



**FISCAL AFFAIRS**

# **VATs and sectoral policies**

**IMF VAT WEBINAR SERIES**

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**Some basics about VATs**

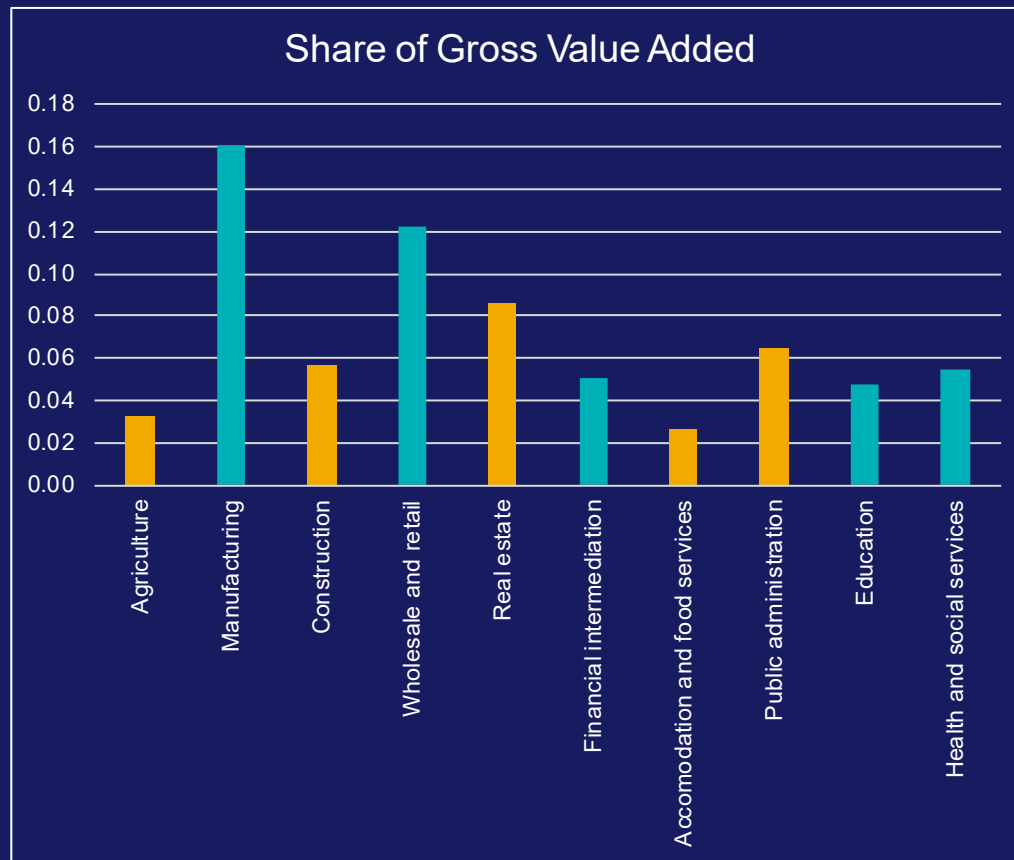
**Reasons for and consequences of  
sectoral VAT policies**

**Framework for sectoral policies**

# Basics

- Some tension between economic principles, their translations into law, and their practical enforcement/collection
- Economic vs. legal/practical meaning of “consumption”
  - Role of “instant” monetary value of consumption vs. temporal dimension
- VATs are sales taxes in practice, which need to be made VA taxes through credits/refunds
  - A source of complexity in design and enforcement, including for sectoral policies
- VATs tax flows and stocks/durables similarly – e.g., restaurant meals vs. residential real estate

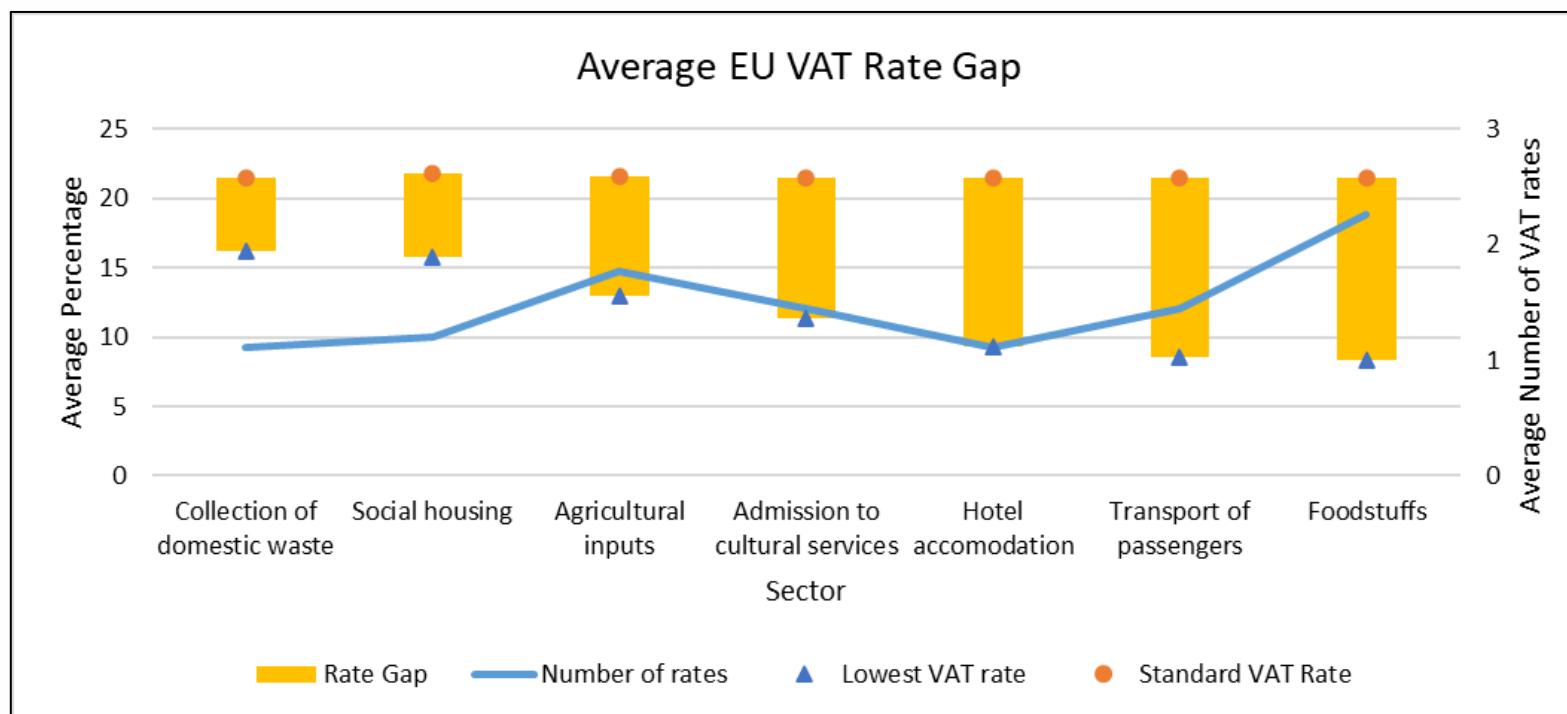
# Value added (VA) by sector can shed light on revenue and efficiency consequences of sectoral VAT policies



Source: World Input-Output Database.

- Consequences are not limited to targeted sector, given interconnectedness and difficulties in ringfencing
- The higher the share of value-added, the more important are the consequences – intended or not
- Averages hide differences across countries, and could explain in part difficulties in VAT coordination in customs union—e.g., EU, WAEMU, GCC

# Examples of sectoral policies: EU rates gaps



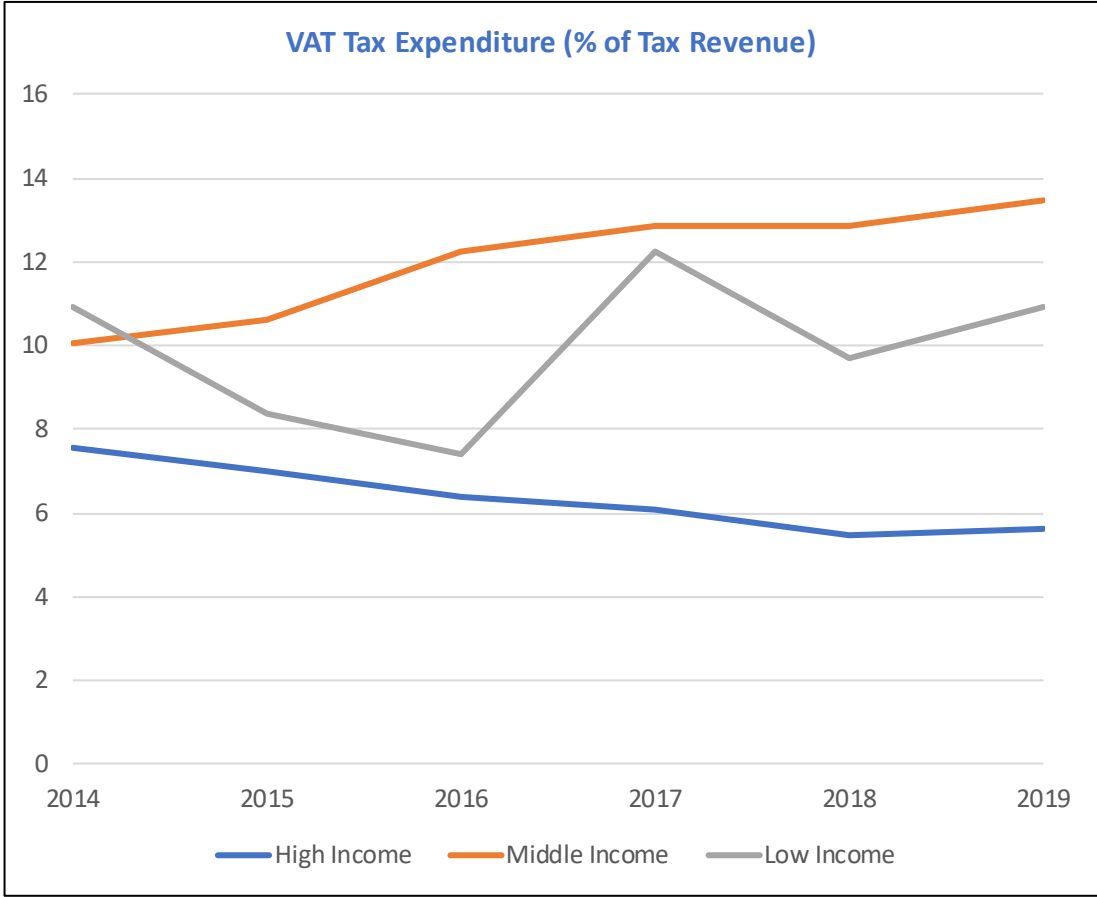
European Commission, VAT Gap in the EU, 2021.

Note: The standard rate is the average across the EU. The lowest VAT rate is the average registered for a selected sectors in Annex III of the EU VAT directive. The bar represents the rate gap: distance between standard and lowest rate. The number of rates is the country average across the EU.

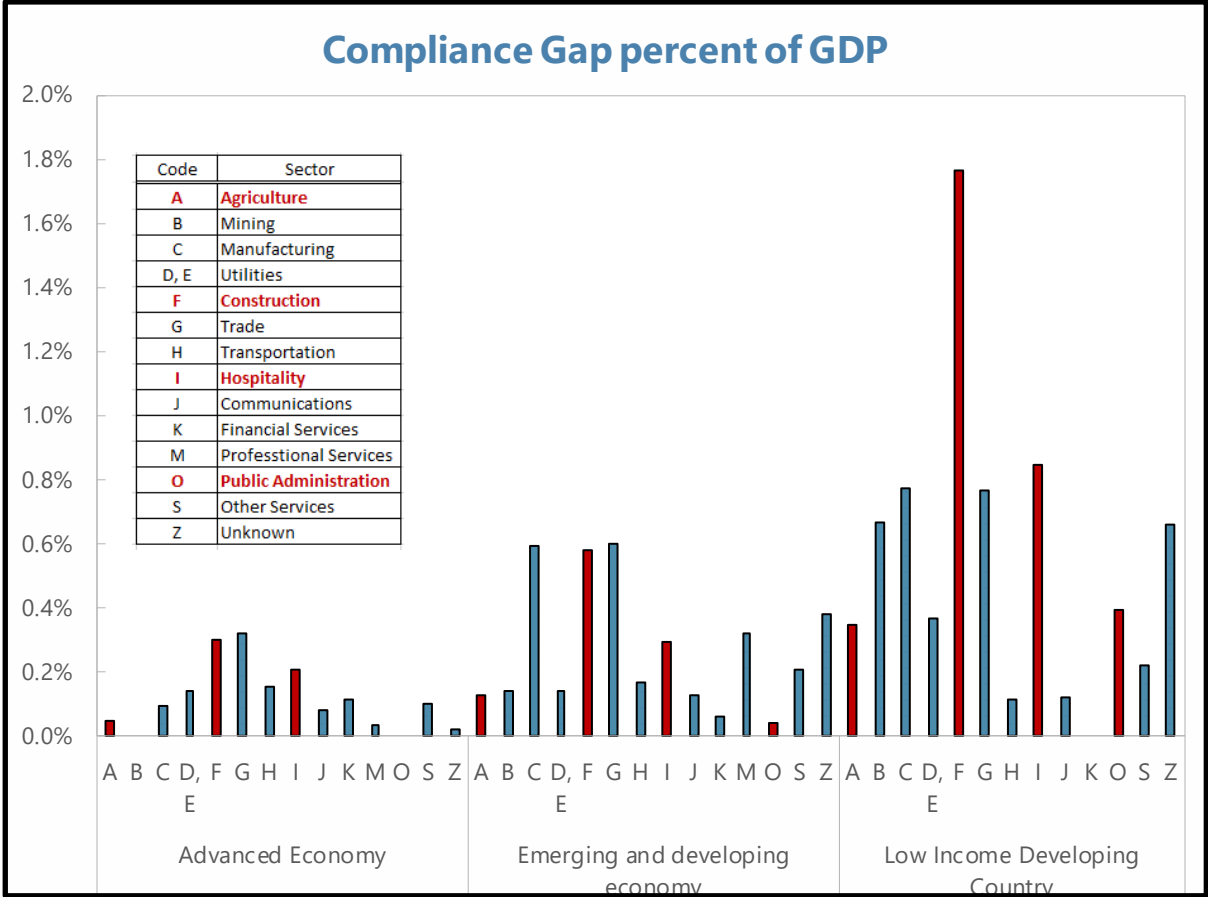
# Reasons for, and consequences of sectoral policies

	Practical issues	Competitiveness	Tax burden/incidence
Key arguments	<p>Often related to tax administration, and stemming from inadequacies of the concepts of “transactional supply” and “valuation” of consumption</p> <p>E.g., residential real estate (total new value vs. imputed rent); financial intermediation; used durables; (free) public goods; notional refunds for exempt sectors; margin schemes; registration threshold</p>	<p>neutrality vis-à-vis capital investment (no need to refund), and attracting foreign investment (attracting foreign consumers/shoppers)</p> <p>Tax administration competition (?)</p> <p>Linkages with other incentives provided in non-tax laws</p> <p>E.g., Agriculture; extractives; footloose manufacturing; tourism</p>	<p>Reduction of relative prices through exemptions or low rates is beneficial to consumers</p> <p>E.g., foods; energy; medication</p>
Revenue impact	<p>Hardly neutral since enforcement is never perfect</p> <p>Creates tax evasion opportunities (so why do it?) – e.g., difficult to ringfence sectors; exempt imports leaked into domestic consumption</p>		<p>Negative or ambiguous</p>
Efficiency impact	<p>Hardly neutral since enforcement is never perfect</p> <p>Ambiguous for some sectors – e.g., public administration.</p> <p>Create tax evasion opportunities – e.g., difficult to ringfence sectors; exempt imports leak into domestic markets</p>		<p>Negative, as production and consumption choices are distorted</p>
Distributional impact (next VAT webinar)	<p>Ambiguous</p> <p>Could be different from policy intention– e.g., increase in foreign investment could come at the cost of less opportunity for domestic firms and labor; imports could be advantaged relative to domestic production</p>		<p>Regressive, as the benefit is a function of household consumption shares, which increase with incomes (e.g., rich consume more gasoline than poor)</p> <p>Could be progressive in relation to expenditures</p>

# Revenue consequences



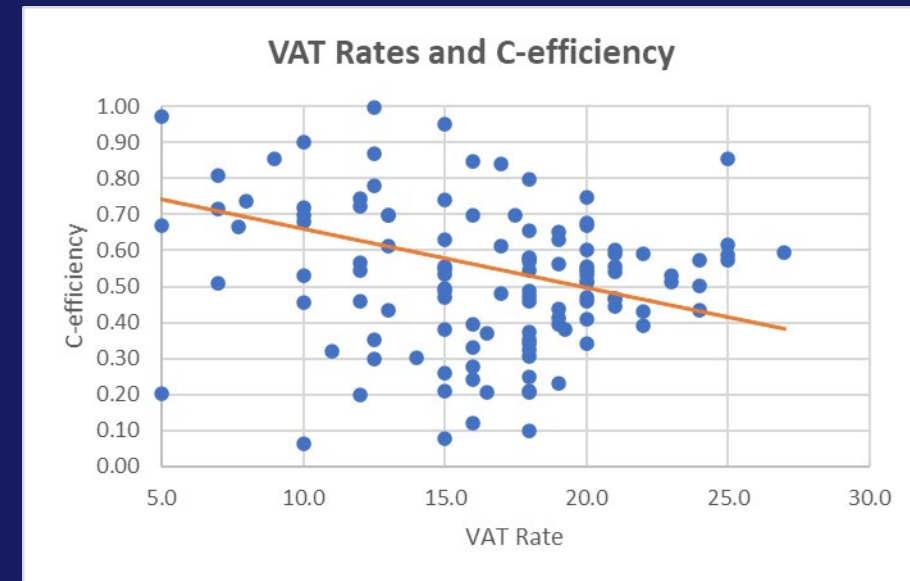
Source: GTED, and IMF staff calculations.



Source: RA-GAP, and IMF staff calculations.

# A framework for sectoral policies

- VATs are best used as revenue tools—and empirical evidence supports this
  - Efficiency costs and unintended consequences are potentially large
  - Instead of simplifying tax administration, sectoral policies often have negative implications on enforcement, and raise governance issues
  - Difficult to target income groups through prices
- Recognize that political economy factors are difficult—VATs are visible and ubiquitous



Source: IMF staff calculations.



# Framework for sectoral policies

	Practical issues	Competitiveness	Tax burden/incidence
Criteria for use	<p>In-depth analysis of balance between good policy design and enforcement/administration measures—can the panel provide examples?</p> <p>If existing tax administration capacity cannot enforce properly-designed policies:</p> <ul style="list-style-type: none"> <li>• Consider tax administration reforms/capacity as a condition for VAT implementation</li> <li>• Consider other policy choices – e.g., single-stage sales taxes with selected excises</li> </ul>	<p>Almost never-can the panel provide examples?</p> <p>In limited cases:</p> <ul style="list-style-type: none"> <li>• Exemptions of special/expensive machinery specific to certain sectors (e.g., mining; large infrastructure) could be contemplated to lessen the interest cost of working capital (which increases the effective VAT rate).</li> <li>• Alternative is to suspend VAT payments (on account) until taxpayers finalize their VAT declaration.</li> </ul> <p>Shielding companies from tax administrations is fraught with governance risks; consider instead transparency, good service delivery to taxpayers, and good governance</p> <p>Not a good practice to include VAT policies in sectoral laws – e.g., investment codes</p>	<p>Highly dependent on income and consumption patterns; hence, needs proper analysis of distributional impacts, including evidence that VAT is superior to other policy tools—e.g., budget transfers; income tax.</p> <p>Mandate proper documentation of tax expenditures related to sectoral policies, and evaluate regularly</p>

**Thank you**