

WEBINAR NO. 6: VAT AND SECTORAL POLICIES

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Questions and Answers

Disclaimer: The technical answers reflect views of IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management. They should not be viewed as technical advice or recommendation, as appropriate responses will be country specific.

1. Are the VAT distributional considerations different in low-income low-capacity environment?

A detailed discussion of distributional considerations can be found in the materials of the [3rd Webinar](#) in this series. Of particular interest is the [panel discussion as well as question #6](#) raised during that session.

As mentioned by Sebastian James during that seminar, the VAT tends to be unpopular owing to the perception that, compared to the rich, the poor may pay more tax as a share of annual income.¹ Moreover, it is important to note that the most effective way of supporting the poor is through social spending programs, and governments need sufficient revenues from taxation to finance these programs. In developing countries, roughly two thirds of tax revenues come from levies on consumption on average – mostly through VAT. Hence, given the prominence of VAT revenues in the overall tax take, the VAT can be a useful tool to raise revenues effectively, notably in the absence of special regimes—like those arising from sectoral policies. Finally, setting an appropriate VAT registration threshold can also strengthen the progressivity of the VAT in developing countries, because the poorest often buy their goods from small traders.²

2. Is the reverse charge effective in mitigating missing trader fraud? Are there other solutions that could be used to address the problem?

The use of 'reverse charging' for business-to-business transactions places the VAT liability on the recipient, rather than the supplier. In effect, the recipient is liable to account for VAT (and therefore able to credit their liability to the extent that it uses the goods or services in making taxable supplies) thereby limiting the opportunity for suppliers to collect VAT and go missing. To combat missing

¹ Yet, if the tax burden is measured as a share of total expenditures—which is arguably a better indicator of economic wellbeing—consumption taxes are often found to be proportional, or even slightly progressive. See [IMF \(2020\)](#).

² Bachas, P., Gadenne, L., & Jensen, A. (2020). Informality, Consumption Taxes, and Redistribution (No. w27429). National Bureau of Economic Research.

trader fraud, some countries use reverse charge mechanisms in the construction sector, and in respect of goods that are often used in missing trader schemes such as high-value and low-weight computer chips and mobile phones. Other strategies used to address missing-trader fraud include enhanced scrutiny and validation of new registrants, cross-border cooperation, and imposing joint liability on traders involved in schemes where they knew or ought to have known that their purchases were connected to VAT fraud.³

3. What are the sources of information used for data matching in the tourism sector?

Data matching in a tax administration is commonly undertaken to detect potential non-compliance. For example, comparing revenue amounts reported by an entity for VAT and income tax purposes could identify under-reporting of sales. In the tourism sector, some countries may rely on bank deposits to validate reported revenues or obtain third-party data from credit card companies, or large suppliers. Using risk engines that are capable of matching and analyzing data from multiple sources will yield the best results. Furthermore, in addition to detecting issues, data matching increases confidence in a tax administration's credibility to detect and mitigate non-compliance.

4. Should there be different registration thresholds for different sectors? Should there be voluntary registration?

An ideal VAT system has a broad base and a single rate of tax with careful setting of a single registration threshold for all sectors. Exceptions to the base, rate, and registration are generally viewed as complexities that will increase compliance challenges and potentially decrease voluntary compliance. Varying thresholds depending on industry would bring small businesses into the VAT net differently which could also increase their compliance burden disproportionately. Small businesses engaged in the supply of taxable goods and services that are below the registration threshold have the option of voluntary registration in many countries. While registration will require them to collect and remit VAT on their taxable supplies, it also entitles them to input tax credits which they may see as a benefit.

5. If differential treatment across sectors is unavoidable, what are the rate structure and base broadening policies that maximize VAT revenue collection?

If sectoral special regimes are unavoidable, they should be rationalized and limited to a few well-defined goods (for instance, margin-based financial services, health care and sometimes basic foodstuffs). The latter would allow the VAT to raise revenue effectively with minimal costs, as the tax is ultimately only levied on final consumption.

³ For more information, refer to IMF Working Paper "VAT Fraud and Evasion: What Do We Know, and What Can be Done? Michael Keen and Stephen Smith, 2007.

Regarding the rate structure, reduced VAT rates generate important costs in terms of forgone revenues, economic distortions, and higher administrative and compliance burdens. For example, while the average standard statutory rate across the world is around 15 percent, in effective terms it is lower, because countries apply reduced VAT rates (including zero) to some goods/services.

In terms of the base, rationalizing special regimes is key to encourage voluntary tax compliance, since each business has an incentive to register and claim tax credits on their inputs. By contrast, VAT exemptions narrow the base and undermine the self-enforcing nature of the tax while causing production distortions. Yet, it is also important to set an appropriate VAT registration threshold. Exempting small traders from VAT registration, such as those in the agriculture sector, reduces compliance costs, and allows the tax administration to focus on large traders.

6. How can we capture the VAT on services bought online such as in tourism sector?

With progress in digitalization, countries are seeking to ensure that transactions are subject to the same VAT rules as when the goods or services are supplied in traditional settings. The tourism sector is particularly engaged in online transactions with large platforms enabling the supply of goods and services internationally. In many countries, when supplies are made online, the digital platform is liable for collecting and remitting the VAT made through the platform to the taxing jurisdiction. This approach may be particularly helpful for countries where administrative capacity is more limited.

[Webinar 5: VAT and Digital Economy](#) and our Technical Note on [Administering the Value-Added Tax on Imported Digital Services and Low-Value Imported Goods](#) explored this topic in more detail.