DECENTRALIZING VALUE ADDED TAXES - APPEARANCE OR REALITY?

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Abstract:
In most countries, subnational expenditures have increased considerably in recent times. This is a consequence of both the devolution of a growing number of public tasks from the national level to the regional (local) authorities, as well as a result of rapid urbanization, and adverse demographic changes. These circumstances affect the need to seek innovative sources of financing local units, which will allow them to meet the challenges described above, while maintaining fiscal sustainability. One of them proposed in this article-could be some form of sub-central value added taxes (VAT). However, applying VAT together by two different tiers of governments within the same country was until very recently considered to be infeasible by most of academics. They pointed out many issues, such as high administrative and compliance costs and the need for border adjustment in case of cross-border trade. The purpose of the article was to present different approaches to VAT decentralization found in some countries and on the basis of their experiences to indicate the right circumstances in which “regional VATs” could work well. The study includes examples of eight selected countries which have introduced various kinds of subnational VATs in the last years. The main conclusion of the analysis is that sub-central VAT in the right circumstances can work well. The effective implementation of this tax at subnational levels usually requires not so much overbearing structural barriers, which rather only changes of an administrative framework. What’s more, the problems arising with sub-central VATs are very closely related to those with national VATs in European Union, so most of proposed solutions could be useful.

Keywords: subnational governments, fiscal decentralization, value-added tax, European Union
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1. INTRODUCTION

VAT is currently implemented in more than 156 countries globally and constitutes one of the most important sources of revenues for governments. Universality of application of that form of taxation is due to its many advantages. The most important are VAT's neutrality and strong fiscal capacity. VAT regimes are designed to be a tax on final consumption that is broadly neutral towards production process and international trade which is the essential quality in the context of the current free-trade globalisation model. Its neutrality is also one of the reasons why the adoption of VAT in developing countries is strongly supported by international organisation, like the IMF, World Bank and European Union. Furthermore, VAT is generally considered as a particularly efficient tax for raising revenues. VAT is the largest source of taxes on general consumption, in 2012 accounting on average for 6,6% of GDP and 19,5% of total tax revenues of OECD governments. (OECD 2014, p. 39).

The success of VAT has raised the question of whether it might be used as a subnational tax by lower levels of government having some autonomy in the design of that tax. This dilemma is becoming more and more active because in most countries, sub-central expenditures have increased considerably in recent times. This is a consequence of both the devolution of a growing number of public tasks from the national level to the regional (local) authorities, as well as the result of rapid urbanization, and adverse demographic changes. These circumstances affect the need to seek innovative sources of financing local units, which allowed them to meet the challenges described above, while maintaining fiscal sustainability. However, applying VAT together by two different tiers of governments within the same country was until very recently considered to be infeasible by most academics. They pointed out many issues such as high administrative and compliance costs and the need for border adjustment in case of cross-border trade.

The purpose of the article was to present different approaches to VAT decentralization found in some countries and on the basis of their experiences to indicate the right circumstances in which "regional VATs" could work well. The study includes examples of eight selected countries which have introduced various kinds of "decentralized" VATs in the last years. These countries are: Australia, Belgium, Brazil, Canada, Germany, India, Mexico and Spain. The main criterion of such selection was a considerable diversity of the adopted territorial VAT systems.

The article is organised as follows. It first discusses in section 2 the main difficulties which could occur once sub-central VAT has been implemented and some alternative solutions to such problems suggested in the literature. Section 3 examines the experiences of countries applying VATs revenue sharing arrangements between Central and subnational governments (with no or very limited tax power to subnational jurisdictions), while section 4 sketches the cases of Brazil, Canada and India which are the only ones in the world countries using separate sub-central (State and provincial) VATs. Section 5 concludes with comparison of the presented solutions and indication decisive conditions under which decentralization of VAT can succeed.

2. DIFFICULTIES WITH THE IMPLEMENTATION OF SUBNATIONAL VATs AND THE MAIN THEORETICAL APPROACHES TO THEM

Over a long period of time many authors believed that VAT should not be implemented at subnational level of government.[1]

The crucial problem of operating VAT at the sub-central tiers of government is that it has to do with cross-border supplies of goods and services among jurisdictions. In the absence of interstate border controls goods imported into a regional (local) jurisdiction would bear the burden of the VAT imposed by the exporting jurisdiction. Hence, a system of independently operated regional VATs would entail taxation on an origin rather than destination basis[2], unless special clearinghouse mechanisms are

[1] For discussions of these issues, see Van Brederode and Gendron (2013).

[2] Under the origin principle the tax is levied in the jurisdiction where the value was added. While under the destination principle, tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction. The main difference between these principles is that the destination principle places all firms competing in a given jurisdiction on an even footing, whereas the origin principle places consumers in different jurisdictions on an even footing (OECD 2014, p. 7).

devised to reverse the outcome[3]. Since origin based VATs are not only more prone to tax competition than destination-based VATs[4], when used to finance local expenditures the former also accord less well than the latter with the principle of benefit taxation traditionally used to guide the design of optimal tax assignment arrangements (Zee 2008).

Another reason of difficulty with implementing VAT at subnational level might be that it could have an important impact on regional inequalities (e.g., in population, income, and local expenditure needs) for setting the Central and local VAT rates, as well as for the VAT revenue sharing ratio between the levels of governments. Such disparities are particularly prominent characteristics in many large developing countries contending with the VAT-sharing problem (Zee 2008).

There are also other challenges to be considered. They are high administrative and compliance costs of imposing two sales taxes on the same base as well as excessive limitation of the scope of central macroeconomic policy by dividing tax prerogatives between the various tiers of governments. Bedsides, it is important to note the Central Governments are rather reluctant to allow others a share in very attractive VAT base (Bird 2013).

In response to these difficulties in theory, various approaches are proposed to resolve the problem of functioning VAT in 'two-level' (Central and subnational) jurisdictions. The most known are: 1)*separate VATs*, 2) *dual VATs*, 3) *joint VAT*, 4) *CVAT* and 5) *VIVAT* (Bird 2013).

The simplest idea is the "*separate VATs*" concept. It means that two levels of government have completely independent taxes. This is for example the European Union case, in which the central authority has no VAT.

In *"dual VATs"* approach each tier of government may have an independent VAT. Every level of jurisdiction sets VAT rates independently but on similar bases. There is no need for any central regulations of the range or amount of State taxes applied to interstate cross-border trade since no such taxes are applied. However, as Bird and Gendron (2000) emphasize, to function properly such a system appears to require both administrative competence and intergovernmental trust.

"Joint" VAT mostly means a Central VAT with some of VAT revenues shares passing on to the States either in accordance with jointly agreed but estimated consumption bases and independently determined rates or with a centrally determined rate and allocation formula (occasionally with some equalization mechanism).

"Compensating VAT" (CVAT) is a theoretical system initially proposed for Brazil by Varsano (1995), and the developed by McLure (2000), under which the Central government applies a zero-rate tax to interstate transactions. In that concept States can levy independent VAT rates, whereas a CVAT might be imposed by the Central government only on sales between States at some appropriate rate such as for example the weighted average of State VAT rates (McLure 2000). Domestic sales would thus be subject to central CVAT and either State VAT or Central "normal" VAT. There would be no need for any State to deal explicitly with any other State nor, generally, would there be any need for interstate clearing of tax credits. Registered traders in the other State would be able to credit CVAT against Central VAT. Since the Central government, which first levies CVAT and then credits it, would gain no net revenue, the effective rate of CVAT is zero (Bird 2013).

The last approach is the *VIVAT* ("*viable integrated VAT*") proposal put first of all for the European Union by Keen and Smith (2000), under which all Member States of the EU would apply the same VAT rate to business-to-business transactions, including cross-border trading within the common market, while being free to apply higher rates to sales to domestic final consumers. However, the main disadvantage of such concept for regional (local) authorities is that it does not permit them to set their own tax rates which are critical to provide an appropriate incentive structure for effective sub-central

[3] One of such mechanisms has been known—and put into practice in the EU—for some years: the zero-rating of inter - jurisdictional trade by exporting jurisdictions combined with the application of reverse charging on such trade by importing jurisdictions. However, while this mechanism works well for transactions between VAT-registered traders (wherever located), it is vulnerable to abuse by VAT-exempt traders and consumers as they take inappropriate advantage of the zero-rated goods crossing jurisdictional borders. (Zee 2008).

[4] Origin based tax is more susceptible e.g. to various forms of transfer pricing, while by taxation on destination-based it is possible to take into account the fact that producers are more mobile than consumers.

government, especially in large federal countries. To sum up, VIVAT approach appears to require at least as much agreement among all subnational governments as the dual VAT or CVAT, while reducing local fiscal autonomy more.

In short, all of the proposition discussed above are very much linked and they need an interaction among all levels of governments. For example, the dual VAT obviously requires a Central VAT—although perhaps one that collects no revenue — and some degree of information exchange and co-operation amongst tax authorities. The CVAT desires more substantial agreement among participating States, some central limits on rates, and probably Central (or consortium based) operation of CVAT itself. VIVAT in turn requires a Central intermediate rate and likely some limits on final rates as well as Central (or possibly consortium-based) operation of clearing of excess credits. The latter two schemes also seem more dependent on rate and base uniformity than the dual VAT.

3. PRACTICAL EXPERIENCES WITH VAT DECENTRALIZATION PROBLEMS – THE CASES OF VAT REVENUES SHARING

In practice most of countries have avoided the complications with sub-central VATs by simply leaving VAT central. However, number of countries, both federal and unitary, have chosen an indirect method of VAT decentralization which are VAT revenue sharing arrangements between the Central and regional (local) governments. Such solution is applied in five of the eight analyzed countries, i.e. in Australia, Mexico, Belgium, Germany and Spain, although the detailed practices in this filed differ slightly. Table 1 below summarizes some of the key characteristics of the design of VAT revenues sharing adopted in in those five countries taking account of such factors such as: tier of subnational government which benefits from VAT yields, apportioning VAT proceeds between Central and sub-central governments, existing of common tax base, place – of- supply rules, scope of competence of each levels of government to determine tax rates, fiscal power of regional authorities and organizing of tax administration.

As shown in column 2 of table 1 *Australia i*s the only case in which all the revenues from the federal good and service tax (GST) are distributed to the States to compensate for the removal of series of inefficient state taxes that were thought to be impeding economic activity (Commonwealth of Australia 2008). In other countries with territorial VAT revenues sharing, there are some variations in the tiers of subnational government which benefit from tax receipts. In *Mexico* significant part of Central VAT collection is transferred to State governments, whereas in *Belgium* the large proportion of tax receipts goes not to the region, but to the "communities" (which are linguistically based units). In *Germany* and *Spain,* in turn, federal VAT yields are distributed to both the States and the Municipalities.

As far as the problem of allocation of VAT proceeds goes, VAT revenues are usually apportioned among States government either through some form of percentage shares in all VAT receipts or through non-earmarked grants financed by federal budget, and often allocated between regions in accordance with special equalization formula. The solution, in which revenue from central VAT transferred to the States are determined as some percentage referring to all central tax receipts, operates in *Mexico***.** In this country all VAT collection (along with other sources of federal revenue) is deposited in a special fund (known as *Recaudación Federal Participable - RFP*) and only then redistributed among regions according to certain criteria specified in the fiscal coordination law (Castañeda and Pardinas 2012, p. 48). Those criteria are: the amount of population and the previous years' allocation corrected by a tax effort indicators and the rate of tax yield growth (IMF 2007, p. 4)

In *Australia* the main aim of distribution of the GST revenues among the States is to equalise fiscal capacity to deliver services to their populations Therefore State's allocation from the GST pool is calculated as an equal per capita share, adjusted for: expense needs, average revenue raising capacities; and the amount of Special Purpose Payments provided to the States to deliver specific policy outcomes in some areas. The distribution of the federal VAT in *Germany* is more complex. The financial equalization law provides that 9,5% of the VAT receipts are first attributed to the Central Government, as a form of compensation for the increase in pension payments made by the Federation (Vandernoot 2014). In addition, 2,2% of the VAT is allocated to the municipalities. The amount that is left is then divided between the federal State (50,5%) and the Länder (49,5%). The share attributed to the Länder is divided into two parts: the first one depends on the Länder's revenues from income tax, corporate tax and Länder tax and the second is shared out proportionately to the population of the Länder.

Spain allocates the subnational VAT share on the basis of estimated “final” consumption in the local jurisdiction. A share of 50% of VAT revenues is distributed to Autonomous Communities in accordance with the centrally determined index of territorial consumption elaborated by the National Statistical Institute. (Sanchez-Maldonado and Gomez-Sala 2006). Additional very low percentage of the remaining Central VAT in Spain goes to municipalities. Allocation formula of *Belgian* Communities VAT shares is also fully detached from VAT revenue and its development. Such mechanism is determined initially by the number of school-age children, with the proceeds being used to finance education. (Spahn 2007).

A common feature of the solutions adopted in the countries applying subnational VAT revenues sharing is that in those countries there is no problem of different tax bases. In all of them VAT is collected only by the Central governments and is based on the unified rules (column 4 of Table 1).

As mentioned before, the main difficulties with regional VAT are connected with cross-jurisdiction crediting under conditions of a lack of internal borders (Bird 2013). The analysed countries have solved this problem in different ways, but all of them adopted destination-based VAT (see column 5 of Table 1).

Table 1: Comparison of features of VAT revenues sharing arrangements

Countries	Which tier of subnational government is the beneficiary of the VAT?	How is the VAT apportioned between Central and sub-central governments?	Is there a common tax base?	What are the place-of-supply rules?	Who determines tax rates?	Is there some tax autonomy for sub-central governments?	Who administers the tax?
Australia	State governments (benefit the whole VAT revenues)	redistribution according to special equalization formula	Yes	Destination-based rules	Central government (required approval of the States)	No	interstate GST Administration Sub-committee (GSTAS).
Belgium	Communities	redistribution according to adjustment criteria (connected with educational needs)	Yes	Destination-based rules	Central government	No	Federal administration
Germany	State government and the Municipalities.	redistribution according to special equalization formula and adjustment criteria	Yes	Destination-based rules	Central government	No	States, with supervision by the Federal government
Mexico	State governments	redistribution of VAT with other Federal tax revenue according to adjustment criteria	Yes	Destination-based rules	Central government	No	States (with all revenues for tax enforcement for States)
Spain	State government and the Municipalities.	redistribution on the basis of estimated “final” consumption	Yes	Destination-based rules	Central government	Only for special two territories	Federal administration, special rules for two territories

Source: Own elaboration based on information from Bird (2013), OECD (2012) and OECD (2013).

Of course, implementing a common system of value added tax in European Union has caused the need to adopt by Member States common place-of-supply. Among the surveyed countries in this group are *Germany, Belgium* and *Spain.*

The EU place-of-supply rules could be very useful also with reference to the VAT decentralization because of a strong similarity between different form of sub-central VATs within a country and national

VATs in a common market. These issues were first discussed in the context of European integration (Shoup 1967). In the initial phase of the functioning of the single EU market after abolition of borders in 1993, it was proposed to tax interstate supplies of goods at the origin-based system with full crediting of the taxes in the Member State of destination (OECD 2012, p. 171). However, that solution wasn't approved by Member States mainly because it would have made the purchasing decisions of consumers primarily dependent on differences in VAT rates. This problem could have been tackled by the introduction of some clearinghouse system to redistribute VAT revenues to the State of consumption, but it would have required that Member States rely on each other to collect a fundamental part of their budget incomes (OECD 2012, p. 172). Due to all these difficulties it was decided to maintain a destination-base VAT but only for a transitional period until definitive implementation of origin- based taxation. Nonetheless, in practice, origin-base VAT has not entered into force so far and European Commission acknowledged that it remains politically unachievable and proposed that this concept should be abandoned (European Commission 2010 and 2011).

In other non-Member States, VAT is also based on the rule of destination. For example *Australian* federal GST generally applies to goods, services and intangibles acquired outside of Australia for consumption in Australia, whereas export is zero-rated, which means that it is based on the principle of destination. The same rule is also established in *Mexico.*

Another important issue concerning VAT decentralization is the scope of competence of each levels of government to determine tax rates and the margin of tax autonomy for sub-central authorities. In all analysed countries applying VAT revenues sharing the rates of VAT are set only by the Central Governments. For example, Australian GST applies a uniform standard rate of 10% and the provinces do not have any fiscal powers in this field (Commonwealth of Australia 2008). However In Australia, unlike any of the other countries mentioned, both levels of government, Federal and State, must unanimously agree to any changes in VAT rate.

VAT rate are also set by Central level of governments in *Germany* (where there is uniform standard rate of 19% and 7% reduced VAT) and in Belgium (where the standard VAT rate is 21% and reduced rates are 12% and 6%).

Nonetheless, two of the analysed countries: Mexico and Spain impose of territorially differentiated rates of VAT. In *Mexico* there is a Federal VAT with standard rate of 16% determined by Central Government. However, there was also a special preferential VAT rate of 11% applied in towns near the United States border (Davis 2011). It was established by the Mexican Department of Revenue because of concerns that the VAT would reduce cross-border shopping in the United States. The case of Mexico, indicated the main disadvantage associated with territorial discontinuity in the VAT rates which was distortion in economic activity toward the preferential tax zone. For this reason the border zone VAT rate of 11% was eliminated from 1 January 2014. In *Spain* there is a standard rate of 21% applied in the whole country, but special regions: Navarre and the Basque Country under the exceptional Foral Regime enjoy full fiscal autonomy providing that the overall effective tax burden does not fall below that of the rest of Spain.

Last but not least, the essential concern in the case of VAT decentralization may also be the problem of the organizing of tax administration. For example, *Australian* GST policy is coordinated through the interstate GST Administration Sub-committee (GSTAS). The States interact with the Australian Taxation Office (ATO) in relation to the collection and administration of the GST legislation. The costs of administering the GST are recovered by the Australian Treasury from the States (Commonwealth of Australia 2009).

A very interesting solution to VATs administration is applied applies in *Mexico,* where States may not only audit and verify compliance with VAT, but they are also entitled to keep a significant share of any additional revenues which come through such activities (Bird 2013). The main advantage of this establishment is that States are highly motivated to encourage tax enforcement efforts due to expected revenue gain. However, such potential virtue may be outweighed by the adverse effects arising from geographic variation in effective taxation[5] as well as reduced incentive for federal enforcement (Bird 2013).

[5] States vary in their interpretation of tax law and their tax enforcement because of varied capacity of local officials, possible corruptions and even tactics to attract business investment.

Germany has a highly decentralised system of tax administration. VAT is administered separately by 16 State (Länder) Taxation Offices, and subject to co-ordination and supervision by the Federal Ministry of Finance (OECD 2013, p. 70).

In *Spain* VAT is collected by Central Spanish State Tax Administration Agency), but two territories (the Basque Country and Navarre) have a special tax system ruled independently by their own institutions. In *Belgium* in turn VAT administration policy remains a sole prerogative of the Federal government.

4. OVERCOMING THE OBSTACLES – THE CASES OF SUB-CENTRAL VATs IN BRAZIL, INDIA AND CANADA

Three of the eight studied federal countries – *Brazil, Canada and India* have introduced different form of separate subnational (State and provincial) VATs, which, like national VATs, are general taxes on consumption administered through a transaction-based credit-invoice approach (Bird 2013). Table 2 contains short comparison of the main features of sub-central VAT designs in those countries.

The first country which adopted comprehensive VAT at both regional and central level of government was Brazil (Bird 2013). In that country VAT on industrial products (*Imposto sobre Produtos Industrializados* – IPI) is levied by the Federal government, VAT on goods, telecommunication, transport services and electricity (ICMS – *Imposto sobre Circulação de Mercadorias e Serviços*) is imposed by the state level and a tax on services (ISS – *Imposto Sobre Serviços*)[6] is set at the municipality level (OECD 2012, p. 166).

Unlike Brazil, *India* has always followed the principle of tax separation which means that the taxes that may be imposed by the States are thus clearly detached from those that may be assigned to the Federal government (the Union). When it comes to VAT, these rules reveal in the fact that Central Government levies a Central VAT (CENVAT) on the manufacture and production of goods, a Service Tax on a specified list of services, and Central Sales Tax (CST)[7] on interstate sales of goods whereas the States levy State's VATs on the sales of goods within the State (OECD 2012, p. 190).

The most comprehensive model of mixed 'dual' federal-regional VAT system is offered by *Canada.* Canada has adopted a Central VAT in the form of the good and services tax (GST). It is important to know that Canada is the only federal OECD country - in which subnational governments have the choice of whether or not to impose their own VATs. Since 1992, five over ten Canadian provinces have harmonised their former retail sales tax with the federal GST imposing Harmonised Sales Taxes (HSTs), which include the federal GST and the provincial sales tax and are applied to the same tax base (OECD 2012). One province – Quebec administers its own VAT (known as Quebec Sales Tax – QST). Three small provinces continue to collect their own Retail Sales Taxes (RSTs), and one province (and three small federal territories) have no sales taxes at all. (Bird 2013).

In countries with sub-central forms of VAT each government level, responsible for administering the tax under its jurisdiction, is collecting the corresponding tax revenues. So, in *Brazil* Federal government is collecting the IPI, the States are beneficiaries of ICMS revenues and the Municipalities gather the ISS receipts. There is no equalization formula in VAT yields, however The Constitution determines federal fund transfers to States and the Municipalities, but it is not connected to VAT proceeds (OECD 2012, p. 204). In *India* two federal taxes: the CENVAT and Service Tax go entirely to federal budget, however revenues of the CST accrue entirely to the States. States are also the only beneficiaries of State's VAT proceeds. In *Canada* HST taxes are collected by the Federal government. Each participating province's share is then determined as per formula based on economic indicators and is passed to it accordingly. The Federal government may pay instalments based on the estimate for the tax entitlement year. Québec province, however, collects the both QST and GST revenues. Additionally, It should be noted that in Canada in order to create an incentive for the provinces to abandon their existing retail taxes, the Federal government compensates them for introducing the HST (OECD 2012).

[6] ISS is not a VAT, because no credit is granted to business to purchase service of their activities, so that tax has a cascading effects (OECD 2012, p. 201).
[7] However, CST is not a classic VAT, because it is not creditable against itself or any other taxes (OECD 2012, p. 167).

Table 2: Comparison of features of sub-central VATs in Brazil, Canada and India

Countries	What are the types of VATs?	How is the tax apportioned between Central and sub-central governments?	Is there a common tax base?	What are the place-of- supply rules?	Who determines tax rates?	Is there some tax autonomy for sub-central governments?	Who administers the tax?
Brazil	IPI at Federal level, ICMS at State level, ISS in Municipalities	Federal budgets benefits IPI, and State and Municipalities –respectively ICMS and ISS, Federal equalization transfers	No	mix and origin and destination principle	IPI rates – Central government, ICMS rates – States (with upper and lower central limits), ISS rates – municipalities (with upper central limits)	States can implement some VAT preferences	The level of government which benefits from VAT
Canada	GST at Federal level, HST in 5 provinces, QST in Quebec, RST –in 3 provinces, No sale tax in 1 province	GST - to Federal budget (in Quebec collected by State administration) , HST- collected by the Federal level and then transferred to Provinces in accordance with allocation formula, QST- collected by Quebec province, RST- collected by Provinces, Special compensating mechanism for Provinces for implementing HST	Yes – in the case of GST and HSTs	destination -based rules	GST rates – Federal government, HST and RST rates - Provinces	States can implement some VAT exemptions and regulations for taxations of capital goods	Canada Revenue Agency in Quebec - Revenue Québec for QST and GST collected in Quebec
India	CENVAT and CST levied by Central Government , At State level –separate sub-central VATs	CENVAT goes to Federal budget, CST and State's VAT s accrue to the States	No	State tax are destination based, CST is origin-based	CENVAT and CST rates – Central Government, Sub-central VATs –States (with uniform rate to certain commodities)	Limited tax competition among Provinces	The level of government which benefits form VAT

Source: As above.

Another important issue for subnational VATs design is the problem of applying the common tax base to Federal and State's part of VAT. In the case of *Brazil,* unlike that of many federation**,** there is no common tax base, because the subjects of taxes assigned to each tiers of government are different (*i. e.:* industrial product - for IPI, goods and telecommunication and transport services - for ICMS and Services for - the ISS). Common tax base is also not applied in *India,* where both tiers of government: Federal and State operate different types of VAT either on goods or services and thus on a different tax base**.** *Canada* is the only case which has implemented common tax base harmonising Provincial sales taxes with the federal GST. Such common tax base is applied to the federal GST and State's HST, however a slight difference between the basis of those taxes is tolerated but cannot exceed 5% (OECD 2012). Besides, Federal government must normally require the agreement of Provinces on every changes in common tax base if they reduce by more than 1% the State revenues.(OECD 2012).

In addition, as has been mentioned previously, the critical issue for subnational VATs are place-of-supply rules. For example, in *India* the VATs levied by the States are destination-based, whereas CST levied by the Central Government is an origin-based[8]. Under the Constitution Amendment Bill introduced by Central Government in 2011 it was proposed to enable both Parliament and State Legislatures to frame laws for the introduction of a Good and Service Tax (GST).[9] This new tax would be a dual Integrated GST consisting of Central GST (CGST) and State GST (SGST) and it would l be implemented form April of 2016[10]. Nonetheless, The IGST would be an origin-based tax. Therefore, it would apply in the State of supplier, although credit will be given to the consumer in the other State (Bird 2013, p. 661). This solution required the creation of special clearinghouse mechanism in which the Central Government would compensate the consuming State according to the destination principle[11]. In practise however this mechanism seems to be very complex and it could increase the compliance burden of companies that will have to monitor three different types of tax credits. (Cnossen 2012).In contrast to India, *Canadian* dual VAT is based on destination principle for both interstate and international trade of goods and services. In the case of Provinces, which adopted HST, as well as in Quebec supplies consumed within the States and imported into there are subject to the VATs applied in those States, whereas supplies exported to other Provinces are zero-rated (Bird 2013).Transaction conducted in the Provinces are also subject usually at the same time, to the federal destination- based GST.VAT system in Brazil is a combination of between the Indian and Canadian solutions that treat interstate transaction according to a mix and origin and destination principle. Regional VATs are essentially origin-based (Ter-Minassian, 2012). The destination principle is normally applied only to overseas transactions. The main drawback of origin-based taxation of interstate transaction is that it may in practise penalise the resources of poorer regions that are usually net importers of taxable goods and services while increasing the receipts of exporting States. One of the big advantage of this system is that it does avoid "carousel fraud"[12] by taxing inters-state trade. (OECD 2012, p. 173). This fraud, which is often carried out by criminal organisations, due to the lack of customs borders, can become particularly acute at sub-central level.

In countries which apply sub-central VATs, the tax rates are determined in diverse ways depending on the sphere of tax competence of each levels of government. In *Brazil* the IPI rates are set by the Central government, whereas ICMS rates are settled by the States, but Federal Senate sets down their minimum and maximum levels. Central authorities also stipulate the ICMS rates that apply to interstate transaction (OECD 2012, p. 203). The ISS rates are established by the Municipalities with the maximum rates set up by the federal law. The IPI rate ranges from 0% to 330%, depending on the classification of the goods in the IPI Rate Table (TIPI). The internal rates of the ICMS currently range from 17% to 30% in the various States of the federation. The rates applicable to interstate operations are 7%[13] or 12%[14] (Lang and Lejeune 2014, p. 156). In *India*, the Central Government comprises the rates of the CENVAT (12%, 6% and 0%) , Service Tax (12%) and CST (2%) while the States have the sovereignty to determine the rates of the State VATs. However, the States agreed to apply uniform State VAT rates to a common list of certain commodities.[15].In *Canada* the rate of the federal GST is

[8] The CENVAT applies only at the production (or manufacturing) of goods, so there is no problem with place of supply rules.

[9] The Constitution Amendment Bill was introduced in the Lok Sabha by the Minister for Finance on March 22,2011.

[10] https://www.taxmanagementindia.com

[11] That mechanism would work as follows: the interstate seller will pay IGST by compensating it with its available credits of IGST, CGST and SGST. The exporting State will then transfer to the Central Government the amount of the credit of SGST used tooffset the IGS. The importer in the other State will be allowed to credit the amount of IGST paid in the purchase. The Central Government will transfer to the importing State the credit of IGST used by the importer to offset his liability of SGST. For more information see: *First Discussion Paper On Goods and Services Tax In India,* 2009.

[12] Those frauds happen when a person (called "fraudster") imports some goods from a State, where they were zero-rated. VAT on the goods should be paid in the State of destination where they have been imported. However, the fraudster fail to remit the VAT to the State Treasury so he "goes missing" with the VAT. Because the supply of goods was zero-rated for export, the importing State has lost the entire VAT that should be paid on this interstate transaction.

[13] In operations involving goods addressed to taxpayers located in the States of the north, northeast and centre-west of the country and Espírito Santo.

[14] In operations involving goods addressed to taxpayers located in the south and southeast of the country, except Espírito Santo.

[15] There are five State VAT rates that apply to a list of commodities common to all States: 4% or 5% to most basic necessity items, industrial and agricultural inputs and capital goods, 1% to gold, silver, other precious metals, 0%

5% and it is set by the Central Government. The HST rates are determined by Provinces, but they include a 5% of the GST, so only remaining percentage is in fact delimited by the provincial authorities[16]. Provinces which have own RST taxes are free to determine their rates. [17]

Besides the possibility of creating VAT rates in all analysed countries regional(local) authorities have been given some other form of tax autonomy. For example in *Brazil* States can implement some VAT preferences (like new exemptions or reductions of the tax base) but only after fulfilling of certain conditions[18]. It is important that States in Brazil, which do not have any tax autonomy in income taxes, often use VAT cuts to attract economic activity. This behaviour resulted in an erosion of the tax base and was even referred to as the “fiscal war” (OECD 2012, p. 201). In *India***,** the different States may exempt some goods from VAT and implement special regulations to which input credits are allowed for capital goods. In *Canada* in turn expansion of the HST which provided a common tax base and common exemptions (except for 5% of the tax base) have limited tax competition among Provinces. Nevertheless some of them apply VAT preferences like benefits to specific sectors of industry.

The last analysed issue is the organising of VAT administration. For example *Brazil’s* strong decentralisation grants administrative tax autonomy to all its levels of government which are fully responsible for the collection of taxes granted to them. Similar situation occurs in *India*, where all federal taxes are administering by the Central Government while sub-central VATs are collecting by the States with some coordination between the State VATs as far as the tax base and tax rates are concerned (OECD 2012, p. 195). In *Canada* the HST is administered by the Canada Revenue Agency with the exception of Quebec, where Revenue Québec is responsible for administering the QST and the GST. It is important to know that Québec receives a special negotiated annual fee for administering the GST in that province (OECD 2012).

5. CONCLUSIONS

Comparative analysis of practical experiences with difference form of "decentralized" VAT in the selected eight countries allows to indicate the two groups of adopted solutions.

The first one applied in the most of analysed countries are *VATs revenue sharing arrangements* between Central and subnational governments which rely on distribution to regional (local) budgets some percentage of central VAT or grants assessed on special formula more or less referring to real VAT revenues collected in State jurisdiction. The second group are autonomous sub-central VATs co-existing simultaneously and independently with VATs levied by the Central authorities (dual VATs).

Subnational VATs revenue sharing arrangements – despite their prevalence - are not in fact the true expression of VAT decentralization, but rather - of appearance of decentralization. The main reason of that is that sub-central governments have no fiscal autonomy to determine tax base and to set VAT rates. In all analysed cases the tax split between the Central and regional authorities is generally established by the Federal level. Furthermore, the key disadvantage of such VAT designs is that the proceeds that State receives are not directly related either to the amount of revenue collected by the Central government from VAT registrants in that region or to the final impact of the VAT on local consumers.

In contrast, *autonomous sub-central VATs* operate in three of eight studied countries and in most cases provide a high range of fiscal autonomy which is very important for achieving real fiscal decentralization of VAT. While such solutions could in practice create problems with co-existing several separate indirect taxes like: uncertainties, economically distorting effects and increase the compliance burden on businesses, Canadian positive experiences with dual VATs could be useful to indicate the main requirements for successful subnational VAT design.

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to the lists of 10 commodities chosen among a list of goods of local social importance, 20% to fuels (petrol, diesel and aviation turbine fuel) and liquor and 12,5% to 15% to all other items. (OECD 2012, p. 194).

[16] The HST rate is generally 13% – with the exception of British Columbia -12%, Nova Scotia - 15% and Québec - 14,975% (OECD 2012).

[17] Wich are 7% for Manitoba, 10% for Prince Edward’s Island and 5% for Saskatchewan (OECD 2012)

[18] Such conditions concern the neccessity of the approval of the representation of the other States in a special council called the CONFAZ -*Conselho Nacional de Política Fazendária* (OECD 2012, p. 201).

First, the crucial point for applying a dual Central and subnational VAT system is of course the political consensus between all levels of governments and a high degree of intergovernmental cooperation and good information exchange especially with regard to tax administration.

Second, a relatively common tax base to Federal and regional part of VAT is essential. Tax rates may be different and it is a prerequisite for effective VAT decentralization to leave the States some competence for determining tax rates – but it seems important that the tax base remains approximately identical in order to ease the administration of the tax, facilitate compliance for businesses and ensure that the VAT is deductible according to standard rules (OECD 2012).

Third, place of supply rules adapted to the legal tradition of the country must prevent rate competition between the States (OECD 2012). This concern is particularly relevant when rate differences between States are significant. The most popular solution is applying the destination – based principle under which inter - jurisdictional supplies of goods and services are treated neutrally and taxed at the VAT rate of the province of deemed consumption, irrespective of whether the VAT rate in the State of origin is higher or not.

Finally, the successful VAT decentralization requires special tax equalization mechanism which redistributes part of the VAT revenues from the richer States to the poorer States. This mechanism should be based on formula determined on economic and poverty indicators.

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