

# How Could We Improve the Federal Tax System?

VALUE-ADDED TAX (VAT)

What is the Canadian experience with a VAT?

**Q. What is the Canadian experience with a VAT?**

**A. Concerns about regressivity, transparency, coordination with state sales taxes, and money machines can be assuaged by observing the Canadian value-added tax experience.**

In 1991, Canada implemented a 7 percent national value-added tax (VAT) to replace a tax on sales by manufacturers. The VAT was introduced by the Conservative party, which had concerns about industry competitiveness and the country's fiscal situation.

Canada addressed distributional concerns by applying a zero rate to certain necessities—including groceries, drugs, and rent—and adding a refundable credit to the income tax. Transfer payments had been indexed for inflation and were highly progressive, further insulating against regressivity.

The Canadian VAT is completely transparent: it is listed separately on receipts and invoices just like sales taxes in the United States.

The Canadian experience also shows that a federal VAT can successfully coexist with either a VAT or a retail sales tax levied by subnational governments.

And the VAT in Canada has not been anything like a "money machine." The standard VAT rate declined over time to 6 percent in 2006 and 5 percent in 2008. In both revenues and expenditures, the size of the Canadian federal government as a share of the economy has shrunk significantly since introduction of the VAT. General government tax revenue and spending in Canada has actually fallen as a share of the economy since 1991.

*Updated May 2020*

---

## Further Reading

Bird, Richard M., and Michael Smart. 2014. "VAT in a Federal System: Lessons from Canada." In *Public Budgeting and Finance* 34 (4): 38–60.

Sullivan, Martin A. 2011. "[VAT Lessons from Canada.](#)" In *The VAT Reader*, 283–90. Falls Church, VA: Tax Analysts.

Tax Analysts. 2011. [The VAT Reader: What a Federal Consumption Tax Would Mean for America.](#) Falls Church, VA: Tax Analysts.

## How Could We Improve the Federal Tax System?

What is the Canadian experience with a VAT?

VALUE-ADDED TAX (VAT)