VALUE ADDED TAX: A COMPARATIVE APPROACH, SECOND EDITION

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I. INTRODUCTION

The Value Added Tax: A Comparative Approach, second edition, continues, updates, and expands a long-standing effort by Schenk and co-authors to present a comparative approach to value added tax (VAT) law in a single volume. This colossal work began with the first edition of the book authored by Schenk and Oldman (2007). This revised magnum opus (the hardcover edition is 560 pages) is ambitious in its blending of legal, economic, and administrative considerations in the course of its comparative analysis of the law. The authors’ approach is not merely theoretical as they review and discuss key VAT cases to illustrate issues.

This book fills a pressing need for consistent, centralized and thematically-organized documentation of VAT cases. The volume of VAT case law has grown so much in recent years that a new peer-reviewed journal has been created whose principal mandate is to analyze legal developments and case law in the area of VAT. A sample contribution therein includes the review of a similar book by Gendron (2013). Of course, the present book does much more than review cases. It discusses VAT starting with the basic principles of consumption taxes and variants of VAT, passing through important administrative considerations, and covering major design issues and difficulties. Interestingly and unexpectedly, the book features a full chapter on Chinese VAT near the end. Simple numerical examples are included in the text to illustrate some of the concepts and mechanics.

The book jacket states that the “book will be an invaluable resource for tax practitioners and government officials.” The authors (or the publisher) are underselling their work here. Based on my experience with the first edition, it seems to me that the book will
also be very useful to VAT scholars who specialize in law, economics, and accounting. The book will also be of assistance to academics, consultants, and government officials with an interest in VAT administration and policy. It will also serve as an invaluable reference to tax directors in the private sector and the non-profit sector. Finally, those of us who teach VAT will find much to use in the book just as we did in the first edition. The book covers areas (e.g., administration, China) which have received few detailed treatments elsewhere. This enhances its value as a teaching tool. Section II will return to this point. The casual reader will treat The Value Added Tax: A Comparative Approach, second edition, as a near-comprehensive reference book and read selectively as needed. The VAT scholar or teacher will find it fruitful to get acquainted with the whole book, even though by design it is not exhaustive in its coverage of the literature. Both casual readers and scholars will benefit from the book in expanding their horizons and identifying avenues and references for further research.

The remainder of this review will provide a summary of each chapter and identify the main themes and challenges, and promising areas for further research. A brief assessment will follow. Finally, I will identify what I consider to be important but unstated lessons from the book.

II. CONTENT AND TOOLS

A. The Chapters

The book contains 15 chapters, including an introduction. Chapters do not appear to be grouped according to a systematic logic. Given the considerable length of the book, it is helpful to group chapters following a functional classification of chapters by subject. Table 1 shows my attempt to do this.

The following description of the chapters is organized along the functional groups laid out in the table. Discussion of cases is deferred until Section B.

1. Consumption Taxes

Chapters 1–3 discuss consumption taxes in general terms. The introduction (Chapter 1) serves as a substantive chapter, not merely an entry point into the book. It presents a brief history of consumption taxes and explains the distinction between direct and indirect taxes and income and consumption bases. It introduces the VAT and presents a very useful glossary of VAT terms.

Chapter 2 continues the discussion of consumption taxes by distinguishing single- and multi-stage sales taxes. The discussion of the methods to calculate VAT liability forms a central part of this chapter and is illustrated by clear numerical examples for different types of VAT (credit-invoice, credit-subtraction without invoices, sales-subtraction, and addition-method). It then provides a brief overview of the most common methods to alter the effective VAT base: exemptions, zero rating, and denial of VAT credits. Multiple rates are also briefly mentioned.
Chapter 3 turns to real-world VAT models. The discussion expands on the following models: European Union (hereinafter “EU”) VAT, Japanese Consumption Tax, and New Zealand Goods and Services Tax. Those models receive much attention throughout the book. The authors mention the Australian and Canadian GST, as well as the South African VAT, from time to time.

2. Tax Base Issues

The real meat of VAT is addressed in Chapters 9 and 11–13, where exclusions from the base and difficult bases are discussed at length. Chapter 9 presents a lengthy discussion of zero-rated and exempt sales and contrasts those two very different methods of excluding supplies or entities from the VAT base. It discusses the difficulties with mixed supplies and bundling of supplies. It provides a detailed discussion of the issues facing government entities and non-profit organizations and the reasons for the commonly observed exemptions of the associated supplies or entities, as well as exemptions granted to diplomats and international organizations.

Chapter 11 discusses the main issues that arise in taxing gambling and financial services (other than insurance). The authors focus the discussion on financial services...
and provide a good discussion of the administrative problems and technical difficulties that are used to justify the mainly exempt treatment of financial services, especially margin-based services. The economic distortions caused by the exemption are described as well. Another important part of this chapter is the discussion of the various methods and schemes that have been used to mitigate the impact of broad exemptions, including those in use in the EU, South Africa, New Zealand, Australia, and Singapore. The chapter also describes the methods that have been proposed to apply VAT on a transactional basis to margin-based financial services.

Chapter 12 shifts the focus on insurance. Of course, the picture is neater than in Chapter 11, since it is straightforward in principle to apply VAT on non-life insurance as demonstrated by the New Zealand VAT. Life insurance remains exempt for reasons similar to those exposed in Chapter 11: it is difficult to extract the value added from implicit margins related to the savings component of life insurance on a transactional basis.

Chapter 13 discusses the many possible treatments of real (immoveable) property under VAT. It also underscores the difficulty that the long economic life of real property poses for the proper application of VAT. The authors mention the complex VAT rules are needed to address special situations (change of use, mixed use, leases, and terminations) surrounding supplies of real property. They close the chapter by presenting proposals for the taxation of real property.

3. Trade and Interjurisdictional Issues

Chapters 7 and 15 address trade and interjurisdictional issues. Chapter 7 discusses the critical issues of tax jurisdiction (where does the VAT end?), place of supply rules under the destination principle, and special issues that arise with trade in services and intangibles. The authors describe the EU’s recently revised VAT rules on services. In addition, they briefly describe the special VAT treatment of certain cross-border services such as telecommunications and electronically supplied services, e-commerce, and international transportation.

Chapter 15 turns to the thorny problems that arise when VAT applies in markets without border controls (EU) or in countries where central (or federal) and subnational VATs coexist, such as Canada, Brazil, and India. The authors present the main competing models that have been proposed to address the weaknesses of destination-based VAT in the presence of cross-border trade: origin VAT, dual VAT, and the little boat (loosely referred to as the compensating VAT) model.

4. Operation and Collection

Chapters 4–6 and 8 examine in detail the operational features that are essential for the proper functioning of a credit-invoice VAT, by far the dominant model worldwide. Collection is understood here as the combination of activities undertaken by taxpayers to comply with their obligations and those undertaken by tax administrations to ensure
that the correct amount of tax is remitted. It would be a grave mistake to view those functions as merely administrative in nature. In practice, VAT stands or falls based on the quality of the work performed by tax administrations.

Chapter 4 describes the absolutely critical aspects of business registration: registration and threshold, determination of who is a taxpayer (many prefer to use registrant because it is less open to misinterpretation), and determination of whether taxable activity takes place. The authors discuss the numerous special rules that are needed to support those activities.

Chapter 5 turns to the equally important notion of supply of goods and services for VAT purposes. The VAT invoice, the central piece of documentary evidence in VAT, is also discussed. The authors address the distinction between goods and services as well as the various deeming rules needed to treat special transactions and situations. Those include, for example, mixed and composite supplies.

Chapter 6 provides a lengthy discussion of the no less important tax credit mechanism. Leaving aside the merits of taxing consumption (a separate discussion), the tax credit mechanism constitutes the main economic attraction of VAT as it is used to relieve registrants (usually businesses) of VAT paid on business inputs, including capital goods. Again, the operation of the mechanism requires numerous rules to work well in practice. The authors describe the conditions registrants must meet in order to claim credits as well as situations where credits would be disallowed and the special rules required. The thorny issues of pre-opening expenses and post-mortem economic activity are also discussed. Finally, the authors discuss the allocation of input VAT between taxable and exempt activities, and the treatment of excess input credits (including refunds). Allocations and refunds are problematical for VAT administrations, with refunds being the more difficult problem to handle as they usually involve resources outside the VAT system (e.g., funds from the Treasury) and a high risk of fraud.

Finally, Chapter 8 describes the various rules for the timing and valuations of transactions for VAT purposes, including the accounting methods that can be used. Special rules for certain supplies or transactions (e.g., installment and deferred payment sales, price adjustments, imports, self-supplies) are described.

5. Difficulties and Special Topics

Chapters 10 and 14 do not really fit in the spirit of the book but they are nonetheless worthwhile and, in the case of Chapter 14, extremely valuable. Chapter 10 provides a relatively brief discussion of VAT evasion and avoidance, including a mention of carousel fraud, a much-discussed problem in the EU.

Chapter 14, humorously entitled “An Anatomy of the Chinese VAT,” is a very different proposition. To my knowledge, this represents the only available full article length treatment of the Chinese VAT in English. The authors discuss major issues such as the coexistence of two complementary taxes (the VAT and the Business Tax, a turnover tax on services) and the transition from that regime to the VAT. They also
discuss key issues with the treatment of small businesses, and restrictions on input credits and refunds and associated incentive schemes. Finally, they describe the Golden Tax Project, a major information technology project to administer VAT, and they comment on challenges facing the expansion of VAT in China.

B. Cases and Reference Tools

The authors list a total of 172 VAT cases in the book, of which 39 are given a textual treatment. The latter are easy to find quickly as they are printed on a shaded background. In addition, all chapters except two end with discussion questions which facilitate the use of the text or individual chapters for teaching. The book features a total of 29 tables and charts.

Reference tools included at the beginning of the book include: a detailed table of contents (11 pages), a list of tables and charts (two pages), a list of cases (eight pages), and a preface to the second edition (one page). Tools included at the end include an appendix on VAT worldwide with country, date introduced, and standard rate (five pages), and an index (seven pages). As is standard with this type of book, all in-chapter referencing is footnote-based with chapter-specific numbering.

III. ASSESSMENT

My assessment of the book is brief and is based on the assumption that most users will treat it as a reference material as opposed to a book to read from cover to cover (which I did). The core strength of the book comes from the presence of VAT cases and case discussions to illustrate the concepts and issues presented in the text. The authors have consolidated a colossal amount of research to do this. The list of cases would have been even more useful had the authors added a chapter reference in the column next to the page reference. That way, readers would have known the distribution of cases by subject. It would also have been helpful to insert a short table of contents with chapter names before the detailed table of contents and to rearrange the sequence of chapters to achieve a thematic grouping (something Table 1 above does rather crudely). Furthermore, the index is relatively short for a book of this size. On the other hand, the presence of tables and charts provides a nice change from what is a dense text.

The strong emphasis on cases and legal and administrative considerations positions the book as a highly valuable complement to other full-length policy-oriented VAT texts such as Bird and Gendron (2011 [2007]). Incidentally, both books were first published at the same time so many readers will already be aware of this duality. Moreover, the changes from the first and second edition of Schenk et al. are very significant in terms of content and sequencing so owners of the first edition should hang on to their copy.

This reader has a few minor quibbles with the contents aside from cases and case references. First, the comparative analysis leans rather heavily on EU VAT. Although the authors devote a fair amount of discussion to the GST in New Zealand and Australia, some key modern VATs such as the GST in Canada and the VAT in South Africa are not
discussed enough in my opinion. More attention to those systems and perhaps others (e.g., Singapore) would have added balance to the text.

Second, some important topics are given a cursory treatment, while a few are not discussed at all. Exclusions from the base, using both exemptions and non-export zero rating, and reduced rates create deeper problems than the authors suggest. These concessions introduce the possibility of disputes between registrants and tax administrations on the classification of goods and services in different tax treatment classes. They also increase the complexity of the VAT law and regulations and increase the administrative effort required to apply the law. In addition, existing concessions create demands to extend preferential treatment to more goods and services. Experience in the field shows that those problems are widespread in practice.

The case of charities, which should have been part of Chapter 9, did not receive the attention it deserves. Charities are almost always exempt but are often subject to a host of special rules for registration, the treatment of grants, and so on. They also sometimes benefit from preferential policies such as the refund of input VAT, a high risk policy given the existence of large numbers of small charitable organizations in many countries and the resulting potential for fraud.

Other tax base issues deserved more discussion. Chapter 11 could have been expanded following the highly readable chapter on gambling and lotteries by Schenk (2008) and adding more discussion of the challenges of applying VAT to life insurance. The taxation of unimproved land is a controversial issue that was not discussed at all but should have been part of Chapter 13.

Some recent literature on thorny cross-border trade issues in the EU VAT was missing from the footnotes. One example is the important paper by Lamensch (2012) on the treatment of digital supplies. This is surprising given EU-wide concerns about the ability of VAT to tax imported services and intangibles. The search for solutions has focused on tools rooted in information technology but radical and destructive ideas such as generalized reverse charges have also been explored by academics and think tanks.

The discussion of fraud is rather cursory given the worries (for good or bad reasons) about VAT fraud, especially in the EU. Missing trader (or carousel) fraud is the most prominent but by no means the only form of VAT fraud, as shown Keen and Smith (2006) in their classic (but uncited) paper on VAT and sales tax fraud. Most writing on the subject, including this book, fails to put VAT fraud in perspective by exploring poor design as a facilitating factor and comparing it to income tax fraud, for example.

On the legal side, it would have been extremely helpful to see a chapter on best and worst practices in VAT law design and drafting. Appendix B of the first edition attempted this indirectly and by brute force by listing the numerous section headings and sub-headings that should be part of a VAT law. Experience in the field shows that poor and incomplete drafting remains a problem in many countries, especially developing ones. There should also have been a discussion of the trend in some countries to codify tax administration more precisely outside the VAT and other tax laws to support the administration. A good example of this trend is illustrated by the Republic of South Africa, *Tax Administration Act No. 28 of 2011*, as amended.
Of course, wishing for a comprehensive and self-contained treatment of all the substantive issues in VAT would have meant a volume of about 1,000 pages, an unreadable epic of Wagnerian proportions. We are lucky the authors did not try.

IV. UNSTATED LESSONS

The style, structure and intent of *Value Added Tax: A Comparative Approach* means that the book does not lend itself to easy in-text summarizing or perspective-taking. It would have been difficult for the authors to write a concluding chapter for a book with such a wide scope. This concluding section provides my own distillation of the key lessons from the book.

First, bad tax policy and design inevitably create economic distortions, increase collection costs, necessitate complex law and regulations, and lead to very expensive and time consuming litigation. In some cases, the litigation revolves around arcane definitions. In many others, disputes could have been avoided altogether if policy had emphasized neutrality of treatment, one of the great strengths of the VAT in theory. The authors eloquently demonstrate both possibilities through their review of EU VAT cases. Particularly troublesome areas for litigation include exemptions, financial services, public bodies (government, non-profit organizations and charities), and real property. In the EU VAT, as well as many others, those happen to be areas where exemptions are the most pervasive. The very low or non-existent VAT thresholds in the EU should be added to the set of bad policies although they are not as important for litigation. Rather, low thresholds increase collection costs and place a disproportionate compliance burden on small businesses without producing much extra revenue.

Second, bad tax policy targeting also leads to complex law, administrative difficulties, ineffectual policies, and absurd results. Good examples include domestically-consumed foodstuffs taxed at the zero rate or at a reduced VAT rate in several EU and non-EU countries. Such policies tend to benefit middle to high income households more in absolute terms as they consume more. Direct expenditures can target benefits far better in this case. In addition, those policies forego significant revenue, which must partly be recouped using high standard VAT rates in many EU countries. Gendron (2012) shows that VAT tax expenditures are expensive and work very poorly in delivering social benefits because the VAT cannot properly target benefits.

Finally, leaving tax policy to be, in effect, determined by courts can lead to odd results that stray far from legislative intent. It is also the most expensive way of making tax policy. This problem is by no means confined to EU VAT although it appears to be especially pronounced in the EU. The book itself contains only a small sampling of the actual volume of VAT litigation, which is enormous worldwide. Again, the problems come not from VAT architecture, but from actual policy designs that deviate too far from what a VAT should be. We are fortunate that later entrants on the VAT scene (New Zealand, 1986; Canada, 1991; South Africa, 1991, Singapore, 1994; Australia, 2000) have made much progress in moving towards the ideal.
REFERENCES


