

1-1-1988

The Canadian White Paper on Sales Tax Reform and the Model Value Added Tax Statute for the United States: A Comparative Analysis

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Recommended Citation

Schenk, Alan. The Canadian White Paper on Sales Tax Reform and the Model Value Added Tax Statute for the United States: A Comparative Analysis. 26 Osgoode Hall L.J. 629, 672 (1988)
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THE CANADIAN WHITE PAPER ON SALES TAX REFORM AND THE MODEL VALUE ADDED TAX STATUTE FOR THE UNITED STATES: A COMPARATIVE ANALYSIS*

BY ALAN SCHENK**

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**Professor of Law, Wayne State University, Detroit, Michigan. This article is an expanded version of a paper presented at the International Tax Conference on The Value-Added Tax held at Osgoode Hall Law School of York University on October 5 and 6, 1988. The author wishes to express his gratitude to Satya Poddar for his very helpful comments on an earlier draft of this article.

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I. INTRODUCTION

Proposals for a national sales tax have a long history in the United States, starting with Professor Thomas S. Adams' recommended value added tax (VAT) in 1921.¹ During World War II, a bill proposing a federal retail sales tax was introduced in Congress, but was not enacted. In 1971, the Nixon administration informally considered a VAT to raise revenue to finance a revenue-sharing program with state and local government. President Nixon did not formally propose a VAT, in part because tax professionals in the United States were not familiar with the value added tax, and in part because additional revenue was needed quickly and Congress would have had to provide a long transition period between the date of enactment and the date that a VAT could have become effective. In 1979 and again in 1980, then chairman of the U.S. House Ways and Means Committee, Al Ullman, proposed a value added tax to finance reductions in the income and social security taxes.² Chairman Ullman was defeated in his 1980 bid for reelection, and the VAT proposal died. In 1985, Senator Roth proposed a Business Transfer Tax (BTT), a sales-subtractive form of VAT,³ to finance cuts in income and payroll taxes. Congress did not formally consider the BTT.

The Section of Taxation of the American Bar Association (ABA) established a committee on value added tax in 1971 in response to the expressed interest in VAT by the Nixon Administration. The VAT committee published five articles on

¹See Adams, *Fundamental Problems of Federal Income Taxation*, XXV Quarterly Journal of Economics 553 (1921).

²H.R. 7015, 96th Cong., 2d Sess., 126 Cong. Rec. 7481 (1980) [hereinafter the *Ullman Bill* or H.R. 7015].

³S.1102, 99th Cong., 1st Sess., 131 Cong. Rec. S.5675 (May 8, 1985) [hereinafter *Roth's BTT*].

VAT,⁴ prepared an unpublished analysis and critique of the 1980 Ullman Bill,⁵ and studied Roth's proposed BTT in 1985. In 1986, the Council of the Section of Taxation asked the VAT committee to draft a model value added tax statute and commentary, and appointed this author to serve as reporter. The reporter was to use the Ullman Bill and the prior committee reports as the starting points to fashion the model statute. The final report,⁶ accepted by the Council of the Section of Taxation on May 12, 1988, deviated from these sources in some significant respects.

Canada has had a federal sales tax since 1924. This manufacturer's tax levied on sales and imports is imposed at a 12 percent rate on a wide range of manufactured goods.⁷ Construction materials and equipment for buildings are taxed at a lower eight percent rate, alcohol and tobacco products are taxed at a higher 18 percent rate, and Schedule III goods, such as some food, heating fuels, clothing, and footwear are exempt from tax.⁸ The federal sales tax (FST) has been criticized⁹ as a tax imposed on a narrow

⁴*Report of the Special Subcommittee of the Committee on General Income Tax Problems on the Value-Added Tax*, 24 *Tax Lawyer* 419 (1971); *A Report of a Subcommittee of the Special Committee on Value Added Tax*, reprinted in *Should the United States Adopt the Value-Added Tax? - A Survey of the Policy Considerations and the Data Base*, 26 *Tax Lawyer* 45 (1972); *A Report of the Special Committee on the Value-Added Tax of the Tax Section of the American Bar Association*, reprinted in *Technical Problems in Designing a Broad-Based Value-Added Tax for the United States*, 28 *Tax Lawyer* 193 (1975); *The Fourth Report of the Special Committee on the Value-Added Tax of the Section of Taxation, American Bar Association*, reprinted in *The Choice Between Value-Added and Sales Taxation at Federal and State Levels in the United States*, 29 *Tax Lawyer* 457 (1976); *The Fifth Report of the Special Committee on the Value-Added Tax of the Section of Taxation, American Bar Association*, reprinted in *Evaluation of an Additive-Method Value-Added Tax for Use in the United States*, 30 *Tax Lawyer* 565 (1977).

⁵*Report on Value Added Tax Provisions of Proposed Tax Restructuring Act of 1980* (Oct., 1980, unpublished).

⁶A. Schenk, reporter, *Value Added Tax - A Model Statute and Commentary: A Report of the Committee on Value Added Tax of the American Bar Association Section of Taxation* (American Bar Association, 1989) [hereinafter referred to as Schenk, reporter, *Value Added Tax - A Model Statute and Commentary*].

⁷*Excise Tax Act*, Revised Statutes of Canada 1970, c.E-13. For certain goods, such as automobiles and cosmetics, the tax is imposed on wholesalers.

⁸*Ibid.*, s. 29.

⁹See generally, Canada, *Tax Reform 1987: Sales Tax Reform* (Ottawa: Ministry of Finance, 1987) June 18, 1987 [hereinafter *White Paper*] at 9-24.

base that distorts production and distribution because businesses attempt to shift activities to a nontaxable stage after the manufacturing level. The FST's effective tax rate on different products varies, and the "federal sales tax has the dubious distinction of being the only national sales tax in the world known to favour imports over domestically manufactured products."¹⁰ The FST is complex, resulting in high tax administration and taxpayer compliance costs.¹¹ The refundable sales tax credit added in 1986 has helped to reduce the adverse impact of the FST on low-income households, but the numerous FST exemptions benefit high-income as well as low-income consumers. In 1987, the government proposed sweeping reforms in federal taxes. As part of that effort, the White Paper on Sales Tax Reform proposed the replacement of the FST with a broad-based multi-stage federal sales tax.¹² The White Paper is an exceptional piece of work that addresses most of the significant policy issues affecting the adoption of a federal VAT.

The White Paper discussed three forms of VAT; the National Sales Tax (an invoice method VAT), the federal Goods and Services Tax (a credit method VAT without invoices), and the federal Value-Added Tax (an invoice method VAT). The National Sales Tax provides a uniform base for federal and provincial sales tax reform. The Goods and Services Tax and Value-Added Tax are variations of a multistage sales tax designed to be imposed at the federal level only.

The federal Goods and Services Tax would rely on accounting records, not invoices to calculate tax liability. A business would calculate tax liability by multiplying taxable sales by the tax rate and would reduce the resulting tax by a credit for tax paid on purchases.¹³ The White Paper treats the Goods and Services Tax as a credit method VAT without invoices. The government assumes that this form of VAT is a viable option only if the tax is broad-

¹⁰*Ibid.* at 15.

¹¹*Ibid.* at 19-23.

¹²*Ibid.* at 25.

¹³*Ibid.* at 55.

based and does not include any exemptions.¹⁴ The federal Value-Added Tax option is a federal only invoice method VAT similar to the White Paper's proposed National Sales Tax that would apply both at the federal and provincial levels. The White Paper's sales tax reform proposal is based on three principles — the sales tax system should support the growth and efficiency of the economy, should be fair, and should minimize tax administration and taxpayer compliance costs.¹⁵

This article will compare the federal VAT with the Model Statute drafted by the VAT committee of the ABA Tax Section. Most of the comments about the federal VAT would apply equally to the National Sales Tax. This article first summarizes the major provisions in the ABA Tax Section's VAT committee report, Value Added Tax — A Model Statute and Commentary. It briefly considers the impact of a federal VAT on the Canadian and American tax systems. The article then discusses the major similarities and differences between the Model Statute and the White Paper proposal for a federal VAT.

II. BROAD OUTLINE OF MODEL VALUE ADDED TAX STATUTE

A. *Statute Provides Only Basic Rules*

The Common Market-style VATs and VATs patterned on this model typically provide statutory rules that include not only basic principles but administrative details. The American tradition is for Congress to delegate to the Treasury the authority to issue regulations that provide the administrative details necessary to implement the principles codified in the statutory rules. The Model Statute, consistent with the American approach, includes only basic rules necessary for the imposition of a federal VAT.

¹⁴*Ibid.* The BTT, a sales-subtractive VAT, is computed by reducing taxable sales by allowable deductions for purchases and multiplying the resulting tax base by the applicable tax rate. *Roth's BTT, supra*, note 3., ss 4001, 4003-4005.

¹⁵*White Paper, supra*, note 9 at 5.

B. *Consumption-Style, Destination Principle, Invoice Method VAT*

1. Method of calculating tax liability

A VAT is a multistage sales tax that imposes tax on the value added to goods and services at each stage of production and distribution. The value added may be calculated under an addition or one of the subtraction methods.¹⁶ Assume the VAT rate is 10 percent, and a distributor sells toys for \$100,000 in a calendar quarter. The distributor's purchases of toys, supplies, and other items acquired from other firms total \$60,000. The distributor also paid wages of \$20,000, rent and interest expense of \$7,000, and had a profit for VAT purposes of \$13,000. The results of operation for this quarter are as follows:

Sales	\$100,000
Cost of purchases from other businesses subject to VAT	(60,000)
Wages	(20,000)
Rent and interest expense	<u>(7,000)</u>
Profit for VAT purposes	<u>\$13,000</u> ¹⁷

Under the addition method, each business in the chain from the sale of raw materials through production and distribution to the sale to final consumers is subject to VAT on the value it adds by employing the factors of production — wages, rent and interest expense, and profit. In the above example, the toy distributor's tax base for the quarter is \$40,000, calculated as follows:

¹⁶For a discussion of a naive and more sophisticated subtraction-based VAT, see, C.McLure, Jr., *The Value-Added Tax: Key to Deficit Reduction?* at 75-79.

¹⁷The profit figure does not include any depreciation on capital goods because these costs are included in the \$60,000 cost of capital goods and all other purchases.

Wages	\$20,000
Rent and interest expense	7,000
Profit	<u>13,000</u>
Tax base	<u>\$40,000</u>

The VAT liability is 10 percent of \$40,000, or \$4,000. The \$60,000 of value added that was taxed to the suppliers is not taxed again when the distributor sells the toys to retailers.

Under a sales-subtractive VAT like Senator Roth's proposed Business Transfer Tax for the United States, the distributor's tax base is \$44,000, calculated by taking the difference between its sales and its purchases from outside vendors. A sales-subtractive tax like the BTT generally would be imposed on a tax-inclusive base.

Sales (inclusive of a 10% VAT)	110,000
Purchases from other businesses subject to VAT (inclusive of a 10% VAT)	<u>66,000</u>
Tax base	<u>\$44,000</u>

To obtain the same revenue as a 10 percent rate applied to a tax-exclusive base, the sales-subtractive rate would be 9.0909 percent applied to the tax-inclusive base. The tax liability is the \$44,000 tax base multiplied by the 9.0909 percent tax rate, or \$4,000.

Under a credit-subtractive or invoice method VAT, the distributor charges VAT on sales and credits against this tax liability (called output tax) the tax charged on its purchases from other taxable businesses (called input tax credits). The distributor's net invoice method tax liability is the same \$4,000, calculated as follows:

Tax on Sales — 10% x \$100,000	\$10,000
Input tax on purchases 10% x \$60,000	<u>(6,000)</u>
Net VAT liability for period	<u>\$ 4,000</u>

The Model Statute drafted by the VAT Committee of the ABA Tax Section is a European-style invoice method VAT that relies on tax invoices to verify tax liability on sales and tax credits for VAT charged on purchases. The White Paper's National Sales Tax and federal Value-Added Tax also are invoice method VATs.

The White Paper's proposed federal Goods and Services tax is closer to a credit-subtractive than a sales-subtractive VAT, except that like the sales-subtractive VAT, it relies on accounting records rather than invoices to calculate tax liability.¹⁸ It therefore is a period tax, not a transactions tax. The seller (if the tax is imposed on a tax-exclusive base) multiplies his taxable sales by the tax rate and reduces this output tax by an input credit calculated by multiplying the taxed purchases by the tax rate.¹⁹ Assuming, however, that the tax is calculated on tax-inclusive prices, the output tax and input credit is calculated on the basis of a fraction of the sales and purchase prices. Thus, with a 10 percent tax and converting the amounts in the above example to tax-inclusive prices, the output tax and input credits are based on 10/110 of the sales and purchase prices. The net VAT liability for the period is the same \$4,000, calculated as follows:

Output tax on sales —	
10/110 x \$110,000	\$10,000
Input tax on purchases —	
10/110 x \$66,000	(6,000)
Net VAT liability	
for the period	<u>\$ 4,000</u>

2. Taxation of capital goods

The Model Statute is a consumption VAT imposed on personal consumption expenditures. Purchases of capital goods used

¹⁸The newly-enacted Japanese Consumption Tax, similar to the White Paper's federal Goods and Services Tax, is a credit-subtractive VAT that relies on accounting records rather than invoices to calculate tax liability. See, H. Watanabe, Reports by Tax Commission on Tax Overhaul, Ministry of Finance, Japan. Mr. Watanabe has confirmed that the VAT enacted at the end of 1988 is the same kind of credit-subtractive VAT. The Canadian Ministry of Finance considered the Goods and Services proposal a viable option only if the tax were imposed on a broad base without exemptions. The Japanese VAT exempts a number of consumer goods and services, and it provides a small business exemption as well. The Japanese Consumption Tax authorizes a business to claim credit for the cost of all purchases, including the cost of purchases from an exempt seller and purchases of exempt goods and services. Revenue lost at an exempt stage under the Consumption Tax therefore is not recouped at a subsequent taxable stage of production or distribution.

¹⁹White Paper, *supra*, note 9 at 55.

in the production or distribution of goods and in the rendition of services are removed from the tax base. Under a consumption VAT, capital goods are included in the VAT base only when the cost of these goods is included in the sales price of the output of the businesses using such goods. For example, assume the toy distributor purchased delivery trucks. The distributor can claim input credit for VAT paid on the purchase of the trucks. These capital goods therefore are held by the distributor free of VAT. The distributor will include the cost of the trucks in the selling price of the toys. The capital goods cost therefore will be subject to VAT when the distributor sells the toys.

3. Jurisdictional reach of the tax

A VAT statute must define the jurisdictional reach of the tax with respect to international transactions. An origin principle tax is imposed on value added within the taxing jurisdiction, whether the goods or services are consumed domestically or are exported. Under an origin principle tax, VAT is not imposed on imports (value was added outside the taxing jurisdiction), but it is imposed on the value added within the taxing jurisdiction to exported items. A destination principle tax is imposed on the value of goods and services consumed in the taxing jurisdiction, whether the goods or services are produced within the taxing jurisdiction or are imported. Under a destination principle tax, VAT is imposed on imports to be consumed domestically, and VAT is rebated on exports to be consumed elsewhere. The Model Statute is a destination principle VAT.²⁰

C. *Broad-Based Neutral Tax*

A significant goal in the development of the Model Statute was to design a broad-based consumption tax that is neutral with

²⁰See Schenk, reporter, *Value Added Tax – A Model Statute and Commentary*, *supra*, note 6, Appendix A Model Value Added Tax Act (hereinafter referred to as *Model Statute*), ss 4003(a) and 4012.

respect to consumer choices and that can be imposed at the lowest possible rate. The Model Statute achieves the neutrality goal by taxing imports and most domestic sales,²¹ except, consistent with a destination principle VAT, it zero rates exports.²² VAT is imposed on necessities such as food, medical care, and housing, on essentials such as clothing, utilities, automobiles, and furniture, on discretionary purchases such as cameras, tickets to athletic or other entertainment events, and on luxuries such as jewelry, boats, and airplanes for personal use. Tax is imposed on sales to income tax-exempt organizations and government entities. Sales by these organizations and entities are taxable if provided for a consideration, but are exempt from VAT if provided without charge.²³

²¹The tax rate is applied to the VAT-exclusive prices of taxable goods and services. See *Model Statute, supra*, note 20, s. 4011(a)(2)(A). While most imports are taxable, the Model Statute, s. 4004(a)(4), does not tax goods imported by travelers and other items that are exempt from customs duties under parts 1 and 2 of schedule 8 of the Tariff Schedules of the United States. The Model Statute, s. 4011(c)(2), taxes only the value of the repair, alteration, assembly, processing, manufacture, or other change in condition of imports of previously exported articles. The VAT is imposed on sales of property and services in the United States. For this purpose, a sale of property occurs in the United States if the property is located in the United States at the time of sale, and a sale of services occurs in the United States if the services are provided from a place of business in the United States. *Ibid.*, s. 4006. Some foreign VATs do not tax imports of all services or rebate VAT on exports of all services. For example, the United Kingdom taxes only imports of services, such as advertising services, legal fees, and rental of property, that are listed in Value Added Tax Act 1983, Sch. 3. Exports of services are zero rated only if the services are listed in Value Added Tax Act 1983, c.55, Sch. 5. These foreign VAT statutes must include rules that classify ambiguous transactions as sales of goods or the rendition of services. The Model Statute does not require complex classification rules to distinguish between sales of goods and the rendition of services.

²²As a pure destination principle tax, VAT is imposed on all imports and is removed from all exports. The Model Statute adopts the British concept of a zero-rated export sale. The Canadian White Paper uses the concept of a tax-free sale that provides the same treatment to exports; that is, there is no tax imposed on sales and the exporter can recoup VAT on purchases allocable to export sales.

²³*Model Statute, supra*, note 20, s. 4014(a), (b). The taxation rather than exemption of sales by income tax-exempt organizations and government entities does not necessarily expand the VAT base. If these entities make sales at below cost and are eligible to receive refunds of excess input credits, the taxation of these sales may reduce the VAT base. The Model Act attempts to prevent this contraction of the tax base by giving the Treasury authority to treat sales at nominal prices as exempt sales and therefore deny input credits attributable to such sales. The White Paper deals with this problem in another way. The White Paper proposes to exempt non-commercial sales by these nonprofit organizations and government entities. See the discussion of the taxation of goods and services rendered by the charitable-governmental sectors *infra* notes 102-119 and accompanying text.

State and local governments in the United States have been quite successful in collecting retail sales taxes from small businesses. The Model Statute therefore does not remove businesses with low quarterly or annual turnover from the VAT rolls. Domestic sales are taxable, whether made by street vendors or multinational corporations.

If VAT were imposed on all isolated sales by consumers, individuals would be required to charge VAT and file ad hoc returns for a sale of a used refrigerator or a used car to a neighbor or for a sale of used clothing at a garage sale. The administrative and compliance cost of taxing these sales would exceed the revenue and neutrality benefits. The Model Statute does not tax casual sales or rentals, unless the sales are of high-priced items, and the rentals are of high-value property.²⁴

Consumption generally declines as income rises above the level needed to purchase necessities. A VAT, as a tax on consumption, therefore is a regressive tax when measured against annual income. The commentary to the Model Statute suggests that regressivity and other concerns about the distribution of the tax burden should be addressed outside the VAT scheme through targeted direct grant programs or income tax credits, not through exemptions or lower rates on necessities.²⁵

D. *Multiple Taxation Avoided*

A goal in the development of the Model Statute was to minimize the imposition of VAT more than once on the same value added to goods and services. This multiple tax effect is most likely to occur if the statute exempts sales of specified items (item exemption) or exempts sales by certain entities (entity exemption) made at an intermediate stage of production or distribution. For example, assume a plumber who operates his own business has low annual turnover and therefore is exempt from VAT under a small

²⁴See *Model Statute, supra*, note 20, s. 4003(a)(3) (taxing a casual sale for consideration exceeding a threshold amount to be prescribed by Congress).

²⁵See, Schenk, reporter, *Value Added Tax – A Model Statute and Commentary, supra*, note 6, at 71.

business exemption. The plumber would not charge VAT on the service he renders to a retail business. Yet, he would bear and presumably would shift to the retailer the VAT he paid on his tools and supplies used in rendering the plumbing service. Assume the plumber charges \$105 for his service to the retailer. The \$105 consists of a \$50 charge for his labor, a \$50 charge attributable to parts, and a \$5 charge for the VAT the plumber paid on the parts. Because the plumber is making an exempt sale, he cannot claim a refund for the \$5 VAT paid on the parts. Since the retailer is not charged VAT on the plumbing service, he would not be entitled to any input credit for the VAT paid on the parts (the tax on value added to the parts) or for the value added by the plumber's labor. Assuming that the retailer includes the \$105 plumbing cost in the sales prices for his products, he will charge VAT a second time on the portion of the sales price attributable to the plumber's \$50 cost of purchases previously taxed.²⁶ The Model Statute attempts to minimize this multiple tax effect by not granting a small business exemption and by limiting VAT exemptions to the supply of goods and services without charge by nonprofit organizations and government entities.

E. Taxation of Employee Benefits

Employers may compensate employees in part with in-kind benefits such as free trips, free use of athletic facilities, and employee discounts that properly can be characterized as consumption. These consumer goods and services provided to employees should be taxed the same as the purchase of the same items by the employees for cash. Some of these benefits, such as meals on a business trip commonly are considered working conditions and not personal consumption of the employees. In fact, there is a personal consumption as well as business element in many of these expenses. As a compromise, the Model Statute taxes only

²⁶The VAT charged on the \$5 VAT previously paid on the parts also creates a tax-on-a-tax or cascade effect. The denial of an input credit on the value of the plumber's labor does not create a multiple tax effect because this labor was not previously subject to VAT.

employee fringe benefits that are taxable to the employee under the income tax rules.²⁷

F. *The Taxable Value of a Sale*

The invoice method VAT generally taxes value added at each stage of production and distribution by imposing tax on the price charged on sales and granting a credit for VAT imposed on purchases. For some business activity, these rules would tax more than value added if a significant portion of the seller's expenses are not paid either to outside taxable suppliers or to employees. Also, following these rules, tax may be imposed on more than the value added by the seller if some of the seller's expenses do not qualify for input credits because they are paid to consumers, not taxable businesses. Insurance, lending activity, gambling, and lottery ticket sales create these special valuation problems. For example, a gambling casino receives cash from the customers' use of slot machines, and pays jackpots to consumers that do not issue tax invoices for the amounts they win.²⁸ Insurance companies receive premiums for issuing policies, and later must pay claims to insured consumers as well as businesses. The Model Statute provides special rules to calculate value added from gambling, insurance, and financial services.²⁹

²⁷*Model Statute, supra*, note 20, s. 4007(b), (c)(2)(B). The fringes that are not subject to income tax generally are described in the *Internal Revenue Code of 1986*, 26 U.S.C. s. 132 (1986).

²⁸If the normal VAT rules applied to gambling transactions, the casino would charge and remit VAT on the cash bet on slot machines, poker, and other games of chance. Assume that in a tax period, the casino received \$10,000 from patrons that bet on one slot machine, and the casino paid or had an obligation (on a progressive jackpot) to pay winners on this machine \$6,000. The casino has an output tax liability of \$1,000 if the VAT rate is 10 percent. Since the winners are consumers that do not purchase this service in connection with a taxable business, the winners will not issue tax invoices for their winnings. The casino is not entitled to any input credit attributable to the \$6,000 payments to winners. VAT would be charged on \$10,000, more than the \$4,000 value added by the casino.

²⁹*Model Act, supra*, note 20, ss 4011(e) (gambling, lotteries, and similar games of chance), 4035 (financial services), and 4036 (insurance).

G. The Input Tax Credit

The input credit is a central feature of an invoice VAT like the Model Statute. A taxable business can claim an input credit for VAT on purchases allocable to taxable sales, whether the purchases are of inventory, supplies, or capital goods. For example, assume a retailer makes sales in a tax period of \$500,000. The retailer purchased in the same period inventory for \$225,000 plus \$22,500 VAT, utilities, advertising, legal and accounting fees, and other noncapital purchases from outside taxable vendors for \$35,000 plus \$3,500 VAT, and new display cases (or other capital goods) for \$25,000 plus \$2,500 VAT. Assuming a 10 percent VAT, the retailer's net VAT liability for the period is \$21,500, computed as follows:

Output tax liability:

Sales — 10% x \$500,000	\$50,000
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Input tax credit:

Inventory 10% x \$225,000	22,500
Utilities, etc. 10% x \$35,000	3,500
Display cases 10% x \$25,000	<u>2,500</u>
	<u>(28,500)</u>

Net VAT liability for period	<u>\$21,500</u>
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Consumers are to bear VAT on their consumption and therefore cannot obtain credit for input tax on their purchases. Nonprofit organizations and government entities cannot claim input credits for VAT on purchases allocable to their exempt supplies of goods and services without charge.

Constructive input credits are available to businesses that purchase used property from consumers. A business also may claim input credits for VAT attributable to bad debts, post-sale price adjustments, and sales refunds. To prevent the imposition of VAT more than once on the same value added, consumers making taxable

casual sales can claim a deferred input credit for VAT paid on the purchase of the property now being sold.

H. *The Person Liable for VAT*

The owner-seller normally is the person liable for the tax on a sale; however, if another person sells on behalf of the owner, the Internal Revenue Service may have difficulty enforcing the seller's obligation to remit VAT on the sale. The Model Statute authorizes the Treasury to issue regulations that treat a non-owner seller as jointly liable with the owner for the tax if he sells on behalf of the owner and has control of the proceeds of the sale.³⁰

I. *Tax Accounting and Tax Payment Rules*

The Model Statute generally links the VAT timing rules to the taxpayer's method of accounting for sales under the income tax. Imports, however, generally are reportable for VAT purposes when goods enter the United States for customs purposes and when services enter for use in the United States.³¹ Congress shall specify the length of the regular tax period, and any shorter period typically provided for taxpayers eligible for refunds of excess input credits. In a novel provision, the Model Statute authorizes a seller to pay his tax liability on certain high-priced sales by filing a buyer's certificate of waiver of input credit. Under this procedure, in sales of entire businesses or other large dollar sales, the buyer must agree to waive her right to claim input credit for VAT imposed on the sale, and both buyer and seller must agree to accept the certificate of waiver as partial payment of the VAT-inclusive sales price.

The Model Statute grants the Treasury authority to issue regulations that require taxpayers to make periodic deposits of tax

³⁰*Ibid.*, s. 4021(b). The non-owner seller that is liable for VAT under this provision may claim input credit attributable to this sale if the owner would have been entitled to a deferred credit on such sale under section 4019 of the Model Statute (deferred credit attributable to taxable casual sales).

³¹See *ibid.*, s. 4024(d)(3).

liability (such as monthly) within each accounting period (likely to be three months).³² It is anticipated that any such required periodic deposits will be based on estimated VAT liability, calculated net of input tax credits.

J. *Impact of VAT on Income Tax*

The Model Statute provides that a business can deduct the VAT collected on sales and remitted to the government as a tax deductible for income tax purposes.³³ The purchaser that claims input credit for VAT paid on purchases must reduce the adjusted basis of the acquired property for income tax purposes by the amount of the allowable input credit.³⁴ For example, if a business purchases a machine for \$10,000 plus \$1,000 VAT and the business claims an input credit of \$1,000 for VAT purposes, the business has a \$10,000 basis in the machine for income tax purposes.

K. *Special Rules to Prevent Tax Avoidance*

A business must pay VAT on business property and services that are diverted to the personal use of the owner.³⁵ A tax also is imposed on a transfer of assets to a creditor in payment or reduction of the transferor's debt.³⁶

To prevent nonprofit organizations and government entities that make exempt supplies from vertically integrating in order to avoid VAT on purchases, the Statute authorizes the Treasury to tax the value of goods and services produced for consumption within the organization or entity.³⁷ For example, assume that a school district exempt from VAT on its educational services purchases each year

³²*Ibid.*, s. 4024(e).

³³*Ibid.*, s. 4032(a)(2).

³⁴*Ibid.*, s. 4032(a)(1).

³⁵*Ibid.*, s. 4033(a).

³⁶*Ibid.*, s. 4039.

³⁷*Ibid.*, s. 4037.

forms and other printed material from an outside printer for \$700,000 plus \$70,000 VAT. As an exempt supplier, the school district cannot claim a refund for the \$70,000 VAT paid on its printing charges. If the school district can establish its own print shop and provide the same printing services in house for less than \$770,00, it may do so. To prevent this incentive toward vertical integration, the Treasury can issue regulations that will require the school district to charge and remit VAT on the value of the printing services supplied in house. The school district therefore would continue to purchase printing services from the outside vendor unless it could provide this service at a cost of less than \$700,000.

If a person switches from taxable to nontaxable status, the Statute requires the taxable person to repay the amount of input credit claimed on purchases that remain on hand on the date of conversion to nontaxable status.³⁸ This rule prevents such person from obtaining an unfair advantage over its competitors. For example, assume a taxable retailer purchased inventory for \$100,000 (exclusive of VAT) and claimed input credits for the \$10,000 VAT paid on the purchases. The retailer's business declines and it becomes exempt from VAT on its sales under a small business exemption. In the absence of a special rule, the retailer can sell this \$100,000 worth of inventory completely free of VAT and thereby obtain a competitive advantage over taxable businesses or even businesses eligible for the small business exemption.³⁹ The Model Statute does not provide a small business exemption. Nevertheless, Congress could add a small business exemption, or a nonprofit organization may decide to stop charging for its services and therefore begin making exempt supplies. The Statute thus provides that in a situation like the above example, the retailer must treat the \$100,000 inventory on hand as a taxable sale to itself in the last tax period before conversion to nontaxable status.

³⁸*Ibid.*, s. 4038(a).

³⁹The latter must bear VAT on their purchases, even though they do not charge VAT on sales.

L. Transition Rules

An American VAT will not replace federal sales taxes other than possibly some selective excise taxes. The United States therefore would not face significant transition problems if it enacted a VAT. The Model Statute does impose VAT on sales after the effective date, even if the sales agreements were executed before the effective date.⁴⁰

III. IMPACT OF A FEDERAL VAT ON THE CANADIAN AND AMERICAN TAX SYSTEMS

The introduction of a broad-based VAT would more dramatically change the American than the Canadian tax system. The Canadian White Paper on Sales Tax Reform⁴¹ proposed a federal VAT to replace a narrow-based, single stage manufacturer's tax that is rife with economic distortions. The manufacturer's tax is complex, does not provide precise border tax adjustments, encourages businesses to shift business activity to a nontaxable stage, and taxes capital goods purchased by firms operating after the manufacturing stage.⁴² Its multiple rates create complexity and economic distortions, imposing uneven effective tax rates on taxed products in the same and different industries.⁴³ On the other hand, the administrative structure for a Canadian federal sales tax exists, and a large number of sellers currently maintain records and file federal sales tax returns. The proposed VAT regimes would provide a more neutral, more broadly-based sales tax that is rebated on exports and imposed on imports.

⁴⁰*Ibid.*, Act s. 5.

⁴¹*White Paper, supra*, note 9.

⁴²See generally *White Paper, ibid.* at 9-24.

⁴³*Ibid.* at 11-12.

All Canadian provinces except Alberta impose some form of general retail sales tax.⁴⁴ If these Canadian provinces replace their sales taxes with a VAT that can piggyback onto the federal VAT, the efficiencies resulting from a unified system may reduce the costs of administering these sales tax systems. Tax compliance costs also may decline for businesses subject both to the existing federal manufacturer's tax and the provincial sales taxes. The replacement of the manufacturer's tax with a broader-based VAT also may provide revenue to offset any revenue lost from the recent reductions in income tax rates.

The existing American federal tax situation is quite different. The 1981 federal tax cuts that did not provide corresponding cuts in federal programs produced record annual deficits and a record national debt. The major income tax reform in 1986 was revenue neutral and therefore failed to address the deficit problem. Indeed, the actual deficit probably exceeds the official estimates.⁴⁵ The centerpiece of the 1986 reform was to broaden the individual and corporate income tax base and substantially reduce the top marginal rates. To raise significant amounts of federal revenue to dramatically narrow the deficit or to raise revenue for new federal programs, Congress could increase the income tax rates, increase revenue from selective excise taxes (such as an oil import tax, higher gasoline taxes, or higher taxes on alcohol and tobacco), or adopt a broad-based consumption tax like the VAT.⁴⁶ Recent estimates indicate that a VAT will yield \$13-22 billion per percentage point in 1989,⁴⁷ but the yield depends upon the number of concessions that Congress would have to make in order to make a VAT politically

⁴⁴Stikeman & Elliott eds, *Doing Business in Canada* (New York: Matthew Bender, 1988) s. 5.04[4] at 5-272.

⁴⁵See, Aaron, *The Political Economy of a Value-Added Tax in the United States*, 38 Tax Notes 1111 (1988).

⁴⁶In a recent article, this author concludes that there are no significant economic or other tax policy reasons for the United States to adopt a federal VAT, unless Congress decides to increase federal revenue and Congress politically cannot increase revenue from existing federal taxes. Schenk, "Value Added Tax: Does This Consumption Tax Have a Place in the Federal Tax System?", 7 Va. Tax Rev. 207 (1987).

⁴⁷Aaron, "The Political Economy of a Value Added Tax in the United States" (1988) 38 Tax Notes 1111-12.

acceptable. In the United States, a VAT would not replace any broad-based single stage or multiple stage tax on consumption because the only federal taxes on consumption are selective excise taxes. An American VAT therefore does not have to overcome deficiencies in existing federal sales taxes. As part of any Congressional debate on VAT, Congress must address the impact of VAT on the tax burden of low income households, on inflation, and on the federal-state relations.⁴⁸ An American VAT would have to gain acceptance as an appropriate method of raising revenue and distributing the federal tax burden.

Except for a limited number of federal excise taxes, the United States does not impose federal sales tax. The state level sales taxes are as diverse as the forty-five states that impose a tax on retail sales.⁴⁹ The items removed from the tax base reflect diverse views on such issues as the propriety of taxing necessities, such as food and drugs, and taxing sales by nonprofit organizations and government entities. In addition, some states impose their retail sales tax on a limited number of services, while others impose the sales tax on a broad range of services.⁵⁰ If the United States Congress enacted a federal VAT, the Internal Revenue Service would have to hire over 20,000 employees to administer the tax at an estimated annual cost of about \$700 million.⁵¹ The government would have to train those expected to administer the VAT, and would have to provide information to the millions of businesses that would be required to maintain records and file VAT returns. The United States Congress therefore would have to impose VAT at a rate that would generate sufficient revenue to justify the administrative and compliance costs associated with the introduction of a federal VAT. It has been estimated that the United States

⁴⁸*Ibid.* at 1112-13.

⁴⁹See Due & Mikesell, *Sales Taxation: State and Local Structure and Administration* 1 (1983) (as of July 1, 1982) [hereinafter *Sales Taxation*].

⁵⁰See generally *ibid.* at 83-105.

⁵¹3 U.S. Dept. of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President* 124, app. at 9-B (1984). The actual cost of a VAT to the government would be even higher because the Treasury estimates do not include the cost of litigating VAT disputes.

would need lead time of about 18 months from the date of enactment until a VAT could become effective.⁵²

IV. ANALYSIS OF MAJOR SIMILARITIES AND DIFFERENCES BETWEEN THE MODEL STATUTE FOR THE UNITED STATES AND THE CANADIAN WHITE PAPER'S FEDERAL VAT

A. *Similarities Between the White Paper and the Model Statute*

1. Invoice method, destination principle, consumption-style VAT

There are significant similarities between the White Paper's proposal for a federal VAT and the Model Value Added Tax Statute for the United States. Both rely on the invoice method of calculating tax liability, utilizing invoices to substantiate tax liability on sales and input tax credits on purchases. Both are relatively pure destination principle VATs that tax imports and zero rate exports.⁵³ These VATs are consumption-style taxes that remove sales of capital goods from the tax base by providing refundable input credits for purchases of such goods.⁵⁴

2. Regressivity of VAT

An essential feature of the Canadian sales tax reform proposal was the decision to expand the sales tax credit that is payable on a quarterly basis to targeted households needing relief in order to offset the regressive effects of a broad-based tax on consumption.⁵⁵ If regressivity is addressed by granting statutory relief to necessities such as food, the tax relief benefits not only

⁵²See *ibid.* at 124.

⁵³*White Paper, supra*, note 9 at 29; *Model Statute, supra*, note 20, ss 4003(a) and 4012. See discussion in text accompanying note 20 *supra*.

⁵⁴*White Paper, ibid.* at 29; *Model Statute, ibid.*, ss 4016(a),(d), 6401(b)(3), and 6402(h).

⁵⁵*White Paper, ibid.* at 45.

consumers with low income but consumers in high income households as well. While the Model Statute does not contain a legislative proposal to address the regressive effects of the VAT, the committee recommends that regressivity be addressed outside the VAT regime through targeted tax credits or increases in direct grant programs.⁵⁶

3. Taxation of international transactions

Both the White Paper and the Model Statute define the jurisdictional reach of the VAT under the destination principle; that is, imports are taxed and exports are freed of tax.⁵⁷ The Model Statute zero rates sales of all goods and services for export.⁵⁸ The White Paper zero rates exports of goods, intellectual property, and some services.⁵⁹ Foreigners can claim refunds for VAT paid on goods exported if their purchases exceed a threshold amount. Sales at duty-free shops also are zero rated.⁶⁰ Services related to zero-rated exports of goods and services also are zero rated. The White Paper lists the kinds of services rendered to nonresidents and

⁵⁶Schenk, reporter, Value Added Tax – A Model Statute and Commentary, *supra*, note 6 at 71.

⁵⁷The White Paper provides that exports are tax-free sales; that is, there is no VAT on the export sales and the seller can claim input credit for VAT attributable to these export sales. *White Paper, supra*, note 9 at 89. The *Model Act* classifies these sales as zero-rated sales.

⁵⁸*Model Statute, supra*, note 20, s. 4012.

⁵⁹*White Paper, supra*, note 9 at 89. Sales of patents, copyrights, know-how and other intellectual property is zero rated if made in Canada to nonresidents who are not taxpayers. *Ibid.* Zero rating is provided for certain international transportation services and services provided in Canada to operators of ships and aircraft used in international transport, services rendered in Canada for a nonresident who is not a taxpayer if (a) the service is for use exclusively outside Canada, (b) the service pertains to goods to be exported, or (c) the services pertains to goods to be exported, or the service pertains to goods situated outside Canada or goods temporarily in Canada for service and export. *Ibid.* at 89-90. Services attributable to real property located outside Canada also are zero rated. *Ibid.* at 90.

⁶⁰*Ibid.* at 90.

services attributable to real property located outside Canada that are entitled to zero rate (tax-free) treatment.⁶¹

The White Paper taxes imports of goods at ports of entry, except for imports eligible for tourist, immigrant, and returning resident exemptions.⁶² In part to simplify the administration of the tax, the White Paper does not directly tax imported services at the point of entry. Imports by businesses engaged in taxable domestic activities are taxable at the stage after import when the importer makes sales at prices that incorporate the value of the imported services. The White Paper suggests that the government rely on a self-assessment system to tax the value of services imported for use in nontaxable activities.⁶³ The Model Statute imposes tax upon the import of goods and services into the United States. Unlike the White Paper, the Model Statute taxes imports of services by businesses when the services enter for use in the United States, not when they are incorporated into goods and services and are sold by the importer.

The White Paper's treatment of imported services apparently was prompted by administrative convenience. It is relatively easy to tax goods at the port of entry because goods can be inspected and taxed. Services cannot be inspected easily by customs officials. Blueprints, know-how, and other services may be transmitted by mail, by satellite, or in person. It is not clear that the Model Statute approach will result in sufficient additional revenue to justify the added administrative and compliance costs.

⁶¹*Ibid.*, at 90. Tax-free exports of services include certain international transportation services, "[s]ervices performed in Canada for non-resident operators of ships and aircraft for use in transporting passengers or goods to or from Canada," "[s]ervices supplied in Canada to a non-resident who is not a taxpayer for use exclusively outside of Canada," "[s]ervices supplied to a non-resident who is not a taxpayer in respect of goods for export from Canada," "[s]ervices supplied in Canada to a non-resident who is not a taxpayer in respect of goods, ordinarily situated outside Canada, that are either situated outside Canada at the time of the supply or are temporarily imported for the sole purpose of having the services performed on them and exported thereafter", and "[s]ervices in respect of real property located outside Canada." *Ibid.*

⁶²*Ibid.* at 91.

⁶³*Ibid.*

4. Taxation of financial services and insurance

The Model Statute approach to the taxation of financial services and insurance was taken in large part from the Canadian White Paper.⁶⁴ The Model Statute therefore resembles the Canadian proposal to tax the value of intermediation services provided by insurance companies and financial institutions, but it needs more study. There are significant problems associated with the implementation of a VAT on intermediation services, particularly transition problems created when rates are changed and problems in computing the tax base when an insurance company also provides financial services. In addition, there is potential for tax avoidance if VAT is not imposed on imports of financial services and insurance by persons making exempt sales. If VAT is imposed on the import of such services, then it is important for the importing businesses to be granted input credits for VAT attributable to such imports.⁶⁵ Both the White Paper and the Model Statute attempt to achieve the admirable goal of taxing the services of these two industries. With few exceptions, other nations have not found a politically acceptable way to tax insurance and financial services under their VATs.

5. Other similarities

The White Paper and the Model Statute tax property and services diverted from business to personal use.⁶⁶ For example, assume a woman operating a retail clothing store as a sole

⁶⁴The Model Statute does not provide specific rules on how the value of intermediation services is to be calculated or how this tax treatment can be integrated into the invoice method VAT. See *Model Statute, supra*, note 20, ss 4035 and 4036. The committee also was influenced by the following two articles: Hoffman, Poddar & Whalley, "Taxation of Banking Services Under a Consumption Type, Destination Basis VAT" (1987) 40 Nat'l Tax J. 547; Barham, Poddar & Whalley, "The Tax Treatment of Insurance Under a Consumption-Type, Destination Basis VAT" (1987) 40 Nat'l Tax J. 171.

⁶⁵Compare the White Paper approach with the approach taken by the authors of the articles in the National Tax Journal cited *supra*, note 64.

⁶⁶See *Model Statute, supra*, note 20, s. 4033, taxing the diversion of property or services to the personal use of the owner of a business (including a member of her family); *White Paper, supra*, note 9 at 100-01.

proprietor takes a suit from inventory for her personal use. The Model Statute treats this diversion to personal use as a taxable sale of the suit at its fair market value. Promotional gifts are not taxed under either the White Paper or the Model Statute.⁶⁷ The White Paper taxes gifts provided to employees; the Model Statute taxes such gifts if they are taxable benefits under the income tax law.⁶⁸

B. *Differences Between White Paper and Model Statute*

There are many notable differences between the White Paper's federal VAT and the Model Statute. These differences should not mask the fact that in most significant respects, the VATs are alike. Many of the differences may reflect differences in the Canadian and American economies and differences in approach, rather than disagreements on major tax policy issues relating to the appropriate base for a federal tax on consumption.

1. Tax period and periodic deposits of tax liability

The Model Statute provides for a uniform tax accounting period (probably three months) and a shorter period for taxpayers such as exporters that can claim refunds of excess input credits. The length of these tax periods is to be set by Congress. The Treasury could require taxpayers to make periodic deposits of tax liability within the uniform tax accounting period. The Canadian proposal would vary the length of the tax period on the basis of the size of the firm and its sales volume. It also would permit taxpayers entitled to refunds of excess input credits to use a shorter tax period to obtain a refund more quickly.⁶⁹ In contrast to the Model Statute, the Canadian approach increases the number of returns required of large firms and reduces the number of returns for small firms. The more frequent returns required of large firms can be expected to

⁶⁷See Schenk, reporter, Value Added Tax – A Model Statute and Commentary, *supra*, note 6, at 26, 46, and 164-65.

⁶⁸Model Act, *supra*, note 20, s. 4007(b),(c)(2)(B); *White Paper*, *supra*, note 9 at 101.

⁶⁹*White Paper*, *ibid.* at 34, 73.

increase taxpayer compliance costs and government processing and auditing costs, unless some of these returns will be treated as interim returns requiring minimal information. While the fewer returns filed by small businesses would reduce these administrative costs, the government would have to wait longer to receive the net revenue from sales made during each such long tax period. On balance, the Model Statute approach is a better compromise, although there are administrative cost advantages in lengthening the tax period somewhat for small firms with low tax liability. A quarterly return with periodic deposits would reduce tax administrative costs by reducing the number of returns, without adversely affecting the flow of tax revenue to the government.

The White Paper proposes that the government pay small businesses a fee to collect and remit VAT.⁷⁰ A fee for businesses to collect the retail sales tax is provided by some American states.⁷¹ The issue of whether to authorize a fee is a political, not tax policy issue. The Model Statute does not include any recommendation for or against the provision of a fee for business to collect an American VAT.

2. Tax base

The White Paper and the Model Statute both propose broad-based VATs, but they use different approaches to achieve this goal. The White Paper imposes tax on a person engaged in a taxable activity.⁷² Taxable activity includes the carrying on of a business by a person. Commercial sales made by persons exempt from income tax,⁷³ and sales and rentals of commercial real property or new housing constitute taxable activity. The White Paper has a small business exemption. Sales by an individual proprietor to a

⁷⁰*Ibid.*, at 37.

⁷¹The fee generally is provided by giving sellers a discount on the payment of the tax that they collect. See, Due & Mikesell, *Sales Taxation*, *supra*, note 49, at 327-29.

⁷²*White Paper*, *supra*, note 9 at 71.

⁷³*Ibid.*

final consumer are not taxed if the sales do not exceed \$5,000 in any calendar year.⁷⁴

The Model Statute adopts a broad concept of a taxable person subject to the VAT. A taxable person is not only a person who engages in taxable and nontaxable transactions⁷⁵ in connection with a business, but a consumer who engages in taxable casual sales for consideration above a threshold amount.⁷⁶ The VAT committee decided that VAT should be imposed not only on casual sales and rental of real property by consumers if the value of the property being sold or rented exceeds a threshold amount, but VAT also should be imposed on casual sales and rentals of other property above the same threshold. Thus, the Model Statute taxes casual sales and rental of high-priced art and other collectibles, boats, planes, and other assets.⁷⁷ The White paper does not appear to have a comparable provision. The Model Statute approach produces a broader tax base. The administrative and compliance cost of taxing these high-priced sales (including the requirement that consumer sellers must file ad hoc returns) is outweighed by the revenue and neutrality benefits of taxing them.

The White Paper, as mentioned above, provides an annual exemption for commercial sales by individuals to final consumers of not more than \$5,000.⁷⁸ Presumably, this exemption applies when sole proprietors make sales below this \$5,000 level. The Model

⁷⁴*Ibid.* at 97. A comparable exemption is provided for sales by a charity, non-profit organization, or government body. *Ibid.* at 109.

⁷⁵Nontaxable transactions include certain transfers by a debtor to a creditor, transfers to a fiduciary representing the interest of a person under legal disability, transfers to trustees or others appointed to manage a debtor's assets for the benefit of creditors, certain tax-free imports, and certain foreign situs sales that are not exports. *Model Statute, supra*, note 20, s. 4004.

⁷⁶See *ibid.*, s. 4005.

⁷⁷To prevent the imposition of VAT a second time on value added that was taxed when the seller purchased the asset, the Model Statute grants the casual or non-business seller a credit for the VAT paid on such purchase. *Ibid.*, s. 4019. Under this provision, a casual seller cannot claim a refund for any excess input credits attributable to a taxable casual sale. Thus, if the output tax on the casual sale is \$1,000 and the deferred input credit is \$1,200, the casual sale does not generate any net VAT liability due or claim for a VAT refund. See *ibid.*, s. 4019(a)(2).

⁷⁸*White Paper, supra*, note 9 at 97.

Statute does not include any small business exemption. The experience with state retail sales taxes in the United States indicates that small businesses maintain adequate records and are able to comply with sales tax return filing requirements. The federal government therefore should be able to impose a VAT even on small businesses. The low threshold for the Canadian small business exemption will limit relief to street vendors, part-time artists selling at art fairs, and the like. As a result of the low small business exemption under the White Paper, there is little practical difference between the two proposals.

The Model Statute, as discussed earlier, taxes fringe benefits provided by an employer to an employee only if those benefits are taxable to the employee under the income tax.⁷⁹ This rule was adopted as a compromise. The committee recognized that consumer goods and services provided to employees in kind should be subject to VAT, but it was concerned that the Treasury and Congress would have the same difficulty identifying the employee benefits that should be subject to VAT that they had in developing the income tax rules on fringe benefits.

The White Paper subjects more fringe benefits to the VAT. Rather than treating the provision of all in-kind benefits to employees as taxable sales, the White Paper treats different kinds of benefits differently. Generally, an employer cannot claim input credits for VAT on purchases of goods and services that are provided to employees in lieu of compensation.⁸⁰ The employer also is denied input credits for VAT attributable to benefits such as health and education services that are exempt from VAT.⁸¹ Even if an input credit is not denied under the above two rules, the employer still cannot claim an input credit for VAT on purchases "of goods and services acquired for use exclusively for the personal benefit of the taxpayer's employees or any individual related to an employee."⁸² Input credit thus is disallowed for VAT paid on the cost of items such as group term life insurance and an employee's

⁷⁹*Model Statute, supra*, note 20, ss 4007(b), (c)(2)(B).

⁸⁰*White Paper, supra*, note 9 at 82.

⁸¹*Ibid.* at 82-83.

⁸²*Ibid.* at 83.

vacation trip.⁸³ Finally, the employer must treat as a taxable sale subject to VAT the value of certain employee benefits.⁸⁴ This rule applies to purchases, such as company cars, that are not used exclusively for the employee's benefit and therefore are not subject to the input credit disallowance rule discussed above. The employer is deemed to make a taxable sale equal to "the value of the employee benefit element of these costs as calculated for income tax purposes."⁸⁵ These rules on employee benefits are similar to the Model Statute rules. The White Paper, however, provides a somewhat broader tax base because it denies input credits for VAT attributable to purchases such as fees and dues paid to clubs providing dining, recreational or sporting facilities for its members.⁸⁶ The White Paper approach therefore is preferable. Indeed, this White Paper input credit disallowance approach could be extended to cover VAT on certain purchases that are not deductible for income tax purposes because they include a personal consumption component. A disallowance rule for the United States could extend not only to VAT on meal and entertainment costs, but to VAT on the portion of luxury cars, computers, and other items that are not deductible for income tax purposes. This link of input tax disallowance to the income tax rules would make it easier to administer the VAT rule.⁸⁷

Gambling, lotteries, and other games of chance are taxable under both proposals. The suppliers of these services make payments to consumers that do not issue tax invoices. If the statute does not provide special rules to compute the taxable amount of these services (output tax), these services would be subject to tax on

⁸³ *Ibid.*

⁸⁴ *Ibid.*

⁸⁵ *Ibid.* This rule does not apply to employers making sales exempt from VAT because they already are denied credits for all VAT attributable to the exempt sales. *Ibid.*

⁸⁶ *Ibid.* at 81. The disallowance rule extends to VAT on purchases, rental, or the construction of similar facilities. This disallowance rule does not apply to taxpayers that use such property in a sporting or recreational business or to taxpayers that sell such property. *Ibid.*

⁸⁷ See generally, *Int. Rev. Code of 1986*, ss 274, 280A, and 280F. The White Paper disallows input credit for VAT on the portion of the sale or lease cost of passenger vehicles that is attributable to the value in excess of \$20,000. *White Paper, supra*, note 9 at 82.

more than value added by the casinos or other providers. The Model Statute defines the taxable amount of these activities as gross receipts, reduced by the amount paid to the winners.⁸⁸ The White Paper taxes the same value added, but calculates the net VAT liability in a slightly different manner. The output tax is based on the proceeds from these activities and the input credit is based on the payments to winners. The tax bases should be equal. The White Paper, however, may tax less gambling and lottery activities because it taxes only those activities conducted on a commercial basis.

3. Input tax credit

The Model Statute provides an input credit for tax charged on all purchases attributable to taxable sales, whether the purchase represents inventory, supplies, or capital goods to the purchaser. Except for purchases attributable to exempt supplies by charitable organizations and government entities, the Model Statute does not disallow an input credit on a purchase as a device to indirectly tax the purchase as taxable personal consumption.⁸⁹ The Model Statute generally allows the input credit but taxes the use of business property for nonbusiness purposes. For example, the Model Statute treats an employer's transfer of property or services to an employee as compensation as a taxable sale by the employer unless the benefit is excludable from the employee's income for income tax purposes.⁹⁰ The Canadian proposal on input credits departs significantly from the Model Statute approach. It disallows the input credit on purchases that are deemed to be personal consumption.⁹¹ The

⁸⁸*Model Statute, supra*, note 20, s. 4011(e). The Model Statute taxes gambling, lotteries, and similar activity whether conducted by businesses operated for profit or by nonprofit organizations and government entities.

⁸⁹See text accompanying notes 86 and 87, *supra*, suggesting that in some cases a disallowance rule may be useful to tax consumption indirectly.

⁹⁰*Model Statute, supra*, note 20, s. 4007(b),(c)(2)(B).

⁹¹The White Paper anticipates that the VAT legislation will include a special rule to require a taxpayer to repay some input credit for VAT on purchases of capital goods that are diverted from business to nonbusiness use. *White Paper, supra*, note 9 at 83-84. The *Model*

disallowed input credit serves as a surrogate for taxing the provision of such goods or services to the consumer. The consumer may be an employee, a customer, or other business associate. According to the White Paper, a business cannot claim credit for input tax on certain membership fees or dues in clubs providing dining, recreational, or sporting facilities for members.⁹² A taxpayer cannot claim input credit for VAT on purchases that are the taxpayer's personal or living expenses, including leases of property for the personal use of the taxpayer or her relatives.⁹³ Input credit generally is disallowed for VAT on purchases of items provided to employees as compensation in kind.⁹⁴ VAT on purchases or leases of a passenger vehicle also is disallowed to the extent that the VAT is attributable to value of such vehicles in excess of \$20,000.⁹⁵ The input tax disallowance rules result in the taxation of final consumption, but it is not clear why only select items were singled out for special treatment. Other business purchases also possess the dual character of business expense to the employer and personal consumption to the employee or other recipient. For example, free parking for employees and free tickets for customers to attend a play contain elements of personal consumption as well as business expense.

If a business provides meals, recreation services, or similar benefits to employees, customers, or others without charge, the business can be expected to include these costs in the sales price of its goods or services. A business making taxable sales therefore will charge and remit VAT on the value of these benefits. If the input tax on purchases used in providing these benefits is disallowed, the cost of these purchases (to the extent they enter the price of the business's taxable goods and services) is taxed twice. Indeed, to the extent the input tax on these purchases is shifted into product prices, there will be a tax-on-a-tax or cascade effect. The multiple

Statute, supra, note 20, ss 4033 and 4038, treats such diversions as taxable sales.

⁹²*White Paper, supra*, note 9 at 81.

⁹³*Ibid.* at 81-82. Travel expenses while away from home on business are not considered personal expenses. *Ibid.*

⁹⁴See *ibid.* at 82-83.

⁹⁵*Ibid.* at 82.

tax or cascade effect also occurs if costs are shifted and input credit is denied for VAT on purchases that are diverted to the personal use of owners of the business or their relatives, or VAT on purchases that are used to provide compensation in kind to employees. The multiple tax or cascade effect may be justified in these situations. Because of the special relationship between a business and its owners and employees, in the absence of a special rule, a business may provide consumer goods and services to these individuals in order to avoid VAT on the value the business adds to such goods and services. For example, a retailer selling televisions purchases a popular Sony stereo television for \$475 plus \$47.50 VAT and generally sells it for \$600 plus \$60 VAT. An employee who wants to purchase this television would prefer to have his employer give him the television rather than cash compensation, unless the cash is \$660 or more. Even if the business is denied an input credit for the \$47.50 VAT on the purchase of this television, and the employee must report at least \$600 as income for income tax purposes, the above transaction saves the employee up to \$12.50 VAT (\$60 VAT on a \$600 sale less the disallowed input credit of \$47.50). The Model Statute removes this advantage by treating the transfer of the television to the employee as a taxable sale by the business for \$600 only in cases such as this where the employee must report the value of the television (compensation in kind) as income for income tax purposes. Despite the multiple tax or cascade effect resulting from the taxation of meals and other benefits to employees and customers, the tax should be levied on the value of consumer goods and services provided to employees and customers. The White Paper approach is better because it attempts to identify and tax more of these items than the Model Statute.

The Model Statute taxes all sales by nonprofit organizations and units of government if the seller imposes a charge or fee; it exempts only supplies by them without charge.⁹⁶ The White Paper exempts from VAT residential rentals and resales of personal

⁹⁶*Model Statute, supra*, note 20, s. 4014(a),(b).

residences.⁹⁷ The Model Statute taxes these sales. The taxation of sales of real property and sales by charitable organizations and government entities is discussed later in this article.

4. Used property

The White Paper and the Model Statute basically tax sales of used property the same. Sales are taxable and the seller can claim credit for VAT attributable to purchases of the used property. When a used property dealer sells used property acquired from a consumer, the dealer is allowed a constructive credit for VAT deemed paid on the purchase.⁹⁸ The White Paper's VAT, however, would deny this constructive credit for purchases from consumers of property that tends to appreciate in value, such as works of art and other collectibles.⁹⁹ If a constructive credit is allowed for the cost of such purchases, then the appreciation that occurred while the consumer held the property would not be subject to VAT. For example, assume a consumer purchased a Picasso painting for \$10,000 plus \$1,000 VAT and sold it to an art gallery for \$27,500. The gallery resold the painting for \$30,000 plus \$3,000 VAT. If the gallery receives a constructive input credit for the \$2,500 VAT deemed paid on the purchase ($10/110 \times \$27,500$, or \$2,500), the gallery remits net VAT of \$500 on the sale (\$3,000 less \$2,500). A total of \$1,500 VAT is imposed and remitted to the government on the sales to the two consumers. The \$15,000 appreciation (net of VAT) occurring while the first consumer held the painting escapes VAT. On the other hand, if the statute denies credit for any part of the cost of such used property acquired from a consumer, the value added represented by the cost of the article to the first consumer (\$10,000) will be taxed a second time. On balance, the VAT committee decided to accept the revenue loss attributable to

⁹⁷*White Paper, supra*, note 9 at 41. There is a transition problem in Canada if Canada chose to tax these sales because the existing federal sales tax has been paid on materials used to construct the existing stock of real property.

⁹⁸See *Model Statute, supra*, note 20, s. 4017, and *White Paper, ibid.* at 99-100. The constructive credit is based on the dealer's purchase price.

⁹⁹*White Paper, ibid.* at 100.

the \$15,000 appreciation that occurs under the Model Statute's constructive credit rule in order to prevent multiple taxation of the same value added.¹⁰⁰ This treatment also avoids the administrative problem of segregating purchases not subject to the constructive credit from purchases eligible for such credit. The White Paper, however, provides a broader tax base by taxing the appreciation.

5. Transportation

The Model Statute taxes the sale of transportation vehicles and transportation services in the United States. The White Paper taxes all such services, with the exception of "local transit services provided on a not-for-profit basis."¹⁰¹ Most transit services provided on a nonprofit basis are provided by government agencies. The White Paper's exemption for subsidized local transit actually may increase the tax base if the input tax on purchases exceeds the output tax that would be charged if this transportation were taxed. In such cases, the taxation of mass transit may enable the transit authority to reduce fares over the level required if the local transit were exempt.

A VAT is more neutral with respect to alternative forms of transportation services (notably commuting to work) if all such services are taxed alike, whether provided by government entities or by private bus companies or taxicabs operated for profit. The Model Statute taxes all such transportation but does not provide pure tax neutrality in this area because VAT is imposed on the

¹⁰⁰See generally, Schenk, reporter, Value Added Tax – A Model Statute and Commentary, *supra* note 6, at 101-107. The statute could tax this \$15,000 appreciation by limiting the constructive credit to the \$1,000 VAT on the first consumer's \$10,000 cost of the painting. If it is administratively feasible to require the used property dealer to support its constructive credit with a copy of the first consumer's VAT invoice for the painting, the constructive credit should be limited to the VAT imposed on the first consumer's cost of the painting.

¹⁰¹*White Paper, supra*, note 9 at 93. The Ullman Bill proposed in the United States in 1980 proposed that mass transportation services provided in urbanized areas be zero rated. H.R. 7015, s. 4013(2). The White Paper suggests that the exemptions for transactions "isolated from other marketing and production chains" will not produce economic distortions or significantly complicate the law. "In fact, they simplify administration and compliance." *White Paper, supra*, note 9 at 41.

price charged for the transportation services. Consequently, the subsidized mass transit will be taxed less than the higher priced, non-subsidized privately-provided transportation services, especially if input credits exceed tax liability on fares charged. There is another alternative. All transportation services are taxed. For highly-subsidized mass transit, the provider could be required to charge VAT on the basis of the value of the services, not on the lower subsidized price.

6. Charitable-governmental sectors

The White Paper's VAT taxes sales of a commercial nature by charities, nonprofit organizations, and government bodies, in order to "ensure fair and uniform application of tax to commercial supplies made by the profit-making and non-profit sectors and minimize competitive distortions".¹⁰² Nevertheless, commercial sales by volunteer organizations¹⁰³ are exempt. Sales (other than land sales) by a charity, nonprofit organization, or government body also are exempt if the annual sales do not exceed \$5,000.¹⁰⁴ The White Paper taxes specific kinds of sales by charities, including sales in a retail store or restaurant, admissions to certain performances and athletic events, and sales of land to private individuals for residential construction or personal use.¹⁰⁵ Nonprofit organizations and governments are taxable on the kind of commercial activity that

¹⁰²*White Paper, supra*, note 9 at 109.

¹⁰³*Ibid.* at 109. A volunteer organization is an organization that conducts an activity provided with unpaid volunteers. *Ibid.*

¹⁰⁴*Ibid.* See also note 115 *infra*. A charity includes "a registered charity or registered Canadian amateur athletic association within the meaning of the *Income Tax Act*." *Ibid.* A non-profit organization includes "any organization established and operated for any purpose other than profit, provided no part of the organization's income is available for the benefit of any member of the organization. Specifically excluded from this definition would be organizations established and operated primarily to provide dining, recreational or sporting facilities for their members." *Ibid.* at 110. Government includes "government departments, agencies, Crown corporations that are agents of the Crown, and municipalities." *Ibid.*

¹⁰⁵*Ibid.* at 109-110. The land sales are not eligible for the volunteer exemption (where "all or substantially all of the staff involved in the management and operation of the activity are unpaid volunteers – *ibid.* at 109), or the \$5,000 small business exemption. *Ibid.* at 110.

generally is supplied by the private sector.¹⁰⁶ Some such taxable activities will be specifically identified. Other than the above described sales of real property to individuals, sales of real property by these entities are exempt from VAT.¹⁰⁷ Nonprofits and government entities are taxable on charges for the kind of admissions that are taxable to charities.¹⁰⁸ Health services provided by nonprofits and government organizations are exempt from VAT.¹⁰⁹ Health services provided by the private sector are exempt if they are covered by the Canada Health Act or under government-funded programs, but other health services by the private sector are taxable.¹¹⁰ The White Paper VAT exempts educational services provided by the charitable-governmental sectors, but taxes ancillary sales, such as sales by bookstores and cafeterias run by these entities.¹¹¹

The exemptions for health services and education may increase the tax base. Health and education services, singled out for special treatment, both are heavily subsidized in Canada. The actual charges therefore represent only a fraction of the cost of providing these services. If these activities were taxed, the service provider may have input credits on purchases that exceed the output tax on the services, entitling them to claim refunds for the excess credits. In this situation, taxing the services would reduce the tax base. The same result may occur if charities or government entities charge nominal fees for services in order to claim refunds for excess input tax credits. The White Paper attempts to avoid this potential loophole and to expand the tax base by taxing only sales incident to commercial activity by nonprofit organizations and governments that generally is provided by commercial businesses.¹¹² The White Paper

¹⁰⁶*Ibid.* at 110. For this purpose, organizations providing dining, recreational, or sporting facilities to its members are not considered nonprofits. *Ibid.*

¹⁰⁷*Ibid.* at 111.

¹⁰⁸*Ibid.*

¹⁰⁹*Ibid.*

¹¹⁰*Ibid.*

¹¹¹*Ibid.* at 111-112.

¹¹²*Ibid.*, at 110.

apparently will not tax most transactions by a nonprofit or unit of government if the sales are made without any expectation of profit.¹¹³ If the seller of a noncommercial sale has taxable purchases that exceed sales, the exemption actually increases the tax base. If, on the other hand, a small fraction of the cost attributable to noncommercial sales is taxable purchases, the exemption reduces the tax base. For example, assume that tuition charges at a public university is \$1,000 and the actual cost of providing this education is \$3,000. The \$3,000 consists of labor of \$1,800 and taxable purchases of \$1,200. If education is taxable at a 10 percent rate, the university must charge \$100 VAT on the tuition and can claim credit for \$120 VAT paid on purchases, producing excess credits of \$70 that would be refundable by the government. If, on the other hand, the \$3,000 cost of the education consists of labor of \$2,500 and taxable purchases of \$500, the university must charge \$100 VAT on the tuition and can claim credit for \$50 VAT paid on purchases, producing a net VAT liability of \$50 that must be remitted to the government.

Nonprofits and other sellers of exempt goods and services have an incentive to produce goods and render services in-house rather than purchase them from outside vendors. These sellers of exempt goods and services can avoid VAT chargeable by the outside vendors by vertically integrating their operations. The White paper attempts to minimize this incentive to vertically integrate operations by taxing self-consumption of a limited number of goods and services. A blanket rule taxing all such self-consumption, according to the White Paper, would be administratively burdensome.¹¹⁴

The White Paper's VAT draws many lines between taxable and exempt sales, and may encourage taxpayers to claim that borderline transactions fit within the exempt categories. For most commercial transactions, however, the nonprofit or unit of government maintains separate records of the activity. The tax

¹¹³ Many of these transactions, if taxable, would generate excess credits that are refundable. The seller would not have excess input credits where the sales price covered the cost of taxable purchases. This situation would arise where a large part of the value of the goods or services provided by the nonprofit or unit of government is attributable to labor employed by the selling entity.

¹¹⁴ *White Paper, supra*, note 9 at 112.

calculation therefore should not be too burdensome for the seller. For some sales, such as sales of real property by charities, the seller must ascertain the buyer's expected use of the property in order to determine the tax consequences of the sale.

The White Paper provides a de minimis exemption for otherwise taxable commercial sales by charities, nonprofit organizations and government bodies. The exemption applies if these sales on an annual basis do not exceed \$5,000.¹¹⁵ If the sale is exempt and the VAT component attributable to the seller's purchases is buried in the selling price, the resale by the purchasing business will produce a cascade tax effect. The exemption for educational services also may produce a cascade effect if an employer pays for the education and cannot claim credit for the VAT component in the tuition payment.

The Model Statute taxes the activities of the charitable-governmental sectors in a different manner. All sales for a consideration by charities and units of government are taxable.¹¹⁶ Only supplies without consideration are exempt from tax.¹¹⁷ By regulation, the Treasury can prevent these entities from imposing a nominal charge in order to claim refunds for excess input credits. For example, assume that a charity charges \$1.00 a night for an indigent to sleep at its facility. If this rental charge is taxable, the charity must charge VAT on the \$1.00 rental and can claim input credits for VAT on all of its purchases attributable to this rental, producing in many situations a refund for most of this input tax. By regulation, the Treasury can treat this rental as exempt from VAT, so that the charity will not charge VAT on the \$1.00 rental charge and will not be entitled to claim a refund for excess input credits.

Self-consumption by exempt sellers are subject to tax on the basis of the item's fair market value. The Model Statute grants the

¹¹⁵*White Paper, supra*, note 9 at 109. The exemption applies "if the revenue from all such supplies made by such an organization does not exceed \$5,000 per annum." *Ibid.* Presumably, this exemption is based on the sales price, not income from the sales. See *ibid.* at 97, for a comparable \$5,000 exemption that is based on the amount of sales made by individuals.

¹¹⁶*Model Statute, supra*, note 20, s. 4014(a).

¹¹⁷*Ibid.*, s. 4014(b).

Treasury authority to designate the self-consumption transactions that are taxable.¹¹⁸

The Model Statute attempts to use an objective definition of sales exempt from VAT. There still will be some line drawing problems created when the Treasury exercises its authority in this area.¹¹⁹ An alternative would be to deny nonprofits and government entities a refund for excess credits, except in situations where they make sales that compete directly with businesses in the private sector.

It is not clear to the author that the White Paper approach to the taxation of the charitable-governmental sectors is better than the Model Statute, or vice versa. The net effect upon the tax base (the revenue) depends upon the level of subsidy for each category of exempt sales. Under both approaches, there are administrative problems in identifying transactions at the fringes of each exempt category.

7. Real property

The White Paper taxes sales and rentals of real property that are made in connection with a seller's business or profit-seeking activities. Sales and rentals for commercial use are taxed.¹²⁰ Hotel and similar short-term rentals, whether for commercial or residential use, are taxed. The business that purchases or rents this property therefore can claim input credit attributable to such property. If these transactions were exempt, the seller or lessor still would include his input tax in the sales price or lease charge, and a business purchaser or lessee could not claim credit for VAT attributable to this purchase or lease transaction.¹²¹

¹¹⁸*Ibid.*, s. 4037.

¹¹⁹If a subsidized service is taxable, the nonprofit organization or unit of government can claim credit for input tax attributable to the taxable service. This allocation may be quite difficult, especially for purchases in the nature of overhead, when the entity is providing both taxable and exempt services.

¹²⁰*White Paper*, *supra*, note 9 at 113.

¹²¹See discussion of the multiple tax effect *supra*, note 26 and accompanying text.

The White Paper exempts most long-term leases of residential real property, sales of used homes, and sales of personal use real property.¹²² For example, residential rentals for 30 days or more, resales of homes and vacation homes, and sales of hobby farms are exempt from VAT.¹²³ The White Paper also exempts sales and rentals of real property by entities in the charitable-governmental sectors. Sales of new homes, on the other hand, are taxable.¹²⁴ Sales of land by nonprofits and governments to individuals are taxable if the individual purchaser will use the land for home construction or other personal uses.¹²⁵ A sale of a used home also may be taxable if the home was purchased, substantially renovated, and resold.¹²⁶ The taxation of these used homes is designed to tax only value added by a taxpayer in the business of renovating and reselling homes, and also to "equate the resale of substantially renovated homes with the sale of new homes."¹²⁷ To prevent tax avoidance where a builder constructs residential rental property, claims input credit on her purchases, and then leases the property to tenants in exempt rental transactions, the White Paper treats this self-supply as a taxable sale of the completed property by the builder to herself.¹²⁸

The Model Statute taxes all sales and rental of real estate, whether by a business in the private sector or by a charitable organization or government entity. The Statute also taxes casual sales and rentals of certain high-priced real property by individuals. Except for this casual sale exception, the Model Statute's taxation of real estate is straightforward. The seller does not have to inquire

¹²²*White Paper, supra*, note 9 at 113, 115.

¹²³If real property is used in part for commercial rental and in part for long-term residential rental, the lessor is denied input credit for VAT attributable to the residential rental portion of the real property. See *ibid.*

¹²⁴When real property not eligible for an input credit at the time of purchase subsequently is resold in a taxable transaction, the seller can claim a deferred credit for that VAT. *Ibid.* at 116.

¹²⁵*Ibid.*

¹²⁶*Ibid.* at 115.

¹²⁷*Ibid.*

¹²⁸*Ibid.* at 116.

into the buyer's use of the property to determine tax consequences, and the tax consequences of a real property sale do not depend upon the status of the seller as one in the private sector or in the charitable-governmental sectors. For high-priced property, it also taxes casual sales and commercial sales of real property alike. The Model Statute approach is preferable if the goal is to design a tax with the broadest possible base. So long as real property appreciates in value, the taxation of this property by charities and units of government should expand the tax base.

V. CONCLUSION

The Canadian government is expected to propose sales tax reform based in large part on the principles contained in the White Paper on Sales Tax Reform. The VAT may be a federal only tax that replaces only the federal sales tax or a combined federal-provincial VAT that replaces existing sales taxes at both levels of government. It is expected that the enactment of a VAT will be combined with an expanded tax credit for targeted low income households. With the enactment of VAT in Canada, the United States will remain the only major Western industrialized nation that does not impose a VAT as a federal revenue source. A Canadian VAT will replace existing sales taxes. An American VAT would not replace any federal taxes on consumption, except possibly for a few selective excise taxes.

The Canadian White Paper and the Model Statute for the United States both propose a broad-based VAT designed to minimize economic distortions, distortions in consumer choices, and the multiple taxation of the same value added. The Model Statute was drafted absent political considerations. The White Paper took some political realities into account.

The Model Statute and the White Paper's federal Value Added Tax are alike in many significant respects. They both are transactions taxes that rely on invoices to calculate output tax on sales and input credits on purchases. Both tax imports and zero rate exports. The Model Statute prefers to tax services upon import. The White Paper would tax imports by businesses when the importer sells goods or renders services at prices that include

the value of the imports. Both remove sales of capital goods to businesses from the tax base. Both favor the use of income tax credits or other programs outside the VAT regime to address the regressive effects of a tax on consumption. The Model Statute adopts the Canadian proposal to tax the value of intermediation services rendered by financial institutions and insurance companies. Both tax the diversion of business property or services to personal use.

There are differences in the administrative aspects of the White Paper and Model Statute proposals. The Model Statute reduces administrative and compliance costs by minimizing the number of returns required, even from large firms, while requiring periodic deposits of tax liability within each tax period. The White Paper apparently would increase the number of returns required each year from larger firms.

There are minor differences between the two proposals as they affect the taxation of small businesses. American states have been highly successful in collecting retail sales taxes from small merchants. The Model Statute therefore taxes all businesses, regardless of the level of their quarterly or annual sales. The White Paper exempts only individual proprietors that make no more than \$5,000 in sales annually, limiting the exemption to street vendors and the like. On the other hand, the Model Statute taxes high-priced casual sales above a threshold amount (or the rental of property worth an amount above the threshold), while the White Paper removes these sales from the tax base. For administrative convenience, it is reasonable to exempt sales of a refrigerator to a neighbor or merchandise sold at a garage sale. It is more difficult to justify exempting sales by a consumer of an original Picasso painting, a rare coin, or a yacht.

The Model Statute taxes consumer goods and services provided by an employer to an employee as compensation in kind if those items are taxable to the employee under the income tax. The White Paper taxes these benefits (although some are taxed by denying an input credit on the purchase of these items by the employer), but it also taxes other consumer benefits provided to employees and others even if they are not taxed under the income tax. Thus, for example, the White Paper generally denies an input credit attributable to a portion of the cost or rental charge on luxury

passenger vehicles and to fees or dues paid to clubs providing dining, recreational or sporting facilities for its members. Indeed, while it may cause some cascade effect, the VAT may be perceived as fairer if the disallowance of input credit were extended to the personal consumption component of other business expenses such as the VAT paid on computers in a home office used both for business and personal purposes, and the VAT on parking or theatre tickets provided without charge to employees, customers, or other business associates. The Model Statute (unlike the White Paper) does not rely on the disallowance of an input credit as a device to indirectly tax the purchase of an item of personal consumption. All input tax is creditable, except for input tax of nonprofits and governments attributable to supplies of exempt goods and services. As discussed above, the VAT may be perceived as fairer if consumer benefits such as free tickets to athletic or entertainment events were taxed. Administratively, it may be easier to tax these benefits indirectly by denying the input credit rather than create a deemed taxable sale to the beneficiary. The taxation of these benefits may create a tax-on-a-tax or cascade effect, but this unfavorable impact is offset if by taxing these benefits, the public perceives that the VAT is fairer.

The White Paper has proposed a VAT that is better than most of the existing VATs. It is especially impressive as a government proposal to tax most goods and services in order to minimize economic distortions created under most national sales tax schemes.