
VALUE ADDED TAX (VAT)



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VALUE ADDED TAX (VAT)



Value added tax (VAT), is a tax on consumer expenditure. It is collected on business transactions and imports.

Purpose of a new law:

- To make domestic producers and foreign enterprises doing business in Iraq more competitive on international markets.
- To make the system an effective means of collection of indirect taxes; and
- Stable and effective source of government revenue.



WHY IS IT CALLED 'VALUE ADDED' TAX?



- Value added is the value a producer (whether a manufacturer, distributor, advertiser, hairdresser, farmer, etc.) adds to raw materials or purchases (other than labor) before selling the new or improved product or service.
- The VAT system includes all businesses in the production chain from manufacture through to retail. VAT is collected at each stage in the chain when value is added to goods or services. For example: the farmer grows wheat, the miller grinds the flour, the baker bakes the bread and the market sells the bread. Each of those businesses add value to what they purchased from the previous business. Hence the name 'Value Added' Tax.



VAT versus SALES TAX



- The simplest form of a sales tax is one that takes a straightforward percentage of all business turnover.
- This form of tax will cascade (tax on tax).
- This can be avoided if sales between registered traders are tax free or if imports to registered manufacturers are tax free; and
- This system is heavily reliant on the registration number, and traders are meant to verify that they sell to or buy from only appropriately registered traders which leads to abuse of registration numbers.

As well.....



VAT versus SALES TAX



Disadvantages of Sales Tax:

- The higher the rate, the more collection weight is put upon the weakest link in the chain - the retailer, especially numerous small retailers.
- All of the revenue is at risk if the retailer chooses to be non-compliant, whereas tax collected at each stage would require all levels to be non-compliant.
- The audit and invoice trail is poorer than under a VAT, especially for services; and
- Revenue is not secured at the easiest stage – importation.



Advantages of a VAT system



- VAT removes the tax on exports.
- The basic book-keeping required for VAT provides a basis for more efficient business practices and in many instances improves profitability.
- Stocks of goods are held free of VAT which facilitates the development of businesses; and
- An efficient VAT system provides the basis for efficient tax administration and addresses the shadow economy.



HOW DOES VAT WORK?



- It is accounted for and paid at all stages of the supply of taxable products and the provision of services.
- All supplies of goods and provision of services within Iraq by a taxable person in the course of conducting economic activities will be subject to VAT.
- The import of goods will be subject to VAT.
- Tax paid on inputs (purchases/expenses) is credited against tax collected on outputs (sales).
- The export of goods from Iraq will be zero-rated. As a result, tax paid on inputs is refunded, making goods produced in Iraq more competitive internationally.



WHO REGISTERS FOR THE VAT?



A taxable person who supplies goods or services above a certain threshold of sales:

- The VAT threshold is a pre determined level of annual turnover of a business, above which the business should apply to the Iraq Tax Commission to become a VAT registered person.
- Businesses with annual turnovers below the VAT threshold are not required to be registered but may do so on a voluntary basis; and
- The activities include production, processing, trade, and service activities, including mining, agriculture and all professional activities, and the use of property and property rights.

It also includes importers.



VAT THRESHOLD DETERMINATION



- A high threshold has the administrative benefit of reducing the number of registered business.
- However, the higher the threshold is the more small producers and retailers are not subject to VAT reducing the yield of the tax.



VALUE ADDED TAX LAW FOR IRAQ



The law should be based upon the invoice or credit method of levying VAT, as follows:

- An invoice issued during a transaction reflects the value of the goods/service, the tax and the registration number of the registered person issuing the invoice; and
- On the strength of the invoice, the recipient of the supply (input) claims a credit for the tax paid, against the tax collected on outputs.



THE VAT SYSTEM



- Registered Persons under the VAT charge VAT on outputs.
- Registered Person deducts any VAT that has been paid on inputs (purchases).
- The balance is then remitted to the Government on a periodic basis or, if inputs exceed outputs, refunded by the Government; and
- As a result, the burden of the tax is borne by the final consumer.



ZERO RATING AND EXEMPTION



Special VAT treatment can be applied on certain goods, works and services. These can be either zero-rated or exempt.

ZERO RATING: A rate of 0% is applied on certain supplies, usually exports. As a result, any VAT paid on goods, works and/services used in their production or distribution can be reclaimed by the supplier.

EXEMPTION: No VAT is chargeable on outputs. In this case, VAT previously paid on goods, works or services, used in their production, cannot be reclaimed.



COMMON EXEMPTIONS



- Financial Services
- Bank notes and coins
- Medicines
- Healthcare
- Education
- Limited land and property



ISSUES FOR FURTHER CONSIDERATION



VAT registration threshold:

1. Number of rates

- International standard practice favors only one positive tax rate. It significantly simplifies compliance and the administration of the tax as it minimizes the number of goods that can fall in more than one category. It also simplifies the credit determination.
- Multi-rate appears to provide relief to certain goods but the revenue loss associated with the lower rates requires higher general tax rate.

2. Timing of implementation.





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