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Africa – Direct Tax or Indirect Tax

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“Mirror, mirror, on the wall, who’s the fairest of them all?” – Brothers Grimm, “Snow White”

Where it all started

Tax evolved like many things in the world we experience today. Taxes were already levied during the various reigns of the Egyptian Pharaohs. The earliest taxes in Rome were customs duties on imports and exports and sales tax. The Saxon kings imposed taxes on land and property and also, sales tax. America was free of direct taxation such as income tax for most of its early history.

Reflecting on history, it appears that indirect taxes such as value-added tax (‘VAT’), goods and services tax (‘GST’), consumption tax and customs duties have been around for centuries and have been the means by which empires, kings, states and governments have funded its existence.

The two sisters of taxation

With history in mind, does direct or indirect tax hold the biggest risk for modern businesses today, with increasing pressure to achieve optimal growth and shareholder returns. Where should the focus be? Sleepless nights because of fear of non-compliance with corporate tax or fear of non-compliance with indirect tax?

Both taxes have the common goal of bringing funds under the control of a government for purposes of meeting their budgeted expenditure. The difference, however, lies in how these taxes arise. Income tax is levied on the taxpayer’s profitability, whilst VAT is levied on consumption transactions in a staged collection process making goods and services more expensive on the final consumer. VAT is therefore, levied irrespective of whether a taxpayer is profitable or not, wealthy or poor.

Before the 1950s and 1960s, African countries were colonies of European countries such as Great Britain, France and Portugal. With independence, the African countries inherited the tax laws established by the colonial administrations. After independence, in many instances, the intention of the legislature was lost and parts of the tax legislation have not been studied or even implemented, although it exists. Taxes collected were used to upkeep infrastructure and development in these African countries, however with independence, many of the knowledge that once existed within the African countries, were lost.

Indirect Tax taking the lead

The African countries have, however started building up tax resources again and many tax legislative changes are seen. Tanzania recently enacted an entirely new VAT legislation in 2015. Professional services firms have advocated for governments to increase the emphasis on VAT as opposed to income tax, in order to make countries better investment destinations, grow savings and ensure that governments rely less on unpredictable taxpayer profits in order to ensure a sustainable economy. Tax authorities in Africa recognises this wisdom, with the majority of the 54 countries enforcing their own VAT legislation fairly rigorously.

The introduction of VAT/GST is continuing to increase globally, with the Indian parliament passing into law GST on 3 August 2016; being the most recent country to approve GST. The UAE plans for all GCC countries to introduce VAT anytime from 1 January 2018 to 1 January 2019.

The global growth in countries adopting VAT/GST has resulted in the expansion of international trade. The OECD in its International VAT/GST Guidelines indicates that the main issue of VAT policy for purposes of international trade, is whether transactions should be taxed by the jurisdiction of origin, i.e. where the value was added or jurisdiction of destination, i.e. where final consumption occurs. The aim of the destination principle is to achieve neutrality in international trade.

The issue of neutrality in international trade comes to play particularly in African countries as the differences in the various VAT/GST systems expose businesses to risks such as double taxation or in the event of not paying tax, increases the risks of penalties, interest and additional taxes. Multinationals also have a reputation to uphold and tax compliance being the current focus, creates further burdens on businesses. These risks are increased due to inconsistencies and complexities in the application of each country's VAT/GST legislation and other than direct corporate tax that may use double tax treaties to reduce the risk of double tax and which provide guidelines of how the treaty should be interpreted, there are no such tax treaties available or applicable to indirect taxes.

Since VAT occurs on a daily basis, as opposed to income tax, which is generally speaking an annual event, the impact of errors or inconsistencies can be exponentially greater than in the context of income tax. There is seldom printed or electronic material available on how indirect taxes are applied by the tax authorities in Africa; often the tax authority websites are not updated, interpretation notes and binding rulings are non-existing or copies are not available or easily accessible. Unfortunately, the tax authority auditors also do not apply the interpretation of the legislation consistently and do not considered the impact of the application on industry level.

How bad can it be?

Apart from common indirect compliance mistakes, other common issues which businesses may experience across Africa with no clear answers or conflicting views, are amongst others:-

- To which extent will business activities trigger a VAT registration liability;
- To which extent will services exported be subject to VAT;
- To which extent will services imported be subject to VAT;
- What about deemed taxable supplies;
- When will goods or services be zero rated or exempt;
- Will non-residents with an appointed tax representative agent be entitled to claim tax credits;
- Are property transfers subject to VAT;

Recent research shows that compliance and indirect tax are priorities for most businesses globally; compliance and VAT going hand-in-hand as VAT applies to transactions daily. That means that on one single supply the same mistake can be made 365 time a year.

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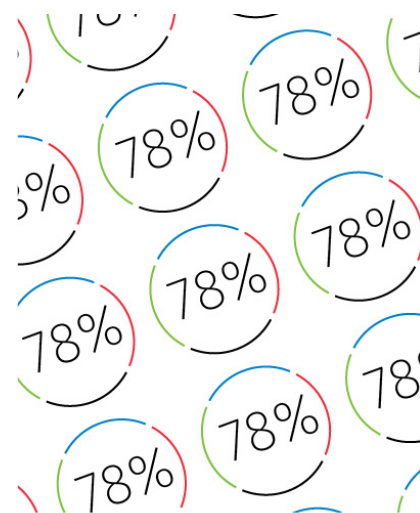
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