

Fiscal Affairs Department

VAT ADMINISTRATION

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7th IMF-Japan High-Level Tax Conference For Asian Countries

Tokyo, April 5-7, 2016

Outline

- VAT Policy Design
- Understanding Compliance – Noncompliance
- VAT Compliance Pillars
- Managing VAT Compliance
- Risk Management as a Tool

VAT POLICY DESIGN

VAT Policy Design Sets the scene

A tax on consumption, but how?... Policy pillars

- **Base**—scope of consumption coverage... or not?
- **Place**—where consumption takes place?
- **Threshold**—scope of taxpayers' coverage?
- **Method**—which approach to value added?
 - **Treatment of excess credit**—Refunds - carry forward - offsetting?
Exporters - capital goods - exempt activities?
- **Rate**—how many?

Policy choices matter for administration...Ideal:

A broad- and destination-based VAT, calculated through the credit-invoice method with single rate and an 'appropriate' level of threshold.

VAT Policy Design Matters

But,... policy choices have been mixed...

- **Base**—multi stages but several countries with too many exemptions, beyond the standard ones
- **Place**—destination principle, the general choice: VAT on imports/exports VAT free (zero-rated), but z-r beyond exports
- **Threshold**—too low thresholds in many countries
- **Method**—invoice-credit and accrual (self-enforced), the choice in most countries
 - **Treatment of excess credit**—all options, but some excessive accumulation
- **Rate**—multiple rates widespread in some regions

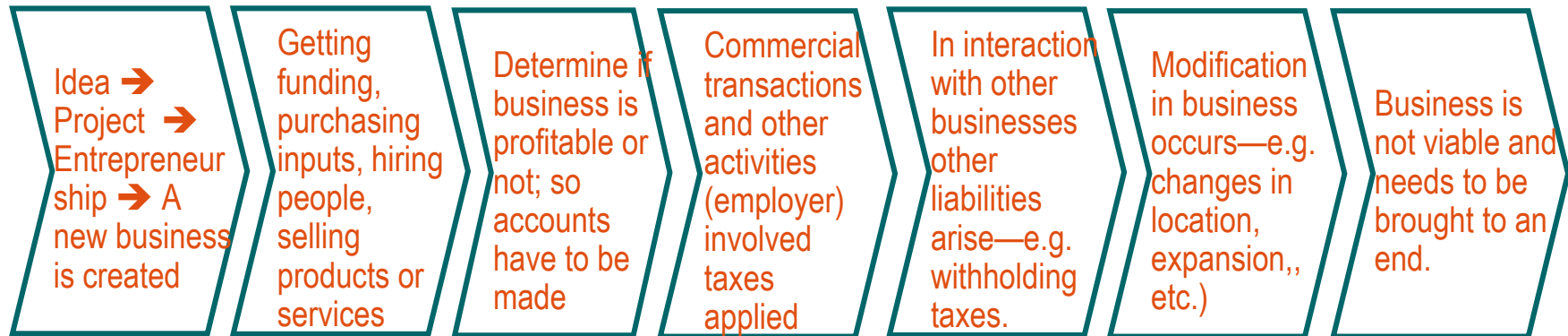
On top, globalization/digitalization of businesses—multiple cross-border transactions,... and digital

➔ **A complex and challenging environment for VAT administration...**

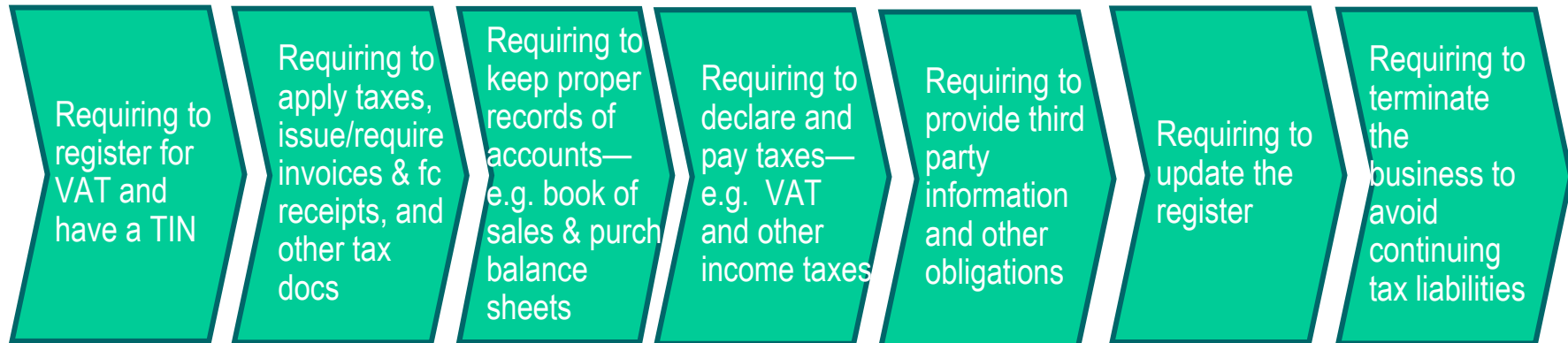
UNDERSTANDING COMPLIANCE – NONCOMPLIANCE

Business and tax compliance cycles

- Several activities by entrepreneurs to undertake businesses



- A *business cycle* used to establish the tax system

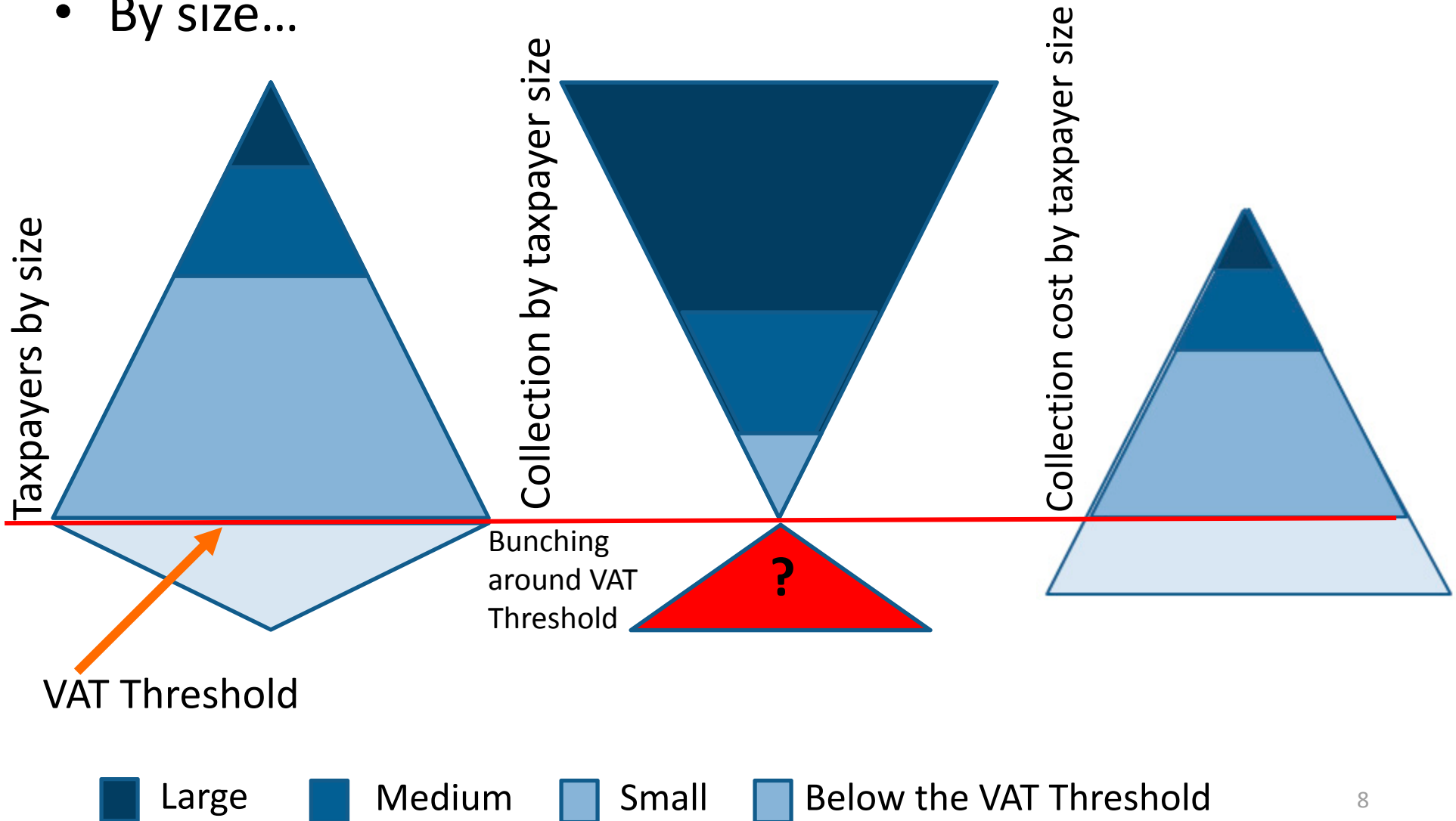


- Creating a *taxpayer compliance cycle* along the *business cycle*

→ So, how it is done matters to minimize burden to taxpayers and maximize tax compliance

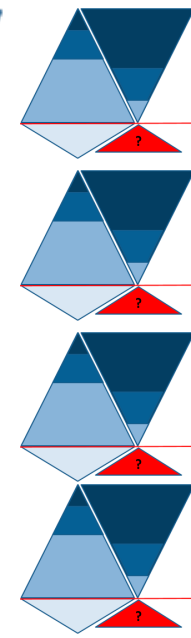
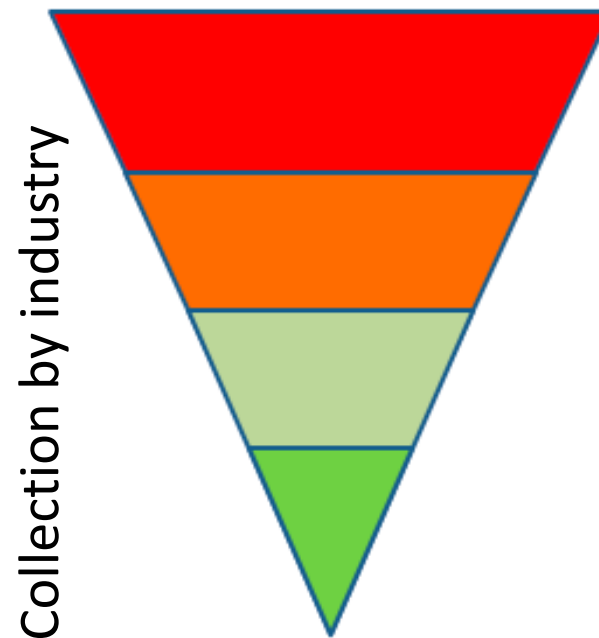
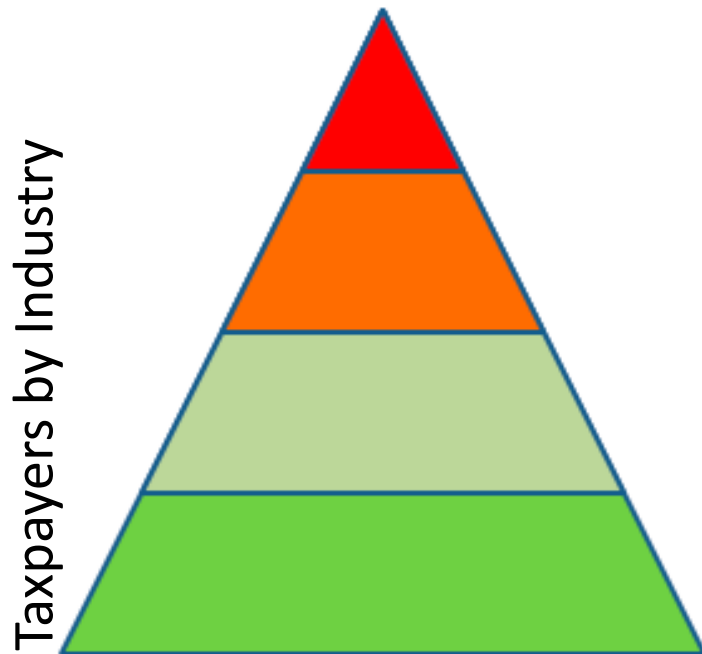
Understanding taxpayer segments

- By size...



Understanding taxpayer segments

- By industry...

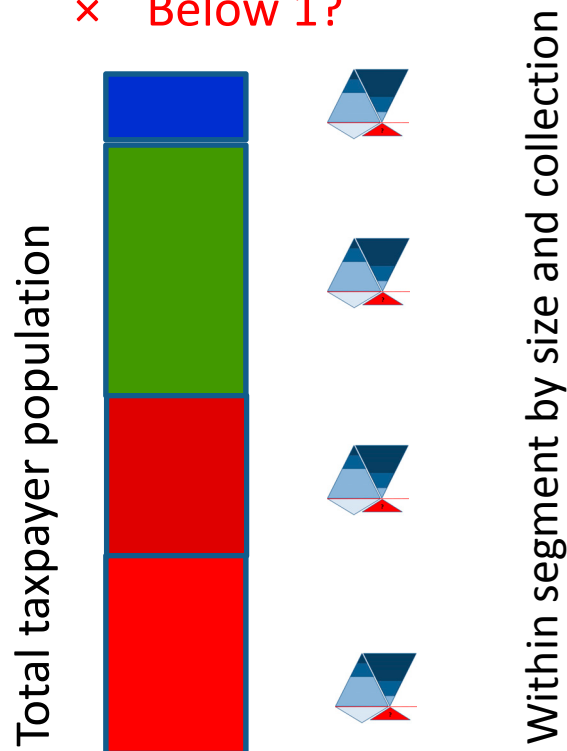


Understanding taxpayer behavior

- By benchmark indicator output/input ratio...

Size of population with VAT output/input ratio:

- ✓ well above 1 (e.g. ≥ 1.5 ?)
- ✓ just above 1 (< 1.5 ?)
- equal to 1?
- × Below 1?



Portions of taxpayer population by these thresholds?

A pyramid again?

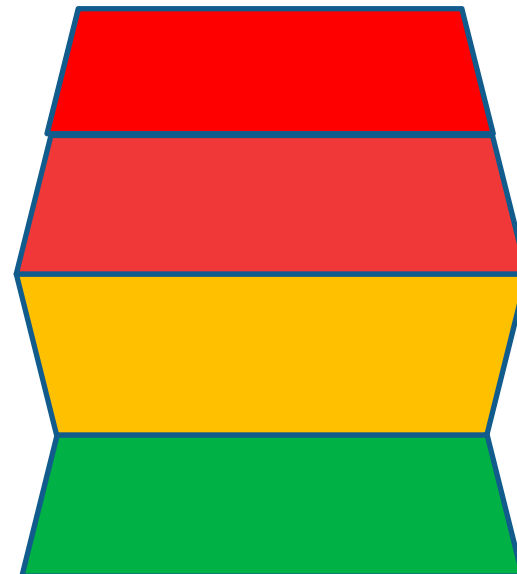
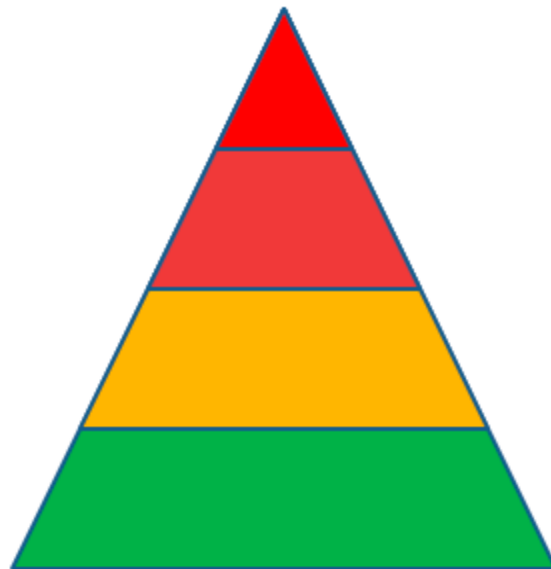
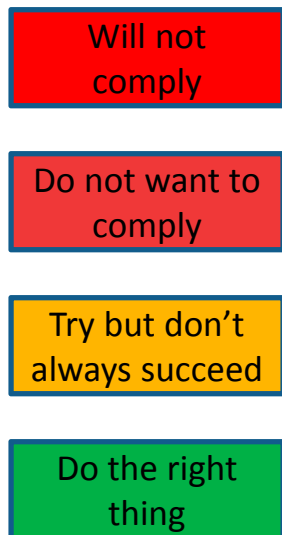
Situation by size and industry-based segments?

Understanding taxpayer behavior

- The attitude to comply...
 - The taxpayer line or pyramid of compliance

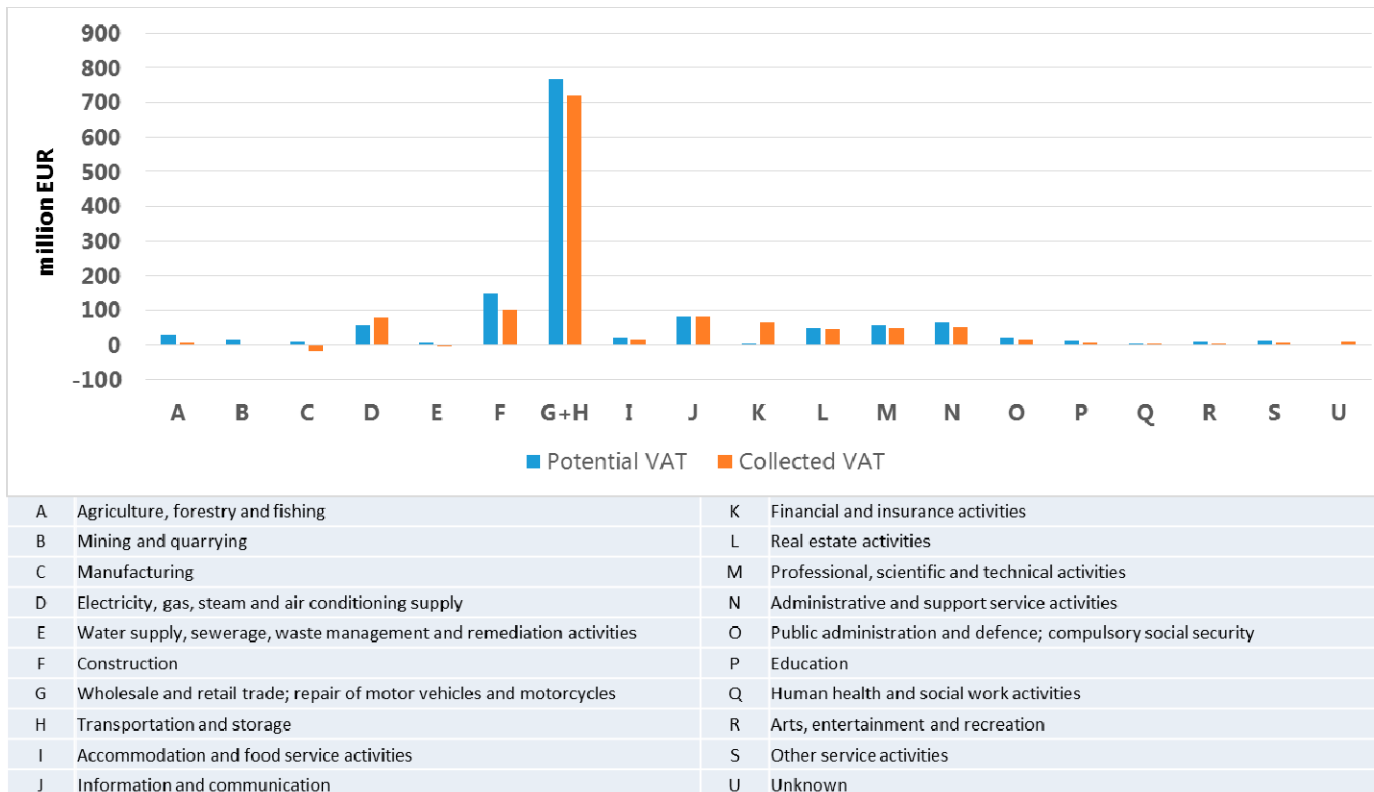
Conventional wisdom

But, if it were like this?



Measuring VAT noncompliance

- By economic sector, among other criteria...



Source: IMF Staff Estimates

➔ In summary: Developing a thorough understanding of VAT compliance and noncompliance; and VAT revenues at risk¹²

VAT COMPLIANCE

VAT key taxpayers obligations

Made the VAT policy choices... compliance pillars

- **Registration**—liable taxpayers must register
 - **Deregister**—inactive should ideally deregister (terminate business)
- **Invoicing**—lawful and in all transactions
- **Keeping records**—complete, all sales and purchases
- **Filing return**—timely and accurate
 - **Clamming refund**—legitimate claims
- **Payment**—timely and in full

And... in most countries taxpayers should **comply voluntarily** with these legal obligations (principle of **self-assessment**).

Mixed compliance

Although no systematic information (difficulties with tax gaps and RA-FIT), some evidence indicates that meeting legal obligations has been mixed...

- **Registration**—not all that should, but too many voluntary registrants
 - **Deregistration**—some resistance
 - **Invoicing**—non issuing, fake invoices, carousel fraud; pervasive problems in some countries
 - **Keeping records**—sales suppression, purchases over-reporting (excess input), misclassification with multiple rates/exemptions
 - **Filing return**—inaccurate and on-time filing far from 100 %
 - **Claiming refund**—fraudulent refund claims a big risk to revenue
 - **Payment**—being in arrears, sometime a too common behavior
- ➔ So, compliance is not always voluntarily and self-enforcing method not always work

Diverse responses

Multiples initiatives,... results has been mixed...

- Massive VAT registration campaign
- Cash registers
- New reporting requirement
- Massive cross-checking of invoices
- Increasing coverage of VAT audits
- Lotteries of invoices and/or final consumption receipts
- E-invoicing
- Reverse charge
- Tax discounts across taxes
- New assessment powers

... also with mixed results to address VAT revenue risks

➔ **Some are implemented in isolation; not as part of a overarching strategy**

MANAGING VAT COMPLIANCE

A holistic approach to VAT Administration

Prioritizing a systematic and synergetic approach to core VAT administration operations

- ***A well-designed and managed system of self-assessment***—universal education and risk-based compliance management. Self-assessment—including self-enforced feature—has proved challenging with VAT
- ***Streamlined VAT procedures and systems***—registration, invoicing, record keeping, filing, and payment
- ***Service oriented approaches***—voluntary-compliance enabler.
- ***Risk-based audit and other enforcement programs***—targeting tax system greatest risks
- ***Accessible and efficient dispute resolution***—solve disagreements in a fair and transparent manner

A holistic approach to VAT Administration

...as well as to VAT organization, management and governance

- ***Efficient organizational structure and staffing arrangements***—strong HQ; function-based; streamlined field operations; taxpayer segmentation; and properly staff.
- ***Effective management arrangements***—governance and accountability to promote performance
- ***Extensive use of digital technologies***—on line tax compliance cycle and enabler of risk-management (including massive cross-checks) and big-data analytics
- ***Modern HR management practices***—promote high performance, integrity and professionalism

...and crucial to continue to pursue

- ***A proper legal framework for VAT administration***—well-designed VAT law and procedures; key determinants of VAT effectiveness.

To deliver effective VAT compliance

...and ensure that these VAT administration pillars achieve the highest level of compliance with the VAT law by:

- ***Educating for compliance:*** through timely provision of information and services that facilitates taxpayers understanding of tax laws, regulations, tax administration processes, and taxpayer obligations.
- ***Facilitating compliance:*** by ensuring processes to make it easy for taxpayers to comply with their obligations across the whole tax compliance cycle, from registration to termination of businesses.
- ***Enforcing compliance:*** by adequate enforcement processes to *deter* noncompliance, entailing clear consequences for noncompliance, proportionate sanctions where there is evasion or fraud and timely recover of tax arrears.
- ***Resolving disputes:*** Accessible tax dispute and appeal processes to solve disagreements between tax administration and taxpayers in a fair and transparent manner.

RISK MANAGEMENT AS A TOOL

Analyzing risks—Criteria

Identifying, assessing, and prioritizing risks to VAT revenues are crucial to guide targeted strategies and improve VAT performance

- By different criteria:
 - ✓ By compliance pillar
 - ✓ By taxpayer segment
 - ✓ By industry
 - ✓ Etc.

Analyzing risks—Assessing impact

An approach to assessing revenue risks...

Consequence / Likelihood	Insignificant	Minor	Moderate	Major	Severe
Remote	Negligible	Negligible	Low	Low	Significant
Unlikely	Negligible	Low	Low	Significant	High
Possible	Negligible	Low	Significant	High	High
Likely	Low	Significant	High	High	Extreme
Almost Certain	Low	Significant	High	Extreme	Extreme

Applying Compliance Risk Management

A structured framework from ATO

Value-Added Tax Industry Compliance Strategy: Specific Economic Sector XX

1. Strategy Overview:	Overall statement with the essence of the targeted strategy to this economic sector.																																	
2. Industry Profile	3. Compliance Risks	4. Risk Treatments																																
2.1 Number of VAT taxpayers (year):	3.0 Overall VAT Compliance Gap:	4.1 Measures for facilitating compliance																																
Total: Large: Medium: Small:	3.1 Registration risk: Overall Risk Large Taxpayers: Specific to LT Medium Taxpayers: Specific to MT Small Taxpayers: Specific to ST	<ul style="list-style-type: none"> • A • B • C • D • E • F 																																
2.2 Amount of VAT revenue (year):	3.2 Invoicing risk	4.2 Measures for dealing with noncompliance																																
<table border="1" style="width: 100%;"> <thead> <tr> <th></th> <th>Revenue</th> </tr> </thead> <tbody> <tr> <td>Gross Domestic VAT</td> <td></td> </tr> <tr> <td>Refunds</td> <td></td> </tr> <tr> <td>Excess Credit</td> <td></td> </tr> <tr> <td>Net VAT</td> <td></td> </tr> </tbody> </table>		Revenue	Gross Domestic VAT		Refunds		Excess Credit		Net VAT		3.3 Filing returns risk	<ul style="list-style-type: none"> • A • B • C • D • F 																						
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Revenue from this segment represents XX of total VAT gross collections: Large: Medium: Small:	3.4 Keeping records risk	<table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th rowspan="2">Number of Actions</th> <th colspan="3">6. Workflows</th> </tr> <tr> <th>Large Taxpayers</th> <th>Medium Taxpayers</th> <th>Small Taxpayers</th> </tr> </thead> <tbody> <tr> <td>Advisory visits</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Pre-filing letters</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Supervision visits</td> <td></td> <td></td> <td></td> </tr> <tr> <td>VAT audits only</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Multiple tax audits</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Debt actions</td> <td></td> <td></td> <td></td> </tr> </tbody> </table>		Number of Actions	6. Workflows			Large Taxpayers	Medium Taxpayers	Small Taxpayers	Advisory visits				Pre-filing letters				Supervision visits				VAT audits only				Multiple tax audits				Debt actions			
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2.3 Main sub- industries: A, B, C,...	3.5 Payment risk																																	
2.4 Key features: Cash transaction, B2B and B2C, ...	3.6 Refund risk																																	
2.5 Important intermediaries: • A. • B. • C. • ...	5. Compliance Indicators																																	
7. Capacity Development	Registration: % increase in registrations Filing: % of tax returns filed on time Payment: % of tax paid on time Reporting: % of audit acts sustained on dispute	<p style="background-color: #d1c4e9; margin: 0; padding: 2px;">Administrative tools</p> For example, specific VAT audit guides for this sector, etc.																																
	<p style="background-color: #d1c4e9; margin: 0; padding: 2px;">Organization and management</p> Changes to support new VAT compliance strategy for this segment	<p style="background-color: #d1c4e9; margin: 0; padding: 2px;">Information systems, data management and analytics</p> For example, e-registration, redesign of VAT service systems, e-audit, VAT gap, etc.																																
	<p style="background-color: #d1c4e9; margin: 0; padding: 2px;">Human resources</p> Improvements (e.g., training) to support new VAT compliance strategy for this segment																																	

➔ But strength of core operations are key success factors of compliance strategies

VAT ADMINISTRATION

**THANKS FOR
YOUR ATTENTION**