SALES TAX

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Glossary*
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Sales tax is levied as a percentage of the price of a good (or a service) that is traded. In general it is paid by the purchaser during every purchase of a good, the seller, however, being responsible for the collection of it and for paying it to the state. Sales tax is an indirect tax because it is not borne by the entity that pays it in. Sales tax is paid, on behalf of the purchaser, by the merchant or trader who does not bear the tax him/her/itself; rather, it is borne by the purchaser as part of the price that is paid. This tax is often called regressive, for its incidence is heavier, in proportionate terms, on taxpayers (*nota bene*, the ultimate payers of the tax) with lower incomes.

Sales tax is distinguished according to the way the base is determined, to the number of tax rates, and the collection points.

According to the determination of the tax base, a sales tax can be introduced for a unit of product, in which case it is called a per unit tax, or is calculated on the value of a product, i.e., it is an ad valorem tax. Most excises (or special taxes as they are also called), on tobacco, for example, or petrol and alcoholic beverages, are expressed as a certain amount for each unit purchased. Unlike the per unit tax, an ad valorem tax is calculated in percentages of the "value of the good purchased".

According to the number of tax rates, a sales tax can be a universal tax, when the same rate of tax is applied to the purchases of all goods, or a selective tax, which is imposed on the purchase of various products at various rates.

According to the points at which the sales tax is collected it can be single-stage or multistage. A multistage sales tax is collected on the same good in all successive levels of the production and distribution chain. A single-stage sales tax is collected at a single point in the production and distribution system – either at the producer or at the wholesaler or at the retailer. The production sales tax is a single-stage tax that is levied on the sale or delivery of the goods of the producer. A single-stage tax on retail sales is calculated on the sale of a good to the end consumer in a retail outlet. In wholesales, it is charged by the wholesaler to the retailer. The advantage of a wholesale sales tax, as compared with the sales tax levied on retail sales on the end consumer, is that there are a much smaller number of taxpayers from whom the tax is collected. But in practice, tax is usually applied to retail sales.

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As for the multistage sales tax that is collected at all phases of production and sales, cumulative or cascade tax needs to be differentiated from value added tax. In cumulative or cascade taxes, traders have no right to deduct the tax paid in the preceding phase, i.e., when they themselves made their previous purchases. In the case of value added tax, traders who later sell on the products are authorised to deduct the previously paid taxes or claim the right to a refund of taxes paid. The problem with cumulative or cascade sales taxes is that traders pay each time the product is sold on to the next stage in the distribution (i.e., from producer to retailer), without the possibility of being able to deduct the tax paid in the preceding phase, and thus the tax is cumulative. Unless products are expressly exempted from the taxation, cascade taxes are incident on most traders, and products that pass through a larger number of distribution phases are burdened with a greater tax burden. The effect is the inflation of the final price that is paid by the consumer. The drawbacks of such a tax led it being replaced in many countries by the value-added tax, which permits the deduction of tax paid in the previous phase from the tax liability of each trader in the production and distribution chain.

The advantage of a sales tax is the simplicity with which it is collected. It is collected from the retailer as a percentage of the sales price. In order to collect this kind of tax, the tax authority need not to possess innumerable data concerning taxpayers as it does for the collection of other kinds of tax, primarily of income tax. In order to evaluate the tax strength of each entity liable, the tax authority has to collect numerous data concerning kinds of income, number of dependents, the taxpayer's various tax-deductible expenses and so on. All this does not need to be done during the collection of a sales tax. But this does not mean that the collection of a sales tax is spared all kinds of administrative problems. The simplest system inheres in the collection of a universal tax on retail sales levied at a single rate. Problems arise when, because of various economic and social considerations, the tax authorities decide to apply differential tax rates , which require the definition of a large number of products. An unclarity tends to derive from the unclarity involved in distinguishing taxable from non-taxable transactions. A classic example is the taxation of bread at lower rates, for the sake of protecting the standard of living. It is necessary here to define bread, for soon fine kinds of bakery products will also find themselves on the list of tax-free items.

The main drawback of a sales tax is its regressiveness, i.e., the characteristic that it will fall relatively more heavily on the poor. The rich, of course, spend a much smaller part of their income, and save (i.e., invest) a greater portion, while the poor on the whole spend the whole of their income, and are unable to save almost anything. Accordingly, the poor pay a relatively larger amount of sales tax in their relatively greater consumption. But at least two issues cast doubt upon this conventional viewpoint concerning the distributive characteristics of a sales tax. Firstly, the reduced share of the spending of the rich in the determination of regressiveness can only be seen in terms of annual income. But research shows that spending as a ratio of lifetime earnings is about the same at all income levels, i.e., all citizens spend a similar part of their lifetime earnings. Accordingly, tax, too, must burden all citizens with a similar load. Secondly, the particular characteristic of a sales tax is that it tends to be shifted. Implicitly it is understood that the whole burden of the tax burden is borne by the consumers of the given goods. But sales tax is shifted, in a complex way depending on elasticities of supply and demand. This can be seen in the following example: through the introduction of a tax on fur coats, the intention is to tax the rich, who are the most common purchasers for such luxury products. But perhaps they will then determine not to buy a fur coat, which the tax has made unattractive to them. Then there will be a decline in the sales of fur coats, and furriers will have to reduce costs, probably including cuts to the wages of their employees. Thus a tax hike on fur does not hit the rich, rather, it is paid, in the form of lower wages, by the much poorer individuals who form the labour force of the furriers. Because of the complicated process of tax shifting it is not easy to define who it is that ultimately bears a sales tax, making it equally difficult to draw conclusions about its regressiveness.

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