

# **Understanding how Value Added Tax (VAT) is applied in the Democratic Republic of Congo**

## **I. Value Added Tax [VAT] in the Democratic Republic of Congo [DRC]: Development and rate.**

Almost unknown in 1960, the value added tax (VAT) is now found in more than 130 countries, raises around 20 percent of the world's tax revenue<sup>1</sup>, and has been the centerpiece of tax reform in many developing countries including the Democratic Republic of Congo.

VAT (*Taxe sur la valeur ajoutée* - TVA) is a consumption tax paid on certain goods and services purchased in the Democratic Republic of Congo (DRC) and is included in the sale price of these goods and services.

In August 2010, The President of the Republic signed a decree replacing the sales tax " Impot sur le chiffre d'Affaires" (ICA) with a value-added tax (VAT), which was introduced on January 1, 2012<sup>2</sup>.

The standard rate of value added tax in the DRC is 16 percent.

## **II. The VAT popularity vs unpopularity discourse in the DRC**

In the DRC, the value added tax (VAT) is imposed on all types of general consumption. In other words, the VAT applies to all supplies of goods and services and importation of goods and services.

### **2.1. VAT is popular for some reasons as compared to sales tax.**

In practice VAT is likely to generate more revenue for government than sales tax since it is administered on various stages on the production – distribution chain. With sales tax, if final sales are not covered by the tax system e.g. due to difficulty of covering all the retailers, particular commodities may not yield any tax. However, with VAT some revenue would have been collected through taxation of earlier transactions, even if final retailers evade the tax net.

There is also in-built pressure for compliance and auditing under VAT since it will be in the interest of all who pay taxes to ensure that their eligibility for tax credits can be demonstrated. VAT is also a fairer tax than sales tax as it minimizes or

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<sup>1</sup> Michael Keen and Ben Lockwood, *The Value Added Tax: Its Causes and Consequences*, May 2007

<sup>2</sup> Ordonnance - loi n° 10/001 du 20 août 2010 portant institution de la taxe sur la valeur ajoutée

eliminates the problem of tax cascading, which often occurs with sales tax. These are facilitated by the fact that VAT operates through a credit system so that tax is only applied on value added at each stage in the production – distribution chain.

At each intermediate stage credit will be given for taxes paid on purchases to set against taxes due on sales. Only at consumption stage where there are no further transactions will there be no tax credits.

Lack of input credit facility in sales tax often results in tax on inputs becoming a cost to businesses, which are often passed on to consumers. Sales tax is often applied again to the sales tax element of the cost, thus there is a problem of tax on tax. This is not the case with VAT, which makes it a neutral tax as it provides the least disturbance to patterns of production and the generation and use of income.

In addition, the audit trail that exists under the VAT system makes it a more effective tax in administration terms than sales tax as it helps with the verification of VAT amounts declared as due. This is made possible by the fact that one person's output is another's input. As with sales tax imports are treated the same way as local goods while exports are zero-rated to avoid anti-export bias.

There is also another major advantage of value added tax is that under this system all traders are dealt equally. Well applied, it also involves minimum distortionary effects on economic activities. Could this be the case in the DRC? Wait and see!

## **2.2. Fears and unpopularity of VAT in the DRC**

Notwithstanding the advantages mentioned above, it is worth noting that VAT is a considerably complex tax to administer compared with sales tax. With the size of the DRC and the lack of infrastructures, it may be difficult to apply to some companies and other informal businesses due to difficulties of record keeping and its coverage in some areas and services sector may be limited.

Since the application of the VAT in DRC dated 1<sup>st</sup> January 2012, the equity impact of the relatively high rates have been a cause for concern as it is possible that the poor spend relatively high proportions of their incomes on goods subject to VAT. In this regard, one could affirm that related to income VAT is therefore regressive.

This is true as when someone with an income of 100 buys a basket of goods on which a VAT of 16 is levied, 16% of his/her income goes to VAT. If someone with an income of 1000 buys the same basket the percentage of income going to VAT is only 1.6%.

As demonstrated, a uniform VAT rate on all goods and services is regressive when related to income and there is need to think how to reduce rates in the DRC in order to decrease the regressive effect of VAT on income. To reduce this regressivity we can suggest introducing the dual rate system in the DRC. With that, goods and

services that are relatively important for the lower income categories should be subjected to a reduced VAT rate. So, there is a certain basket of goods and services subjected to a standard VAT rate and a basket subjected to a reduced rate.