Canada's Dual VAT

George Anderson
Forum of Federations

Conference on Making the 18th Amendment and the NFC Award Work

Islamabad
October 30-31, 2010

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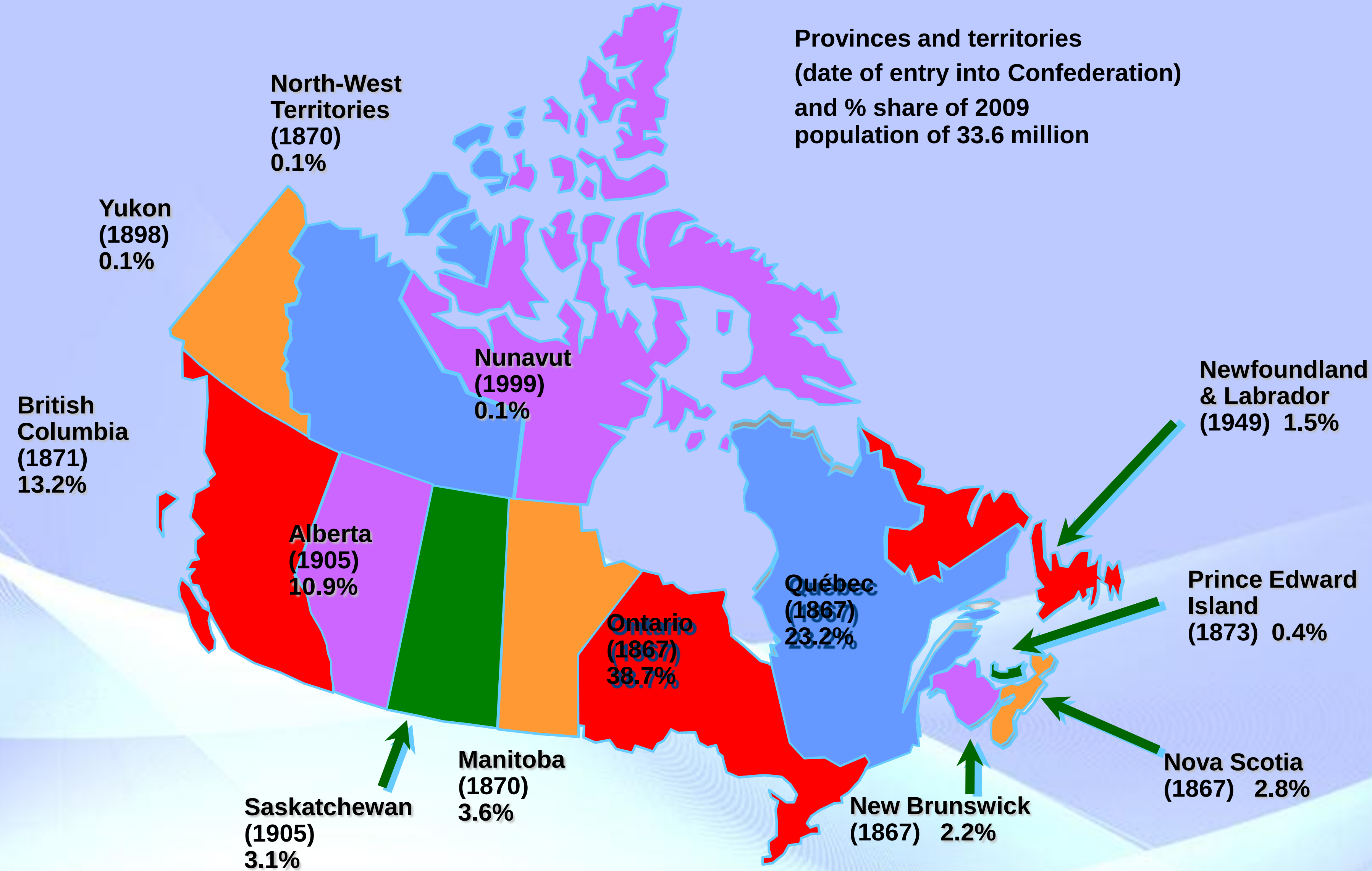
A quick overview of Canada



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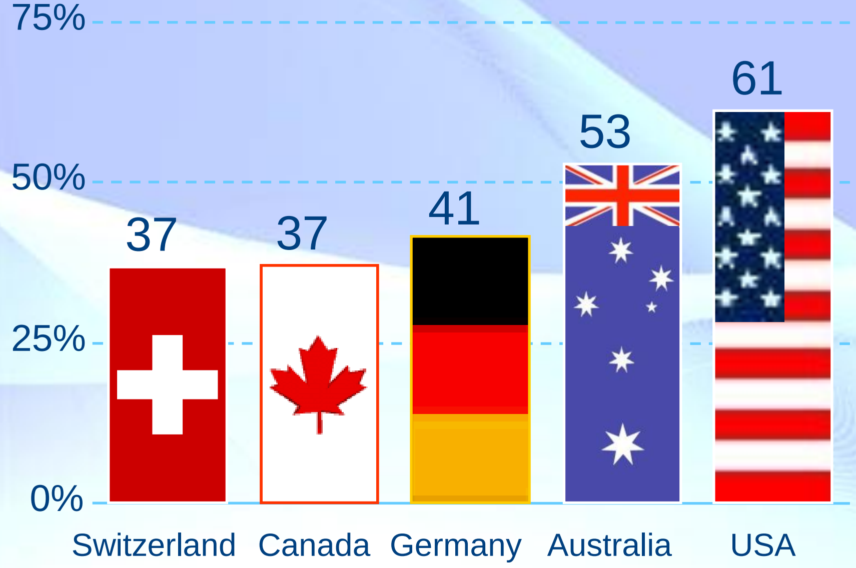
Canadian provinces have a high degree of autonomy including significant fiscal resources and independence

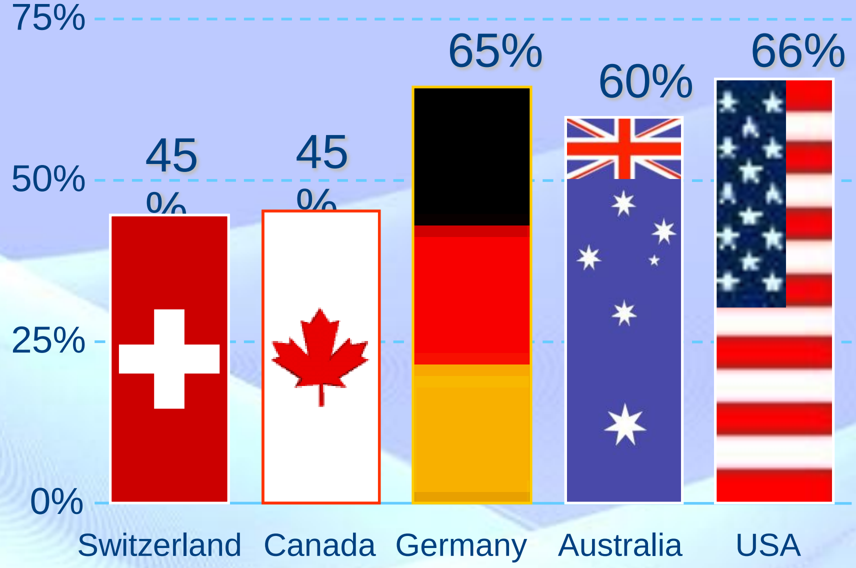
Expenditures

Federal share of direct spending



Revenues

Federal share of own-source revenues



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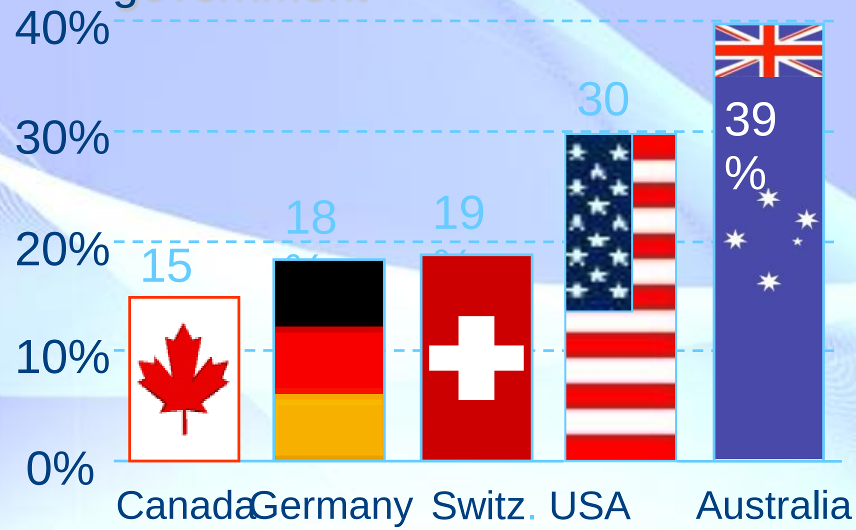
The particularly high degree of autonomy exercised by Canadian provinces reflects:

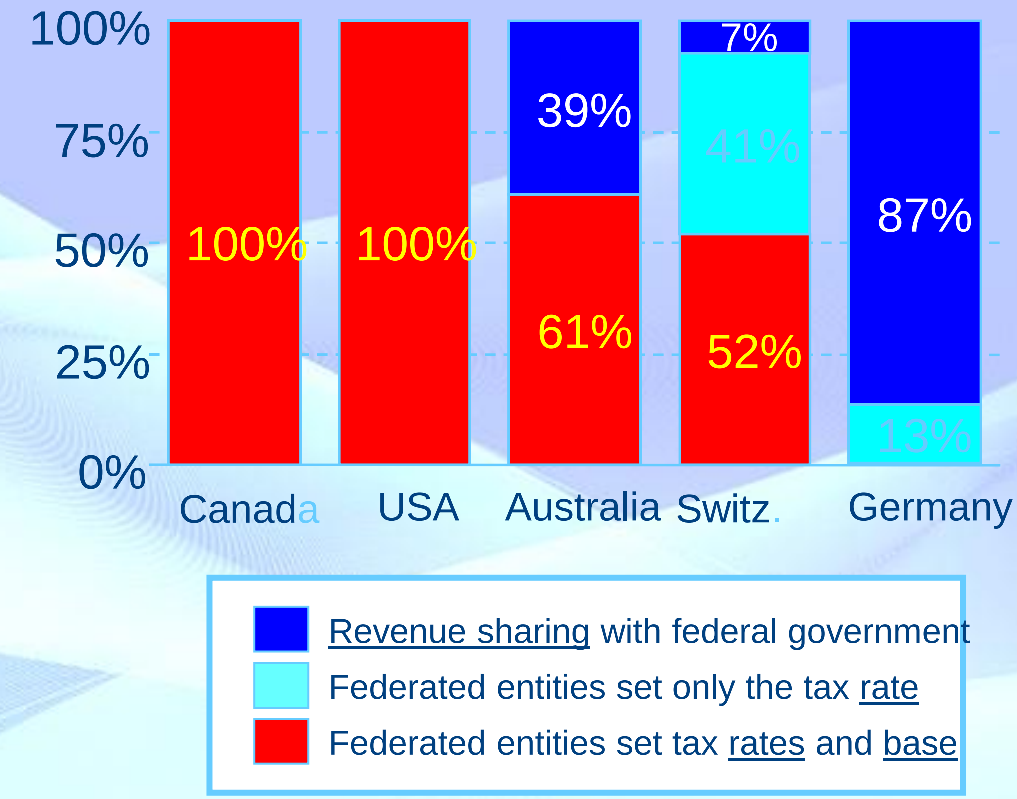
Their low dependence on federal transfers…

Federal transfers as a % of total revenues of other levels of government



…and significant control over their own-source revenues

Non-federal own-source revenues, by degree of fiscal control



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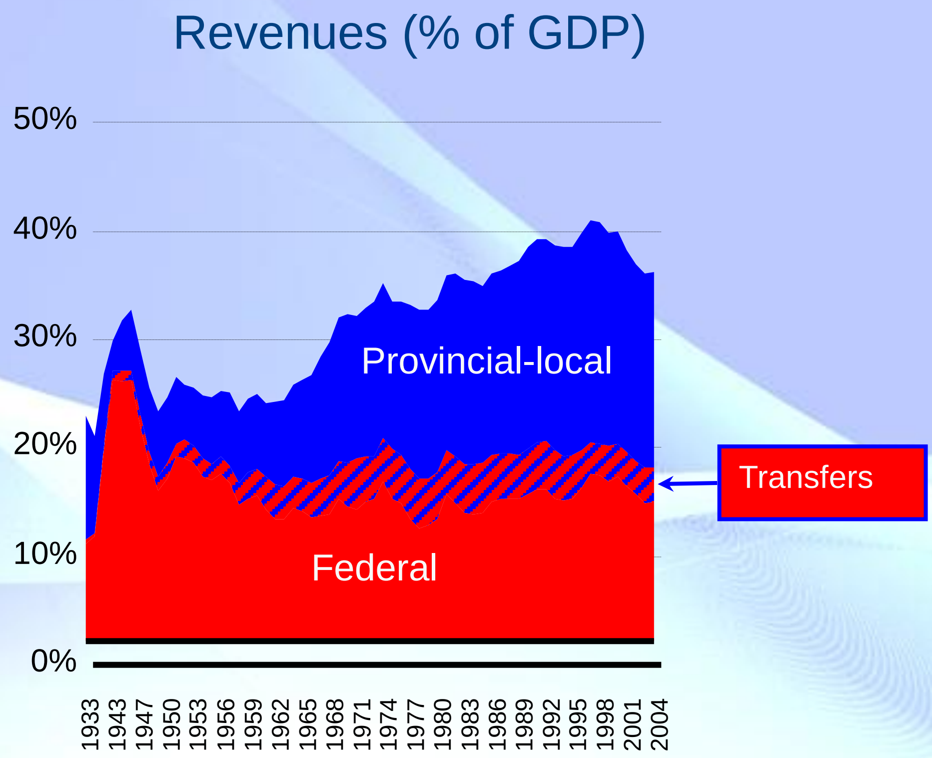
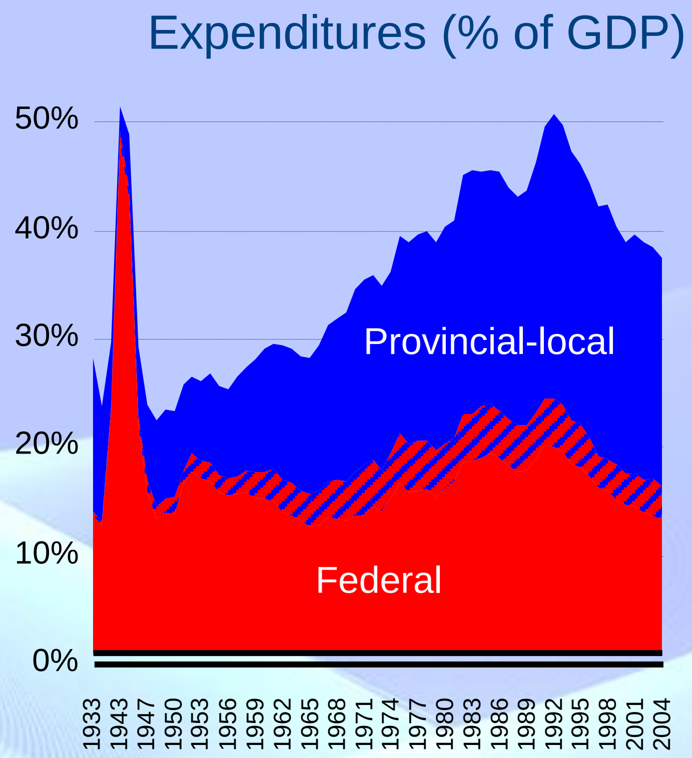
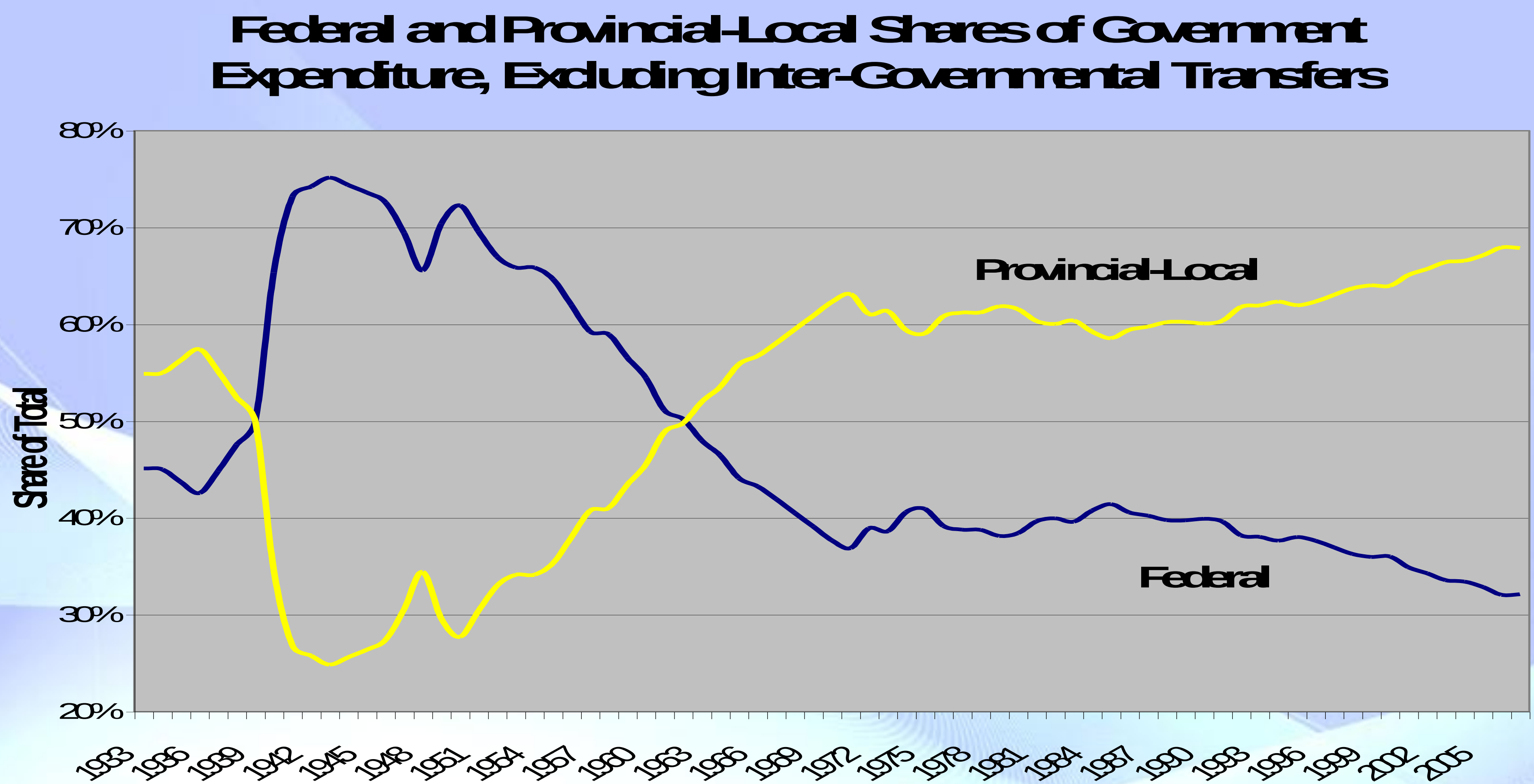
There is a long history of fiscal decentralization in Canada going back to the post-war period. It has been driven by provincial powers and responsibilities and Canada's political dynamics





Source: Statistics Canada

The federal share of government spending after transfers is exceptionally low



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Canada's Transition to Value Added Tax

- Federal government had manufacturing sales tax which provided 15% of revenues
- Nine provinces had sales taxes, with different rates and designs
- 1991 Federal GST and Quebec QST
- 1997 Newfoundland, New Brunswick, and Nova Scotia join HST
- 2010 Ontario and British Columbia join HST
- Only three small provinces still have conventional sales taxes outside the HST system. Alberta and territories have no sales tax.

Why such a long transition?

- Extremely difficult politics
- Manufacturing sales tax was hidden; GST/QST/HST usually added at point of sale so highly visible
- Provinces had very different designs and usually much smaller bases (though often higher rates)
- Public not sensitive to economic benefits, but business lobbied strongly for change
- Federal government has had to bribe provinces:
  - With large transition payments
  - Offer to assume collection costs
- Federal Conservative lost 1993 election massively
- BC voters currently seeking a referendum to overturn HST

The basic architecture

- Federal goods and services tax across Canada
- Five provinces now have provincial tax which is based on federal GST and administered by federal government (Harmonized Sales Tax)
- Quebec has Quebec Sales Tax, which is closely modelled on federal GST, and it administers federal GST
- Provinces essentially must use federal base, but have some liberty to vary rate
- Revenues are distributed on a deemed destination basis

Comparison of Some Key Features of Canada's Subnational VAT Regimes

	QST	HST	HST (Ontario)
On destination basis	Yes	Yes	Yes
Autonomy in rate-setting	Yes	Yes (in principle)	Yes (in principle)
GST base	Yes (with minor exceptions)	Yes	Yes
More zero-rating than GST	Yes	Yes	Yes
Input credit restrictions	Yes	No	Yes
Good administration	Yes; provincial	Yes; federal	Yes; federal
Good cooperation between central and sub-national governments	Yes	Yes	Yes

The Federal GST

- Was intended to be revenue neutral, with broad base including most services and housing and direct imports by consumers. Initial rate 7%; now 5%
- Difficult politics led to exclusion of “basic groceries” at last minute. Also a targetted refundable income tax credit was designed to deal with distributional issue
- Uses rebates for VAT relief: about 14 categories including MASH, charities, housing—different rates
- Huge effort during transition to explain tax to VAT registrants
- Efficient system of input credits, e.g. in 2003 $144B on sales with $130B claimed as credits for net $14B revenue.
- Non-compliance estimated at 4%
- Demonstrates that a federal VAT can exist alongside provincial sales taxes

The Harmonized Sales Tax

- Original three agreed on rate of 8%, but now BC is 7% and Ontario 8%. Atlantic provinces agreed they needed unanimity to lower rate and 2 out of 3 to raise it. Ontario and BC are free on rate, with adequate notice
- While all provinces must use federal base, the effective rates of tax vary because of different rebate schemes. Federal-provincial agreements limit extent of rebates.
- Unlike federal GST, prime criterion for *services* at provincial level is “place of performance” not location of final consumption, so provincial tax on interprovincial services is largely on origin, not destination basis. However, credits generated against such HST may be offset against GST, so in this sense it is a national scheme

Credits and Rebates in the HST Provinces

	GST		HST	
		NB	NS	NFLD
MUSH Rebates (Municipalities, Universities and public colleges, Schools and Hospitals)	M -100%[a] U -67% S – 68% H – 83%	M – 57.14% U – 0% S – 0% H – 0%	M – 57.14% U -67% S – 68% H – 83%	M – 0% U – 0% S – 0% H – 0%
Charity and Qualifying NPO Rebates	50%	50%		
New Housing Rebate	36% with a maximum of C$6,300[b]	No rebate	18.75% with a maximum of C$1,500[c]	No rebate
New Residential Rental Property Rebate	36% with a maximum of C$6,300	No rebate	No rebate	No rebate
Point-of-Sale Rebates under the HST	n/a	Books	Books	Books
Other HST rebates related to the 8% provincial portion of the HST (federally legislated)	n/a	-Exports from a harmonized province; -Investment plan and segregated fund rebate -Tourism industry rebate	-Exports from a harmonized province; -Investment plan and segregated fund rebate -Tourism industry rebate	-Exports from a harmonized province; -Investment plan and segregated fund rebate -Tourism industry rebate
Other HST rebates related to the 8% provincial potion of the HST (provincially legislated)	n/a	-Specially-equipped vehicles; -Segregated funds; -Research and development rebate.	-Household energy[d]; -Fire departments; -Motor vehicle rebate; -Computer rebate; -Heritage properties; -Segregated funds.	-Rebate program for building materials for Labrador homes; -Home heating rebate programe .
Low-Income Credit	Yes	No credit	No credit	Yes

Allocating HST Revenue

- System is not based on tracking of the revenue collected in any particular province
- Payments in any given year are based on a projection of revenues, allocated using the shares of two years previous. A province's revenue is based on a formula that applies its share of the total GST taxable base to its tax rate. Taxes paid by federal and HST provincial departments are excluded from the pool as are specified refunds and rebates.
- No allowance for unpaid GST or any revenue after closing date for adjustments. The federal government keeps such gains, but must "eat" unpaid GST ($1.3B in 2006)
- There is detailed calculation of the revenue pool, e.g. 130 categories of consumption expenditure, GST border collections, rebates to public agencies etc.

The Quebec Sales Tax

- QST destination-based, credit-invoice VAT at rate of 8.5%, applied on GST inclusive price (tax on tax)
- Base has become largely identical to GST, but large businesses are denied some input tax refunds. Export of goods and services are zero-rated (with minor exceptions). QST rebate rates are lower than GST rebate rates.
- Both GST and QST apply to foreign imports, while QST applies to domestic imports for registered QST payers on a self-assessment basis for others—but not if they would have been eligible for an input tax refund
- Quebec receives a fee for collecting GST for federal government. It has an incentive to enforce it well because the QST base grows with GST collections. Evasion estimated at 8%

Economic effects of HST reform

- Various estimates. National consumer prices permanent rise of 0.4% from Ontario and BC reforms (50% of economy). Consumer spending likely not to vary because of other tax offsets. Total tax packages are mildly redistributive in favour of low incomes (gain) relative to high incomes (loss). Expect immediate 10-15% annualized increase in business investment in machinery and equipment.

- A study in British Columbia estimated gains over ten years of $11.5B in capital investment and 113,000 jobs. The marginal effective tax rate on capital for large businesses will drop from 29.5% to 21.5%--and be more than halved for small business (to 9%)

Some Concluding Observations

- Canadian experience with a dual VAT regime has been successful and is economically superior to retail sales tax regimes. Proves an invoice-credit destination-based VAT can work at the sub-national level
- Both the HST and the QST models function well. A single national administration has compliance cost advantages, but devolved administration can work, perhaps especially with only one opt out. Intergovernmental cooperation is essential.
- The dual system preserves provincial autonomy over rates, but depends heavily on a shared base, with limited special rebates etc.
- Federal involvement is critical. For establishing the base. For border collection. And for facilitating provinces taxing their own residents effectively given extensive inter-provincial trade.

Acknowledgements

- This presentation drew substantially on the paper "Sales Taxes in Canada: The GST-HST-QST-RST 'System'" by Richard M. Bird and Pierre-Pascal Gendron. The two tables are taken from this article which can be found at http://ssrn.com/abstract=1413333

- Slides 2-6, with the colour graphics, were prepared by David Peloquin who works within the Government of Canada's Policy Research Initiative and has been generous in permitting me to use these and other slides on occasion.

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