Kluwer International Tax Blog

Indirect Tax across Africa: Can your business systems handle a VAT rate error

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International VAT Principles

Multi-Stage Tax

Value-Added Tax (VAT) is designed to collect tax through a staged process. Each business in the supply chain takes part in the process of controlling and collecting the tax based on that supply chain. The business will then remit the portion of tax corresponding to its margin, in other words on the difference between the VAT input and the VAT output. The tax is in principle collected on the "value added" portion per supply chain stage. Governments like VAT because it tends to increase revenue. Because VAT is such an easy way to collect revenue, more than 160 countries impose VAT. The US is the only OECD country that does not have VAT.

Tax on consumption

The purpose of a VAT system is to impose tax on consumption, which is understood to mean final consumption by households. In principle only private individuals, as opposed to businesses, engage in the consumption at which a VAT is targeted. In practice, however, many VAT systems impose VAT burden not only on consumption by private individuals, but also on various entities that are involved in non-business activities, such as educational services, certain road and railway transportation services, financial services but to name a few.

VAT allows for a deduction of taxes on purchases by all but the final consumer. This ensures that VAT remains a neutral tax. As a result VAT "flows through the businesses" to tax supplies made to final consumers.

Cascading – Minimal or none

Value added tax is imposed on "value added" or amount charged in addition to the original cost [Sale Price (output tax) – Purchase Price (input tax)]. This method surpassingly prevents the cascading effect of tax on tax.

EXAMPLE

In case of no VAT (sales tax/consumption tax)
A sells to B matches for 100 PLUS tax @10% EQUALS **110**

B sells to C the same matches and wants a profit of 20, so total of 130 PLUS tax 10% (13) EQUALS **143**

In case of VAT
A sells to B matches for 100 PLUS VAT@10% EQUALS **110**
Now when B sells to C the same matches, VAT is applied only on the value added (profit), so on the 20 because B was entitled to claim the 10.

B sells to C for R120 PLUS VAT@ 10% (12) EQUALS **132**

Difference = 11

Reason for VAT

Implementing VAT should avoid any cascading effect of Tax on the Tax (the 10 in the Sale from A to B) as well as any potential double tax (the 10 relating to the tax rate on the original sale and 1 relating to the Tax on Tax amount.

Double /Non-taxation

Double payment of VAT still happens. There are many examples across Africa of differences in the way jurisdictions implement or interpret the neutrality or place of taxation principles and the "flow through principle" is not applied effectively. There are also many examples across Africa of differences in the way jurisdictions treat the specific facts of cross-border transactions, differences in how a supply is characterised and differences in the interpretation of the domestic rules by parties to a cross-border supply. These differences could lead to double taxation or unintended non-taxation and to disputes.

VAT rates varies across countries globally. In Africa, Djibouti and Botswana are countries with lower VAT rates of 10 percent and 12 percent, with Ethiopia, Gambia, Namibia and recently South Africa adopting a rate of 15 percent, and other countries such as Benin, Cameroon, CAR and Guinea Conakry have much higher rates of between 18 and 20 percent

System configurations for correct VAT rates

The true extent of an incorrect VAT rate is more than just the percentage of the mistake and one can only wonder about the real cost of such a "mistake" as it could affect not only the consumer, but also the VAT vendors, which could create major administration challenges.

How will your Accounting and IT Infrastructure cope with the VAT increase?

Across Africa, VAT vendors must always ensure that sales and secondary systems used for billing, barcoding, price determination, price advertised and many more are updated to include the correct VAT rate. Most systems are set up with a predefined, non-variable VAT rate and in such cases, there should be allowed for timely consultation with information technology specialists in order to make the necessary system changes where applicable.

In some instances, transactions processed at a specific time may however still be subject to a different rate or a rate applicable in a previous period. Accounting resources should be alerted to certain rules and exceptions and there should be confirmed that the accounting system is able to

accommodate the different rates.

Advertising can cost you!

Care should be taken that cash register slips and tax invoices issued reflect the correct VAT rate. Prices advertised for goods should also take changes into account, as the barcode will still reflect the correct item at the point of sale, but the price advertised may not have been corrected to consider the increased VAT rate, which may mean an extended "Black Friday" until the error is detected for many retailers.

Updating documents

In cases where tax invoices issued incorrectly reflect an incorrect VAT rate, a vendor can only claim input tax at that rate. The supplier will then have to be contacted where an incorrect VAT rate is reflected on a document, or the amount is incorrectly calculated. Often, central systems do not import data from branch systems, until the information is posted to the central system. If the information is posted to the central system, any incorrect VAT rate or a VAT rate change would effectively have been implemented in the central system, hence not reconciling with the VAT rate charged by branch systems for the previous day and may even override the branch VAT rate.

Vendors issuing debit or credit notes must carefully ascertain that the correct VAT rate is reflected and applied when determining the VAT amount. Debit or credit notes will generally reflect the VAT rate where it relates to supplies of goods or services, subject to certain exceptions.

Vendors should ensure through adequate planning, consultation, knowing and applying the correct VAT rules and exceptions, testing for errors and checking that transactions are processed and reflected at the correct VAT rate. By doing this, not only will potential disputes with customers be avoided, but also any potential late payment penalties and interest due to the Revenue Authority in a country where output tax is under declared or input tax deduction over claimed because of the incorrect VAT rate used.

Have you updated your budget?

Furthermore, any potential knock-on effect on financial reporting should also be avoided and where budgets have been set for the year, the use of an incorrect VAT rate, if incorrectly treated due to system or human error will be a cost to the vendor and may have a major impact on already approved budgets if not continuedly monitored to detect any incorrect changes made, because there is only so much time to reprint advertised prices and inform the end consumer of any mistakes.

How much time do you need?

Where system configurations are not done in time to accommodate the correct VAT rate, vendors will have to manually recalculate their systems generated amounts frequently and constantly to take into account the difference when the VAT reporting period (tax period) is closed off for purposes of submitting VAT returns as well as to monitor any potential loss of revenue should the incorrect VAT rate become a cost due to errors.

Not registered for VAT?

It would also be important to note the even small businesses not registered for VAT or businesses

making exempt supplies would need to consider the impact of the correct VAT rate on their expenses. This may just lead to increased prices to cover additional costs.

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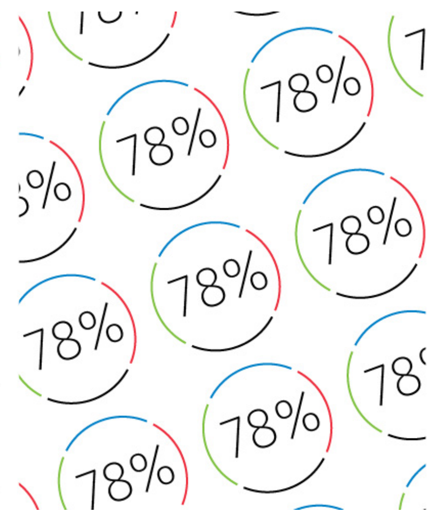

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