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Are Tax Treaties for the Benefits of Taxpayers or Maximisation of State Revenue? A Review of VAT Treaty between Lesotho and South Africa

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Abstract

The Governments of the Kingdom of Lesotho and the Republic of South Africa have entered into double taxation treaty (DTA), as a cross border strategy to prevent fiscal evasion with respect to value-added tax. DTAs, worldwide do not only address prevention of fiscal evasion of tax, but they benefit businesses and individuals against double taxation. It has however been observed that certain services between the Republic of South Africa and Lesotho are taxed twice when being imported into Lesotho. The study analysed the DTA to determine whether this was in line with the agreement. Such an analyis was based on literature review, document analysis in the form of Acts and the DTA itself. From the analysis, it was found out that recharging tax for the identified services was contrary to the DTA and Value Added Tax governing the DTA. The general conclusion is that the treatment of VAT on services is for tax revenue maximisation not in the interest of the tax payers.

Keywords

DTA, Tax Evasion, Tax Avoidance, VAT

1. Introduction

Globally, governments enter into double taxation agreements (DTAs) for a number of reasons. Tax avoidance and fiscal evasion have been identified as one of the reasons for entering in DTAs (Selezen, 2017; Baker, 2014). Tax evasion and avoidance cost governments a lot of money, especially when they extend beyond national borders (Trandafir, 2017; Mugarura, 2018). DTAs are seen as innovative strategies to deal with tax avoidance and evasion (Baker, 2014;

Mugarura, 2018; Castillo-Murciego & López-Laborda, 2019). DTAs do not only enhance revenue collection by governments but protect taxpayers against double taxation (Pham, Pham, & Ly, 2019; Baker, 2014). Baker (2014: p. 341) defines double taxation as "the levying of taxes on the same income (capital) of the same taxpayer in the same period across two jurisdictions." Double taxation is regarded as harmful to trade and there has been a call by OECD to harmonize tax laws across countries (Baker, 2014; Selezen, 2017; Mugarura, 2018; Schoeman, Steyn, & Homeier, 2015). According to Mugarura (2018) harmonization of tax laws promotes convergence and standardized practices of states in dealing with overlapping tax exigencies globally, improving institutional capacity of member states to address common tax avoidance and evasion challenges. Oguttu (2015: p. 160) defines a double tax agreement (DTA) as

> essentially an agreement between two contracting states that regulates the taxation of income derived from cross-border transactions of the residents of the two states, alleviates any impediments to cross-border transactions (for instance the double-taxation of income) as well as prevents any fiscal evasion and avoidance of income by such residents.

In the long-term DTAs promote trade and investment between contracting states (Pham, Pham, & Ly, 2019; Baker, 2014). Judge Valley, in the case of AB LLC and BD Holdings LLC vs The Commissioner of the South African Revenue Services, SATC: 13276, argues that double/taxation treaties necessitate free flow of trade which is the common feature of globalised world. Without such treaties businesses from different countries would suffer adversely as the result of being taxed in different countries; where, their "residence" is established (page 3) and where their operations are based (p. 4). It is generally recognised that countries enter into DTAs to facilitate international trade which their residents carry between two contracting states (Oguttu, 2015: p. 199). Oguttu (2015) argues that, this is done through allocating taxing rights between the two contracting states and prevents double taxation by restricting the tax claims of the contracting states. Worku, Mendoza and Wielhouwer (2016) reiterate that trade represents a direct means to attain higher tax revenues, economic diversification, and sustainable growth. Judge Valley, in AB LLC and BD Holdings LLC vs The Commissioner of the South African Revenue Services, SATC: 13276 (page 5) captures the essence of double taxation treaties in this manner:

> To deal with this problem, double taxation treaties were concluded between countries, and as a result a paradigmatic shift in international tax law occurred. Regarding these double taxation treaties certain Conventions commonly known as Model Conventions on double taxation (more will be said about this in a little while) have been crafted for the benefit of all countries. Using them as templates countries have come to conclude what is commonly referred to as Double Taxation Agreements. These agreements tend to be bilateral in nature. It is said that the purpose of Double Taxation

> Agreements is to ensure that there is a free flow of trade and investment across countries, as well as a recognition that taxation is not avoided by the latitude afforded by the flow of free trade and investment. To achieve this purpose the two countries that are party to the Double Taxation Agreement agree that one of them will forego revenue. Which one ultimately does so depends on the facts regarding the business enterprise's operations as well as on the interpretation of the terms of the agreement concluded between the two countries.

The increase in tax evation has been observed with Value Added Tax (VAT) (Keen & Smith, 2006). VAT is recognised as the most efficient form of tax in terms of revenue collection and administration (Keen & Lockhood, 2010; Keen, 2009; Bach & Isaak, 2017). The role and imporance of DTAs can be understood within the contexts of tax evasion and avoidance. It can be generally observed that literature tends to use the concepts tax evasion and avoidance interchangeably (Karlsson & Matthiasson, 2015; Liu, Shi, & Ferrantino, 2016). There has been attempts to differentiate between tax avoidane and evasion. The key distinguishing feature between the two has been legality (George, 2018). Thus, tax evasion is generally regarded as a criminal offence while avoidance is not (George, 2018; Mugarura, 2018). George (2018: p. 19) articulates the difference as follows:

> Tax avoidance is legally minimizing tax liability, including deductions (prescribed by the legislation), tax credits, tax deferral plans. Whereas, tax evasion, on the other hand, is not a simple journey. Tax evasion is illegal as it is the failure of a taxpayer to pay actual taxes that they owe to the authorities by deceit, or by concealing the exact tax amount.

However, Blaufus, Hundsdoerfer, Jacob & Sünwoldt (2016) question the issue of legality. They argue that the line between legal and illegal tax actions is often blurred and differs across countries; and further that both tax avoidance and evasion are strategies for minimizing tax by individuals and businesses (Blaufus et.al. 2016). This observation proves the problematic nature of trying to differianciates the two concepts in practice. This dilemma may arise from a number of factors. The most important factor would be the overall effect of the two. Both leads to the loss of revenue since they are counter to the main goal of tax collection – increasing tax revenue. Karlsson and Matthiasson (2015: p. 16) observe the overall effects of both as follows:

> First of all, it diminishes public revenue. The consequences of this are less equality, reduced government services, unbalanced public finance, decreased foreign investments and higher taxes for those who do not evade taxation.

Form an individual perspective, the overall aim is to pay less amount, which may be achieved through either avoidance or evasion. With avoidance, one is allowed to "exploit legal grey areas through the use of aggressive schemes to in-

crease "tax efficiency" (Mugarura, 2018: p. 188). It has been argued that, tax avoidance is characterised by exploiting legal loopholes brought about by the complexities in the implementation of tax laws (George, 2018; Mugarura, 2018). Multinationals are generally seen as major culprits in this instance as they have a tendency to repatriate to areas where they can pay less tax (George, 2018). Mugarura (2018: p. 188) further observes that "unilateral tax regimes by individual countries potentially create regulatory disparities which fuels tax avoidance and evasion internationally." He illustrates this by giving an example of USA where tax evasion is an offence but promoted in Switzerland to boost shareholders equity. Cnossen (2015) identifies policy contexts as potential grounds for promoting tax avoidance and evasion. As noted by Cnossen (2015: p. 1100)

> zero-rating and exempting goods and services generate problems of definition and interpretation, create opportunities for evasion and exacerbate administrative control problems.

The incidence of tax evasion has been linked to the fairness of a tax system (Karlsson & Matthiasson, 2015; Coetzee & Meiring, 2015). This leads to the thinking that tax evasion may either be intended or untended response to taxation (Karlsson & Matthiasson, 2015). According to Karlsson and Matthiasson (2015: p. 2) "Willful tax evasion is more likely to occur if consensus regarding fairness and equality of the tax-code is lacking." On the other hand unintended tax evasion is brought by the nature of economic activities, in particular non-formal sector or non-observed economy (Karlsson & Matthiasson, 2015). Thus tax evasion is an integral part of the non-formal sector (Karlsson & Matthiasson, 2015). It has also been observed that tax avoidance and evasion may be linked to some macro-economic factors. Andowh (2017: p. 174) notes that higher inflation may leads to "an incentive for domestic VAT avoidance and evasion."

To combat both tax avoidance and evasion, The Governments of the Kingdom of Lesotho and the Republic of South Africa have entered into DTAs on different types of taxes, namely income tax and VAT. These DTAs are closely modeled around the OECD Model of DTAs (PwC). This study reviews the Value Added Tax (VAT) agreement between Lesotho and South Africa in relation to the Value Added Tax levied on services in South Africa. The importers of goods in Lesotho from South South Africa, who had paid for services related to the goods are required to pay for VAT at Lesotho borders irregardless of whether VAT has been paid or not. Examples of these fees are administrative fees in the case of exporting vehicles, labour on repairs, and so on. While a number of studies have been undertaken to assess the impact of DTAs on Foreign Direct Investment (Selezen, 2017; Castillo-Murciego & López-Laborda, 2019; Baker, 2014), this study contributes on the implementation of DTAs in developing countries. It will further contribute to the literature related to DTAs in countries such as Lesotho. This area is under researched.

The objective of this study is to determine whether the charging of VAT on

services by Lesotho, on services on which VAT has been levied by South Africa, is in line with the DTA on VAT between Lesotho and South Africa. The study will be guided by the following main research question:

1) To what extent does the charging of VAT on services levied in South Africa on goods imported in Lesotho in line with the "Agreement between the Government of the Republic of South Africa and the Government of the Kingdom of Lesotho on Mutual Assistance and Co-operation and the Prevention of Fiscal Evasion with Respect to Value-Added Tax"?

This will be translated into the following sub-questions:

a) What are the terms and conditions of the Agreement that guide VAT treatment on the cross-border transactions in relation to services between Lesotho and South Africa?

b) How does the tax legislation of the two countries treat such services?

c) What conclusion can be made on the current practice in relation to the Agreement?

2. Research Methodology

Since the purpose of the study was to determine the basis of levying VAT on services whose VAT have already been levied on the side of South Africa, the research method adopted consisted of literature review of the DTA and relevant provisions of tax legislation of the Contracting States. The research design was mainly doctrinal research since it focussed on analysing legislation (University of South Africa, 2018). Since the treaty itself is part of the domestic law of the contracting states (Oguttu, 2015), the Agreement was analysed within the context of the Contracting States' VAT legislation. These included the review of Lesotho Value Added Tax Act, Act 9 of 2001 (as amended) and South African Value-Added Tax Act, Act 89 of 1991 (as amended). In understanding the meaning and intentions of the provisions of the said legislation of the Contracting States, rules of statutory interpretation and court decisions were applied.

The application of the case law (judicial precedent) did not pose any problem as the two countries has a common heritage of application of judicial precedent due to their inheritance of Roman-Dutch law. Palmer and Poulter (1972: p. 76) observe

> The various South African provincial and local divisions correspond to the High Court of Lesotho, and the Appellate Division is roughly equivalent to the Lesotho Court of Appeal. The rules of precedent applied by the South African courts, which are of some relevance to the position in Lesotho, are as follows: a provincial or local devision is generally bound to follow a decision of the Appellate Division, but decisions of one provincial division are not binding on another though they are of high persuasive authority ...

3. Context of the Study

The study was based on the context of Lesotho as the basis of analysis, to high-

light the possibility of both tax avoidance and evasion. Lesotho is a totally landlocked country, completely surrounded by the Republic of South Africa. Lesotho's geographic situation has made South Africa its only neighbour, to the extent that it is its major trading partner. The bulk of Lesotho's trading activities, both imports and exports, are between South Africa. According to the Bureau of Statistics (2014) most of Lesotho's imports originated from the Republic of South Africa during the years 2007 to 2011. On average Lesotho's imports from South Africa during this period was 92.24%. The pattern and origin of imports are provided by **Table 1**. **Table 1** shows the flow of imports from Lesotho's major trading partners by regions and Southern countries.

Other than imports, Lesotho also exports to other countries of the world. **Table 2** shows the countries to which Lesotho exports to. The table indicates that in 2014, South Africa was the main importer of Lesotho goods and services, followed by the USA and Canada. **Table 2** shows the direction of Lesotho's exports (Bureau of Statistics, 2014).

On analysis of trade activities reflected by **Table 1** and **Table 2**, Lesotho generally experience trade deficit (Bureau of Statistics, 2014). This situation has a far reaching implication on its economic development, as it has to continuously borrow to finance its activities. The bulk of importation of goods and services from South Africa has also contributed to the loss of tax revenue, in the form of VAT, due to non declaration of goods and services (Morakabi & Halahala 2011). Non declaration of goods and services imported into the country constitute VAT evasion or avoidance. Tax evasion or avoidance impacts negatively on fiscal needs of a country as tax revenue, in particular VAT, represents one of the biggest

Table 1. Directions of imports by regions and SACU Countries, 2007-2011.

	Value (Million Maloti)					Percentage				
Region	**2007**	**2008**	**2009**	**2010**	**2011**	**2007**	**2008**	**2009**	**2010**	**2011**
America	19.1	64.4	12.2	180.7	67.7	0.3	1.0	0.2	1.9	0.6
Arabia	2.7	0.0	0.3	8.1	1.2	0.0	0.0	0.0	0.1	0.0
Asia	138.1	176.0	190.9	1475.6	175.9	2.1	2.5	2.5	15.8	1.7
Australia	0.1	0.0		3.6	0.0	0.0	0.0	0.0	0.0	0.0
Botswana	0.6	1.6		23.4	12.9	0.0	0.0	0.0	0.3	0.1
Europe	52.4	152.9	119.3	184.8	22.9	0.8	2.3	1.6	2.0	0.2
Namibia		4.5		3.1		0.0	0.1	0.0	0.0	0.0
Other Africa	0.0	2.6	23.5	51.2	91.9	0.0	0.0	0.3	0.5	0.9
South Africa	6568.2	6360.0	7210.1	7350.8	10246.6	96.8	94.0	95.2	78.8	96.4
Swaziland	0.2	3.6	0.8	8.4	0.5	0.0	0.1	0.0	0.1	0.0
Other	2.4	0.1	13.4	34.0	11.0	0.0	0.0	0.2	0.4	0.1
Total	**6783.8**	**6765.7**	**7570.5**	**9323.7**	**10630.6**	**100.0**	**100.0**	**100.0**	**99.9**	**100.0**

Source: Bureau of Statistics (2014).

Table 2. Value of exports by major trade partners (Thousand Maloti) by Percentage Shares.

Trade Partners	Percentage share
South Africa	44.9
U.S.A	40.7
Canada	5.6
Belgium	3
United Arab Emirates	0.7
Swaziland	0.7
Egypt	0.5
Germany	0.4
Vietnam	0.4
Mauritius	0.4
Total	97.3

Source: Bureau of Statistics (2014).

Table 3. Budget contribution of tax revenue (in millions).

	2014/15	Contribution	2015/16	Contribution	2016/17	Contribution
Total Revenue	**14,582.5**		**15,299.9**		**13,845.0**	
Tax Revenue	5785.4	39.7	6578.1	43.00	7044.2	50.8
Taxes on income, profits and capital gains	3058.6	21.0	3643.7	23.8	3726.5	26.9
VAT	2116.8	14.5	2210.2	14.4	2665.6	19.3

Source: Parliament of the Kingdom of Lesotho (2017).

sources of revenue for governments globally (Keen 2008; Blaufus, Hundsdoerfer, Jacob, & Sünwoldt 2016; Andowh 2017). In Lesotho, tax revenue constitutes over 40 per cent of the national budget, of which VAT contribute 10 per cent. VAT revenue contributes over 10 per cent of the total budget revenue. **Table 3** indicates contribution of tax revenue during the budget period of 2014/2015 to 2017/2017.

This section highlighted the direction of trade, in terms of both imports and exports. The pattern of both imports and exports pointed to the significance of engaging in bilateral DTAs with South Africa to maximise revenue collection, which might be affected during cross-border trade.

4. Findings

The findings were from the literature and assessment of the national laws of Lesotho and South Africa.

4.1. DTAs and National Laws of Contracting States

It widely recognised that when a country enters into a DTA with another coun-

try, generally, the treaty becomes part of the domestic tax law of that country (Oguttu, 2015). In South Africa the modes in which the DTAs such as the VAT agreement can be incorporated into the national laws has been extensively discussed by Du Plessis (2015). The Constitution of the Republic of South Africa (The Constitution) and the relevant piece of legislation play a central role in incorporating the DTA in the national laws (Du Plessis, 2015). Three ways of incorporating the DTAs into the domestic law has been identified by Du Plessis (2011) (as quoted by Du Plessis, 2015: p. 1192) as follows:

> *First*, the provisions of a treaty may be set out in an Act of Parliament. *Second*, the treaty may be included in an Act as a schedule thereto, or *third*, "an enabling Act of Parliament may give the executive the power to bring a treaty into effect in municipal law by means of proclamation or notice in the Government Gazette."

From South African side a number of cases have been decided on determining how DTAs may be incorporated within South African domestic law. This does not exist from Lesotho's side.

The *Agreement Between the Government of the Republic of South Africa and the Government of the Kingdom of Lesotho on Mutual Assistance and Co-Operation and The Prevention of Fiscal Evasion with Respect to Value-Added Tax*, the DTA, has been domisticated within the South African national laws through section 75(2) of the Value-Added Tax, 1991 (Act No 89 of 1991) and section 231(2) and (4) of the Constitution of the Republic of South Africa, 1996 (Act No 108 of 1996). Section 231 of the Constitution outlines the requirements of the domestication of DTAs as follows:

1) The negotiating and signing of all international agreements is the responsibility of the national executive.

2) An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).

3) An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.

4) Any international agreement becomes law in the Republic when it is enacted into law by national legislation; but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.

5) The Republic is bound by international agreements which were binding on the Republic when this Constitution took effect.

Section 7 (1) and (2) of Value-Added Tax 1991 reads as follows:

1) The National Executive may enter into an agreement with the government

of any other country whereby arrangements are made with that government with a view to:

a) the prevention, mitigation or discotinuance of the levying, under the laws of the Republic and such other country, of vlue-added tax or any similar tax where the supply of goods or services is subject to such tax in either the Republic or such other country and such supply or the importation of such goods or services is also subject to such tax in other country which is a party to the agreement;

b) the refunding of value-added tax or any similar tax, or any portion of such value-added tax or similar tax, levied under the laws of the Republic and such other country in respect of the supply of goods or services in the Republic or such other country, as the case may be, where such goods or services are imported into such other country or the Republic, as the case may be;

c) regulating or co-ordinating any matter with regard to the levying and collection, under the laws of the Republic and such other country, of value-added tax or any similar tax; or

d) the rendering of reciprocal assistance in the administration of and the collection of value- added tax or any similar tax under the laws of the Republic and such other country, or in respect of the execution of the arrangements provided for in any agreement entered into in terms of this section.

2) As soon as may be possibe after the approval by Parliament of such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the *Gazette* and thereupon the arrangements so notified shall have effect as if enacted by this Act.

Based on the interpretation of DTAs in connection to Income Tax, it could be argued that the DTAs in connection to VAT is not of a type as insinuated by section 231(3) of the Constitution since it has to be approved by the Parliament before it can be domesticated (Du Plessis, 2015).

From Lesotho's side the DTAs are not as extensively covered as in South Africa. Lesotho Value Added Tax Act 2001 empowers the Minister to enter into agreements on behalf of the government. Section 87 of Value Added Tax Act 2001 provides as follows:

1) The Minister may, on behalf of the Government, enter into an agreement with the Government of another country on a reciprocal basis for the prevention of fiscal evasion or avoidance, the rendering of assistance and cooperation and the establishment of a refund system in respect of general sales tax or value added tax collected in the participating countries.

2) An agreement entered into under subsection (1) may be laid before the National Assembly as soon as may be after the agreement is entered into.

3) The Minister may, at any time, amend or terminate an agreement entered into under subsection (1).

4) An agreement made under this section may be published in the Gazette.

5) Where an international agreement provides for reciprocal assistance in the

collection of tax and the Commissioner has received a request from a country pursuant to that agreement for the collection from any person in Lesotho of an amount due by that person under the tax laws of the country, the Commissioner may, by notice in writing, require the person to pay the amount on a date specified in the notice to the Commissioner for transmission to the proper authority in that other country.

6) If a person fails to comply with a notice under subsection (5), the amount in question may be recovered by commissioner for transmission to the proper authority in that country as if it were a tax payable by the person under this Act.

Based on the observations from the proceeding sections, it can be observed that the DTA on VAT between Lesotho and South Africa has been incorporated within their domestic laws. In South Africa, the DTA has been incorporated by its Constitution and the Value Added Tax 1991, on the other hand, in Lesotho, the DTA has been domesticated through the Value Added Tax 2001.

4.2. Taxability of Services within the Contracting States

Since the study focuses on the services, the concept of services will be explored within the tax legislation of the two countries to establish their implied treatment within the DTA.

4.2.1. The nature of the DTA between Lesotho and South Africa

The agreement recognises the complexities of cross-border tax evasion and avoidance and their effect on budget, distortion of business practices and conditions of competition and the need to join hands in combating such practices. The agreement provides that tax legislation of both countries shall be applicable in treating issues related to tax. Article 1(k) defines "tax" as value-added tax in Lesotho and South Africa. In Lesotho this is *Value Added Tax Act, Act 9 of 2001 (as amended) and South African Value-Added Tax Act, Act 89 of 1991* (as amended). Article 1 (m) defines "tax legislation" as legislation which provides for the levy and payment of value-added tax in Lesotho and South Africa.

The agreement identifies tax authorities of the "Contracting States" as responsible for administering and implementing the agreement, on Lesotho's side is the Commissioner General of the Lesotho Revenue Authority (LRA) while on South Africa's side is he Commissioner for the South African Revenue Service (SARS). The Agreement recognises that there would be some instances of cash refunds between the two States and hence provides for the establishment of VAT Refund Administrator (VAR) (PwC South Africa, 2015). Article 3 of the Agreement provides that the VAR administers refund and assessment of tax for economic activities of the two countries. According to Article 3 of the Agreement, the operation of such office shall be determined by the tax legislation and Memorandum of Understanding (MOU) developed by the Contracting Countries. Article 4 of the Agreement provides for the following operational procedures to be covered by the MOU:

1) any matter relating to the refund of tax in respect of exports from an export State to and import State;

2) the determining and monitoring of the amounts refundable in terms of the Agreement;

3) the intervals at which refunds are to be made in terms of the Agreement;

4) the responsibilities of a Claims and Refund Manager; and

5) any matter that will facilitate or improve the operation of the refund system provided for in the Agreement.

Articles 3 (5) and 3(6) of the Agreement provide for the framework on how refunds works. Article 3 (5) provides as follows

> Where tax has been charged and collected by a vendor in the export State on a sale or supply of goods which have been exported, any refund due in respect of such amount of tax shall, after deduction of any commission due to the Claims and Refund Manager, be transferred to the tax authority in the import State or refunded to the importer. The terms and conditions for the transfer or refund must be determined by the tax authorities of the Contracting States in the Memorandum of Understanding.

The condition for underpayment is stated by Article 3 (6) as follows:

> Where an importer has paid a lesser amount of tax in the export State in respect of a sale or a supply of goods that have been exported than the tax liability in the import State, the deficit shall be recovered from the importer by the tax authority in the import State.

4.2.2. Requirements for a Successful Refund

The VAT paid by importers of goods and services is claimed by LRA from SARS through VAR system. Recently SARS VAR has introduced a change that stipulates that an invoice will only be accepted if VAT payment has already been made to the South African supplier. Three main requirements are necessary for the refund to be effected. As the general rule the claim should be made within 90 days of export from South Africa (PcW South African, 2015, https://www.thesait.org.za/news/259544/VAT-Refund-Administrator-VRA—VAT-Refund-Claims-.htm). The following documentary proof may be required:

- The original tax invoice in respect of the goods purchased in South Africa;
- Copy of the qualifying purchaser's trading license;
- Copy of the cartage contractor's tax invoice issued to the qualifying purchaser;
- Proof of payment for the supply of goods from the South African vendor;
- Export and customs documentation (SAD 500, CN1, CN2, EDI release notification); and
- In the case of registrable goods, proof of registration in the export country is required (copy of registration certificate, certified by a commissioner of oaths.

4.3. The Legal Requirements of Services

The focus of the study was to assess whether the charging of tax on services provided on goods imported into Lesotho from South Africa is within the confines of the DTA. Such services are administrative charges and labour, to name the few. The focus was on administrative fee charged for clearing vehicles. The general tendency for vendors is to show the cost of the vehicle together with VAT and also administrative fee together with VAT. These items appear on the same invoice, but clearly showing the cost elements. The importer, whether a business or private individual is charged VAT on the service (administrative fee) upon entering into Lesotho. This is so despite having paid tax on the SARS side. To establish the correctness of this act, the legislation of the two countries was reviewed.

The Meaning of Services

On review of the tax legislation from both countries it appeared that the concept of service is similar. Section 1 of South African *VAT Act* 1991 defines services as "anything done or to be done, including granting, assignment, cession or surrender of any right or the making available of facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of goods". On Lesotho side, section 3 of *Value Added Tax* 2001 "services" is defined as "anything that is not goods or money". This view gives rise to services as taxable supply. This means that tax is levied on them. Section 1 of *VAT Act* 1991 defines taxable supply as: any supply of goods or services which is chargeable with tax under the provisions of section 7 (1) (a), including tax chargeable at the rate of zero per cent under section 11. The said section 7 imposes value added tax on goods and services. It reads as follows:

> Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax (a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course of furtherance of any enterprise carried on by him.

In the similar manner VAT Act 2001 regards taxable supply of goods or services as those levied with tax. *VAT Act* 2001 defines taxable supply of goods as a supply of goods and services by a vendor (Section 12 (1) & (2)). The *VAT Act* 2001 specifically defines supply of services. Section 8 (4) (a) to (d) defines the supply of services as follows:

> (4) Except as otherwise provided by or under this Act, a supply of services means anything done that is not a supply of goods or money including:
> (a) the performance of services for another person;
> (b) the making available of any facility or advantage;
> (c) the toleration of any situation or the refraining from the doing of any

act; or

(d) the application by a vendor of services to own or exempt use, but only if the vendor has been allowed an input tax credit in respect of those services.

The *VAT Act* 2001 goes further to establish the relationships between the supply of goods and services or services and goods. This relationship was relevant to the study since our main focus was the taxation of services on the Lesotho side which had been previously taxed on the South African side. Section 8 (7) (8) and (9) provides

(7) A supply of services incidental to the supply of goods is part of the supply of goods.

(8) A supply of goods incidental to the supply of services is part of the supply of services.

(9) A supply of services incidental to the import of goods is part of the import of goods.

Section 5 of the VAT Act imposes tax on the taxable supply. Section 5 states the conditions for imposing tax as follows:

Subject to this Act, value added tax is hereby imposed on:

(a) every taxable supply; and

(b) every taxable import.

Since the study focused on the services related to imports, the concept of taxable import arises. Section 13 of *VAT Act* 2001 stipulates that "an import of goods or services is a taxable import unless it is an exempt import." Thus:

An import of services occurs:

(a) in the case of services related to an import of goods, on the date of the import of goods; or

(b) in any other case, on the date determined by applying section 9 to the import on the basis that the import is a supply of services.

4.4. Exempt Imports

Exchange of goods or services between two countries are referred to as exports and imports. Imports represent goods brought into a country by individuals and businesses. On the other hand exports are goods or services sold to other countries. South Africa's exports to Lesotho represent Lesotho's imports. In terms of South African *VAT Act* 1991 exports of goods and services are taxble supplies, charged at the rate of zero percent (zero rated) (section 11 (1) & (2) of VAT Act 1991). If these goods are exported to Lesotho, Lesotho is referred to as an export country. Similarly, Lesotho's exports to South Africa are taxable supplies at the rate of zero percent (*VAT Act* 2001, section 19(1) & (2)).

In situation where export supply has been charged with zero rate, upon entry into the import country they are charged at the standard rate of tax, namely 15

percent. Article 3 (6) of the DTA provides:

> Where an importer has paid a lesser amount of tax in the export State in respect of a sale or a supply of goods that have been exported than the tax liability in the import State, the deficit shall be recovered from the importer by the tax authority in the import State.

Similarly, in situation where export supply has been taxed at the standard rate in the export country, the importer will be refunded. As Article 3 (5) of the DTA explains:

> Where tax has been charged and collected by a vendor in the export State on a sale or supply of goods which have been exported, any refund due in respect of such amount of tax shall, after deduction of any commission due to the Claims and Refund Manager, be transferred to the tax authority in the import State or refunded to the importer. The terms and conditions for the transfer or refund must be determined by the tax authorities of the Contracting States in the Memorandum of Understanding.

Within the current practice LRA will claim tax charged by SARS through the refund system established by the DTA.

4.5. Services and DTA

4.5.1. The DTA and Domestic Laws of Contracting States

The DTA has become part of South African law by virtue of being concluded in terms of section 231 (4) of the Constitution of the Republic of South Africa, 1996 (the Constitution) read together with section 75(2) of the Value-Added Tax, 1991 (Act No 89 of 1991) and being approved by the legislature under these provisions and duly gazetted. This interpretation is recognised by South African courts (see, Krok v C.SARS (20230/2014 and 20232/2014) [2015] ZASCA 107 (20 August 2015; Du Plessis, 2020; AB LLC and BD Holdings LLC and The Commissioner of the South African Revenue Services). The interpretation of section 231 of the Constitution of the Republic of South Africa which has been made in relation to Income Tax Act 1962 is equally applicable to *VAT Act* 1991. In the case of The Commissioner for South African Revenue Services and Werner Van Kets, Case No: 13446/2011, Western Cape High Court, Cape Town, Davis J. concluded that

> It would thus appear as if the DTA provisions become part of domestic income tax. Given the manner in which the DTA stands to be treated in terms of s231of the Constitution, its provisions must rank at least, equally with domestic law, including the Act. For this reason, the provisions of the DTA and the Act, should; at all possible be reconciled and read as one coherent whole.

Based on this conclusion it follows therefore that the DTA between Lesotho and South Africa in relation to value-added tax is part of domestic law, including

VAT Act 1991. By necessary extension, the DTA has also become part of Lesotho laws since it has been concluded in terms of Section 87 of *Value Added Tax Act* 2001 (Act No 9 of 2001). Domestic law does not only include legislation but also include case law and common law of a land. The DTA caters for mutual assistance and co-operation in addressing problems of tax evasion and tax avoidance. In addition it caters for regulating various issues relating to tax and pooling together of experiences in taxation. It also provides for the collection and refund of taxes paid or unpaid in the two countries. The DTAs by nature are entered into by countries to protect their citizens against the adverse of double taxation. This understanding has been well articulated by Vally J in the case of AB LLC and BD Holdings LLC and The Commissioner of the South African Revenue Services, page 2; in this manner:

> It is said that the purpose of Double Taxation Agreements is to ensure that there is a free flow of trade and investment across countries, as well as a recognition that taxation is not avoided by the latitude afforded by the flow of free trade and investment. To achieve this purpose the two countries that are party to the Double Taxation Agreement agree that one of them will forego revenue. Which one ultimately does so depends on the facts regarding the business enterprise's operations as well as on the interpretation of the terms of the agreement concluded between the two countries.

The purpose of the DTA between Lesotho and South Africa is mutual assistance and co-operation, and the prevention of fiscal evasion with respect to value-added tax.

4.5.2. Services and DTA

In both countries, services constitute taxable supply as indicated in previous sections (see, section 7 (1) of VAT Act 1991 and sections 5 & 13 of VAT Act 2001). Services charged on imported goods into Lesotho are regarded as part of the import of goods (section 8 (9) of VAT Act 2001). Since the service is part of the goods being exported on South African side, the supply of goods constitute a taxable supply at the rate of zero percent ((section 11 (1) & (2) of VAT Act 1991). The tax levied on both goods and services, would therefore be refunded by SARS to LRA. The vendor or private individual cannot be required to pay tax upon entry into Lesotho as per clauses 5 and 6 of the DTA. Based on this analysis it can be concluded that Lesotho importers adversely suffer double taxation, in contradiction to the respective domestic laws of the Contrating States and the DTA. It appears that Lesotho charges importers to fufil revenue motives, ignoring importers rights within the DTA. Articles 3 (5) and (6) of the DTA are very crucial in this instance.

The critical question is "what should taxpayers do under such circumstance?" The DTA does not provide for conflict resolution of individual importer if he/she feels aggrieved. Rather, it provides for the resolution of conflicts between the Contracting States. Article 7 of the DTA provides as follows:

> The tax authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Agreement. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place directly between representatives of the tax authorities of the Contracting States.

However, there are international measures such as Mutual Agreement Procedure (MAP) based on OECD and UN Model Tax Conventions (MTCs) which could be explored by tax payers (Oguttu, 2015: p. 161). It is nonetheless beyond the scope of this study to explore strategies in addressing this misnomer.

5. Conclusion

The study was intended to explore the taxing of services between Lesotho and South Africa within the context of VAT agreement signed between the two Contracting States. The charging of tax on services which have been paid tax in South Africa is tantamount to double taxation and undermines the spirit of the DTA between the two countries. The DTA provides for the refund of taxes paid in South Africa or charge taxes which have not been levied on South African side upon importation in Lesotho. Lesotho VAT Act provides that VAT incidental to the supply of goods is part of the goods. Lesotho acts beyond its laws when charging such services, which were levied tax. It is therefore logical and within the spirit of the DTA if VAT has not been charged on services to charge it upon entry into Lesotho not when such has been levied on South African side. The general conclusion would be that the additional tax charged by Lesotho would be justified by revenue maximising motive, which increases the tax burden on tax payers.

While the study has highlighted the importance of interpreting the DTA within the Contracting States laws, it could have been illuminating to solicit opinions from tax authorities' officials of the Contracting States. However, given the logistical difficulties caused by the Covid-19 Pandemic, it was not possible to conduct interviews with tax authorities to get an insight as to why this practices. The future research should explore how tax payers understand the DTAs and whether they work in their own interests.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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