

## WEBINAR NO. 4: MANAGING VAT COMPLIANCE AND ADMINISTRATION

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### Questions and Answers

*Disclaimer:* The technical answers reflect views of IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management. They should not be viewed as technical advice or recommendation, as appropriate responses will be country specific.

#### **1. How does digitalization impact voluntary compliance of VAT obligations? Is the lack of digital technologies an obstacle in low income countries?**

Digitalization –the integration of digital technologies into everyday life– benefits VAT compliance through two main channels: easing tax transaction costs and increasing deterrence by making taxpayers aware that revenue authorities have timely, reliable, and accurate access to their economic transactions. Anecdotal evidence suggests that countries with greater digital-driven tax tools (e.g., e-invoicing, e-filing, e-payment, e-audit, e-bookkeeping, etc.) tend to have higher VAT compliance levels (other factors being also important). Moreover, these tools, combined with other information reporting obligations, are enabling revenue authorities to pre-populate VAT returns (e.g., Chile, Italy, Spain), thus further reducing compliance costs. Low-income counties with more basic infrastructure may be able to leapfrog directly to the latest digital technologies (e.g., Afghanistan) however, digital inclusion remains a challenge. Governments must ensure that as many individuals and businesses as possible are able to access the digital world and are taking up digital technology. In low-income countries rollout of new technology and initiatives must be carefully designed, recognizing the transition time and costs for adoption by individuals and businesses.

For further information see: [Digital Revolutions in Public Finance](#)

#### **2. Do e-invoicing, electronic fiscal devices (EFDs) and similar tools help revenue authorities to enhance VAT compliance?**

An important component of a comprehensive VAT compliance strategy is the effective control of fictitious invoicing. A comprehensive VAT compliance strategy typically includes elements such as proactive pre- and post-registration checks; systematic, credible, prioritized, and transparent processes of cross-referencing purchase invoices back to sales; taxpayer education and assistance;; audits and prosecutions with the help of dedicated teams specialized in detection and technology-based tools such as electronic invoicing and EFD (electronic cash registers and fiscal printers), which not only strengthens deterrence but provides useful information to the tax administration; exchange of information protocols internally and abroad) on fraud trends/developments and, if the law permits, on actual/suspected fraudsters; and sufficient dedicated human resources and skilled analysts to combat fraud. Dabla-Norris and others (2019) find that in Peru, VAT e-invoicing increased firm sales, purchases and value-added inputs by almost 10 percent, mostly among relatively smaller

firms and in sectors with high non-compliance. However, the aggregate effects on actual VAT collections are small. Casey and Castro (2015) analyze the use of EFD by developing countries and argue they can only be effective if they are part of a comprehensive compliance strategy. Only an effective use of the data obtained from these tools to cross-check tax return information can enhance enforcement in the long run. Moreover, combined with other information these innovations are enabling some revenue authorities to pre-populate VAT returns (e.g., Chile, Italy, Spain) further reducing compliance costs.

For further information see: [Digitalization to Improve Tax Compliance: Evidence from VAT e-Invoicing in Peru](#), and [Electronic Fiscal Devices \(EFDs\): An empirical study of their impact on Taxpayer Compliance and Administrative Efficiency](#).

### **3. What are good practices in managing VAT credits and refunds effectively?**

Timely and full refund of excess credits is an essential component of a VAT system based on the destination principle (they do not constitute an incentive or subsidy). Practices vary by country, but they tend to range from the extremes of an immediate refund system to (indefinite) carry forward of excess credits to offset against future VAT (and other taxes) liabilities. The denial or delay of refunds to a business represents an opportunity cost in terms of time value of money and may cause serious cash flow problems for the entity. In the case of exporters, denial or delay of refunds makes the VAT resemble a production tax through its unrelieved burden on inputs. Countries should not try to prevent the accumulation of excess credits by limiting the amount of input VAT that can be recovered. The result of such an action may be the conversion of a small number of large claims (exporters, gross capital formation) to a large number of small claims that are much more burdensome on the tax administration and the taxpayers. These policy measures may fail to provide a solution to growing refund problems because they do not address the root causes of unwarranted refunds such as domestic zero rating, reduced VAT rates, and VAT withholding. On the administrative side, a best practice consists of having a risk-based refund management system as a part of a broader VAT compliance strategy discussed in 2 above.

For further information see: [TPAF - VAT Refunds and Common Issues](#).

### **4. What is an appropriate guide in setting the VAT threshold?**

It is common practice to exclude small businesses from the requirement to register for VAT through the application of a registration threshold. This registration exclusion results in small traders paying unrecoverable VAT on their taxable purchases and not being required (nor permitted) to charge VAT on their supplies, such that their value-added is effectively taken out of the VAT base. At the same time, these small businesses are relieved of VAT compliance obligations. The standard recommendation is to use a single threshold applied across all industries (e.g., without differentiating between goods and services). Multiple thresholds are difficult to administer and open up classification disputes and tax planning opportunities. To safeguard against the potential avoidance of the VAT threshold through the artificial segregation of activities across multiple related

businesses, related firms should be grouped, whenever possible, for the purposes of determining whether they fall under or above the threshold. Modern VAT laws include rules for the registration of branches, groups of companies, and private firms set up by families to mitigate this type of avoidance. Good practice also allows for voluntary VAT registration of businesses falling under the threshold, provided these businesses are able to maintain reliable books of account substantiating their transactions.

For further information see: [TPAF - VAT Threshold](#).

**5. What do you mean by 'Trade' when referring to compliance gap? Are the compliance gap indications presented on manufacturing the reality everywhere?**

In the context of the VAT gap studies conducted in capacity development missions by FAD's Revenue Administration Gap Analysis Program (RA-GAP), "Trade" is broadly based on the economic activities of retail, wholesaling, storage, and transportation. The same studies, conducted in 32 countries, observed significant compliance gaps in the manufacturing sector in some, but not all, of the countries studied.

**6. In addition to informal tax cultures, what can be other causes for non-compliance?**

In revenue administration, broad concepts such as the informal economy are not particularly helpful for practical policy making to address compliance risks. Such risks arise in VAT from a broad range of non-compliant taxpayer behaviors, from simple errors, through failure to register for VAT or file returns, to under-reporting of sales and under-payment. Significant risks can also arise from more systematic frauds, such as the misdescription of commodities, claiming fictitious input tax credits and the large-scale evasion of VAT due on imports. These issues are explored further in the IMF's 2015 policy paper, "Current Challenges in Revenue Mobilization – Improving Tax Compliance", which can be found at the following link: <https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Current-Challenges-in-Revenue-Mobilization-Improving-Tax-Compliance-PP4944>

**7. With regards to resourcing of tax administrations, why do you consider tax administration staff per citizen, as opposed to per taxpayer?**

A variety of metrics are useful in looking at the resourcing of tax administrations. The tax administration needs to focus not only on registered taxpayers, but also to detect unregistered businesses and individuals that ought to be registered, filing returns, and paying VAT. The number of citizens in relation to the number of tax administration staff is thus important from a compliance perspective and therefore an important metric when considering resourcing needs.

## **8. What controls can be put in place to enhance VAT compliance?**

Improving VAT compliance requires long-term reform efforts that begin with strengthening the organization and management of the revenue administration, implementing robust collection mechanisms, and building capacity in core tax administration functions: registration, processing of refunds, filing and payment, debt collection, risk-based verification and audit programs, taxpayer services, and processing of appeals. In recent years, increases in digitalization in revenue administrations have helped transform revenue administration operations, including enhancing VAT compliance risk management. Digitalization enables innovative measures such as electronic invoicing which has been shown to improve tax compliance. For more information, refer to “The Experience of Digitalization to Improve Tax Compliance: Evidence from VAT e-Invoicing in Peru.”

<https://www.imf.org/en/Publications/WP/Issues/2019/11/01/Digitalization-to-Improve-Tax-Compliance-Evidence-from-VAT-e-Invoicing-in-Peru-48672>

## **9. What are some considerations and options to ensure VAT compliance on digital supplies made by foreign entities??**

Countries around the world use various methods to ensure compliance of VAT on digital supplies made by foreign suppliers. Some countries, for example, employ vendor collection models whereby non-resident suppliers are required to register for VAT in the foreign jurisdictions where they make supplies to final consumers, charge and collect VAT on those supplies, and remit the revenue to the foreign jurisdiction. Filing compliance can be enforced by authorizing the revenue administration to issue default assessments of VAT when a supplier fails to file a tax return within the required time frame. Where a non-resident business fails to remit its VAT liability, some countries require financial institutions and other businesses to stop paying monies owed to the business and instead transfer the payment to the revenue administration. Also, where agreements are in place, countries may make requests under the *Convention on Mutual Administrative Assistance in Tax Matters* to the country in which the non-resident business is based for their assistance in collecting the outstanding amounts.

## **10. Could you discuss the management and control of VAT for online transactions?**

Approaches to the taxation of e-commerce have substantially evolved in recent years with countries seeking to adjust VAT rules to address challenges such as the intangibility of foreign supplies of digital goods and services to consumers and increases in imported parcels below traditional de-minimis tax and customs thresholds.. International guidelines (OECD 2017 [Link <http://www.oecd.org/ctp/international-vat-gst-guidelines-9789264271401-en.htm> ] ) and country experiences for example in the EU [Link: [https://ec.europa.eu/taxation\\_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce\\_en](https://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en) ] and Australia [Link:

<https://www.ato.gov.au/business/international-tax-for-business/gst-on-imported-services-and-digital-products/> ] provide relevant practical guidance to inform reform efforts including options to leverage the prominent role of digital platforms in facilitating sales to final consumers.

#### **11. Should less developed economies consider an alternative system beyond VAT?**

VAT is a modern tax; used by more than 160 countries as of 2020. The VAT is a major source of revenue in many economies as well as a relatively efficient tax, generating small welfare losses (See: IMF TPAF – “Is the VAT efficient?” <https://www.imf.org/en/Data/TPAF>). VAT is considered to be a good choice for developed and less developed economies because its implementation is relatively easy, and its design makes tax fraud less likely."