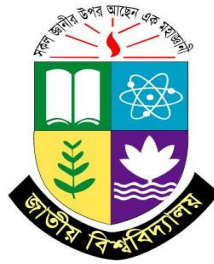


# DR. MALEKA UNIVERSITY COLLEGE, DHAKA



## Term Paper On Value Added Tax Practice in Bangladesh



### Submitted To:

**Second Examiner**

**Md. Abul Kalam**

Head of the Department

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Session: 2012-2013

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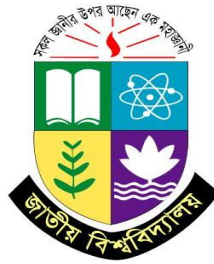
Dr. Maleka University College, Dhaka

**Date of Submission: 4<sup>th</sup> October 2015**

# DR. MALEKA UNIVERSITY COLLEGE, DHAKA



## Term Paper On Value Added Tax Practice in Bangladesh



### Submitted To:

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**Date of Submission: 4<sup>th</sup> October 2015**

## Letter of Transmittal

To

**Md. Mojibur Rahman**

Assistant Professor

Department of Accounting

Dr. Maleka University College, Dhaka.

Subject: **Submission of Term Paper on Value Added Tax Practice in Bangladesh**

Dear Sir,

I am please and happy to submit this Term Paper on **Value Added Tax Practice in Bangladesh** Endeavors has been made to make it comprehensives as far as possible.

It is original work of mine done in partial fulfillment of the requirement for obtaining BBA degree. I request you to take any mistake or shortcoming make in the report with a good grace.

Thank you.

Sincerely Yours,

.....

**Farzana Akter**

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## Certificate of Second Examiner

I hereby declare that the project report on **Value Added Tax Practice in Bangladesh** is an original work by Farzana Akter a student of BBA (Hon's), Department of Accounting, Dr. Maleka University College, Dhaka has completed her Term Paper under my supervision and submitted for the partial fulfillment of the requirement of the degree of bachelor of Business Administration (BBA) at Dr. Maleka University College.

.....

**Md. Mojibur Rahman**

Assistant Professor

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Dr. Maleka University College, Dhaka.

## Acknowledgement

I must first this opportunity to thank the almighty Allah to favor me to complete the Term paper. I am very grateful to my supervisor **Md. Mojibur Rahman**, Assistant Professor, Department of Accounting, Dr. Maleka University College, Dhaka., Dhaka for assigning and preparing this report and to help me all the way through in completion of this report successfully, which enrich my academic career as well practical knowledge and aptitude on this particular report. I have the pleasure to submit this Term Paper on **Value Added Tax Practice in Bangladesh** a study on NBR for your kind evaluation.

## Abstract

VAT is a tax on consumer spending. It is collected by VAT-registered traders on their supplies of goods and services effected within the State, for consideration, to their customers. Generally, each such trader in the chain of supply from manufacturer through to retailer charges VAT on his or her sales\* and is entitled to deduct from this amount the VAT paid on his or her purchases. [In some circumstances, particularly in the construction industry, VAT is not charged by the supplier, but instead the customer simply accounts for the VAT as if it had been charged. The effect of offsetting VAT on purchases against VAT on sales is to impose the tax on the added value at each stage of production - hence Value-Added Tax. For the final consumer, not being VAT-registered, VAT simply forms part of the purchase price.

## Table of Contents

S/L. No:	Contents	Page No.
<b>1</b>	<b>CHAPTER-1</b> <b>Introduction</b>	01-04
	1.1 Introductory Background	01
	1.2 Statement of VAT	01-04
	1.3 Objective of VAT	04
<b>2</b>	<b>CHAPTER-2</b> <b>Conceptual Issues</b>	05-11
	2.1 Clarifying the concepts Involved	05
	2.2 Research	06-11
<b>3</b>	<b>CHAPTER-3</b> <b>Database</b>	12-15
	3.1 Nature of Data Qualitative of VAT	12-13
	3.2 Sources and Uses of VAT	14-15
<b>4</b>	<b>CHAPTER-4</b> <b>Findings of the Study</b>	16-23
	4.1 Briefing overview of the companies concerned (EU's Value-Added Tax (VAE) Impact U.S (Companies)	16-19
	4.2 Details Description of VAT	20-23
<b>5</b>	<b>CHAPTER-5</b> <b>Conclusion</b>	24-26
	5.1 Summary of Major Findings, Policy Recommendations	24
	5.2 Concluding Remarks	25
	<b>References</b>	26

# **CHAPTER ONE**

## **Introduction**

### **1.1 Introductory Background**

Value Added Tax (VAT) is basically a tax to be levied on the value added by an organization at each stage of its rendering services or producing goods. The VAT is a tax on the final consumption of goods or services and is ultimately borne by the consumer although it is collected at every stage of production or distribution and a tax credit is granted at each stage for tax paid at the earlier stage in the chain of transfer/sale of goods or services till it reaches the final consumer. Few fiscal issues are more important in developing countries than the Value Added Tax (Bird, 2005). The rise of the VAT around the world has been one of the most important tax developments in the recent century. This tax is considered to have advantages compared with other taxes, because it eliminates cascading, allows for zero rating of exports, and it is broad based and difficult to evade. VAT was first introduced on an extensive scale in France in 1954. Since then, more than 130 countries in the world had adopted a VAT of some kind. Like many developing countries, Bangladesh introduced VAT in 1991 with a view to mobilize its internal revenue collection and to bring transparency to its indirect tax system. At present, VAT is a significant source of revenue in Bangladesh. For the last 20 years more than 30 percent of revenue collected by the National Board of Revenue (NBR) in Bangladesh was from VAT and its contribution is increasing day by day. The question arises then who actually who bears the burden of VAT in Bangladesh. This paper tries to answer this question by measuring the progressivity of VAT in Bangladesh.

### **1.2 Statement of VAT;**

Owner managers today need to be able to understand finance; leaving everything to an accountant is easy, but isn't practical. The basics of finance are worth a bit of effort to learn and understand, as you can glean invaluable business information.

### **Profit and Loss Account (P&L);**

When you consider your strategic objectives and your annual business plan, you will want to define the objectives in financial terms (as well as marketing, quality and people terms). If a key objective is to make money, then one of your targets must define return on capital. If you are in manufacturing, then you are likely to have an investment in capital that is high compared to sales turnover (and, consequently, a low asset turnover).

### **Balance Sheet;**

VAT is tax paid on the value added at each stage of delivery of a product or service. It is a method whereby businesses act as tax collectors for the Government. If you are registered for VAT, by submitting a VAT return you can claim back what you have paid in VAT, and hand over what you have collected.

### **Cash flow Statements;**

A cash flow statement simply shows all the receipts to, and payments by, the business. Cash flow statements for historical periods usually show what happened for a year, though as with other statements, they can be prepared for any period. The cashflow statement shows how money flowed into and out of the business during the period and relates the P&L (profit and loss) account to the balance sheet. In particular, it shows by how much the working capital in the business increased or decreased and highlights the reasons for the changes. It does not show the amount of working capital available - that is on the balance sheet. Remember that a cash flow statement only shows cash in and cash out, so non-cash items such as depreciation are ignored.

### **Choosing Appropriate Objectives;**

When you consider your strategic objectives and your annual business plan, you will want to define the objectives in financial terms (as well as marketing, quality and people terms). If a key objective is to make money, then one of your targets must define return

on capital. If you are in manufacturing, then you are likely to have an investment in capital that is high compared to sales turnover (and, consequently, a low asset turnover).

### **VAT (Value Added Tax):**

VAT is tax paid on the value added at each stage of delivery of a product or service. It is a method whereby businesses act as tax collectors for the Government. If you are registered for VAT, by submitting a VAT return you can claim back what you have paid in VAT, and hand over what you have collected.

#### **Field**

Starting Date

Ending Date

Include VAT Entries Include VAT Entries

Round to Whole Numbers

Show Amounts in Add. Reporting Currency

#### **Description**

- ❖ Enter the date you want the time interval for VAT statement lines that appear in the report to start.
- ❖ Enter the date you want the time interval for VAT statement lines that appear in the report to end.
- ❖ Select one of the available options.
- ❖ Select one of the available options.
- ❖ Select if you want the amounts in the report to be rounded to whole numbers.
- ❖ Select if you want report amounts to be shown in the additional reporting currency.

### **1.3 Objectives of VAT:**

1. Increase in government revenue
2. Developing stable source of government revenue
3. To make the tax system more transparent
4. To avoid cascading effect.
5. To reduce tax evasion practices
6. To increase in exports.

## CHAPTER TWO

### 2.1 Clarifying the Concepts involved:

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. This input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax. The Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month). If, for example, input worth Rs. 1,00,000/- is purchased and sales are worth Rs. 2,00,000/- in a month, and input tax rate and output tax rate are 4% and 10% respectively, then input tax credit/set-off and calculation of VAT will be as shown below:

(a) Input purchased within the month: Rs. 1,00,000/-

(b) Output sold in the month: Rs. 2,00,000/-

(c) Input tax paid: Rs. 4,000/-

(d) Output tax payable: Rs. 20,000/-

(e) VAT payable during the month: Rs. 16,000/-

after set-off/input tax credit [(d) - (c)]







#### Coverage of Set-Off / Input Tax Credit

This input tax credit will be given for both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilised/sold. This also reduces immediate tax liability.

Even for stock transfer/consignment sale of goods out of the State, input tax paid in excess of 4% will be eligible for tax credit.

## 2.2 Research

### Product Price and VAT analysis of Pran Group:

S/L No.	Product Photo	Product Name	Actual Price (Without 15% Vat)	15% VAT	Total Amount
1.	 (Weight: 350g)	Pran Orange Jelly	153/-	27/-	180/-
2.	 (Weight: 900g)	Pran Tomato Sauce	178.50/-	31.5/-	210/-
3.	 (Weight: 400g)	Crispy tasty and hot chanachur	72.25/-	12.75/-	85/-
4.	 (Weight- 100ml)	Pran Frooto Mango Juice	97.75/-	17.25/-	115/-
5.	 (Weight- 5kg)	Pran Kataribhog Rice	756.50/-	133.5/-	890/-
6.	 (Weight-300g)	Pran Garlic Pickle	153/-	27/-	180/-

## Power of Adjudication

adjudication related to the cases of confiscation or levy of a Monetary penalty under this act or any rules shall be done,-

(a) in the case of import and export, in accordance with the provisions of section 179 of the customs act, and

(b) in the case of supply of goods and rendering of service, by the vat officers, according to the following table, namely:

The Table

Nature of adjudication	Officer	Power
1	2	3
(a) adjudication related to monetary penalty in the case of confiscation of goods or services and tax evasion	Commissioner	value of the goods when exceeds tk. 15.00 lakh;
	Additional Commissioner	value of the goods not exceeds tk. 15.00 lakh;
	Joint Commissioner	value of the goods not exceeds tk. 10.00lkh;
	Deputy Commissioner	value of the goods not exceeds tk. 5.00 lakh;
	Assistant Commissioner	value of the goods not exceeds tk. 3.00lakh;
	Superintendent	value of the goods not exceeds tk. 1.00lakh;
(b) adjudication in the other cases of impossible monetary penatly	Revenue officer	full power

**Appeal.-**(1) any vat officer or any person aggrieved by any decision or order given by a vat officer under this act or the rules, may appeal against such order, except against an order of seizure or sale issued under section 56 in case of supply of goods or rendering of services or those issued under sections 82 and 98 of the customs act in the case of import of goods, within 3 months of giving such decision or order;-

(a) To the commissioner (appeal) against the decision or order issued by an additional commissioner or any vat officer subordinate to him; and

(b) to the excise and appellate tribunal constituted under section 196 of the customs act, hereinafter called the appellate tribunal against the decision or order issued by the commissioner, the commissioner (appeal) or any vat officer of equivalent rank and status.

(1a) following the acceptance of an appeal under sub-section(1).- (a) if the appeal is filed to the commissioner (appeal), commissioner (appeal) may conduct an enquiry about the appeal if he considers it necessary or collect information and may after giving to the appellant reasonable opportunity of being heard uphold the decision or order applied or amend it, or reject it or give such fresh decision or order as he deems fit: provided that if the commissioner (appeal) is satisfied that the appellant could not file the appeal within the said three months time due to sufficient reason, he may permit the appellant to file the appeal within two months next following the said period.

(b) if the appeal is filed to the appellate tribunal, the appellate tribunal, shall, notwithstanding anything contained in this act, dispose of the appeal following, as far as practicable, the provision of the customs act regarding the said tribunal.

(2) if any person intends to prefer an appeal under sub-section(1) against a decision or order relating to a demand of vat payable on any goods or service or to fine charged under this act he shall have to pay, at the time of filling his appeal,-

(a) in the case of an appeal filed to the commissioner (appeal), 10% of the fine charged or tax demanded;

(b) in the case of an appeal filed to appellate tribunal against an order issued by the commissioner or any vat officer of his equivalent rank, 25% of tax demanded or fine imposed;

(c) in the case of an appeal filed to the appellate tribunal against an order of the commissioner (appeal), 15% of the demanded or fine charged in the govt. treasury or to a vat officer authorized by the govt. in behalf

(3) no appeal under sub-section(1) shall be filed in respect of any decision or order after any proceeding under section 43 has been initiated by the board with regard to that order or decision.

(4) notwithstanding anything's contained in this act, if the appellate authority fails to give any decision on the appeal within 9 months from the date of its receipt, the appeal shall be deemed to have been granted by the appellate authority.

(5) if any appeal filed to the board under section 42 within the specified date or any appeal order given by the board or any matter arising out of or relating to such appeal remains undisposed of or unimplemented immediately before the said date, as the case may be, it shall be transferred to the appellate tribunal on the specified date and shall, as far as practicable, be disposed of by the appellate tribunal in accordance with the procedure specified in section 196 of the customs act.

### **Power of the board to requisition and examine records, etc.**

(1) the board may suo motu call for and examine the records of any proceedings under this act in order to satisfy itself about the legality and appropriateness of any decision or order passed by any vat officer subordinate to it, and can pass such order as it deems proper:

provided that no order of confiscation of goods of higher value, or increasing the amount of fine in lieu of confiscation, or imposing fine, or paying non-levied or short-levied vat or, where applicable, vat and supplementary duty, shall be given without giving the person likely to be aggrieved by it an opportunity of showing cause or being heard in person or through a counselor or any other person duly authorized by him.

(2) record in respect of any proceedings relating to an order or decision of any vat officer shall not be called for and examination under sub-section(1) after the expiry of 2 years of giving such order or decision.

(3) in a case where any appeal under sub-section 42 is pending, no proceeding under sub-section(1) shall be initiated till the disposal of the appeal.

**Appearance through authorized representative and vat counselor, etc.-** (1) any person entailed or summoned to appear before any vat officer, appellate authority the board or the govt. in connection with any proceeding under this act or the rules may appear through a person mentioned in section 196k of the customs act and the provisions of that section shall apply to him as if were enacted under this act for appearance under this section. (2) the board may give license to any person to act as vat consultant for the purpose of any procedures under this act or the rules, to perform any act related to vat or to appear according to sub-section(1) before any officer, or authority, mentioned in that sub-section or the board or the govt. on behalf of any registered or resistible person or to advise him on any matter which originated or may originate from this act or the rules.

**Power of the govt. to summon and examine records etc.-**

the govt. may at its own motion or on an application from any person, summon and examine, in order to be satisfied about legality or justifiability of an order under this act or the rules, the records of the proceeding of such order within one year of the passing thereof and after such examination it may pass such order as it deems fit, correcting any apparent error or mistakes:

provided that an order confiscation of goods of enhanced value. or increasing the amount of fine in lieu of confiscation or imposing fine or directing to pay non-levied or short-levied vat or, where applicable, vat and supplementary duty shall not be given without giving the person likely to be aggrieved by it an opportunity of showing cause or being heard in person or through a counsel or any other person duly authorized by him: provided further that in a case where a person failed to avail himself of the opportunity of filing an appeal under section 42 though such opportunity was avail vale to him, his application under this sub-section shall not be acceptable.

**Power to search.-** any vat officer, not below the rank of an assistant commissioner of vat may, if he believes or has reason to believe that, any goods or service liable to levy of vat is or has been supplied, given or borne in contravention of any provision of this act or the rules from or by any place, house, premises, vehicle or any other transport, authorize by order or in writing any vat officer to enter such place, house, premise, vehicle or any other transport and in such order authority may also be given to search such, house and premise, vehicle and other transport.

**Delegation of the power of magistrate of vat officer.-** to achieve the objectives of this act and the rules there under, the govt. may, by notification in the official Gazette, delegate to a vat officer, not below the rank of an assistant commissioner, the powers of a first class magistrate specified in schedule iii to the code of criminal procedure, 1898 (act v of 1898), hereinafter referred to as code of criminal procedure to exercise the power under section 36 of code of criminal procedure.

**Power to arrest.-** any vat officer authorized by the board in this behalf, may arrest such person who, the said officer believed or has reason to believe has committed an offence punishable under this act.

### **Tax Payer's Identification Number (TIN)**

The Tax Payer's Identification Number will consist of 11 digit numerals throughout the country. First two characters will represent the State Code as used by the Union Ministry of Home Affairs. The set-up of the next nine characters may, however, be different in different States.

### **Audit**

Correctness of self-assessment will be checked through a system of Departmental Audit. A certain percentage of the dealers will be taken up for audit every year on a scientific basis. If, however, evasion is detected on audit, the concerned dealer may be taken up for audit for previous periods. This Audit Wing will remain delinked from tax collection wing to remove any bias. The audit team will conduct its work in a time bound manner and audit will be completed within six months. The audit report will be transparently sent to the dealer also. Simultaneously, a cross-checking, computerized system is being worked out on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise and Income Tax to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise and Income Tax. This comprehensive cross-checking system will help reduce tax evasion and also lead to significant growth of tax revenue. At the same time, by protecting transparently the interests of 12 tax-complying dealers against the unfair practices of tax-evaders, the system will also bring in more equal competition in the sphere of trade and industry.

# CHAPTER THREE

## DATABASE

### 3.1 Nature of Data Qualitative of VAT;

#### Notion of VAT

The value added of a firm is the difference between a firm's sales and a firm's purchases from all other firms. In other words, a firm's value added is simply the amount of value that a firm contributes to a good or service by applying its factors of production (land, labor, capital, and entrepreneurial ability). Value-added tax is a tax imposed by a government at each stage in the production of a good or service. Every company that handles a product during its transformation from raw materials to finished goods pays the tax. The amount of the tax is determined by the amount of the value that a company adds to the materials and services it buys from other firms. Suppose that a company making writing pads buys paper, cardboard, and glue worth € 1,000. The company adds € 500 in labor costs, profits, and depreciation, and sells the scratch pads for €1,500. The value-added tax is calculated on the € 500. If the VAT rate were 20%, the tax due would amount to € 100. The companies that had sold the paper, cardboard, and glue to the writing pads company would also pay a tax on their value added. In this way, the total value added taxed at each stage of production adds to the total value of the final product.

A firm's net VAT liability is usually calculated by using the credit method. According to this method, a firm determines its gross tax liability by multiplying its sales by the VAT rate. Then the firm computes its net VAT liability by subtracting VAT paid on purchases from other firms from the firm's gross VAT liability. The other firms also have to charge VAT to all their customers, including our firm and will be paying this to the government. Since we are paying this indirectly to the government through our suppliers, we don't have to pay it directly and can deduct this from our liability to the government. If the VAT rate is 20%, in our example, total VAT collected should be € 300 (20% of 1500). VAT paid to suppliers, which can be deducted, should be € 200 (20% of 1000). So, the net VAT liability is € 100 (300 - 200). This is the same result as in the earlier presentation. However, understanding this method is useful because it allows us to take into account multiple tax rates.

There are minor variants of the VAT. Some countries do not allow deduction of VAT on fixed assets. Other countries allow deduction only at the time of depreciation, so as to spread the effect of VAT deduction over many years. However, most developed countries prefer to allow the deduction on fixed assets immediately. This stimulates the sale of plant and machinery and ensures that there is nothing to hinder technological advance.

**On goods and services, not on people :**

From the above example, you would note that company essentially pays VAT on the items on which VAT is not charged earlier. Where a supplier has already charged VAT, the company now gets a deduction. It therefore does not deduct VAT on factors of production such as wages and profits. In strictly economic terms, a case can be made for not charging it on rent on interest too. But today, many countries include VAT on some forms of commercial rent and on some banking expenses. In such cases, the VAT on these would be paid by a company to the supplier of these services and then deducted from its VAT liability to the government. The reason for excluding depreciation is that the VAT has already been charged on the Fixed Asset at the time of acquiring it, and this has already been deducted from the VAT liability.

**Indirect tax;**

Most firms that pay a value-added tax try to pass this expense on to the next buyer. As a result, most of the burden of this tax in time falls on the consumer. In this sense, the final effect is equal to that of a retail sales tax.

**Proportional tax:**

The tax is levied at a fixed percentage rate and applies to all goods and services. However, many nations use multiple rates. In these nations, the less necessary a product is, the higher the rate usually is. However, lower VAT rates may also be used to stimulate key activities or socially desired sectors. In the EU, Annex H to the sixth directive lists the category of goods to which such reduced rates apply (examples: foodstuffs, water, Pharmaceuticals, medical equipment, publications, etc).

### 3.2 Sources and Uses of VAT; Value Added Tax;

The National Retail Federation releases a report on the macroeconomic effects of a value added tax. "The three principal findings of the report are: 1. An add-on VAT would reduce retail spending by \$2.5 trillion over the next decade. Retail spending would decline by almost \$260 billion or 5.0% in the first year after enactment of the VAT. 2. An add-on VAT would cause GDP to fall for several years. The economy would lose

850,000 jobs in the first year, and there would be 700,000 fewer jobs ten years later. By comparison, a comparable reduction in the deficit through reduced government spending would have less adverse effects on the economy, and could have positive effects for economic growth. 3. Although lower deficits and debt would have positive long-run effects for the economy, most Americans over 21 years of age when the VAT is enacted would be worse off due to enactment of an add-on VAT. A VAT would have significant redistribution effects across generations, reducing real incomes and employment for current workers."

**Rich Spending:** A new poll by Gallup shows spending by people making less than \$90,000 a year tumbled in September. "The decline in lower- and middle-income Americans' spending to new lows over the past two months may be a precursor of another significant drop in the overall economy. Gallup's self-reported spending data tend to measure consumers' discretionary or marginal expenditures, making these measures highly sensitive to shifting consumer spending patterns. Gallup modeling suggests that lower- and middle-income spending is significantly more sensitive to job market conditions than is upper-income spending. In this regard, the September decline in lower- and middle-income spending may reflect the sharp increase in unemployment over the same period and continued high underemployment levels. Further, the lagged effects of continuing high and increasing unemployment are probably yet to be fully felt."

#### **Trade Risks:**

**Nouriel Roubini** worries about the effects of global currency and trade wars. "Currency wars eventually lead to trade wars, as the recent US congressional threat against China shows. With US unemployment and Chinese growth both at almost 10%, the only mystery is that the drums of trade war are not louder than they are. If China, emerging markets, and other surplus countries prevent nominal currency appreciation via intervention - and prevent

real appreciation via sterilization of such intervention - the only way deficit countries can achieve real depreciation is via deflation. That will lead to double-dip recession, even larger fiscal deficits, and runaway debt. If nominal and real depreciation (appreciation) of the deficit (surplus) countries fails to occur, the deficit countries' falling domestic demand and the surplus countries' failure to reduce savings and increase consumption will lead to a global shortfall in aggregate demand in the face of a capacity glut. This will fuel more global deflation and private and public debt defaults in debtor countries, which will ultimately undermine creditor countries' growth and wealth."

## **CHAPTER FOUR**

### **Findings of the Study**

#### **4.1 Briefing Overview of the companies concerned (EU's Value-Added Tax (VAT Impacts U.S. Companies));**

This report provides an overview of the EU's Value Added Tax (VAT) rules and how these rules impact U.S. exporters of goods and services to the EU. VAT is a complex area consisting of many rules and exceptions. While the guidelines for VAT policy are set at the EU level, the Member States implement, administer and enforce the rules. Therefore, VAT rates differ in each Member State, and currently vary between 15 and 25%. Member States, at their discretion, may apply reduced rates for specific goods and services, or even temporary derogations. This report focuses on the basic set of principles that will help U.S. companies understand and navigate the VAT system.

#### **Introduction**

VAT obligations for U.S. companies involving business transactions can vary according to the following criteria:

- Where the U.S. company is operating from;
- Where a company's final customers are based;
- Whether a particular customer is a business or a consumer; and
- Whether services or goods are being supplied by the original company.

In the EU's VAT language, applying VAT is relevant only to "taxable persons." A "taxable person" is described as any individual, partnership, or company that supplies taxable goods and services in the course of business. Thus "taxable persons," where stated in this report, refers to these categorizations of individuals/entities that are involved in economic activity.

The most important pieces of legislation on VAT are the EU VAT Directive 2006/112/EC and its Implementing Regulation 282/2011 . See the last section for additional legislative developments.

Topics in this report:

Section I: Overview of the VAT system and how it works;

Section II: How the VAT impacts U.S. companies supplying goods to the EU or within

its borders;

Section III: Rules for providing services to EU customers;

Section IV: Specific VAT rules applicable when supplying ESS (Electronically Supplied Services);

Section V: Business activities that may qualify for a VAT refund;

Section VI: Useful web links.

I. What is the VAT? How does VAT work? And who pays for VAT? The VAT is a tax on consumer spending that is collected by VAT registered traders on sales of goods and services. The premise behind the VAT is that a tax on the "value added" is imposed at each stage of the production and sales process of a good; it is the final consumer - at the end of this process - who absorbs the tax as part of the total purchase price. "VAT is charged when VAT-registered (taxable) businesses sell to other businesses (B2B) or to the final consumer (B2C). VAT is intended to be 'neutral' in that businesses are able to reclaim any VAT that they pay on goods or services. Ultimately, the final consumer should be the only one who is actually taxed. Businesses operating in the EU are given a VAT identification number and have to show the VAT charged to customers on the invoices."

Please note: Not all goods and services are subject to VAT. For a list of exemptions, consult Title IX of the VAT Directive.

### **a) Taxing Process**

Companies need to pay out VAT on business inputs before being able to recover it through their VAT returns. VAT is charged when a VAT registered business sells to either another business (a "taxable person") or non-business customer (a "non-taxable person"). There are two forms of VAT relevant to business transactions: Output and Input VAT. Each participant in the supply chain - from manufacturer to retailer, through wholesaler and distributor - charges VAT on the sales it makes. This is labeled Output VAT. When a trader pays VAT on its purchases, this is referred to as Input VAT. Traders take what VAT they have received and compare it to the VAT they have paid out themselves and then submit the surplus to the appropriate VAT authority. If their total VAT payments (input VAT) surpass their total VAT receipts (output VAT), then the entity receives the difference.

When a VAT registered business buys goods or services, it can generally reclaim the VAT it has paid. Please note that if an entity is not a VAT registered business, it may not reclaim VAT that it has paid on goods and services. One must establish its business as a "VAT-

registered business" if it sells VAT-taxable goods and/or services and its turnover for a 12-month period reaches or exceeds a certain financial threshold. To consult with a particular tax authority in a Member State country where one wishes to do business, consult the list here. (See the VAT refund section below).

## **b) VAT Rates**

The EU's VAT system is semi-harmonized. While the guidelines are set out the EU level, the implementation of VAT policy is the prerogative of Member States. The EU VAT Directive allows Member States to apply a minimum 15% VAT rate and a maximum of 25%. However, they may apply reduced rates for specific goods and services or temporary derogations. Therefore the examination of VAT rates by Member State is strongly recommended. These and other rules are laid out in the VAT Directive. The best sources for navigating the VAT process are the following websites of the European Commission:

- Basic information on the application of VAT in the Member States
- An updated list of the Member States' VAT rates
- Table of the derogations
- A List of the Member States; | VAT authorities

For more information on VAT rules, consult the EUjjs VAT webpage, its webpage on the place of taxation, and the EUj|s VAT Committee guidelines. Please keep in mind that the VAT Committee guidelines are not legally binding and can therefore be challenged by Member States.

II. How does VAT impact a U.S. companyj|s supply of goods and what is its VAT obligation?

VAT is applied at the place of supply of a good or service (meaning where the good is sold or provided to the end user). Therefore, VAT is relevant when the place of supply is in the EU, as this determines the VAT rate to be applied to the transaction. Regarding cross-border sales between a business and another business (between EU states), the VAT is calculated and collected in the Member State where the final sale of the good (or service, discussed below) takes place. The VAT for goods (and services) provided from a business to a customer is paid by a supplier in the Member State where the sale occurs or where the supplier is established.

It is important to note, however, is that this j|s"place of supply;" principle does not always

determine whether it is the supplier or the customer who is liable to pay the VAT to the tax authorities.

A supplier's VAT registration and collection responsibilities depend on several variables, the most important of which are:

- Where the supplier is based;
- Where the customers of the supplier are based;
- Whether the supplier's customer is a private consumer or a business; and
- Whether services or goods are being supplied by the company

The following sub-sections present VAT scenarios that a typical U.S. exporter and business might face.

a) The importation of goods from the U.S. to the EU

A U.S. producer will most likely first have to export a good to the EU. The importation of goods from non-EU countries, like the U.S., requires that the producer be taxed at the point of importation/entry. Calculating this taxation rate is determined on a country-by-country basis. An exemption to paying tax at this point-of-entry does exist if goods, upon entry to an EU country, are placed under a "suspensive customs procedure;" (e.g. a bonded warehouse) which is an "ir.-transit" procedure. The VAT subsequently paid would be at the rate of the Member State that is the goods' final destination. The import VAT is calculated based on the value of the goods plus any customs duty. The importer of record (the person or firm that manages the payment of different VATs) is responsible for paying all VAT accounts at this point. In "business to business;" transactions (B2B), this importer of record is often the business customer. This means that the U.S.-based supplier does not need to register for VAT or collect any tax on the sale. However, if the U.S.-based exporter is the importer of record then it would have to be registered for VAT and therefore handle all the accounting for VAT and customs duties in the Member State of importation.

b) VAT on the cross-border supply of U.S. goods within the EU (Intra-EU movement) As just discussed, an import tax must almost always be paid when a U.S.-produced good arrives in the EU. Once a product has been imported into one particular Member State, VAT is subsequently applied to its onward supply to customers in other Member States. Determining the place of taxation depends, according to the VAT legislation, on where the acquisition of goods legally takes place, usually the final destination.

## 4.2 Detail Description of VAT:

### Who pays VAT?

VAT is a tax on consumer spending so everyone who pays for good and services pays VAT. It is built into the cost of many commonly consumed items such as clothing and petrol, so you don't see what percentage of VAT you are paying. However, when you are buying items such as computers, electricity and professional services, you will see the amount of VAT and the rate at which you are being charged on your bill.

### How VAT is charged?

VAT is charged at every stage of sale where the cost of an item is increased. The standard rate of VAT is 23%.

For example:

A manufacturer sells a television to a wholesaler for €100 and charges him VAT on that amount at 23%. Therefore, the wholesaler pays €123 for the television. The manufacturer then pays the VAT of €23 to the government.

The wholesaler goes on to sell the television to a retailer for €200. He adds on VAT at 23%, so the retailer pays a total of €246. The wholesaler must pay the government the VAT of €46, but he can reclaim the €23 VAT he has already paid to the manufacturer, leaving €23, which he pays to the government.

When the retailer comes to sell the television to a consumer, he must also add on VAT to his selling price. He sells the television for €300, plus VAT at 23%, making a selling price of €369 for the consumer. The retailer must pay the VAT to the government but he can claim back the €46 VAT that he paid to the wholesaler, leaving €27 for the government.

The government has now received 23% on the price paid for the television by the consumer (€69). The retailer, wholesaler and manufacturer only paid the amount of VAT they charged to the next group down the line.

### VAT on imports

This section only deals with VAT for private individuals who buy goods for personal use.

In general, you have to pay VAT and import duty on any goods you are bringing into Ireland from outside the EU. This includes goods purchased online and by mail order. You will have to pay VAT at the same rate as applies in Ireland for similar goods.

Within the EU, VAT is usually paid in the Member State you purchased the goods, however, there are some exceptions - see below.

## **Rates**

VAT is charged at different rates for various goods and services. You can get an extensive list of VAT ratings from the Revenue Commissioners.

23% is the standard rate of VAT and all goods and services that do not fall into the reduced rate categories are charged at this rate. They include alcohol, audio-visual equipment, car parts and accessories, CDs, computers, consultancy services, cosmetics, detergents, diesel, fridges, furniture and furnishings, hardware, jewellery, lawnmowers, machinery, medicines (non-oral), office equipment, pet food, petrol, paper, tobacco, toys, tools, washing machines, bottled water. 13.5% is a reduced rate of VAT for items including fuel (coal, heating oil, gas), electricity, veterinary fees, building and building services, agricultural contracting services, short-term car hire, cleaning and maintenance services. 9% is a new reduced rate of VAT for tourism-related activities including restaurants, hotels, cinemas, hairdressing and newspapers. It applies for the period 1 July 2011 to 31 December 2013. (It is proposed to extend the reduced rate for tourism-related activities to the end of 2013.) 4.8% is a reduced rate of VAT specifically for agriculture. It applies to livestock (excluding chickens), greyhounds and the hire of horses. 0% (Zero) VAT rating includes all exports, tea, coffee, milk, bread, books, children's clothes and shoes, oral medicine for humans and animals, vegetable seeds and fruit trees, fertilisers, large animal feed, disability aids such as wheelchairs, crutches and hearing aids.

## **Exempt from VAT**

You do not have to pay any VAT on financial, medical or educational services. You may also not pay VAT for live theatrical and musical performances (except those where food or drink is served during all or part of the performance).

## **Difference between exemption and zero-rating**

If a business person supplies taxable goods or services, including zero-rated ones, they can claim VAT back from the government on their taxable business purchases. However, if someone only supplies exempt goods or services, they cannot reclaim VAT. A value-added tax (VAT) is a fee that is assessed against businesses by a government at various points in the production of goods or services—usually any time a product is resold or value is added to it. For tax purposes, value is added whenever the value of a product increases as a result of the application of a company's factors of production, such as labor and equipment. VAT must be paid by every company that handles a product during its transition from raw

materials to finished goods. For example, tax is charged when a manufacturer sells to a wholesaler and again when a wholesaler sells to a retailer. With VAT, the taxable amount is based on the value added at each stage of the process of producing goods and bringing them to market. As an example, say that a company that makes socks buys cotton yarn for \$1,000; adds \$500 to its value in terms of labor, depreciation of knitting machines, and profits; then sells the completed socks for \$1,500. VAT would be calculated as a percentage of the \$500 value added by turning cotton yarn into socks. Of course, the sock company would also get credit for the amount of VAT it paid on the purchase of inputs, like cotton yarn. In general, the total VAT accrued during the production of goods is reflected in the price of items sold to final consumers, because each reseller along the way usually passes along its VAT costs. In this way, VAT is somewhat similar to a national sales tax, and the two forms of taxation are often compared by governments. Experts claim that VAT entails higher administrative costs but is easier to enforce than a national sales tax.

The concept of VAT was first adopted by France in 1954. By 2000, it was used by Canada and 40 other industrialized countries. In most cases, the percentage of tax charged varies based on the necessity of the particular product, so the tax on food would generally be less than the tax on luxury items like boats. In recent years, VAT has been proposed for use in the United States as a way to simplify business and personal income tax laws. Proponents claim that VAT would replace other forms of taxation and reduce the costs of tax compliance. In fact, some people say that adopting VAT would eliminate tax returns for individuals and make the Internal Revenue Service obsolete. On the other hand, opponents argue that VAT would be more complicated to implement than other tax-reform options, such as a national sales tax. They also worry that it would increase the cost of food, medicine, and other necessities, which would hurt the poor.

### **Vat and E-Commerce**

VAT is a common form of taxation in the European Union (EU). In fact, VAT rates are as high as 25 percent in some EU countries. In 2000, a group of these countries proposed implementing a VAT for online businesses. The proposed tax would cover all digital products downloaded over the Internet in member countries, including software, videos, and music. Since the products of electronic retailers were not previously subject to VAT, EU leaders felt that these businesses gained an unfair advantage over domestic, brick-and-mortar retailers. In addition, they argued that the EU nations were being deprived of tax income on

goods sold in their countries by what were essentially foreign corporations. As E-commerce expands in popularity, it may create hardships for some traditional retailers. As these brick-and-mortar businesses earn lower profits and hire fewer employees, they are likely to generate less tax revenue for their governments. If the new Internet competitors were based in the same country, then the tax situation would likely balance out. But the nature of online businesses often means that they can locate anywhere with sufficient technology and telecommunications capacity. Experts predict that increasing numbers of Internet businesses will base their operations in countries where taxes are low. Some low-tax jurisdictions, like Bermuda, have begun to enact favorable laws to attract such businesses. "Thus governments have to face the prospect of permanent flows of taxable profits out of their jurisdictions," Christine Sanderson wrote in *International Tax Review*. "Taking a European view, there is clearly a potential issue for tax authorities, since E-commerce and Internet development is likely to mean a flow of tax profits away from Europe."

The basic problem facing EU leaders is to determine how to apply VAT laws—which were developed with physical products and traditional retail markets in mind—to new types of goods and services delivered over the Internet. In 2000, representatives of 29 countries got together to develop the Ottawa Framework for dealing with these issues. Although the guidelines have not been finalized, they are expected to bring a higher level of certainty and consistency to the tax situation for E-commerce.

## **CHAPTER FIVE**

### **Conclusion**

#### **5.1 Summary of Major Findings, Policy Recommendations;**

Contrary to general opinion Value added tax is one of the more complex areas of tax law. VAT chargeable on the supply of goods and services within the State by a taxable person in the course or furtherance of any business carried on by him, and on goods imported into the State from outside the EU. VAT is also chargeable on the intra-Community acquisition of goods by VAT registered persons and on the intra-Community acquisition of new means of transport such as motor vehicles, boats etc. by either a registered or unregistered person.

The amount on which VAT is chargeable is the total consideration which the person supplying goods or services becomes entitled to receive. Taxable persons account for VAT on their outputs and they are allowed credit against this liability for tax borne on business purchases and other inputs as evidenced by correctly prepared VAT invoices. Taxable persons (generally, people or corporate entities in business) must be registered with the Revenue Commissioners for VAT purposes where the amount of their annual turnover (i.e. the amount of receipts excluding VAT) from the supplies of taxable goods and services exceeds or is likely to exceed certain limits. For suppliers of goods the limit is Euro75,000 . For suppliers of services the limit is Euro37,500. Farmers, sea fishermen and traders whose turnover is below these limits are not generally obliged to register for VAT, but they may do so if they wish.

## 5.2 Concluding Remarks;

In Conclusion-

Lowering the statutory VAT rate may generate growth and employment. However, lowering the VAT rate would result in a more inequitable redistribution of income and wealth. Lowering the VAT should be considered in combination with a revenue replacement strategy, such as an increase in direct taxes, to maintain the progressiveness of the tax structure and therefore equality. Zero-rating food may give immediate poverty relief, as there is a positive welfare effect. Zero-rating food should be accompanied by an increase in direct taxes to prevent government revenue from falling. The employment effects (through a decline in investment) are less severe when government savings remain constant. Increasing direct taxes will also improve the progressiveness of the tax structure. Zero-rating financial services led to an increase in the employment of semi-skilled labor. When zero-rating financial services while increasing direct taxes, an increase in factor income was experienced by all factors. However, zero-rating financial services will increase the regressiveness of the VAT structure, as high income households spend the largest portion of their income on financial services. At the same time, combining zero-rating financial services with an increase in direct taxes, may maintain the progressiveness of the complete tax structure. Zero-rating financial services may also make them more accessible to poor households. Factors that were not considered in the model are the administrative and compliance cost aspects associated with restructuring VAT or applying differential VAT rates. These however would require comprehensive surveys of registered VAT payers. Future research may seek to obtain data on collection and compliance cost to include these aspects in the model.

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