Value Added Tax
An Overview

What is a Value Added Tax (VAT)?

VAT is a tax on consumer expenditure. It is collected on <u>business</u> transactions and imports

Why does Iraq need a VAT?

- 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
- Stable and effective source of Government Revenue

The Growth of Value Added Tax

- VAT was generally accepted to have been introduced first in France in the late 1940s.
- The definition of a VAT is:
  - A broad-based tax levied on commodity sales up to and including, at least, the manufacturing stage, with systematic offsetting of tax charged on commodities purchased as inputs against that due on outputs.
- Currently VAT is a key source of revenue for more than 125 countries worldwide, raising more than $18 trillion – roughly a quarter of all government revenue.
- About 4 billion people, 70% of the world's population, now live in countries with a VAT.
- More than 75% of countries adopting a VAT have done so since 1990.

Value Added Tax – Why?

- Value added is the value a producer (whether a manufacturer, distributor, advertiser, hairdresser, farmer, etc.) adds to raw materials or purchases (other than labour) before selling the new or improved product or service.

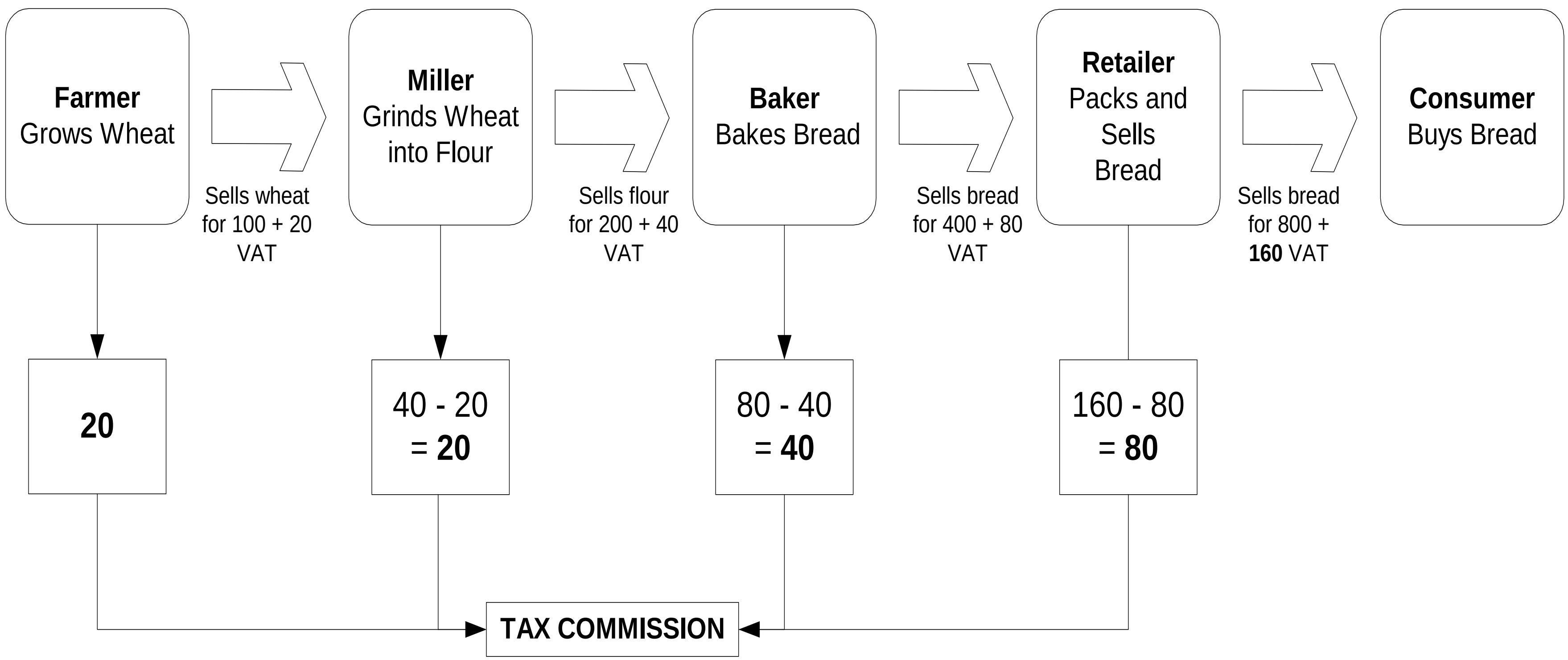
- The VAT system includes all businesses in the production chain from manufacture through to retail.

- VAT is collected at each stage in the chain when value is added to goods or services. For example: the farmer grows the wheat, the miller grinds the flour, the baker bakes the bread and the market sells the bread. Each of these businesses add value to what they purchased from the previous business. Hence the name "Value Added" tax.

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 his economic activities will be subject to VAT
- The import of goods into Iraq 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

The VAT 'Chain'



VAT Registration and Taxable Persons

- **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 register but may do so on a voluntary basis
  - 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**

Compulsory Registration for VAT

Example assumes business started in Jan 05 and that VAT threshold is 15million within any 12 consecutive months.

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Turnover	2.0m	2.3m	2.4m	1.8m	2.4m	2.5m	2.3m	0.5m	1.8m
Cumulative Turnover	2.0m	4.3m	6.7m	8.5m	10.9m	13.4m	15.7m	16.2m	18.0m

A business is required to monitor turnover on a monthly basis and once the threshold is exceed is required to register and charge VAT from the month following the month in which the threshold was exceeded. In the above example the threshold of 15m was exceeded on 31st July and the business must register and become a taxable person on 1st August.

Voluntary Registration for VAT

Why should a business operating below the threshold of 15m want to register for VAT?

Taxpayer A

Assumes business provides consulting services mainly to the general public and all inputs are taxable with VAT @ 20%

Purchases/Expenses	=	7.2m
Sales	=	10.0m
Gross Profit	=	2.8m

Taxpayer B

Assumes business provides consulting services mainly to VAT registered businesses and all inputs are taxable with VAT @ 20%

Purchase/Expenses	=	7.2m
Less VAT on Taxable Inputs	=	(1.2m)
Net Purchase/Expenses	=	6.0m
Sales	=	10.0m
VAT charged on sales	=	2.0m
Gross Profit	=	4.0m

As customers of Taxpayer B are all registered for VAT and are entitled to claim VAT charged on Taxpayer B's sales as a credit then they pay the same net price for the services whether they use A or B. The big beneficiary is Taxpayer B as he is entitled to claim the VAT paid on his purchases as a credit as he is registered for VAT.

The VAT System

- Registered Persons charge VAT on outputs (sales)
- Registered Persons deduct any VAT that has been paid on inputs (purchases and expenses)
- The balance is then remitted to the Government on a periodic basis or, if inputs exceed outputs, refunded by the Government

Monthly VAT Account

Date	Description	Value	VAT
January	Raw materials imported from Amman	10,000,000	(2,000,000)
January	Raw materials purchased in Baghdad	20,000,000	(4,000,000)
January	Wages paid to employees	50,000,000	-
January	Sales to Baghdad Customers	150,000,000	30,000,000
January	Export Sales to Syria	20,000,000	-
January	Overhead Expenses	40,000,000	(8,000,000)
January	Exempt Overhead Expenses	5,000,000	-
January	Exempt Sales to Mosul Customers	30,000,000	-
January	Materials purchased for exempt sales	20,000,000	(4,000,000)*
	Total Purchases/Expenses for month	149,000,000	(18,000,000)
	Total Sales for month	200,000,000	30,000,000
	VAT Payable to Tax Commission		16,000,000

*VAT paid on purchases or expenses used to make exempt supplies is not allowable as a credit

Zero-Rating and Exemptions from VAT

Special VAT treatment can be applied on certain goods 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 paid on goods or services, used in their production, cannot be reclaimed as a credit. Common examples of exempt supplies are:

  Financial services
  Insurance services
  Social services
  Healthcare
  Education
  Limited land and property

Example VAT Return

VAT Return					
Name	Company A			TIN	123456789
Address	123, Haifa Street, Baghdad				
Period of Return		1st - 31st January 2005			
	NET			VAT	
Taxable Sales	150,000,000			30,000,000	
Exempt Sales	30,000,000			0	
ZeroRated Sales	20,000,000			0	
Total Sales	200,000,000			30,000,000	
Taxable Purchases	60,000,000			12,000,000	
Imports	10,000,000			2,000,000	
Exempt Purchases	79,000,000			0	
Total Purchases	149,000,000			14,000,000	
Net VAT Payable				16,000,000	

The Tax or VAT Invoice

- 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/services supplied, the amount of tax, the tax rate and the registration number of the Registered Person issuing the invoice
  - On the strength of the invoice, the recipient of the supply claims a credit for the tax paid, against the tax collected on outputs

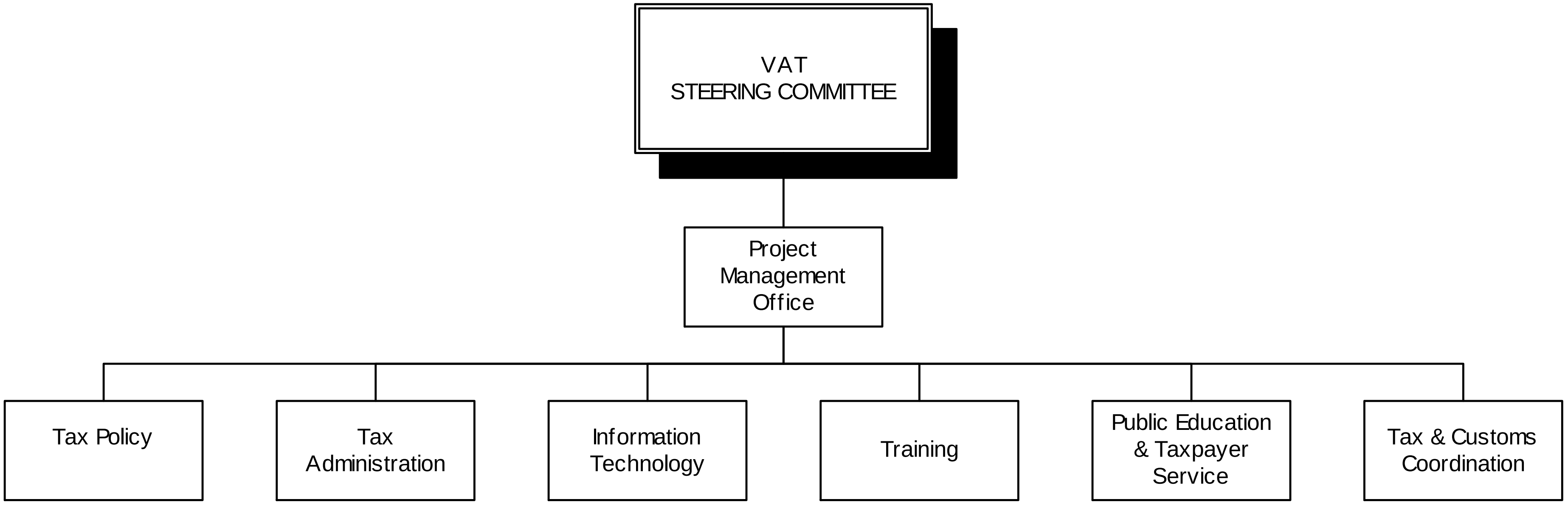
Example VAT Invoice

Value Added Tax Invoice								
SELLER:	Company A						**Invoice No.**	100056
	123 Haifa Street						**Date**	28/1/2005
	Baghdad					**VAT Registration No.**		123456789
BUYER:	Company B							
	987 Haifa Street							
	Baghdad							
Description:		Consulting services for the month of January 2005						
			Value		10,000,000			
			VAT @ 20%		2,000,000			
			Total		12,000,000			

All necessary information required on a VAT invoice is noted in bold

VAT – Implementation Considerations

Implementation Management



Implementation – Policy issues

- Key Tasks:
  - ✓ Drafting the legislation
  - ✓ Circulating the draft for public comment
  - ✓ Finalising the legislation
  - ✓ Publishing the legislation
  - ✓ Drafting enabling regulations
  - ✓ Publishing the enabling regulations

- Key Considerations:
  - ✓ VAT Registration Threshold
  - ✓ Tax Rate
  - ✓ Exemptions and zero-rating

Policy Issues – VAT Registration Threshold

A useful rule of thumb is that the largest 10% of all businesses account for 90%+ of the total turnover.

Worldwide experience has shown that the application of a very low threshold has been one of the greatest weaknesses of the VAT adopted.

The degree to which the VAT base is concentrated among a relatively small number of taxpayers and the limited administrative capacity in many developing countries supports the setting of a relatively high threshold, particularly at the time of introduction.

Selected VAT Thresholds				
Lebanon	$149,000		**Jordan**	
			Manufacturers	$85,000
Palestine	$8,500		Service Providers	$42,500
			Traders	$142,000
Egypt				
Manufacturers	$9,500			
Traders	$26,000			

Policy Issues – VAT Rates

Selected Standard VAT Rates							
Egypt	10%		Austria	20%		Armenia	20%
Jordan	13%		Belgium	21%		Estonia	18%
Lebanon	10%		France	19.60%		Georgia	20%
Palestine	17%		Germany	16%		Kazakstan	16%
Tunisia	18%		Ireland	21%		Poland	22%
Turkey	18%		UK	17.50%		Russia	18%

❖International standard practice favours 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-rates appear to provide relief to certain goods but the revenue loss associated with the lower rates requires higher general tax rate.

Policy Issues – Zero-Rating and Exemptions

❖Zero-Rating: Means that the business is fully compensated for the VAT paid on his purchases/expenses and the transaction is, therefore, genuinely exempt from the tax.

❖Exemption: Means that the business has to pay VAT on his purchases/expenses without being able to claim any credit for this tax paid on his inputs.

Exporter	
Inputs	600
VAT credit on Inputs	100
Outputs (sales)	**1000**
VAT on Outputs	0
Profit	500

Financial Service Provider	
Inputs	600
VAT credit on Inputs	0
Outputs (sales)	**1100**
VAT on Outputs	0
Profit	500

Implementation – Administrative Issues

- Key Tasks:
  - ✓ Design the organisational structure
  - ✓ Design forms and instructions
  - ✓ Draft bookkeeping requirements
  - ✓ Develop operational procedures for:
    - ➢ Registration
    - ➢ Return processing
    - ➢ Audit
    - ➢ Collection
    - ➢ Refund mechanism
  - ✓ Develop educational material for taxpayers

- Keys Considerations:
  - ✓ Organisation of the tax administration
  - ✓ Self-assessment system

Administrative Issues – Organisational Choice

New VAT Department	Customs Department	Existing Tax Administration
Pros: ▪Allows clean break from existing procedures ▪Helps focus on VAT	**Pros:** ▪ Allows exchange of information on imports and exports	**Pros:** ▪Permits a more modern functional-based administration ▪Facilitates coordination between VAT and direct tax administration
Cons: ▪Increases fragmentation of the tax administration and impedes coordination between direct taxes and VAT ▪Increases costs of tax administration ▪Resistance from existing tax administration ▪Difficult to find good personnel resources	**Cons:** ▪General Customs procedures not suitable for VAT administration ▪Customs staff have different skills ▪Impedes coordination of VAT and direct taxes	**Cons:** ▪Possibility of insufficient focus on specifics of VAT administration

Administrative Issues – Self-Assessment

- **Conditions for an effective self-assessment system**
  - **Simple Tax Laws** – A simple VAT would contain limited exemptions, a single positive rate, a zero rate limited to exports and a high registration threshold.
  - **Taxpayer Service** – Taxpayers must receive clear information describing their obligations and must have easy access to information and tax forms.
  - **Simple registration, filing, payment and refund processes**.
  - **Collections** – Prompt identification and action against delinquent taxpayers.
  - **Audit** – Taxpayers need to know that failure to comply with the tax laws will lead to detection and assessment.
  - **Penalties** – Penalties must be strictly enforced for non-compliance.
  - **Appeals** – Taxpayers should have access to a transparent and fair dispute resolution system.

Implementation – Information Technology

- Key Tasks:
  - ✓ Develop the strategy for VAT
  - ✓ Draft the technical specifications for:
    - ➢ Registration and deregistration
    - ➢ Return and payment processing
    - ➢ Interest and penalties
    - ➢ Refund processing
    - ➢ Third-party links (Customs)
  - ✓ Develop and implement software
  - ✓ Define and procure hardware needs
  - ✓ Train system users

Implementation – Training Issues

- Key Tasks:
  - ✓ Define the number of personnel
  - ✓ Develop training modules by function:
    - ➢ Registration
    - ➢ Return Processing
    - ➢ Audit
    - ➢ Collection
    - ➢ Taxpayer Service
  - ✓ Deliver training to ‘trainers’
  - ✓ Roll-out training to all affected staff

Implementation – Public Education and Taxpayer Service

- Key Tasks:
    - ✓ Conduct VAT awareness campaign for citizens
    - ✓ Develop partnerships with taxpayer/business organisations
    - ✓ Distribute informational materials
    - ✓ Conduct VAT education campaign for taxpayers
    - ✓ Initiate telephone ‘help-line’ and website
    - ✓ Provide seminars/workshops for taxpayers

Implementation – Tax and Customs Coordination Issues

- Key Tasks:
  - ✓ Develop a single Taxpayer Identification Number for all businesses
  - ✓ Develop a system of information exchange
  - ✓ Redesign export/import documentation
  - ✓ Consider introduction of VAT deferment policy

VAT – Implementation Issues

Timing of Introduction

VAT Implementation – Timing Issues

- In general the timetable to introduce a VAT should not be less than 24 months from the decision on adoption. This is particularly the case in countries which have a poor level of taxpayer compliance and little exposure to self-assessment of taxes. The presence of the following may reduce such a timetable:

  - **Experience in operating a broad-based indirect tax**
  - **Experience with a tax credit mechanism**
  - **Existence of a modern computer system**
  - **Strong political commitment, ensuring timely legislative process**
  - **Experience with implementing large-scale tax changes**
  - **Availability of high-quality personnel**
  - **Commitment of MoF to adequately fund introduction**
  - **Complexity of the VAT legislation – simpler the tax = quicker**