

VAT in Emerging Economies: Does Third Party Verification Matter?*

Shekhar Mittal[†] Aprajit Mahajan[‡]

First Version: July 23, 2017

Abstract

A key stated advantage of the value-added tax (VAT) is that it allows the tax authority to verify transactions by comparing seller and buyer transaction reports. However, there is limited evidence on how these paper trails actually affect VAT collections particularly in low compliance environments. We use a unique data set (the universe of VAT returns for the Indian state of Delhi over five years) and the timing of a policy that improved the tax authority's information about buyer-seller interactions to shed light on this issue. Using a difference-in-difference strategy we find that the policy had a large and significant effect on tax collections from wholesale firms relative to retail firms. We also find significant heterogeneity with almost the entire increase being driven by changes in the behavior of the biggest taxpaying firms. We also find suggestive evidence that improvement in information and enforcement are complementary for a subset of firms.

JEL codes: H26, H32, O38

*This study would not have been possible without the generous time, access to data, and answers to questions provided by officials in the Department of Trade and Taxes of the Government of National Capital Territory of Delhi. We thank Sanjiv Sahai, Principal Secretary, Department of Finance for his undiminished support. We also thank Pierre Bachas, Michael Best, Christian Dippel, Stefano Fiorin, Paola Giuliano, Adriana Lleras-Muney, Jan Luksic, Ricardo Perez-Truglia, Dina Pomeranz, Nico Voigtlander, Roman Wacziarg, the team at JPAL-SA and participants at RIDGE Conference-Public Economics, the GEM seminar (Anderson School, UCLA). We acknowledge financial support from the International Growth Center (India) Grant #89412 and JPAL-GI.

[†]Anderson School of Management, UCLA; 110 Westwood Plaza, C502, Los Angeles, CA 90095. shekhar.mittal.2017@anderson.ucla.edu

[‡]Dept. of Agricultural & Resource Economics, UC Berkeley, Giannini Hall, Berkeley, CA 94720-3310. aprajit@gmail.com