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Cardin to Release VAT Legislation

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Summary by taxanalysts

Senate Finance Committee member Benjamin L. Cardin, D-Md., told Tax Analysts December 8 that he will release legislation later in the week proposing a VAT that he hopes will prompt serious discussion on the matter in the 114th Congress.

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Senate Finance Committee member Benjamin L. Cardin, D-Md., told Tax Analysts December 8 that he will release legislation later in the week proposing a VAT that he hopes will prompt serious discussion on the matter in the the 114th Congress.

"It's finished," Cardin said of the bill, adding that he will likely release it on December 10.

Cardin said he is not seeking cosponsors on the bill at this time since it will have to be reintroduced next year but noted that he's worked with many lawmakers who are interested in the legislation.

"We're putting it in for serious discussion in the next Congress," he said.

While the details of Cardin's bill are unclear, Joint Committee on Taxation Legislation Counsel Viva Hammer December 5 suggested lawmakers interested in a VAT should look to Australia's and New Zealand's goods and services taxes for a model of how to treat financial institutions.

The taxation of financial institutions is the most complicated aspect of a consumption tax, Hammer said at the Practising Law Institute conference in Los Angeles on corporate tax strategies. The complication arises because consumption taxes do not tax investment income such as interest, dividends, or capital gains, but financial institutions mix interest charges, which are nontaxable, with service charges, which are taxable.

"I'm not going to give you an answer because no one has found one," Hammer said of the problem, "but Australia and New Zealand have done a yeo-woman's job of trying to get the answer right."

In New Zealand, financial services companies may zero rate otherwise exempt financial services supplied to GST-registered customers, but only if 75 percent or more of the customer's sales are subject to a GST, either at a positive or zero rate. Also, under New Zealand's GST, financial services provided to another financial services company may be zero rated to the extent that the second company supplies financial services that are zero rated.

Most countries, though, exempt financial services from VAT. Exemption of financial services does not entitle the seller to an input credit for VAT imposed on purchases allocated to the exempt sale, while a zero rating allows full input recovery.

Australia takes the middle ground between a zero-rate system and exempting the transactions by allowing a recovery of 75 percent of VAT on inputs allocable to exempt financial services.

This challenge, however, is not limited to consumption tax systems. In the U.S., borrowers may deduct their interest expense, but the interest spread is also deductible. In the Office of Management and Budget's "Analytical Perspectives, Fiscal Year 2015" report, it estimated that the income spread tax expenditure will cost taxpayers $10.17 billion for fiscal years 2015 through 2019.

"So on a long winter's evening, when the Aussies and Kiwis are enjoying long summer days, you might take a look and see what the Down Under GSTs are up to for banks, insurance companies, investment vehicles, and real estate," Hammer said.

"The late-night reading will give you a flavor of dreams to come."

Lindsey McPherson contributed to this article.

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