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VAT? A Look Inside Canada's Experience With the Goods and Services Tax*

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I would first like to thank my wife Nicole and the rest of my family for supporting me throughout my legal education. Sincere gratitude is well deserved by my faculty advisor, Professor Dennis Lilly, for the time he invested and the advice he provided. Finally, I would like to thank Graduate Programs Coordinator, Lee Russell, both for her concern and her invaluable guidance during my tenure at USD Law School.

I. INTRODUCTION

Consumption taxes have been and continue to be utilized as a staple revenue producer within systems of taxation.[1] The value-added tax (VAT) is one form of consumption tax that has grown in popularity among nations over the last several decades. In fact, after the passage of a goods and services tax (one type of VAT) in Australia in 2000, the United States now stands alone as the only remaining OECD[2] nation, among its 30 members, without some form of a value-added tax on consumption.[3] As the massive topic of tax reform continually appears at the forefront of the political landscape, having potentially far-reaching effects of a political, social and economic nature, this comment seeks to provide insight into one country's recent experience with a value-added tax.

Section II of this paper includes a brief history of the value-added tax, an explanation of the basic structure of a VAT and its foundational principles, distinguished from alternative forms of taxation and concludes with a list of generally accepted economic effects resulting from the institution of a value-added tax. Section III delves into Canada's value-added tax, the Goods and Services Tax (GST),[4] exploring the origins of GST, public opinion surrounding GST and its subsequent passage, purposes for its adoption, implementation, administration and enforcement, and a detailed look into the structure of the tax itself. Section IV investigates whether the economic effects from the Canadian GST have emulated those understood by the tax community to result from instituting a VAT and what Canada has done to address the effects brought about by the GST. Section V provides an overall conclusion about Canada's experience

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1. *Consumption Tax Trends: VAT/GST, Excise and Environmental Taxes*, ORG. FOR ECON. CO-OPERATION & DEV. 8 (2001), *available at* http://www1.oecd.org/publications/e-book/2301111e.pdf.

2. *The OECD: What is it?*, ORG. FOR ECON. CO-OPERATION & DEV., http://www.oecd.org/document/18/0,2340,en_2649_201185_2068050_1_1_1_1,00.html#what (last visited Oct. 5, 2006) (describing the

> Organization for Economic Co-operation and Development as a unique forum where the governments of 30 market democracies work together to address the economic, social and governance challenges of globalisation as well as to exploit its opportunities. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and co-ordinate domestic and international policies.

It is a forum where peer pressure can act as a powerful incentive to improve policy and implement "soft law"—non-binding instruments such as the OECD Corporate Governance Principles—and can on occasion lead to formal agreements or treaties).

3. *Consumption Tax Trends: VAT/GST, Excise and Environmental Taxes*, *supra* note 1, at 8.

4. Brian Arnold, *GST Update*, 3 TAX NOTES INT'L 41, 41 (1991) (explaining that the GST was enacted on December 13, 1990 and was to be effective beginning January 1, 1991).

with the GST, what lessons, both good and bad, can be extrapolated and whether the Canadian experience encourages or cautions nations exploring the possibility of instituting a VAT.

II. VALUE-ADDED TAX (VAT)

A. What is a VAT?

A value-added tax (VAT) is a multi-stage tax on the consumption of goods and services, collected at every stage of the product development and distribution process, relative to the amount of value added during each stage.[5] A VAT is imposed at the location where goods and services are consumed, known as the "destination" or "source" principle,[6] rather than where goods are produced or where services are performed, known as the "origin" or "residence" principle;[7] consequently, under a value-added system of taxation, exports are not taxed whereas imports are taxed.[8]

There are several methods of calculating VAT liability, the most common of which is the invoice-credit method.[9] This method relies on invoices from both purchases and sales. Businesses are responsible for collecting VAT on the amount of their taxable sales, but are given a credit referred to as an "input tax credit" for the amount of VAT paid on taxable purchases of business inputs; the excess of VAT collected from sales over VAT paid on purchases of business inputs must be remitted to the body administering the tax.[10] If the input tax credit exceeds VAT liability on taxable sales, the taxpayer does not pay any tax and the excess amount is either refunded or carried over and applied against future tax liability.[11]

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5. GEORGE N. CARLSON, VALUE-ADDED TAX: EUROPEAN EXPERIENCE AND LESSONS FOR THE UNITED STATES 2 (1980).
6. Colleen Klanchnik, *United States-European Union Dispute on Foreign Source Income, Export Activity and the Extraterritorial Income Exclusion Act*, 3 J. INT'L BUS. & L. 143, 146 (2004); Sijbren Cnossen, *Coordination of Sales Taxes in Federal Countries and Common Markets*, 9 CONN. J. INT'L L. 741, 741-42 (1994).
7. Colleen Klanchnik, *United States-European Union Dispute on Foreign Source Income, Export Activity, and the Extraterritorial Income Exclusion Act*, 3 J. INT'L BUS. & L. 143, 146 (2004); Cnossen, *supra* note 6, at 721-42.
8. Alan Schenk, *Policy Issues in the Design of a Value-Added Tax: Some Recent Developments in OECD Countries*, 1 TAX NOTES INT'L 111, 112 (1989).
9. Schenk, *supra* note 8, at 112; CARLSON, *supra* note 5, at 2.
10. CARLSON, *supra* note 5, at 2.
11. *Id.*

B. Illustration of a VAT

The following is a basic illustration of how a VAT operates: the product in our example is a hockey mask; there are four levels involved in the process from production through the sale to the end consumer. The manufacturer of raw materials (business 'A') sells to the manufacturer of hockey mask parts (business 'B') who sells to the wholesale producer of finished hockey masks (business 'C'), who sells to the retailer (business 'D') who finally sells to the end consumer ('E'); the VAT rate imposed is 10%, and the final sale price of the hockey mask is $100.00. Therefore, in this example, the total amount of VAT collected should be $10, or 10% of $100.

A provides the raw materials (e.g., plastic, Kevlar, paint) necessary to make each part of the hockey mask (helmet, visor, chin strap). B pays a total cost of $20 for the raw materials necessary to construct one hockey mask. B pays $2 in VAT (10% of $20) to A for the cost of these materials. For simplicity, we will assume that A did not incur any VAT liability in obtaining the raw materials. Hence, A would remit the $2 ($2 - $0) in VAT collected to the government.

At this point, $2 in VAT has been collected

After constructing finished parts for the hockey mask, B then sells the items necessary to construct one hockey mask (one helmet, one visor and one chin strap) to C for $40. B collects $4 in VAT (10% of $40) from C. But rather than remitting the entire $4 to the government, B receives an input tax credit for VAT paid ($2) for the purchases of business inputs that went into constructing each part of the hockey mask. B collects $4 in VAT from C, but gets a credit for $2 in VAT paid to A. Hence, B remits $2 ($4 - $2) in VAT to the government.

At this point, $4 ($2 + $2) in VAT has been collected

After constructing a finished hockey mask, C sells the assembled hockey mask to D for $60. C collects $6 in VAT (10% of $60) from D. C then calculates VAT liability by subtracting the amount of VAT paid on business inputs ($4) from the amount of VAT collected on purchases ($6). C must then pay the $2 in VAT liability ($6 - $4) to the government.

At this point, $6 ($2 + $2 + $2) in VAT has been collected

Finally, D, the retailer, sells the hockey mask to E, a consumer, for $100. D collects $10 (10% of $100) from E, and receives an input tax credit of $6 (10% of $60) for VAT paid on business inputs, resulting in VAT liability of $4 ($10 - $6), which is later remitted to the government.

A Total of $10 ($2 + $2 + $2 + $4) in VAT has been collected

It is worth noting that the same $10 amount would also be collected under a retail sales tax (RST),[12] the difference being that in an RST system, the 10% VAT would be imposed only at the final sale to end consumer resulting in $10 of RST being collected by the retailer, from the purchaser, and subsequently being remitted to the government. Reasons why a VAT may be preferable to an RST are explored in the next section.

C. Distinguishing a VAT From Other Taxes

One of the most unusual characteristics of a VAT, as contrasted with other taxes, is its multi-stage format; most taxes are imposed at only one stage on a product or service. Single-stage taxes include retail sales taxes (RST), manufacturers' sales taxes (FST), and wholesale-level taxes, among others.[13] Multi-stage taxes possess both costs and benefits which are not attributable to their single-stage counterparts.

A sales tax imposed at the retail level should theoretically derive the same revenue as a VAT; instead of being collected incrementally throughout the creation of a good or service, an RST is assessed at the final sale to the consumer on the full value of the good.[14] Moving from a single stage tax (e.g., RST) to a multi-stage tax, like a VAT, significantly increases the amount of paperwork and recordkeeping necessary for compliance and administration. These costs are arguably offset by several benefits. For one, the paper trail inherent in a VAT makes tax evasion more difficult[15] because both parties to a transaction are recorded.

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12. *Id.*

13. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 1010, at 5 (Peter H. Wood, FCA & Irene J. David eds., 7th ed. 1998).

14. CARLSON, *supra* note 5, at 2.

15. Lester B. Snyder, *The Truth About Consumption Taxes*, 21:2 USD L. ADVOC. 26, 26 (2005); *contra* CARLSON, *supra* note 5, at 58 (1980) (explaining that VAT guarantees neither compliance, nor collection of tax; for e.g. the tax still must be collected from the seller responsible for collecting the tax from the purchaser; false purchase invoices; personal use of business assets; products/services that are back loaded with majority of value-added at retail stage may incentivize retailers to conceal sales

In order to conceal tax liability, a conspiratorial relationship may become necessary. Also, in single-stage taxes, many goods are exempted to mitigate or preclude entirely the taxation of business inputs, resulting in a narrow tax base.[16] In reality however, many inputs remain taxable, effectively causing tax cascading (taxing inputs purchased to make a product and subsequently taxing the entire product price consisting of some inputs that have already been taxed). A broad-based VAT dispels the need to utilize an incomplete list of business input exemptions, as well as the accompanying tax-cascading, by providing tax credits for business inputs.[17]

D. Economic Effects of a Value-Added Tax

Several economic effects, which may vary by degree and/or existence from one instance to another, are generally accepted by experts in the tax community to result from institution of a VAT.

A VAT is an effective revenue-producing mechanism; this is illustrated by the overwhelming number of countries which have adopted a VAT over the last 50 years. It is a useful vehicle for increasing savings and investment because these activities bear no tax.[18] A VAT increases compliance and reduces tax evasion, enhancing the collection of tax revenues.[19] A VAT improves a country's trade balance by making domestically produced goods more competitive in the international market.[20] On the contrary, a VAT is criticized for being inflationary,[21] regressive (shifting the tax burden to the poor, a group which consumes a larger portion of its income),[22] and costly to administer and comply

because the tax liability they can avoid on sales will greatly outweigh the minimal input tax credit forfeited).

16. Michael Rushton, *A Value-Added Tax for the United States: Lessons from Canadian Experience*, 1993 PROCEEDINGS OF THE EIGHTY-SIXTH ANNUAL CONFERENCE ON TAXATION 96.

17. NATASHA MENON, A PRACTICAL GUIDE TO THE GOODS AND SERVICES TAX 5 (3d ed. 2004); Rushton, *supra* note 16, at 97 (explaining that VAT is not completely devoid of tax cascading, this occurs when an exempt supply is made at an intermediate stage in the production process, because there would have been tax paid on some inputs that was never given an input tax credit).

18. Snyder, *supra* note 15, at 26.

19. *Id.*; CARLSON, *supra* note 5, at 58.

20. Schenk, *supra* note 8, at 120 (explaining that this assumes that VAT is replacing a tax that burdened businesses or that if VAT is being implemented as a new type of tax, that it is accompanied by a decrease in other tax rates).

21. Rushton, *supra* note 16, at 97; CARLSON, *supra* note 5, at 65-69.

22. Snyder, *supra* note 15, at 26-27; CARLSON, *supra* note 5, at 70.

with.[23] These effects will be explored later relative to Canada's experience with the GST.

III. CANADA'S VAT: GOODS AND SERVICES TAX

A. Origin

The idea of a value-added tax (e.g., GST) is not a new concept. Conceptually, the idea originated in Germany as early as 1919 and France enacted the first value-added tax in 1955.[24] After formation of the European Economic Community (EEC),[25] several countries followed suit with VATs' of their own in the late 1960s and early 1970s.[26] The Canadian GST is similar to these VAT systems originally conceptualized and enacted in Europe and Britain.[27] Canada specifically based its GST model (and consequently, its name as well[28]) on the GST enacted in New Zealand in 1985.[29]

B. Public Opinion and Passage

Canada originally introduced its plan to enact a GST as Phase II of its 1987 Tax Reform Package.[30] No real push for a GST occurred until 1989, when the Progressive Conservative Government of Prime Minister Brian Mulroney made the institution of a GST a primary goal of its administration.[31] The effort to get GST passed was delayed for many reasons, including the federal government's failure, after a two-year effort, to convince the provincial governments to agree to consolidate their provincial taxes with the federal GST, an idea which required these

23. Schenk, *supra* note 8, at 123; John Turro, *Goods and Services Tax*, 2 TAX NOTES INT'L 14, 15 (1990).
24. CARLSON, *supra* note 5, at 6.
25. *Id.* at 6-7 (explaining the EEC was created by the Treaty of Rome in 1995 where the goal of the community was to establish a common market by way of the free movement of persons, goods, services and capital, one of the primary methods of achieving this goal was through tax harmonization).
26. *Id.* at 6.
27. MENON, *supra* note 17, at 6.
28. Brian J. Arnold, *The April 27, (26?) 1989 Federal Budget*, 1 TAX NOTES INT'L 41, 41 (1989).
29. Schenk, *supra* note 8, at 111.
30. *The April 27, (26?), 1989 Federal Budget*, *supra* note 28, at 41.
31. ANSWERS.COM, *Goods and Services Tax (Canada)*, http://www.answers.com/topic/goods-and-services-tax-canada (last visited Oct. 5, 2006).

provinces to agree to a uniform tax base.[32] Once the federal government decided to postpone its hopes for a single harmonized tax system, it would face stiff opposition from consumer advocates, small businesses, and eventually, the legislature as well.

With the exception of big business being the lone advocate for GST, the GST proposal was staunchly opposed.[33] The public disapproved of the GST on many fronts. One of the advertised benefits of GST over the previous tax regime was the ability to make domestic goods more competitive in the international market by exempting exported goods from GST.[34] So, when GST was advertised as revenue neutral (meaning the amount of revenue collected would remain the same as compared to the previous tax regime), a portion of tax liability would shift away from exported goods and the lost revenue would be replaced by money from the pockets of Canadian consumers.[35] This shifting of tax liability from exports onto consumers is amplified in a heavy-resource exporting country like Canada.[36] Another problem consumers had with GST was the hidden nature of the tax. Consumers' groups claimed that GST would be less transparent than the tax system being replaced, and that the government would raise GST rates once it became effective in order to subsidize other plans, such as narrowing the deficit.[37] Empirical evidence derived from international experiences lends credence to consumers' concerns that value-added taxes trigger higher government spending and increase tax burdens.[38] Small businesses were critical of GST primarily due to the heavy administrative burden certain to result from having to comply with yet another tax system.[39]

Opposition within the government could have been the death knell of the GST. After the House of Commons approved the GST bill on April 10, 1990,[40] it was up to the Senate to give final approval to the GST. After studying the proposed GST, the Senate indicated its intention to defeat the bill, citing the wishes of the Canadian people who were solidly opposed to the bill as the rationale for its decision; given the

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32. *The April 27, (26?), 1989 Federal Budget*, *supra* note 28, at 41.
33. *Tax Reform Plan Endangers the Government's Political Support*, 1 TAX NOTES INT'L 394, 394 (1989).
34. Rushton, *supra* note 16, at 96.
35. *Goods and Services Tax (Canada)*, *supra* note 31.
36. Discussion with Professor D. Lilly, October 2005.
37. *Tax Reform Plan Endangers the Government's Political Support*, *supra* note 33, at 394; Turro, *supra* note 23, at 15.
38. Daniel J. Mitchell, *Beware the Value-Added Tax*, THE HERITAGE FOUNDATION, May 16, 2005, http://www.heritage.org/research/taxes/bg1852.cfm.
39. *Tax Reform Plan Endangers the Government's Political Support*, *supra* note 33, at 394.
40. Brian J. Arnold, *Non-Residents and the GST*, 2 TAX NOTES INT'L 589, 589 (1990).

Liberal party's possession of the Senate majority, the GST seemed destined to fail.[41] Prime Minister Mulroney then executed a power play; by utilizing a little known power in the Canadian Constitution, Mulroney was able to temporarily stack the Senate to give his party the majority and get the GST bill passed.[42] Despite a subsequent filibuster in the legislature, judicial action[43] and a major decline in approval rating,[44] the Canadian GST received Royal Assent on December 13, 1990.[45]

C. Purposes for Adoption of GST

Canada had several reasons for adopting the goods and services tax. This discussion focuses on four primary reasons:

1. To form one national tax by harmonizing the tax system through consolidation of provincial taxes with the GST;[46]
2. To raise revenue;[47]
3. To replace the outdated manufacturer's sales tax;[48] and
4. To improve the trade balance and make domestically manufactured goods more competitive in markets, both domestic and international.[49]

Prior to efforts by the federal government to enact the GST, it planned to harmonize GST with the provincial retail sales taxes and benefit from simplification of compliance, ease of administration, and centralization of responsibility for overseeing the tax, all of which would have saved the government a considerable amount of money. At the time the GST was adopted, Canada had ten different broad based sales taxes consisting of eight provincial single-stage sales taxes, and two multi-stage taxes,

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41. Brian J. Arnold, *GST Update*, 2 TAX NOTES INT'L 1145, 1146 (1990).
42. *GST Update (1990)*, *supra* note 41, at 1146.
43. *Id.*; *Goods and Services Tax (Canada)*, *supra* note 31.
44. *Goods and Services Tax Sparks Revolt in Canada*, 2 TAX NOTES INT'L 633, 634 (1990) (explaining, that according to a Gallup poll, Mulroney's approval rating has sunk to an unprecedented low of 17%, much of this decline attributed to GST).
45. *GST Update (1991)*, *supra* note 4, at 41.
46. Brian J. Arnold, *The Proposed Canadian Goods and Services Tax*, 1 TAX NOTES INT'L 163, 163 (1989).
47. *The April 27, (26?), 1989 Federal Budget*, *supra* note 28, at 41.
48. Rushton, *supra* note 16, at 96.
49. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 1025, at 10 (Peter H. Wood, FCA & Irene J. David eds., 7th ed. 1998).

the federal GST and the Quebec Sales Tax (QST).[50] The provincial sales taxes varied slightly, but generally excluded services from the tax base while taxing many inputs to production, cutting against a critical mechanism of GST.[51] The government offered to assume the responsibilities currently held by the provincial governments. By administering, collecting and monitoring the provincial retail sales taxes, the federal government would simply submit a check to each provincial government for the portion to which it was entitled.[52] Had the provinces adopted the GST tax base and maintained their current provincial tax rates, the change would not significantly alter the amount of incoming revenue, and the costs of administering the provincial sales taxes would vanish.[53] However, the provincial governments, which tend to be very protective of their autonomy, were not prepared to participate in a national sales tax that required a common tax base. Continuous efforts by the federal government to negotiate a harmonized national sales tax with the provinces proved to be an unsuccessful endeavor.[54] With the exception of a partial harmonization with Quebec, the provinces turned down the offer.[55] The federal government eventually formed an agreement, in 1997, to harmonize the GST with the sales taxes of three provinces (Newfoundland and Labrador, Nova Scotia, and New Brunswick).[56] However, Canada's failure to fully harmonize GST with all of the provincial sales taxes (PST) resulted in a large variance in tax rates and tax bases, greatly hindering both administration and compliance, and eliminating a significant advantage of a GST.[57]

One of Canada's primary motivations for instituting the GST was to raise revenue. The need to raise revenue was partly the result of a recession that began in 1990.[58] Canada estimated that the GST would

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50. Sean C. Aylward, *Proposed GST Reforms in Canada Include Integrated National, Provincial VAT*, 5 J. INT'L TAX'N 473, 473 (1994).

51. Rushton, *supra* note 16, at 98.

52. Rushton, *supra* note 16, at 98 (explaining there is a similar arrangement with the federal income tax system where every province, save Quebec, has adopted the federal income tax base, and the federal government is now responsible for administering and collecting the tax).

53. Rushton, *supra* note 16, at 98.

54. Aylward, *supra* note 50, at 473.

55. *The Proposed Canadian Goods and Services Tax*, *supra* note 46, at 163; Rushton, *supra* note 16, at 98.

56. MENON, *supra* note 17, at 4; Discussion with Prof D. Lilly, October 2005 (explaining that the three provinces to agree to harmonization, probably not coincidentally, are three of the poorest provinces in Canada; the incentive to alleviate the burden of administering their PSTs and simply collecting a check is far more appealing to these weaker provinces).

57. Turro, *supra* note 23, at 15.

58. FINDARTICLES.COM, OECD Economic Outlook, *Canada—Economic Indicators* (July 1991), http://www.findarticles.com/p/articles/mi_m4456/is_n49/ai_11078834.

increase revenues by C$5.5 billion to C$24 billion and simultaneously reduce the deficit by stimulating economic growth.[59]

Canada introduced the GST as a replacement for the manufacturer's sales tax (FST) that had previously been applied at the wholesale level on manufactured goods.[60] The FST had a number of flaws found in most single-stage taxes.[61] Many goods purchased by producers were exempt from tax while a number of manufactured inputs were not, which caused tax cascading (i.e., paying tax on goods taxed previously) and non-neutrality.[62] The imposition of tax on manufactured inputs also caused goods which were intended to be tax-free (e.g., exports, groceries), to include tax in their pricing.[63] Attempts to exempt goods purchased primarily by producers resulted in a narrow tax base (covering approximately one third of consumer goods) and a higher tax rate.[64] Additionally, some manufacturers were able to avoid FST by funneling advertising and marketing through wholesalers and retailers, resulting in disparate tax rates on competing goods.[65] Finally, the FST placed domestically produced goods and services at a disadvantage compared with competitive imports because importers could avoid taxes on expenses incurred after the manufacturing stage (e.g., costs for marketing and distribution), whereas many domestic manufacturers could not.[66] The GST created a level playing field by imposing the tax at the point of consumption, ensuring that the value added to imported goods through marketing and distribution would be taxed when the importer or subsequent distributor sold the imported goods at prices that included these costs.[67]

In addition to making domestically produced goods and services more competitive with competing imports, replacement of the FST with the GST was aimed at improving the trade balance by making exported

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59. *Tax Reform Plan Endangers the Government's Political Support*, *supra* note 33, at 394.

60. *Goods and Services Tax (Canada)*, *supra* note 31; *The April 27, (26?), 1989 Federal Budget*, *supra* note 28, at 41.

61. Rushton, *supra* note 16, at 96.

62. *Id.*; *The Proposed Canadian Goods and Services Tax*, *supra* note 46, at 163; Schenk, *supra* note 8, at 120.

63. Rushton, *supra* note 16, at 96.

64. *Id.*; Schenk, *supra* note 8, at 120; *The Proposed Canadian Goods and Services Tax*, *supra* note 46, at 163.

65. Schenk, *supra* note 8, at 120.

66. *Id.*

67. *Id.* at 121.

goods and services more competitive in the international market.[68] One major concern for Canada was post-1992 European economic integration,[69] since its economy was so dependent on international trade.[70] As compared with the GST (which exempts exports from tax and provides tax credits for business inputs), the FST was levied at a higher rate on a smaller base of goods and services and assessed before the item reached the consumer, resulting in a reduction of Canadian exports, more competitively priced imports, and a higher cost of capital investment to Canadian companies.[71] Under the FST, the tax on business inputs that is not rebated on Canadian exports accounted for an estimated 0.9% of the sales value of exports and over 10% of the profit margin of several exporters.[72] The FST put domestic manufacturers at a competitive disadvantage with exports and imports, increasing the price of goods by one to two percent, and costing Canada an estimated 1.4% of GDP (roughly nine billion Canadian dollars).[73] The institution of GST aimed at solving all of these costly problems.

D. Implementation of GST—Transitional Provisions

Simultaneous with implementation of the GST, Canada repealed several taxes, including the manufacturer's sales tax, which was specifically being replaced by the GST. Included in the Canadian GST were several provisions[74] intended to make the transition from the FST to the GST as smooth and organized as possible, to limit exploitation (i.e., tax avoidance), and to relieve double taxation.[75] A brief description of some of these provisions follows.

The GST typically applies to transfers of real property, only if both possession and title was transferred from the seller to the buyer after 1990. As long as a purchaser either had possession or legal title to real property prior to 1991, no GST liability would attach.[76] For example, a

68. *Id.* at 120.

69. Barry Eichengreen, *European Economic Community*, THE LIBRARY OF ECONOMICS AND LIBERTY (1992), http://www.econlib.org/library/Enc/EuropeanEconomicCommunity.html (noting that The Single Market Program was set out in a white paper published by the European Commission in 1985; it recommended nearly three hundred measures to remove obstacles to intra-European competition; The Single European Act (SEA) of 1986 committed EC members to implement those measures by the end of 1992).

70. Turro, *supra* note 23, at 14.

71. *Tax Reform Plan Endangers the Government's Political Support*, *supra* note 33, at 394.

72. Schenk, *supra* note 8, at 120.

73. Turro, *supra* note 23, at 14.

74. Excise Tax Act, R.S.C., c. E-15, §§ 336-47 (1985).

75. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 15005, at 1123 (Peter H. Wood & Irene J. David eds., 7th ed. 1998).

76. Excise Tax Act, R.S.C., c. E-15, § 336(1) (1985).

person who, prior to 1991, leased land with an option to buy, but exercised the option after 1990, incurred no GST liability on the option price because possession was transferred pre-1991. If both possession and legal title were transferred post-1990, then the date of the purchase-sale agreement controlled.

Personal property transactions received similar treatment. If either possession or ownership was delivered prior to 1991, the transaction did not trigger GST liability.[77] Specifically, GST did not apply if either the sale was made pursuant to a written agreement entered into before 1991, or consideration for the sale became due or was paid before May 1991. In contrast with the treatment of real property, GST generally applied if an option to purchase personal property (possessed prior to 1991) was exercised after 1990.[78] If both ownership and possession of personal property remained with the seller after 1990, then GST generally applied to any consideration that either became due or was paid without having become due, after August 1990.[79]

With respect to services, GST generally did not apply to consideration which was paid or became due prior to May 1991, if all or substantially all of the services were performed prior to 1991.[80] If all or substantially all of the services were performed after 1991, no GST liability attached for payments that became due prior to May 1991 which related to services performed prior to 1991.[81] However, payments (for taxable supplies) made after August 1990, but before 1991, which either became due in that period, or did not become due, were taxable under the GST.[82]

The aforementioned provisions are indicative of the full body of transitional provisions promulgated by the Canadian government. These provisions aimed to place the revenue recognized from transactions involving goods and services into the appropriate time frame to determine which tax regime (old, new or both) should apply to which revenue. Additionally, these provisions employed protective devices to ensure that parties engaging in transactions were not burdened with double tax liability should both tax regimes be triggered.

77. *Id.* § 337(1).
78. *Id.* § 337(1.1).
79. *Id.* § 337(5).
80. *Id.* § 337(1).
81. *Id.* § 337(2).
82. *Id.* § 337(3).

While these provisions may have been well written and even effective when utilized, it was necessary for businesses and consumers to know of the provisions and understand how to use them. Upon implementation of the GST, many commentators expressed concern that neither businesses, nor the tax authorities were prepared for the new GST, as illustrated by the small number of businesses which registered for the tax.[83] This is not surprising considering the Senate's public announcement that it would not approve the GST bill, followed by the unusual method utilized (stacking the Senate by means of a never before used Constitutional provision) by the Prime Minister to get the bill approved. Therefore, irrespective of how effective the transitional provisions may have been theoretically, the slow response of those subject to the tax to make use of these transitional provisions likely mitigated their potential beneficial effect.

E. Administration and Enforcement of GST

The GST (as well as the Harmonized Sales Tax (HST) and the Federal Income Tax) is administered solely by the Canada Revenue Agency (formerly known as the Canada Customs and Revenue Agency and Revenue Canada).[84] However, all but three provinces maintain their own body to administer and collect provincial taxes causing increased cost and complication of the Canadian tax system.

Canada uses a system of registration as its primary mechanism to administer the GST. Every person[85] who makes a taxable supply[86] in the course of a commercial activity[87] must register for the GST unless the

83. *GST Update (1991)*, *supra* note 4, at 41.

84. ANSWERS.COM, *Canada Revenue Agency*, http://www.answers.com/topic/canada-revenue-agency (last visited Oct. 5, 2006) (explaining that The Canada Revenue Agency administers tax laws for the government of Canada and for most provinces and territories, international trade legislation, and various social and economic benefit and incentive programs delivered through the tax system).

85. Excise Tax Act, R.S.C., c. E-15, § 123(1) (1985) (defining a "person" as "an individual, a partnership, a corporation, the estate of a deceased individual, a trust or a body that is a society, union, club, association, commission, or other organization of any kind").

86. *Id.* § 123(1) (defining a "supply" as "the provision of property or a service in any manner, including sale, transfer, barter, exchange, license, rental, lease, gift, or disposition").

87. *Id.* § 123(1) (defining a "commercial activity" of a person as a business carried on by the person, an adventure or concern of the person in the nature of trade, and the making of a supply by the person of real property of the person; if aforementioned activities are carried on without a reasonable expectation of profit by an individual, a personal trust or partnership, all of the members of which are individuals, or if activities are attributable to the making of exempt supplies, they are NOT commercial activities).

person is a small supplier,[88] the person's only commercial activity is the sale of real property other than in the course of business, or the person is a non-resident who does not carry on any business[89] in Canada.[90] Although small suppliers are not required to register for the GST, they may find it beneficial to do so voluntarily, if they are permitted.[91]

Regardless of whether businesses are registered for GST, they are assigned reporting periods by which they must abide. Non-registrants[92] have a monthly reporting period whereas the period for registrants[93] depends on the amount of taxable supplies made by a registrant in a particular fiscal year and, to some extent, the will of the taxable person. Any person may make an election to have fiscal months as their reporting period.[94] The election of fiscal quarters[95] is limited to persons that are charities on the first day of the fiscal year and persons whose fiscal year sales of taxable supplies do not exceed C$6,000,000. The election of fiscal years for a reporting period is limited to registrants that are charities on the first day of a fiscal year and registrants whose fiscal year sales of taxable supplies do not exceed C$500,000 (i.e., small businesses).[96] Canada generally requires taxpayers to report transactions (using the accrual method of accounting) at the earliest of the following dates: (1) date invoice was issued; (2) date payment became due under a written agreement; (3) date of delivery (for sales of personal property);

88. *Id.* §§ 123(1), 148(1) (defining a "small supplier" as a person who sales of taxable supplies did not exceed $30,000 ($50,000 for public service bodies) in the four preceding quarters); Excise Tax Act, R.S.C., c. E-15, §240(1.1) (1985) (explains that any small supplier carrying on a taxi business also must be registered for the GST).

89. *Id.* § 123(1) (defining a "business" to include: a profession, calling, trade, manufacture, or undertaking of any kind whatever, whether the activity or undertaking is engaged in for profit, and any activity engaged in on a regular basis that involves the supply of property by way of lease, license or similar arrangement, but does not include an office or employment).

90. *Id.* § 240(1).

91. *Id.* § 240(3) (permitting registration to a person who: (1) is engaged in a commercial activity in Canada; (2) is a non-resident person who in the ordinary course of carrying on business outside of Canada regularly solicits orders to be consumed in Canada, has entered into an agreement to supply services, or intangible personal property relating to real property in Canada, tangible personal property usually in Canada or services to be performed in Canada; (3) is a listed financial institution resident in Canada; or (4) is a particular corporate resident in Canada).

92. *Id.* § 245(1).

93. *Id.* § 245(2).

94. *Id.* § 246.

95. *Id.* § 247.

96. *Id.* § 248(1).

or (4) date ownership is transferred or date purchaser takes possession (for sales of real property).[97]

Although reporting periods are restricted, taxpayers may select more frequent reporting for, among other reasons, alleviating cash flow problems.[98] Cash-flow can be a benefit or a hindrance. Taxpayers may experience a negative float (cash-flow loss)[99] under which a taxpayer essentially finances the government either by remitting the amount of tax due prior to receipt of payment from customers with favorable credit terms or delinquent accounts or by being forced to wait for a refund to which they are entitled. Taxpayers with taxable business inputs whose sales themselves are not taxable (e.g., exporters), represent a group commonly affected by negative floats. Alternatively, taxpayers may experience a positive float (cash-flow gain)[100] under which a taxpayer has a net tax liability which comes due after receipt of customer payment. Taxpayers experiencing a positive float can earn interest on this money until the tax liability comes due. Thus, taxpayers with a negative float are incentivized to choose shorter reporting periods (despite more paperwork) and receive refunds more frequently, whereas taxpayers with a positive float are incentivized to stretch out reporting periods (which may not be permitted) and reap interest off the government's money.[101]

The actual physical collection of GST (HST for participating provinces) on individual transactions is broken down into three groupings. As previously discussed, registered businesses are required to collect the 7% GST (15% HST for businesses located in a participating province) from the recipient of a taxable supply (excluding zero-rated supplies)[102] made in Canada, on the consideration paid for the supply.[103] Importers of goods will be assessed the 7% GST for customs by Canada Revenue Agency (CRA); this tax is eligible for input tax credit treatment in the same manner as domestically produced goods.[104] If imported goods are not for commercial use and the recipient resides in a participating province, CRA will also collect the additional 8% component of HST.[105] Finally, recipients of directly shipped imported taxable supplies are required to self-assess the 7% GST (15% HST if residing in a participating province). If the taxable supply is intended for use, consumption, or supply in the course of commercial activities, an input tax credit is

97. Schenk, *supra* note 8, at 117.
98. *Id.* at 116.
99. *Id.*
100. *Id.*
101. *Id.* at 117.
102. To be discussed in next section.
103. CANADIAN MASTER TAX GUIDE, ¶ 16115, at 1337 (58th ed. 2003).
104. CANADIAN MASTER TAX GUIDE, ¶ 16185, at 1348 (58th ed. 2003).
105. CANADIAN MASTER TAX GUIDE, ¶ 16185, at 1348 (58th ed. 2003).

available.[106] This system demonstrates the holistic strategy Canada has employed to capture revenue on every taxable transaction.

Despite efforts to design GST so as to capture tax on all taxable transactions and incentivize reporting (i.e., input tax credits), enforcement and accountability issues remain.[107] Input tax credits serve to motivate taxpayers to obtain invoices on transactions to ensure they receive credits for business inputs, while also creating a record of the transaction which can be tracked. However, once a taxpayer is in possession of this documentation, the taxpayer has no further motivation to ensure that his supplier has remitted the taxable portion of his purchase to the government.[108] The final transactional stage from business to end consumer is even more problematic—it does not produce an invoice because the consumer is not eligible for an input tax credit. The opaque nature of this final transaction encourages advantageous business owners to omit sales from their books.[109] Indeed, imposition of the GST is estimated to have driven one quarter of small businesses into the underground economy.[110]

Certain areas of commerce are more prone to fraud and represent challenges to the tax collecting authority (e.g., retail sales, of which the end consumer is most often the customer). Businesses where most of the value is produced at the final stage (e.g., services industries—hotels, restaurants, repair activities) present a difficult test because they have very little input tax to track.[111] Businesses may attempt to produce false purchase invoices to gain an input tax credit to which they are not entitled.[112] Finally, another commonly practiced exploitation that is difficult to trace is the personal use of business assets which allows businesses to consume taxable supplies tax-free.[113]

F. Structure of GST

Canada's Goods and Services Tax is a broad-based tax on the consumption of goods and services. A tax that is broadly based is designed to capture revenue across the board and provide uniform tax treatment

106. CANADIAN MASTER TAX GUIDE, ¶ 16195, at 1349 (58th ed. 2003).
107. CARLSON, *supra* note 5, at 58.
108. *Id.*
109. *Id.* at 59 (explaining that this omission from sales volume can somewhat be controlled through awareness of retail margins).
110. Mitchell, *supra* note 38, at 10.
111. CARLSON, *supra* note 5, at 59.
112. *Id.*
113. *Id.*

both to suppliers in similar situations and to goods and services in similar categories. There is a definite tendency for the tax base of a value-added tax to narrow as it navigates its way toward legislative enactment.[114] Indeed, political, social and economic norms prevent any system of taxation from being entirely devoid of exceptions and compromises, the Canadian GST included. Although the GST provides preferential treatment to specified suppliers, goods, and services, this tax went a long way toward placing its citizens on equal footing, in stark contrast with the previous FST regime.

1. Tax Rates

Originally proposed at 9%,[115] the GST was enacted at a single rate of 7%.[116] Canada's decision to impose one standard rate (and no accompanied reduced rates) contrasts with more than three fourths of the remaining twenty-eight OECD member countries with a value-added tax on consumption.[117] This is a significant difference because a single rate system is believed both to ease administration and reduce the costs businesses incur in order to comply with the tax.[118]

Although the Canadian GST is assessed at a single rate, there are additional taxes, at both the federal and provincial levels, assessed at different rates and collected by different bodies that complicate the overall tax system in Canada. The aforementioned harmonized sales tax is one example. This tax is substituted for the GST and assessed at 15% in the three participating provinces. Canada Revenue Agency (a federal body) collects this tax and remits 8% (excess of HST over GST) to the participating provincial governments. This method arguably mitigates the burden of administration because duties of tax collection and distribution are assumed by one body instead of two. However, because only three of the ten provinces utilize the HST, questions of where a good or service is destined, whether is it intended for commercial use or consumption, and which tax gets applied illustrate the increased burden of compliance. The Quebec Sales Tax (QST) presents a similar problem. QST has a tax base that has been partially harmonized with GST. Whether a good or service is taxable by GST, QST, or both is compounded by issues of destination and intended use. Further consideration of the

114. Schenk, *supra* note 8, at 113.
115. *Id.*
116. *Canadians Set to End Liberals' Reign*, CNN, January 23, 2006, http://www.cnn.com/2006/WORLD/americas/01/23/canada.election.ap/index.html (explaining that the new Prime Minister vowed to lower the GST to 5%).
117. *Table IV.1—Rates of Value-Added Taxes/General Sales Taxes*, ORG. FOR ECON. CO-OPERATION AND DEV. (2005), http://www.oecd.org/dataoecd/12/13/34674429.xls.
118. Schenk, *supra* note 8, at 113.

provincial taxes (in six of the seven remaining provinces) which are assessed at varying rates, some of which tax previously computed GST and some of which do not, make apparent the degree of complexity within Canada's tax system.[119]

2. Domestic Zero-Rate, Exemptions

Systems of taxation touch every sector within a country and have effects on a national level. While uniformity and impartiality amongst the masses may appear ideal in theory, it is a forgone conclusion that exceptions in the tax system will be necessary and preferences will be provided to different goods and services and different groups of people based on policy decisions of the governing body. Two mechanisms that can be used to alter a tax system in order to effectuate policy decisions are a domestic zero-rate and exemptions. Before detailing Canada's decision to zero-rate or exempt what would be otherwise taxable supplies, it is important to understand the difference between these mechanisms.

The primary difference between a zero-rated supply and an exempt supply is that input tax credits are available to suppliers who participate in the production of zero-rated supplies, but are not available for suppliers producing exempt supplies. Additionally whether a supply is zero-rated often depends on the identity of the person who will consume the supply. On the contrary, exempt supplies are usually exempt from tax regardless of who the consumer is.[120] Whether a supply is zero-rated or exempt, the effect sought is to ensure the consumer does not incur any tax liability when purchasing the good or service.

a. Zero-Rated Supplies

A domestic zero-rate applies 0% GST on the sale of select goods and services to select non-taxable parties; each supplier participating in the supply's production process receives a deduction (input tax credit) for purchases of items related to the supply. Thus, not only is no tax collected on the final sale, but all tax that was assessed during the production process is refunded, ensuring that the good or service bears

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119. MENON, *supra* note 17, at 10.
120. *Id.* at 65.

no hidden tax, a significant advantage of a zero-rated supply over its exempt counterpart.[121]

The government's selection of which supplies to zero-rate derives from policy decisions of a political, economic and/or social origin. One policy choice of the government is that the population should not bear any additional cost in acquiring certain goods and services which are both fundamental and necessary.[122] Included among the categories of zero-rated supplies are prescription drugs & biologicals,[123] medical and assistive devices,[124] basic groceries,[125] agriculture & fishing,[126] exports,[127] travel services,[128] transportation services,[129] international organizations & officials,[130] certain financial services,[131] and collection of customs & duties.[132]

The first three categories of supplies are zero-rated for the purpose of achieving some vertical equity in the tax system by eliminating some of the regressive nature of consumption taxes.[133] The regressive nature of a consumption tax can be understood as follows. An income tax taxes what one earns; the more one earns, the more one is taxed, resulting in wealthier individuals paying more income tax. A consumption tax, however, taxes spending or consumption; the more one spends or consumes, the more one is taxed. Although wealthier individuals will spend more than poorer individuals (resulting in more tax paid), they also possess the capability of saving more tax-free because the GST only taxes consumption. Contrast poor individuals, who lack the capability of saving tax-free and spend a much larger portion (if not all) of their income on basic needs such as groceries and medicine. To mitigate the bias inherent in the GST, the government chose to eliminate the taxation of these supplies.

The fourth category of zero-rated supplies taxes certain inputs in the agricultural and fishing industries at a rate of 0% GST because the government felt that businesses involved in this sector may suffer from difficult cash-flow problems as a result of the GST's credit-invoice system.[134] The rationale for the fifth category of zero-rated supplies

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121. Rushton, *supra* note 16, at 96.
122. MENON, *supra* note 17, at 65.
123. *See* Excise Tax Act, R.S.C., c. E-15, Sch. VI, Pt. I (1985).
124. *See id.* Pt. II.
125. *See id.* Pt. III.
126. *See id.* Pt. IV.
127. *See id.* Pt. V.
128. *See id.* Pt. VI.
129. *See id.* Pt. VII.
130. *See id.* Pt. VIII.
131. *See id.* Pt. IX.
132. *See id.* Pt. X.
133. Rushton, *supra* note 16, at 96.
134. *Id.*

(exports) reflects an international ideology. Canada operates under the "source" principle of taxation. Consistent with this principle is the idea that goods produced in the domestic country which are intended for export are taxed only in the foreign country (from which the "source" of revenue originates) where the final purchase and consumption occur.

As illustrated in the rationale for and the classification of zero-rated supplies, policy decisions which originate outside the realm of tax often have significant effects inside of tax systems. This phenomenon endures in Canada's choice to exempt a select list of goods and services.

b. Exempt Supplies

When a supply is exempt, no GST is collected from the consumer, but the seller also receives no credit for purchases of business inputs that went into the production of the exempt good or service sold.[135] Exempt supplies are intended to be tax-free just like zero-rated supplies. However, because there is no available input tax credit to suppliers, it is almost inevitable that exempt supplies will include some tax in their purchase price.

If the final sale of a good is exempt, there is an implied tax on the purchase of between 0% and 7%, depending on how much value was added in the final stage of production; the more value added at the final stage, the higher the implied tax on the so-called "exempt" good.[136] If the exempt good is made at an intermediate stage, the effective tax rate on the good will exceed the 7% standard GST rate.[137] This is because the intermediate-stage producer who incurs tax on business inputs would receive no credit for these inputs, and the 7% GST which applies to the final sale of the good, would be assessed on a price which includes the unreimbursed tax from the intermediate stage. If the tax-exempt supply is involved in the production of an export, the unintended tax transfers either to the foreign purchaser (through a higher sale price) or to the Canadian producer (through smaller sales volume resulting from a less competitive price in the international market).[138]

Although the above discussion reveals weaknesses in the exemption scheme, it remains utilized as an effective vehicle for providing preferential

135. *Id.* at 96-97.
136. *Id.*
137. *Id.*
138. Rushton, *supra* note 16, at 97.

treatment underlying policy decisions of the government. Included in the preferred list of exempted supplies are real property,[139] health care services,[140] educational services,[141] child & personal care services,[142] legal aid services,[143] supplies by charities,[144] supplies by public-sector bodies,[145] certain financial services,[146] and ferry, road & bridge tolls.[147]

The seventh category exempts supplies from municipalities, universities, schools, and hospitals (MUSH). To fulfill the government's promise that the MUSH sector would remain revenue neutral after the transition from the previous FST to the new GST regime, this exemption was coupled with restricted tax rebates for each sector to offset the increase in tax inherent in the exemption system.[148] Charities and other non-profit organizations that are substantially funded by the government receive similar preferential treatment in the form of 50% rebates on input tax paid.[149]

The eighth category (financial services) of supplies exempted from GST is somewhat of an anomaly because it is not the product of policy. Although financial services properly belong in the tax base of a personal consumption tax, Canada has encountered much difficulty in taxing this category.[150] Whether the difficulty stems from the intangible nature of financial services and/or the challenge of placing a number on the amount of value added at each stage, Canada chose to exempt most financial services from taxation. This decision enhances the regressive nature of a GST because these services are disproportionately consumed by wealthy individuals.[151] Conceptually, the decision to exempt the supply of financial services depends on what role the supply plays. If the financial sector were principally supplying an input to production, it would be better to zero-rate the service because the goal of GST is to avoid taxing inputs. If the financial sector were mostly supplying a product, it would be better to exempt the service (in the absence of being able to assess the full tax) because the consumer would pay at least a

139. Excise Tax Act, R.S.C., c. E-15, Sch. V, pt. I (1985).
140. *Id.* pt. II (1985).
141. *Id.* pt. III (1985).
142. *Id.* pt. IV (1985).
143. *Id.* pt. V (1985).
144. *Id.* pt. V (1985).
145. *Id.* pt. VI (1985).
146. *Id.* pt. VII (1985).
147. *Id.* pt. VIII (1985).
148. Rushton, *supra* note 16, at 97; Schenk, *supra* note 8, at 115.
149. Schenk, *supra* note 8, at 115; Rushton, *supra* note 16, at 97.
150. Schenk, *supra* note 8, at 115.
151. *Id.*

partial tax as a result of the restriction on input tax credits of exempt supplies.[152]

3. Special Schemes

In addition to exempting and zero-rating supplies to select groups of persons, the Canadian government devised special schemes that were better suited for policies they sought to implement. One significant scheme is the small supplier exemption,[153] which targets areas where the compliance requirements under the GST system are not practicable. Businesses with total taxable sales (including zero-rated sales) of goods and services of less than C$30,000 per year (C$50,000 for public service bodies) may qualify for small supplier treatment,[154] under which they need not collect nor pay any GST.[155] The taxable sales calculation is determined by combining sales from the four calendar quarters preceding the current quarter;[156] thus, a business may experience a strong quarter, still fall beneath the threshold for taxable sales in the calendar year, and lose the exemption.

The small business exemption is not the only illustration of Canada's decision to facilitate and encourage domestic capital investment; this policy is emulated in the GST treatment of capital property as well. In general, a GST registrant may claim an input tax credit for GST paid on real and personal property in proportion to the extent to which the property is acquired for use in commercial activities. Specifically, capital personal property and capital real property receive different treatment under the GST. If capital personal property is acquired for use primarily (more than 50%) in a commercial activity, or is improved and immediately used primarily in commercial activities, a *full* input tax credit is permitted.[157] Contrast capital real property, from which a *proportional* input tax credit is available to registrants at the point of acquisition; any tax paid by a person on capital real property represents non-commercial use of the property at that time.[158]

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152. Rushton, *supra* note 16, at 97.
153. Excise Tax Act, R.S.C., c. E-15, § 148 (1985).
154. Rushton, *supra* note 16, at 97.
155. *The Proposed Canadian Goods and Services Tax*, *supra* note 46, at 164.
156. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 7105, at 528-30 (Peter H. Wood, FCA & Irene J. David eds., 7th ed. 1998).
157. Excise Tax Act, R.S.C., c. E-15, § 199(2-4) (1985).
158. *Id.* § 206 (1985).

The Canadian government employed several devices including a domestic zero-rate, exemptions, and other programs for the purpose of achieving the desired balance of taxation among the population. Despite the tendency of these preferential mechanisms to limit uniformity within a tax system, the Canadian GST remains one of the broadest based value-added taxes on consumption in the developed world.[159]

IV. CANADA'S EXPERIENCE WITH A VALUE-ADDED TAX

A detailed look into the structure of the Canadian GST was necessary for a foundational understanding of both the underlying policy of the tax and the theoretical consequences of its enactment. We now shift to a more concrete analysis of the economic effects of GST in the Canadian economy.

Value-added taxes are renowned for their uncanny ability to capture large amounts of revenue. Taxes on consumption (e.g., value-added tax) are thought to exploit consumers' habitual practice of consumption, and increase government spending through the relative ease with which the rate of the VAT cash cow can be increased. The Canadian GST may appear to be a revenue-making machine, but this view does not necessarily reflect reality. The GST had to replace lost revenue from the FST that was being phased out, and the government's stated objective was that this transition would be revenue neutral. Although GST was designed to tax a much broader base, it was assessed at a lower rate and ultimately did not result in an inordinate amount of tax revenue being collected.[160] The increase in compliance and reduction in tax evasion that accompany a VAT may have created the capture or collection of additional revenue; but this surplus would first need to be applied to cover the increased administration and enforcement costs which also accompany a VAT. Finally, it should be noted that although the GST has been amended during its 15-year life span, the rate has remained constant contrary to the forecasts of its adversaries.

The effect of GST on the trade balance of Canada is difficult to gauge with any particularity. Canada possesses an inherent amount of leverage in the international market because it is a heavy resource-exporting country. This is illustrated by the growth rate in Canadian exports which has exceeded the growth rate of Canadian imports over the last twenty-

159. Schenk, *supra* note 8, at 113 (explaining that only the New Zealand GST possesses a broader tax base than Canada).

160. *Fiscal Reference Tables*, DEPARTMENT OF FINANCE CANADA 11, 16 (2005), *available at* http://www.fin.gc.ca/frt/2005/frt05_e.pdf (showing the amount of FST, GST, and total revenue collected for the years 1961-2005).

five years.[161] The United States is Canada's largest trading partner of goods and services, both inbound and outbound. 87% of Canadian exports and 64% of Canadian imports are destined for and originate from the United States.[162] Canada's position of power in international trade, when combined with the magnitude of the US-Canada partnership (strengthened by the North American Free Trade Agreement), no doubt has had an inelastic influence on the marginal increase in price competitiveness of Canadian supplies produced for the international market. Obtaining a clear picture on the effect of GST on Canada's trade balance is further complicated by the recession and resulting inflation that occurred in the late 1980s through mid 1990s. Canada's economy has since recovered recording budget surpluses every fiscal year since 1997-98.[163] This steady improvement in the economic health of Canada (whether in conjunction with GST or not) has prompted an 8.5% decrease in the effective tax on corporate income over the last five years.[164] This trend has certainly decreased the cost of doing business in Canada and placed domestic businesses in a more competitive position in the international market. The proper way to synthesize the Canadian experience is not to conclude that countries who enact value-added taxes (such as the Canadian GST) will inevitably improve their international trade position. Rather, Canada's experience with the GST serves to fortify that increased competitiveness within international commerce, even under volatile economic conditions, is a conceivable goal of countries with systems of value-added taxation.

One criticism of value-added taxes is the inflationary effect they are said to have on goods and services. During the enactment of GST, Canada was in the middle of a recession, which tends to cause inflation.[165] Additionally, whereas the Canadian FST was borne partly by producers and partly by consumers, the new regime (Canadian GST) is borne

161. Samantha Hettihewa & Girijasankar Mallik, *The Economic Transformation—Australia and Canada From 1981-2001*, UNIV. OF W. SYDNEY, SCH. OF ECON. & FIN. (WORKING PAPER SERIES), March 2003, at 7, *available at* http://www.uws.edu.au/download.php?file_id=9169&filename=2003_01_hettihewa_mallik.pdf&mimetype=application/pdf.

162. *Id.* at 12-13.

163. *Fiscal Reference Tables*, DEPARTMENT OF FINANCE CANADA 9 (2005), *available at* http://www.fin.gc.ca/frt/2005/frt05_e.pdf (showing the amount of FST, GST and total revenue collected for the years 1961-2005).

164. *Corporate Income Tax Rate*, ORG. FOR ECON. CO-OPERATION AND DEV. (2005), http://www.oecd.org/dataoecd/26/56/33717459.xls.

165. *Canada—Economic Indicators*, *supra* note 58.

entirely by the consumers; consequently, the consumer price index was expected to rise.[166] Several experts weighed in with estimates of inflation post-GST enactment ranging from 1.4% to 6.5%. Critics spoke of wage spirals and uncontrollable interest rates, holding that estimates on the high end were underestimated and based on overly optimistic assumptions.[167] When the dust settled, CPI experienced moderate increases of 1.3% in 1991 and 1.5% in 1992 (both well within the Bank of Canada's targeted range),[168] thus refuting critics' catastrophic outlooks and emboldening the image of GST.

Another criticism of value-added taxes is their regressive tendency to shift the tax burden onto the poor.[169] Whereas the income tax dons a progressive rate scale under which higher income households pay higher rates of tax, a broad-based value-added tax (e.g., GST) is regressive because the proportion of income spent on consumption declines as income rises. Low income households typically spend all of their income, most of which is reserved for basic necessities, while high income households generally are able to save a portion of their income (which is not subject to value-added taxation because it is not consumed).[170] Canada has addressed the problem of regression by zero-rating supplies which serve the basic needs of its citizens and providing low-income relief through a refundable GST credit.[171] This credit is available to individuals, couples (married and unmarried), and families with incomes below C$30,000. The credit is indexed to account for increases in inflation and is paid in four quarterly installments to alleviate financial difficulties experienced by low-income citizens.[172] These programs prompt experts to conclude that Canada leads the pack among countries with value-added taxes in mitigating regressive effects on low-income households.[173]

Although Canada has been able to mitigate perceived inherent weaknesses of value-added taxes such as regression, multiple-rate structures, and inflation, resolutions (e.g., zero-rating, exemptions, single-rate structure)[174] to these challenges are coupled with increased financial

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166. Rushton, *supra* note 16, at 97.
167. *Id.*
168. *Id.*
169. Snyder, *supra* note 15, at 26-27; CARLSON, *supra* note 5, at 70.
170. Schenk, *supra* note 8, at 122.
171. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 1040, at 16 (Peter H. Wood, FCA & Irene J. David eds., 7th ed. 1998); Schenk, *supra* note 8, at 123.
172. 1 THE COMPLETE GUIDE TO THE GOODS AND SERVICES TAX: COMMENTARY AND ANALYSIS ¶ 1040, at 16 (Peter H. Wood, FCA & Irene J. David eds., 7th ed. 1998); Schenk, *supra* note 8, at 123.
173. Schenk, *supra* note 8, at 123.
174. *Id.*

burdens in the areas of administration and compliance. When the United Kingdom enacted a broad based value-added tax to replace a narrow tax at the wholesale level (similar to the situation in Canada), the tax base became nearly 18 times larger and the administration staff was increased from 2,000 to 12,000.[175] The increase in financial burden certain to accompany this type of growth was compounded by Canada's inability to harmonize GST with provincial taxes resulting in multiple taxes with dissimilar tax bases being administered by several different bodies; taxpayers (i.e., consumers and businesses, both domestic and international) have been forced to comply with this complex, unintegrated system of taxation.[176] While these facts should not unilaterally eliminate the consideration of a value-added tax from the table of interested countries, they illustrate the necessity of a serious cost-benefit analysis before moving forward.

V. CONCLUSION

This year marks the fifteenth anniversary of the enactment of the Goods and Services Tax in Canada. Canada had several goals in mind when the GST was instituted. Namely, Canada wanted a tax system that would efficiently raise revenue, be broad-based, fair and simplified, and would place Canada in a more competitive position in the international market. Canada succeeded in replacing a tax (FST) which was archaic, narrowly based, drowning in exemptions, and full of loopholes and problems, with a tax that was broadly-based, fair, and addressed inherent weaknesses. Canada capitalized on the GST by maintaining a consistent stream of revenue, discouraging tax evasion, and reducing the cost of business as evidenced through the steady growth of international trade coupled with reductions of tax rates on corporate income.

There is only one failure that really stands out, but it is a failure that carries a great amount of weight; Canada's desire to simplify their tax system appears to have backfired. Although the benefits of administering and complying with only one tax (GST integrated with provincial taxes) instead of two (GST separate from provincial taxes) are real and substantial, Canada's efforts to harmonize resulted in four types of taxes (GST, HST, QST, and provincial taxes), multiple administrative bodies, and a compliance nightmare for taxpayers. The fact remains that if Canada

175. CARLSON, *supra* note 5, at 61.
176. Turro, *supra* note 23, at 15.

had just decided to institute GST on top of provincial taxes, the burdens of compliance and administration would be significantly reduced. I do not intend to criticize the efforts made to harmonize, but once the battle was clearly lost, harmonization should have either been scrapped, tabled for a period when all provinces would ratify the strategy, or altered to make the plan more appealing (e.g., by allowing provinces to collect GST and remit to the federal government); it should come as no surprise that the provinces were not supportive of a federal body controlling money entitled to the provinces. Canada's unlikely strategy and narrow structure greatly increased the cost of GST, and no doubt consumed a portion of the financial benefits reaped from GST as well.

Overall, the Canadian experience with the GST is a positive one. There are important lessons to be learned, specifically in areas of compliance and administration which invokes concerns about Federalism vs. States' rights, but this tax by no means resembles "The Gouge and Screw Tax,"[177] a moniker used by its most staunch opponents. While countries considering a value-added tax should take pause to consider the difficulties of integration and administration, they should also take comfort in the tangible benefits of the Canadian experience.

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177. *Goods and Services Tax (Canada)*, *supra* note 31.