

# The Importance of Value Added Tax (VAT) in the Economic Growth

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**Abstract:** The purpose of this study is researching of an importance of VAT as a source of revenue for balancing the government budgets. This study examines the extensive literature, concentrating on theory and empirical studies, on the relationship between VAT revenue and economic growth of China.

**Keywords:** Value Added Tax, Economic Growth, China.

## INTRODUCTION

### What is VAT. Explaining in simple terms

In this article, we will explain what VAT is and why it is needed. And we will also give detailed instructions on how to correctly calculate it, depending on the specific situation.

What is VAT and why is it needed?

VAT is a value added tax. That is, they are subject to the difference between the sale price and the cost of purchase or production. VAT must be paid on the sale of goods, services or property rights, as well as on the import of foreign-made products into the territory of the Russian Federation.

VAT - value added tax. An indirect tax that is levied on most sales of goods and services.

Simply put, VAT is a kind of surcharge on the cost of goods. As a rule, the business does not pay it itself, but issues an invoice to the final buyer. The amount of tax is calculated based on the difference between the cost of goods and its selling price. The money goes to the treasury along the chain: from the initial stage of production to the final sale to the buyer.

For example, a company manufactures furniture. For the production of one batch, it purchases materials for \$600. Of these, \$100 is VAT (at a rate of 20%). Sellers of materials will transfer this amount to the tax. Then the same thing will happen when a batch of finished furniture is purchased by a retailer: 20% of the proceeds (for example, \$140 from \$840) will be given to the state by the manufacturer. And then the store - when it sells furniture (for example, \$200 from \$1000).

It seems that the state gets too much money for the same thing. This is not so: any of the participants in this chain can return part of the VAT that he has already paid upon purchase. This is called a VAT refund.

### Story

The founder of the VAT is considered to be the director of the French Ministry of Economy, Finance and Industry Maurice Loret. The effect of the tax in test mode in France began in 1954. After positive tests,

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the project tax was recognized as effective, and after 4 years it was officially introduced into the taxation system.

## RESEARCH CONTEXT

VAT is an indirect tax, the calculation of which often causes difficulties for entrepreneurs. We will tell you how to correctly calculate VAT based on the taxes presented by suppliers. Value added tax is familiar to most people, there is a corresponding line in any sales receipt. Accountants know how to calculate it. But for novice businessmen, this consistently raises questions.

*Let's take an example. Company A buys a bag of grain from a farmer for \$110. This price includes the cost of production - \$100 and 10% VAT. The farmer will give these \$10 to the state when he pays taxes.*

*Company A sells a bag of grain in the city for \$165. This amount also includes VAT at 10%, that is, \$15. When company A pays taxes, it will be able to deduct from the amount of VAT what the farmer has already given to the state. That is, the farmer will have to pay \$15-\$10=\$5.*

*In practice, this chain can be much longer. But each subsequent counterparty will pay VAT only on the value added to the product.*

In general, exemption from this tax is a popular measure to support various industries. But usually it is valid for a certain period of time.

How VAT is calculated

The VAT rate is tied to the type of transaction. Now in Russia there are three types of rates:

*for most goods and services - 20%;*

*for food products, medical and children's goods, books and magazines - 10%;*

*when exporting - 0%.*

How it looks in practice.

The company buys a plastic for \$12,000. The cost of the material itself is 10,000 + 2,000 VAT at a rate of 20%. They made furniture out of plastic and then sold them to another country. The VAT rate for such a transaction is 0. But from this zero you need to deduct the already paid VAT for materials at 20%. This is a negative tax that the company will receive from the state budget.

## How to calculate VAT

To obtain VAT, you need to multiply the tax base by the rate and divide by 100. The tax base is the actual amount of the sale without VAT. If the cost of products for the buyer is \$100, and the rate is 20%, then the tax will be equal to \$20.

## How to allocate VAT from the amount: formula?

This task seems more difficult, but it has to be solved more often. The formula assumes that you know the tax rate for this type of product.

*The total amount must be divided by 120 and multiplied by 20, this will be the amount of VAT.*

*For example, a company paid \$120,000 for a product. For the calculation you need:  $120,000/120 * 20 = \$20,000$ .*

**If VAT is 10%, then the total amount will need to be divided by 110 and multiplied by 10.**

## How to calculate the amount with VAT?

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Knowing the taxable base, you can immediately calculate the total amount including VAT. To do this, you need to multiply the taxable base by 1.2, if the tax rate is 20%. If the rate is 10%, then the taxable base is multiplied by 1.1.

*For example, a product costs \$100. With VAT 20% you need:  $100 * 1.2 = \$120$ . And at 10%:  $100 * 1.1 = \$110$ .*

### Formulas for calculating VAT

*VAT amount (20% rate) = Price without VAT \* 20/100*

*VAT amount (10% rate) = Price without VAT \* 10/100*

*Amount with VAT (20% rate) = Price without VAT \* 120/100*

*Amount with VAT (10% rate) = Price without VAT \* 110/100*

*Amount without VAT (20% rate) = Amount with VAT / 120 \* 100*

*Amount without VAT (10% rate) = Amount with VAT / 110 \* 100*

How to correctly calculate VAT payable

To calculate the value added tax, you need to take into account the input and recovered VAT, if any.

Input VAT is tax that has already been included in invoices from vendors. For example, in order to produce products, the company bought raw materials, and the seller of raw materials included VAT in the bill. This means that his counterparty will be able to deduct this amount from his VAT.

Recovered VAT occurs when it is found that the right to deduct input VAT is lost. This is regulated in the Tax Code of many countries.

**The VAT payable formula looks like this:  $\text{Outgoing} - \text{Incoming} + \text{Recovered} = \text{VAT payable}$ .**

Since VAT is paid along the chain, any of these links may not exist. With restored VAT, this is intuitive. But with input VAT, this situation occurs when the counterparty does not pay it.

### Value Added Tax (VAT) in China

Value Added Tax (VAT) in China is notoriously complex. It's one of the most comprehensive among the many countries of the world that have implemented VAT (or equivalent tax). The difference between Chinese accounting standards and the West is that China adopts a multiple VAT rate system where the rate depends on the industry.

### How is China VAT Tax Paid?

VAT tax in China is added at each step throughout a supply chain through which a product (or service) progresses through towards its end user. Each time a product is enhanced, adding value, more VAT is added and must be paid.

### What Are the Current China Taxation Rates?

The standard rate of VAT is 13%. Following the 2012-16 VAT reforms, there are only four VAT rates in China, plus nil rating. There are other taxes, including Business Tax (3% to 20%) on services. For small entrepreneurs, the VAT rate applicable is 3% with limits on VAT deductions.

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Tax rebates most commonly focus on exports. Commonly, the exporting company may apply for a VAT rebate once the products have been exported. They can supply their customs declaration, export invoice, export of foreign exchange check-offs list and other official information related to the export.

There are two significant categories of fapiao – general fapiao and special value-added tax (VAT) fapiao. Only special VAT fapiao can be used for tax deduction purposes, while general VAT fapiao is only used to provide evidence of a payment or transaction. (fapiao (发票) is a document issued as official proof of payment for goods and services. However, not all so simple. Fapiao is used by the Chinese authorities for tax control, and this function makes these pieces of paper especially important. Thus, a fapiao is both a check and an invoice.)

Industries	Applicable VAT Rate
Sales and importation of goods	13%
Provision of repairs, replacement, and processing services	13%
Tangible movable property leasing services	13%
Sales or importation of necessity goods (e.g. agricultural products, water, gas)	9%
Transportation services, postal services, basic telecommunications services, construction services, immovable property leasing services, sales of immovable properties, transfer of land-use right	9%
Value-added telecommunications services, financial services, modern services (except for leasing services), consumer services, sales of intangible properties (except for land-use right)	6%

China's tax system has two types of VAT status: small-scale taxpayers and general taxpayers. Small taxpayers are companies in China with annual revenue below 5,000,000 RMB. These companies are subject to 3% VAT. However, VAT is not deductible if you are a small-scale taxpayer and becomes a direct cost to your business.

Once the company has received the general VAT taxpayer status, VAT can be deducted, which can benefit tax control.

In addition to VAT, there are a range of other indirect taxes, including:

Stamp Duty

Customs Duty on imports and luxury goods

City Construction and Maintenance Levy

National Education Tax

Local Education Tax

VAT calculation for general taxpayers

The VAT payable shall be the balance of output tax for the period, after deducting the input tax for the period. The formula is:

$$\text{VAT Payable} = \text{Output VAT} - \text{Input VAT}$$

Output VAT is calculated based on the value of the taxpayer's sales, namely,  $\text{Output VAT} = A \times B$ , where  $A$  = sales value and  $B$  = tax rate.

A general taxpayer will usually purchase goods or receive taxable labor services during the course of doing business. The VAT paid by the general taxpayer is input VAT. The input VAT is used as a credit against the output tax levied on selling the goods.

VAT calculation for small-scale taxpayers

From January 1, 2009, the VAT thresholds for those enterprises that do not qualify for general taxpayer status have been amended. First, the sales threshold for small-scale taxpayers has been reduced from 1 million yuan (\$147,060) and 1.8 million yuan (\$264,700) to 500,000 yuan (\$73,530) and 800,000 yuan (\$117,650), respectively. And second, non-enterprise units and entities that normally do not engage in taxable activities are given the choice whether or not they are taxed as small-scale taxpayers while individual (natural person) taxpayers with business turnover exceeding the threshold shall continue to be taxed as small-scale taxpayers. The current VAT rate for small-scale taxpayers is 3 percent.

As previously noted, these are taxpayers whose annual taxable sales value falls below a certain level (500,000 yuan for enterprises engaged primarily in the production of goods or the provision of taxable services; 800,000 yuan for enterprises engaged in the wholesaling or retailing of goods).

Such taxpayers cannot deduct input VAT, so the formula is as follows:

$$\text{VAT payable} = \text{Sales Value} \times \text{Tax Rate (3 percent)}$$

## CONCLUSION, LIMITATION AND FUTURE RESEARCH

A value-added tax, or VAT, is a common form of consumption tax that is due at every stage of a product's production from the sale of the raw materials to its final purchase by a consumer. More than 170 countries worldwide, including all of the countries in the European Union, levy a VAT on goods and services. This system differs from a sales tax (which is found in the United States), in that a sales tax is only paid once, by consumers, at the point of sale.

Proponents of the value-added tax have suggested that VAT might be able to improve economic performance by facilitating a reduction in other taxes, such as personal and corporate income taxes. A broad-based sales tax would almost certainly distort economic choices less than the income tax does. Additionally, an important advantage of the value-added form of sales tax is the fact that tax is collected

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as products move from stage to stage in the production-distribution process. Thus by the time a product reaches the retail stage, much of its total value has already been taxed.

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