

VAT Refunds



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Views expressed here are mine, and should not be attributed to the IMF, its Executive Board or its management

Outline: VAT refunds

- Why are VAT refunds so important?
- What challenges do countries face to properly manage VAT refunds?
- What is a good practice framework for managing all aspects of VAT refunds:
 - Tax administration
 - Budget
 - Treasury management
 - Debt management
 - Fiscal statistics

VAT refunds – reference materials

- Harrison-Krelove Working Paper
 - VAT Refunds : A Review of Country Experience
- New FAD Technical Note being drafted
 - Managing VAT Refunds

Why are VAT refunds so important?

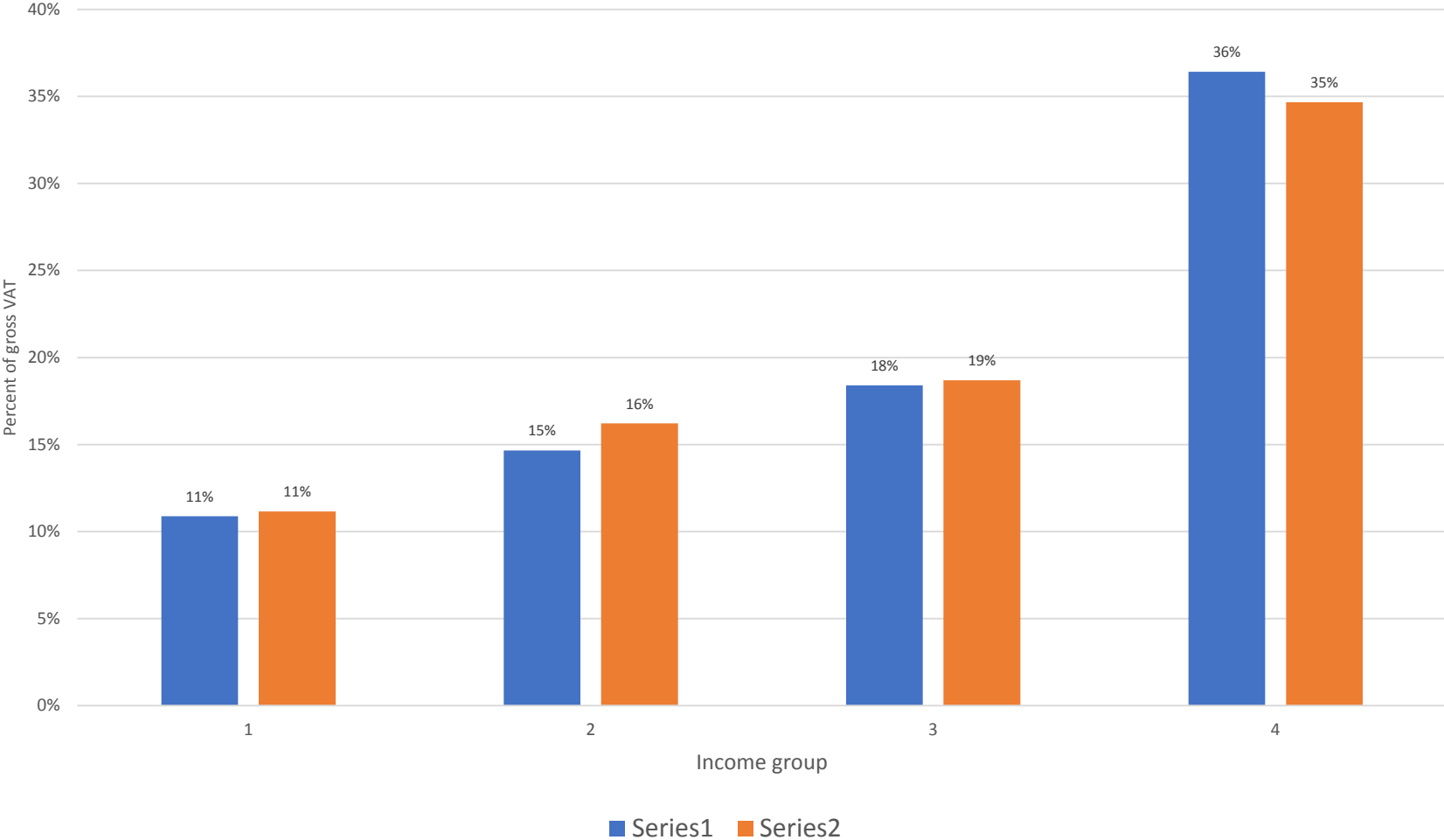
- VAT is a consumption tax - intended to be borne by final consumers
- Need mechanism to remove VAT paid on inputs
- Recovery of excess tax credits essential to correct functioning of VAT
- Well-designed and implemented VAT, promptly refunds credits
- Refund approaches vary:
 - Immediate refund
 - Limited carry-forward
 - indefinite carry-forward

Challenges

- VAT becomes distortive if excess input VAT not refunded:
 - Discourages investment and production
 - Cascading in production-distribution chain
 - Potential inflation of consumer prices or profit reduction
- Or delays in refund occur:
 - Strains business cashflow
 - Increases cost of production
 - Shrinks return on investment
- Risk of fraudulent claims
- Well-functioning refund mechanism has macroeconomic implications for competitiveness, productivity, and capital formation

Level of VAT refunds

Figure 1. Level of VAT Refunds by Country Income Group (2014-15)



Source: ISORA and the IMF survey data for 2014 and 2015.

Efficient administration of refunds

- Few legal restrictions to making claims
- Few administrative layers
- Based on risk analysis to
 - Process in timely manner
 - Mitigate against fraudulent claims
- Fully resourced
- Transparent—with revenue and refunds reconciled, accounted for and registered in national accounts

VAT design issues

- Poorly functioning refund mechanism has adverse impact on VAT design, undermining efficiency and neutrality
- Limit amount of input VAT recoverable through refund:
 - Exemptions on imports
 - Deferral of import VAT
 - Zero-rating domestic supplies
- Results:
 - Increase complexity of VAT
 - Increase compliance costs
 - Weaken self-policing aspects
- Keep design and legal framework simple

Fiscal policy issues

- Many countries record gross VAT collections without properly accounting for VAT refunds to be made
- Risks inflating tax revenues
- Gives false picture of fiscal space
- Risk of committing resources that do not accrue to government – but belong to taxpayers
- Delayed payment of refunds increases stock of government arrears

Funding VAT refunds

- Resource requirements based on actual amount required to pay approved refunds
- Realistic assessment of net VAT is needed
 - Affects reliability of revenue forecast and budget
 - Helps cash management
- Ideally finance refunds out of gross VAT
 - Retain full amount
 - Retain fixed amount
 - Retain fixed percentage of gross VAT
- Or direct financial allocation as part of budget process
- Or issue treasury bonds/tax certificates

PFM good practices

- Gross VAT collections should not be treated as final or available for spending
- Only net VAT should be reflected as revenue item and available for government expenditure
- VAT refunds should not feature in the budget
 - Not a resource that belongs to government
 - Does not require parliamentary scrutiny like other spending

Tax administration good practices

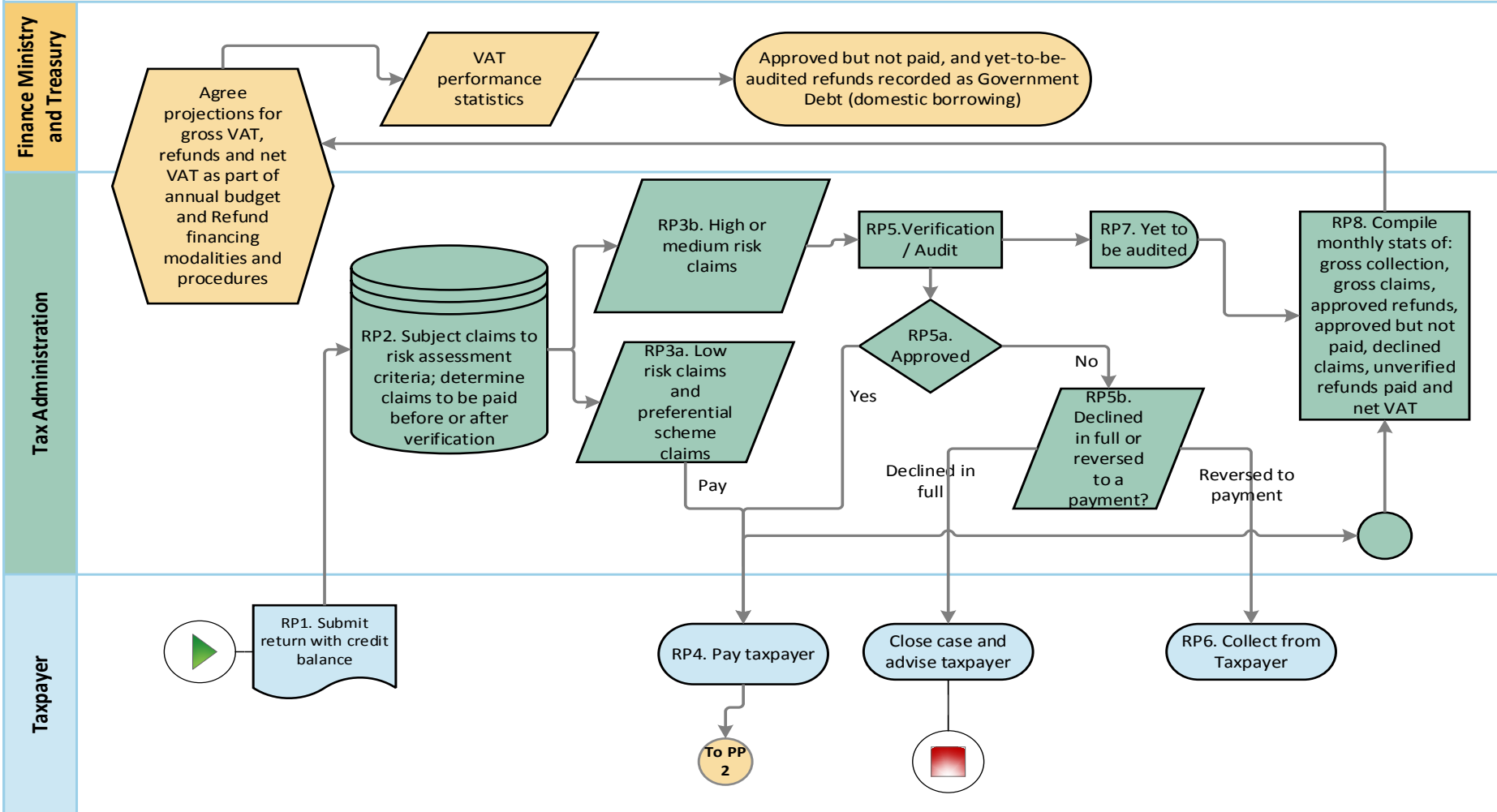
- Refunds claimed on tax return
- No administrative restrictions to entitlement
- Real-time cross matching of transactions
- Objective risk profiling indicators to screen claims
- Targeted verification actions - based on risk
- Linked to broader compliance risk management
- Set, publish, and monitor reasonable refunds processing deadlines

Debt management good practices

- Unpaid VAT refunds are part of government liabilities
- Need to be clearly recognized for effective debt management
- Should pay interest on arrears and unprocessed claims

VAT refund process flowchart

VAT Refund Process Flowchart



Summary of conclusions

- Simplify legal framework
- Implement automated risk-analysis for processing
- Base resource requirements for refunds on actual amount required to pay approved refunds
- Obtain realistic assessment of net VAT needed
- Finance refunds out of gross VAT
- Create separate Treasury sub-account to secure resources
- Record outstanding stock of claims as government liability
- Record VAT collection on net basis for statistical purposes

VAT Refunds

Thank you