tax system, at the standard rate of 10%. At the end of the 1991/92 fiscal year Lesotho reported an outturn of M123m collected in sales tax revenue, M5m less than the expected outturn.\textsuperscript{39} The tax rate was reviewed downwards to 10% standard rate, 5% on all amenities, and 20% on liquor.\textsuperscript{40} At this juncture the two countries’ commodity taxes lost out on the previous harmony they had been in and Lesotho experienced massive losses in the sales tax revenue.\textsuperscript{41}

4. Areas of the value-added tax legislation that affect Lesotho’s tax base

While in other parts of the world tax policies by one country could be pursued without much concern about the impact of such policies on neighbouring countries, the same cannot be said of Lesotho and South Africa. Membership of these two countries in organisations such as the Southern African Customs Union (SACU) and the Common Market for East and Southern Africa (COMESA), as well as trends on globalisation generally, means that actions by Lesotho as a policy maker for its people, and by the Basotho as taxpayers and consumers, have come to be greatly constrained and influenced by the actions of the South African Government in trade and tax matters. In particular this has had some important spill-over effects on cross border shopping between Lesotho and South Africa. A favourable commodity tax regime that is less regressive by comparison in South Africa has attracted to that country a large tax base from Lesotho.\textsuperscript{42}

In this article we traverse provisions of the \textit{Value-Added Tax Act} 89 of 1991, of South Africa on tax rates and other measures designed to combat regressivity of the tax system as imported by that statute. We shall endeavour to show that the absence of similar provisions in the present Lesotho \textit{General Sales Tax Act} 8 of 1982, leads to a decline in the tax revenue of Lesotho while increasing that of South Africa. We conclude by recommending harmonisation of the tax rates provided for by statutes of the two countries.

\textsuperscript{37} Lesotho’s Third Five-Year Development Plan, 1980-85.
\textsuperscript{38} \textit{Sales Tax Act} 8 of 1982.
\textsuperscript{39} Kingdom of Lesotho Budget Speech 1993/94:7.
\textsuperscript{40} Legal Notice No. 266 of 1991, in terms of which most exemptions were removed in an effort to make up for the loss brought about by the low rate.
\textsuperscript{41} Kingdom of Lesotho Budget Speech 1993/4:7.
\textsuperscript{42} Tanzi 1996:5.
4.1 The Value-Added Tax Act 89/1991 of the Republic of South Africa

Section 23(1) of the act provides that every person who carries on an enterprise, and has a total value of taxable supplies that exceed R300 000 per annum, shall be registered as a vendor for value-added tax purposes. Person is defined as including:

Any public authority, any local authority, any company, any body of persons (corporate or incorporate), estate of any deceased or insolvent person and any trust fund;

Enterprise is defined rather extensively, but may be summed up to include the following attributes: it must be carried on continuously or regularly, in an activity that supply goods or services; the activity need not necessarily be for profit-making purposes; and it specifically includes welfare organisations. It may be carried out either wholly or partly within the Republic of South Africa, and the leviable supply must be made for consideration.

It is common cause that a great percentage of the businesses in Lesotho are branches of South African based enterprises. Carrying on business partly in South Africa as it is in this situation can therefore mean the inclusion of these enterprises into the tax net of South Africa.

As pointed out earlier, value-added tax is characteristically regressive if applied as is. To reduce the regressivity, legislators dealing with it worldwide either apply a reduced rate on essential commodities and exempt others or apply a zero-rate.

In South Africa, section 11 of the Value-Added Tax Act provides for zero-rating of certain taxable supplies. The zero-rating of basic foodstuffs, export supplies to branches outside South Africa and farm implements, all have some bearing on the exportation of the tax base from Lesotho to South Africa and consequently on the loss of tax revenue by Lesotho for the benefit of South Africa.

Theoretically if one state imposes taxes on consumption that are much higher than those imposed by a neighbouring state, individuals of the “high tax” state will be encouraged to shop in the other state, thus contributing to the tax revenue of the neighbour. This is happening between Lesotho and

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45 Examples of these include, without being limited to, Woolworths Stores, Ackermanns, Shoprite-Checkers, Sales House and Jet of the Edgars group, Ellerines, Morkels and Pep Stores, to name a few.
46 The supplies include: (i) export supplies; (ii) listed food commodities such as maize meal, samp, mealie rice, dried silo screened mealies, dried beans, lentils, pilchards, milk powders, dairy powder, rice, raw vegetables, vegetable oil, cultured milk, fresh milk, wheaten meal, eggs, edible legumes and unprocessed peanuts.
her only neighbour. Whether this may be described as tax degradation or not is subject to debate. The fact of the matter is that the zero-rating of food commodities especially, has the additional impact of motivating domestic and business shoppers from Lesotho to do their shopping on all commodities in South Africa.

The supply of goods by a vendor to or for purposes of a branch, or for the main business operating in an export country, is zero-rate. This provision of the law is a great incubator for tax fraud, as shall be demonstrated below. In terms of the law, to qualify for the zero-rate the branch must be separately identifiable and must maintain an independent system of accounting.

It is reasonable to assume that all enterprises registered in Lesotho have to maintain a system of accounting in order to account for company tax deriving from their business activities. One assumes further, that having acquired their trading stock free of value-added tax, the branches in question are liable to commodity tax law applicable in the foreign country, in this case Lesotho. That law is the Lesotho General Sales Tax Act 8/1982, according to which the standard rate is 10%. Research (evidenced in the form of till slips) has however revealed contrary practices as indicated in Table 4.1.

Table 4.1

<table>
<thead>
<tr>
<th>South African branch operating in Lesotho</th>
<th>Type of commodity tax charged to consumer</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Woolworths Stores</td>
<td>Value-Added Tax</td>
<td>14%</td>
</tr>
<tr>
<td>Ackermanns</td>
<td>Value-Added Tax</td>
<td>14%</td>
</tr>
<tr>
<td>Pep Stores</td>
<td>Value-Added Tax</td>
<td>14%</td>
</tr>
<tr>
<td>Sales House and Jet</td>
<td>Value-Added Tax</td>
<td>14%</td>
</tr>
<tr>
<td>Shoprite Checkers</td>
<td>General Sales Tax</td>
<td>10%</td>
</tr>
</tbody>
</table>

All these shops are registered for General Sales Tax purpose which would support the presumption that they are separately identifiable and maintain a separate accounting system. Basotho taxpayers are defrauded of the 4% that they pay in this way. The amount thus collected is not due and payable to either the South African revenue authorities by virtue of section 11(1)(i) of the South African statute, nor is it payable to the Lesotho General Sales Tax Department under the Lesotho General Sales Tax Act 8/1982.

Despite the above-mentioned, the President of the Republic of South Africa has the authority to decide that any particular country is not an export country. The rationale behind the President's discretionary powers is given as the laxity of border controls between South Africa and her neighbours.

48 Tanzi 1996:3 describes tax degradation as a situation whereby some countries change their tax systems to raid the world tax base and export their tax burden.
50 Registration in a foreign country would support a presumption that the entity is separately identifiable.
Lesotho included.52 Pursuant to this discretion, Lesotho and South Africa
concluded a memorandum of understanding under which Lesotho is
declared, for value-added tax purposes, not an export country, thus subjecting
all supplies to the former country from the latter to the value-added tax levy of
14% in accordance with the provisions of section 7(1)(a) of the Act. Exports
are classified as either direct or indirect. Direct exports are made wherein a
vendor in South Africa consigns or delivers goods to a recipient at an address
in an export country. Indirect exports, on the other hand, are made where
goods are supplied and delivered in South Africa for subsequent export to a
country outside South Africa.53 Both direct and indirect exporting apply to
Basotho shoppers in South Africa under different circumstances.

Lesotho and South Africa are members of the SACU, as a result of
which no tariffs are charged on the movement of goods between the two
countries. This is the cause for the present laxity of control by customs
officials at the border gates between the two countries. It is therefore this felt
laxity of customs control that led to a declaration being made that Lesotho
is not, for purposes of the Value-Added Tax Act 89/1991, an export country.

So as not to defeat the core object of Value-Added Tax, an Export Incentive
Scheme was introduced,54 and under this scheme goods transferred to a
foreign country are zero-rated.

The conclusion is therefore that, whether entering Lesotho as an indirect
export supply or under the Export Incentive Scheme, supplies to branches
situated in Lesotho are zero-rated, and should be subjected to a 10%
General Sales Tax presently in operation and not to a 14% Value-Added
Tax, which is not legal in Lesotho. Bringing the tax rate to a 14% level in the
proposed legislation, we suggest, would in some ways ease the
implementation of a more efficient tax administration and protect Basotho
taxpayers against the apparent tax fraud. On the part of the Lesotho fiscus
the apparent similarity in the price that one pays in a similar shop in South
Africa and in Lesotho will remove doubts in the minds of shoppers. With the
implementation of the envisaged engagement of the SARS by Lesotho,55
shopping for clothes and furniture in the RSA may cease to be a profitable
option and more shopping would be done in Lesotho.

4.2 Sales tax law in Lesotho

Presently, Lesotho has in place the General Sales Tax Act 8/1982, as
amended. A Value-Added Tax Bill 2000 is in circulation and is according to plan
to be put into effect by October 2001.56 The Value-Added Tax Bill 2000 follows
the same broad structure as the General Sales Tax Act 8/1982.57 Attempts are
made in the proposed statute to retain the provisions of the General Sales Tax Act 8/1982, including the present standard rate of 10%.

The proposed act imposes Value-Added Tax on every taxable supply,\(^{58}\) and on every taxable import.\(^{59}\) The same definition as that of the South African statute is given to a taxable supply.\(^{60}\) Imports are, unless otherwise exempted, taxable.\(^{61}\)

Exempt supplies include sale of a going concern, unimproved land, manufacturer’s goods rented out, water, postal services of a public nature, transport, medical and dental supplies, and financial, insurance and educational services.\(^{62}\) The provisions of the Lesotho statute is in this regard a replica of the South African statute.

The minister has powers\(^{63}\) to make regulations for purposes of the Act.\(^{64}\) It is envisaged in terms of the draft regulations to the VAT Bill 2000, that zero-rate will apply only to exports.\(^{65}\) All other supplies, including foodstuffs, are taxable at the standard rate of 10%. Contract services undertaken for the Lesotho Highlands Development Authority (LHDA) are also supplied at zero-rate.\(^{66}\)

4.3 Issues arising from a comparison of the two statutes

It is envisaged that the proposed Lesotho Value-Added Tax Bill will introduce the tax at 10% standard rate, 15-20% on liquor, and 5% on electricity and telephones. The tax will operate against a value-added tax standard rate of 14% in the neighbouring South Africa. This may give a prima facie impression that the tax leviable under the Lesotho system is by comparison less regressive. The present General Sales Tax Act, although different in overall effect, technically is applied at the same rates.

The proposed Lesotho legislation contains a broad range of exempt supplies, almost similar to, if not exactly the same as, those found under the Value-Added Tax Act 89/1991 of South Africa. Perhaps there is harmonisation in the sense that it means equivalence between the two statutes. However, exempting supplies is not the most efficient way of easing the burden in any tax regime. Where supplies are exempted, the prices offered at retail stage include the tax paid against the purchases of the component parts of the commodity. For example, books for education purposes may be an exempt supply while the supply of paper used in printing the books is taxable, therefore the tax levied on the paper used in

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58 Value-Added Tax Bill : section 5(a).
59 Value-Added Tax Bill : section 5(b).
60 See Value-Added Tax Act : section 12(1).
61 Value-Added Tax Bill : section 6(4).
62 Value-Added Tax Bill : section 6(2).
63 Value-Added Tax Bill : section 88(1)(a).
64 Value-Added Tax Bill : Explanatory memorandum: 91.
65 King 2000:16.
the making of the book forms part of the retail price of the book. The retailer is not a participant in the tax system, and as such cannot off-set his input tax against output tax. The output tax may well be zero, but the input tax is not. The final consumer bears the burden of the input tax, and to make matters even worse he is not made aware of this because the supply is at this stage outside the tax system as an exempt supply.

The zero-rate is, in terms of the proposed regulations to the Value-Added Tax Bill, applicable to exports. There is no indication that any specific commodities supplied within Lesotho borders shall be zero-rated. The same situation prevails under the General Sales Tax Act 8/1982. When comparing this situation to what prevails in South Africa, one observes that most of the Lesotho town centres are situated within an average of about 15 kilometres from the nearest town in South Africa. In South Africa a range of about 19 items of basic foodstuffs is supplied at a zero-rate of value-added tax. Basotho shoppers are therefore motivated to do their shopping in South Africa.

While it is arguable that the purchasing of items that are zero-rated does not extend South Africa’s tax base per se, it is equally arguable that this, nevertheless, erodes Lesotho’s tax base since these commodities would attract 10% sale tax in Lesotho which is lost when shopping is done outside Lesotho. This does not only affect commodity tax revenue but have implications on other taxes as well. Less sales implies a decrease in profit, which in turn adversely affects corporate and other income taxes.

Research results in table 4.2 reflect the volumes of people crossing the border for shopping in South Africa.

Table 4.2

<table>
<thead>
<tr>
<th>Border gate</th>
<th>Number of persons crossing within a period of 3 hours on sample day from RSA into Lesotho</th>
<th>Number of persons reporting to SARS office for vat refund</th>
<th>Number of persons reporting to sales tax office for payment of 10% sales tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maseru Bridge</td>
<td>150</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>Ficksburg</td>
<td>320</td>
<td>50</td>
<td>06</td>
</tr>
<tr>
<td>Van Rooyen’s</td>
<td>200</td>
<td>50</td>
<td>12</td>
</tr>
<tr>
<td>Caledonspoort</td>
<td>175</td>
<td>50</td>
<td>03</td>
</tr>
<tr>
<td></td>
<td>845</td>
<td>200</td>
<td>31</td>
</tr>
</tbody>
</table>

Taking a controlled sample of persons out of a total of those crossing at any particular point in time, the results lead to a conclusion that not all shoppers claim for a 14% refund of VAT paid in South Africa. Of those who do, out of every 200 people who make a claim about 15% tender payment of the 10% Sales Tax due to Lesotho.

A survey was carried out targeting a different group than the one captured in the observation exercise. This was carried out in the form of questionnaires. In the questionnaire people were asked why they chose to
do their shopping in South Africa, leaving behind similar shops in Lesotho. From the 20 responses received (out of the 50 questionnaires distributed), the following conclusions are drawn:

- Fourteen responsees felt that one pays much less for similar items purchased in South Africa than in Lesotho;
- Six responsees felt that there was a broader variety of items from which to choose in South Africa than is the case in Lesotho.

It is submitted that the above reflects the true position, which is that one pays a little less for grocery shopping in South Africa than he would in Lesotho. The same may not be necessarily true with regards to other commodities, but South African shops have managed to win Lesotho shoppers' confidence.

The effect of the zero-rate on foodstuffs can be illustrated as follows, taking Shoprite Checkers as a model shop. If, for instance, in South Africa the shelf price for milk is R3.99, the shopper pays R3.99 at the till. In Lesotho, if the same carton of milk costs M3.99, the shopper pays R3.99 plus 40 lisente at the till. This means that for a similar item in one shop — one operating in South Africa the other in Lesotho — the price paid for milk is not the same. Against R3.99 paid in South Africa, R4.39 is paid in Lesotho.

When asked, ordinary shoppers have interpreted this to mean that Shoprite has a centralised pricing system that automatically includes the 14% VAT. This price is transferred to Lesotho, and by paying an additional 10% at the till, the total tax that one pays in Lesotho is therefore 24%. The true answer of course centres around that fact that the rate of tax on milk is 0% against 10% leviable in Lesotho. Placing Lesotho's tax system at par with that of South Africa, in so far as the zero-rating of food commodities is concerned, will go some way in winning back consumer confidence in the former country.

Finally on the question, it is submitted that winning back consumer confidence in Lesotho can enhance the revenue collection capacity and encourage more shopping inside her borders. Prices paid in South Africa must not only be equivalent to those paid in Lesotho, but must also be seen to be the equivalent. Charging 10% against 14% without discriminating commodities has failed to do that. The second factor relates to the operations of South African branches in Lesotho. Our submission is that tax administration relating to these branches would be made easy if the whole tax amount collected by these branches would be the amount due and payable to the Lesotho government. A levy of 14% on the sales of commodities other than foodstuffs would provide a ready answer to the problem.

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67 See note 45 and Table 4.1 above.
5. Tax administration in Lesotho

5.1 Possibility of implementation of the harmonisation proposal

That Lesotho is desirous of changing from the present day general sales tax regime to a value-added tax system is without doubt. There are several reasons for this: this trend is in vogue; value-added tax is a relatively better commodity tax system compared to general sales tax; and being a member of a customs union Lesotho is disadvantaged by maintaining a different tax system. She operates with rather limited freedom in this regard.

A question then arises: is Lesotho ready to put in place the necessary administrative mechanism needed for the value-added tax system?

The engagement of experts from the International Monetary Fund looking at the feasibility of introducing a value-added tax system in Lesotho indicates the felt need for the levelling of the play-ground before engaging in the exercise.68

The IMF’s findings are that as a general rule an exercise of self-assessment and a pre-existing tradition of paying taxes are some of the necessary pre-conditions for the implementation of a value-added tax system.69 Tax administration reforms must therefore necessarily precede the implementation of any new tax system.70

A self-assessment exercise was carried out and reported upon in March, 1996.71 According to the report,72 Lesotho is “highly import-dependent (with respect to consumer goods and production inputs) with total imports amounting to 114% of Gross National Product (GDP) ...". Secondly, the amount of sales tax collected from this significantly high importation of goods at border posts was significantly extremely low as most of these imports entered the country tax free.73 At its closure the report emphasises the need for taking measures to address observed limitations on policy and administrative fronts.

It is evident from our findings that a high propensity to evade tax and to defraud taxpayers by business exists in Lesotho.74 Even more imports are now entering Lesotho tax free under the import incentive scheme introduced as part of the VAT legislation of South Africa. This, coupled with the unavoidable weakness of the customs regulatory mechanism at the border gates, lead to a conclusion that the tax paying tradition in Lesotho

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68 So far three IMF Missions have been engaged in the exercise of doing the preparatory work for the implementation of VAT law in Lesotho: one in 1993, the other in 1996, and the third in 2000.
70 IMF 2000:155.
71 IMF 1996.
73 IMF 1996:2.
74 See Table 4.1 above.
leaves much to be desired. In other words, there is more to say about tax evasion than the voluntary payment thereof. It is against the foregoing background that tax administration issues for optimisation of value-added tax revenue in Lesotho are transversed in the discussion that follows.

Lesotho experiences an estimated 40% collection leakage of sales tax collected, both at the border gates\(^{75}\) and within the borders of Lesotho. Whilst a holistic survey of the possible reasons for the leakage has not been carried out, our findings leads to the following conclusions: revenue is lost because a certain percentage of goods enter Lesotho from South Africa tax free; a large majority of the South African based businesses levy an unlawful 14% VAT in Lesotho which in turn leads to an erosion of the tax base from Lesotho to South Africa, in the form of shoppers crossing over to South Africa to do shopping there.

To address these two possible factors it has firstly been recommended\(^{76}\) that the commissioner of sales tax issue regulations setting out in detail standards of accounting records required to be kept by vendors seeking exemption from tax. At present the yardstick for granting a tax exemption certification is a M150 000 turn-over. Whilst it is easy on the vendor’s part to know his turn-over level, it is extremely difficult for the Sales Tax Department officials to determine with any degree of certainty a vendor’s turnover in the absence of prescribed accounting records.

Secondly, with the Export Incentive Scheme now in place, Basotho are benefiting from claiming 14% VAT refund at the border gate. Strictly speaking, the law is that all imports into Lesotho are taxable. There is however no enforcement machinery to effect the collection of the 10% Sales Tax due to the Lesotho fiscus. It is proposed in this regard that the SARS stationed at the border gates to effect a 14% VAT refund, as they do presently, be commissioned to simultaneously withhold the 10% Sales Tax due to Lesotho. Under the present system the SARS withholds or levies a 1.05% administrative fee for every refund made. Taking on board the collection of amounts due to Lesotho entails an additional levy of a specified administrative fee, probably an additional 1.05%. For the Lesotho importer this would mean that against every claim of a 14% refund, a 10% equivalent will be withheld and a 2.10% administrative fee levied. The only gain remaining will be 1.9%. This alone may well act positively in encouraging more business within Lesotho’s own borders.

Our alternative view is that if Basotho shoppers were to be encouraged to do more shopping in Lesotho where 14% sales tax or VAT, as the case may be, is levied, and the same commodities as those under South African legislation are zero-rated, the administration of the commodity tax system in Lesotho, both at the border gate and within Lesotho, would be less difficult.

\(^{75}\) IMF 1996:6.
5.2 The establishment of a National Revenue Authority

In terms of the present administrative arrangement the Department of General Sales Tax is a separate unit under the supervision of a commissioner. The commissioner answers directly to the Ministry of Finance. The Department employs a staff of approximately one hundred, forty of whom are deployed at the border gates on a 24-hours rotational shift basis. Two other revenue departments, namely Customs and Excise and the Department of Income Tax, operate alongside that of Sales Tax.

It has been observed that the administration weaknesses that are so evident at the present time will only be exacerbated by the introduction of the envisaged value-added tax system. The recommendation is that a National Revenue Authority should be established. This body would be accountable to the Ministry of Finance, and its responsibilities would include the administration of revenue collection, a function currently carried out by the three revenue departments of the Ministry of Finance, namely Sales Tax, Customs and Excise and Income Tax. Effectively the recommendation introduces a privatisation arrangement of the present revenue collection institutions. Even though the merits and demerits of such a step are outside the scope of this work, it is submitted that the only positive aspect about it is that it envisages the recruitment of experienced lawyers who would work for the authority.

Although the recommendations include the establishment of the office of the Chief Legal Counsel within the National Revenue Authority, it is silent on the establishment of a tax tribunal as a specialised court for the quick disposal of tax cases. In our opinion the tribunal is a necessary component of the whole structure as it would address the chronic incidences of tax evasion and tax fraud that are presently experienced in the sales tax system of Lesotho.

6. Conclusions

From the preceding discussions the following conclusions are drawn:

6.1 Because of its geographical proximity Lesotho is affected by trade and taxation policies made in South Africa. Lesotho is therefore not able to optimize revenue collection unless it maintains a tax policy that is in harmony with what obtains in South Africa.

6.2 Lesotho as member of both SACU and COMESA finds herself in a situation where she cannot impose tarrifs on goods crossing her borders. As a result of this, border controls are not very stringent, which in turn creates room for tax fraud and makes it difficult to even enforce the legal requirement that there is to be a 10% sales tax payment on all imports into Lesotho.

King 2000:47.
6.3 Research undertaken has shown that the zero-rating of foodstuffs, agricultural implements and all exports from South Africa into Lesotho is catalytical to the loss of trade and tax revenue collection on the part of Lesotho. Harmonisation in the sense of applying a zero-rate in Lesotho on commodities zero-rated in South Africa for purposes of commodity tax may be one possible way of winning back the apparent lost consumer trust in Lesotho.

6.4 Although the envisaged VAT legislation in Lesotho proposes to levy tax at 10% standard rate, 15-20% on liquor and 5% on electricity, all of which may appear to be lower than the VAT rate of 14% across the board applicable in South Africa, it will not encourage trade in Lesotho unless Lesotho puts in place a zero-rate on essential commodities. It is thus envisaged that the current erosion in Lesotho’s tax base will not be changed by the introduction of the new legislation.

6.5 Some of the South African based branches operating in Lesotho levy 14% VAT on sales effected in Lesotho; a practice that is fraudulent because it is against the laws of Lesotho.

6.6 The Lesotho tax authority is aware of the practices discussed above but have up until now not been able to put a stop to it due to weaknesses in its own administration.

7. Recommendations
It is our considered opinion, based on the research findings herein, that it will not help Lesotho in her revenue collection endeavours to continue with the practice of levying a tax at 10%, whether it be called Sales Tax or VAT. What Lesotho needs to do, we believe, is to adopt a similar VAT regime to that of South Africa, especially one that imposes a zero-rate on selected commodities.

Specifically we recommend as follows:

7.1 That the envisaged standard VAT rate of 10% be revised upwards to 14%.

7.2 Basic commodities such as maize-meal, milk, eggs, brown bread, frozen fish, fresh meat, samp, medical supplies and educational implements should all be taxed at zero-rate. The recommendation is in due cognizance of the fact that educational supplies are exempt supplies under both the present statutes of South Africa and Lesotho. The list of zero-rated supplies may, but need not necessarily be exactly the same as that forming part of the South African legislation.

7.3 In order to strengthen her tax administration, Lesotho should put in place, as a matter of urgency, a legal department equipped to enforce the provisions of all the tax legislation in force at a specific point in time.
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