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Abstract
On 1 July 1992, Fiji implemented a broad-based, value added tax (hereinafter VAT). The introduction of the tax has been controversial. It was decreed by an interim caretaker government, and many sectors of the community vigorously opposed it. This article discusses the broad-based VAT that has been adopted in Fiji, looking specifically at the background of the adoption of VAT, the arguments for and against its adoption in Fiji, what the tax is and how it works.

Keywords
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THE ADOPTION OF A CONSUMPTION TAX IN FIJI

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This article discusses the broad-based VAT that has been adopted in Fiji, looking specifically at the background of the adoption of VAT, the arguments for and against its adoption in Fiji, what the tax is and how it works.

Background on the adoption of VAT

After the severe economic disruption of the 1987 coups, the Fiji Interim Government faced the task of restoring business confidence and security. The stabilisation of the Fijian dollar and the balance of payment figures indicate that it has been successful in reviving the economy. It has gone further by devising an economic package which aims to bring about economic reform, providing more employment and improving standards of living.

The economic reform package designed by the Interim Government evolved between 1988 and 1992. VAT, as part of the package, was not proposed with certainty until later in the Interim Government's term. The package included several other changes to the taxation system, such as increased depreciation and other capital incentives. The most significant incentive for investment, however, was the 13-year tax holiday on export industries, which was introduced in early 1988.

The Interim Government, encouraged by the responses to its initiatives but recognising the need for further economic reforms, hosted a national economic summit in June 1989. At this summit, the government tabled its recommendations, which endorsed a policy to "reform the system and improve indirect taxation to minimise distortions, and improve incentives for risk taking and effort."

The lack of economic growth was because previous economic policies had emphasised reliance on the two leading industries, sugar and tourism, for which the policies included:[1]

- high tariffs, which led to high costs and inefficient production;
- "regulated" wages, which were not responsive to productivity;
- the increased size of government, which was a drain on the economy; and
- high taxes, which stifled incentives to growth (ie, effort, training and entrepreneurship).

The coups of 1987 had prompted economic reform. The corresponding currency devaluation and the accompanying wage cuts had reduced the country's cost structure in relation to other countries and improved the country's competitiveness. "That competitiveness has made our change to export orientation much easier than would otherwise have been the case."[2]

Exports provide the income that drives Fiji's economy. The devaluation combined with wage restraint gave the country the opportunity to become an efficient exporter because of its reduced costs and prices in comparison to other countries.

The Interim Government, with confidence for its reforms from the business community and with advice from overseas experts, supplied by the aid budgets of neighbouring countries and the World Bank, set in place the preparatory measures for implementing the VAT system.

The Fijian community was shown the sincerity of the government's economic reforms by immediate income tax cuts, which were then progressively reduced from a maximum rate of 52.5% to 37.5%. A VAT section of the Inland Revenue Department was set up and commenced an education program to clarify uncertainties and allay fears.

By the end of the Interim Government's term in May 1992, they had put everything in place for VAT, including legislation, costing and pricing orders, operating systems, income tax amendments and the education process. The newly-elected government was committed. The newly-elected Prime Minister stated, "it is a legally binding decree which cannot be reviewed immediately ... it cannot be changed because the implementation date was decreed to be 1 July, and this will be before the first sitting of the new Parliament".[3]

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1 *VAT* (Inland Revenue Publication) Booklet 2.

2 Kamikamica Josevata, *Budget 1992* (Fiji Government Publication) 26 November 1991, p 9.

3 Rabuka Sitiveni, "Rabuka Defends VAT" *Fiji Times*, 15 June 1992, p 1.

The Interim Government was heavily criticised for taking such steps as a caretaker government. Certainly, it normally would have taken considerable political skill and voter sophistication to introduce a completely novel tax in a country in which elections are held every five years and "when only 11% of the population was paying tax".[4]

VAT is now installed in Fiji and taxpayers await the changes in the economy which it was intended to deliver.[5]

Arguments advanced for adoption of VAT

As part of its defence for the adoption of VAT, the Interim Government emphasised that the correct pre-conditions must exist before economic growth can occur. One such pre-condition was a taxation system that encourages effort, improvement and efficiency. The current Minister for Finance had said that VAT was vital, necessary and long overdue; it would encourage economic growth through reducing the burden on income earners, freeing exports completely from domestic taxes, encouraging more efficient and competitive production and providing resources for development needs.[6]

The predominantly income-based tax system faced many problems, which the adoption of VAT hoped to address as follows.

To attract skilled staff to administer the tax system

Fiji's previously high income tax rates (top marginal rate of 52.5% on income over $15,000) were a strong motivation not to comply with the income tax legislation and understate income on tax returns. The checks on the system include scrutiny of tax returns and random income tax audits penalising non-compliance. The effectiveness of this system is limited by the strength of the "black" economy. Such evasion is countered by a complete analysis of asset position. These investigations, which are costly to administer, could only be undertaken sporadically, as the skilled personnel required for such work are scarce. The coups of 1987 dramatically worsened this situation. In the three years following the coups, half the 2000 odd professionals (lawyers, accountants, engineers, doctors etc) emigrated.

Internal training of local staff for such work takes several years. Externally-trained personnel are not available, because higher wages are available within the private sector.

On the other hand, VAT's invoicing requirements on registered sellers is aimed at ensuring the compliance tasks are simpler. Training staff to administer its legislation requires a smaller financial commitment. The level

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4 Rabuka Sitiveni, "Support VAT says Rabuka" *Fiji Times*, 16 May 1992, p 1.

5 Fiji's nearest neighbour, Western Samoa, intends copying Fiji's lead by implementing a VAT in 1993.

6 *Fiji Times*, 13 June 1992, p 1.

of professional skill required is generally lower, thus making more personnel, otherwise unemployed, available for government service.

To reduce avoidance and evasion by picking up in the consumption tax net those who would avoid or evade direct income taxation

The motivation to evade income tax will be reduced by the compensating drop in income tax rates. In Fiji, to date, there has been approximately a 15% reduction.

On the other hand, the VAT will be collected by third parties on behalf of the consumer. There is less motivation to withhold this tax, as it is sourced from funds excess to a seller's earnings. Any enduring motivation to withhold this tax is minimised by VAT's invoicing system of credits and reconciliation.

To assist in reducing the high marginal tax rates in order to increase incentives to work

The financial rewards for professional workers in Fiji will be increased by the reduced marginal rates of tax. The effect of lowering the tax rates is multiplied in the case of increased reward for overtime or promotion. For example, a 15% drop in the top marginal rate of tax will result in a 30% increase in take home overtime payments for skilled workers, the majority of whom are forced up into the top tax scales by overtime payments.

To increase domestic savings

In Fiji, most consumption on non-essential items is expenditure on imported goods. Essential items such as food, clothing and utilities are available locally, but most manufactured items, such as electrical goods, motorised goods and luxury items, are imported. A consumption tax will therefore penalise those consumers who spend their available earnings and reward those who save their excess earnings after essential expenditure. This will reduce the country's expenditure on imported goods and offshore loans.

This effect is complemented by the full VAT rebate for exports, thus encouraging the development of export businesses as opposed to domestically-oriented business. It will also help redress any current account deficit.

The consumption tax will also assist in the business development of the native Fijian. With a different and less economically sophisticated cultural heritage, these people have been slower to respond to the country's business opportunities than the remainder of the population, who are predominantly Indian in origin.

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In respect to direct taxation, many native Fijians contribute to government revenues through the PAYE system. Very little is contributed through provisional tax or company tax. Native Fijian business, as yet, has failed to develop to an extent where it contributes significantly to the country's revenue. Moving from a predominantly employee status group to an employer orientation is one of the problems. Business success will require new skills. One of the fundamental changes, and one on which many small businesses fail, is budgeting to pay the annual income tax bill. Changing the taxation emphasis away from income tax towards a consumption tax, which is collected as transactions occur, will help reduce the complexity of changes required.

Arguments against the adoption of VAT

One of the strongest arguments against VAT in Fiji is the risk of increasing poverty traps. Whilst some measures have been adopted to absorb the impact of VAT on Fijian spending power, it effectively covers only the 11% of the population who presently pay income tax. The remaining 89%, who are now paying tax for the first time, may find it difficult to make ends meet with their often meagre incomes.

Fiji has no social system that could be used to soften the impact of price increases. Although government has provided $7 million in capital funds to be used for poverty alleviating projects, it will be some time before these projects generate the funds to assist those who stand to benefit.

In addition, the criteria for allocation of funds could be so stringent that, like other assistance provided by the government, those who are supposed to benefit may not reap the benefits of such schemes. In the meantime, the majority of the population may have to endure hardship in order to be able to purchase necessities and maintain their basic lifestyle. Without any form of broad-based compensatory payment, VAT has reduced the purchasing power of the majority of the population.

Opponents of the VAT system in Fiji, which include many charitable organisations, doubt whether VAT will bring about the promised benefits to the country. They refute the claim that it will encourage domestic savings. For the majority of the people in Fiji, the concept of savings is meaningless if they cannot first obtain the bare necessities for living. In the event that saving does occur, this will, in the short term, counter the objectives of increasing economic growth. Reduced domestic spending will have a negative impact on economic growth, as reduced domestic spending will have a negative impact on the economic activity which could result in slower economic growth, a lower level of employment and a continuing unfavourable balance of payments.

There are also many opponents of VAT in the business community, particularly big business, control of which, in Fiji, is shared between European and Indian Fijians. Many of them see themselves as bearing an

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unfair share of the taxation burden. Paying most of Fiji's company tax, they are more responsive to changes in their taxation obligations. They are also too big to take advantage of the black economy. They do not see VAT significantly affecting the black economy and they fear that it will add high administration costs to their organisations.

Many of the new factories in Fiji are owned by New Zealand expatriates with recent experience in the introduction of a similar goods and services tax. They fear the high cost of complying with the new legislation, claiming that the high volume of recording work and confusion in the tax content of most transactions will lead to a dissipation of their scarce skilled labour hours.

What is value added tax?

Fiji's VAT is orthodox in nature. It is a multi-stage tax imposed at all levels on all providers of goods and services (save those exempted). The essential feature of VAT is that it taxes final and intermediate sales at each stage of the production and distribution process. This is usually implemented using a credit offset mechanism, otherwise known as the invoice method. Under the invoice method, credit is given for inputs purchased. In effect, each firm is taxed only on the "value added" to the product. In other words, tax is levied on taxable sales minus purchases of taxable inputs. This means that, when the tax at each stage of the transaction is aggregated and credits subtracted, the total amount of tax paid is equivalent to the final consumer price times the VAT rate.

Example of an invoice-type VAT

Assume that a retailer sells goods at $1100, inclusive of tax at 10%. The goods were purchased from a wholesaler for $660; the wholesaler had purchased the goods from the manufacturer for $275. The final consumer had paid $1000 for the goods plus $100 tax. It must be noted that the wholesaler had paid $60 tax, and the manufacturer $25, ie, a total tax of $185, unless the tax that was paid on previous purchases further down the chain was exempted.

The exemptions are obtained using the credit offset or invoice mechanism. The convenience store can claim a tax credit of $60 paid by the wholesaler only if it receives an invoice stating that purchases are VAT-inclusive. Likewise, the wholesaler can claim a tax credit of $25 in his VAT return if he received a VAT invoice from the manufacturer, ie, subtracting the tax credits of $85 from the gross tax paid of $185 leaves a balance of $100, which is borne by the final consumer.

For Fiji, there are two notable exceptions to the value added tax explained above.

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1 Exempt supplies are contained in the First Schedule to the Value Added Tax Decree 1991 (hereinafter the Decree), and the

2 Zero-Rated Supplies in Schedule 2 to the same decree.

Zero-Rated Supplies, eg, exporters' supplies, effectively have no tax on the goods or services imposed. In other words, these goods and services are taxed at zero-rate. This is carried out for exporters, for example, by allowing a credit for all VAT paid on the imports of supply to the exporter, who then is not required to apply VAT to the export price of his goods.

Some goods and services are exempted from VAT. These are known as Exempt Goods and Services, eg, financial services, including banking, insurance and share trading, supply of donated goods and services by a non-profit organisation etc. They differ from zero-rated goods and services in that the supplier of the exempted goods and services will not be allowed to claim credit for VAT paid by the supplier on inputs used in producing the exempted goods and services.

Example of an invoice-type VAT with zero-rated sales on exports

At a VAT rate of 10%, the garment exporter paid $660 on import of material, $600 for material and $60 VAT. No tax is paid at the point of export, but a credit of $60 can be claimed for tax paid for the import of material.

Example of an invoice-type VAT with tax exempted financial services

An exempt sale yields no tax on sale, but receives no credit for inputs purchased. If the NAB paid Instant Printing to print some cheque books for $660, the $660 is inclusive of tax. There is no credit available. NAB pays $60 in taxes on inputs and so does not fully escape the tax.

How does Fiji's VAT work?

Fiji has adopted the rate of 10% for VAT. VAT was charged on most goods and services (save those listed in Schedules 1 and 2) from 1 July 1992.

By s 6 of the Decree, the Commissioner for Taxation is charged with the responsibility of administering the Decree and the control and management of the collection of the taxation charged thereon, including all matters incidental thereto and all officers employed in the Department.

Section 15 imposes the tax at the rate of 10% on the supply (excluding exempt supplies) in Fiji of goods and services on or after 1 July 1992 by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply. In other words, s 15 contains the requirements placed on persons (defined in s 2 to include a company, an association or body of persons, a corporate or unincorporated entity, a local authority and a public authority) for imposition of VAT. There must be:

1 *Supply of goods and services* (except exempt supplies as listed in Schedule 1). "Supply" has the same meaning as in s 2 of the Sale of Goods Act, Cap 230.

2 *By a registered person*. Section 22 contains the requirement that every person other than a produce supplier who, after July 1992, carries on any taxable activity must be registered. Small operators with annual revenue from taxable goods and services of $10,000 or less (or $20,000 if dealing solely in goods) and "produce" suppliers, do not have to register, although they may do so voluntarily. Such operators may choose to register to obtain the benefit of input tax credits, or to allow them to issue tax invoices to customers who are registered persons conducting taxable activities. If they are not registered then, of course, the organisation cannot claim the credits. (The only other time when input tax credits cannot be claimed is when a person buys goods or services to provide tax exempt goods and services or for private use).

3 *In the course or furtherance of a taxable activity*, defined in s 4 as:

(a) any activity which is carried on continuously or regularly by any person, whether or not for pecuniary profits, and involves, or is intended to involve, in whole or in part, the supply of goods and services to another person for a consideration; and includes any such activity carried on in the form of a business, services, trade, manufacture, profession, vocation, association or club; and

(b) without limiting the generality of paragraph (a) of this subsection, the activities of any local authority or public authority ...

The requirement covers a wide range of activities and includes both business and domestic purposes, unlike the requirement of the imposition of income tax which is based on "assessable income". It is not the activity that is registered but the person conducting it, and it covers all the taxable supplies made by that person.

4 *By reference to the value of that supply*. A VAT registered activity will:

(a) charge VAT on taxable goods and services and;

(b) collect it from customers.

Such a taxpayer is also entitled to claim "input tax credits" for VAT paid on business purchases and used for the production of these goods and services. If the VAT charged exceeds the tax paid for imports, the difference must be remitted to the Commissioner of Inland Revenue. If it is less, a refund can be claimed.

Conclusion

Despite much opposition, VAT was introduced in Fiji. Its supporters projected that VAT was the answer to Fiji's problems; VAT was to act as the catalyst for economic growth. Without it, the economy would continue to stagnate. Although projected as a fairer and simpler system of collecting tax, many have seen it as unfair, creating in this developing nation greater gaps in the distribution of wealth. The poor are being forced into greater hardship while the rich enjoy greater business opportunities.

The hardships of the poor in a developing country can, however, only increase while a country remains poor. A stronger economy creates resources which could be used to assist rich and poor. VAT is no economic quick fix; there is no perfect taxation system. It is a question of being able to find the right mix for this developing economy and being able to control the variables that cause changes in the economy.