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Is it time for a chat about VAT?

VALUE ADDED TAX

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1. Introduction

One of my friends, a Kenyan tax practitioner, likes to refer VAT as 'very annoying tax'. I think this is such a good joke that my colleagues have begged me to stop telling it: but it's one of the privileges of age to repeat oneself, and I continue to use this gag at every opportunity, at the risk of being considered an old bore. Like all the best jokes, the humour derives from the accuracy of the observation: VAT can be annoying, and worse, it can be a significant obstacle to successful investment. I first learned this 20 years ago when I had newly arrived in Kazakhstan, my first foreign posting, and found that I was no longer only expected to advise clients solely on corporate income tax (my previous role in the UK), but also indirect taxes and even personal tax.

I had to first master input and output tax concepts that a central to the operation of any VAT system. The VAT charged by the seller of goods and services is known as output tax while the VAT incurred on the purchase of goods and services is input tax. Taxpayers only have to remit VAT to tax authorities if their output tax exceeds the input tax in which case they pay the difference. Taxpayers are entitled to a refund of VAT if their input tax exceeds the output tax. I then had to wrestle with import and reverse charge VAT which confounds many taxpayers when a client came to me asking for advice on a zinc mining project. Reverse charge VAT departs from the norm where the seller of goods and services charges, collects and remits the VAT to the tax authorities by flipping the rules. The recipient/buyer rather than the seller of services self-charges output VAT on the imported services received and where applicable remit the VAT to the tax authorities.

The viability of this zinc project depended to a significant extent on the speed with which the company could recover input VAT on mine development costs, mostly deriving from imported goods and services. As the mine was focused on export sales (which are zero rated, of course) there would be no output VAT against which to offset the input tax incurred. We spent long hours with the client debating the possibility that the tax authorities would come up with the cash to repay the input VAT, or even agree to offset it against other taxes on the project. At the time, the government was so short of money that it was likely that VAT repayments would not materialise for years. My client was not happy with that answer, and the project did not proceed. Since 1998, I have seen similar issues in every emerging market I have worked in and major foreign investments delayed or abandoned as a result. One exporting client in Russia had dozens of tax disputes going through the courts simultaneously: each one resulting from the tax authorities refusing a repayment claim for input VAT. In that context 'annoying' seems a very appropriate word to use!

2. Origin of VAT

The concept of VAT was initially developed during the 1914-18 world war and has been adopted by more than 160 countries worldwide, including recently by India and the Gulf states. The USA is the only major economy not to have implemented a VAT system. Since the French colonial administration introduced VAT in Côte d'Ivoire in 1954, it has been widely applied in Africa and was key feature of the tax reforms that many developing countries undertook in the 1990's. The International Monetary Fund ("IMF") has been a consistent advocate of VAT and played a major role in its implementation across Africa in the last two decades.

VAT was introduced in Uganda in July 1996 replacing Sales Tax and Commercial Transactions Levy (CTL) that were levied on the sale of goods and services respectively. Uganda followed in the footsteps of Kenya which introduced VAT in 1990. Tanzania and Rwanda introduced VAT after Uganda in 1997 and 2001 respectively. Though VAT is conceptually superior to sales tax, it is interesting that the business community in Uganda was apprehensive at the beginning, strongly objected to its introduction and even staged a countrywide strike protesting its implementation in October 1996. With continued engagement and sensitization, VAT was accepted by the Uganda business community and there is now a fair amount of knowledge on how it operates. On the continent, VAT typically contributes around 25% of total tax revenue, though in Uganda the percentage is lower: around 16% for 2017/18 according to the Uganda Revenue Authority (URA) website.

3. Ugandan VAT technical aspects

In the administration of any VAT system, 4 key technical issues stand out, namely the place of supply, the time of supply, the value of the supply and the applicable tax rates, All these are addressed adequately in Uganda's VAT legislation("VATA") as I set out. With the exception of services and goods imported into Uganda, all other supplies come within the realm of the VATA if they are made in the country. Goods are deemed supplied in Uganda if the goods are delivered or made available in Uganda by the supplier or if the delivery or making available involves transportation, the goods are in Uganda when the transportation commences.

Determination of the value of the supply is also important as it establishes the taxable base upon which VAT is imposed. In general, the taxable value of a qualifying supply in Uganda is the total consideration paid in money or in kind by all persons for that supply. There are special rules that apply when a business uses its own supplies for non-business purposes or there is an adjustment to the nature of the supply made including but not limited to cancellation, downward revision of order, discount and rebate.

Time of supply also helps ascertaining the timing of the VAT payment. VAT is ordinarily payable in Uganda within 15 days following the month of making the supply. A supply of goods or services generally occurs at the earliest of the date on which the goods are delivered or made available or the performance of the service is completed or the payment for the goods or services is made or a tax invoice is issued.

The standard VAT rate in Uganda is 18% consistent with what Rwanda and Tanzania charge. The standard VAT rate in Kenya is 16%. Exports of goods and services are subject to VAT but at the zero rate like other most essential items including but not limited to drugs and medicines, educational materials, some agricultural inputs and produce.

4. Criticisms of VAT

Though there is a powerful body of opinion that VAT is an appropriate fiscal tool for all governments, it is not always been a popular one and as I highlighted above its introduction in Uganda in 1996 was followed by a strike. Malaysia introduced a VAT system in 2015, only to abandon it 3 years later, following political and practical problems with implementation. Kazakhstan has also recently considered the option of abolishing VAT. Critics of VAT systems point to several issues, for example:

a) It is a tax on consumption rather than income or wealth and therefore seen as affecting the poor disproportionately (because rich people save, whilst poor people must spend all their income on VAT-able goods);

b) Businesses (particularly SMEs) dislike the record keeping and reporting requirements;

c) VAT compliance is also onerous for tax authorities, which may have limited capacity to manage all the administrative requirements, particularly in developing countries;

d) The cash-flow issues created by delayed repayments can significantly increase project costs (as my Russian and Kazakhstan clients discovered);

e) Repayment claims create opportunities for fraud, bribery and corruption.

To which we can add, in the case of Uganda, the fact that for most taxpayers, reverse charge VAT on imported services is not creditable as input tax. This means that while reverse charge VAT is tax neutral in most jurisdictions, taxpayers have to bear the cost in Uganda.

5. Arguments in support of VAT

The critics of VAT have not been very successful in getting their points across as the number of countries which have adopted a VAT system attests. Malaysia is the only country I can think of that has recently abandoned an existing VAT regime. For most governments, the revenue generated is simply too material, the collection machinery too complex, and too deeply embedded, to consider changing.

Proponents of the VAT system often argue that VAT is conceptually superior to the general sales tax because VAT addresses the cascading impact that sales tax can have where tax is imposed on tax, if sales tax is collected at every stage in the production-distribution supply value chain. The tax base at any single stage is therefore the sum of the sales value of the goods plus the tax charged cumulatively in previous stages along the production-distribution supply value chain. Tax on tax escalates the prices of goods and services. Businesses are however able to claim the input VAT that they incur on their purchases for business operations. This ensures that the final consumer to whom a sale is made pays VAT only on the value added by the business which is not the case with sales tax thereby eliminating the cascading impact of tax.

The other advantages that the advocates of VAT, the IMF prominent amongst them, point out to are:

a) Whilst VAT has some regressive characteristics (i.e. unduly burdensome for the poor) it is less regressive than the alternatives: consumption and import taxes;
b) The regressive effects of VAT are reduced by government spending financed by VAT receipts on education, health and other expenditure which reduced poverty;
c) Recording and reporting VAT helps to create a culture of compliance in businesses and assists in the collection and audit of other taxes by tax authorities.

The IMF has devoted considerable energy to helping governments find ways to improve the operation of VAT repayment systems, for example, by encouraging the establishment of accounting which doesn't permit gross receipts to be allocated to spending before expected repayments have been accounted for. VAT exemptions have also come under scrutiny, particularly where these are seen as providing scope for abuse and evasion.

6. Are there alternatives to VAT?

As mentioned above, Malaysia recently suspended its VAT system and returned to a sales tax regime. Though popular, this is expected to raise only about half of the tax revenue which has prompted several tax changes to increase revenues from other sources. If Uganda were ever to consider abolishing VAT, the government would need to consider carefully how to replace the revenue currently generated by the tax. The most obvious option would be a sales tax applicable to retail sales of goods (and possibly services). Arguably this would be no more regressive than the current system, as the economic burden would still fall on the final consumer of those goods and services, without the need for complex administration of input and output tax on intermediate sales. Property taxes have also been highlighted as an underexploited source of government revenue in Africa see for example Taxing Africa, by Mick Moore, Wilson Prichard and Odd-Helge Fjeldstad (Zed books, 2018). This source of revenue is seen as much more progressive than VAT or sales taxes as it impacts the rich (who own property) much more than the poor (who do not).

7. Relevance of the debate for Uganda

Uganda is on the cusp of a significant growth opportunity created by investment in oil. Much of the economic growth resulting will be driven by exports, not only of crude oil, but of oil products from the Hoima refinery, a new petrochemicals industry and other new industries that will grow up as a result of the more vibrant economic environment created by the oil industry. Uganda also has huge, underexploited potential for agribusiness and food processing, which capital generated by oil exploitation will help to release. The problem with VAT repayments raised in my first paragraph could become a significant obstacle to investment in all these projects unless investors can be convinced that VAT repayment claims will be made promptly. If they can, there's no problem, but experience suggests that investors, particularly foreign investors will approach this with scepticism (based on experiences in places like Russia and Kazakhstan). At this critical turning point, it is important to ask the question whether a VAT system is still the best option for Uganda.

8. Conclusions

As a tax adviser, I have seen practical problems with VAT in developing countries, particularly those which intend to promote economic growth through exports. It is of course, easier to criticise the status quo than to come up with a workable alternative and given the investment that has already been made in developing and implementing VAT in Uganda, it would be very hard to make a change. That being said, it will only become harder in future, and its is at least worthwhile considering whether VAT is still 'fit for purpose' as Uganda moves towards oil development and export led growth, and whether there are better options out there.

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From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates, he had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

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