Comparative study of VAT (Value Added Tax)&Sales Tax with special reference to State of Haryana

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Abstract

The State of Haryana passed the Haryana Vat Act in 2003 to levy taxes on goods bought or sold in the state. This act forms the basis of the Commercial Tax Department to levy and collect VAT in Haryana. Suitable amendments and changes have been made over the course of time to stay on par with the ever changing economic trends and practices. This act is called "THE HARYANA VALUE ADDED TAX ACT, 2003"A value-added tax (VAT) is a type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale. VAT is most often used in the European Union. The amount of VAT that the user pays is the cost of the product, less any of the costs of materials used in the product that have already been taxed.A sales tax is a consumption tax imposed by the government on the sale of goods and services. A conventional sales tax is levied at the point of sale, collected by the retailer and passed on to the government. A business is liable for sales taxes in a given jurisdiction if it has a nexus there, which can be a brick-and-mortar location, an employee, an affiliate, or some other presence, depending on the laws in that jurisdiction.Sales tax is collected by the retailer when the final sale in the supply chain is reached via a sale to the end consumer. End consumers pay the sales tax on their purchases. Businesses issue resale certificates to their sellers when buying business supplies/inputs that will be resold since sales tax is not due. Tax jurisdictions do not receive the tax revenue until the sale is made to the final consumer. VAT (Value-Added Tax) is collected by all sellers in each stage of the supply chain. Suppliers, manufacturers, distributors and retailers all collect the value added tax on taxable sales. Suppliers, manufacturers, distributors, retailers and end consumers all pay the VAT on their purchases. Businesses must track and document the VAT they pay on purchases that will be resold in order to receive a credit for the VAT paid on their tax return. Tax jurisdictionsreceive the tax revenue throughout the entire supply chain as opposed to at the sale to the final consumer chain.

INTRODUCTION

- **Sales Tax**

A sales tax is a consumption tax imposed by the government on the sale of goods and services. A conventional sales tax is levied at the point of sale, collected by the retailer and passed on to the government. A business is liable for sales taxes in a given jurisdiction if it has a nexus there, which can be a brick-and-mortar location, an employee, an affiliate, or some other presence, depending on the laws in that jurisdiction.

BREAKING DOWN 'Sales Tax'

Conventional or retail sales taxes are only charged to the end user of a good or service. Because the majority of goods in modern economies pass through a number of stages of manufacturing, often handled by different entities, a significant amount of documentation is necessary to prove who is ultimately liable for sales tax. For example, say a sheep farmer sells wool to a company that manufactures yarn. In order to avoid paying the sales tax, the yarn maker must obtain a resale certificate from the government saying that it is not the end user. The yarn maker then sells its product on to a garment maker, which must also obtain a resale certificate. Finally, the garment maker sells fuzzy socks to a retail store, which will charge the customer sales tax along with the price of said socks.Different jurisdictions charge different sales taxes, which often overlap, as when states, counties and municipalities each levy their own sales taxes. Sales taxes are closely related to use taxes, which governments charge residents who have purchased items from outside their jurisdiction. These are generally set at the same rate as sales taxes, but are difficult to enforce, meaning they are in practice only applied to large purchases of tangible goods. An example would be a Georgia resident who purchases a car in Florida; she would be required to pay the local sales tax, as though she had bought it at home.

Nexus

Whether a business owes sales taxes to a particular government depends on the way that government defines nexus. A nexus is generally defined as a physical presence, but this "presence" is not limited to having an office or a warehouse; having an employee in a state can constitute a nexus, as can having an affiliate, such as a partner website that directs traffic to your business' page in exchange for a share of profits. This scenario is an example of the tensions between e-commerce and sales taxes. For example, New York and other states have passed "Amazon laws" requiring internet retailers such as Amazon.com Inc. (AMZN) to pay sales taxes despite their lack of physical presence in the state.

Excise Taxes

In general, sales taxes take a percentage of the price of goods sold. For example, a state might have a 4% sales tax, a county 2% and a city 1.5%, so that residents of that city pay 7.5% total. Often, however, certain items are exempt, such as food, or exempt below a certain threshold, such as clothing purchases of less than $200. At the same time, some products carry special taxes, known as excise taxes. "Sin taxes" are a form of excise tax, such as the $4.35 New York State charges per pack of cigarettes.

Value-Added Tax

The U.S. is one of the only rich countries where conventional sales taxes are still used (note that, with limited exceptions, it is not the federal government that charges sales taxes, but the states). In most of the developed world, value-added tax (VAT) schemes have been adopted. These charge a percentage of the value added at every level of production of a good. In the fuzzy sock example above, the yarn maker would pay a percentage of the difference between what they charge for yarn and what they pay for wool; similarly, the garment maker would pay the same percentage on the difference between what they charge for socks and what they pay for yarn. Put differently, this is a tax on company's gross margins, rather than just the end user.

- **VAT**

A value-added tax (VAT) is a type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale. VAT is most often used in the European Union. The amount of VAT that the user pays is the cost of the product, less any of the costs of materials used in the product that have already been taxed.

For example, when a television is built by a company in Europe, the manufacturer is charged VAT on all of the supplies it purchases to produce the television. Once the television reaches the shelf, the consumer who purchases it must pay the applicable VAT.

BREAKING DOWN 'Value-Added Tax - VAT'

Value-added taxation is based on a taxpayer's consumption of goods rather than his income. More than 160 countries around the world use value-added taxation. In America, advocates claim that replacing the current income tax system with a federal VAT would increase government revenue, help fund essential social services and reduce the federal deficit. Critics disagree, arguing that a VAT places an increased economic burden on lower-income taxpayers.

Pros and Cons of Value-Added Taxation

On the plus side, a VAT would collect revenue on all goods sold in America, including online purchases. Despite efforts to close tax loopholes that allow Internet businesses to avoid charging taxes to customers in states where they do not have a brick-and-mortar business, unpaid taxes on online sales cost states billions in potential income that could fund schools, law enforcement and other services.

Proponents of a VAT suggest that replacing the current income tax system with a federal VAT would make it much more difficult to evade paying taxes. They claim it would also greatly simplify the complex federal tax code and increase the efficiency of the Internal Revenue Service.

Opponents, however, note many potential drawbacks of a VAT, including increased costs for business owners throughout the chain of production. A federal VAT could also create conflicts with state and local governments across the country, which charge their own sales taxes at rates set at the state and local levels.

Critics also note that consumers typically wind up paying higher prices with a VAT. While the VAT theoretically spreads the tax burden along every phase of manufacturing from raw goods to final product, in practice, increased costs are typically passed along to the consumer.

In contrast to the current income tax, which levies more taxes on high-level earners than on low-income workers, a VAT would apply equally to every purchase. This could significantly benefit taxpayers with high incomes, who typically spend far less than they earn and save a large portion of their income. Since low-income workers often live from paycheck to paycheck and spend their entire income every month, they would pay a much higher proportion of their income in taxes with a VAT system than wealthy earners.

Key Differences between Sales Tax and VAT

The following are the major differences between Sales Tax and VAT:

- Sales Tax is a tax on sales. Value Added Tax is a tax on value addition done by each party of the supply chain like supplier, producer, wholesaler, distributor or retailer, etc.
- Sales Tax is a single-stage tax, but VAT is a multi-stage tax.
- In VAT, the chances of tax evasion are very less as compared to Sales Tax in which evasion of tax can be done easily.
- Double taxation is always there in case of Sales tax, whereas VAT is totally free from cascading effect.
- The sales tax is levied on total value, but in VAT tax is charged only on the value added to the commodity.
- Sales Tax is easy to calculate while VAT calculation requires time and effort.
- In Sales Tax, the tax burden is borne by the consumer. On the other hand, the tax burden is rationalized.

- Input Tax Credit (ITC) is available in VAT but not in Sales Tax.
- The authority of levying sales tax is in the hands of both Central Government and State Government, but VAT is levied by the State Government only.

A very common question in the tax community is "What is the difference between sales tax and VAT?" To answer this question, let's outline some of the similarities and differences.

Sales Tax vs. VAT overview

Sales tax is collected by the retailer when the final sale in the supply chain is reached via a sale to the end consumer. End consumers pay the sales tax on their purchases. Businesses issue resale certificates to their sellers when buying business supplies/inputs that will be resold since sales tax is not due. Tax jurisdictions do not receive the tax revenue until the sale is made to the final consumer.

VAT (Value-Added Tax) is collected by all sellers in each stage of the supply chain. Suppliers, manufacturers, distributors and retailers all collect the value added tax on taxable sales. Suppliers, manufacturers, distributors, retailers and end consumers all pay the VAT on their purchases. Businesses must track and document the VAT they pay on purchases that will be resold in order to receive a credit for the VAT paid on their tax return. Tax jurisdictions receive the tax revenue throughout the entire supply chain as opposed to at the sale to the final consumer chain.

What triggers the tax administration requirement?

Sales tax:

- Nexus – Taxpayers with sufficient presence in a tax jurisdiction.

VAT:

- Permanent Establishment – Existence of a facility, bookkeeping facilities or ability to enter contracts.
- Registration Threshold – Taxpayers with business activities that exceed the monetary threshold in a tax jurisdiction.

Who collects and remits the tax?

For both sales tax and VAT, the seller is responsible for collecting the tax and remitting to the appropriate tax authority.

Invoicing

Sales tax: The seller should separately state sales tax.

VAT: The seller should separately state VAT and include registration number for a VAT invoice, however, in most VAT jurisdictions prices are tax inclusive.

Who pays the tax?

Sales tax: The final consumer.

VAT: All purchasers.

Taxability of purchases by business?

Sales tax: Resellers issue an exemption certificate to the vendor and do not pay tax on purchases of items to be resold.

VAT: Resellers pay tax to the vendor and reclaim the VAT for the tax amount paid on business inputs.

Audit sticking points?

Sales tax: Vendors that sell to resellers must keep valid exemption certificates on file or risk audit assessment turning exempt sales into taxable sales.

VAT: All parties must keep invoices for purchases documenting VAT paid in order to get the reclaimed VAT. Review of transactions where zero or reduced rate VAT was paid and the reasons for this.

Revenue timing for tax authorities

Sales tax: Tax authorities do not get tax revenue until the sale to the final consumer.

VAT: Tax authorities receive tax receipts earlier, getting them along the entire distribution chain as value is added.

What should a purchaser do when a vendor does not have a liability to collect tax, or on specific items as stated in tax law?

Sales tax: Calculate and remit the appropriate use tax to the appropriate tax authority.

VAT: As a general rule a purchaser should calculate and report a reverse charge when necessary.

Conclusion

In India, VAT was introduced for the first time in the year 1986 as MODVAT i.e. Modified Value Added Tax but because of some shortcomings, Central Value Added Tax (CENVAT) was brought by the Government in 2000. Haryana became the pioneer in the adoption of VAT system for the first time among all states of the country. Thereafter, some other states followed the footsteps of Haryana and opted to apply VAT. At present, VAT is applicable to all the states in the country. From past few years, Sales tax is suffering from some controversies like it lacks transparency and double taxation which is the very reason for tax evasion. That is why Sales Tax has been replaced by VAT.Land revenue has lost its significance in the tax structure of Punjab and Haryana and its percentage contribution to state's own tax revenue has also declined whereas, VAT/sales tax hasbecome the major source of revenue in both the state's. Around50 per cent of state's tax revenue comes from VAT/sales tax inboth the states with a view to generate more revenue. A slight revenue improvement in the VAT/sales tax collection would generate more revenue than any major improvement in other tax spheres. Therefore, it is immensely important to study the structure of value added tax in the state's of Punjab and Haryana. This study is an attempt at an in-depth study of value added tax as a growing source of revenue.

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