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**Committee of Experts on International
Cooperation in Tax Matters
Twenty-fifth session**

18-21 October 2022

Item 3(n) of the provisional agenda

Indirect Taxes

Co- Coordinators' Report

Summary

This note is presented to the Committee for discussion and decision.

At its 23rd Session, the Committee of Experts on International Cooperation in Tax Matters agreed to establish a Subcommittee on Indirect Taxation with a mandate to identify priority issues where guidance from the Committee may most usefully assist, in particular, developing countries in differing situations, on taxation issues related to indirect taxation, with an initial focus on value added tax/goods and services tax (VAT/GST) issues.

At its 24th Session, the Committee considered and approved note E/C.18/2022/CRP.7 that identified priority areas with the objective to develop a series of good practices in the design, compliance and administration issues that developing countries may face related to VAT/GST.

This Co-Coordinators' Report describes the various meetings, since the last session, organized by the Subcommittee to inform its ongoing work and ensure that the Subcommittee work plan responds to developing countries' needs and challenges.

The Subcommittee seeks from the Committee:

1. approval on the work streams and proposed priorities - detailed in Annex 1;
2. guidance regarding the contents of the outlines of the following workstreams:
 - a. Overview of VAT/GST in developing countries;
 - b. VAT treatment of Small enterprises;
 - c. VAT refunds.

The details of the outlines are set out in the attached Annexes 2-4.

Annex 5 lists the name of Government representatives sharing their VAT/GST experiences with the Subcommittee.

Co- Coordinators' Report on Subcommittee on Indirect Taxation

Background Subcommittee Mandate

- 1) At its 23rd Session, the Committee of Experts on International Cooperation in Tax Matters considered note E/C.18/2021/CRP.34, and agreed on the establishment of a Subcommittee on Indirect Tax, with a mandate to identify priority issues where guidance from the Committee may most usefully assist, in particular, developing countries in differing situations, on taxation issues related to indirect taxation, with an initial focus on value added tax/goods and services tax (VAT/GST) issues.
- 2) The aim is to develop practical series in VAT/GST, which represent an important tax base for countries, to contribute to strengthening domestic resource mobilization for developing countries and meeting the Sustainable development Goals as a totality.

Work plan

- 3) At its 24th Session, the Committee considered and approved the note E/C.18/2022/CRP.7 that identified priority areas and proposed to develop a series of papers highlighting good practices in the design, compliance and administration issues that developing countries may face related to VAT/GST. The series include the following priority issues:
 - VAT design:
 - Good VAT design:
 - Simplified schemes / Registration thresholds/ Small and Medium size businesses/ etc.
 - VAT & Government entities, charities, and donor-funded projects
 - Interaction between VAT & other taxes:
 - VAT & Excises/VAT & TP¹/etc.
 - Advantages and disadvantages of collection mechanisms:
 - Reverse charge mechanisms/Withholding/Advance collection systems
 - Compliance and administration issues:
 - How to promote compliance for small and medium size businesses?
 - How to manage efficiently VAT refunds?
 - How to design and achieve adequate infrastructure to manage an IT system that takes into account developing countries constraints?
 - What are the steps to achieve effective electronic invoicing?
 - How to promote electronic payments/e-invoices (B2B or B2C)/digitalization of reporting and “big data” analysis
 - Tackling VAT - fraud and evasion
 - VAT in special sectors

Subcommittee meetings

- 4) On 10 May 2022, the Subcommittee held a virtual meeting to discuss the implementation of the work plan and decided to streamline the work streams to enhance the outputs for the readers. It was agreed that separating design issues from compliance challenges would not be realistic. As such, the Subcommittee agreed to consolidate these topics.
- 5) On 26 July 2022, ten Government representatives, one each from the countries of Botswana, Chile, Jamaica, Malawi, Myanmar, Pakistan, Rwanda, South Africa, South Korea, and Zambia shared their country's VAT/GST experience with the subcommittee participants (see Annex 5 for the list of representatives). They shared their countries exposure related to the issues covered in the work plan. The objective of the meeting

¹ In liaison with the transfer pricing Subcommittee.

was to ensure that the Subcommittee work plan was truly responding to developing countries' needs and challenges. The presentations confirmed that the priority areas identified were challenges that the representative countries needed guidance on.

- 6) On 27 and 28 of July 2022, the Subcommittee participants discussed and reviewed the workstreams, considering the feedback received during the meeting on the 26 July, 2022. They suggested to work on the workstreams listed in Annex 1.
- 7) The Subcommittee proposed also the following priority topics for the next 18 months for which the drafted outline is detailed in Annexes 2 to 4:
 - Workstream 1: Overview of VAT/GST in developing countries;
 - Workstream 2: VAT treatment of Small enterprises;
 - Workstream 3: VAT refund.
- 8) The draft outline of workstream 1 on the overview of VAT/GST in developing countries aims, among others, to provide a basic understanding of the workings of the VAT and the options and implications of different basic design elements. It purposes also to discuss the administrative and compliance issues and to inform readers of the forthcoming papers by the subcommittee. Details are provided in Annex 2.
- 9) The draft outline of workstream 2 on the VAT treatment of small enterprises seeks to discuss policy options and implementations tools that developing countries may consider under a VAT system. Details are provided in Annex 3.
- 10) The draft outlines of workstream 3 on VAT refunds considers refunds from the perspective of both tax administrations and taxpayers. It provides an overview of the reasons for the existence of refunds and discusses the various factors that should be taken into account in the administration of refunds. Details are provided in Annex 4.

Issues for Decision and discussion by the Committee

- 11) The Committee is invited to:
 - Approve the workstreams and the proposed priorities workstream
 - Discuss and provide guidance to the Subcommittee regarding the contents of the outlines on:
 - a) Overview of VAT/GST in developing countries;
 - b) VAT treatment of Small enterprises;
 - c) VAT refunds.

Annex 1**List of workstreams topics by priorities**

Workstream	Topics by priorities
1	Overview paper on VAT
2	VAT/GST and Small and Medium size Enterprises (SME)
3	VAT/GST refunds
4	Use of new technologies to improve VAT compliance (IT systems, E-invoices/big data)
5	Interaction between VAT/GST and Transfer Pricing
6	VAT and specific sectors: <ul style="list-style-type: none"> • Tourism • Construction
7	VAT and government entities, charities and donor-funded project

Annex 2

Overview of VAT/GST in Developing Countries

Draft outline

Drafters:

- Marius VAN OORDT (University of Pretoria, South Africa)
- Oluwole ONI (Federal Inland Revenue Service (FIRS), Nigeria)
- Emeka NWANKWO (ATAF, South Africa)
- Raja BOODOO (Mauritius Revenue Authority, Mauritius)

Summary

The overview chapter on VAT in developing countries will discuss the context, adoption, and performance of VAT in developing countries. It will provide a basic understanding of the workings of the VAT and the options and implications of different basic design elements. The existing empirical evidence of the burden distribution will be considered and introductory administrative and compliance issues will be discussed. It will also inform readers of the forthcoming papers by the subcommittee.

Cover pages

In this section, we provide information on the mandate of the subcommittee and definitions of terms to be used in this report.

Introduction

In this section, we create context for the report and rest of the series by discussing 1) the merits of the VAT within the tax system, 2) the spread of the VAT through developing countries, 3) the statistical VAT potential and performance of developing countries, and 4) common issues that prohibit developing countries from achieving their VAT potential. We also identify which of these common issues will be discussed in the reports of this subcommittee and refer to literature on issues not to be discussed.²

Understanding the VAT

In this section, we discuss what a VAT is and what it is not, from both legal and economic perspectives, including the economic difference between the VAT and an income tax, an investment tax, and a wage tax. With the use of illustrative examples, we show how the VAT works and when it is collected, and discuss the potential implications (i.e. pros and cons, including VAT refunds) of a) a supply chain of only taxable supplies, b) a supply chain that includes exempt supplies (both on intermediate goods or services and on consumer goods or services), c) a supply chain that includes zero-rated and other reduced rate supplies, d) a supply chain that involves VAT withholding.

Basic design elements of a VAT

In this section, we discuss the decisions involved in a) defining the tax base, b) selecting VAT rates, c) identifying the taxpayer, including an introductory discussion on the registration threshold and government entities, charities and donor-funded projects, and d) inter-jurisdictional issues, including an introductory discussion and references to literature on place of taxation and the destination principle.

Is the VAT regressive?

In this section, we discuss whether and the extent that the VAT is regressive within a developing country context, which includes large informal sectors. We discuss recent empirical literature on VAT pass-through and the VAT's burden distribution. We discuss options to address the potential regressivity of the VAT and the viability of these options in a developing country context.

² This includes cross border VAT issues with reference to the OECD VAT/GST Guidelines.

Compliance and administration of VAT

In this section, we give a general overview of compliance and administration of the VAT. We discuss introductory administration and compliance issues for SME's, VAT refunds, specific sectors, interaction between VAT and transfer pricing, and the potential for new technologies to improve VAT administration and compliance.

Conclusion

In this section, we conclude the report, and we provide further details on the reports to be published by this subcommittee.

Annex 3

The VAT treatment of small enterprises Draft Outline

Drafters:

- Fabiola ANNA CONDIA (IBFD)
- Marie LAMENSCH (UCLouvain and the Vrije Universiteit Brussel)
- Marius van OORDT (University of Pretoria)

1. Introduction

In this section, we provide background for the report by providing context and outlining the reasons why it is relevant to apply special rules for small sized enterprises under a VAT system. We also outline the challenges that states face when seeking to include small enterprises in the tax net.

2. Objective of this report

In this section, we clarify that the objective of this report is to 1) identify the main policy options currently used to address the specific situation of small traders and 2) highlight the pros and cons of each option, taking into consideration the perspectives of tax authorities and taxpayers. The report seeks to provide a holistic analysis of the different policy options, which includes a specific discussion on the sensitivity to avoidance and fraud and the opportunities offered by technology.

3. Policy Options

3.1. Small enterprises exemption

In this section, we discuss the pros and cons of exempting small traders and keep them out of the VAT system. We discuss issues related to the setting of thresholds and practical aspects of the exemption, such as “opt-in” or “opt-out” systems.

3.1.1. Registration Threshold

3.1.1.1. Conditions and requirements

3.1.1.2. How to calculate the turnover

3.1.1.3. Alternative Registration Threshold for Specific Sectors

3.1.1.4. Temporarily Exceeding the Threshold

3.1.2. VAT Registration

3.1.2.1. Incentives

3.1.2.2. Late Registration

3.1.3. Voluntary Registration

3.1.3.1. Conditions and requirements

3.1.4. VAT Registration Avoidance

3.1.4.1. Possible Scenarios

3.1.4.2. Mitigation Measures

3.1.5. Current Practice and Trends in Several Countries)

3.2. Simplifications for small enterprises

In this section, we discuss policy options that may improve compliance, reduce compliance costs, or simplify the standard VAT regime for small enterprises. We also discuss anecdotal evidence of the success of these policy options in developing countries.

3.2.1. Simplifying VAT Obligations

3.2.1.1. Registration process

3.2.1.2. Tax Returns

3.2.2. Possibility of adjustments

3.2.2.1. Taxable Periods

3.2.2.2. Refunds

- 3.2.3. Cash accounting
 - 3.2.3.1. Concept
 - 3.2.3.2. Applicability to small enterprises

3.3. Special schemes for small enterprises

In this section, we discuss special schemes currently used to tax small enterprises, regarded as alternative VAT regimes. We discuss evidence of the success of these schemes.

- 3.3.1. Special schemes
 - 3.3.1.1. Twofold goal: raising revenues and fostering formal economy
 - 3.3.1.2. Scope (VAT or VAT and Other Taxes)
- 3.3.2. Eligibility based on business structure
 - 3.3.2.1. Standalone Businesses
 - 3.3.2.2. More than one Establishment
- 3.3.3. Eligibility based on Type of Transaction
 - 3.3.3.1. Domestic transactions
 - 3.3.3.2. Encompasses Cross-Border transactions
- 3.3.4. Threshold
 - 3.3.4.1. Definition of the Threshold – Elements to be Considered
 - 3.3.4.2. Threshold exceeded: Next Steps
- 3.3.5. Types of Special Schemes
 - 3.3.5.1. Graduated Tax Regime
 - 3.3.5.2. Fixed Quota

4. The use of technology for assisting small enterprises and tax authorities

In this section, we discuss how technology can be used to reduce compliance and administration costs and to improve the enforcement of the tax. We will in particular focus on *sole standing* technology tools (e.g. cash registers) as technology tools *underlying* the simplifications/special regimes discussed in section 3.2 and 3.3 will be directly discussed in these sections.

E-invoicing will be covered in a dedicated chapter and will therefore not be discussed here.

5. Conclusions

In this section, we conclude by summarizing the main findings of the report and provide suggestions on policy options and implementation tools that developing countries may consider for small enterprises under a VAT system.

Small enterprises - Possible topics to consider

1. Why to introduce a small enterprises VAT special regime?
2. What are the elements to consider when doing it?
3. Who can benefit from this regime: Businesses with only one establishment? Legal entity + Associates? Cross-Border transactions?
4. Different possible regimes:
 - 4.1.Registration Threshold (*not regarded as a taxable person*) *could be also obliged to register but transactions exempt!*
 - 4.2.Flat-rate taxation
 - 4.3.Graduate tax relief (full relief/partial relief)
 - 4.4.Simplified regime including several taxes (VAT and others) with a fixed amount per period (e.g. Monotributo in Latin America)
 - 4.5.Other regimes (e.g. Simplified method for calculating input tax credits, less frequent filing of tax returns, annual apportionment of input tax deductions, etc)
5. Topics to consider when designing a special regime: How to calculate the registration threshold(s)? What is the ideal threshold? What to include (taxable supplies, exempt supplies, gross revenues, disposals of capital assets, etc)? Is the regime optional or mandatory? Anti-abuse measure? No right to deduct input tax/ partial right to deduct input tax/ or exceptions? Input tax adjustments? Flat-rate automatically applicable by the taxpayer (taxable person) or needs to be approved by the tax authorities? Minimum or maximum period to apply the regime? Invoicing and bookkeeping requirements?

Annex 4**VAT/GST Refunds
Draft outline****Drafters:**

- Lesley O’CONNEL XEGO (South African Revenue Service (SARS), South Africa)
- Muhammad Ashfaq AHMED (Committee Member)
- Emeka NWANKWO (ATAF)

The reality and importance of VAT refunds that inevitably arise due to the very nature of a value-added tax cannot be underestimated. Refunds pose an inherent risk to revenue collections, which can only be mitigated by various interventions that should be undertaken by tax administrations; on the other hand, legitimate businesses who have submitted refund claims rely on the prompt payment of such refunds which if delayed, may have a devastating impact on their very existence. Striking a balance between these 2 competing realities for tax administrations is an ever-present challenge which is exacerbated by the ever-increasing reality of fraudulent refund claims.

This paper considers refunds from the perspective of both tax administrations and taxpayers. It provides an overview of the reasons for the existence of refunds and discusses the various factors that should be taken into account in the administration of refunds.

1. Introduction

- a. What is ideal in a properly functioning VAT? i.e., policy rationale - VAT is a tax borne by the end consumer, when refunds are not paid, business is effectively an end consumer which is contrary to a proper functioning VAT
- b. aim is to refund legitimate refunds in a timely manner – risk mitigation vs the importance of efficient refunds processing
- c. refunds are key to a well performing VAT
- d. realities of withholding refunds
- e. types of “refunds” – full cash refund, partial offsetting, no offsetting (i.e. no /delayed payment), government bonds

2. The reality of the existence of refunds in a VAT

- a. Deducting the VAT incurred and whether/how it should be limited
 - Consideration to be given to
 - Matching inputs vs outputs
 - allowing deductions based on the accrual principle (i.e. entitlement to deduct when expense is incurred/accrued)
 - Cash flow and administrative considerations for taxpayers and revenue administrations where refunds are allowed on accrual vs payment vs use/consumption and the impact on accounting practices
- b. Good practice vs current practices (rationale, pros and cons)
- c. Circumstances that give rise to /factors resulting in refunds
 - zero rating (local consumption)
 - exports
 - capital expenditure
 - expenditure
 - affected sectors
 - trends
 - multiple rates

3. Mechanisms to request refunds

- a. Variety of processes followed
- b. Submission of supporting documents
- c. Period allowed for submission

4. Budgeting for refunds, including the development of a model to estimate the likely level of refunds that may be refunded in a fiscal year

Engagement with the World Bank and IMF to evaluate current models-

- a. the reality of under or over refunding
- b. limiting the value of refunds paid in a particular period
- c. offsetting of refunds to other taxes/periods as a means of managing cashflow
- d. country experiences – identified countries to be engaged

5. Reasons for refunds not being paid in a timely manner (i.e. why are there deviations)

- a. Cash flow limitations (country levels)
- b. Resource constraints
- c. Low compliance levels
- d. Tax policy/tax administrative procedures (including poor/lack of administrative controls)

6. Impact on taxpayers where inefficient refund mechanisms/processes

- a. Negative cashflow / Interest expense/ exchange rate fluctuations
- b. Costs incurred e.g. Professional services to engage with tax administration due to *inter alia* the increased likelihood of audits, follow up regarding outstanding refunds
- c. Impact on business – contradicts principle of VAT not being a cost to VAT registered business
 - i. Increases cost for business that
 1. will ultimately be passed on to the customer or
 2. decrease business profits
 - ii. results in tax cascading where customers are businesses

7. Tax administration considerations

- a. Registration risk
- b. Revenue risk mitigation
 - i. Factors to be taken into account to identify risk
 - ii. Link to Corporate Income Tax and the impact of reconciliations being performed between various taxes
- c. Cashflow limitations
- d. Resource allocation
 - i. Pre and post refund audit considerations
- e. Need for and impact of technology on refund administration including risk mitigation – extent of automation of return submission, 3rd party data, e-invoicing

8. Fraudulent refund schemes

- Experiences from tax administrations (both from developed and developing countries)
- Research to be conducted
- Experience from tax administrations
- Impact on compliant taxpayer behaviour

9. Country experiences

- Challenges experienced and improvements implemented (success stories)

10. Conclusion

Annexures

1. Refund statistics

To be provided from identified jurisdictions and will include -

- VAT as % of GDP
- Refunds as a % of VAT collections
- Best practice – monitoring of refunds YoY, sectors, trends,
- Analytical tools to estimate refunds for an identified period including the functionality to monitor and adjust where necessary

2. Impact of technology and cost of implementation for both revenue administrations and taxpayers

- A broad overview may be included, depending on availability of a drafter with the requisite skills and experience
- Consideration to be given to outsourcing the drafting

Annex 5**Name of Government representatives sharing their VAT/GST experiences with the Subcommittee**

Country	Name of representative
Botswana	Itumeleng KGOSIETSILE, Revenue Manager, Rulings & Directives, Botswana Unified revenue Service
Chile	Nicolas Chau SAN PEDRO, Legal advisor of the International Taxation Department, Chile
Jamaica	Bevon SINCLAIR, Chief Technical & Tax Dispute Resolution Advisor, Tax Administration Jamaica
Malawi	Kondwani SAUTI PHITI, Deputy Commissioner responsible for Indirect Taxes, the Malawi Revenue Authority
Myanmar	May SABAI, Assistant Director, Internal Revenue Department, Ministry of Planning and Finance, Republic of the Union of Myanmar
Pakistan	Dr. Muhammad Ashfaq AHMED, Director General, International Taxes, Federal Board of Revenue, Pakistan
Rwanda	Ronald NIWENSHUTI, Assistant Commissioner in Charge of Tax Audit Division Rwanda Revenue Authority
South Africa	Lesley O'CONNEL XEGO, executive in National Revenue Management, responsible for revenue augmentation and enhancement, South African Revenue Service
South Korea	Yongyoo LEE, Director, International Tax Division, Tax and Customs Office, Ministry of Economy and Finance, Republic of Korea
Zambia	Catherine CHILAMBE, Director-Investigations, Zambia Revenue Authority