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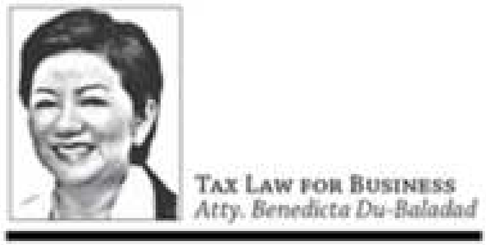

BDB Law's "Tax Law for Business" *appears in the opinion section of* ***Business Mirror*** *every Thursday.*

The evils of VAST–Part 2

As mentioned in Part 1 of this article, the removal of the input-tax credit mechanism, which is the best feature of the value-added tax (VAT) system makes the VAST a multistage general-turnover tax, plain and simple. The reduction of the rate from 12 percent to 6 percent makes it palatable on the surface, especially to the general consuming public, but its impact on the prices of goods, on the competitiveness of Philippine exports, on the survival of small and medium enterprises, and on the erosion of government revenues is grave.

VAST will increase prices of goods

The 6-percent VAST is imposed on the value of goods and services as many times as there are turnovers—from importation to production, to distribution, up to consumption. In my previous example, a manufactured product sold to a wholesaler, then from a wholesaler to another wholesaler, from a wholesaler to a retailer and from a retailer to the final consumer will be subject to VAST four times. If the materials used to manufacture that product is imported or purchased domestically and the VAST had been paid on that, the number of times the VAST is paid on that same product would be five times, or a total of 30 percent, using simple addition.

Clearly, a VAST has a cascading effect—meaning, it is a tax on tax. The same product is taxed several times depending on the number of turnovers. The 6-percent tax paid on goods upon purchase will add up to the cost of goods when sold on which another layer of 6-percent VAST is imposed. In short, the rate of VAST on a product is not just 6 percent but it is the accumulation of all the VAST paid on previous turnovers. The effective rate that is passed on to the final consumer is actually higher than the nominal rate of 6 percent that appears on the invoice.

As the VAST is a passed-on tax that forms part of the cost of a product as it goes through the distribution chain, the total VAST paid is pushed to the final consumer as part of the price of the product. In the end, it is the final consumer that shoulders the burden of the tax by way of higher prices. While some businessmen may be willing to take some costs and shed off some profits, they may not be able to sustain the current prices without incurring losses because of the substantial impact of the VAST on costs.

Let's take a simple illustration of an imported product that goes to a two-stage distribution channel.

	Under VAT (assumes a 2% margin)	Under VAST (assumes a 2% margin)
Value of importation	100	100
VAT/VAST paid	12	6
Total Cost	**112**	**106**
STAGE 1		
Sale by importer to Retailer		
Selling price	102	108.12
VAT/VAST paid	12.24	6.49
Total Selling Price	**114.24**	**114.61**
VAT/VAST payment		
Output/VAST	12.24	6.49
Input Tax	(12.00)	-
Tax Due	**.24**	**6.49**
STATE 2		
Sale by Retailer to consumer		
Selling price	104.04	116.90
VAT/VAST payment	12.48	7.01
Final Selling Price	**116.52**	**123.91**
VAST/VAT payment		
Output/VAST	12.48	7.01
Input Tax	(12.24)	-
Tax payment	**.24**	**7.01**
Total Tax Payments		
By importer	12	6
By manufacturer	.24	6.49
By dealer	.24	7.01
Total Tax Paid	**12.48**	**19.50**

Clearly, as compared with the VAT which imposes a 12-percent tax (but with an input-credit mechanism), a 6- percent VAST has the effect of increasing prices by substantial leaps and bounds. Will it affect basic commodities which are exempt from VAST? Yes, because the cost of inputs to bring these basic goods to the market, such as electricity, transportation and gasoline, will likewise increase under the VAST. The VAST creates a ripple effect and the price of goods and services may soar.

VAST will make Philippine exports uncompetitive

Although the VAST bill exempts exports from the 6-percent tax, the abolition of the input-tax credit mechanism that enables exporters to claim as refund or recover the taxes paid on their inputs will make the prices of goods more expensive. As the taxes paid on inputs can no longer be recouped, these will be imbedded in the price of the product for export, thus making it more expensive and less competitive in the international market.

VAST will kill small- and medium-sized enterprises

To reduce the number of turnovers and save on VAST, businesses will be forced to consolidate. Conglomerates and big businesses operating under a common control or interest will regroup as a single entity capturing all phases of the production and distribution chain. By consolidating and cutting on turnovers, big businesses can price their goods cheaper than those that are unable to do so such as the medium-sized and small enterprises. In short, competition will now be shifted to favor those who have the ability to consolidate. In the end, only big businesses will survive, leaving behind the medium and small businesses.

VAST will erode government revenue

The VAT has an imbedded self-checking mechanism—it provides an audit trail to track down underreporting of income. The input-tax credit mechanism provides enough incentive to buyers of goods and services to ask for official receipts and keep it in their record. Such receipts will provide the necessary data to track down any underreporting by sellers. Many businesses are forced to report their true income because of fear of being counterchecked by the BIR using data provided by any of their buyers or suppliers.

Under a system without a checking mechanism, such as the VAST, the chances of underreporting become bigger, because then, the "fear factor" of being caught is lost. A VAST, coupled with an income-tax system that allows the use of the optional standard deduction where taxpayers need not keep complete record of their transactions, is like a tax holiday for tax evaders. On the other hand, it is a total nightmare to tax administrators.

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