



Modernizing VATs in Africa

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Book review by ANTONIJA BULJAN*
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African countries continuously struggle with sharply increasing debts while their tax revenues are not sufficient to finance their development needs. The African Development Bank estimates that Africa's available finances per year are less than half of the needed amount to fund infrastructure alone (Commodore, 2020). In order to reach the UN Sustainable Development Goals in education, health, water and sanitation, roads and electricity by 2030, African countries need to mobilize domestic revenues (Gaspar and Selassie, 2017; UN, 2015). One of the tax forms with the largest revenue-generating potential is value added tax (VAT), a non-distortive tax, which is "growth friendly", important in the context of low potential growth in African countries.

That is why the book *Modernizing VATs in Africa* by Sibbren Crossen puts VAT in Africa in the spotlight. The author is a professor of Economics at the University of Pretoria and academic partner of CPB Netherlands Bureau for Economic Policy Analysis. He has published numerous books and articles on the effects of taxation and on tax policy and advised many countries on the design of their tax systems.

The purpose of this book is to propose solutions for the reform of VAT design in Africa, to boost the revenue-generating capacity, while advocating a neutral, simple and revenue-productive VAT. At the moment, African VAT systems abound in exemptions and zero rates which hinder its collection efficiency, while nine countries in Africa do not have it yet. As stated in the title, the mission of this book is to make Africa's VAT systems more modern. While the traditional VAT system – implemented in the EU – contains numerous exemptions and reduced rates, a modern VAT – implemented in Japan (1984), New Zealand (1986), Canada (1991), South Africa (1991), Singapore (1994) and other countries that learned from the EU mistakes – will minimize the number of exemptions and apply just one rate to a broad tax base. Both kinds were introduced in Africa: based on the New Zealand goods and services tax (GST) in Southern Africa as well as on the EU's Common VAT Directive (2006) in franco, anglo- or lusophone countries. The proposed VAT modernization is primarily concerned with broadening the VAT base (through minimization of exemptions and zero rates), rather than with modification of the VAT rates. The author emphasizes that efficient regressive taxes combined with well targeted social transfers can result in a fiscal system that is equalizing, while zero rates and exemptions introduced for equity goals are proven not to be efficient and mostly benefit high-income groups.

The book examines the role of VAT in the context of economic and monetary union in Africa. With closer economic integration import duties are to be phased out and VAT is the main candidate for replacing lost revenue. The guiding principle for VAT design in this book is to broaden the VAT base while minimizing distortions of market competition and economic efficiency.

This book can be useful to tax professionals, policy makers and everyone interested in the specifics of VAT in Africa. It gives a valuable review of consumption

taxes implemented in African countries in the context of regional economic communities, with a detailed overview of exemptions, zero and reduced rates. Due to its excellent critical approach to different taxing regimes, not just in Africa but worldwide, the book is recommended to anyone interested in modernizing VAT design in any country.

The book compares the current treatment of standard and non-standard exemptions and zero rates in Africa to that in other developed and developing countries. It lists the pros and cons for different taxing regimes, then it draws up the best practice examples and recommendations for African countries. The problems arising in each of the exemptions are discussed in detail in individual chapters, with interesting and sometimes innovative ideas to extending the coverage of VAT.

The author is well aware of administrative constraints in African countries, pointing out that “methods that are very complex should not be considered even if they can yield the correct result” (p. 218). Therefore, the proposal is not necessarily the best practice one, but the one that is the most appropriate given the stage of economic development and administrative capacities of African countries. Accordingly, the book suggests transitional measures intended to soften the impact of base-broadening changes.

The book is divided in 18 chapters and 4 appendices. Chapters 1-3 accentuate the need for reform of VAT in African countries, explain the basics of VAT, describe a best practice design and compare VAT with other consumption taxes.

Chapters 4-8 familiarize the reader with consumption taxation in Africa. This part gives an overview of VAT in African countries grouped by regional economic communities. It accentuates the need for VAT harmonization and the abolition of import duties. It also highlights the shortcomings of other existing sales tax regimes in African countries that did not implement VAT. In order to draw attention to the VAT base, the book then analyses VAT revenue generating performance, which is significantly lower in Africa than the world average, reviews the literature on the redistributive efficiency of zero rates and exemptions and discusses the current practice in Africa. It further discusses the application of higher than standard rates or excise taxes on luxury products and gives an overview of types of economic integration in Africa. It analyses VAT and excise taxes coordination and discusses the level of coordination needed to establish common markets.

Chapters 9-15 focus on the VAT base and treatment of standard and non-standard exemptions, exclusions and zero rates; repercussions of their application in the context of economic distortions and administrative complexities; comparisons of exclusions in EU with exclusions in New Zealand’s GST and South Africa’s VAT. While chapter 10 reviews non-standard exemptions and zero rates applied in Africa, chapters 11-15 analyse treatment of goods and services that are considered standard exemptions under EU VAT Directive 2006/112/EC: public utilities and cultural

goods, immovable property, financial services, insurance, gambling and lotteries. These exemptions as applied in African countries are not in accordance with modern best practices in Australia, New Zealand, Canada, Singapore and South Africa. The author reviews the pros and cons of different taxing approaches, the best practice scenario and puts forward proposals for VAT modernization in Africa. He reviews possible solutions to the problem of taxing margin-based financial services and gives an overview of new and innovative methods that have not yet been implemented anywhere: cash flow method and modified reverse-charging.

Chapter 16 discusses the treatment of small businesses and farmers. Chapter 17 reviews the main tax administration processes: registration, filing, payment, collection, enforcement, audit and fraud, however, without going much into detail on the main administrative issues which are of major importance in African countries. The last chapter concludes with a review of the principal findings and recommendations for VAT modernization.

As compared with other academic discussions of VAT (Bird and Gendron, 2007; Ebrill et al., 2001, etc.), this book draws attention almost exclusively to its design. VAT administration, apart from one brief chapter, is not the focus of this book. Although better design should make VAT administration easier as administrative and compliance costs rise with multiple exemptions, zero rates and low threshold, the VAT administration itself should not be neglected. Especially not in Africa. The book does highlight the need for VAT administration reform as it states: “Changes in VAT design cannot achieve much if inefficient and wasteful, indeed sometimes counterproductive, administrative processes are left in place” (p. 6). Other issues such as the international aspects of VAT (treatment of cross border services supplies and so on) are not given much attention in the book, either.

Finally, we can summarize how the book envisions a more modern VAT in Africa. In order to broaden the VAT base, most non-standard exemptions should be abolished. Public transport and specific unprocessed items should temporarily remain exempt and gradually be replaced by the standard rate or a positive reduced rate. All services should be taxed unless they are exempt for social (healthcare, education, social services) or administrative reasons (margin-based financial services). As for standard exemptions, the book recommends taxing financial services, insurance, lotteries and gambling, supplies by public bodies (that can also be performed by private sector) and immovable property (except rental values, rents and sales of used dwellings). Transfer duties should be confined to transfers of immovable property between non-taxable persons. As for insurance, exemption should be confined to life and health insurance. A high registration threshold of US\$50,000 or higher and a minimum threshold are recommended to exert less pressure on VAT administration while threshold differentiation for services is not recommended. The combination of high threshold and the zero-rating of agricultural inputs that have no use outside the agricultural sector should be sufficient for small farmers not to bear the burden of VAT.

From the very beginning, it is clear that the author is aware of the difficulty of implementing the suggested modernization of VAT design in African countries. The book starts with a quotation that “one general lesson is the political difficulty of making sensible changes to a VAT once it has been introduced: Mistakes made at introduction are hard to undo” (Keen, 2009). Political support is indispensable for any of the suggested modernizations to achieve viability. The book concludes that modernizing VATs requires a “change in mindsets”, referring to political elites in Africa. Political attention nowadays is predominantly focused on tax changes that are perceived as pro-poor and pro-growth such as zero rates, exemptions or tax holidays, rather than on the changes in expenditure that are really pro-poor and pro-growth such as healthcare, education, infrastructure and legal protection.

Sjibren Cnossen did an excellent job of describing the features of a modern VAT design and outlining the reform directions for African countries. Having said that, perhaps “modernizing VAT design in Africa” would have been a more suitable title for the book. Given its current title, more attention should have been paid to the administration. To develop a fully modern VAT it is necessary to reform both the design and the administration.