

and the net is payable to the Government. In essence, the tax is thus on the "value added" by him as represented by the difference between the value of his total sales and the value of his total purchases. "Purchases" include all types of goods and services—components either as raw materials or semi-processed goods; capital goods, such as plant machinery and equipment; goods used up in manufacture; business furniture, etc. The manufacturer, of course, will bill his customer for the 10 percent tax on the sales price of the articles he sells, just as the manufacturer was earlier on his purchases billed 10 percent by his suppliers. The tax is invoiced separately on all sales and is thus not hidden in the sales price.

The process is repeated at the wholesale stage—the wholesaler pays the Government 10 percent of his sales less the taxes paid previously by the wholesaler on his purchases—and the wholesaler then bills the 10 percent tax to his customers. But of course no pyramiding should occur since the taxes paid by the wholesaler are kept apart from the price of the goods he purchased and he can subtract this tax cost. The process is repeated once again at the retail stage—the retailer pays the Government 10 percent of his sales, less the taxes the retailer paid—and of course the retailer charges his customer for the 10 percent tax. The process ends there if the retail sale is for personal consumption—food, an automobile, furniture, clothing. But if a business concern buys the article for use in its business—say an automobile or a desk—the process begins again as the concern will subtract the tax on the automobile or desk from its tax bill.

There is one additional important facet to note: Under the German system, tax is due each month. Suppose a concern has paid more tax on its purchases than is due on the sales to its customers—its sales may be slow, for example. The Government here makes a refund each month of any excess tax paid, so that the cost of carrying the value-added tax is not borne by the concern beyond a month or two.

All this adds up to a 10 percent retail sales tax on personal consumption—the 10 percent value-added levy is designed to be passed along from concern to concern until the consumer is reached and he is left with the tax. The 10 percent tax is not intended to enter into the price structure until that final sale—until then it is a tax item that accompanies each sale, is kept separate on the books, and is so indicated. If the tax item is not promptly moved along the business chain, the Government refunds it promptly. (If a concern has to finance the tax during this month or two, this cost would enter into the price structure.)

Since the economic effect is that of a retail tax, the distortions due to pyramiding, differential burdens on integrated or non-integrated firms and industries, and differences in distribution patterns that beset a manufacturers tax or a wholesale tax, are essentially avoided. At the same time the pressure for strong policing at the retail level that would exist under a retail tax is eased, since under the value-added approach the tax will have been partially collected at a prior level. If a retailer evades the tax, the Government has at least taxed the value at the wholesale level. And the chances of retail evasion are lessened, since the wholesaler has notified the Government of his sales to the retailer. Parenthetically, it is quite likely, however, that countries underestimate their capacity to enforce a retail tax. Even some developing countries are finding they can adequately administer such a tax if care is paid to its design and structure.¹ The Royal Commission (Carter) Report on Taxation in Canada (1966) recommended a retail tax to replace its present manufacturers tax and chose the retail tax in preference to a value-added tax.

The mechanics of the value-added tax are designed to keep the tax from entering into business costs even when a concern buys goods at retail that are used in its business activities. (A retail tax can meet this problem by exempting such purchases through a registration system; the value-added tax provides a refund of tax instead of exemption.) Of course, the value-added tax does involve pushing every concern into the act, and there is a lot more bookkeeping, tax paying and tax refunding, and paper passing than would occur under a retail tax. Moreover, the fact that every stage in the production process is nominally taxed can result in pressure drives for rate reductions by industries or groups concerned about their ability to keep passing the tax along. The value-added tax thus has an inherent potential for breeding exceptions and special treatment. But if a country feels it can't efficiently handle a retail tax, then a value-added tax is the next best thing.

¹ Due, *The Retail Sales Tax in Honduras*, in Bird and Oldman Readings on Taxation in Developing Countries (Rev. Ed., 1967), 326.