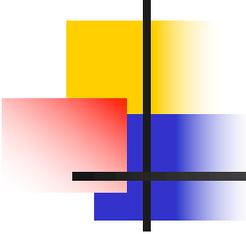


VAT Lessons from European Experience by Sijbren Cnossen

17 November 2016, 15:00 – 17:00 hrs.

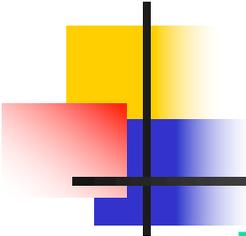
Two topics:

- Requirements for a “best practice” VAT and VAT productivity in SADC countries
- What is wrong with the EU (and your?) VAT?



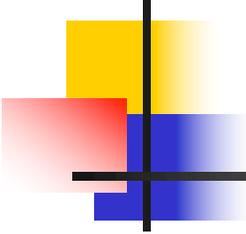
Requirements for a best-practice VAT (SADC Guidelines)

1. VAT should be revenue productive
 2. Its impact should be neutral
 3. VAT should be applied on a destination basis
 4. VAT should be simple
 5. Collection costs should be low
 6. And so should compliance costs
- Best-practice VAT measured by VAT productivity = actual VAT collections as % of GDP divided by standard rate



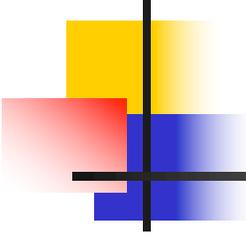
VAT revenue productivity

Country	VAT productivity >0.45	Country	VAT productivity <0.45
Seychelles	0.64	Namibia	0.41
Zimbabwe	0.62	Botswana	0.38
Lesotho	0.62	Malawi	0.34
South Africa	0.49	Mozambique	0.31
Swaziland	0.47	Zambia	0.24
Mauritius	0.47	Madagascar	0.12



Causes of low VAT productivity

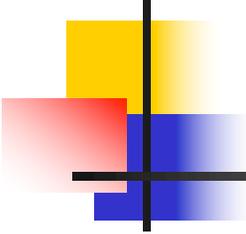
- Not standard rate but tax base and enforcement
- **Policy gap:**
 - *exemptions (standard and non-standard)
 - *lower-than-standard rates (including zero rate other than on exports)
- **Compliance gap**



Five lessons from European experience

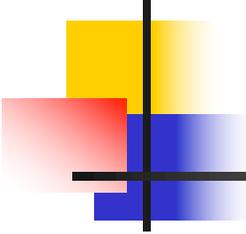
Five lessons from European Experience

1. Limit number of exemptions
2. Beware of rate differentiation
3. Provide for high threshold
4. Coordinate VATs in common markets or federations
5. Target enforcement controls



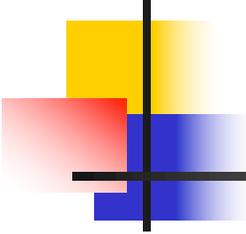
Lesson 1: Limit number of exemptions (1 of 3)

- Europe exempts health, education, culture, gambling, postal services, public broadcasting, finance, insurance, housing, agriculture
- Exemptions were introduced because it was considered “not done” to tax (semi-) public bodies
- This was a serious mistake, because exemptions cause under- or over-taxation, can become tax on exports, distort input choice, penalize outsourcing, and promote “exemption creep”
- Also, exemptions greatly increase administrative and compliance costs



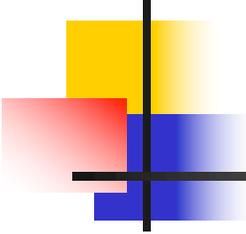
Lesson 1: Limit number of exemptions (2 of 3)

- SADC VAT Guidelines: “that it is best practice that exemptions...should be minimised”
- Distinguish between ‘standard’ and ‘non-standard’ exemptions
- Many non-standard exemptions in DR Congo, Madagascar, Malawi, Mozambique, Seychelles, Zambia



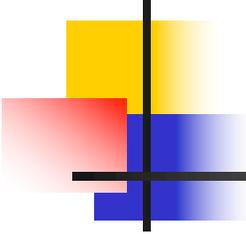
Lesson 1: Limit number of exemptions (3 of 3)

- Advice: confine exemptions to primary education, housing (except if newly created), life insurance, and perhaps financial services
- Merit good argument not valid if activity subsidized
- Regressive effects can be offset through income tax and social-benefit adjustments, or by using revenue to finance universal health care or by providing targeted education subsidies
- VAT Guidelines: “to develop ... a standardised minimum list of exemptions” Is this sound advice?



Lesson 2: Beware of rate differentiation (1 of 4)

- Europe started with highly differentiated rate structures to mimic burden distribution of old turnover taxes, which discriminated in favor of foodstuffs and other “worthy” products
- Zero or lower rates mainly benefit the rich and complicate administration
- SA Katz Commission: “Providing relief to the poor through exemptions and VAT zero rating is likely to be unsound tax policy and ineffective social policy”

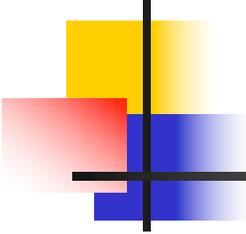


Lesson 2: Beware of rate differentiation (2 of 4)

- SADC VAT Guidelines: “that it is best practice thatzero-rating (other than for exports ...) should be minimised
- Yet, zero-rating prevalent in all SADC member states; many zero-rates in Namibia, Malawi, Zambia

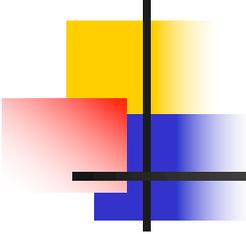
Dutch VAT examples of gross value added nonsense (3 of 4)

Reduced rate	Standard rate
Books, newspapers, coloring book	e-books, digital newspapers, writing pads
Rabbit feed	Guinea pig feed
Bird feed ($\geq 95\%$ grains)	Bird feed ($\leq 95\%$ grains)
Fish offal	Fish feed
Dried flowers; flower bouquet	Painted flowers, flower arrangements
Flee poison for cat, pill administered by you	Flee poison for cat's basket, pill by veterinarian
Walker (push support)	Walking stick
Liquid and distilled water	Frozen and demineralised water
Straw	Sawdust
Haircut human being	Haircut dog
Admission ticket for lecture, piano recital	Admission ticket seminar, counseling piano rehearsal
Bicycle repair	Repair moped



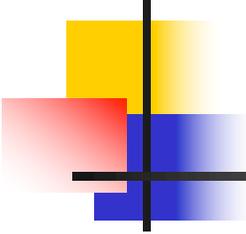
Lesson 2: Beware of rate differentiation (4 of 4)

- Advice: tax all food for human or animal consumption, consumed on or off premise, at –
 - standard rate
 - at lower-than-standard but positive rate, except alcoholic beverages and soft drinks (second-best)
- Do not zero-rate foodstuffs and new housing
- Zero rate major agricultural inputs
- Do not introduce higher-than-standard rates



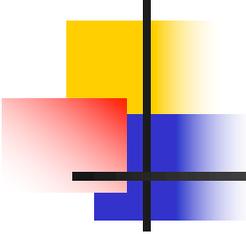
Lesson 3: Provide for high threshold (1 of 2)

- Most EU countries have no or low thresholds (€5,000) on the philosophy that every business should be on the tax roll
- Low thresholds greatly increase administrative and compliance costs (80% of VAT revenue is collected by 20% of registered firms)
- Compliance costs are disproportionately higher for smaller businesses



Lesson 3: Provide for high threshold (2 of 2)

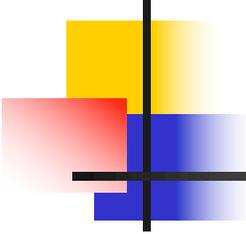
- Rule of thumb: threshold of, say, \$100,000 would reduce number of potential registrants to perhaps less than 40%
- Exempt small businesses would account for less than, say, 3% of total VAT receipts, but since they would be taxed on inputs, VAT revenue foregone would be less than 1%
- Low thresholds in Namibia and Malawi
- No advice in VAT Guidelines on thresholds



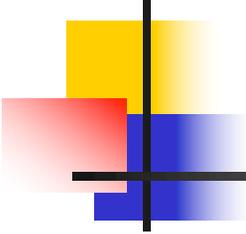
Lesson 4: Coordinate VATs in Regional Economic Communities

- European as well as Canadian experience indicates that states/provinces can operate their own VATs without or alongside a federal VAT
- REC members should zero rate exports to other states and tax imports from other states (destination principle)
- Cross-border audit controls are useful in REC

Lesson 5: Target enforcement controls

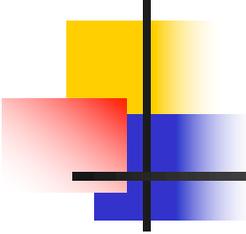


- European experience indicates that VAT fraud and evasion accounts for some 11-12% of collections under a full compliance VAT
- VAT fraud is dominated by shadow economy fraud (4-5%), contrived insolvency fraud and abuse of tax credits (4%), but not by carousel fraud (1-3%)
- Carousel fraud lower in RECs in view of border controls



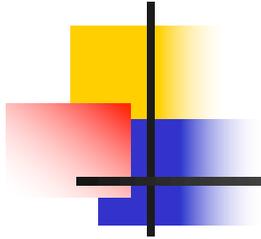
Conclusion

Don't do what the Europeans did, but examine VATs in countries, such as New Zealand, Singapore, and South Africa which have broad-based VATs (with very few exemptions), impose a single rate, and have a sizable threshold



Literature on VATs in Africa

- Sijbren Cnossen, Mobilizing VAT Revenues in African Countries, *22 International Tax and Public Finance* 22 (on line, February 20, 2015), 1077-1108
- Sijbren Cnossen, Coordination of Indirect Taxes in the Southern African Development Community, *Tax Notes International* (March 21, 2011), 943-969



Thank you for your attention!