# EXPLANATORY MEMORANDUM

# ON THE VALUE ADDED TAX AGREEMENT

# BETWEEN

# THE REPUBLIC OF SOUTH AFRICA

# AND

# THE KINGDOM OF LESOTHO

It is the practice in most countries for an indirect tax, known as value-added tax, to be imposed on the supply of certain goods and services. Cross border transactions have the potential to lead to practices of tax evasion and tax avoidance across the national borders of the Contracting States which in turn will lead to budget losses and are therefore liable to bring about distortion of business practices and conditions of unfair competition. As the nature of the problem renders national measures insufficient because their effect does not extend beyond national borders, this Agreement provides for mutual assistance and co-operation for the prevention of fiscal evasion with respect to value-added tax.

It must also be noted that in this Agreement a refund system is also provided for whereby each country will provide assistance in collecting VAT that is due to each country upon the importation of goods into each respective country. As each country has similar provisions in their laws in respect of VAT payable on importation of goods, this reciprocal VAT refund system between each countries tax administrations is an efficient manner in collecting revenue in respect of goods imported from the contracting state. This will entail refunding the VAT charged directly to the tax authority of each country.

In South Africa Section 75 of the Value-Added Tax Act, 89 of 1991 (Act) empowers the National Executive of the Republic of South Africa to enter into such an agreement with the Government of another country for the purposes of:

a. Preventing and mitigating double taxation - where the supply of goods or services is subject to value-added tax (VAT) in either the Republic or the other country and such supply or the importation of the goods or services is also subject to VAT in such other country;

b. The refunding of VAT levied under the laws of each country where goods or services are imported into each country;

c. Regulating or co-ordinating any matter with regard to the levying and collection of VAT, subject to the laws of each country; or

d. Providing reciprocal assistance in the administration of and the collection of VAT under each countries law or in executing of the arrangements provided for in any agreement, subject to the laws of each country.

In the explanation which follows, the general principles of each Article of the Agreement are set out.

## PREAMBLE

The Preamble records that the object of the Agreement is to make provision for and regulate various matters relating to this indirect system of taxation, taking into account the domestic tax legislation of the Contracting States. It is further recognised that not only is exchange of information between the Contracting States vital for correct assessment or refund of tax but is also imperative in detecting and confirming irregular practices where such tax has been or may be evaded or avoided in order to obtain an undue tax benefit.

## ARTICLE 1

## DEFINITIONS

This Article defines various expressions which are used in the body of the Agreement. Several of these definitions are self-evident and are not further explained.

"Claims and Refund Manager" is defined as a person specifically designated to manage the refund system in accordance with the domestic tax legislation of Lesotho or South Africa, as the case may be.

"Person" is defined to include any public authority, local authority, any company, any body of persons (corporate and unincorporated), the estate of any deceased or insolvent person and any trust fund which is treated as an entity for tax purposes.

The definition of "South Africa" includes not only the sovereign territory but also those areas outside its territorial sea over which it may exercise jurisdiction in accordance with international law, for example, in relation to the exploitation of natural resources.

"Tax" means value-added tax. It does not incorporate any other type of tax apart from this indirect tax.

## ARTICLE 2

## TAXES COVERED

Paragraph 1 provides for the Agreement to be applied in accordance with the tax legislation of each of the Contracting States.

Paragraph 2 stipulates that the Contracting States must inform each other of any significant changes in their legislation.

## ARTICLE 3

## REFUND SYSTEM

This Article deals with the implementation and application of a refund system.

Paragraph 1 provides that a refund system to administer the refund and assessment of tax as provided for in this Agreement, be instituted by the Governments of the Contracting States.

Paragraph 2 provides that each State may appoint a Claims and Refund Manager and stipulates that the other State must be informed of any such appointment.

Paragraph 3 deals with refunds in respect of tax. Such refund must be administered by the relevant Contracting State or by the Claims and Refund Manager ─ subject to tax legislation and in accordance with this Agreement.

Paragraph 4 specifies that a Memorandum of Understanding should be developed setting out operational procedures with regard to:

(a) the refunding of tax in respect of exports from an export State to an import State;
(b) the determining and monitoring of the amounts refundable;
(c) the intervals at which refunds are to be made;
(d) the responsibilities of a Claims and Refund Manager; and
(e) any matter that will facilitate or improve such refund system.

Paragraph 5 provides that where tax has been charged and collected by the exporting vendor on a sale or a supply of goods, such tax must be transferred to the tax authority in the import State or refunded to the importer after any commission due to the Claims and Refund Manager has been deducted. The methodology must be determined in the Memorandum of Understanding.

Paragraph 6 deals with the situation in which an importer pays a lesser amount of tax in respect of a sale or supply of goods in the State of export than the tax liability levied in the import State. In such a situation, the deficit must be recovered from such importer by the tax authority in the import State.

## ARTICLE 4

## EXCHANGE OF INFORMATION

Paragraph 1 provides for the exchange of information relevant for the correct assessment, refund of tax or to combat the evasion or avoidance of tax. It further stipulates that such exchanges of information are done in accordance with the Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income in force between the Contracting States and must adhere to the same limitations on use and confidentiality.

Paragraph 2 provides for the tax authorities of the Contracting States to communicate directly with each other and if so desired, to permit officials of the other State to be present in their territory. These officials must, however, be able to furnish proof of their official capacity at all times.

## ARTICLE 5

## NOTIFICATION OF ASSESSMENT, CLAIM OR DECISION

Paragraph 1 ensures that a person resident in the territory of the requested authority may, on request by the requesting authority, be notified by the requested authority of any assessments, claims or decisions in relation to tax on behalf of the requesting authority. This notification will be carried out in accordance with the domestic legislation and practice in the requested State.

Paragraph 2 stipulates that the contact details as well as the details and information pertaining to the request for notification must be furnished by the requesting State.
Paragraph 3 provides that the requesting authority must be informed of actions taken and date on which the person concerned was informed.

## ARTICLE 6

## AMENDMENTS

This Article allows for amendments to be instituted through an Exchange of Notes through the diplomatic channel.

## ARTICLE 7

## RESOLUTION OF DIFFICULTIES

This Article institutes a mutual agreement procedure for difficulties arising out of the interpretation or application of the Agreement. Furthermore, it authorises the representatives of the tax authorities of the Contracting States to have an oral exchange of opinions in order to reach agreement.

## ARTICLE 8

## ENTRY INTO FORCE

Paragraph 1 stipulates that the Government of the Kingdom of Lesotho and the Government of the Republic of South Africa will notify each other in writing, through the diplomatic channel, once the necessary constitutional requirements in each country have been implemented. The Agreement will enter into force on the date of the later of these notifications.

Paragraph 2 specifies that the Agreement will remain in force indefinitely unless 3 months notice is given in writing through the diplomatic channel. All outstanding obligations at the time of termination must be fulfilled.