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Research in Brief

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Perception of Taxpayers and Tax Administrators towards Value Added Withholding Tax in Zimbabwe

Summary of ATAP 26 by Simbarashe Hamudi

Value Added Tax in Africa

Value added tax (VAT) has grown in importance in Africa since it was introduced on a large scale in the 1990s. It is now the largest single source of tax revenue for African governments. At the same time, and almost perversely, the efficiency of VAT collection is lower in Africa than in any other world region. It follows that nominal rates of VAT are relatively high in Africa, but many enterprises manage to evade paying, leaving others facing an unfairly high VAT burden.

Adding Withholding to VAT

One of the policy responses to this problem has been the addition of the withholding principle into VAT collection – the Value Added Withholding Tax (VAWHT). Withholding, sometimes known as *tax retention*, is an important component of efficient taxation. Withholding is based on the fact that typically some proportion of the payments made to suppliers by companies and other economic agents should ultimately be remitted to government as taxes. The essence of withholding is that:

- Some of these economic agents are designated by revenue administrations to act as withholding agents.
- Withholding agents do not pay their own suppliers' bills in full, but retain the proportion that the supplier would typically be required to remit to government in taxes in relation to that transaction.
- They remit the retained amount directly to the revenue administration, leaving the supplier and the revenue administration to determine later whether the supplier has overpaid or underpaid its actual tax bill.

Globally, the most common form of withholding is PAYE (Pay As You Earn): personal income tax liabilities are deducted directly from employees' salaries by their employers, and remitted to government. The motivation for using withholding is that it is generally easier for tax administrations to engage with and collect revenue from larger economic enterprises

designated as withholding agents rather than individuals or small and informal businesses. Withholding should reduce the amount of unpaid revenue.

VAWHT in Zimbabwe

VAWHT exists in several Africa countries. It was introduced in Zimbabwe in January 2017, and did result in an increase in VAT revenue collection. VAWHT is charged at the rate of one third of the applicable VAT rate. Formally, it is an advance payment and an attempt to collect some VAT, not a substitute for the normal VAT regime, that requires VAT-liable enterprises to engage directly with the Zimbabwe Revenue Authority (ZIMRA). The supplier who pays VAWHT to a withholding agent should obtain a withholding tax certificate from the withholding agent and use that to settle its final accounts with the Revenue Authority. There are currently 78 withholding agents in Zimbabwe. All are large companies. Many are engaged in mining.

Like all withholding arrangements, VAWHT generates problems of its own.

The Research

The purpose of the research was to understand how tax payers and tax administrators in Zimbabwe perceive the VAWHT, and to get their views on how its administration could be improved. Four main research methods were used:

- A questionnaire survey of all 78 withholding agents (73 responses), 150 suppliers registered for VAT (136 responses), and 150 ZIMRA staff (142 complete responses).
- In-depth telephone and online interviews with 282 people who had responded to the questionnaire survey.
- 16 groups discussions, mixing different types of respondents.
- Examination of revenue and budget data from ZIMRA and the Ministry of Finance.

Key Findings

Respondents working for withholding agents believe that the VAWHT system is fair, effective, and suitable for Zimbabwe. Correspondingly, most ZIMRA staff who are familiar with VAWHT because they work in the Larger Clients Offices and are responsible for administering the tax, believe that the withholding agents understand the system well.

The picture is however less positive in relation to the suppliers who are subject to VAWHT deductions:

- They have little knowledge of the system. Few of them have attended a single VAWHT seminar or training programme. It is dominantly the staff of the withholding agents who attend the VAT-specific seminars organised by ZIMRA.
- The inclusion of a withholding tax certificate in payments made to suppliers by withholding agents leads to recurrent misunderstandings and friction. Suppliers may refuse the certificate, renege on their agreements to deliver supplies, or try to increase prices to compensate for their 'loss' of the VAWHT payment.
- ZIMRA staff noted that withholding agents sometimes failed to remit VAWHT to ZIMRA or delayed issuing withholding tax credit certificates to suppliers. And suppliers themselves did not always keep control of the tax credit certificates that they did receive. In consequence, suppliers sometimes built up large refund entitlements with ZIMRA that they could not in practice claim.
- Partly in consequence, VAWHT has left some suppliers with shortages of working capital.

Most respondents, whether suppliers or agents, highlighted that the new VAWHT has increased the administrative burden on firms that are already struggling because of the state of the Zimbabwe economy. They feel that VAWHT will boost government revenue at the expense of suppliers and agents. This accords with the findings in the research literature. However, they are not the only parties that face increased transactions costs because of VAWHT. While VAWHT has generated a small increase in tax revenue, it has also required ZIMRA to devote more resources to the already-problematic task of dealing with requests for VAT refunds.

It is not clear whether on balance the new VAWHT system will be beneficial in Zimbabwe when examined from all relevant perspectives. Note that, while VAT withholding is generally justified as a way of mitigating VAT non-compliance among smaller businesses, in Zimbabwe VAWHT is being applied to relatively large businesses that supply other larger business or government agencies. The majority of small and medium enterprises are unaffected. Neither is it obvious that they should be: this would add in more complexity and higher transactions costs for all parties concerned.

Key Policy Recommendations

The following suggestions should be considered:

- Businesses that are already tax compliant, as demonstrated by the fact that they are appointed as VAT withholding agents, should not have to pay VAWHT when they act as suppliers to other VAT withholding agents.
- ZIMRA's system for paying out VAT refunds needs to be strengthened.
- More effort should be made to train the companies liable to pay VAWHT in how the system works.
- Further automation would allow ZIMRA to automatically receive information about a VAT withholding event and automatically credit the supplier's account with the amount remitted by the agent, thus reducing administrative costs.
- Increase the number of VAWHT agents, so that suppliers will be less inclined to avoid supplying goods and services to appointed VAWHT agents.
- Reduce the VAWHT rate from one-third of the chargeable VAT tax rate to maybe one quarter or one-fifth, in line with other countries. The purpose of the VAWHT system should be to obtain additional intelligence on the transactions taking place between suppliers and their customers. In Zimbabwe, VAWHT is being used for direct revenue raising purposes.
- Allow VAWHT agents to claim administrative expenses. These should be allowed as deductions in terms of the Income Tax Act.
- Conduct more public awareness campaigns on radio stations, national television, billboards, twitter, Facebook and tax conferences.

Further reading

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Credits

Simbarashe Hamudi is a Zimbabwe-based tax specialist with an extensive background working with accounting firms and revenue authorities. He specialises in Zimbabwe direct and indirect tax, transfer pricing and international tax.

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