

A low-angle, upward-looking photograph of several large, light-colored stone columns of a classical building. The columns are fluted and have ornate capitals. The sky is a clear, bright blue. The perspective creates a sense of height and grandeur.

# CONSUMPTION TAXATION

## Chapter 19

Presentation prepared by Sevren Williams to teach Economics  
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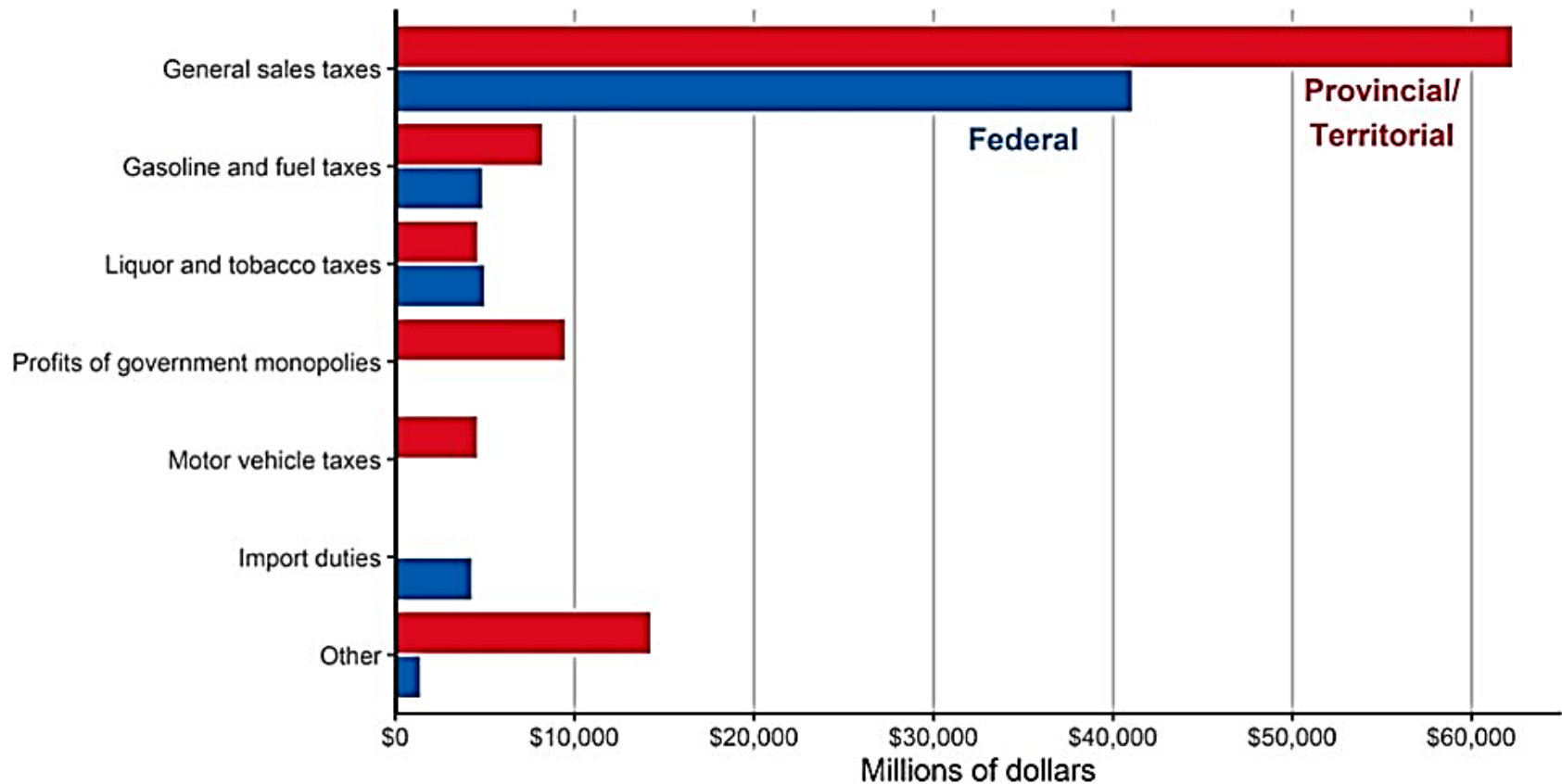
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# Overview

Types of consumption taxes:

- General sales taxes (broad-based sales taxes)
  - Goods and Services Tax (GST), Retail Sales Tax (RST), and Harmonized Sales Tax (HST)
    - GST and HST are examples of a value-added tax (VAT)
- Selective sales taxes (excise taxes, differential commodity taxes)
  - Customs duties
- Sales taxes generally take one of two forms: unit or ad valorem

# Composition of Consumption Tax Revenue by Order of Government (2020–21)



# Reasons for Consumption Taxes

The need for revenues continues to be the primary reason for using consumption taxes.

## Administrative considerations

- A main attraction of consumption taxes → ease of administration.

## Efficiency issues

- Consumption taxes do not distort decisions related to saving and investment.
- Can be analyzed in the life-cycle model of consumption and saving.

# Reasons for Consumption Taxes (cont.)

## Equity Issues

- Progressiveness
  - Conventional view of the distributional effects of sales taxes is that they are regressive
  - Tax as a proportion of *annual* income
- Annual versus lifetime equity

# How a Value-Added Tax Works

A **value-added tax (VAT)** is a percentage tax on value added applied at each stage of production.

## Implementation of a Value-Added Tax (VAT)

Producer	Purchases	Sales	Value Added	VAT at 10 Percent Rate
Farmer	\$0	\$400	\$400	\$40
Miller	400	700	300	30
Baker	700	950	250	25
Grocer	950	1,000	50	5
Total	\$2,050	\$3,050	\$1,000	\$100

# Value-Added Taxes: Implementation Issues

- Certain administrative decisions have a major impact on a VAT's ultimate economic effects.
- Three key implementation decisions:
  1. Consumption-type VAT
  2. Net income-type VAT
  3. Gross income-type VAT
- Collection procedure: invoice-credit method
- Rate structure

# Value-Added Taxes: Efficiency and Distributional Implications of the Rate Structure

## Value-Added Tax with Zero-Rated and Tax-Exempt Items

### A. Value-Added Tax with Groceries Zero-Rated

Producer	Purchases	Sales	Tax on Sales	Credit Allowed	Tax Due
Farmer	\$0	\$400	\$40	\$0	\$40
Miller	400	700	70	40	30
Baker	700	950	95	70	25
Grocer	950	1,000	0	95	-95
Total					\$0

### B. Value-Added Tax with Groceries Tax-Exempt

Producer	Purchases	Sales	Tax on Sales	Credit Allowed	Tax Due
Farmer	\$0	\$400	\$40	\$0	\$40
Miller	400	700	70	40	30
Baker	700	950	95	70	25
Grocer	950	1,000	0	0	0
Total					\$95

### C. Value-Added Tax with Milled Flour Tax-Exempt

Producer	Purchases	Sales	Tax on Sales	Credit Allowed	Tax Due
Farmer	\$0	\$400	\$40	\$0	\$40
Miller	400	700	0	0	0
Baker	700	950	95	0	95
Grocer	950	1,000	100	95	5
Total					\$140



# Value-Added Taxes: Improving the GST

- Liberal government 1994 platform → commitment to repeal the GST
- Unable to honour this commitment, even though the GST was resented by Canadians, because none of the alternative taxes were particularly attractive
- Harmonization efforts
- Compliance and administration costs
- Other improvements (e.g., New Zealand and Singapore)

# Provincial General Sales Taxes

- Retail Sales Tax (RST)
  - Second form of general, or broad-based, sales tax widely used in Canada
  - Single-stage tax that is collected by retailers at the point of sale
- RST vs VAT
- Rate and revenues
- Tax base

# Provincial General Sales Taxes: Rates and Revenues

## Provincial Consumption Tax Rates and Revenues (2020/21)

Region	RST Rate or Provincial Portion of HST (%)	RST/HST per Capita Revenue (\$)	Tax Rate on Cigarettes (\$/carton)	Tax Rate on Gasoline (¢/litre)	Consumption Tax Revenue (\$ millions)	Consumption Tax Share of Own- Source Revenue (%)
NL	10	\$2,139	59	14.5	\$1,752	26.6
PE	10	1,962	55.04	8.47	460	19.6
NS	10	1,874	59.04	15.5	2,864	23.6
NB	10	1,809	51.04	10.87	2,188	20.7
QC	9.975	1,936	29.8	19.2	24,663	18.1
ON	8	1,917	36.95	14.7	36,627	23.6
MB	7	1,578	60	14	3,387	19.8
SK	6	1,913	54	15	3,685	24.1
AB	—	—	55	13	4,429	9.6
BC	7	1,475	59	14.5–27*	12,008	20.5
NT	—	—	60.8	6.4–10.7*	69	2.8
NU	—	—	60	6.4	55	2.2
YT	—	—	62	6.2	41	2.6

\*Note: Reflects range in tax rates across different localities.

# Excise Taxes and Customs Duties

## Excise taxes or duties

- Targeted consumption taxes on specific goods and services.
- Some apply to the consumption of specific items, regardless of where they were produced, while others apply only to imported goods.

## Excise taxes

- Levied on select goods and services (imported or not).

## Customs import duties

- Taxes levied on goods at the time of import or export.

# Excise Taxes and Customs Duties (cont.)

## Selected Rates for Federal Excise Taxes and Duties, 2022

Gasoline	10.0¢/litre
Diesel and aviation fuel	4.0¢/litre
Cigarettes	74.47¢/5 cigarettes
Manufactured tobacco	\$186.18/kg
Cigars	\$32.42/1,000 cigars
Tobacco sticks	14.89¢/stick
Cannabis (combined rate)*	Greater of \$1/gram or 10% of sales price
Wines:	
Alcohol, 1.2% or less	2.2¢/litre
Alcohol, 1.2% to 7%	33.0¢/litre
Alcohol, over 7%	68.8¢/litre
Distilled spirits	\$13.042/litre of alcohol
Beer:	
Up to 1.2% alcohol	\$2.89/hectolitre
1.2% to 2.5% alcohol	\$17.41/hectolitre
Over 2.5% alcohol	\$34.82/hectolitre

\*Revenue from cannabis excise taxes is shared between the federal, provincial, and territorial governments, with the federal government receiving 25 percent of revenues to a maximum of \$100 million per year.

# Questions For Discussion (1 of 3)

Zach lives two periods, earning \$31,500 in the first and nothing in the second. The rate of return on savings is 8 percent. Zach faces a sales tax rate of 5 percent and a tax rate on interest income of 20 percent. His pre-tax consumption level in the first period is \$16,000. The rest of his earnings are used to pay the sales tax and to save for the second period. Determine how much Zach saves and how much he consumes in the second period. Determine how much Zach pays in sales taxes in each period and how much he pays in interest income tax.

## Questions For Discussion (2 of 3)

In the table below, with a GST rate of 5 percent, how much does each producer (a) collect in GST; (b) receive as a GST credit; and (c) remit to the government?

	Sale by producer X to producer Y	Sale by producer Y to producer Z	Sale by producer Z to consumer
Sale value	\$200.00	\$600.00	\$1,600.00
GST collected			
GST credit			
GST remitted			

## Questions For Discussion (3 of 3)

Amy and Shirley both live two periods. Both have earnings of \$1,000 in the present and zero in the future. The interest rate is 8 percent. Suppose that they are each subject to an income tax, and Amy's first period consumption is \$200 while Shirley's is \$300. Who has the higher lifetime tax burden? Under a proportional consumption tax, how would their lifetime tax burdens compare?

Hint: Try the case where the tax rate is 20% ( $t=0.2$ )