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Indirect Tax Alert

Consumption Tax Trends 2014 – OECD reports published

The OECD now published the 10th edition of the Consumption Tax Trends Report. The report shows the evolution of consumption tax revenues between 1965 and 2012 and looks in more detail at the main features of VAT regimes in OECD countries, the impact of reduced VAT rates and the main features of excise duties and vehicle taxes and their impact.

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The shift from direct to indirect taxes continues

164 countries now operate a VAT

The OECD confirms the tax landscape is shifting away from allegedly more distorting taxes on labour and corporate income towards what are considered by many to be more ‘growth friendly’ sources of revenue, like consumption taxes and property taxes. VAT is an important source of revenue for OECD countries, representing on average approximately 20% of total tax revenues compared to 11.9% in 1965.

Almost all countries now levy general consumption taxes. In the vast majority this tax is a VAT; a minority applies retail sales taxes. With the exception of the U.S., where resale sales taxes are levied at sub-national level, all OECD countries levy VAT (a list of all 164 countries operating a VAT is included in the annexes to the report). And yet, even in the U.S. the discussion on a U.S. VAT has recently been reintroduced. On 12 December Senate Finance Committee member Benjamin L. Cardin released the Progressive Consumption Tax Act (PCTA) bill: rather than taxing income, it is proposed the Progressive Consumption Tax would generate revenue by taxing the purchase of goods and services. For now the bill is just to be considered as a discussion document; no effective implementation is expected any time soon.

Increase in standard VAT rates

The OECD highlights the strong increase in standard VAT rates. In January 2014 the OECD countries have an average standard VAT rate of 19.1%, up from 17.6% in January 2009. With an average of 21.7% the 21 OECD countries that are members of the European Union average is significantly above the OECD’s average. The OECD states that the rate increase has managed to largely compensate the decline in consumption tax revenue as a consequence of the global economic crisis.

Limited base-broadening measures

While most OECD countries have increased their standard VAT rates, only a few have taken measures to broaden their VAT base. Many OECD countries continue to use reduced VAT rates and exemptions mainly for equity and social objectives. Although reduced rates were changed in five OECD countries, no country has abolished their reduced VAT rate(s). The OECD report Distributional Effects of Consumption Taxes in OECD Countries however shows that many of the reduced VAT rates might actually benefit higher income households more than lower income households. According to the OECD, in certain circumstances a more effective way to achieve distributional objectives may be to compensate low-income households directly through the social or benefit systems rather than through than VAT system.

Potential for additional VAT revenue

According to the OECD, broadening the tax base and improving VAT systems' performance would allow to raise considerable additional revenues. Across the OECD it is estimated that 45% of the potential VAT revenue is not collected. The 45% gap represents the difference between the VAT revenue collected and what would theoretically be raised if VAT was applied at the standard rate to the entire potential tax base in a 'pure' VAT regime, that is a VAT system without any exemptions and reduced rates and free from fraud, evasion and tax planning.

Revenues from excise duties remain rather stable

The revenue from excise (i.e. excise duties on tobacco, alcoholic beverages and mineral oils) in OECD countries has been relatively stable over the past 20 years, representing about 8% of total tax revenue in 2011 compared to 14.2%in 1965. A list of excise tax rates in OECD countries is published in the annexes to the report.

Taxation of vehicles to influence consumer behaviour

Taxes on vehicles were introduced in most OECD countries in the first half of the 20th century. For more than 15 years these taxes have been adapted to influence consumer behavior, nowadays mainly to achieve environmental objectives. In 2014, 27 out of 34 OECD member countries have been applying lower taxes or exemptions on purchase or annual registration charges according to environmental or fuel efficiency criteria. Among these 21 have based purchase or annual registration taxes directly on polluting emissions and 19 have tax rebates or exemptions for electric or hybrid vehicles.

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