The Proposed Value Added Tax- A View from the Tourism Sector

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Introduction

Empirical evidence suggests that the value-added tax (VAT) could be a most efficient means of raising Government revenue from legitimate economic activity. However, although the VAT has been hailed as a rather resourceful tax and an efficient revenue generation mechanism, its success depends squarely on the capacity of public administration as well as the ability of local businesses to effectively implement and competently manage the new process.

The tourism sector would indeed benefit from a simplified, fairer and more transparent taxation system that negates any inherent anti-export bias from the current tax regime. Of course, as the leading economic sector in St.Lucia, it must be prepared to pay its fair share of taxes, as it does indeed, but the burden of taxation must be spread as equitably as possible so that the incidence of the VAT and its effect on overall economic activity is not counterproductive. In other words, the incidence of the VAT must be such that it has a neutral, if not positive, effect on the distribution of economic welfare. Moreover, the Authorities should be ever mindful of the fact that the VAT's incidence or burden does not depend on where the revenue is collected but on the price elasticity of demand and price elasticity of supply for the particular good or service whose production (value-added) is being taxed. Hence, the introduction of VAT must be based on the principles of equity, efficiency and administrability.

Equity

Equity requires that the VAT be applied fairly. The main purpose of taxation is to allocate the burden of funding the operations of government and of paying for public services. The tourism sector relies heavily on government facilitation and support services including Customs and Immigration Services, infrastructural development, destination and sub-sector marketing support and the maintenance of law and order. The sector already bears a significant tax burden through, inter alia, taxes on importation of goods and services, property tax, withholding taxes on payments to non-residents, consumption and excise taxes on local consumption, hotel accommodation tax, cruise passenger head tax, airline ticket tax and airport departure taxes. Consequently, the implementation of the VAT should be done in as transparent and equitable a manner as possible and must not in any way place a greater burden on tourism or any other sector.

The prospect of levying an introductory VAT that would result in a higher net rate of tax than the combined effect of other indirect taxes that it replaced could be very tempting to policy-makers who are keen on increasing the overall revenue intake. One would however caution that the most effective and sustainable means to ensure an increase in revenue is to (1) increase the level of compliance; (2) tighten the exemptions regime; and (3) rely on the buoyancy of the tax system rather than on increases in the tax rate. Tax buoyancy refers to the situation where an increase in tax revenue is dependent on growth in economic activity such that when GDP goes up there is an equivalent or sometimes even greater rise in the tax revenue without increasing the tax rate.

It would be interesting to see what the effect on economic activity, and by extension on overall Government revenue, would be if an introductory VAT rate of 10% is applied after factoring in deserved exemptions and zero rated items. Of course, in some instances this would represent a net reduction in the replaced taxes, such as consumption tax, but the net effect on economic activity could more than offset such a reduction if that approach results in a veritable economic stimulus. Besides, various taxation studies have shown that a simple tax rate, that is easy to calculate and apply, generally results in greater compliance and enhances the fairness and transparency of the tax regime.

Efficiency

Optimal efficiency requires that the cost of administering the VAT must be justified by the amount yielded by that tax. One of the key issues that have been consistently mooted by the VAT Implementation Office is the VAT's replacement aspect, which posits that, "*VAT will not be an additional tax but a replacement for some existing indirect taxes. It will be a broad based, comprehensive and simplified system of taxation on transactions*."

That statement notwithstanding, the challenge would be how to ensure that the administration of the new VAT system does not cost more than the combined administrative costs of the taxes that it replaced. Thus, the Authorities would have to ensure that the management of the VAT implementation process does not represent an additional charge on the public purse but lowers the overall cost of tax administration. This would be the best indicator of increased efficiency and would undoubtedly assist the overall public sector reform effort, which in turn should lower the cost of public services. The entire economy and not just the tourism sector would benefit from such an outcome.

Administrability

Perhaps the biggest challenge of VAT implementation in a small developing country is how to ensure that the business sector develops the requisite understanding and technical capacity to handle the VAT payment, collection and reporting process. Failure to adequately address that issue and to make sure that the private sector and indeed the country as a whole is well equipped to make the transition to a

VAT system could undermine the credibility and acceptability of the system. The VAT must therefore be introduced only after such technical understanding and managerial capability is achieved.

By the same token, the public sector has to demonstrate a high level of competence in implementing, monitoring and enforcing the VAT. Policy consistency and ample administrative competency in managing the process are essential to its success and general acceptance.