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GST in Select Countries of the World: Lessons for India

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ABSTRACT

With the impending GST law in India, this paper examines the functioning of GST in certain select countries of the world such as Canada, Australia, Malaysia, New Zealand and Singapore. The experience of other countries have shown that exempting or reducing GST on certain items did not mean that tax savings would be passed on to consumers. Therefore, the GST should be kept broad-based to keep the GST low and the GST system simple, while help is directly provided to the lower-income through transfers and subsidies. Critics have argued that the GST is a regressive tax, which has a more pronounced effect on lower income earners, meaning that the tax consumes a higher proportion of their income, compared to those earning large incomes. However, due to the corresponding reductions in personal income taxes, state banking taxes, federal wholesale taxes and some fuel taxes that were implemented when the GST was introduced in some of these countries, it is claimed by some that people were effectively paying no extra tax.

Keywords: *Goods and Services tax (GST); Broad-based tax; Federal taxes.*

1.0 Introduction

With the GST law close to being implemented in India, India is now looking at a major indirect tax reform that will do away with the problems of multiplicity of taxes, complex tax structure, distortions, cascading effect and lack of tax compliance. GST is proposed to be a nationwide tax levied on supply of goods and services that will subsume all major central and state indirect taxes. This paper is an attempt to understand the functioning of GST in select countries of the world and derive lessons for India.

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1.1 Review of literature

Despite the increasing popularity and success of GST implementation around the world (Hooper & Smith, 1997), there is normally a need to convince citizens of a country with this new tax scheme. The proponents of GST contend that GST tax is necessary to reduce federal government deficit (McGowan & Billings, 1997). It is also believed that GST would be able to provide government with a constant flow of income, thus increasing government abilities to invest more in public services and improve economic stability. On the other hand, the opponents of GST argue that GST is difficult to implement and increased in tax revenue would only promote larger government spending (Bickley, 1989). In addition, GST would have profound impact to lower income group as opposed to higher incomes group (Hooper & Smith, 1997). Such contradictory views lead to misconceptions and hence raise the need to increase awareness on what constitute GST. One of the fundamental ways to increase public awareness is through knowledge (Mohani, 2003). Tan & Chin-Fatt (2000) assert that tax knowledge can be imparted through general understanding of the tax regulations. Knowledge provide the taxpayers with the ability to comprehend the need for a new tax reform and this would eventually promote compliance (Singh, 2003).

Bird (2012) cites the Canadian experience of GST and demonstrates that an invoice-credit, destination-based value-added tax (VAT) is workable at the subnational level, with both federal and provincial governments retaining full control over the rates of their sales taxes as well as retaining a good degree of policy freedom with respect to the base of the tax. James (2010) details the history of VAT reform in Australia, Canada and the United States over a period of four decades, 1965-2005, where the global uptake of the VAT was at its highest, but where VAT reform in each jurisdiction was highly controversial. The analysis suggests that while consumption tax reform in Australia, Canada and the United States was highly controversial, these controversies were the product of different political and economic factors, which pull in competing directions towards convergence and divergence in tax reform outcomes. The Article concludes with an assessment of the factors that contribute towards tax policy convergence and localised resistance.

2.0 GST in Canada

GST was introduced in Canada on January 1, 1991. It replaced a hidden 13.5 percent manufacturers' sales tax (MST) because the MST was hindering the manufacturing sector's ability to export competitively. The introduction of the GST was very controversial. The GST rate is 5 percent, effective January 1, 2008.

GST is levied on supplies of goods or services purchased in Canada and includes most products, except certain politically sensitive essentials such as groceries, residential rent, and medical services, and services such as financial services. Businesses that purchase goods and services that are consumed, used or supplied in the course of their "commercial activities" can claim "input tax credits" subject to prescribed documentation requirements. This avoids "cascading" (i.e. the application of the GST on the same good or service several times as it passes from business to business on its way to the final consumer). In this way, the tax is essentially borne by the final consumer. This system is not completely effective, as shown by criminals who defrauded the system by claiming GST input credits for non-existent sales by a fictional company. Exported goods are exempt ("zero-rated"), while individuals with low incomes can receive a GST rebate calculated in conjunction with their income tax.

In 1997, the provinces of Nova Scotia, New Brunswick and Newfoundland (now Newfoundland and Labrador) and the Government of Canada merged their respective sales taxes into the harmonized sales tax (HST). In New Brunswick, and Newfoundland and Labrador, the current HST rate is 13 percent, while in Nova Scotia it was raised from 13 percent to 15 percent, effective July 1, 2010. HST is administered by the Canada Revenue Agency, with revenues divided among participating governments according to a formula. Ontario and British Columbia both harmonized the GST with their provincial sales tax (PST) effective July 1, 2010.

The three territories of Canada (Yukon, Northwest Territories and Nunavut) do not have territorial sales taxes. The government of Quebec administers both the federal GST and the provincial Quebec Sales Tax (QST). It is the only province to administer the federal tax. The tax is imposed at the rate of 5 percent on the supply of goods and services that are purchased in Canada, except certain items that are either "exempt" or "zero-rated":

For tax-exempt supplies, the supply is not subject to GST and suppliers do not charge tax on their exempt supplies. Furthermore, suppliers that make exempt supplies are not entitled to recover GST paid on inputs acquired for the purposes of making the exempt good or service. Tax-exempt items include long term residential rents, health and dental care, educational services, day-care services, music lessons, legal aid services, and financial services.

For tax-free (i.e. "zero-rated") sales, GST is charged by suppliers at a rate of 0 percent so effectively there is no GST collected. However, when a supplier makes a zero-rated supply, it is eligible to recover any GST paid on purchases used in producing the particular supply or service. This effectively removes the cascading tax from these particular goods and services. Common zero-rated items include basic groceries, prescription drugs, inward/outbound transportation and medical devices. Certain exports of goods and services are also zero-rated.

3.0 GST in Australia

GST in Australia is a value added tax of 10 percent on most goods and services sales. GST is levied on most transactions in the production process, but is refunded to all parties in the chain of production other than the final consumer. The tax was introduced on July 1, 2000, replacing the previous federal wholesale sales tax system and designed to phase out a number of various State and Territory Government taxes, duties and levies such as banking taxes and stamp duty.

All Australian businesses whose turnover is above the minimum threshold are required to register for GST. Businesses whose turnover is below the threshold may register if they wish to. A GST-registered business must charge its customers GST on taxable goods and services it provides, but is entitled to a credit for any GST it has paid for its expenditures on these goods and services as well as capital purchases (called input tax credits). A registered business must periodically lodge Business Activity Statements (monthly, quarterly or annually), and at the same time pay the net amount of GST owed to the tax office (if more GST is paid than collected, a refund is paid by the tax office instead).

Some goods and services (notably salaries, wages, fresh food, and real estate) are exempt from GST. Other goods and services (rental income and financial services) are "input-taxed", which means that GST is not charged on the sale, but GST paid by that part of the business is not eligible to be claimed as an input tax credit. GST is applicable to a supply of goods, services and transactions related to real property, obligations or rights. The supply must be for consideration to a relevant entity registered for GST in the course of enterprise. This does not include employment or hobby income.

Taxable supplies include goods wholly within Australia, from or to Australia or real property in Australia. Certain types of supplies are free of GST as, for example, fresh unprocessed food, medical services, education courses, childcare, exports, pre-owned real estate and going concerns. When an enterprise purchases goods or services to be consumed or used for resupply to an end customer they may receive a refund (input tax credit) on the amount of GST contained in the price, which means in effect no GST is paid on those supplies.

New residential and commercial properties are subject to GST but re-sale of existing properties is not. All real estate agent fees on either new or second-hand property are subject to GST. Processed foods such as biscuits, soft drinks, restaurant meals and take-away foods are also subject to GST.

Registered enterprises for GST must complete a Business Activity Statement (BAS) for reporting to the Australian Taxation Office (ATO) for each quarter ending March, June, September and December. Businesses must lodge their Statements with the ATO within twenty working days of the end of each quarter.

Critics have argued that the GST is a regressive tax, which has a more pronounced effect on lower income earners, meaning that the tax consumes a higher proportion of their income, compared to those earning large incomes. However, due to the corresponding reductions in personal income taxes, state banking taxes, federal wholesale taxes and some fuel taxes that were implemented when the GST was introduced, it is claimed by some that people were effectively paying no extra tax.

4.0 GST in Malaysia

GST is a value added tax in Malaysia. GST is levied on most transactions in the production process, but is refunded with exception of Blocked Input Tax, to all parties in the chain of production other than the final consumer. The existing standard rate for GST effective from 1 April 2015 is 6%. GST was scheduled to be implemented by the government during the third quarter of 2011, but the implementation was delayed until April 1, 2015. Its purpose is to replace the sales and service tax which has been used in the country for several decades. The government is seeking additional revenue to offset its budget deficit and reduce its dependence on revenue from Petronas, Malaysia's state-owned oil company. The 6% tax will replace a sales-and-service tax of between 5–15%.

The Goods and Services Tax Bill 2009 was tabled for its first reading at the Dewan Rakyat (the lower house of the Malaysian parliament) on December 16, 2009. It was delayed amid mounting criticism. The government responded by asserting that the tax on oil income will not be sustainable in the future.

During the government reading of the 2014 budget, Malaysian Prime Minister Najib Razak announced a GST tax of 6% starting on April 1, 2015. Implementing GST tax is a part of the Government’s tax reform program to enhance the capability, effectiveness and transparency of tax administration and management.

During the unveiling of the national budget, it was announced that the following goods and services would be exempted from GST:

- Agricultural products—paddy, fresh or chilled vegetables, certain provisionally preserved vegetables
- Essential foodstuff—oils, salt, flour, etc.

- Livestocks and livestock supplies or poultry—live animals and unprocessed meat
- Eggs
- Fish—live, fresh, frozen and dried
- First 300 kwh of electricity for domestic use
- Water for domestic users
- Goods supplied to designated areas from Malaysia—Labuan, Langkawi & Tioman
- Exported goods
- Exported services—such as architecture services in connection with land outside Malaysia
- Selected services in Malaysia—such as pilotage, salvage or towage services
- International services—such as transport of passengers or goods from a place in Malaysia to a place outside Malaysia
- RON95 petrol, diesel and LPG
- Sale of Residential Property
- Services provided by Government which are not considered commercial services, such as permits, licences etc. Services considered commercial are TV advertisement, rental of equipments, rental of multifunction halls etc.

5.0 GST in New Zealand

GST is a value added tax in New Zealand. GST in New Zealand is designed to be a broad based system with few exemptions. Exceptions that do exist include rents collected on residential rental properties, donations, precious metals and financial services. End-users pay this tax on all liable goods and services indirectly, in that the purchase price of goods and services includes GST.

The existing rate for GST effective from October 1, 2010 is 15 percent. GST was introduced by the Fourth Labour Government of New Zealand on October 1, 1986 at a rate of 10 percent on most goods and services. It replaced existing sales taxes for some goods and services. GST was a part of the economic reforms initiated by Labour Finance Minister Roger Douglas. GST was introduced in conjunction with compensating changes to personal income tax rates.

Since its introduction it has had two increases, on July 1, 1989 the rate increased to 12.5 percent and on October 1, 2010 it increased again to 15 percent. GST-registered organisations and individuals pay GST only on the difference between GST-liable sales and GST-liable supplies (i.e. they pay GST on the difference between what they sell and what they buy: income less expenditure). This is accomplished by reconciling GST received (through sales) and GST paid (through purchases) at regular periods (typically every two months, with some qualifying companies opting for one-month or six-month periods), then either paying the difference to the Inland Revenue (IRD) if the GST collected on sales is higher or receiving a refund from IRD if the GST paid on purchases is higher.

Businesses exporting goods and services from New Zealand are entitled to "zero-rate" their products: effectively, they charge GST at 0 percent. This permits the business to claim back the input GST, but the eventual, non-New Zealand based consumer does not pay the tax (businesses that produce GST-exempt supplies are not able to claim back input GST).

As businesses claim back their input GST, the GST inclusive price is usually irrelevant for business purchasing decisions, other than in relation to cash flow issues. Consequently, wholesalers often state prices exclusive of GST, but must collect the full, GST-inclusive price when they make the sale and account to the IRD for the GST so collected.

6.0 GST in Singapore

GST in Singapore is a broad-based value added tax levied on import of goods, as well as nearly all supplies of goods and services. The only exemptions are for the sales and leases of residential properties and most financial services. Export of goods and international services are zero-rated. Before 1986, Singapore's corporate income tax rate and top marginal personal income tax rate both stood at 40%. Such high rates were deemed to be uncompetitive. On the recommendation of the 1986 Economic Committee, Singapore's government decided that it needed to shift from direct to indirect taxes, to maintain its international competitiveness in attracting investments, and to sustain its economic growth to create well-paying jobs for Singaporeans.

The GST was part of a larger tax restructuring exercise to enable Singapore to shift its reliance from direct taxes to indirect taxes. The government argued that tax reform was necessary to maintain Singapore's competitiveness, to sustain long-term growth and job creation. The government also argued that with an ageing population, Singapore's income tax base was expected to decline. With a broad-based GST, the taxation burden would be more evenly spread among the population.

A value-added tax, like the GST, also has several features that make it attractive. A tax on consumption, not income, the tax system inherently encourages savings and investments instead of consumption. The tax also has a self-policing mechanism that discourages evasion, unlike a retail sales tax system or an income tax system, which would be relatively easier to evade.

GST was implemented at a single rate of 3% on April 1, 1994, with an assurance that it would not be raised for at least five years. To cushion the impact of GST on Singaporean households, an offset package was also introduced. Simultaneously, corporate tax rate was cut by 3% to 27%, and the top marginal personal income tax rate was cut by 3% to 30%. The initial GST rate of 3% was among the lowest in the world, as the focus was not to generate substantial revenue, but to allow people to get adjusted to the tax.

In 2002, the Economic Review Committee reviewed Singapore's tax policy, and recommended that further tax reform was necessary to bring in new investments. The committee noted that other countries were aggressively cutting their direct tax rates to attract internationally mobile capital and labour, and recommended that the government rely more on GST for its tax revenues, while again cushioning the impact on Singaporean households through an offset package.

The government accepted the committee's recommendations. The GST rate was increased from 3% to 4% in 2003, and to 5% in 2004. Each increase was accompanied by an offset package that was designed to make the average Singaporean household overall better off, even after accounting for the additional costs imposed by the increase in GST rates. Direct tax rates were also reduced correspondingly. On February 15, 2007 (Budget Day), Second Finance Minister Tharman Shanmugaratnam announced that the GST rate would be increased to 7% with effect from July 1, 2007.

Some critics consider GST to be a regressive tax, meaning the poor pay more, as a percentage of their income, than the rich. However, defenders contend that GST can be considered a proportional tax if tax payments are expressed as a percentage not of income, but of lifetime consumption; savings and investments are tax-deferred, and when converted to consumption are subjected to GST. Others point out that the more important question to ask is not whether GST is regressive, but whether GST is more regressive than the alternative indirect taxes, namely, sales, excise and turnover tax (not income tax because that is a direct tax). In addition, they argue that what affects poverty and fairness is not the impact of any particular tax, but the impact of the tax structure as a whole, and how tax revenues are redistributed. When GST is combined with progressive taxes, and the revenues distributed to the poor, the total fiscal structure can be progressive.

To maintain the progressive nature of total taxes and transfers on individuals, Singapore reduced income tax on lower-income earners, as well as instituted direct transfer payments to lower-income groups, resulting in an overall lower tax burden for most Singaporean households. These offsets included lower income taxes, lower property taxes, rebates on rental and service & conservancy charges for public housing, and additional subsidies for health, education and community services. As a result of the income tax cuts, additional tax reliefs and rebates in 1994, about 70% of individuals that used to pay income taxes no longer needed to do so.

The Singapore government has argued that the GST on its own is a flat tax, but that it is part of an overall fiscal system that is highly progressive: higher-income earners pay the highest fraction of their income in taxes, and also spend more. When all taxes were taken into account (income tax, property tax, GST and other indirect taxes), the top 10% of households accounted for 38% of the taxes paid, while the top 20% contributed 53% of all taxes. In contrast, lower-income earners receive substantially more transfers than the taxes they pay. Low- and middle-income households effectively pay 'negative' tax. From 2006 to 2010, the second bottom decile of Singaporean households (ranked by income from work) received transfers (net of all taxes paid) amounting to 23% of their income, the 5th decile received transfers that netted off taxes paid, while the effective tax rate for the top decile was 11%. In particular, when the GST rate was raised from 5% to 7% in July 2007, a household in the bottom 20% had to pay additional GST of $370 per year, but received an offset package of $910 per year, in addition to permanent benefits of $1,000 per year.

6.1 Calls to exempt basic essentials from GST

Some critics contend that basic essentials such as food and healthcare should be made exempt from GST, to help lower-income households. The government argued that having such exemptions would actually help the higher-income more than poorer Singaporeans, because well-off households usually spend much more on essentials (whether food or healthcare or other basic necessities) than a lower-income household. In addition, lower-income households would not benefit much from such an exemption, as spending on essentials constitutes a small proportion of lower-income household expenditures. For example, for the bottom 20% of households, essential food items comprised only 6% of their total household expenditures; after including all other food items, the total was only 15% of their expenditures.

If essentials were to be exempted from GST, there would be a need to make up for the revenue shortfall through a higher GST rate on other goods and services, which lower-income households would also have to bear. The government argued that the experience of other countries demonstrated that granting exemptions would distort production and consumption decisions and cause a contentious and highly complex process of determining the goods and services that merit exemption. This would increase compliance and administration costs for businesses, and these costs would be passed on to consumers.

In addition, the experience of other countries have shown that exempting or reducing GST on certain items did not mean that tax savings would be passed on to consumers. Therefore, the GST should be kept broad-based to keep the GST low and the GST system simple, while help is directly provided to the lower-income through transfers and subsidies. In addition, the government has been absorbing GST in full for all subsidised patients in public hospitals and polyclinics since the GST was introduced in 1994. GST has also been absorbed for all subsidised patients receiving long-term care services.

7.0 Conclusion

The experience of other countries have shown that exempting or reducing GST on certain items did not mean that tax savings would be passed on to consumers. For instance, some critics argue that basic essentials such as food and healthcare should be made exempt from GST, to help lower-income households. However, in many cases such exemptions would actually help the higher-income more than poor people as well-off households usually spend much more on food or healthcare than a lower-income household. Therefore, the GST should be kept broad-based to keep the GST low and the GST system simple, while help is directly provided to the lower-income through transfers and subsidies. Critics have also argued that the GST is a regressive tax, which has a more pronounced effect on lower income earners, meaning that the tax consumes a higher proportion of their income, compared to those earning large incomes. To maintain the progressive nature of total taxes, countries such as Singapore reduced income tax on lower-income earners, as well as instituted direct transfer payments to lower-income groups, resulting in an overall lower tax burden for most Singaporean households. These offsets included lower income taxes, lower property taxes, rebates on rental and service & conservancy charges for public housing, and additional subsidies for health, education and community services.

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