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## WHAT THE INCREASE IN VAT SHOULD MEAN TO YOU by Bidemi Eluyemi, Taxville

Value Added Tax (VAT) is definitely the best-known tax in Nigeria. Apart from the fact that we find VAT on receipts given to us almost everywhere e.g at the mall, the cinemas, etc, the Federal Government has practically made Nigerians memorise everything about the proposed increase in VAT like some form of national anthem.

We are thus very certain you know that almost everyone in your family knows, that people at the owambes you've been attending know and that all your connections on social media also know that the Federal Executive Council (FEC), has approved an increase in VAT rate from 5% to 7.5%. It is yet to be ratified by the National Assembly, but we should keep our fingers crossed however. Besides, the VAT Act has to be amended for the increase to take effect.

Do you know what this increase will mean for you and how it will impact your day to day activities?

### WHAT IS VAT ALL ABOUT?

VAT is an indirect tax that you pay when you purchase goods and services. It is levied when there is Supply.

We all know from school that in a basic chain of Supply, there is the manufacturer, the wholesaler, the retailer and the final consumer. As VAT is levied on supply, the actual tax burden is shifted from one party to the next until the final consumer. Thus, when the manufacturer is supplied raw materials, manufacturer pays VAT. When manufacturer supplies finished goods to the wholesaler, wholesaler pays VAT. When the wholesaler supplies the goods to the retailer, retailer pays VAT. When the retailer supplies to the final consumer, the final consumer (aka you) pays VAT.

The only issue is that the law allows the manufacturer, wholesaler and the retailer to transfer their VAT burden to the final consumer so that the final consumer actually ends up paying the VAT of everyone in the chain of supply. (To understand how this happens, please see our **Tax Video** on how value added tax works - and our **article** on Value Added Tax)

### RATE OF VAT

VAT is currently levied at a flat rate of 5% and is administered by the Federal Inland Revenue Service (FIRS). The FEC has however approved a VAT increase to 7.5% and the proposed rate is not to take effect until the VAT Act is amended.

The flat rate of VAT means that it applies uniformly to everyone who consumes goods or services regardless of their income because of its flat rate. VAT is thus a regressive tax.

Imagine lining up able bodied men and women, old people above 70 years, youth, children less than five years, pregnant women, disabled people etc. Then imagine making everyone of them run 500 metres. While some people may be able to reach the finish line, some by virtue of their physical circumstances may not begin, complete or survive the experience. This is how a regressive tax works. It gives everyone the same treatment and while this may seem fair, it may also turn out unjust.

To put more in perspective, Madam Aza and Madam Totori both purchase clothing worth N10,000 for their children and they pay N350 as VAT. Madam Aza earns N140,000 monthly making the VAT she paid amount to 0.25 percent of her income. Madam Totori earns N40,000 monthly making the VAT she paid amount to 0.9% of her income. Though the rate of tax for both of them is the same, Madam Totori pays a higher percentage of her income. The flat rate of VAT thus doesn't favour lower-income consumers.

## **VAT-EXEMPT ITEMS**

To reduce the effect of the regressive nature of VAT, some goods and services are exempt from VAT, i.e., VAT will not be paid when there is a supply of these items. Goods exempt include: all medical and pharmaceutical product, basic food items (uncooked and unprocessed), books and educational materials, baby products, fertilizer, locally produced agricultural equipment and all exports. Services exempt include: medical services, services by community banks, People's bank and mortgage institutions and all exported services.

## **WHAT THE PROPOSED INCREASE MAY RESULT IN FOR YOU**

1. Increasing the VAT rate means increasing the amount that you as final consumer will pay for goods and services that are not VAT exempt. This is another way of telling you that there will be increase in prices. You will be spending more money for purchasing the same thing. The prices of VAT exempt items ought not to increase as well but because of the general increase in other items, their prices will be hiked as well.
2. If you are a worker, your boss will most likely not increase your wages or salary and your children's school fees will not reduce because Federal Government increases VAT. Your purchasing power will however reduce as there may be no increase of income in sight to neutralise the increase in prices.
3. You as the final consumer are not the only one being slammed with increase in prices. The different people in the chain of supply also have to pay more for various other activities they engage in that are unrelated to the good or services being supplied to you. The effect of their other burdens may however manifest in reduced quality or quantity in the goods and services supplied to you notwithstanding the increase in price.

5. We all know that all things being equal, an increase in price of goods leads to decrease in quantity of goods demanded. Increase in VAT thus discourages your consumption of goods and services except they are necessary or basic. This also slows down economic activities and business productivity. This could also mean that some people may lose their jobs because *no market, enu gbe!*
6. The increased VAT rates and the inflation that will surely follow will only push more people to default in complying with taxes, thus drastically increasing tax evasion.

## POSSIBLE ALTERNATIVES TO INCREASING VAT

At this point in time, given the prevailing economic situation of Nigeria, is an increase in VAT the next best thing?

According to Better Tax, about 59% of Nigerians did not pay any kind of tax last year. This is a cogent issue that the FG may address to meet revenue requirements rather than inducing inflation and economic sluggishness through increased VAT.

The tax net should thus be widened instead of increasing the tax rate. The Government may strive towards effectively collecting taxes rather than causing hardship to those who are in the tax net and already paying taxes.

The importance of accountability by the Government with regards to revenue already collected over the years cannot be overemphasised. The FIRS was seen to have generated 5.3 trillion Naira in 2018, the highest ever in Nigeria's history. The more important duty of accounting to Nigerians for every kobo of the generated revenue has not been discharged. What taxpayers seem to get for paying taxes is the demand to pay even greater taxes. Compliance with a VAT increase will be a hard pill to swallow when it seems paying taxes is as good as putting hard earned money in a pile and setting it on fire.

Though the Nigerian VAT rate is relatively very low when compared with that of other countries, taking into consideration the state of the Nigerian economy and the current standard of living, increase in VAT should not occupy the front burner among steps the government should consider to further its revenue generation ambitions.

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