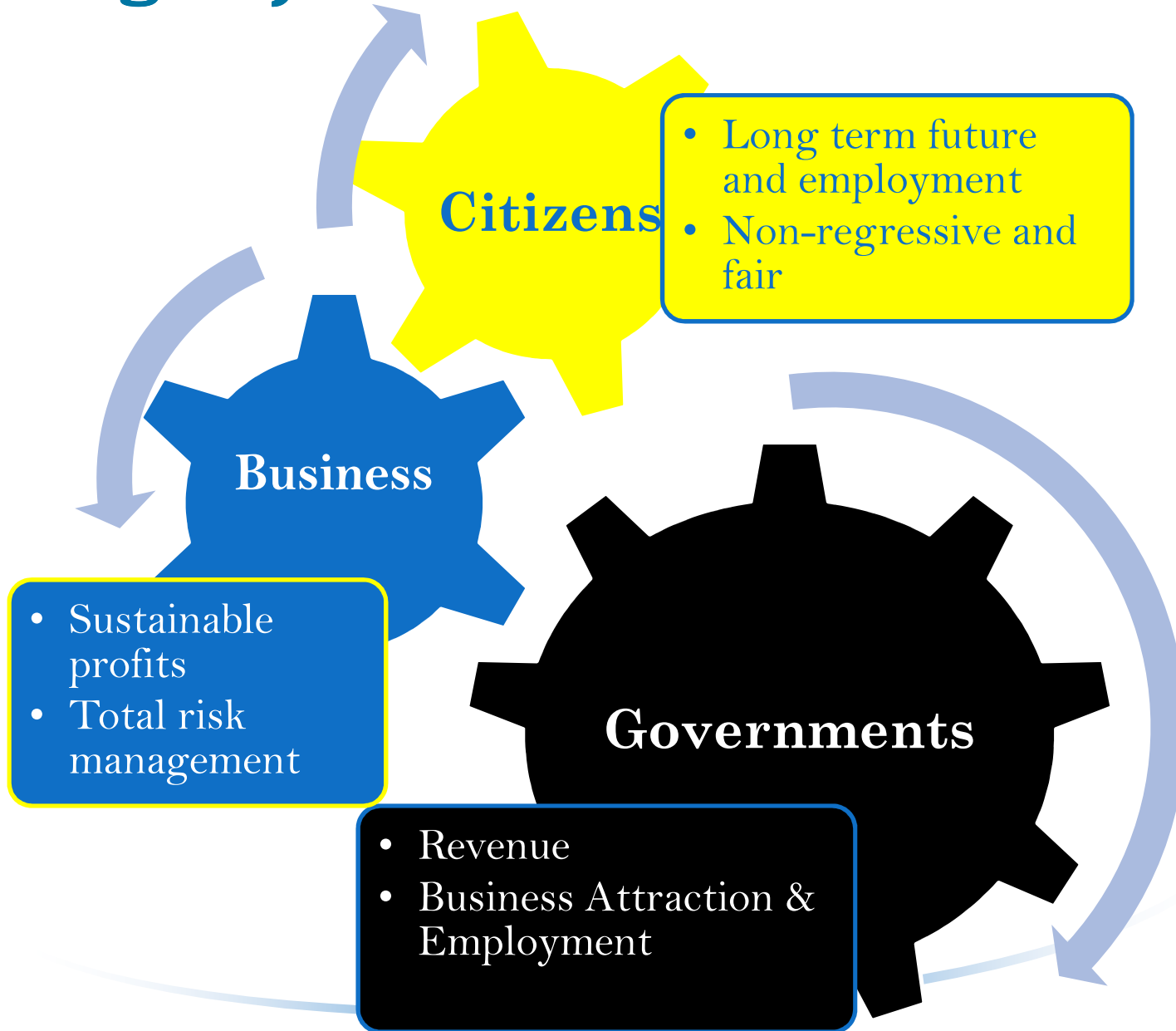


# VAT

# THE BEST CHOICE FOR THE BAHAMAS



# Meeting Objectives of Three Stakeholders





## **What options were considered as the central element of a tax reform package?**

- income tax (personal and/or corporate);
- payroll tax; and
- consumption tax (sales or VAT).





## What elements of **income tax** made it not viable as the central element in tax reform?

- The **personal income tax** can also be tailored to be quite progressive which, as may be seen in some countries, involves the imposition of somewhat steep tax rates on higher levels of income. In some cases, marginal tax rates well in excess of 50 per cent are applied.
- The principal drawback of the personal income tax is that it acts as a disincentive to work effort and entrepreneurship. It also discourages saving as interest income, dividends and capital gains are subject to tax.
- Likewise, the **corporate income tax** on profits discourages investment and innovation.
- **These options have significant compliance burden for both.**



What elements of payroll tax made it not viable as the central element in tax reform?

The main drawbacks of a payroll tax are

- that it represents a clear impediment to employment and ;
- that, being based on employment, it is highly cyclical.



## Why wasn't sales tax a contender?

- Buyers may seek to avoid the payment of tax;
- Sellers may be tempted to acquiesce in order to complete a sale.
- These are easily concealed to the detriment of the Government's coffers;






# Why is VAT the best choice of the consumption tax?

- **Unlike a retail sales tax**—under which tax is collected only at the point of sale to the final consumer—revenue is collected throughout the production process.
- **Unlike a simple turnover tax—which** levies tax on all sales, intermediate or final—producers can reclaim the tax they have been charged on their inputs.
- **This makes VAT more transparent!**



# What's the VAT advantage?

- All firms whose annual turnover exceeds a specified threshold must participate—not only those involved in making final sales to consumers.
  - While there are other ways in which one can try to tax consumption—such as a retail sales tax—the feature of the VAT that tax is collected throughout the production chain gives it a considerable practical advantage.
  - The VAT raises revenue in a neutral and transparent manner. Some suggest that “a VAT is the most effective instrument for generating government revenue” and that “the marginal cost of raising funds for public purposes through VAT is generally lower than it would be if other taxes were employed.”
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## Further Readings:

- Is VAT the Best Way to Impose a General Consumption Tax in Developing Countries, Richard M. Bird, Pierre-Pascal Gendron, Andrew Young School of Policy Studies, Georgia State University
  - Personalized VAT Increasing Revenue Collection and Compensating the Poor, Alberto Barreix, Martín Bès, Jerónimo Roca, Stanford School of Policy Study, Duke University & IDB (Inter-American Development Bank)
  - The EU VAT Experience: What Are the Lessons?, Ine Lejeune, Tax Analysts
  - Value Added Taxation: Mechanism, Design, and Policy Issues, Tuan Minh Le, World Bank course on Practical Issues of Tax Policy in Developing Countries (Washington D.C., April 28–May 1, 2003)
  - An International Perspective on VAT, Alain Charlet and Jeffrey Owens, Tax Notes Int'l, September 20, 2010, p. 943
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