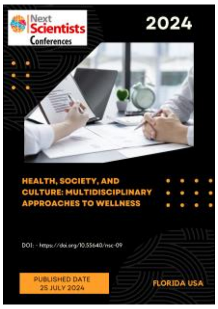

ECONOMIC IMPACT OF VAT EXEMPTION OF FINANCIAL SERVICES

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ABSTRACT

This study examines the issues of VAT on financial services. The consequences of exempting financial services from VAT are analyzed. Based on the analysis, the corresponding conclusions are made.

KEYWORDS: Financial services, taxation, VAT, benefit, transaction.

INTRODUCTION

The taxation of financial services by VAT is one of the current problematic issues in the scientific literature on taxation. The problems considered in the literature can be reduced to two main questions: "Should VAT be levied on financial services?" and if financial services are subject to VAT, "how can they be taxed?" However, in the studies conducted, there was no clear consensus on these two issues and no clear opinions on these issues. However, in most countries, financial services are exempt from VAT due to difficulties in calculating financial value added and lack of a clear method for taxing financial services. The significant growth of the financial sector in the last decade, in turn, this favor reduces tax revenues in the country and creates imbalances in the economy (López-Laborda and Peña, 2018).

Exemption of financial services from VAT creates several inconsistencies. First, financial institutions cannot deduct input VAT on all non-financial transactions, this tax amount can be added to the cost of financial services, which means that consumers are taxed. Therefore, businesses using financial services make relatively higher payments. This results in businesses being overtaxed, while households are relatively undertaxed. Second, avoiding non-refundable input VAT creates incentives for integration. In addition, differences between non-exempt and exempt transactions imply compliance costs, further complicating taxation. It can be shown that the payment of VAT on financial services has a positive effect on the demand for financial services by enterprises (reduces the interest rate on loans and gives the possibility of receiving a credit for the input VAT), but has a negative effect on households (taxation leads to an increase in consumer prices) (Huizinga, 2002).

THE MAIN FINDINGS AND RESULTS

It should be noted that indirect taxation of financial services does not affect the size of the financial sector. Generally, the VAT accounting mechanism ensures that the prices purchased by businesses registered as taxpayers are not affected. However, the exemption of financial services from VAT is not for the banks or their customers, but for the downstream customer of the consumer customers. Also, exemption of financial services from VAT is often due to technical reasons. In particular, the use of VAT on financial services has been discussed in detail by most economists, confirming that 3/2 of all financial services are based on margin, and emphasizing the difficulty of introducing the VAT invoicing system. However, there are ways to solve this problem, for example, in Germany, VAT is paid on options when providing loans, which indicates that there is an acceptable methodology for taxation of margin-based financial transactions. According to the results of the analysis, the exemption of financial services from paying VAT creates imbalances in the costs of the banking sector and the consumption of financial services, as well as in the tax cascade. At the same time, it has been determined that full taxation of bank loans can lead to an increase in violence (Yilmaz and Baydur, 2017). When asked how to make financial services subject to VAT, a potential option was suggested as a GST (once proposed in Canada) on financial services. That is, it is indicated that the company's goods should be taxed using the tax levied on the excess of the cost of the company's goods. However, the use of the invoice-credit method in the VAT system is not appropriate and does not allow determining the existing VAT on transaction transactions. However, in principle, these difficulties can be avoided by applying VAT on a "cash flow" basis (Boadway R., Keen M, 2003). Also, in New Zealand, other than life insurance, insurance, advisory services, equipment leasing, creditor protection and certain other financial intermediation services are not exempt from Goods Services tax. However, transactions related to funds, issuance of securities, loans and borrowings are also exempted from life insurance services (Poddar & Kalita, 2008). New Zealand's system of taxation of non-life insurance services is in effect in a number of countries, including South Africa and Australia. In this case, gross premiums are broadly taxable, but allow policyholders to recoup the withheld tax on GST payments. In this case, the tax is applied to the cash flow of policyholders as value added. Exemption is made for brokerage and brokerage services, and only borrowing and lending operations are included. In Australia, however, there is a scheme known as the Reduced Input Tax Credit (RITC) which mitigates the negative impact of input tax on resource costs. This scheme is the Australian GST code, which is unique in that it allows suppliers of financial services to recover 75% of the tax paid on relevant resources. The main objective of the RITC scheme is to eliminate the focus on vertical integration (self-sufficiency) to facilitate outsourcing in terms of cost efficiency (PWC,2006).

Perhaps there is no debate, at least in principle, about the taxation of B2B transactions. The clear consensus given is that these transactions should not be taxed, and this can be achieved in two ways: a full taxation regime or a zero-rated rate on B2B transactions. These two methods are equivalent for B2B transactions. Further, the research suggests that the gains from full taxation of financial services may be greater if there is a corrective income tax. Therefore, firms with low efficiency are left out of the market, and capital is distributed among firms with high efficiency. There are different views among economists regarding the taxation of B2C transactions. Exemption of financial services from VAT is contrary to the principle of taxation. That is, it will make it impossible for financial institutions to recover the input VAT and lead to the disruption of the chain. VAT can be applied to spreads on tax interest rates and can be distributed between participants of transactions (customers in lending and borrowing). This assessment process will bring transparency of transaction margins not only for the tax authorities but also for the general public, which in turn will reduce information asymmetry, which is one of the causes of the crisis. Abolishing the financial services VAT exemption will reduce the high pressure on banks and create a level playing field with other companies.

CONCLUSION

In general, the exemption of financial services from VAT contradicts the principles of taxation, limiting the possibilities for accounting of input VAT for banks, leading to a break in the chain. This leads to the violation of the essence of VAT, that is, the exemption from tax turns this tax into a direct tax on production. Although consumers may be the only parties affected by the VAT exemption, consumers are not advised to provide excessive amounts of financial services. For this reason, taxing financial services at a zero rate may lead to a decrease in VAT revenue, but the loss in this revenue is compensated by the increase in the income of banks.

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