Value Added Tax Overview

Harley Duncan, KPMG
Joe Huddleston, EY
Boston, August 4, 2017
Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.
Agenda

VAT around the world
How VAT Works
VAT Challenges in the Digital Economy
VAT Around the World
VAT in a nutshell

**General tax**
- Tax applies to all sales of goods, services, and intangibles
- Few exemptions: financial services, real estate, basic food products

**Global tax**
- More than 165 countries have a VAT
- 20% of OECD average tax revenue v. 8% for corporate income taxes*
- Average tax rate: 19% for OECD countries

**Consumption tax**
- The final consumer in general bears the economic burden of the tax
- Tax generally applies where consumption occurs and not where production occurs

**Indirect tax**
- The tax applies on each transaction
- Businesses act as tax collectors
- Not a tax on business entities

**Neutral for businesses**
- VAT incurred on purchases is generally creditable
- Exceptions: when making exempt sales or specific purchases

*OECD, Consumption Tax Trends 2016
The U.S. and Consumption Taxes

OECD Average Sources of Tax Revenue, 2013

- Property Taxes 5.6%
- Corporate Taxes 8.5%
- Individual Taxes 24.8%
- Social Insurance Taxes 26.1%
- Consumption Taxes 32.7%
- Other 2.4%

United States' Sources of Tax Revenue (Federal, State, and Local, 2013)

- Corporate Taxes 8.4%
- Property Taxes 11.3%
- Consumption Taxes 17.4%
- Social Insurance Taxes 24.2%
- Individual Taxes 38.7%


TAX FOUNDATION @TaxFoundation TAX FOUNDATION @TaxFoundation
VAT enactments timeline

Source: OECD, Consumption Tax Trends 2016; WNT Research
How VAT Works
## VAT/GST vs. RST

<table>
<thead>
<tr>
<th></th>
<th>VAT/GST</th>
<th>RST</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxpayer?</strong></td>
<td>Sellers (or buyers) of taxable goods and services</td>
<td>Sellers (or buyers) of taxable goods and services with physical presence</td>
</tr>
<tr>
<td><strong>What?</strong></td>
<td>All goods and services</td>
<td>All tangible personal property and enumerated services</td>
</tr>
<tr>
<td><strong>Where?</strong></td>
<td>Where goods/services are consumed</td>
<td>Where goods/services are received/enjoyed</td>
</tr>
<tr>
<td><strong>When?</strong></td>
<td>At each stage of consumption chain</td>
<td>Sale to end consumer</td>
</tr>
<tr>
<td><strong>Tax base?</strong></td>
<td>Sales price</td>
<td>Sales price</td>
</tr>
<tr>
<td><strong>Tax burden?</strong></td>
<td>End consumer</td>
<td>End consumer and businesses when transaction is non-exempt</td>
</tr>
</tbody>
</table>
Retail sales tax example

Supplier

Sale – material
$100

Factory

Sale – product
$200

Wholesaler

Government
Income $50

Retailer

Sale – product
$300

Individual

Sale – product
$500 + $50 Tax

$50 remitted
How does VAT work?

- **Supplier**
  - Sale – material
  - $100 + $10 VAT
  - $10 remitted

- **Factory**
  - $10 remitted ($20 VAT – $10 credit)

- **Wholesaler**
  - Sale – product
  - $200 + $20 VAT
  - $10 remitted ($30 VAT – $20 credit)

- **Government**
  - Income $50
  - $10 remitted
  - ($20 VAT – $10 credit)

- **Individual**
  - Sale – product
  - $500 + $50 VAT
  - $20 remitted ($50 VAT – $30 credit)

- **Retailer**
  - Sale – product
  - $300 + $30 VAT

- **Retailer**
  - Sale – product
  - $300 + $30 VAT

- **Supplier**
  - Sale – material
  - $100 + $10 VAT
  - $10 remitted
# Operation of VAT

<table>
<thead>
<tr>
<th>VAT rate = 10%</th>
<th>Sells</th>
<th>VAT return</th>
<th>Govt. gets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier (raw materials)</td>
<td>$100 + $10</td>
<td>10.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>Factory [buys 100 + 10]</td>
<td>$200 + $20</td>
<td>20.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>Wholesaler [buys 200 + 20]</td>
<td>$300 + $30</td>
<td>30.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>Retailer [buys 300 + 30]</td>
<td>$500 + $50</td>
<td>50.00</td>
<td>$20.00</td>
</tr>
</tbody>
</table>

Total: $50.00
### VAT terminology

#### Output tax
- VAT charged by businesses on sales made to their customers
- “Output” meant to reflect outgoing sales

#### Input tax
- VAT spent by businesses on qualifying business expenditures
- “Input” meant to reflect incoming purchasing

#### Supply
- VAT terminology for a “sale”
- Goods: tangibles; Services: intangibles

#### Consideration
- Payment received in return for the supply of goods or provision of services
- Generally, “everything received in return for the supply of goods and services,…”

#### Reverse charge mechanism
- Situation in which seller of services (usually foreign) is not liable for VAT, and instead buyer is required to account for VAT

---

Note the focus on movement on goods/services, rather than movement of money
### VAT rates

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard</strong></td>
<td>EU VAT rates range from 17% to 27%. Average EU VAT rate is approaching 21.5% – somewhat less in ASPAC and LATAM</td>
</tr>
<tr>
<td><strong>Reduced</strong></td>
<td>Any rate lower than the standard rate</td>
</tr>
<tr>
<td></td>
<td>E.g., basic food stuff, books – usually political decision</td>
</tr>
<tr>
<td><strong>Zero-rated</strong></td>
<td>No VAT is charged, but seller <strong>HAS</strong> a right to credit input tax</td>
</tr>
<tr>
<td></td>
<td>E.g., exported goods and services</td>
</tr>
<tr>
<td><strong>Exempt</strong></td>
<td>No VAT is charged, but the seller <strong>HAS NO</strong> right to credit input tax</td>
</tr>
<tr>
<td></td>
<td>E.g., certain financial, medical and education services</td>
</tr>
<tr>
<td><strong>Outside scope</strong></td>
<td>Not within the scope of VAT in the jurisdiction concerned</td>
</tr>
<tr>
<td></td>
<td>E.g., charities and non-business</td>
</tr>
</tbody>
</table>
## Chargeability and recovery

<table>
<thead>
<tr>
<th>Distinction made between</th>
<th>Output tax charged</th>
<th>Input tax recoverable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Zero – rate</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Exempt</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>
Proffered Rationale for VAT
Why do jurisdictions adopt VAT?

— Broad-based tax
  ▪ From policy perspective, broad-based taxes more desirable than applicable to narrow set of transactions or taxpayers
  ▪ VAT may help to stabilize revenue and less volatile than personal and corporate income tax

— Revenues collected sooner
  ▪ Because revenues are collected at each stage, governments receive tax revenue sooner than waiting for tax revenue from retail sales tax or excise taxes

— Simple Administration
  ▪ Taxpayers collect VAT for the government
  ▪ No need of exemption certificates
  ▪ Improvement in technologies are making administration and compliance easier

— Taxes consumption and not savings, investments, or business inputs
Why do jurisdictions adopt VAT? (continued)

— Neutral, growth friendly tax
  - Sales tax meant to be collected at final point of sale, but not necessarily so in practice (business inputs often taxed)
  - By collecting taxes throughout process, VAT system is able to avoid cascading tax effect

— Favorable to international trade
  - Domestic and foreign products treated equally:
    - Generally, exports are not subject to VAT, but imports are subject to VAT
VAT in the US?
Key issues in design of a U.S. VAT

- Choice of VAT structure
  - Addition, subtraction, credit-invoice
- Choice of VAT base (assuming credit-invoice)
  - Dealing with essentials; filing thresholds
- Choice of VAT rate
- Single rate vs. multiple rates
  - Dealing with regressivity
- “Inside the tax” or “outside the tax”
  - Structuring credits, exemptions and expenditures
- Dealing with special sectors
  - Housing, financial services, government, nonprofits
- Administration
  - Who collects?
Key design issues – Coordination

• State and local officials generally view VAT as encroachment on traditional sub-national source
  - Potential crowding out in the consumption tax space
  - Potential calls to cede policy and administrative control to federal government
• Federal VAT could improve structure of sales taxes
  - Potential for improving structure and operation of retail sales taxes
  - Potential for improving sales tax compliance
  - Potential for reducing sales tax compliance burden
• Would require accommodation by state officials
  - Greatest improvements flow from close coordination with federal
VATs in a Federal System
Canada
Overview of indirect taxes in Canada

Federal level:

- Goods and services tax (GST): credit-invoice method levied at a rate of 5% and administered by the Canadian Revenue Agency (CRA)

Provinces and territories level

- No local tax – 4 jurisdictions
- Provincial sales tax (PST): retail sales tax similar to the U.S. states’ retail sales tax – 3 jurisdictions
- Harmonized sales tax (HST): local taxes are harmonized with GST whereby the tax rate comprises a federal and a provincial portion – 5 jurisdictions
- Quebec sales tax (QST): rules are broadly harmonized with GST, but it is a separate tax and is administered by Revenue Quebec
HST

— HST combines a federal component (i.e., 5% GST) and a provincial component
— Same tax base and rules as GST
— Administered by the Canada Revenue Agency (CRA)
— A person registered for GST is also registered for HST
— One combined GST/HST return
— Specific rules to HST
  ▪ HST place of supply rules
  ▪ Recaptured input tax credits (RITCs) in some HST provinces
  ▪ A few point-of-sale rebates for provincial component of HST
— Various special calculations for some financial institutions including pension plans
India
### Indirect taxes levied in India

<table>
<thead>
<tr>
<th>Indirect tax</th>
<th>Taxing authority</th>
<th>Applicable on</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise duty</td>
<td>Federal government</td>
<td>Manufacture of goods in India</td>
</tr>
<tr>
<td>Service tax</td>
<td>Federal government</td>
<td>Provision of taxable services</td>
</tr>
<tr>
<td>Central sales tax (CST)</td>
<td>Federal government</td>
<td>Inter-state sale of goods</td>
</tr>
<tr>
<td>VAT</td>
<td>State governments</td>
<td>Sale of goods within the state</td>
</tr>
<tr>
<td>Entry tax/octroi</td>
<td>State governments/local authorities</td>
<td>Entry of goods in state/local area for consumption, use or sale</td>
</tr>
</tbody>
</table>
## Structure Proposed for GST in India

### Framework
- **Levy:** Tax on all supplies (including stock transfers);  
- **Mechanics:** Dual GST: CGST for Centre (federal) and SGST for states; IGST on inter-state supplies  
- **Situs:** Place of supply rules (sourcing rules) to determine situs of supply of goods & services  
- **Credits:** Full credit of all GST paid, except cross credits between CGST and SGST

### Coverage
- **Subsumed:** Excise duty, Countervailing Duty (CVD), Special Additional Duty (SAD), Service tax, state VATs, Central Sales Tax (CST), Entry tax, Purchase tax, Entertainment Tax, Luxury Tax, Cesses
- **Excluded products:** Alcohol for human consumption, Petroleum products

### Rates
- **Rate structure:** Finalized as per the latest GST Council meeting:  
  - Lower Rate – 5%  
  - Standard Rate – 12% and 18%  
  - Higher Rate – 28%  
  - Sin / Demerit Rate – 28% + Cess (for specified goods)
- **Rate Schedule:** yet to be released
Mechanics of GST Levy

Dual GST will consist of CGST and the SGST, which in themselves, would include both Goods Tax and the Services Tax

<table>
<thead>
<tr>
<th>Intra-state sale of goods</th>
<th>Rate</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise Duty</td>
<td>12.5%</td>
<td>12.50</td>
</tr>
<tr>
<td>Value Added Tax (VAT)</td>
<td>5%</td>
<td>5.63</td>
</tr>
<tr>
<td><strong>Total Invoice Value..</strong></td>
<td></td>
<td><strong>118.13</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Intra-state supply of goods</th>
<th>Rate</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>CGST</td>
<td>9%</td>
<td>9</td>
</tr>
<tr>
<td>SGST</td>
<td>9%</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total Invoice Value..</strong></td>
<td></td>
<td><strong>118</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inter-state sale of goods</th>
<th>Rate</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise Duty</td>
<td>12.5%</td>
<td>12.50</td>
</tr>
<tr>
<td>Central Sales Tax (CST)</td>
<td>2%</td>
<td>2.25</td>
</tr>
<tr>
<td><strong>Total Invoice Value..</strong></td>
<td></td>
<td><strong>114.75</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inter-state supply of goods</th>
<th>Rate</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>IGST</td>
<td>18%</td>
<td>18</td>
</tr>
<tr>
<td>...............</td>
<td>....</td>
<td>....</td>
</tr>
<tr>
<td><strong>Total Invoice Value..</strong></td>
<td></td>
<td><strong>118</strong></td>
</tr>
</tbody>
</table>

*Calculations are made assuming GST of 18% and State and Centre share equally.*
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. NDPPS 585269

The KPMG name and logo are registered trademarks or trademarks of KPMG International.