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From VAT to VAST–Part 1

Watch out! A bill to replace the value-added tax (VAT) system is seriously being considered in the House of Representatives. This is the value-simplified tax system, or VAST. VA is for "value" and not "value added"—which means it is a tax imposed not only on the value added by a seller, as in the case of VAT, but on the total value of the goods and services sold.

Because of President Aquino's assurance to the public that there will be no new taxes during his administration, the House has thought of this bright idea that instead of imposing new taxes to increase revenue collection, the VAT system should be changed instead. Well, the VAST may not be a new tax. It is a replacement tax (as it replaces the VAT) but its effects may be far worse than a new tax.

This article comes in two parts. Part 1 contains the features of the VAST bill while Part 2 will present the evils of this tax system.

The VAST bill (House Bill 3850) was approved by the House Committee on Ways and Means on December 7, 2010, and it is now ready for plenary discussion. It proposes to simplify the present VAT system by replacing it with a business tax, with features similar to a transaction tax or turnover tax. Under the proposed VAST system, the rate of VAT is reduced from 12 percent to 6 percent. It sounds good at the outset, doesn't it? However, the input VAT-credit mechanism, which is the main feature of the present VAT system, is removed. And this makes the VAST a bad system, after all.

Effectively, the removal of the input-VAT credit mechanism that enables the seller to recoup the taxes paid on its inputs makes the VAST a simple turnover tax. It is a straight 6-percent tax imposed every time the goods change hands—from the manufacturer to wholesaler, from wholesaler to retailer, from retailer to retailer, from retailer to consumer. If the inputs used to manufacture the goods are imported, that would be another layer of tax since the 6- percent VAST is also imposed upon importation. Thus, the tax component of a product could be as high as 30 percent (or more when compounded) by the time it reaches the consumer. Wouldn't this drive prices up by this rate as well? As compared with the VAT, the tax rate is only 12 percent for the whole duration of the life of a product—from production to consumption—regardless of the number of turnovers in between.

Also, with the removal of the input tax-credit mechanism, the difference between zero-rated and exempt transactions is automatically eliminated. In fact, the bill removed the classification for zero-rated and effectively zero-rated transactions and lumped them under one section—the “exempt transactions” category. Under this setup, exporters and sellers of zero-rated transactions (including effectively zero-rated) can no longer recover the taxes paid on their inputs, just like exempt transactions. The incentive for exporters is then lost.

In addition to making the zero-rated transactions as exempt transactions, HB 3850 retained the exemption given to transactions previously exempted from VAT. In fact, it made it more appealing by increasing the threshold amount for exemption. For example, it increased the exemption threshold from P1.5 million to P2.5 million. Gross sales or receipts not exceeding P2.5 million are exempt from VAST. Likewise, the exemption threshold with respect to sales of residential lots have been increased from P1.5 million to P2.5 million, and from P2.5 million to P 3.5 million, for a residential house and lot. The exemption level for rental of residential units has been increased from a monthly rental of P 10,000 to P 20,000.

In recognition of the contributions of retired personnel of the Armed Forces of the Philippines, Philippine National Police, Coast Guard and Customs police, and also retired public-school teachers to the government, a new provision has been introduced to exempt from VAST their purchases of goods and services, if their service in the government were for a period of not less than 30 years, or even earlier or if retirement was due to injuries or sickness suffered while in the line of duty.

The same rules on registration, invoicing and bookkeeping requirements under the VAT system have been adopted under the VAST.

With respect to unused input-tax credits when the VAST system takes effect, the same shall be allowed as deductions from gross income, in accordance with the rules to be issued by the secretary of Finance, and in consultation with the Congressional Oversight Committee. This would mean that taxpayers with excess input-tax credits as of the time of the adoption of the VAST can only recover as much as 30 percent of the value of these taxes paid on their inputs, in contrast to the VAT system, which allows a 100-percent recovery through the input tax-credit mechanism.

As mentioned in the explanatory note of the bill, the VAST aims to simplify the collection of tax by removing the areas of discretion or interpretations of tax applicability that increase temptation for corruption, and reduce the tax-collection efficiency of the government. According to some framers of the bill, the claim for input-tax credit has been excessively abused. There is a proliferation of spurious invoices and receipts that are being used as a source of input-vat credit and yet, these have remained undetected by the Bureau of Internal Revenue.

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