

Highlights of [GAO-11-867T](#), a testimony before the House Committee on Ways and Means

Why GAO Did This Study

Dissatisfaction with the federal tax system has led to a debate about U.S. tax reform, including proposals for a national consumption tax. One type of proposed consumption tax is a value-added tax (VAT), widely used around the world. A VAT is levied on the difference between a business's sales and its purchases of goods and services. Typically, a business calculates the tax due on its sales, subtracts a credit for taxes paid on its purchases, and remits the difference to the government. While the economic and distributional effects of a U.S. VAT type tax have been studied, GAO issued a report in 2008 that looked at lessons learned from VAT administration in Australia, Canada, France, New Zealand, and the United Kingdom. These countries provided a range of VAT designs from relatively simple to more complex.

This statement, which is based on the 2008 report, focuses on (1) the effect VAT design choices, such as exemptions and enforcement mechanisms, have on compliance, administrative costs, and compliance burden; (2) Canada's experience with administering a VAT in conjunction with several different subnational consumption tax arrangements; and (3) the experience that some countries had transitioning to a VAT.

View [GAO-11-867T](#) or key components. For more information, contact Jim White at (202) 512-9110 or whitej@gao.gov.

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VALUE-ADDED TAXES

Potential Lessons for the United States from Other Countries' Experiences

What GAO Found

VATs have grown in popularity over the past five decades with recent estimates showing more than 130 countries worldwide using a VAT. Nonetheless, like other tax systems, even a simple VAT—one that exempts no goods or services—has compliance risks and, largely as a consequence, generates administrative costs and compliance burden. For example, all of the study countries reported devoting significant enforcement resources to compliance issues. Like an income tax, VATs can be vulnerable to compliance schemes that either result in undercollection of taxes due or overclaiming of credits for taxes paid. Also, as with other taxes, adding tax preferences—such as exempting certain goods or services from tax—generally decreases revenue, increases complexity, and increases compliance risks. Increased complexity also increases the record-keeping burden on businesses and government resources needed for enforcement.

Major Types of Compliance Risks for a VAT

Undercollection of tax due on sales		Overclaiming of tax paid on inputs	
Missing-trader fraud	A business is created for purposes of collecting VAT on sales and disappears without remitting VAT to the government.	Fraudulent refunds	A business or fraudster submits false returns requesting VAT refunds from the government.
Failed businesses	A business fails or goes bankrupt before remitting VAT collected to the government.	Misclassifying purchases	A business falsely claims input tax credits by misclassifying personal consumption expenses as business expenses.
Underreporting cash transactions	A business either charges a lower, VAT-free price for cash transactions or underreports cash sales and retains VAT collected.	Fictitious or altered invoices	A business creates or alters invoices to inflate the amount of input tax credits it can claim.
Import fraud	A business or individual imports items for personal consumption and undervalues them for VAT purposes.	Export fraud	A business creates fraudulent export invoices for goods that are not exported to claim input tax credits.

Source: GAO.

Canada's experience administering a national VAT along with a variety of provincial VATs and sales taxes demonstrates that multiple arrangements in a federal system are feasible, but increase administrative costs and compliance challenges for both governments and businesses. Businesses, particularly retailers, in provinces with a sales tax face greater compliance burdens than those in other provinces because they are subject to dual reporting, filing, and remittance requirements.

When implementing their VAT, Australia, Canada, and New Zealand all devoted considerable resources to educate and assist businesses subject to the new tax. Both Australia and Canada provided direct monetary assistance to qualifying small businesses to help meet new bookkeeping and reporting requirements. Both had trouble getting businesses to register for the VAT by the implementation date.