VALUE ADDED TAX

A Possible Revenue Source for MENA Countries?

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SOME HISTORY

- France 1954 – replacement for sales taxes
- Brazil soon after
- Became standard method of taxation in EEC
- Then a requirement for entry
- Adopted by former Communist countries
- Spread through lesser developed countries
  – Reduced revenue from import duties
MORE HISTORY

• Now in about 150 countries
• Only one OECD country without VAT – USA
• Japan’s VAT is different
• New Zealand introduced GST – same as VAT but first country to go for wide base at standard rate
• South Africa followed the NZ model (almost)
• Canada and Australia (almost)
IMPORTANCE OF VAT

- Only two OECD countries with VAT in 1965
- OECD – 19.8% of all tax revenue in 2006
- Has replaced excise - 5.8% in 1965 down to 3.7% in 2008
- In 2006 VAT was 7.4% of GDP across OECD
- Up from 1.7% in 1970
WHY SO POPULAR?

- Self-policing
- An indirect tax collected by business
- Wide base available – neutral economic impact (unlike excises)
- Internationally neutral – no Border Tax Adjustments
- Rates can be adjusted easily
- NO ONE-SIZE FITS ALL
HOW VAT WORKS

• Charged by business at every stage of supply
  – Output Tax

• VAT incurred by business can be deducted
  – Input Tax

• Business remits to government the difference between Output Tax and Input Tax
EXAMPLE – VAT RATE OF 10%

- Timber Grower sells timber to furniture manufacturer $100 + 10% = $110
- Timber Grower remits $10 to government
- Manufacturer sells furniture to retailer for $350 + $35
- Manufacturer remits ($35-$10) $25 to gov
- Retailer sells to consumer for $500 + $50
- Retailer remits ($50-$35) $15 to gov
EXAMPLE CONTINUED

- Government has received
  - From Timber grower = $10
  - From Manufacturer = $25
  - From Retailer = $15
  - TOTAL = $50

- $50 is the VAT paid by the consumer
INVOICE/CREDIT

• This system is known as the Invoice/Credit VAT
• Japan’s VAT is different using the subtraction method
  – Based more on annual accounts
• All other countries use invoice/credit
• Invoice is at heart of the system
• Evidence for seller’s output tax
• Evidence for buyer’s input tax deduction
RATES

• Most countries have more than one rate
• “Old world” countries tend to have more reduced rates
• Countries that have adopted VAT more recently tend to have fewer reduced rates
• New Zealand has widest base at standard rate
• Singapore has wide base and low standard rate
REDUCED RATES

• Most common reduced rates:
  – Basic Food
  – Water
  – Books and newspapers
  – Public transport
  – Medicine
  – Admissions to cultural and sporting events
REDUCED RATES – WHY?

• VAT is seen as regressive
  – E.g. poor spend greater proportion of their income on food
  – But wealthy people spend much more on food and benefit more as a result

• Better to target benefits to poor (using VAT receipts)

• VAT needs to be seen as part of overall tax system
EXEMPTIONS

• Unlike reduced rates (including 0% rate)
• No deduction of input tax
• In effect, treated as “consumers”
• Most common exemptions:
  – Financial services (hard to tax)
  – Health (merit – but not hard to tax)
  – Education (merit – but not hard to tax)
  – Gambling (hard to tax?)
EXEMPTIONS

- Should be as few as possible
- They distort because no deduction of input tax within the supply chain
- Therefore an element of “double taxation”
- Healthcare and education can be taxed (at a low rate if necessary)
- Gambling can be taxed
- Financial services more difficult
OTHER ASPECTS

- **Time of Supply**
  - When does the tax become due?

- **Value of a supply**
  - E.g. what happens to discounts?

- **Place of Supply**
  - Destination principle
  - Exports zero-rated; imports taxed at rate applicable in importing country
• AND FINALLY................
VAT designed for sub-optimal performance

**KEY FEATURES**

- Narrow base (at std rate)
- Low thresholds
- Multiple rate structure
- Large numbers of small value payers

**REQUIRED**

- High standard rates
- Multiple rate structure
- Incentives to evade
- Complexity

**LEADING TO**

- Poor use of agency resources

**RESULTING IN**

- Poor compliance
- High compliance costs
- High administration costs