



CONSEQUENCES OF EXEMPTING FINANCIAL SERVICES FROM THE VAT

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ABSTRACT

This paper studies the effects of exempt treatment of financial services under a VAT system. The consequences of exempting financial services from VAT are analyzed theoretically and practically. Based on the analysis, appropriate conclusions were drawn.

KEYWORDS: Financial sector, banks, taxation, value added tax, tax rate.

INTRODUCTION

Ensuring stability and development of the banking system is implemented under the general influence of forms and methods of public administration, with particular emphasis on taxation instruments. In practice of developed countries, taxation of banks is characterized by the following methods of regulation: comprehensive use of wide-ranging tax concessions (creating reserve funds, deductions to cover losses, etc.); providing discounts on the total amount of gross income, all costs associated with its acquisition, exemptions from paying indirect taxes (VAT, etc.) related to banking operations; exemption from the partial or complete income tax and income tax on interest on debts of legal entities and natural persons (Starodubtseva, 2007). The question of how to tax the financial sector has been the subject of academic debates. Financial services provided in exchange of a fee such as the provision of safes has not led to controversy as there is a consensus that those shall be subject to taxation, notably VAT (Boadway and Keen, 2003).

According to the data of the KPMG, currently the VAT is applied in over 170 countries and is considered to be widely-spread tax (KPMG, 2023). The VAT is an indirect tax levied on the added value created at each stage of production. In various countries Value Added Tax is considered to be a one of the stable and reliable sources of government tax revenue, while revenues from direct taxes have a negative trend. In addition, in the framework of fiscal policy during a downturn in the economy, the governments of many countries reduce the rates of direct taxes, and at the same time increase the rates of indirect taxes, because they are neutral to production; the burden of payment is shifted to the final user, which is the main reason for the stability of income from indirect taxes. Therefore, during periods of recession and economic growth, it is easier to ensure stable budget revenues from indirect taxes, among which VAT takes the leading place in accumulating budget funds (Kononchuk, 2018).

THE MAIN FINDINGS AND RESULTS

The issue of including intermediary services in the taxable base of the VAT has been considered by many scientists-economists (Grubert and Krever, 2012; Lockwood, 2014). For example, Grubert and Mackie believe that there is no use to introduce financial services in the taxable



base as these services don't have a function of profitability for consumers. However, Edgar proposes to tax financial services as they are assessed as consumption. Some authors share this point of view and add value to the provision of financial services and the use of real resources (Hoffman, Poddar, and Whalley, 1987; Barham, Poddar va Whalley, 1987). Huizinga believes, the net taxable margin is uncertain because it is difficult to calculate the amount of cash and risk premium for each transaction. From the point of view of Goncharenko most of the tariffs for banking services are not based on concatenated value, and the level of tariffs for banking transactions makes an impact on various factors, such as credit risk, interest rate risk and currency risks (including currency risk exposures).

It should be noted that the financial sector entities, including banks, are considered to be one of the most complicated and controversial issues in the taxation of financial products and services to the VAT. Therefore, in many countries, exemption from VAT on financial products and services is a widespread practice, which means that consumers are not taxed, but the cost of the related costs is not restored. In practice, along with their own resources, banks use outside resources purchases of which may be subject to VAT. There is a wide variation in policy practices across countries, but, in most instances, purchases of the "arranging for" services by financial institutions are subject to VAT. These services include checking, evaluating or authorizing credits, monitoring payment records, credit management services, credit card promotion, market research, document processing and preparation, research, analysis and assessment services, payroll and IT services. When a bank provides a service that is exempt from VAT, it is unable to recover the resulting VAT embedded in the price of these inputs.

Mirrlees supposes, exempting financial services from the VAT is contrary to the principle of taxation which breaks the continuity of the chain. However, this definitely contradicts the principle of taxation and makes the VAT a direct tax on production.

Table 1
Financial indicators of the companies being in various conditions in terms of the VAT payment, in monetary units

Indicators	Exempted from the VAT payment	VAT is imposed at 20% rate
1 Net proceeds from sales	1000	1000
2 VAT on the sales	-	200
3 Expenses on production (VAT excluded)	472	472
4 Purchase cost of the production (VAT excluded)	200	200
5 VAT leading to the expenses	40	-
6 Amount of the VAT deductible	-	40
7 Taxable profit (1 row-3 row-4 row- 5 row)	288	328
8 Profit tax (7 row x20/100)*	57,6	65,6
9 Net profit (7 row-8 row)	230,4	262,4



10	Profitability (9 row/1 row x 100)	23	26,2
11	Tax burden (8 row – 6 row)/1 row x 100)	5,8	2,6

Source: developed by the author on the basis of conventional indicators

CONCLUSION

The exemption from the VAT is illustrated on the example of performance of two economic entities: a legal entity which is fully exempted from the VAT and a legal entity which pays the VAT at the rate of 20%. See Table 1. According to the data provided in Table 1, taxpayers exempted from paying the VAT, have less net profit than those who pay the VAT, and under other equal conditions the tax burden is higher than net revenues. From the point of view of Baydury va Yilmaz exemption of the banking financial services from the VAT and taxation of the banking lending services in a consequence can ensure sufficient provision for banks, consumption of financial services, as well as enhancing welfare in future. Banks combine labor and taxable savings to provide financial services, but they can partially replenish their full VAT on purchase costs. The part of the VAT which has remained uncovered is added to the cost of financial services rendered to the households and firms.

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