

**International Experience in Implementing VATs in
Federal Jurisdictions: A Summary**

Victoria J. Perry

Fiscal Affairs Department
International Monetary Fund

June, 2009

This paper was prepared for an American Tax Policy Institute conference, "Structuring a Federal VAT: Design and Coordination Issues," held in Washington on February 18-19, 2009. The views expressed are those of the author alone, and do not represent the position of the International Monetary Fund, its Management or Executive Board.

I. Introduction¹

The value-added tax has been implemented in a number of countries with multiple levels of government, including some in which versions of the tax are imposed at both the national levels and at the sub-national level. It is natural, therefore, to inquire what lessons these examples may hold for the United States, with its long history of sub-national consumption taxes, should the U.S. consider the adoption of a federal value-added tax. This paper examines briefly the consumption tax systems in five countries which have, or are frequently said to have, value-added taxes at either both levels of government or at the sub-national level only. This group includes one of the oldest existing VATs (Brazil), as well as one of the newest (India)--the latter still under development, the former presently the subject of government plans for substantial amendment. Other countries included are Australia, Italy and Germany.² After describing the systems in these countries, the paper concludes with observations on the potential relevance of these cases for the United States.

II. Sub-national VATs: five examples³

Australia

The Australian GST entered into force in July, 2000. Although it is sometimes mistakenly thought to be an example of how simple administering a state level VAT can be, the Australian GST is not in fact a state-level tax, but rather an earmarked federal-level tax.⁴ The GST completely replaced a collection of economically inefficient state-level consumption taxes, and its proceeds are by law fully distributed to the state governments. The states pay an administration fee to the federal government to administer the GST for their benefit. Control of GST policy is outside the power of the states, individually and collectively. Authority to make any significant changes, including to the rates or to the base, lies jointly with the states

¹ The author would like to thank Sijbren Cnossen, Michael Keen, Ricardo Varsano, Satya Poddar, Partho Shome, Pierre Pascal Gendron, and the late Oliver Oldman for comments and information, and Charles McLure and Reuven Avi-Yonah for editorial advice. All errors and omissions remain those of the author alone.

² Canada's GST and provincial level consumption taxes present the closest analogy to the U.S. situation. They are not addressed here, however, as the important Canadian experience is the subject of a separate paper prepared for this conference by Richard Bird and Pierre-Pascal Gendron. The EU experience--which holds lessons for the implementation of parallel coordinated VATs among a group of jurisdictions without tax borders, somewhat analogous to the U.S. states-- is likewise discussed in another accompanying paper for this session, prepared by Sijbren Cnossen.

³ This heading is somewhat misleading, in that these taxes are not all truly "sub-national," and not all are truly consumption based VATs. Nonetheless, all of the jurisdictions examined here are frequently referred to as having "sub-national VATs."

⁴ This fact was first explicitly acknowledged by the government in 2008.

and the federal government, requiring federal approval as well as state unanimity. Revenue allocation is unrelated to the distribution of the base of the tax. It is determined neither by the location of consumption nor of the production of goods and services, but rather by means of a formula determined from the estimated overall revenue capacity of each state, and, importantly, also based upon their expenditure needs. The Australian GST was thus designed as a federal tax earmarked to serve as an explicit redistributive mechanism across the states.

Germany

Germany has a dual tax system, in that both the federal and state ("Laender") governments have autonomous systems of revenue administration, each with networks of headquarters, regional and local offices across, respectively, the country or the individual state. The federal Constitution regulates the assignment of government spending responsibilities and tax revenues between the federal, state and local levels. The revenues from the major taxes-- including the VAT, and the corporate and personal income taxes-- are split between the Laender and the federal government. The task of *administering* the VAT on behalf of both levels of government falls to the Laender. However, the Laender can choose only the form and operation of their tax administrations--they cannot alter the structure, base or rates of the VAT itself (or of the other taxes). Thus, Germany has only a very minimal level of subnational revenue autonomy. By one measure,⁵ over the period 1996-2001, on average 49.3 percent of German general government tax revenues were sub-national but only 7.2 percent (about one-seventh of this amount) were deemed "autonomous own-tax revenues." By contrast, the comparable figures for U.S. general government tax revenue over the same period were approximately 35 percent sub-national, but these were *entirely* "autonomous own-tax" revenues--that is, legislated, levied and retained by the states and localities without federal control. Thus, the two federal systems operate on entirely different bases.

German VAT revenues, although collected by the various Laender, are split between the federal and Laender governments. Notably, as in the case of Australia's allocation of GST revenues to the states, this splitting is based upon a national formula, even though the collection occurs at the state rather than the federal level in the German case. VAT revenues are not split between each Lender and the federal government based upon the location of tax collection, consumer consumption, or production of taxable goods and services, but rather based upon redistributive equalization formulas.

Is this model of state level collection of national taxes workable and efficient? It functions reasonably well in Germany, but it is frequently criticized for inefficiency and wasteful duplication of effort. Needs for better administrative quality control, more coordination across states, and much better information technology have been the subject of struggle and

⁵ Bosch and Duran (2008).

controversy since the early 1990's. Attempts to agree upon and develop a unified information technology system for the Laender have failed at several points.⁶

Italy

Italy has a national VAT, meeting the requirements of the European Union. Since 1997, it has also had a regional tax--the exact nature of which has been the subject of legal controversy-- known as the "regional tax on productive activities" (IRAP). The IRAP is a nationally mandated tax, but regional governments have some control over its rates and base. The proceeds go to the regions, for the purpose of financing certain specified programs (e.g., health care). The IRAP is a subtraction method (as opposed to credit-invoice), accounts based tax, *imposed on the origin basis* between regions. It falls upon an income base, due to the fact that capital purchases and inventories are not creditable nor immediately deductible, but are depreciated. In fact, then, the IRAP is neither a traditional credit-invoice VAT, nor a retail sales tax.⁷ It more closely resembles the former Michigan Single Business Tax than a European VAT or any other type of tax familiar in the United States experience. And, as in the case of the Michigan SBT, the fact that the IRAP is imposed on an origin basis,⁸ coupled with regional control over bases and rates, has given rise to competitive pressures to lower rates and to apply multiple rates to various favored activities in specific regions, greatly narrowing the tax base.

Brazil

Brazil introduced one of the world's first VATs in 1965, when the existing state sales taxes were replaced at the state level by the "ICM,"⁹ a VAT-type tax. The central government at about the same time introduced another VAT-type tax--the "IPI"--on "industrialized products."¹⁰ These taxes essentially remain in place today, and taken together are very

⁶ Bosch and Duran.

⁷ The IRAP is perhaps best known for being the subject of recent EU litigation regarding whether it violated Article 33 of the EU Sixth Directive--now revised and renamed the "Commission Directive on the Common System of Value Added Tax"--which forbids the enactment of taxes that could interfere with the application of the VAT. The question was whether or not the IRAP in effect constitutes a second Italian VAT. The European Court of Justice held that the IRAP does in fact violate the Sixth Directive in this way. While this is certainly a highly debatable point, it has no real relevance outside the EU.

⁸ See "*Brazil-Problems with the Operation of the ICMS*," below.

⁹ The tax is now called the "ICMS."

¹⁰ Municipal governments also levy a cascading tax on services, called the "ISS." This tax is still in place, and remains not creditable against the ICMS or the IPI. In addition, there are three other relatively significant consumption type taxes in Brazil, likewise not creditable against the others, and therefore leading to significant

(continued)

important economically. The Brazilian system is perhaps the polar opposite of the Australian one, in that it is widely noted as the most complex existing arrangement for a consumption tax system.

Early tax system

Until 1934, the Brazilian states' largest source of revenue was a state-level export tax, an origin based tax imposed on shipments of goods both to other states and to foreign countries. With the Constitution of 1934, domestic taxes became more important; states were prohibited from imposing an export tax, *per se*, on inter-state transactions, and the rate of tax which they could impose on international shipments was limited. However, the states adopted domestic general turnover taxes (known as the "IVC"), which were imposed on sales made for interstate transactions as well as intrastate ones—that is, the new tax was levied on an origin basis between Brazilian states, as well as with respect to international exports. In addition, a federal-level "Consumption Tax" became of increasing importance relative to foreign trade taxes. By 1964, this national tax became the "IPI" federal tax, and the state IVC had similarly become the (then-named) "ICM." Changes implemented in both taxes at that time improved the economic efficiency of the Brazilian consumption tax system relative to the previous state of affairs--credits were allowed for tax on inputs--although it remained seriously sub-optimal from an economic efficiency standpoint.

The ICMS

Since 1967, the most productive source of state tax revenue in Brazil has been the sub-national VAT—now called the ICMS.¹¹ From the beginning, this tax gave rise to serious horizontal coordination problems, which still exist. Like the U.S., Brazil has a tradition of very strong federalism.¹² As a result of this history, any alteration in the sub-national tax system is extremely difficult; significant transformations would require not only the states' agreement but in some cases Constitutional amendment.

The ICM was based upon the then-existing 1948 French "pre-VAT," since the Brazilian tax was developed before the European Economic Community (EEC) adopted the Sixth

cascading-- the COFINS (partially cumulating tax on imports, production and marketing); the PIS (same); and the CIDE-fuels (cumulative tax on imports and marketing of oil and natural gas and derivatives thereof).

¹¹ This section draws heavily on Varsano, 2000.

¹² The Brazilian federation was created in 1889 by the conversion of the old provinces that existed under the unitary colonial system into autonomous states, rather than by the joining of previously autonomous colonies as in the U.S.

Directive and the modern version of the VAT. There was thus at the time no existing model for taxation of interstate transactions. The Brazilian tax followed a recent proposal for a “restricted origin basis” made in the 1963 Neumark Report for the EEC countries. This proposal suggested taxing trade with third countries on the destination basis, and *inter-community trade on the origin basis*. It was then believed that such a scheme would require that the members use the same, or very closely aligned, tax rates. This proposal was more or less adopted for the Brazilian ICM.¹³ “Uniform rates were required within each geo-economic region of the country.”¹⁴ This Brazilian tax differed from a consumption type VAT in that tax on capital inputs was not subject to credit.

The next major developments in the ICMS occurred with the adoption of the 1988 federal Constitution, which in general strengthened decentralization of government. More federal transfers to sub-national governments were provided for in the new constitution, and more transactions—fuel, electricity, minerals, communication and transportation services—were included in the ICMS with corresponding federal excise taxes on those goods and services being eliminated.¹⁵ Notably, a proposal to shift the ICMS from origin to destination based taxation for transactions between states was rejected, and there was successful resistance to any improvement in the design of the ICMS that could reduce any state's revenues, despite widespread acknowledgment of the tax's flaws. Not until 1996 was state level taxation of many international exports eliminated, and capital goods made fully creditable.¹⁶ And even now the tax does not operate as a true destination-based tax on an international basis, due to failure as a practical matter to refund credits on zero-rated international exports, thus rendering it to some extent an international tax on production.

The IPI

An increase in complexity and reduction in efficiency has occurred in the federal level IPI. Its importance in the eyes of the federal government has eroded since 1988, since at that time, in conjunction with the Constitutional move to greater decentralization, an increased proportion of the revenue from the tax--now well more than half--was allocated to the states through a revenue sharing formula. Partially as a result, the tax has become a favored means of granting sectoral exemptions at the federal level, and thus operates more like a selective excise and import tax than a true VAT-type broad based tax.¹⁷ The rate structure is

¹³ Although international exports of non-manufactured items were still allowed to be taxed by the states on an origin basis at that time.

¹⁴ Varsano, 2000.

¹⁵ Other services remained taxable only under the local governments' “ISS” taxes.

¹⁶ Complementary Law no. 87, introduced in 1996.

¹⁷ Varsano 2000.

correspondingly complex. Brazil does not, therefore, really have a general, broad-based national level VAT with a corresponding system of state VATs, as is sometimes thought to be the case.

Problems with the operation of the ICMS

The federal Senate sets the ICMS rates on transactions between states--12 percent standard, and 7 percent on goods moving from richer states to poorer states. The individual states set rates for *intrastate* transactions; these rates tend to be higher than the interstate rate, and each state in practice sets multiple intrastate rates for different goods. There are dozens of rate variations, as a result. In theory, the ICMS is governed by a collegiate body of state finance secretaries, which is in charge of harmonizing the bases of the state ICMSs. Elaborate rules for maintaining such harmonization were set in the 1988 federal Constitution. Despite this attempt, however, coordination in both rates and bases has eroded, and rampant inter-state fiscal competition has set in--the so-called "fiscal war" between the states. Such inter-jurisdictional consumption tax competition is generally far more likely under an origin system than under a destination system, due to the fact that the tax attaches to goods (or, theoretically, services) sold outside the taxing jurisdiction. Thus, producers in each jurisdiction may lobby for special tax breaks or lower rates in order to make their goods more competitive with those sold from other jurisdictions.¹⁸ In addition to the tax competition problem, this wide variation in tax rates, and especially bases, creates high compliance costs for businesses operating in multiple jurisdictions, and economic efficiency is undermined. Further, under the origin system, transfer pricing problems akin to those found in the income tax may arise, in an effort to locate "value added" in the most tax-advantaged manner.

The application of the origin basis, and the reduced (7 percent) rate applicable to trade on goods shipped from high income (producing) states to lower income (consuming) states is a central weakness of the tax, and does not solve the redistributive problem for which it was designed.¹⁹ For example, a large wholesaler located in a high income state can sell to the poor northeastern states at the applicable rate for such sales of 7 percent. The domestic rate applicable to internal transactions in those states is more typically around 17 percent, and the rate that would apply were the dealer selling into another wealthy state would be 12 percent. These rate differentials presumably distort consumption decisions in the destination state,²⁰

¹⁸ Under a destination based system, goods or services are subject to the tax applicable in the jurisdiction of consumption, regardless of where they are produced. If the tax could be perfectly applied in the case of all cross-border transactions, including cross-border sales to final consumers, there would therefore be no possibility of tax competition.

¹⁹ This paragraph draws heavily on Gendron.

²⁰ Of course, this reflects the basic difference between the origin basis and the destination basis--the former equating tax on all goods produced or sold in a jurisdiction, the latter equating the tax burden on all

(continued)

and additionally provide ample opportunity to develop ingenious methods of distortionary tax minimization and avoidance. One well known tax fraud under this system is descriptively called “invoice sightseeing.” Interstate sales are simulated, when goods are really being transferred in intrastate transactions. Apparently the Western Amazon states, with respect to which the rate on inbound interstate transfers is even lower--zero--are preferred destinations for the invoices in question, though not for the goods. Likewise, in another example of the distortionary complexity of the Brazilian tax, interstate--though not intrastate--transfers of fuel all take place at a special rate of zero, and a large number of fraudulent simulated transfers occur as a result. And in some cases, goods are physically shipped on long, irrelevant journeys to take advantage of the tax consequences of their physical presence in certain jurisdictions.²¹ The Brazilian system, exacerbated by inequality among the states, also gives rise to the problem that the wealthier industrial states import more goods from abroad, on which they collect VAT on import. The generally poorer, agricultural states, export their products abroad and must give refunds for included tax (although this problem is in practice mitigated to some extent by the failure to give refunds that are lawfully required).²²

Proposal for reform

A major tax reform proposal was submitted to the Brazilian National Congress by the government in the winter of 2008, after lengthy discussion with the states, labor, and business over the course of 2007.²³ The proposed legislation covers all aspects of the tax system, and six major goals were listed by the government: simplification and administrative streamlining to reduce compliance costs; reduction in economic informality; elimination of economic distortions; ending the "fiscal war between the states;" overall reduction of the tax burden; and improvements in regional development policy. The reform proposal includes major changes in the ICMS.

This proposal aims to reduce the cascading of the existing six indirect taxes on goods and services. It points out that capital goods are not fully credited under the ICMS (although the tax now does include capital input crediting, credit for capital investment is required only to be recovered over 48 months). The proposal takes aim at the myriad problems generated with regard to interstate operations in the present system.

consumption within a jurisdiction. To avoid this, one would need to apply the destination basis to interstate trade, or to adopt a uniform rate on all intra and interstate transactions across the states, thus eliminating state autonomy with respect to the consumption tax rates within their borders.

²¹ Causing the Brazilian Ministry of Finance to lament that, among its other many failings, the existing tax system puts an excessive burden on the nation's transportation infrastructure.

²² Longo.

²³ The proposal is described in "Tax Reform," Ministry of Finance, February 28, 2008.

The principal simplification for the ICMS is stated to be the unification of the 27 state ICMSs into a single law. Rates would become uniform throughout the country, although the method of determining these many rates does not appear to be particularly simple.²⁴ The proposal would levy the ICMS "predominantly" in the destination state, rather than on the origin basis as currently. The "precise calibration" of resulting gains and losses generated on a state by state basis would be required of the government, to permit the possibility of introducing full or partial offsetting transfers. This shift to the destination basis, it was hoped, would stop the tax competition between the states. However, it was determined that this could not be done all at once, because of the impact on distribution of revenues between the states, and because benefits already granted to individual businesses at the state level could not be immediately cancelled. Thus, the proposal would adopt a lengthy transition period, gradually reducing the rates of tax charged at origin (currently, as noted above, 12 percent standard, and 7 percent (or 0) on sales from higher income into low income states). In addition to worries regarding measuring and mitigating the economic impact of shifting the tax base among the states, the practical mechanisms for implementing the destination based VAT among jurisdictions remained to be fully worked out in the Ministry's proposal. The transition was expected to last for 8 years, and to end with a 2 percent rate retained on sales at origin, as "an instrument for stimulating inspection activities." In other words, the existence of this minor tax in the state of origin was intended to create an incentive for the origin state's tax administration to audit these interstate transactions there, or at least to cooperate fully with the state of destination--which would obtain most of the tax on the transaction--in doing so.²⁵ The proposal would permit (although would not necessarily have required) the use of a clearinghouse mechanism, under which the destination based tax would be initially charged at sale in the origin state, and the funds thus collected would be transferred to the state of destination through an interstate mechanism.²⁶ Finally, a Revenue Equalization Fund would be created to compensate states for possible revenue losses from the overall tax reform.

With elimination or reduction of taxes on investments and exports and the levying of the ICMS primarily in the state of destination...the Brazilian system of taxation on goods and services will come quite close to that envisioned by the bill: a transparent system of taxation of consumption in which the tax rate corresponds to what the consumer is

²⁴ The Senate will define the applicable rate brackets; "Confaz" (the tax coordination group of the state ministers of finance) will propose to classify all goods and services within the rate brackets; the federal Senate will then approve or deny this classification. And, in addition, the states will be permitted to set differentiated rates for a limited number of goods and services, "to be defined in complementary legislation."

²⁵ Of course, the benefit of auditing intrastate (domestic) transactions would presumably be much higher for the origin state authorities, regardless of this relatively small incentive with regard to interstate transactions, and the possible result of this feature is therefore not clear.

²⁶ This is based upon a method long suggested but not adopted in the European Union.

effectively paying. The major exception will be the continued cumulative levying of the ISS....["The Tax Reform" (2008)]

This sweeping reform to the tax system with its proposed changes to the ICMS remained resting in the Congress, months after its introduction, despite the fact that it had seemed, prior to the introduction, that needed negotiation and compromise had been reached.

India

India, like the United States, is a populous and geographically very large, robust federal democracy. Similarly, too, the powers of the 28 autonomous states and 7 "union territories" in relation to the central government are set out in Constitutional provisions which circumscribe the scope for distributing the tax bases between the center and the states. While these provisions differ from those in the U.S. Constitution, the process of engagement and reform in the face of the federal-state relationship, as well as the solutions adopted, may be instructive. India is presently engaged in a multi-year process of adopting value-added taxes at both the state and federal levels. This represents the culmination of a two decade project to reform the complex and inefficient indirect tax system of the country.

Pre-existing indirect tax system

Prior to 2005, the Indian federal government imposed a national level central "excise" tax on manufactured goods, at 16 percent, and a 10 percent tax on a specified long list of services. Taxation of services is reserved under the Constitution to the federal government, and taxation of transactions of goods by it constrained to the "manufacturing stage." The Indian states imposed taxes on the sale of "movable goods" beyond the manufacturing stage. The state sales taxes did not provide credit for any sales taxes paid on inputs, unlike a VAT, and thus included elements of cascading.²⁷ In addition, the so-called "central sales tax" (CST) was imposed on the origin basis by the exporting state, at 4 percent, on inter-state sales of goods between registered dealers. This tax was mandated uniformly by the federal government, but for levy by the states. Intrastate sales between registered dealers were exempt from the state level sales taxes; all sales by dealers to final consumers or unregistered dealers were subject to non-creditable tax at point of sale (ie., on the origin basis with respect to inter-state sales). In addition to the cascading problem, this origin based state sales tax system led to increasing "rate wars" between states, as well as ever-expanding systems of sales tax incentives in the various states.

The White Paper

²⁷ Thus, while not exactly a retail sales tax, the base of the state sales taxes resembled in some ways the U.S. state sales taxes--being imposed upon goods only beyond the manufacturing stage. In addition, the states (subject to the same constraints) impose various other "special" or "additional" taxes on consumption items.

In 1999, an "Empowered Committee of State Finance Ministers" was constituted by the federal Ministry of Finance, with the charge of working out a more economically efficient state level consumption tax--aiming toward a state level VAT. The Empowered Committee moved forward on the basis that there would at least initially continue to be a dual system of national and sub-national consumption taxes. The Committee focused on replacing the cascading state sales taxes, the numerous additional more minor state level taxes, and the CST by a coordinated state level VAT to be adopted by all the states. Preliminary steps had been taken in the 1990's to end the sales tax rate war among the states by implementing a floor on rates for different categories of goods, applicable in all states. Industrial incentive schemes adopted by various states were, similarly, to be eliminated by January 1, 2000. After that point, steps began toward a state level VAT. The White Paper of the Empowered Committee, published in January 2005, aimed at a single basic design, but one which would allow the states "freedom for appropriate variations consistent with the basic design," in recognition of the autonomous power of the states to design and impose their own taxes. The White Paper also provided that the CST would be gradually phased out; this is now in process, with a rate of zero to be reached by April 2010.

"Unified" or "Dual" GST?

Throughout this process, debate has continued as to whether it would be best--assuming it were Constitutionally possible--to have a single, federal level VAT (GST), the proceeds of which could be allocated to or shared with the states, or rather to have a so-called "dual GST," in which the states and the federal government each operated separately their own GSTs. While many informed voices have noted (and are still doing so) that on both policy and practical grounds, a single federal level GST would be most efficient and administratively feasible,²⁸ it now appears that the dual GST path is well in process. Even this route leaves open many questions which are yet to be resolved, however. In addition to the practical issues involved in implementing a destination based VAT among the states--a course which has been agreed upon for the design of the uniform state level GST--the other principal issue is how to resolve the Constitutionally divided tax base problem. The distinctions between manufacturing and post-manufacturing, and particularly the distinction between goods and services, are not as clear cut as they were assumed to be when the original rules were promulgated. One route would be a Constitutional amendment. Simpler, relatively speaking, and more likely possible would be uniform agreement between the states and the center to share all the bases on a voluntary basis, thus permitting a uniform GST to be promulgated at the federal level and across all the states. This path is still not fully assured as of this writing, however.

²⁸ See, e.g., the Kelkar Report, 2004; Poddar, 2009.

Design and implementation of the state VAT

By January 2008, the final state had adopted its VAT law in accordance with the Empowered Committee plan. The uniform features adopted by the Empowered Committee include, *inter alia*, credit for input taxes, and self-assessment (replacing the existing system of administrative assessment by inspection). Input tax credits are to be given with respect to inputs included in goods sold outside the state as well as within it, and credit must also be given for capital inputs (with the states having the option to give the latter credit over any period from immediately up to 36 months). The VAT provides a turnover threshold below which small traders are not required to register, although with provision for voluntary registration. The state level VATs operate on a destination basis (with the remaining CST overlaid as an origin based tax until 2010). Efforts are being made to improve the technology and procedures needed for information exchange in this system. The definitive mechanism to ensure that the destination based interstate VAT works correctly has not yet been adopted; indeed, as of early 2009, proposals for smooth functioning of this system were still being made.²⁹

The federal GST

The government announced in 2006 that a federal level VAT ("GST") would be implemented by April 1, 2010, following the dual GST plan. As of late 2008, however, the details of such a tax, and in particular its interaction with the state VATs, had not been finalized. At the end of 2007, the Empowered Committee submitted another report on the adoption of the GST. Following that plan, there will likely be two separate chains of crediting (no cross crediting of inputs between the state and federal GSTs), and two separate levels of administration. It was deemed "advisable" to cover services in both chains, yet, as noted, the means for achieving this have not been agreed. And a good deal of debate about the rates necessary to achieve a revenue neutral result is also underway--in part because the exact structure of the bases has yet to be made final. Nonetheless, by early 2010, India is intended to have a system of federal and state VATs in place.

III. Lessons for the U.S.

The main lesson to be taken from the examples above may be the obvious one, that any consumption tax solution adopted in a country with federal traditions must depend upon the national context, history and Constitutional requirements. Clearly, the autonomy of the U.S. states would have to be retained in a way that would prohibit the Australian or German solutions. It is evident that, despite common beliefs to the contrary, Australia and Germany do not have state level value-added taxes, nor do they have dual level consumption taxes.

²⁹ See, e.g., Poddar and Ahmad (2009), proposing a "PVAT."

Rather, they have national VATs only. In the former case, the tax is administered at the national level with earmarked revenues shared among the states based on a revenue sharing formula. In the latter case, the national tax is administered by the states, with revenue shared between the national government and the states, but, again, the distribution of the states' shares is based, as in the Australian case, upon redistributive equalization formulas, and the structure of the tax is not within the control of the states. This model thus bears little relevance to economic or political reality in the United States.

The Italian IRAP permits greater state level autonomy, but again is not directly analogous to the U.S. case. The tax is a nationally administered, nationally mandated tax but with considerable base autonomy granted to the regions, which retain all revenues. The IRAP is essentially a subtraction method, accounts based tax which falls on income, rather than consumption, as a result of the amortization of capital costs. It is applied on an origin basis. Thus, it bears essentially no resemblance economically or politically to the existing U.S. autonomous state level retail sales taxes--nor even to a destination-based, credit-invoice method state level consumption-based VAT.

Clearly there would be no advantage to replicating a tax anything like the very old and patchwork Brazilian system in a country starting today from an existing system of state level retail sales taxes and adopting a federal VAT. But some common factors should nonetheless be borne in mind. In particular, the autonomy of the widely economically disparate U.S. states, like that of the Brazilian states, will not be lightly forfeited. A decision whether to impose a state level VAT on a destination or origin basis would have to be taken, as in Brazil. It seems unlikely that the latter would be selected, given the more serious problems that it potentially poses in respect of tax competition and transfer pricing, and observing the experiences of Brazil and of Italy. Nonetheless, as in Brazil and India, there is no coercive mechanism available in the U.S. which could impose a uniform decision regarding this question, or any others, upon the states.

The process of reforming the complex and inefficient Indian dual level consumption tax system may be instructive for the United States. The country, like the U.S., has a strongly federalist tradition, with vast differences in wealth, productive and administrative capacity among the numerous states. Nonetheless, despite idiosyncratic constitutional requirements, and although neither the policy process nor implementation is yet complete, it does appear that India will wind up with dual level state and federal VATs with some degree of uniformity, imposed on trade among the states on a destination basis. It remains to be seen, however, what will be the exact nature of the end result.

In addition to the lesson of national idiosyncracies, perhaps the primary observation to be drawn from these examples is the problem of tax competition, which clearly arises under subnational origin-based systems (e.g., Brazil, Italy, India). The U.S. states have wide variations in the taxation tastes of the U.S. states, their economic capacities, and a long

history of destination based retail sales taxes at the state level. It therefore seems likely that, should some or all the states decide to move from the existing retail sales taxes to a VAT (more or less) coordinated with a federal VAT, that these taxes will -- and should -- be operated on the destination basis.

Bibliography

Afonso, Jose Roberto and Rafael Barroso, “*Brazilian Tax Affairs*,” February, 2007 [extension of chapter included in Tax Systems and Tax Reforms in Latin America]

Arvind, D., “*Indirect Tax Expectations*,” Business Line, February 28, 2007.

Bagchi, A. and Poddar, S., “*The Long Road Ahead to GST*,” “*GST for India: Some Basic Questions*,” and “*GST Roadmap II: Balancing Harmonization and Fiscal Autonomy*,” 2006.

Bosch, N. and Jose M. Duran, eds., Fiscal Federalism and Political Decentralization: Lessons from Spain, Germany and Canada, Edward Elgar (2008), pp. 137-146; 193-207.

Cnossen, Sijbren, “*VAT Coordination in the European Union: It's the Break in the Audit Trail, Stupid!*” August, 2008 (unpublished draft)

Dimri, Rajeev, “*Taking Stock of the Goods and Service Tax*,” Tax Economics, www.livemint.com/Articles/PrintArticle.aspx, February, 2008.

Ebrill, L., M. Keen, J. Bodin and V. Summers, The Modern VAT, IMF (Washington, DC, 2000)

Empowered Committee of State Finance Ministers, “*A White Paper on State-Level Value Added Tax*,” New Delhi, January 2005.

Gendron, Pierre-Pascal “*Background: Multi-Level Indirect Taxation*,” May 4, 2007; “*International Experiences with Multi-Level Indirect Taxation*,” June 11, 2007; “*Summing Up: International Best Practices with Multi-Level Indirect Taxation*,” June 18, 2007 [papers commissioned under the Consolidation of Fiscal Federalism in Brazil Project (World Bank)]

Khan, N.A., “*Roadmap for GST in India*,” The Economic Times, January 9, 2008.

Longo, Carlos A., “*Lessons from Brazilian Experience with the VAT*,” in Malcolm Gillis, Carl Shoup, and Gerardo P. Sicat, editors, *Value Added Taxation in Developing Countries* (Washington: International Bank for Reconstruction and Development, 1990), pp. 121-28.]

Ministry of Finance (Brazil), “*Tax Reform*,” February 28, 2008.

Ministry of Finance (India), “*Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003*,” (July 16, 2004) (the “Kelkar Report”).

Oldman, O., R. Bird and S. Cnossen, *"Letter to the President of the European Court of Justice Concerning the Italian IRAP and the European VAT,"* July, 2005.

Poddar, Satya, *"Is a Unified GST Better than a Dual One?"* Business Standard, July 1, 2009.

Poddar, S. and E. Ahmad, *"GST Reforms and Intergovernmental Considerations in India,"* Ministry of Finance Working Paper No. 1/2009-DEA, Government of India, March 2009.

Schenk, Alan, *"Italy's IRAP: An Analysis from Across the Atlantic,"* International VAT Monitor, July/August 2006, pp. 242-246.

Ravikumar, V. *"VAT in India—Issues and Concerns,"* The Chartered Accountant, June, 2005, p.1616.

Varsano, Ricardo *"Subnational Taxation and Treatment of Interstate Trade in Brazil: Problems and a Proposed Solution,"* May, 2000