



## **WORLD INFORMATION TECHNOLOGY AND SERVICES ALLIANCE**

### **STATEMENT**

#### **IMPACT OF VAT EXEMPTION ON INFORMATION TECHNOLOGY OUTSOURCING**

**September, 1999**

#### **Introduction**

VAT exemption for industries and firms inhibits the use of outsourcing for information technology services by creating a price differential between the cost of contracting and performing services in-house. This, in turn, provides a disincentive for such firms to seek outside expertise and negatively impacts their competitiveness in the global marketplace.

The most notable example of this situation is the financial services industry in Europe, though other countries have raised the issue as well. Since the global IT market in financial services exceeds US \$200 Billion, any disincentive for outsourcing is significant.

#### **World Information Technology and Services Alliance**

The World Information Technology and Services Alliance (WITSA) is a consortium of 38 information technology (IT) industry associations from economies around the world (list attached). As the global voice of the IT industry, WITSA is dedicated to:

- advocating policies that advance the industry's growth and development;
- facilitating international trade and investment in IT products and services;

- strengthening WITSA's national industry associations through the sharing of knowledge, experience, and critical information;
- providing members with a vast network of contacts in nearly every geographic region of the world; and
- hosting the World Congress on IT, the only industry sponsored global IT event.

Founded in 1978 and originally known as the World Computing Services Industry Association, WITSA has increasingly assumed an active advocacy role in international public policy issues affecting the creation of a robust global information infrastructure, including:

- increasing competition through open markets and regulatory reform;
- protecting intellectual property;
- reducing tariff and non-tariff trade barriers to IT goods and services; and safeguarding the viability and continued growth of the Internet and electronic commerce.

### **Impact of VAT Exemption on Cost of Procuring Services Externally**

The value-added tax is designed to impact the total cost of goods and services only once, although it is recovered at each stage of production. For example, a manufacturer pays VAT on goods and services it buys from its suppliers and charges a VAT when it sells the goods it produces. Subsequently, the manufacturer submits the two transactions simultaneously to its taxing authority and recovers the amount it paid in VAT to its suppliers. Thus, the only cost the manufacturer incurs is the VAT on the profit, or the difference between what it sells its product for and what it pays for the product's components.

When an industry or firm is exempt from VAT, consumers do not pay VAT on its products and services. In theory, the organization should pay tax on its inputs and charge tax on its value added. However, when the services are exempt, the institutions collect no tax from consumers and are therefore unable to recover the VAT that the institutions pay to their suppliers and service providers.

When an exempt institution acquires services, such as information technology services, from an outside company--one not affiliated with the institution--it must pay a VAT on those services. In contrast to the manufacturing example, where the company passes the VAT on to the end user of the service, the exempt institution cannot recover from its taxing authority or its customer the tax it paid to its information technology supplier. Thus, the institution must absorb the cost, reducing the flexibility it has in pricing its end products or services.

On the other hand, when an institution provides information technology services in-house to itself, it does not have to pay VAT. Thus, the cost of services in-house is automatically less expensive by the percentage VAT which would normally be paid. Thus, a VAT-exempt entity would only acquire outside information technology services when the

perceived value of obtaining those services externally exceeded the cost of in-house provision by the amount of the VAT.

## **Impact on VAT-Exempt Industries and Firms**

The cost differential between in-house provision and externally-sourced services thus inhibits outsourcing of information technology services. Such a situation ultimately limits access to new ideas and processes and reduces the effectiveness and efficiency of the firm.

Many industries are fast becoming globally integrated and intensely competitive. The WTO Financial Services Agreement concluded in December, 1997, is expected to accelerate this trend. Firms are not only facing competition from foreign companies in their own markets but are actively expanding into foreign markets. Competition in the global market promises innumerable economic benefits to industry, its users, and its suppliers, not the least of which is lower prices at every step in the chain.

For example, many firms offer a broad range of products and services to individual and commercial consumers, made possible largely through the availability of innovative technology. It is through the efficient and cost effective application of state-of-the-art technologies that enable institutions to offer services to consumers at a competitive price. Technology allows institutions to develop new products and services as well as enables them to make their operations more efficient and cost effective.

Compounding this problem in the near term is the intense demand for technological expertise to solve the Year 2000 date conversion problem affecting mission critical computer systems. In addition, in Europe, the prospects of a European single currency pose further information systems challenges.

Thus, companies of all types must be flexible to react to ever-changing markets and pressures. They need the ability to marshal resources from a variety of sources, internal and external, to remain competitive. A particular tax treatment which inhibits such flexibility and access to specific expertise is not helpful. In other words, the tax treatment should not distort the business decisions of VAT exempt industries and firms.

### **Options**

Governments wishing to provide the effect of tax exemption to particular industries or firms have a number of options:

- a) They could "zero rate" them with respect to VAT. Under this scenario, the institution would charge VAT to customers at a zero rate but, therefore, be technically capable of recovering VAT paid to suppliers.
- b) Depending on the nature of the VAT regime, the provision of information technology services could be deemed to be an acquisition for a "creditable purpose", for VAT exempt organisations. This would enable the organisations to reclaim any VAT paid on the acquisition of information technology services.

c) In the case of financial services, they could require financial institutions to charge VAT on service fees, such as transaction fees, loan fees and so on. This would enable the financial institutions to reclaim all or part of the VAT paid on inputs such as information technology services.

### **Recommendation**

Governments should as far as possible avoid taxation arrangements which distort commercial business decisions and adopt one of the options described above in their treatment of VAT exempt industries.

## The World Information Technology and Services Alliance (WITSA)

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| <b>Argentina</b>      | Cámara de Empresas de Software y Servicios Informáticos (CESSI)<br><a href="http://www.cessi.com.ar">http://www.cessi.com.ar</a>   |
| <b>Australia</b>      | Australian Information Industry Association (AIIA)<br><a href="http://www.aiia.com.au/">http://www.aiia.com.au/</a>  |
| <b>Bangladesh</b>     | Bangladesh Computer Samity (BCS)<br><a href="http://www.samity.org">http://www.samity.org</a>  |
| <b>Brazil</b>         | Sociedade de Usuários de Informática e Telecomunicações - Sao Paulo (Sucesu-SP)<br><a href="http://www.sucesusp.com.br">http://www.sucesusp.com.br</a>   |
| <b>Canada</b>         | Information Technology Association of Canada (ITAC)<br><a href="http://www.itac.ca/">http://www.itac.ca/</a>   |
| <b>China, Taipei</b>  | Information Service Industry Association of China, Taipei (CISA)<br><a href="http://www.cisanet.org.tw/english/index.html">http://www.cisanet.org.tw/english/index.html</a> /<br><a href="http://www.worldcongress2000.org">http://www.worldcongress2000.org</a> |
| <b>Colombia</b>       | Colombian Software Federation (Federación Colombiana de Software - FEDECOLSOFT)<br><a href="http://www.fedecolsoft.org.co">http://www.fedecolsoft.org.co</a>   |
| <b>Czech Republic</b> | Association for Consulting to Business (Asociace Pro Poradenství v Podnikání - APP)  |
| <b>Egypt</b>          | The Co-operative Society for Computers of Egypt (CSCE)   |
| <b>Finland</b>        | Information Technology Services Association (Tietotekniikan Palveluliitto - TIPAL)<br><a href="http://www.tipal.fi/index.html">http://www.tipal.fi/index.html</a>  |
| <b>France</b>         | Syntec Informatique<br><a href="http://www.syntec-informatique.fr/syntec/ow/home.cgi">http://www.syntec-informatique.fr/syntec/ow/home.cgi</a>   |
| <b>Germany</b>        | Bundesverband Informationstechnologien (BVITeV)<br><a href="http://www.bvit.de/home-eng.htm">http://www.bvit.de/home-eng.htm</a>   |
| <b>Greece</b>         | Federation of Hellenic Information Technology Enterprises (SEPE)<br><a href="http://www.hol.gr/sepe/sepe1en.htm">http://www.hol.gr/sepe/sepe1en.htm</a>  |
| <b>Hong Kong</b>      | Hong Kong Information Technology Federation (HKITF)<br><a href="http://www.hkitf.org.hk/">http://www.hkitf.org.hk/</a>   |
| <b>India</b>          | National Association of Software and Service Companies (NASSCOM)<br><a href="http://www.nasscom.org/index.html">http://www.nasscom.org/index.html</a>  |
| <b>Israel</b>         | Israeli Association of Software Houses (IASH)<br><a href="http://www.iash.org.il/">http://www.iash.org.il/</a>   |
| <b>Italy</b>          | Associazione Nazionale Aziende Servizi Informatica e Telematica<br><a href="http://www.anasin.it/">http://www.anasin.it/</a>   |
| <b>Japan</b>          | Japan Information Service Industry Association (JISA)<br><a href="http://www.jisa.or.jp/">http://www.jisa.or.jp/</a>   |

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| <b>Lithuania</b>         | The Association of Lithuania's Information, technology, telecommunications and office equipment (INFOBALT) / <a href="http://www.infobalt.lt">www.infobalt.lt</a>   |
| <b>Malaysia</b>          | Association of the Computer Industry (PIKOM)<br><a href="http://www.pikom.org.my">http://www.pikom.org.my</a>   |
| <b>Mexico</b>            | Asociación Mexicana de la Industria de Tecnologías de Información (AMITI)<br><a href="http://www.amiti.org.mx/">http://www.amiti.org.mx/</a>  |
| <b>Mongolia</b>          | Mongolian National Information Technology Association   |
| <b>Morocco</b>           | L'Association des Professionnels de L'Informatique de la Bureautique et de la Telematique (APEBI) / <a href="http://www.atlasnet.net.ma/forum-apebi/present.htm">http://www.atlasnet.net.ma/forum-apebi/present.htm</a> |
| <b>Netherlands</b>       | Federation of Dutch Branch Associations in Information Technology (Federatie Nederlandse IT - FENIT) / <a href="http://www.fenit.nl/">http://www.fenit.nl/</a>  |
| <b>New Zealand</b>       | Information Technology Association of New Zealand (ITANZ)<br><a href="http://www.itanz.org.nz/">http://www.itanz.org.nz/</a>  |
| <b>Northern Ireland</b>  | Software Industry Federation in Northern Ireland (SIF)<br><a href="http://www.sif.co.uk">http://www.sif.co.uk</a>   |
| <b>Poland</b>            | Polish Chamber of Information Technology and Telecommunications (Polska Izba Informatyki i Telekomunikacji - PIiIT) /<br><a href="http://www.piit.org.pl/index_e.htm">http://www.piit.org.pl/index_e.htm</a>            |
| <b>Portugal</b>          | Associação Portuguesa das Empresas de Tecnologias de Informação e Comunicações (APESI)  |
| <b>Republic of Korea</b> | Federation of Korean Information Industries (FKII)<br><a href="http://www.fkii.or.kr/english/index.html">http://www.fkii.or.kr/english/index.html</a>   |
| <b>Romania</b>           | IT&C Association of Romania (ATIC)<br><a href="http://www.softnet.ro/atic/">http://www.softnet.ro/atic/</a>   |
| <b>Singapore</b>         | Singapore Information Technology Federation (SITF)<br><a href="http://www.sitf.org.sg">www.sitf.org.sg</a>  |
| <b>South Africa</b>      | IT Association of South Africa (ITA)<br><a href="http://www.ita.org.za">http://www.ita.org.za</a>   |
| <b>Spain</b>             | Asociación Española de Empresas de Tecnologías de la Información (SEDISI)<br><a href="http://www.sedisi.es">http://www.sedisi.es</a>  |
| <b>Sweden</b>            | Swedish IT-companies' Organisation AB (Svenska IT-Företagens Organisation AB)<br><a href="http://www.sito.se/">http://www.sito.se/</a>  |
| <b>Thailand</b>          | The Association of Thai Computer Industry (ATCI)<br><a href="http://www.bdg.co.th/atci/atcihome.htm">http://www.bdg.co.th/atci/atcihome.htm</a>   |
| <b>United Kingdom</b>    | Computing Services & Software Association (CSSA)<br><a href="http://www.cssa.co.uk/cssa/">http://www.cssa.co.uk/cssa/</a>   |
| <b>United States</b>     | Information Technology Association of America (ITAA)<br><a href="http://www.ita.org/index.htm">http://www.ita.org/index.htm</a>   |
| <b>Zimbabwe</b>          | Computer Suppliers' Association of Zimbabwe (COMSA)   |