

The Impact of Trade Agreements on Tax Systems: SADC Trade Agreements

Puseletso Letete*

The increasing integration of the world economies has revived interest in regional integration schemes, as a first step in the process of globalisation. Africa is not left behind in this process of globalisation. With particular interest, the southern African countries have also shown their increased interest in regional integration. These have resulted in the existence of the following regional economic initiatives:- the Southern African Development Community (SADC)ⁱ; the Common Market for Eastern and Southern Africa (COMESA)ⁱⁱ; and the Southern African Customs Union (SACU)ⁱⁱⁱ. This research focuses on SADC which is a free trade area. Taxation is central to the current economic development agenda in African countries and there is no doubt that taxation shapes the environment in which international and regional trade and investment take place. Therefore there is a case to examine the relationship between regional trade agreements and tax systems of the member countries of SADC.

Keywords: Trade Agreements, Tax Agreements, SADC, (Finance/Tax)

1. Introduction

The origins of Southern African Development Coordination Conference (SADCC) lie in the Frontline States ((Clough & Ravenhill 1982), a group of Southern African countries that fought for independence from colonial rule. Their aim was to help liberate the whole region from colonial rule. In the 1960s and 70s, these newly independent states supported national liberation movements in the region by coordinating their political, diplomatic and military struggle to bring an end to colonial and white minority rule. The idea was to secure international cooperation for economic liberation and collective self-reliance (Gibb, 1998). SADCC was formed in 1980 and it was transformed to Southern African Development Community (SADC) in 1992 with a focus on both socio-economic cooperation and political-security cooperation (Saurombe, 2009).

This regional organisation was formed as an international regional organisation established in terms of a treaty and declaration referred to as the "Treaty of Southern African Development Community" signed by the heads of state and government of the signatory Member States in Namibia on 17 August 1992 (Saurombe 2009).

The SADC Treaty provides the legal framework of the organisation by setting out the status, principles and objectives, obligations of Member States, membership, the institutions, procedural matters relating to areas of cooperation among Member States, cooperation with other international organisations, financial issues, dispute settlement

and lastly sanctions, withdrawal and dissolution. The SADC Treaty gives provision for formulation of subsidiary legal instruments such as protocols giving specific mandates to various SADC institutions. A total of twenty three protocols have so far been formulated.

The paper examines what impact, if any, do trade agreements which are entered into to achieve free movement of goods, labour and capital have on the members' tax systems? What impact, if any, does the non-tax agreements, have on the general tax systems of the various member countries? The paper also looks into what kind of impact, if any, should these trade agreements have on the member countries' tax systems. These questions are examined in the context of the legal instruments which govern issues of trade amongst member states of SADC as well as in the context of the Free Trade Area (FTA) agreement which has been concluded between SADC, COMESA and the East African Community (EAC) in 2011.

The paper commences with a reflective literature review on the legal regime in SADC member countries and the status of trade agreements. The paper critically examines the relationship between these trade agreements and tax issues and the relevance of tax issues vis-a-vi trade agreements. It is argued that taxation should form part of trade issues and agreements particularly in this developing economic situation. As regional integration deepens and trade barriers are being lifted, it is the time that taxation should be at the centre of such developments. The paper examines whether SADC trade agreements do take cognisance of tax issues and how those can impact on trade and regional integration. Finally the paper draws conclusions on the main themes of this research.

2. Legal Regime in SADC

The SADC institutional and legal framework is enshrined in a Treaty and a wide range of protocols, Memorandums of Understanding, Charters, Declarations, Regulations and Guidelines. Apart from these fundamental instruments, SADC has also adopted three major strategic documents, which are: - the Regional Indicative Strategic Development Plan (RISDP), the blueprint for development, and the Strategic Indicative Plan for the Organ on Politics, Defence and Security Cooperation (SIPO).

2.1 The SADC Protocol on Trade

The SADC Protocol on Trade was adopted in 1996 and its implementation began in the year 2000. The Protocol on Trade provides a framework for SADC's trade integration programme. Article 22 of the SADC Treaty gives a legal mandate for Member States to conclude such Protocols as may be necessary in each area of cooperation. (The Protocol on Trade was therefore created pursuant to the SADC Treaty and met the criteria in Article 22.) This Protocol on Trade sets out the basis for regional economic integration, a key objective of economic liberation as set out in the first statement of the

preamble of the Treaty. Through the Protocol on trade, SADC has already established a Free Trade Area in terms of Article 2(5) thereof.

The purpose of the Protocol is to regulate trade among SADC Member States, as well as with third party states at both the bilateral and the multilateral level. Annex VI of the SADC Protocol on Trade establishes a trade dispute settlement mechanism between SADC members which is modelled on the World Trade Organisation dispute settlement mechanism (Letete & Saurombe 2012).

2.2 Current status of integration in SADC

SADC has laid out its plan to achieve full regional integration. This plan was to begin with the creation of a Free Trade Area (FTA) in 2008 which was planned to be followed by a Customs Union in 2010, a Common Market in 2015, a Monetary Union in 2016 and a single currency in 2018 (Saurombe 2009). However, since the creation of the FTA was postponed to 2011, it is clear that this implementation of the plan cannot go ahead as initially planned.

The agreement by SADC Member States to move towards a customs union (and a common market); and to gain the full benefit of freer trade within the region will increase pressure to relax internal border controls on trade between Member States. The consequence of this move requires examination of all the relevant components to free trade such as taxation policies and laws. This provides SADC with a major agenda in the years to come.

In practice the issues of taxation are no longer confined to national territories and jurisdiction only as significant changes to the economic environment in recent years have brought international tax issues to the forefront. Globalisation has increased world trade and increased the mobility of capital and labour (Letete 2012).

3. SADC Memorandum of Understanding on Cooperation in Taxation and Related Matters

The SADC tax coordination and integration agenda is reflected in the SADC MOU in Taxation of 2002. The memorandum deals with issues such as the establishment of a SADC data base; personal capacity building; the application and treatment of tax incentives for income tax purposes; tax treaties; indirect taxes; and some review and dispute settlement arrangements. In the preamble, the Member States recognise that the memorandum is intended to pursue and attain the objectives of SADC as an organisation. These include among other things, development and economic growth; achieve complementarity between national and regional strategies; harmonise their political and socio-economic policies and plans; and to improve economic management and performance through regional cooperation and reduce economic imbalances.

In its Article 2, the memorandum recognises the need to have a comprehensive database which is publicly accessible. Member States will be required to take the necessary steps to develop the SADC Tax Database which will include detailed information regarding all direct and indirect taxes and other levies for each Member State. In order to keep the Tax Database up to date, Member States undertake to provide, on an annual basis or when significant changes occur, the relevant information to the relevant body. However it remains to be determined who will host the database as well as issues pertaining to accessibility for other countries that still struggle with their ICT capabilities. The question is 'who can compete with the South African Tax system that is so complex and advanced to the extent that it meets global standards.

Article 3 of the memorandum deals with capacity building. This article recognises the need to develop expertise of tax officials and to develop training initiatives to develop the professionalism in tax. Member States also recognise the importance of information technology and the challenges which they face in this area. They undertake to work together in responding to such challenges, including the review of issues relating to E-Commerce, E-Billing or E-Customs clearance and the impact they may have on tax revenue collection and on the flow of goods and services. In order to achieve this collaboration between Member States requires rules, not a loose agreement or memorandum.

In its Article 4, the memorandum deals with the application and treatment of tax incentives. In this provision, Member States agree to achieve a common approach to the treatment of tax incentives. This will ensure a more similar coordinated approach of tax incentives in order to avoid tax competition which is likely to arise in Member States from the different treatment and application of tax incentives. The issue of tax competition is a serious issue in taxation and needs to be discouraged as it can distort trade practices.

Article 5 deals with Tax Treaties. The Member States recognise the importance of developing a common policy for the negotiation of tax treaties either between themselves with other countries outside the Community or amongst themselves. The Member States intend to develop a model tax treaty for SADC, which takes account of the particular socio-economic development needs of Member States. This approach will be enhanced by Member States drawing guidelines for the effective exchange of information and the implementation of mutual assistance and co-operation procedures. The memorandum in its Article 6 recognises the fact that Member States will, in line with the WTO Agreements, gradually substitute taxes on internationally traded goods and services with broad-based taxes on consumption. The article also emphasizes the need for SADC Member States to take explicit steps to achieve effective coordination and harmonisation in the administration of indirect taxes. At the centre of this harmonisation will be the possible coordination of excise duties; value added tax (VAT) and sales tax. The memorandum also provides for establishing a SADC forum for dealing with VAT matters at the regional level by Member States.

The Memorandum is relevant to SADC's policies and is intended to pursue the objectives set out in the SADC Treaty. With the intention of SADC to become a customs union (and later a common market), this requires discriminatory border taxes to be abolished and the adoption of uniform and common tax systems. Therefore, the implementation of the memorandum will be the first step towards achieving a coordinated and harmonised indirect tax system in SADC. With the customs union having failed to materialise as planned in 2010, it is therefore submitted that this memorandum will pave way to the full realisation of the customs union (Letete & Saurombe 2012).

3.1 Tripartite Free Trade Agreement between COMESA, EAC and SADC 2011

The recently concluded (2011) tripartite FTA agreement between the member states of COMESA, EAC (which is a customs union aiming to achieve free trade amongst member states and a common external tariff with third states) and SADC does not make any provision for taxation and related matters. The tripartite FTA agreement is based on three key issues which are market integration, infrastructure development and industrial development (Pearson 2011). The objectives of the agreement are to facilitate trade and to make provision for non-tariff barrier programmes. This agreement leaves out crucial issues of taxation which underlie the facilitation of trade or how such issues, if they arise, should be dealt with, within the existing economic climate at the regional level (Letete & Saurombe 2012).

4. The relationship between trade and tax agreements

4.1 Trade Agreements

Trade agreements are multilateral in nature but are generally limited to trade-in-goods issues and exclude investment issues and, in some cases, trade in services (Slemrod & Avi-Yonah 2001-2002). Since trade agreements (such as World Trade Organisation Agreements, SADC's Free Trade Agreements, economic partnership agreements, international investment agreements, etc.) address trade measures, references to taxation often do not specify what aspects of taxation and tax measures are to be regulated. However, it has become globally recognised that trade agreements have an important regulatory impact on taxation.

The objectives of trade agreements are limited to trade in goods and in some cases trade in services. Trade agreements also address how to reduce or remove barriers to trade (tariffs, quotas, technical barriers, voluntary import and export restraints, import expansions and export subsidies) (McDaniel 2002). Most importantly, trade agreements provides for the principle of 'national treatment' which deals with the notion of non-discrimination between domestic and foreign producers (McDaniel 2002). This means that producers in a state will be treated the same and be afforded similar opportunities

and should be taxed in the same way despite whether they are based domestically or in a foreign country.

Trade agreements also make provision for the principle of 'most favoured nation' which entitles all parties to a trade agreement to the benefits offered by one signatory to any of the others (McDaniel 2002). These principles are the main pillars of trade agreements either at the multilateral level or regional level. As far as WTO is concerned, prior to 1985, GATT procedures rarely applied to tax expenditure provisions that could distort free movement of goods, capital and labour as envisioned by GATT. The Uruguay Round on GATT significantly increased the likelihood that tax expenditures will be subject to review by the WTO. The WTO has been supplied with treaty powers which appear likely to increase its involvement in examining a given country's tax expenditures which, one or more other member countries charge violate GATT as 'prohibited subsidies' (Slemrod & Avi-Yonah 2001-2002). The first step in the analytical process is to establish that a challenged provision is a 'subsidy'.

4.2 Tax Agreements

In contrast, a tax system has to address issues of the tax base; tax rates; the taxable unit; accounting principles; application of the tax to cross-border transactions; and administrative rules which are all important consideration for business and investment (McDaniel 2002). In view of these issues which the tax system has to address, we need to examine whether trade agreements within SADC do in anyway tend to affect (or not) any of the tax issues which underlie the tax system of a member country. The importance of the relationship between trade agreements and taxation becomes evident when a trade agreement is objectively interpreted by a third party.

Tax agreements on the other hand, deal with tax issues related to trade and investment issues (Slemrod & Avi-Yonah 2001-2002). Tax agreements will transcend what exists within tax systems (tax policies) of member states. This means that, the tax agreements will deal with issues such as the tax base, tax rates, the taxable unit, accounting principles, application of the tax to cross-border transactions, administrative rules.

Taxation is central to the current SADC's development agenda (Letete 2012). It provides a stable flow of revenue to finance development priorities. Tax policy shapes the environment in which international trade and investment take place. Certainty and consistency of tax treatment, the avoidance of double taxation and efficient tax administration are all important considerations for business.

5. Summary and Conclusions

This paper raises the issue that both trade and tax agreements can impact the extent to which goals of free trade are achieved. It is also clear that trade agreements do need to take cognisance of tax issues arising at the regional or multilateral level. It is

acknowledged that a multilateral agreement covering only tariffs would not be sufficient to achieve free trade. It can also be argued that subsidies provided through the tax system should be the subject of inquiry under the trade agreements – they should not be removed from the scrutiny of the trade agreements just because they are drafted as ‘tax’ rules. It is also interesting to highlight that among nontariff barriers to trade are subsidies, including both production and export subsidies, and taxes, including both indirect and direct taxes (Slemrod & Avi-Yonah 2001-2002). This research recommends that SADC should take note of any interrelationship between trade and tax issues within member states. Therefore, trade agreements which are negotiated in future should be able to take this issue into consideration to ensure that there are no conflicts between such agreements and tax agreements concluded at the regional level or within member states.

End Notes

i Hereinafter referred to as SADC which is a regional organisation which amongst others drives the agenda for development integration which includes trade liberalization. SADC has fifteen members which are:- Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

ii Hereinafter referred to as COMESA. COMESA is a preferential trade area and its main objective is to forge economic integration with the establishment of a Common Market and the consolidation of their economic cooperation through the implementation of common policies and programmes aimed at achieving sustainable growth and development. COMESA has nineteen members which are: - Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

iii Hereinafter referred to as SACU. SACU is a customs union providing for free trade in goods and a common external tariff. SACU has five members which are:- Botswana, Lesotho, Swaziland, Namibia and South Africa.

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