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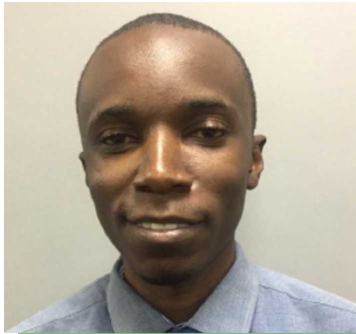
What to watch out for about VAT refunds and your cash flow



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It is interesting that while normal business transactions are often on credit, taxes have to be settled in cash. Cash is certainly king, and in planning of cash flows, businesses cannot afford to overlook their VAT positions, particularly when they are in a refundable position. Processing of VAT refunds by the tax authority has taken a while to get through. Businesses have constantly raised concerns to the Tanzania Revenue Authority (TRA) for delaying the verification process. On the other hand, the authorities are weary of fraudulent claims and have sought to verify the genuineness of the claims.

The mechanics of VAT are pretty straight forward, at least in principle. A business has a right to recover VAT charged on its purchases and a duty to remit in full, the VAT it collects on supplies. When VAT on sales is higher than VAT on purchases, the net amount has to be remitted to the TRA. In case of negative balance, the same has to be accounted as a tax credit recoverable, which is often the case for entities that primarily export their products.

The right for VAT refunds arise when a business has a negative balance for at least six consecutive months. Exporters and mining businesses in most cases end up in negative balances that they become monthly claimants of VAT refunds. However the right to refund expires when the claims are not lodged in time.

One cannot address every element of the refund process as part of it is the responsibility of the government. However, some challenges can be mitigated by proactive measures. Consequently, the following areas need to be borne in mind.

Exchange rates

Most businesses quote prices in foreign currencies while local currency is used for accounting for local taxes. Businesses have a practice of setting and using internal exchange rates for a certain period without using daily exchange rates issued by the central bank.

A dilemma arises when two businesses translate the same invoice into local currency using different internal exchange rates. The effect is amplified when the amounts are significantly material. In this case, using a single exchange rate ensures consistency, as credit can only be claimed against what has been remitted to the TRA.

Business expenditure

In practice not all taxable purchases qualify for the input tax credit. The law imposes limits as to what purchases qualify as input tax credit. A business has to provide solid evidence that an input tax credit relates to a purchase that was for furtherance of business. In this regard a business cannot claim input tax credit on purchases that can be considered to be used to provide entertainment, hospitality, membership in social clubs or other expenditures incurred on passenger vehicles.

Supporting the claims
The current exercise of verification of the past and present refund claims underlines the sensitivity of supporting the refunds claims with valid documents. The quality and authenticity of invoices and receipts must be ensured by both suppliers and customers. In many cases, applications for input tax credit have been discarded due to the failure to support the claims with authentic fiscal receipts. In a few cases, businesses claim input VAT in advance before being issued with a fiscal invoice by a supplier as most suppliers do not issue fiscal receipts until payment is effected by the customer. Equally, late issuance of fiscal invoices or receipts has caused businesses to lose out on VAT credit.

Accounting reconciliations
The right to refund does not guarantee the receipt of the amount applied for until the TRA is satisfied that the correct output VAT has been accounted for. Since a business entity poses as an agent for tax authority in case of output VAT, the correct amount has to be declared and remitted to the TRA beforehand. In this case reconciliations of the VAT returns and financial accounting information for each period before one applies for refund is unavoidable.

The reconciliation provides an added boost of confidence on the chances of obtaining the input credit amount applied for. It is also a useful way of ensuring that the business' accounting system is producing the numbers accurately.

Cash management is central to business success. Prudent businesses would do well to not overlook the importance of improving internal controls and reviews before lodging refund claims. Procurement departments and accounting/tax departments have to keep up constant communications in order to understand the implications of their decisions / indecisions as virtually any action or inaction from these parts of the business have VAT, and therefore cashflow implications.

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