Caritas Zambia

Civil Society for Poverty Reduction (CSPR)

Jesuit Centre for Theological Reflection, JCTR

Memorandum on

The Ramification of the Proposed Sales Tax

Joint Submission to

THE NATIONAL ASSEMBLY, BUDGET COMMITTEE AND COMMITTEE ON ECONOMIC AFFAIRS, TRADE AND LABOUR MATTERS

April 2019

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Introduction/Background

On 28th September, 2018, during the budget presentation for 2019, Government through the Minister of Finance proposed to abolish the Value Added Tax (VAT) and replace it with what Government called a simpler and non-refundable Sales Tax. According to the Minister, the move aimed to improve taxes contribution to the national treasury and minimize revenue leakages. Government's concern seemed to have been huge amounts that were being paid in VAT refunds claim. The Minister assured that after extensive consultation with all key stakeholders, she would present to the house, the necessary legislation to repeal the current VAT legislation. A bill has since been drafted to effect implementation of the sales tax. This analysis (memorandum) looks at the proposed bill and general issues surrounding sales tax.

Concerns on the Proposed Bill

i. The bill does not have or contain specification of the rate at which the Sales tax will be introduced. Much information needs to be supplied on the administrative regime.

ii. The bill does not have or contain much information on who will charge sales tax on their goods and services.

iii. The bill does not provide information on whether there will be any goods to be exempted and how the ultimate users will be determined. Though under objectives, there is a statement to the effect that "certain supplies, imports and exports of goods and services will be exempted from sales tax".

iv. Sales Tax is traditionally charged on goods not services. The bill has not explained how services will be taxed under the new system which can erode the tax base further. Will it be a sales and services?

v. Transition to Sales Tax poses challenges. The Government will face system changes, will need to train staff and agents and confront other administrative costs in a short time period. Malaysia, which switched to Sales Tax on 1st of September 2018, estimated these requirements to cost US$6 billion, about 2 percent of GDP in lost revenue. With fiscal consolidation steering up through perceived increased revenue mobilization, the Government needs to create a provision for more implementation time and lost tax revenue.

General Concerns on reintroducing Sales Tax

i. A. There has not been much information regarding how Sales tax reintroduction will really improve consumption taxes contribution to the national treasury. For instance, there are no estimated revenues to be raised through its reintroduction. The revenues being estimated in the 2019 Budget are for VAT.

ii. B. Requisite infrastructure to support administration of the sales tax is not readily available.

iii. The government's selling point of simplicity of administration is certainly not convincing enough.

iv. Sales Tax resolves the VAT refund challenge, because while VAT is charged at all levels of production with resellers paying tax to the vendor and reclaiming VAT paid on business inputs.

v. Sales Tax is applicable to only final consumption sales at each level and not on goods to be used in production.

Consequences of Implementing the Sales Tax

i. Tax evasion is higher under a sales tax system as the retail level is the weakest link in the enforcement chain. The government would have no record of the transaction and the retailer responsible for making payment to the government for the tax they collect knows this. As a result, compliance rates can be low. Unlike with VAT, the chain of crediting creates a natural audit trail. The seller knows the buyer is reporting the transaction to claim a credit, so the seller has more incentive to report the transaction and pay tax. With sales tax also, once the retailer evades paying tax, the full tax on the sale is lost. Further, there is no paper that enforcers can follow.

ii. Disposition Sales Tax does not have the sort of self-enforcing mechanism exhibited in VAT, where purchasers help enforce VAT as they insist on correct invoices from suppliers to claim input VAT. Thus, compliance levels under a Sales Tax are fragile. With taxes collected only at final point, the Government remains at the mercy of retailers who are responsible for remitting the tax collected from the consumer to the authorities.

iii. Sales Tax can lead to cascading or the “tax on tax” effect, stemming from the tax burden falling on production inputs, which VAT avoids through refunds. Failure to address this ‘tax on tax effect’ can result in sellers passing on the tax cost accrued, to consumers. This may lead to economy-wide inflationary pressures and jeopardize the macroeconomic objective of keeping inflation within 6 to 8 percent.

iv. The sales tax system makes goods more expensive and uncompetitive. This is largely due to cascading which occurs when taxed inputs are used to produce taxed outputs, (Tax on Tax) so that the total tax on the goods compounds beyond what was intended. This can be avoided by exempting all business purchases from taxation but separating business purchases from consumer purchases is difficult. With the VAT, this is avoided as businesses receive credits for the taxes paid on their input purchases.

v. Additionally, price increases will impact industry’s costs of production, and in turn result into slower economic activity (maybe below the 4 percent growth target) hence lower revenues. Mitigating cascading will require a lower Sales Tax rate, combined with use of resale and exemption certificates.

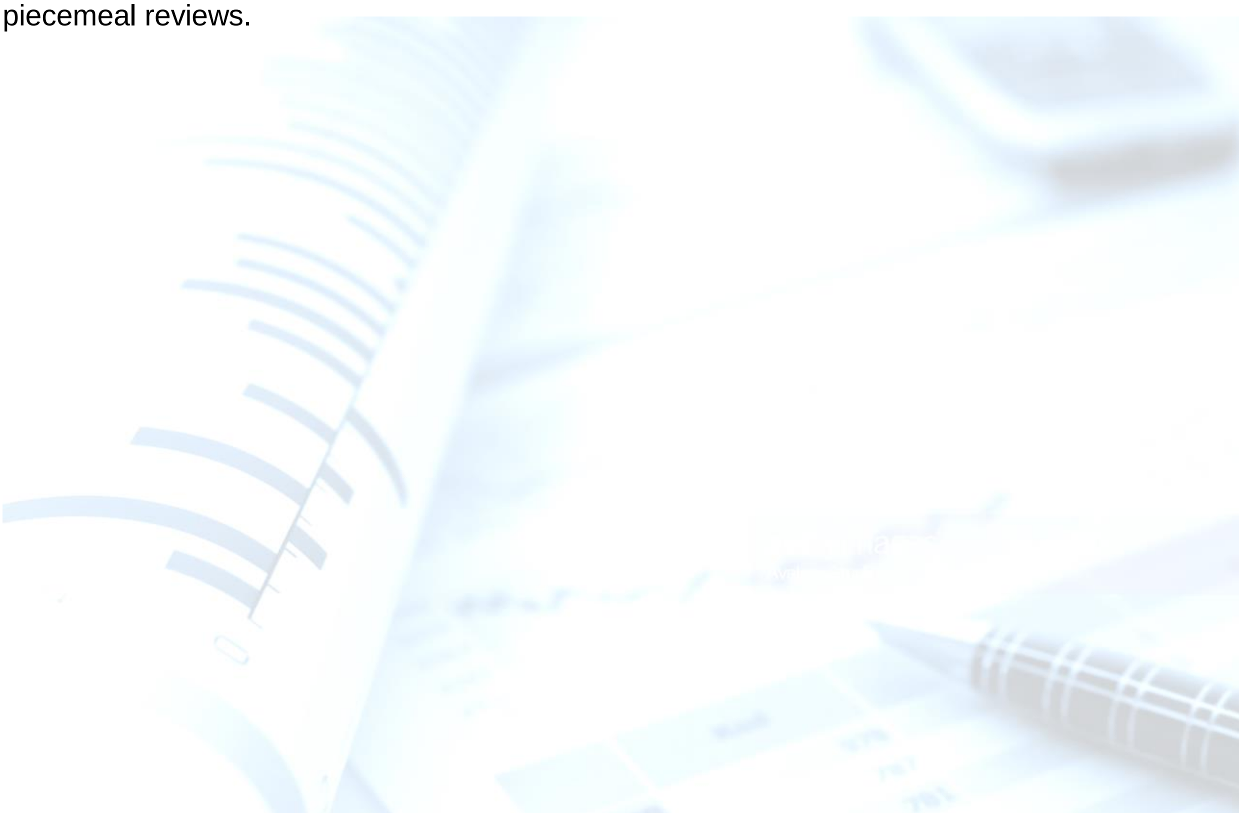
CONCLUSION

The implementation of the sales tax does not stand to improve tax administration. There is still need for thorough consultation and solution found on the leakages that come with sales tax administration. Further, whereas Sales Tax presents an opportunity, it also poses risks to revenue which must be mitigated. We urge government to think through the design of compliance systems, how to reduce the cascading effect through resale and exemption certificates, consider what tax can be applied sustainably for services and review the transition period.

RECOMMENDATION

It is our informed view that if Government insists on implementing sales tax, they seriously take into consideration challenges that come with sales. Otherwise our inclination is that Government should have stayed with VAT and just addressed areas of concern in its administration.

To address the revenue challenges, Government needs to conduct comprehensive tax reform with full participation of main stakeholders to redesign both the tax and administration rather than piecemeal reviews.



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