

## **"VAT: WHY THE PRIVATE SECTOR COMPLAIN SO MUCH, AND WHAT WE MAY BE ABLE TO DO ABOUT IT"**

Value Added Tax (VAT) as a broad based tax collection system is a very good idea.

The VAT system captures tax on income generation from both formal and informal economic activity through the purchases of goods and services channel in the economy.

For Zambia in particular, the majority of goods and services are imported or delivered through formal businesses. This provides an option for VAT to capture tax at the import or services supply end.

As the goods and services integrate into the economy the opportunities for taxation become more difficult with often much need to implement elaborate and expensive mechanisms to collect relatively low taxes. The viability of tax collection in some cases becomes questionable.

The percentage rate for the purchases of goods and services that goes to VAT is a basic issue which has implications on the cost of goods and services to the consumer, and the capacity for the VAT collection agency to remit the dues to the Revenue Authority.

When VAT is high (17.5% in Zambia), most businesses will hike their prices on imports to cover the VAT component that will have to be remitted to the Revenue Authority. This is done because VAT and Customs Duty paid at the port of entry for imports can only be claimed after the goods have been sold to another party where the VAT component is passed on to the buyer. This investment in taxes by the importer is costly as the goods may not sell for some months, and the cost of money from the commercial banks (around 25% per annum for Zambia) has an interest component that makes the cost of doing business quite high. The sum total of these pressures results in price hikes to mitigate against currency fluctuations and the cost of doing business.

The situation is further exasperated by the fact that the profit margin on goods and services is competitive with the high rate of VAT charged. This has a direct bearing on the cash flow of any business where the motivation to employ the VAT collections in the business cash flow at the expense of remittances to the Revenue Authority is very high.

The administration of the VAT system is very crucial as to whether VAT facilitates business, or becomes a barrier to improved business and economic activity.

The current practice by many Revenue Authorities is to provide for stiff penalties for late submission of VAT returns, in addition to hefty monthly interest rates. This phenomenon is not progressive. It either encourages businesses to evade VAT altogether, or opens doors for corruption within the Revenue Authority to 'fix' the problem. The option for the Revenue Authority to encourage businesses to register for VAT and willingly pay their dues is the most progressive way of making VAT a

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success. Token penalties for late submission and a very small interest rate for monthly late payments is supportive of businesses that may be experiencing liquidity shortfalls due to foreign exchange fluctuations, increased fuel prices, increased power costs, and external pressures brought about by an influx of imports or global commodity pricing. The Revenue Authority must clearly distinguish the difference between tax evaders and tax defaulters. Tax evaders must be punished, but tax defaulters must be facilitated and mentored to continue business and grow to enable current and future tax collection.

The challenges that face the Zambian tax administration in respect to VAT include a mechanism to broaden the tax base possibly by reducing the VAT percentage rate but spreading it across all goods and services in the economy. An argument for this scenario is that even though most essential goods are VAT free, manufacturers and suppliers add the effect of VAT to their selling price as they do for Customs Duties, and the consumer ends up footing the bill anyway. Studies of the basic Zambian Food Basket over the last five years indicate that essential commodity prices have doubled, and in some cases trebled, even though they have never been subject to VAT.

The current option for companies to voluntarily register for VAT is welcome, but the cost of administering and managing the collection of VAT from small and medium enterprises is likely to lead to the Revenue Authority imposing a minimum turnover level for VAT registration which will effectively place the burden of VAT on the larger and formal enterprises.

Due to the higher rate of VAT (17.5% in Zambia) it is not uncommon for consumers and businesses to collude to evade VAT payment by offering to purchase goods and services without the VAT component, and forgoing VAT claims on their own monthly VAT returns. It simply results in business being conducted at 17.5% cheaper than it is supposed to be. But, because this is an informal arrangement, the cost of the product to the end user will still bear the VAT component and result in a higher profit to the company.

Options for deferred VAT payments need to be considered as a means to stimulate more economic activity and make the money in the economy turn over more frequently thus creating more wealth, more jobs, and more taxes.

In Zambia, most VAT payments are made on the due date of the 21<sup>st</sup> day of the month. There are endless queues from morning till dusk as companies try to submit their returns at the last possible moment. Since cash flow is a major issue with Zambian companies, this last minute phenomenon is as old as the introduction of the VAT system itself.

The Revenue Authority is currently working on a solution to this problem by providing for Electronic VAT Submission systems that will be de-centralized and therefore decongested. The private sector welcomes this initiative as a measure to manage the collection system more efficiently, but continues to lobby for a more progressive policy for broader VAT collection, and the development of a business friendly VAT administration that has the capacity to contribute to Government revenues much more than it currently does.

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