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DISCRIMINATION OF DOMESTIC SUPPLIES RELATIVE TO IMPORTS FOR THE VALUE ADDED TAX EXEMPTIONS

DYSKRYMINACJA DOSTAW KRAJOWYCH W PORÓWNANIU Z IMPORTEM W WYPADKU ZWOLNIEŃ Z PODATKU OD WARTOŚCI DODANEJ

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Abstract: The general idea of the value added tax is to be neutral in respect of the choice of suppliers according to their location. This is the reason why exports are taxed with the 0% tax rate and domestic supplies or imports are taxed with the same tax rates. To ensure neutrality of the tax the legislator applies the same exemptions from the value added tax to domestic supplies and imports. At first glimpse this solution seems to give the same results, but in fact it means that domestic supplies are discriminated in favour of imports. The main objective of the article is to prove that, when the recipient of goods is a consumer or a non-taxable entity, the exemption from the value added tax, which applies both to imports and domestic supplies of goods, causes discrimination to the latter. In the article a few examples of exemptions on imports from the Polish Value Added Tax Act are presented. They were chosen because of their possible influence on a choice of suppliers based on their location.

Keywords: VAT, tax exemption, import, Poland, European Union.

Streszczenie: Za jedną z podstawowych zalet podatku od wartości dodanej uznaje się jego względną neutralność. Zakłada się w szczególności, że podatek ten nie powinien wpływać na wybór dostawcy w zależności od tego, czy jest to dostawca krajowy, czy zagraniczny. Z tego powodu eksport jest objęty stawką 0%, a dostawy krajowe oraz import opodatkowane są według tych samych stawek. W celu zapewnienia neutralności podatku prawodawca ustanawia również zwolnienia w imporcie, gdy dostawa określonych towarów na terytorium państwa jest zwolniona z podatku od wartości dodanej. Wydaje się, że to ostatnie rozwiązanie zapewnia równe traktowanie obu rodzajów transakcji, w rzeczywistości jednak powoduje dyskryminację dostaw krajowych względem importu. W artykule autor udowadnia, że w wypadku gdy odbiorcą towarów jest konsument lub podmiot niepodlegający opodatkowaniu podatkiem od wartości dodanej, to zwolnienie z podatku od wartości dodanej dotyczące zarówno importu towarów, jak i dostaw krajowych oznacza dyskryminację tych ostatnich. W artykule przedstawione zostały także przykłady zwolnień w imporcie wynikające z ustawy z 11 marca 2004 r. o podatku od towarów i usług, które zdaniem autora mogą zachęcać do wyboru dostawców zagranicznych.

Słowa kluczowe: VAT, zwolnienie, import, Polska, Unia Europejska.

1. Introduction

Taxes perform different functions. Taxes can influence the decision whether to buy from a local entity or from abroad. To protect local entrepreneurs a government may impose custom duties or taxes of special structure. It is hard to imagine that public authorities of any country use taxes to support entities from abroad.

The general idea of the value added tax is to be neutral¹ also in respect of the choice of suppliers, according to their location. It is the reason why exports are taxed with the 0% tax rate and why domestic supplies or imports are taxed with the same tax rates. To achieve the goal the same exemptions from value added tax apply to domestic supplies and imports. At first glimpse the latter solution seems to give the same results, but in fact it means that domestic supplies are discriminated in favour of imports.

The value added tax exemption means that a supply of goods and services is untaxed and an input tax connected with the exempt supply cannot be recovered. The scope of the exemptions from value added tax varies depending on a country. Typical examples of the exemptions are those concerning activities of state bodies, activities of non-profit organisations, gambling, to some extent real estate supplies, microentrepreneurs' activities, agricultural activities and also financial intermediation services, educational and health services.

An exemption from a tax is usually associated positively, but when it refers to the value added tax it can have multiple meanings. If an exemption applies to the final stage of production and distribution (when goods are sold to consumers), then it is generally evaluated as beneficial for a supplier. If it applies to the intermediate stage, similar evaluation is not obvious. One of the interesting consequences of extending the scope of exemptions from value added tax is a possible increase in tax revenues of public authorities.

The main objective of the article is to prove that, when the recipient of goods is a consumer or a non-taxable entity, the exemption from the value added tax, which applies both to imports and domestic supplies of goods, causes discrimination against the latter.

2. The value added tax mechanism

The value added tax mechanism under credit-invoice method could be explained with an example of a supply chain with three taxable persons: A, B and C. An entity A does not make any purchases, and its value added is 100 monetary units. An entity B purchases from the entity A. The value added of B is 100 monetary units. The last

¹ "In reality, VATs will not be neutral in their effect on trade, for at least two reasons. First, VATs are a substitute for other taxes, especially income taxes, that do affect trade. Second, in practice, a VAT will not be neutral; concern over distributional issues, as well as administrative difficulties, inevitably leads to a tax whose rate varies substantially across industries" [Feldstein, Krugman 1990].

entrepreneur in this supply chain is an entity C, which has also the value added of 100 monetary units. The entity C is a supplier to a consumer. The value added tax rate was assumed at the level of the basic tax rate applicable in Poland – 23%.

Table 1. The value added tax mechanism in the situation where all stages of production and distribution are taxed with the basic tax rate of 23%

Subject	Net purchase price	Input tax	Value added	Net selling price	Output tax	Payment to tax administration	Gross sales price
A	0	0	100	100	23	23	123
B	100	23	100	200	46	23	246
C	200	46	100	300	69	23	369

Source: compiled by the author.

The value added tax, when it works according to the above-described mechanism, has many advantages. If all stages of production and distribution are taxed according to the general principles, there is no cumulative effect – the tax is levied only on the value added, and not on a tax from the previous stages. The object of taxation is only value added at a particular stage – there is no multiple taxation of the same value added at subsequent stages. The tax does not encourage vertical accumulation of different stages. At each stage of production or distribution it is possible to determine the tax included in the price, which is of particular importance in the case of export. The tax does not burden investments made by entrepreneurs. The total value of the tax paid by taxpayers from all stages is the tax included in the price for a consumer. All these advantages disappear when an exemption appears at an intermediate stage of production or distribution. An exemption does not cause major distortions only when it refers to the final stage.

3. The value added tax exemption of domestic supplies

An exemption granted under the credit-invoice value added tax at the last stage of production and distribution when it refers to a domestic supply could be considered as beneficial for an exempt entrepreneur, if it is compared with the situation when all stages are taxed with the basic tax rate.

When the supply of goods is exempt from the tax at the last stage, the entity is not entitled to claim an input tax from previous stages. Even if the exempt entity gets an invoice with an input tax on it, the entity does not have the right to recover it.

Table 2 presents the situation in which the supply in the last step of the process (entity C) is exempt. In this case, the price for a consumer compared to the initial situation described in Table 1 is lower. There is a price of 346 instead of 369 monetary units. As it has been shown in Table 2, it is consumers who benefit from the exemption in the form of lower prices. The exempt entrepreneur could also capture the benefit

of the exemption in the form of higher prices after raising a value added – in particular profits. However, who ultimately benefits from the exemption depends on market conditions.

Table 2. The value added tax mechanism in the situation where the first two stages of production and distribution are taxed with the basic tax rate of 23% and the last stage is exempt

Subject	Net purchase price	Input tax	Value added	Net selling price	Output tax	Payment to tax administration	Gross sales price
A	0	0	100	100	23	23	123
B	100	23	100	200	46	23	246
C	246	–	100	346	–	–	346

Source: compiled by the author.

The attractiveness of the tax exemption at the last stage is relative. If the situation described in Table 2 is compared with the situation in Table 1, the exemption seems beneficial. However, if we assume that the situation affects an open economy, where apart from entities, i.e. taxpayers operating in a country, there are also foreign companies that supply goods to consumers (non-taxable entities), the assessment of an exemption may be different.

4. The value added tax exemption on imports

The value added tax is present in more than 160 countries worldwide [OECD 2014]. In countries where the value added tax is levied, its structure, and in particular the scope of exemptions can vary. Within the European Union the value added tax is subject to harmonization, but the process does not apply to all countries in the world. The existence of different systems of commodity taxation, including those where the value added tax does not exist, has an impact on international trade.

The value added tax is based on the rule of destination country. Application of the 0% tax rate to export, which allows claiming input tax from previous stages of production and distribution, eliminates the problem of double taxation and does not discriminate import of goods in favour of domestic supply. If imports and domestic supplies of goods are taxed at the same rate, the value added tax should not affect entrepreneurs' or consumers' choices whether to buy from their county or from abroad. The neutrality in the selection of a national or foreign supplier can be considered as the undoubted advantage of the value added tax.

The tax neutrality in the selection of national or foreign supplier does not exist, if a domestic supply and import of goods are exempt. In the case when the exemption applies to both domestic supply and import of goods to the consumer or non-taxable entity, it results in the preferential treatment of import relative to domestic supply. The correctness of this outcome can be illustrated by comparing the figures in Tables

2 and 3. In the example described in Table 3, it is assumed as earlier, that the entity C sells to consumers (non-taxable entities), but the goods sold come from abroad. It is assumed that the foreign value added tax at the first two stages of production and distribution is settled on general principles with the tax rate of 23%. The foreign entity C is treated abroad as an exporter and applies the 0% tax rate, which results in the right to recover the input tax from the previous stages. Therefore, if the input tax at the previous stages was 46, at the moment of export, when the 0% tax rate applies, it is returned to the entity C. In this case goods leave the territory of an exporter state without any turnover tax. If in the country of destination import is exempt, then it is charged neither in the exporter state nor in the importer state. In this case, the price offered to consumers (non-taxable entities) could be at the level of 300 monetary units.

Table 3. The value added tax mechanism in the situation where the first two stages of production and distribution are taxed with the basic tax rate of 23% and the last stage is taxed with 0% tax rate

Subject	Net purchase price	Input tax	Value added	Net selling price	Output tax	Payment to tax administration	Gross sales price
A	0	0	100	100	23	23	123
B	100	23	100	200	46	23	246
C	200	46	100	300	0	-46	300

Source: compiled by the author.

It should be emphasized that the rule in the value added tax is to apply the 0% tax rate on exports even if domestic supply of goods is exempt. The application of the 0% tax rate in exports enables to eliminate the value added tax burden from the exporter country, if pre-export stages were not exempted. If in the country of export the supply of goods made by B was exempted, then there would be an incentive for C to take over the entity B. If the vertical concentration was not possible, then the entities from countries that do not levy all stages sales tax would have a stronger competitive position.

The above described problem of discrimination of domestic supplies in relation to imports does not apply to intra-Community transactions within European Union. To benefit from the exemption on import it is necessary to apply the 0% tax rate in the country of origin. It is of course valid only in the case when in the country of origin the value added tax exists. Although according to the current rules intra-Community supply of goods is subject to the 0% tax rate, the intra-Community supply of goods materialize only when a recipient is a taxpayer of the value added tax, who pays a tax on intra-Community acquisition in a country of destination. If the recipient has to pay the tax on general terms, it means that the intra-Community acquisition of goods cannot be exempted.

The comparison of the data from Tables 2 and 3 allows for concluding that if the exemption relates to both domestic supplies and imports of the same goods then it

results in discrimination of domestic supplies. The national entity C, gaining the added value of 100 monetary units, could offer a price to the consumer (not-taxable entity) at the level of 346 monetary units, while in the case of imports, with the same level of the value added for entity C, the price would be 300 monetary units.

The above described preferences are not the only reason why domestic supplies may be regarded as discriminated against. The structure of the value added tax, if the import of goods (intra-Community supply of goods) is made by taxpayers and the tax is accounted without cash, encourages buying from entities located abroad. In that case domestic entities have to pay the net price and the tax due on imports (intra-Community acquisitions) would be offset with the input tax. If an entity purchases from domestic suppliers it has to pay a gross price and the input tax included in that price will be deducted in the future. These differences may be of particular importance if taxpayers do not benefit from a trade credit, when the production cycle is long, an inventory turnover ratio is low, and tax authorities delay the moment of paying out the excess of input tax over output tax.

5. The import tax exemption in the Directive 2006/112/EC

In the European Union the value added tax is harmonized. The main act which determines the tax is the Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [The Directive 2006/112/EC].

The directive settles the tax in details, leaving relatively little leeway to the member states to adjust regulations to a specific situation in an individual country. The exemptions on importation are regulated in the articles 143–145 of the Directive. In particular, the article 143(a) of the Directive that member states shall exempt from taxation “final importation of goods of which the supply by a taxable person would in all circumstances be exempt within their respective territory.”

The article 143(a) of the directive suggests that the legislator considers an exemption from the tax of both the domestic supply and import to be an identical treatment of the two transactions. Such interpretation of that provision can also be found in the comments to the directive. In the book *The VAT Directive: Commentary* edited by K. Sachs and R. Namysłowski one can find an opinion that “the purpose of taxing import is to ensure that tax burdens for import and local transactions are similar, thereby the conditions for competition are the same, regardless of whether goods are produced in a country or abroad. To fulfil this function tax rates and exemptions for imports should be identical to those used in domestic supplies. [...] To achieve comparable tax on domestic supply and import it is necessary to proclaim that if the domestic supply is exempt, the same exemption applies also to import. A reflection of this principle is the provision of the article 143(a), according to which the exemption from the tax applies in case of final importation of goods, when their supply within the territory of a country, if it is made by a taxable person, would in all circumstances be a subject to exemption” [Sachs, Namysłowski (eds.) 2008].

The scope of the exemptions on imports as an outcome of the article 143(a) is limited because with the strict meaning of the phrase “in all circumstances,” the number of cases in which the supply of goods by a taxable person is exempt within the territory of a member state is not high. Among them it is possible to point out supplies of human organs, blood and milk, some supplies of buildings, their parts, and a ground connected with them.

If the phrase “in all circumstances” from the article 143(a) of the Directive was understood in a more liberal way, the scope of the exemptions on imports would be broader. Regardless of the scope of the exemption under the article 143(a), one should pay attention to the fact that in the article 143 there are many other points (letters from a to l). Among them the article 143(b) of the Directive deserves special attention. The article 143(b) refers to the two directives which constitute additional exemptions on imports. The first one is the Directive 2009/132/EC of 19 October 2009 determining the scope of Article 143(b) and (c) of Directive 2006/112/EC as regards exemption from value added tax on the final importation of certain goods [The Directive 2009/132/EC]. The second directive invoked in article 143(b) is the Directive 2006/79/EC of 5 October 2006 on the exemption from taxes of imports of small consignments of goods of a non-commercial character from third countries [The Directive 2006/79/EC].

All directives which constitute exemptions on imports are reflected in the Polish legislation. The scope of the exemptions on imports applicable in Poland is specified in the Polish Value Added Tax Act of 11 March 2004 and in regulations of the Polish Minister of Finance.

6. The tax exemptions on imports in the Polish Value-Added Tax Act of 11 March 2004

The Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [The Directive 2006/112/EC] and other directives constituting the value added tax determine the Polish Value Added Tax Act of 11 March 2004 [Ustawa z 11 marca 2004] (the Act) as well as other regulations related to the tax.

In Poland exemptions on importation of goods are in general regulated by the Act in articles 45 to 82. The list of these exemptions is long. Below there are mentioned only a few selected groups of exemptions without details on their conditions of use. The selection criteria for the following exemptions are based on their possible impact on the choice of suppliers of goods due to their location. The first group of exemptions relates to medical activities. In this case it is possible to distinguish exemptions on imports which refer to:

- blood, plasma at full strength, blood cells or blood products of human origin, which are not drugs (Art. 45 paragraph 1 item 7 of the Act),
- animals specially prepared for laboratory use (Art. 57 paragraph 1 item 1 of the Act),

- not produced in the country biological or chemical substances which are suitable mainly for scientific purposes, imported in amounts which do not indicate commercial intent (Art. 57 paragraph 1 item 2 of the Act),
- therapeutic substances of human origin (Art. 58 paragraph 1 item 1 of the Act),
- blood-grouping reagents (Art. 58 paragraph 1 item 2 of the Act),
- tissue-typing reagents (Art. 58 paragraph 1 item 3 of the Act),
- the special packaging essential for the transport of therapeutic substances of human origin or blood-grouping or tissue-typing reagents and also any solvents and accessories needed for their use which may be included in the consignments (Art. 58 paragraph 1 item 4 of the Act),
- consignments which contain samples of reference substances approved by the World Health Organisation for the quality control of materials used in the manufacture of medicinal products and which are addressed to consignees authorised by the competent authorities (Art. 59 of the Act).

The second group of exemptions on imports of goods refers to imports of small consignments. In this case it is interesting whether the custom authorities are in fact able to verify value and quantity of goods or other conditions of the exemption. This group of exemptions applies in particular to:

- import of goods in consignments sent from a third country directly to the recipient in the country, provided that the value of the goods in the consignment does not exceed EUR 22 (Art. 51 of the Act),
- import of goods in consignments sent from a third country by private persons to other private persons in the country, where the quantity and type of goods indicates non-commercial character, the quantity of goods does not exceed certain limits, are sent by the sender to the consignee without payment of any kind, the consignments are of an occasional nature and the total value does not exceed EUR 45 (Art. 52 of the Act),
- import of goods to be carried in the personal luggage of travellers arriving from a third country to the country, if the quantity and type of goods indicates non-commercial character and the total value does not exceed EUR 300 (Art. 56 of the Act).

Among the value added tax exemptions one can also indicate goods for charitable or philanthropic organisations. Within this group it is possible to distinguish exemptions on imports which refer to:

- medicines, clothing, food, cleaning agents and other things to preserve health; medical goods imported by social organisations or agencies established to conduct charitable activities or humanitarian aid for distribution free of charge to needy persons (Art. 61 of the Act),
- goods specially adapted for the purposes of social, vocational and medical rehabilitation, advancement of handicapped persons and educational, cultural assistance for them if such goods are imported by social organisations or

organisations whose primary statutory objective is to rehabilitate and provide educational and cultural assistance to those persons, and if they were given to such institutions free of charge and without any economic gains (Art. 62 of the Act),

- goods imported by state agencies, social organisations or organisations established to conduct charitable activities or humanitarian aid if they are dedicated for distribution free of charge to victims of a natural disaster or catastrophe or are available to victims of a natural disaster or catastrophe and remain the property of those agencies and organisations (Art. 63 paragraph 1 item 1 of the Act),
- goods imported by rescue agencies for their needs, in conjunction with their activities (Art. 63 paragraph 1 item 2 of the Act).

The exemptions on imports of goods for charitable or philanthropic organisations, as a rule, do not distort competition. They cause, however, that running charitable or humanitarian aid from abroad may be easier than from a country. Among the exemptions included in this group the article 63 paragraph 1 point 2 of the Act raises the most concerns. The exemption of goods imported by rescue agencies without additional limitations means that these agencies could prefer imports relative to domestic supplies.

According to the article 73 of the Act there is a exemption from the tax on import of folders, brochures, books, magazines, guides, mounted or unmounted posters, unmounted photographs and photographic enlargements, illustrated or non-illustrated geographical maps, illustrated calendars whose primary purpose is to encourage foreign trips, in particular to participate in meetings or events of a cultural, tourist, sporting, religious or business character. Due to the exemption of goods listed in the article 73 it would be better to print those goods in third countries rather than in the inviting country or in other member states.

The exemptions from the value added tax are constituted not only in the Act of 11 March 2004. The law which also defines the value added tax exemptions is the Regulation of the Minister of Finance of 20 December 2013 on the exemption from the value added tax and the conditions for the exemptions [Rozporządzenie Ministra Finansów]. Among these exemptions one deserves special attention. It is described in the paragraph 3 point 1 item 16 of the Regulation. According to it there is an exemption on imports of goods made by institutions or bodies of the European Union, having their registered office or agency in the territory of the country where those goods are imported for official purposes of these institutions or bodies. It is interesting that institutions or bodies of the European Union, which should uphold the interests of entities operating within its borders, could benefit from the law that explicitly discriminates taxpayers operating in the community in favour of those from third countries.

7. Conclusions

The consequences of the value added tax exemptions of domestic supplies differ from the consequences of the exemptions on imports. When the exemption in parallel applies to both kinds of mentioned transactions it discriminates domestic supplies in favour of imports.

The list of the value added tax exemptions on imports is long, but the scope of these exemptions is not very broad. The limited scope of the exemptions on imports should be assessed positively. However, it should be noted that the current exemptions lead not only to a reduction in revenue of public authorities, but also promote supplies from third countries. The exemptions from the value added tax of domestic supplies on one hand and on imports on the other hand discriminate not only entities from a particular country of the European Union, but also those operating in the other Member States.

The exemption on imports to a consumer or a non-taxable person is equivalent to the 0% tax rate in a domestic supply. If the intention of the legislator is not to discriminate domestic supplies in relation to imports, it should first review the list of exemptions on imports, removing those exemptions on imports which are not justified. If, however, it recognizes that these exemptions have legitimate reasons, the corresponding domestic supplies should be taxed with the 0% tax rate.

Polish authorities identifying the shortcomings of certain structural elements of the value added tax have limited power to change them. In order to improve the tax it is necessary in the first step to convince European partners that the changes are justified. In the current situation it is not possible to change the Polish Value Added Tax Act unless it is consistent with the Directives.

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