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Executive summary

Consumption taxes generally consist of *general taxes on goods and services* ("taxes on general consumption"), consisting of value-added tax (VAT) and its equivalent in several jurisdictions (goods and services tax, or GST), sales taxes, and other general taxes on goods and services; and *taxes on specific goods and services*, consisting primarily of excise taxes, customs and import duties, and taxes on specific services (such as insurance premiums and financial services).

Consumption taxes accounted for 31% of total tax revenues in OECD countries in 2012, on average. While the share of all taxes on consumption (taxes on general consumption plus taxes on specific goods and services) as a percentage of total tax revenue has remained relatively stable since 1975, the composition of consumption taxes has fundamentally changed. Over time, OECD countries have relied increasingly on taxes on general consumption. Since 1965, the share of these taxes as a percentage of GDP in OECD countries has more than doubled, from 3.2% to 6.8%. They presently raise 20.2% of total tax revenue on average, compared with 11.9% in 1965. VAT has become the largest source of taxes on general consumption, accounting on average for 6.6% of GDP and 19.5% of total tax revenue in OECD countries in 2012. While revenues from taxes on general consumption fell between 2005 and 2009, as a consequence of the global economic crisis, they have now returned to the pre-crisis levels largely due to the rise in standard VAT rates in many countries. In contrast to this increase, revenues from taxes on specific goods and services, the bulk of which are excise taxes, have fallen over time as a percentage of GDP (from 5.6% in 1965 to 3.4% in 2012) and as a percentage of total tax revenue (from 24.3% in 1965 to 10.7% in 2012). Between 2000 and 2012, revenues from these taxes fell by 0.3% as a percentage of GDP and by 0.8% as a share of total taxation.

Key trends

Strong increase in standard VAT rates

- Between 2009 and 2014, 21 countries raised their standard VAT rate at least once, while two lowered their standard VAT rate temporarily and raised it again. The OECD average standard VAT rate reached 19.1% in January 2014, from 17.6% in January 2009. Ten OECD countries now have a standard rate above 22% versus four in 2009. The average standard rate of the 21 OECD countries that are members of the European Union (21.7%) is significantly above the OECD average (19.1%).

Limited base-broadening measures

- Many OECD countries continue to apply reduced rates to a broad range of products such as basic essentials, culture, sport, or pharmaceuticals. While standard rates of VAT have risen, the base to which these rates are applied has often remained unchanged. In the majority of the OECD countries that increased their standard rate at least once since 2009, the reduced VAT rates were not increased or they were increased to a lesser extent than the standard rates. Reduced VAT rates have been changed in five OECD countries, but no OECD countries have abolished their reduced VAT rate(s). Most OECD countries make extensive use of exemptions for activities that are hard to tax (for example, financial services) and/or to pursue distributional objectives (such as exemptions for basic health, charities and education). One adverse consequence of VAT exemptions is that they create "cascading" when applied in a B2B context. This creates distortions and hinders the neutrality of the tax.

OECD International VAT/GST Guidelines: A global standard

- The OECD is developing International VAT/GST Guidelines for applying VAT to cross-border trade, focusing on trade in services and intangibles, which aim to reduce uncertainty and risks of double taxation and unintended non-taxation resulting from inconsistencies in the application of VAT in a cross-border context. A first set of Guidelines was endorsed as a global standard for the application of VAT to international trade at the second meeting of the OECD Global Forum on VAT in April 2014. These Guidelines set standards in two key areas: ensuring VAT neutrality and implementing the destination principles for B2B trade in services and intangibles. The OECD is working to extend its Guidelines notably to cross-border sales of services to private consumers (B2C). This will be completed in 2015.

Key findings

The VAT Revenue Ratio (VRR) suggests there is potential for additional revenue

- The VRR provides a comparative measure of how exemptions and reduced rates affect tax revenues and countries' ability to secure effectively the potential tax base for VAT. It measures the difference between the VAT revenue collected and what would theoretically be raised if VAT was applied at the standard rate to the entire potential tax base in a "pure" VAT regime. Across the OECD, the unweighted average VRR is at 0.55, meaning that 45% of the potential VAT revenue is not collected. Only six OECD countries have a VRR above 0.65. Although the VRR has to be interpreted with care and tax base erosion may be caused by a variety of factors, this VRR estimate suggests that there is significant potential for raising additional revenues by improving VAT systems' performance. One way of increasing the VRR would be to broaden the tax base, with goods and services now subject to reduced rates gradually being taxed at the standard rate. However, a more effective way to achieve distributional objectives may be to compensate low-income households directly through the social or benefit systems rather than through the VAT system.

Revenues from excise duties remain relatively stable

- The revenue from excise in OECD countries has been relatively stable over the past twenty years, accounting for about 8% of total tax revenue in 2011, after a long decline between 1965 (14.2% of total tax revenue on average) and 1990 (average share of 8.1%). There are large differences between countries, with excise accounting for 2.8% of total tax revenue in New Zealand and 17.8% in Turkey. In two-thirds of OECD countries, the weight of excise is between 5% and 10% of total tax revenue although it is less than 5% in Belgium, Canada, Mexico, New Zealand and the United States and for more than 10% the Czech Republic, Estonia, Greece, Ireland, Poland, Slovak Republic, Slovenia and Turkey.

Taxation of vehicles used to influence customer behaviour

- In 2014, 27 out of 34 OECD member countries have been applying lower taxes or exemptions on purchase or annual registration charges for vehicles according to environmental or fuel efficiency criteria. Among these, 21 have base purchase or annual registration taxes directly on polluting emissions and 19 have tax rebates or exemptions for electric or hybrid vehicles.

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