VALUE-ADDED TAX IN EXTRACTIVE INDUSTRIES

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To be discussed

1. Brief description of VAT
2. VAT and extractive industries: problems and possible solutions
3. Conclusions

1. BRIEF DESCRIPTION OF VAT

General characteristics of the value-added tax (VAT)

- A broad-based consumption tax collected all along the production chain
- The tax burden falls on the end consumer
- Uses enterprises as collection agents
- Makes it possible to credit the tax paid on inputs against the tax collected on sales
- It operates under the destination principle

Advantages of the VAT

- It does not distort production or commercial decisions
- It is neutral in respect of international trade
- It is non-cascading
- Ultimately, the tax base is the net value of the end sale
- As it is applied all along the production chain, there is less risk of it not being collected
- Relatively simple to administer

A simple illustration

Supplier → **Enterprise** → **End consumer**

Value added = $400
VAT (20%) = $80
Price =$480

- There are no prior transactions, so remits VAT of $80

Government collects $80

Costs = $400
Value added = $600
IVA (20%) = $200
Price = $1,200

- VAT charged $200, but has credit of $80, so remits $120

Government collects $120

Price = $1,200

- Pays $1,200, including VAT of $200

End consumer pays $200

Conditions for VAT to work

- Records system in sync with administrative capacity
- "Zero" rate for exporters
- Modern risk-based audits
- Efficient and timely credits and rebates system
- A minimum of exemptions and exonerations

2. VAT IN EXTRACTIVE INDUSTRIES: PROBLEMS AND POSSIBLE SOLUTIONS

Features of EI that have a bearing on VAT

- Large capital investments during exploration and development
- Long gaps between the time these investments are made and the start of production
- Mainly export products, although they are also sold in domestic markets

Problems with VAT rebates in EI

- It is normal for extractive enterprises to have VAT credit balances that generate rebates...
- ... However, a common complaint is that these rebates are made after long delays, if at all.
- This is generally due to:
  - Problems with the design or administration of the tax
  - Anti-tax fraud or corruption measures
  - Public policy decisions

Common responses to the lack of timely rebates

- Carrying forward the VAT credit balance (with or without interest) to future fiscal years
- Applying a zero tax to inputs acquired by extractive enterprises
- Excluding inputs acquired by extractive enterprises from VAT
- Allowing capitalization of the VAT paid and its amortization against income tax

Common responses to the lack of timely rebates (2)

- Excluding a limited list of goods imported by extractive enterprises from VAT
- Creating a deferred payment system for imports to be used exclusively in extractive activities
- Allowing crediting of the VAT paid on inputs purchased against other taxes
- A negotiable credit notes system

3. CONCLUSIONS

Both the design and administration of the tax are important

- Shortcomings in the handling or administration of rebates may cause the VAT burden to be borne by the extractive industries
- When that happens, the VAT ceases to be a tax on consumption and becomes a tax on investment
- That in turn may trigger extra costs and distort investment and production decisions

Best practices

1. **Best:**
   - 0% rate for exported minerals
   - The enterprise pays VAT on inputs and receives a rebate when it has earned credits
2. **Second best**: If rebates are problematic
   - 0% rate for exported minerals
   - Exclude a limited list of goods imported by extractive industries from VAT or create a differed payment system for imports
3. **Other alternatives:**
   – Allow VAT to be credited against other taxes
   – Negotiable credit notes

Thank you