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A more sustainable tax system:
the role of indirect taxation

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Outline

- Characteristics of indirect taxes
- Sustainability and threats to sustainability
- Design of indirect taxes
- (Equivalence of destination-based cash flow tax and value added taxation)

Indirect taxes

- Indirect: Paid on anonymous transactions
- Uniform or differentiated value added tax
 - chain of production and distribution
- No tax on input of produced goods
- Exemptions and zero-rating
- Remittance and incidence

- Excise taxes

Magnitudes

- VAT in more than 160 countries
- VAT in many countries around 20% of tax revenue
- Taxes on goods and services around 30%
- Increasing trend worldwide
- Recommended by the OECD

Desirable VAT design

- Neutral tax for efficient use of resources
 - all commodities taxed at the same rate
 - with certain qualifications
- Favouring some discriminates others
 - reallocation may be desirable
- Administratively costly to have different tax rates (for businesses and tax collectors)

Threats to sustainability

Erosion of tax bases/tax revenue

- International mobility erosion
- Lobbying erosion
- Evasion/avoidance erosion
- Tax rate erosion

International mobility, avoidance

- Mobility of capital and business taxes
- Statutory corporate tax rate in the OECD from 32% in 2000 to 24 % in 2018
- Race to the bottom?
- Corporate taxation still a significant source of revenue
- Effective tax rate, breadth of tax base, level of corporate income

International mobility

- General consumption is a fairly immobile tax base
- Tourism
- Cross-border shopping

Avoidance/evasion

- Services evading income tax and VAT
- False claims
- Misclassification of goods
- Zero-rating of exports

Extent

- Built-in mechanism (sequence of invoices)
- Losses 10% of net VAT receipts in some EU countries
- Nygård, Slemrod, Thoresen.
Collusive tax evasion in Norway
VAT loss NOK 4 billion – revenue 310 billion
- No worse than other taxes

Lobbying erosion

- Unfair
- Unproductive
- Uniform taxation as a principle is a bulwark against lobbying erosion
- Sørensen, P.B. 2007. The theory of optimal taxation: what is the policy relevance?
International Tax and Public Finance 14

Tax rate erosion

- Laffer (Dupuit) curve
- Narrow tax bases
- Substitution towards low-taxed/subsidised commodities
 - electric cars in Norway
eroding vehicle taxation

The role(s) of indirect taxation

- The purpose of VAT is to raise revenue – not to be burdened with many other objectives
- Environmental taxes – carrots vs sticks
- Other concerns and targeted instruments

Differential VAT rates

Zero, exemptions and reduced rates

- Food
- Accommodation
- Restaurants
- Transport
- Newspapers
- Cultural activities

The role models: Denmark and New Zealand

Nordic differences

- Restaurants: reduced rate in Sweden and Finland
- Newspapers: Zero in Norway and Denmark, reduced rate elsewhere
- Cinemas: Standard rate in Sweden and Denmark, reduced rate elsewhere
- Electric cars: Zero only in Norway

Typical arguments

Accurate targeting and efficiency

- Distribution
- Jobs

Further arguments

- Negative externalities
- Positive externalities

Further arguments

- Tourism
- Crossborder shopping

- Cross-border shopping 15 billion,
- Price elasticity of domestic sales $-0,004$
- Price elasticity of consumption $-0,0025$
- Increase VAT rate from 0,15 to 0,25
- If 9% price increase
- Additional cross-border purchases 2 billion
- Quantity $2/0.7=3$ billion
- Efficiency loss $3 \times 0,2 \times 1000 \text{million} = 600 \text{million}$

- With 2/3 shifting. Efficiency loss 400 million
- Additional revenue 14600 million
- Relative efficiency loss 2.7 – 4.1 %

Upper bound but only illustration

Destination based cash flow tax

- Auerbach, Devereux, Keen,..
- Huge international mobility
- Makes little economic sense to ask where an enterprise makes its profits
- Distortions at many margins
- DBCFT removes many of those
- Tax on (pure) profits

Equivalence with VAT

- DBCFT equivalent with VAT and corresponding reduction in taxes on wages
- VAT is a tax on wages and profits
- Removing the wage part yields a tax on profits

More on equivalence

- Tax rate 20%
- Labour cost 60
- Other cost 40
- Sales 150
- DBCFT tax base 50
- DBCFT 10
- VAT tax base 110
- VAT 22
- Relief labor cost -12
- Net tax 10

Questions

- Do we want to leave the normal return untaxed?
- Should the tax on the normal return be a personal tax?

Summary

- Consumption is a sustainable tax base
- Should be a major source of revenue
- VAT rates should be (close to) uniform
 - yields neutrality, good for sustainability (less administrative cost, evasion, and lobbying)
- Use excises for environmental policy