OECD's Current Tax Agenda

APRIL 2011

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Table of contents

Value Added Taxes: Could Do Better?

There is wide diversity in the way countries have implemented VAT. Each country has a specific mix of rates, exemptions, thresholds, etc derived from local historic, economic and political conditions. However, all governments aim to obtain the best yield from the tax, in particular at a time when many are seeking ways to address large fiscal deficits. Raising the standard VAT rate is often considered the easiest way to increase revenues from the tax. However, this has its own limitations, in particular in countries where the rate is already relatively high. Improving the performance of the tax is another option. This includes broadening the tax base, a more limited use of reduced rates and exemptions, more efficient tax administration and better compliance.

The meaning of "performance" in this context requires clarification. In theory, the tax is at its most "efficient" when imposed on all goods and services at a single standard rate. One recent study showed that a single VAT rate is the best policy choice from a purely economic point of view because exemptions and reduced rates involve additional compliance and administrative costs, which reduce the efficiency of the tax. However, it is recognised that, in local circumstances, reduced rates and exemptions in carefully targeted sectors may provide some benefits and, in that sense, be a means of meeting particular policy objectives.

Precise measurement of VAT performance is not easy. A VAT system should be considered, in absolute terms, "efficient" when it covers the whole of the potential tax base (consumption by end users) at a single rate and where all the tax due is collected by the tax administration. One tool considered as an appropriate indicator of such a performance is the VAT Revenue Ratio (VRR).

How is the VAT Revenue Ratio calculated?

Put very simply the ratio is calculated by comparing the VAT actually collected with the application of the standard rate of VAT to consumption by households (taken from the national accounts). Thus, if all consumption was taxed at one rate and all the tax due was successfully collected the VRR outcome is

1 (*i.e.* 100%). However, this is far from simple as definitions of household consumption need to be carefully considered given that exemptions in VAT (for example in the financial services sector) distort the figures by blocking tax recovery by banks. The tax "collected" by this blocking of input tax recovery becomes part of the overall VAT revenue and therefore overstates the performance of the VAT when compared to household consumption. A lot of work needs to be done on refining the data in order to ensure a consistent approach across all countries.

What are the results of the VAT Revenue Ratio?

The results, which are published in the OECD's biennial publication *Consumption Tax Trends*, should be seen as a trend, over a number of years, within each country rather than a comparative exercise. All countries retain the sovereign right to apply reduced rates and exemptions so a "low" performance may simply reflect the political choice of the country concerned. However, a "low" performance may also suggest that, in times of fiscal deficits, that simply raising the standard rate of VAT is not the only policy option open to governments. Removing reduced rates may also be a policy option, although this would need to be considered within the overall tax package of each country.

Low performance may also reflect poor compliance and poor tax administration. This would be the case if a country had a relatively wide base at the standard rate and yet fell well below 100% VRR.

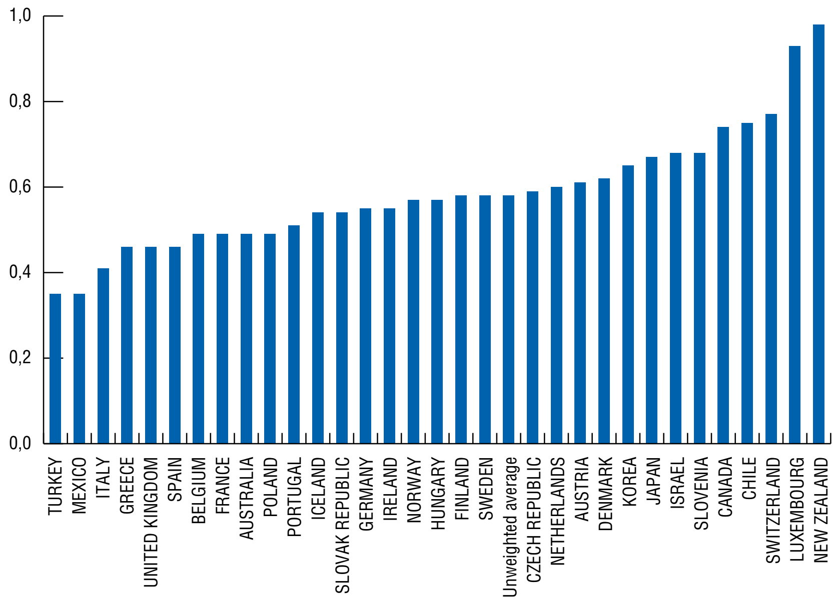
The unweighted average for all OECD countries in 2008 was 58% (in other words, 42% of the potential VAT revenue is not collected). It follows, therefore that, in many countries, there is significant room for widening the tax base at the standard rate and improving compliance and tax administration. The figures range from 98% (New Zealand) to 35% (Mexico and Turkey). Eight countries (including major economies such as France and the UK) have a ratio of less than 50%.

It appears that the level of the standard rate has a limited influence on the VRR. Countries with comparable standard rates can have very different VRRs. Luxembourg and Mexico for example both employed a standard rate of 15% in 2008 but their VRR is respectively 93% and 35%. One of the factors explaining the high VRR for Luxembourg is the relatively large financial sector within its economy, which provides additional VAT revenue due to the cascading effect of exemption. On the other hand, the low VRR for Mexico probably result from a combination of an extended use of the domestic zero rate, a reduced rate for the sale of goods in the border regions and a lower compliance rate.

Although the majority of countries (19 of 32) have a VRR between 0.50 and 0.75, they have standard VAT rates which vary widely, from 5% (Canada) to 25% (Sweden) without correlation between the level of the VAT rate and the VRR. Denmark, Norway and Sweden have high standard VAT rates (25%)

with a higher VRR (respectively 0.62, 0.57 and 0.58) while Australia and Spain have lower standard rates (respectively 10% and 16%) with lower VRR (respectively 0.49 and 0.46). It is difficult to draw typical profiles for "efficient" and "inefficient" countries in the collection of VAT revenues on the basis of this VRR. Only Japan combines a single (low) VAT rate, an absence of domestic zero rate and a high VRR (0.72).

VAT Revenue Ratio



Source: Figure 4.1, OECD (2011), *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, Paris.

The impact of VAT fraud is more difficult to detect through the VRR. For example the UK tax administration discovered a significant increase of large scale VAT carousel fraud (a fraud that exploits a perceived weakness in the operation of intra-Community supplies in the European Union). Although this type of fraud began in the 1990s its impact does not appear to be reflected in the VRR, which remained stable. This might be explained by an offsetting increase in the size of the financial services sector in the UK at the time and the consequent cascading effects.

More globally, the performance of VAT systems depends on three main factors:

- The structural features of the tax, *i.e.* rates, exemptions, bases and thresholds;
- The capacity of the tax administration to manage the system in an efficient way; and

- The degree of compliance of taxpayers.

The interaction between these three factors is crucial. For example, a high standard rate may encourage evasion while multiple lower rates often lead to misclassifications and create high compliance and administrative burdens. Reasonably high registration or collection thresholds may ease the burden on tax administrations by allowing them to concentrate on the larger taxpayers. Exemption by sectors of activity may create distortions and incentives for evasion, which require additional administrative capacities. Inefficient tax administration, burdensome administrative requirements and complex VAT mechanisms may also reduce the degree of compliance of taxpayers.

Whilst the VRR is a useful tool for observing countries' performance, more work is needed to identify the specific factors that influence the performance of VAT and how they interact. An article on this topic appears in the 2010 edition of the OECD's *Consumption Tax Trends*.

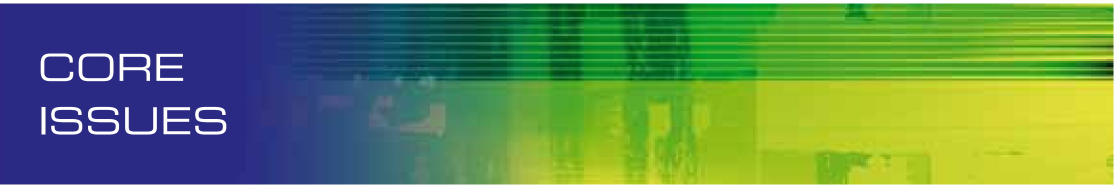
Key Publications

- OECD (2011), *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing

Consumption Taxes on the Web

- *www.oecd.org/ctp/ct*
- *OECD Tax Database: www.oecd.org/ctp/taxdatabase*

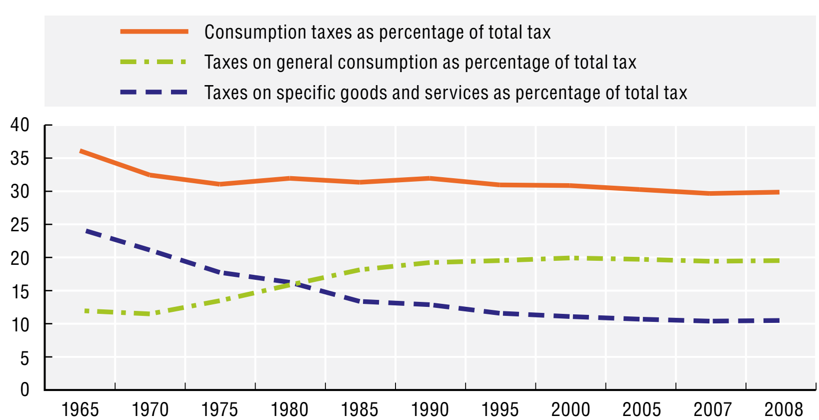
Consumption Taxes



The spread of Value Added Tax (also called Goods and Services Tax – GST) has been the most important development in taxation over the last half century. Limited to less than ten countries in the late 1960s, it has now been implemented by nearly 150 countries and it often accounts for one fifth of total tax revenue. The recognised capacity of VAT to raise revenue in a neutral and transparent manner has drawn all OECD member countries, except the United States, to adopt this broad-based consumption tax. Its neutrality principle towards international trade has also made it the preferred alternative to customs duties and sales taxes in the context of trade liberalisation.

OECD member countries have relied increasingly on Value Added Tax (VAT) as a source of revenues. Over the last ten years, the share of VAT as a percentage of total taxation has risen from 17% to 19%. These ratios vary considerably between countries, but in 27 of the 33 OECD countries with VAT, the tax accounts for more than 15% of total taxation. Following its adoption by a growing number of countries, a shift occurred within the category of taxes

Figure 1. **Share of consumption taxes as percentage of total taxation**



Source: OECD (2011), *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, Paris.

"I have been impressed by the contributions made by governments, businesses and academia to the work on the International VAT/GST Guidelines, through the Technical Advisory Group to Working Party 9 on Consumption Taxes. This unique co-operation ensures that the OECD builds on the experience of all and takes into account each stakeholder's needs when developing Guidelines for greater efficiency in VAT systems."

Mr. Piet Battiau
Head of Consumption Taxes Unit, Centre for Tax Policy and Administration, OECD.

on consumption so that while the share of VAT rose, the revenue from consumption taxes on specific goods and services (mainly excise taxes) fell from 24% to less than 11%. Figure 1 shows the share of consumption taxes as a percentage of total taxation.

The International VAT/GST Guidelines

At the same time as VATs have been spreading across the world, international trade in goods and services has also been expanding rapidly. As a result, the interaction between value added tax systems operated by individual countries has come under greater scrutiny as potential for double taxation and unintended non-taxation has increased. Recent work, led by the OECD's Committee on Fiscal Affairs (CFA) in co-operation with business, has revealed that the current international consumption taxes environment, especially with respect to trade in services and intangibles, is creating obstacles to business activity, hindering economic growth and distorting competition. Complex, unclear or inconsistent rules across jurisdictions are difficult to manage for revenue bodies and create uncertainties and high compliance costs, which can lead to reduced compliance. Such an environment may also facilitate tax fraud and avoidance.

Since 2006, the CFA has been working on the development of the OECD International VAT/GST Guidelines (www.oecd.org/ctp/vatguidelines). These will include a broad range of issues in the VAT area including international trade in services and goods; refund or relief mechanisms for foreign businesses and dispute resolution mechanisms. In 2008 two consultation documents were issued by the CFA, both of which attracted support for the principle of applying the tax rules of the jurisdiction in which the customer is located for cross-border business-to business supplies of services and intangibles. Guidelines expanding on this were published for consultation purposes in February 2010 and received support. Work is now progressing on the need for exceptions to this principle where applying it would produce an inappropriate outcome or impose excessive compliance burdens on business. A report on the difficulties businesses have in recovering VAT incurred in countries where they have no establishment was released at the same time and draft Guidelines on Neutrality to address this, and similar problems, were published for consultation purposes in December 2010. Work is also being undertaken on international supplies between establishments of single entities (the so-called "branches" issue).

CORE ISSUES

VAT Abuse

Despite their self-policing features, VAT systems have been subject to a significant level of fraud and aggressive tax planning over recent years, especially among EU countries. Given the extent and nature of abuses of the VAT systems in recent years, the CFA has established a secure system for member countries to exchange information about various types of frauds, avoidance and other abusive practices. This information is not taxpayer specific, but rather acts as a means of alerting member countries to possible attacks on their VAT systems. In 2010 the system was used as an early warning to member governments of suspected VAT frauds in trading exchanges for commodity service areas such as electricity and gas. Further development of the system is now under way.

The OECD also works closely with the Financial Action Task Force (FATF) in this area, notably as regards the laundering of the proceeds of VAT fraud. The emergence of software designed to enable businesses to reduce their VAT liability by artificially reducing sales (so-called "zappers") is an issue that is being worked on in co-operation the OECD's Forum on Tax Administration.

Consumption Tax Trends

This biennial publication presents information about VAT/GST and excise duty rates in OECD member countries. It provides information about indirect tax topics across OECD countries and contains articles on recent developments of interest. The 2010 edition contains all the usual data and an expanded description of the VAT Revenue Ratio – see *Hot Topics: Value Added Taxes – Could Do Better?*

Key Publications

- OECD (2011), *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, Paris.

Consumption Tax on the Web

- *www.oecd.org/ctp/ct*
- International VAT/GST Guidelines: *www.oecd.org/ctp/vatguidelines*

- **Did you know...** in 27 of the 33 OECD countries with VAT, the tax accounts for more than 15% of total taxation?
- **Did you know...** the share of taxes on general consumption as a percentage of total taxation has risen to 19.5%?
- **Did you know...** that growth-oriented tax reforms generally involve shifting revenue from corporate and personal income taxes to consumption and property taxes?

Want to Know More?

Key Links

Consumption tax	*www.oecd.org/ctp/ct*
Dispute resolution	*www.oecd.org/ctp/dr*
Exchange of information	*www.oecd.org/ctp/eoi*
Harmful tax practices	*www.oecd.org/ctp/htp*
Global Forum on transparency and exchange of information for tax purposes	*www.oecd.org/tax/transparency*
OECD tax database	*www.oecd.org/ctp/taxdatabase*
Partnerships with non-OECD economies	*www.oecd.org/tax/globalrelations*
Tax administration	*www.oecd.org/ctp/ta*
Tax crimes and money laundering	*www.oecd.org/ctp/taxcrimes*
Tax evasion	*www.oecd.org/tax/evasion*
Tax policy analysis	*www.oecd.org/ctp/tpa*
Treaty Relief and Compliance Enhancement	*www.oecd.org/tax/trace*
Transfer pricing	*www.oecd.org/ctp/tp*
Tax treaties	*www.oecd.org/ctp/tt*
Tax treatment of bribes	*www.oecd.org/ctp/ttb*

Key Publications

- Revenue Statistics 1995-2009 (2010 edition)
- Taxation, Innovation and the Environment (2010)
- OECD Tax Policy Studies No.19: Choosing a Broad Base – Low Rate Approach to Taxation (2010)
- OECD Tax Policy Studies No. 20: Tax Policy Reform and Economic Growth (2010)
- Model Tax Convention on Income and Capital (2010)
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010 update)

- Taxing Wages (2010)
- Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues
- Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2010
- Global Forum on Transparency and Exchange of Information for Tax Purposes, 18 Peer Review Reports

Key Events in 2011

- Tax and Crime: A Whole-of-Government Approach in Fighting Financial Crime, Oslo, 21-23 March 2011
- Second Plenary Meeting of the informal Task Force on Tax and Development, Paris, 11-12 April 2011
- 11th Annual U.S. & Europe Tax Planning Strategies Conference, Paris, 14-15 April 2011
- Global Forum on Transparency and Exchange of Information for Tax Purposes, Bermuda, 31 May – 1 June 2011
- OECD-USCIB Tax Conference, Washington, 6-7 June 2011
- High Level Seminar: Current Issues in Transfer Pricing – Delhi, India, 13-14 June 2011
- OECD 50th Anniversary: High Level Tax Reform Conference, Paris, 30 June 2011
- 16th Annual Tax Treaty Meeting, Paris, 15-16 September 2011
- First Annual Transfer Pricing Meeting, Paris, 3-4 November 2011
- Fifth ITD Global Conference on Inequality, 5-7 December 2011
- Seventh Forum on Tax Administration, Argentina, 18-19 January 2012

Tax News Alerts

To receive the latest OECD tax news, register with our free e-mail alert service: ***www.oecd.org/OECDdirect***

OECDdirect

Tax Publications

Subscribe to our OECDiLibrary and statistics services:
www.oecdilibrary.org

OECDiLibrary

Order our publications

Order our publications through the OECD online bookshop at ***www.oecdbookshop.org***, where you can browse titles on your screen before your buy.

OECD online bookshop

Write to us:

OECD
Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
FRANCE

The Centre for Tax Policy and Administration offers challenging and rewarding opportunities to economists, lawyers and tax administrators with experience in tax policy or tax administration issues of the type described in this brochure. Vacancies are posted on *www.oecd.org/hrm/vacancies.*