INTERNATIONAL PRACTICE OF APPLYING VALUE ADDED TAX MECHANISMS

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Abstract: This article describes the stages of development and various mechanisms of value added tax in international practice. The analysis mainly analyzed the features and systems of VAT implementation in the USA and European countries. Research has shown that in practice there are two mechanisms of VAT: sales tax and VAT mechanism, and two methods such as invoicing and deduction are used in the calculation.

Key words: VAT, sales tax, invoice, consumption, tax base.

МЕЖДУНАРОДНАЯ ПРАКТИКА ПРИМЕНЕНИЯ МЕХАНИЗМОВ НАЛОГА НА ДОБАВЛЕННУЮ СТОИМОСТЬ

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Аннотация: В данной статье описаны этапы развития и различные механизмы налога на добавленную стоимость в международной практике. В ходе анализа в основном анализировались особенности и системы внедрения НДС в США и странах Европы. Исследования показали, что на практике существует два механизма НДС: налог с продаж и механизм НДС, и при расчете используются два метода, такие как выставление счета и вычет.

Ключевые слова: НДС, налог с продаж, счет-фактура, потребление, налоговая база.

INTRODUCTION

Pre-VAT indirect taxes were generally limited to a narrow range of products (such as excise taxes on alcohol and tobacco) and, in particular, sales and turnover taxes. The economic inefficiencies and revenue losses resulting from these tax systems (for example, encouraging vertical integration of industries solely to reduce tax liabilities) coupled with increased demand for revenue have prompted the search for alternative taxes to taxing consumption. In turn, in the first half of the 20th century, new tax mechanisms (VAT) were created to improve existing consumption tax mechanisms and to replace them. [1]. Today, the analysis of the experience of foreign countries in terms of taxation of added value shows that VAT or other consumption taxes equivalent to it have been introduced in about 170 countries of the world. Studying the steps and various mechanisms of the introduction of this tax in the world practice plays an important role in choosing the appropriate model for the same country.

LITERATURE REVIEW

In international practice, there are mainly two types of VAT:

The first is the sales tax, which is a one-time tax levied on the final consumption of goods and services.

The second is value added taxation.

Sales tax is a consumption tax levied at a single point of sale. A system of one-stage taxation of added value (consumption) can be applied to any individual stage of the production and sales chain. This can be the manufacturing, wholesale or retail stage. Therefore, if it is imposed at the wholesale stage, it is a wholesale tax. If it is levied at the retail stage, it is considered a retail sales tax.

Since sales tax applies to a single stage of trade, it is not necessary to deduct tax credits or business purchases from the tax base. Therefore, in theory, it allows retail sales tax and value added tax to collect the same amount of tax if the casdagar tax rate is the same.

This tax is considered a success of the fiscal reforms implemented in the USA in the first half of the 20th century. It originated as a desperate experiment during the height of the Great Depression, and was introduced by the state of Mississippi in 1932 by replacing the flat rate of the general business tax with a two percent tax on retail sales. This tax was phased in by US states as an alternative fiscal instrument to combat declining property tax revenues during the Great Depression. [2].

Today, this type of consumption tax is mainly seen as an American model. Among developed countries, only the US at the state and local government level and provincial governments in Canada have introduced retail sales taxes. Also, this tax was introduced in Malaysia on 1 September 2018 under the name of Sales and Services Tax, which replaced the existing Goods and Services Tax system (from 2015) and is divided into local and two separate (local and federal) regulated by law.

Although the sales tax system does not contribute to budget revenues at the federal level in the United States, it forms the basis of budgets at the local level. In particular, sales tax in the US today is implemented in a total of 46 states at the state level and 37 states at the local (city and municipal) level.

Tax liability varies from state to state, as well as at the state and local government levels, depending on which sales of goods are taxed or exempt. Generally, the seller is responsible for collecting the tax from the consumer, and the consumer then remits the tax collected to the state or local tax authorities. Table 1 below provides examples of sales tax collection methods that apply at the state level.

Table 1

Peculiarities of the sales tax collection mechanism in the United States [1]

Tax collection methods	Content and mechanism	Applicable States
	A business can pay sales tax itself (tax absorption)	Michigan, Missouri and South Carolina

[1] Манба: URL: https://www.masterclass.com/articles/vat-vs-sales-tax-explained#what-is-vat-tax

1. States with a preferential seller or merchant tax. (tax for the privilege of doing business within the state)	The business collects the tax from the consumer (tax transfer) is possible	Connecticut and Kentucky
2. States with a consumption tax	The seller collects tax on behalf of the state from the consumer at the time of retail sale. (Tax embezzlement by the seller is prohibited)	Vermont, West Virginia and Oklahoma
3. States in which the transaction is taxed	Both the buyer and the seller are responsible for paying sales tax	In Colorado it is illegal to embezzle sales tax, but in Georgia it is legal.
4. States that impose a gross receipts (turnover) tax	States that do not charge an income tax charge a gross receipts tax, which is a state-level tax, rather than a sales tax.	Washington and Delaware

METHODOLOGY AND ANALYSIS

The share of sales tax in US local government revenue varies by state, with an average of 35.5% of local government revenue coming from this tax. Vermont (15.7%), New York (17.7%), District of Columbia (19.2%), Virginia (23.2%), and Massachusetts (24.2%) were the states with the largest share of the sales tax budget. The states include Texas (67.9%), Florida (64.6%), South Dakota (64.2%), Nevada (60.8%), and Tennessee (58.4%). The average sales tax share of personal income by state is 2% (see Figure 1).

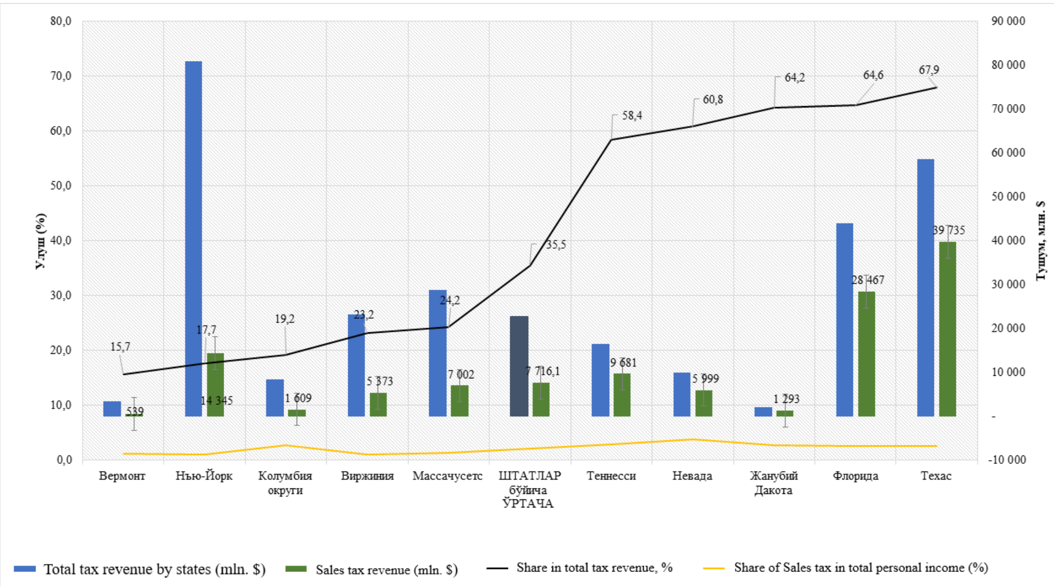

Figure 1. US sales tax revenue by state[2]

[2] State Sales Tax Breadth and Reliance, Fiscal Year 2020 []https://taxfoundation.org/sales-tax-base-reliance-2020/

The advantage of sales tax is that since it applies to a single stage of sales, it is not necessary to deduct tax credits or business purchases from the tax base. Therefore, it does not create a cascading effect, and theoretically, under the same tax rate, it allows to collect the same level of tax as the value added tax.

Ensuring the economic efficiency of this tax regime depends on the extent to which two main principles are ensured: [3]

First, this tax should be applied at the same rate to all sales at the final consumption stage.

Second, it should not tax savings or intermediate consumption in production.

In general, a one-step sales tax creates a serious loophole in the tax system and results in revenue leakage. In particular, tax collection is limited to only one stage of the chain. If some businesses manage to get out of this tax coverage, there will be an immediate decrease in tax revenues.

Sales tax, being a complex tax regime, poses a great challenge to the tax administration. Also, most international organizations point out that taxing consumption through the sales tax mechanism in developing countries is inefficient, as it is mainly effective in generating budget revenues at the local level. [4].

Therefore, since 1980, most developed and developing countries have replaced the existing sales tax system for consumption taxation with VAT. This process led to the rapid spread of VAT from Europe to the rest of the world. This event is considered the most important event in the evolution of the tax structure in the second half of the 20th century. With the introduction of VAT by Western European countries, many developing countries began to pay more attention to it as a way to rationalize (develop) their sales tax and increase revenue.

Table 2.

Regional distribution of VAT [5]

(number of countries that have introduced VAT by year)

Year	Europe	Asia	Africa	North America	Latin American and Caribbean countries	Oceania countries
1960-1969	6	0	1	0	2	0
1970-1979	8	2	0	0	6	0
1980-1989	4	5	4	0	5	1
1990-1999	21	19	20	1	9	4
2000-2009	6	3	16	0	5	3
2010-2020	1	6	6	0	5	1
Total	**46**	**35**	**47**	**1**	**32**	**9**

Table 2 shows the number of countries that introduced VAT by regions and years. The acceleration of the introduction of VAT across the region is explained by the following:

- In Western Europe - after the decision of the European Community to accept VAT as a general form of trade tax; and
- In Latin America - after the initiative in Brazil.

By the mid-1980s, the only countries outside these regions to adopt VAT were Côte d'Ivoire, Indonesia, Israel, Senegal, South Korea, and Turkey.

Since the late 1980s, the acceleration of the spread of VAT took place in three directions:

- acceptance by the majority of transition economies;
- the spread of a large number of developing countries, especially in Africa, as well as in the Asia-Pacific region (more than half of all countries in these regions now have VAT, compared to about 15% ten years ago);
- Introduction by small island economies, almost none of which had VAT before 1990 [6].

Although there is a strong intellectual and practical connection between the distribution of VAT across regions, the underlying objective in each case has been different. In particular, the adoption of VAT in Western Europe is closely related to the provision of deeper economic integration between the member states of the European Union. Because VAT prevents international trade distortions, especially those associated with the cascading indirect taxes it replaces. On the contrary, it is argued that VAT was adopted in Latin America because it was a more efficient tax to raise sufficient revenues, consistent with an outward-oriented economic policy. [7]. The rapid introduction of VAT in countries with economies in transition reflects the need to replace traditional sources of revenue that are declining as a result of economic reforms (for example, levies from state-owned enterprises) with a tax regime adapted to a developing market economy.

From an economic point of view, there are minor differences between VAT and retail sales tax. Being levied at the same rates and covering the same amount of goods and services, both taxes raise the same amount of revenue. If VAT is the same as retail sales tax, it is a legitimate question why retail sales tax has been replaced by VAT by many jurisdictions. Although the economic impact of both taxes is the same, the design and administration of the taxes are different. VAT is generally preferred by many countries and international organizations for four reasons [8]:

- width of the potential tax base frame;
- his ability to distinguish producer goods from consumer goods;
- ability to (effectively) correct tax violations; and
- its administrative suitability.

Today, VAT is called by different names in the countries where it is introduced, but based on the method of tax calculation, it follows two main mechanisms. In particular,

1) Invoicing (invoice or indirect deduction) method. In this case, the amount of tax paid to the budget is determined by deducting the amount of VAT paid to the supplier of goods for production (commercial) purposes from the amount of VAT received on resale of products.

2) Deduction (Direct deduction) method. In this method, the amount of value actually added (created) by the enterprise during the creation of the finished product is determined by deducting the amount of material costs for which VAT has been paid from the value of the finished (final) product, and it is taxed.

Calculation of VAT based on this procedure is valid only in the Japanese tax system [9].

Today, the invoice-based VAT mechanism is the most common form of VAT in practice. Although VAT is currently calculated in this way in almost all countries of the world, they are based on two main models. Most European countries and most high-income countries use the traditional (European) VAT model. The modern (New Zealand) model of VAT is common in most developing countries.

The main difference between these models is explained by the fact that the traditional model introduces a tiered rate in the design of the tax rate and uses a wide range of benefits.

CONCLUSION

1. The initial views on taxation of added value were developed in the early 20th century in the USA and European countries as an alternative to the existing tax mechanisms at that time. The analysis of the literature showed that VAT was developed mainly in two directions, that is, on the basis of "traditional" and "modern" models.

2. From a practical and theoretical point of view, having an ideal (good) VAT mechanism is determined by its consumption-based, comprehensiveness and ability to reach the retail stage. Ideally, its mechanism involves taxing all and only final consumption expenditures at a single optimal rate, without any concessions and including input VAT for intermediate consumption.

3. Analysis of the experience of foreign countries, it became known that currently taxes of two tkr are used for taxing the added value (consumption) in the countries. These are, a) sales tax - based on taxation of added value created at a certain stage of the production chain (wholesale or retail); b) VAT – refers to the transfer of the total tax generated along the chain to the final consumer by taxing each step in the value-added chain.

4. The analysis of the countries where VAT has been introduced has shown that two main methods of calculating it apply. In particular, the first method, i.e. the invoicing method, envisages taxing the added value created at each stage of the production chain, while the second method, i.e. the deduction method, envisages taxation of the value determined by deducting the costs incurred from the cost of the final product.

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