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REFORMING THE UK VAT SYSTEM: A COMPARATIVE ANALYSIS AND REFORM DESIGN

Research Paper

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ABSTRACT

This paper examines reform options for the United Kingdom's ("UK") Value Added Tax ("VAT") system, which currently forgoes £97 billion in revenue through reduced rates and exemptions. Through comparative analysis of New Zealand and Singapore's broad-based single-rate systems, the study evaluates how social and distributional goals can be achieved without differentiated rates, and demonstrates that targeted social transfers can effectively address VAT regressivity while maintaining system efficiency.

This paper finds that broadening the UK's VAT base while lowering the standard rate to 18% could generate sufficient revenue to fully offset the total annual VAT payable by households in the lowest four income deciles, or fully offset the additional annual VAT payable by households up to and including the 9th income decile. For financial services, the study examines Singapore's approach of taxing financial intermediation services, as well as allowing input tax credit in respect of financial services supplied to VAT-registered customers, in contrast to New Zealand's zero-rating of financial services supplied to a VAT-registered customer, suggesting these could offer viable solutions to the UK's current exemption regime. The paper also proposes implementation strategies including offset measures to mitigate the immediate impact on affected stakeholders and a bottom-up approach to soliciting public support. The findings suggest that comprehensive VAT reform, properly designed and implemented, can enhance both efficiency and equity in the UK tax system.

CONTENTS

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1. INTRODUCTION

Since its introduction in 1973, VAT has grown to become one of the UK's most important taxes. Total VAT receipts in the financial year 2024-25 increased slightly over the previous year to £171.1 billion[2], comprising 20% of the total taxes collected by HMRC. In principle, the VAT system is simple to administer, yet many goods and services are zero-rated, subject to a reduced rate, or exempt in the UK. Within these categories, further distinctions arise to determine what exactly qualifies for which rate, which has led to the system becoming complex and increasing business and administration costs. These reduced, zero-rate and exemptions have been estimated to represent £97 billion of forgone revenue in 2022–23[3].

This paper considers how the UK VAT system can be reformed to address its current complexities, distortionary effects as well as high administrative and compliance costs, while achieving its social and distributional goals. Section I discusses the problems with a multiple-rate VAT regime such as that of the UK, including its effectiveness in achieving the intended social goals and its inherent costs. Section II looks to a modern broad-based single-rate VAT regime in New Zealand and Singapore to understand how social and distributional goals can be achieved without the complexity of differentiated rates, as well as what measures can be put in place to address distortions arising from exemption of financial services.

Section III explores how the VAT base in the UK can be broadened and paired with targeted social transfers to address the equity issue, and discusses possible transplant of policy options relating to financial services in New Zealand and Singapore to the UK. Section IV discuses practical implementation considerations, including the design of offset packages to cushion reform impacts

[2] HM Revenue & Customs, HMRC Tax Receipts and National Insurance Contributions for the UK (Annual Bulletin), (22 May 2025), https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk/hmrc-tax-receipts-and-national-insurance-contributions-for-the-uk-new-annual-bulletin.
[3] Isaac Delestre and Helen Miller, Tax and Public Finances: The Fundamentals, (August 2023), https://ifs.org.uk/sites/default/files/2023-08/IFS-Report-R270-Tax-and-public-finances-the-fundamentals_final.pdf

on suppliers and consumers, and strategies for building public support for comprehensive VAT reform. Finally, Section V concludes with key recommendations and implementation considerations for modernising the UK VAT system.

Section I: Problems with the UK VAT system

2. RATIONALE FOR A MULTIPLE-RATE SYSTEM

The inherent regressivity of VAT is often used to justify the application of reduced rates or exemptions for certain essential or merit goods and services, whereas goods and services such as financial services that are perceived as difficult to tax are exempt from VAT. In the UK, the design of the VAT base was largely influenced by its predecessor – the Purchase Tax, which sought to tax luxury items and as a corollary excluded essential items[4]. The same policy rationale underpinning the Purchase Tax was carried over to the design of VAT, thereby reinforcing the notion that essential items should not be subject to tax. At the core of the public debate on the application of reduced rates to goods or services deemed essential or merit is the equity argument. The paper next examines whether such a base-narrowing measure indeed delivers on the equity promise.

3. THE EQUITY DELUSION

To achieve the envisaged social or distributional goals of reduced rates and exemptions, the decrease in tax must be passed on to consumers through reductions in price. While studies show heterogeneous responses to VAT changes, there is growing evidence that pass-through for tax decrease is generally incomplete.

The limitation of reduced rates was demonstrated in the labour-intensive experiment carried out across several European countries at the turn of the 21st century. The experiment was premised on the assumption that the introduction of reduced rates on labour-intensive services would lower consumer prices, which would in turn lead to increase in demand, and accordingly increase in employment and decrease in the size of the black market. As the experiment unfolded, the participating Member States reported that the impact on prices of affected services was minimal, while part of the rate reduction translated into an increase in profit margin of the service providers, and any reduction in prices was only temporary[5]. The final verdict of the experiment was that its aims had failed to materialise because the first condition that the reduced VAT rate would lower consumer prices was not fully met[6].

Similarly, also covering European countries, an empirical study on the extent of pass-through for a variety of VAT changes taking place from 1999 to 2013 show that changes in standard rates are more likely to be passed on to consumers, whilst the pass-through for reduced rates and base-

[4] Rita de la Feria, 'The UK VAT at 50: the Good, the Bad and the Ugly', British Tax Review 3 (2023), 279−294.
[5] Commission of the European Communities, Report from the Commission to the Council and to the European Parliament: Experimental application of a reduced rate of VAT to certain labour-intensive services, (Brussels, 2 June 2003), COM(2003) 309 final; Commission Staff Working Paper, Evaluation report on the experimental application of a reduced rate of VAT to certain labour-intensive services ("Evaluation report"), (2 June 2003), SEC (2003) 622.
[6] Evaluation report, n 5, 28.

narrowing reclassifications is generally lower[7]. Another study on Finnish hairdressing services, on the impact of the rate reduction and subsequent increase, shows that responses to rate changes is asymmetric, with increases more likely to be passed on than decreases, and the study also found similar level of asymmetry for all VAT changes in the European Union[8]. Not only do consumers not benefit fully from reduced rates, a study on the pass-through effect of reduced VAT rate to meals consumed in French sit-down restaurants shows that the restaurant owners are the primary beneficiaries[9]. More recent studies in the UK reached the same conclusion – the reduction of VAT rate to zero percent on women's sanitary products and e-books did not lower consumer prices, but benefitted the retailers and publishers respectively instead[10].

The studies discussed above reveal overwhelming evidence that reduction in VAT rate is generally not fully passed on to consumers. Even if rate reduction does lead to price adjustment, it remains uncertain if the desired social and distributional objectives can be fulfilled. While the lower-income households may consume more in proportion to their income, the higher income households' consumption is higher in absolute terms[11]. Any reduced rates or exemptions are therefore likely to benefit the higher income households more[12]. Where reduced rates apply to services that are provided by both private and public sectors, the higher income households are likely to benefit more from the rate reduction, since they tend to choose the private services[13]. Similarly, the rich are more likely to consume merit goods such as books and cultural events more than the poor[14].

Reduced rates and exemptions, though seemingly intuitive in enhancing vertical equity, may not always do the job well. Therein lies the equity delusion many people have subscribed to. Keeping status quo and the misconceived sense of equity can be a pragmatic option, but not if it comes at substantial costs.

4. THE INHERENT COSTS

Maintaining a multiple-rate VAT regime with wide exemptions for essential and merit goods and services can be costly. The first element to consider would be the tax expenditure arising from the exclusions from the VAT base. One measure of the broadness of the VAT base is the VAT Revenue Ratio ("VRR"), which represents the actual VAT collection in a country as a proportion of the revenue that would be raised if the standard VAT rate were applied to all consumptions. The VRR in UK for 2022 is 0.49, which falls below the OECD average of 0.58, suggesting that an estimated 51% of theoretical potential VAT revenue is not collected[15].

Other than revenue loss, high administrative and compliance costs arising from definitional and interpretation issues are commonly associated with the application of multiple rates and exemptions. The difficulties with determining the correct treatment for different products inevitably lead to a high level of litigation. An infamous litigation case that has turned into a musical in UK involves the classification of Jaffa Cakes[16], specifically whether they are cakes, in which case could be zero-rated, or biscuits, in which case should be standard-rated. More recently, mega

[7] Dora Benedek, et al, 'Varieties of VAT Pass Through', (2020) 27 International Tax and Public Finance 890−930.
[8] Youssef Benzarti, et al, 'What Goes Up May Not Come Down: Asymmetric Incidence of Value-Added Taxes', (2018) NBER Working Paper 23849.
[9] Youssef Benzarti and Dorian Carloni, 'Who Really Benefits from Consumption Tax Cuts? Evidence from a Large VAT Reform in France', (2019) 11(1) American Economic Journal: Economic Policy 38−63.
[10] Tax Policy Associates, How the abolition of the 'tampon tax' benefited retailers, not women, (8 November 2022); Dan Neidle, 'The Abolition of VAT on ebooks was a £200m Handout to Publishers', Tax Policy Associates, (9 February 2023), https://taxpolicy.org.uk/2023/02/09/ebooks/.
[11] Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards A Post-Modern VAT', in R. de la Feria (ed.), VAT Exemptions: Consequences and Design Alternatives (The Hague: Kluwer Law International, 2013).
[12] Rita de la Feria and Michael Walpole, 'The impact of Public Perceptions on General Consumption Taxes', (2020) 67/5 BTR 637−669, 644.
[13] Ibid.
[14] Ibid., 645.
[15] OECD, Consumption Tax Trends (2024), 69.
[16] United Biscuits (UK) Ltd (No. 2) v CC&E [1991] BVC 818 (LON/91/160).

marshmallows[17] have become the subject matter of litigation in UK court, hinging on the issue of whether they are confectionary normally eaten with the fingers, and accordingly standard-rated.

Reduced rates and exemptions also create distortions to competition, since competing products may be treated differently for VAT purposes[18]. This may in turn incentivise suppliers to alter their products in order to benefit from the reduced rate or exemption, and inadvertently subsidise inefficient production[19]. Other than distortions to competition, exemptions also give rise to tax cascading and create bias towards self-supply and away from outsourcing[20]. Last but not least, a differentiated regime will inevitably invite political lobbying of interest groups, as in the case of the UK, covering consumer products from pasties to women's sanitary products and e-books, as well as operators in the hospitality and tourism industry.

The uncertainty of reduced rates and exemption in achieving social and distributional goals, coupled with the inherent costs of maintaining such a VAT structure, raise the question of whether a broader single-rate modern VAT regime operating in other jurisdictions such as New Zealand and Singapore may serve the UK better. In the next section, the paper compares the VAT regimes in New Zealand and Singapore, with particular focus on implementation efforts, how the broad-based system works with targeted social transfers to address the equity issue, and how distortions from exemption of financial services are mitigated.

Section II: Comparative studies – New Zealand and Singapore

5. SINGLE-RATE GST SYSTEM WITH LIMITED ZERO-RATING AND EXEMPTIONS

The Goods and Services Tax ("GST") systems of New Zealand and Singapore share common characteristics in their application of a single-rate structure to most goods and services. In New Zealand[21], GST is charged on most taxable supplies at the standard-rate of 15%, while zero-rating is limited to the exports of goods and international services, certain financial services,[22] the first sale of refined fine metal, land acquired by a non-profit body, and certain supplies involving land between GST-registered persons. Exemption applies on donated goods and services, financial services that do not qualify for zero-rating, rental for residential buildings, residential accommodation under a head lease, penalty interest and the supply of fine metals.

Similarly, Singapore's single-rate GST system applies a flat 9% to most goods and services with few exclusions. Zero-rating is limited to the export of goods and international services, and exemption applies to four categories of goods and services - financial services, the sale and lease of residential properties, the supply of digital payment tokens and the import and supply of investment precious metals.

6. PACKAGING IMPLEMENTATION AND RATE INCREASES WITH TAX AND BENEFITS REFORM

[17] HMRC v Innovative Bites Limited [2025] EWCA Civ 293.
[18] Rita de la Feria, 'Blueprint for Reform of VAT rates in Europe', (2015) 43(2) Intertax 155−172, 168.
[19] Ibid.
[20]
[21] Inland Revenue, Charging GST, accessed 2 February 2025, https://www.ird.govt.nz/gst/charging-gst .
[22] If the customer is GST-registered and 75% or more of their supplies in a 12-month period are taxable supplies. Otherwise, such supplies to recipients that do not meet these criteria are treated as exempt supplies.

6.1 New Zealand

New Zealand's journey towards a single-rate structure was announced in its 1984 Budget, where the New Zealand Government announced plans[23] to implement GST on 1 April 1986 (subsequently deferred to 1 October 1986) as a single rate to a wide range of goods and services. Broad-based implementation was regarded as most efficient based on overseas experience with similar taxes and New Zealand's experience with wholesale sales tax.

To gain public acceptance, the introduction of GST was positioned within a broader context of tax reform, with the Government emphasising the rising tax burden on the average wage and salary earner. GST would enable average income tax rates and high effective marginal income tax rates to be lowered. This approach promised relief to middle- and upper-income earners, while assuring protection for low-income earners and families with children through redistributive measures in the tax and social welfare systems.

The development of the GST Act was characterised by an extensive two-tiered public consultation process. A White Paper was released for public discussion in March 1985 on the administration of the proposed tax. Over 1,400 submissions were considered by an independent advisory panel, and the panel used the submissions as a basis for making its report[24]. On 21 June 1985, the report was made public, accompanied by comments by the Minister of Finance on recommendations that were accepted. The GST draft legislation was subsequently released in August 1985 and referred to a Select Committee. This step provided another opportunity for public input.

The comprehensive nature of New Zealand's tax and social benefit reforms was outlined in a parliamentary economic statement on 20 August 1985[25]. This statement announced significant changes to the personal income tax structure, including a reduction from a 5-step to a 3-step scale, lowering the bottom tax rate, and decreasing the top rate.

Assistance to families would be improved, with Family Support[26] to be paid to all low- and middle-income families from 1 October 1986 (a date that coincided with the implementation of GST). The Government also pledged to ensure a guaranteed minimum family income[27] for all full-time earners with dependent children. Reforms to the benefit system were announced, under which all basic benefits were increased by five percent from 1 October 1986 to compensate for the introduction of GST.

A similar approach of tax and benefits reform was taken for GST rate increases. New Zealand's first GST rate increase from 10% to 12.5% on 1 July 1989 was primarily offset by substantial cuts in the company tax rates and personal income tax rates. A low-income earner rebate was also introduced to protect lower-paid workers, and adjustments to benefits and pensions were made in view of the higher GST rate[28]. When the GST rate was increased from 12.5% to 15% on 1 October 2010, the increase was again packaged with reductions in company and personal income tax rates. Immediate compensation in the form of tax credits was provided to people receiving social

[23] New Zealand, Parliamentary Debates, House of Representatives, vol. 458, 4 October-3 November 1984, 1433, https://babel.hathitrust.org/cgi/pt?id=uc1.b3281409&seq=617.
[24] Alan Teixeira, Claudia Scott and Martin Devlin, Inside GST: The Development of the Goods and Services Tax, (Wellington: Victoria University Press for Institute of Policy Studies, 1986).
[25] New Zealand, Parliamentary Debates, House of Representatives, vol. 465, 6 August-12 September 1985, 6558, https://babel.hathitrust.org/cgi/pt?id=uc1.b3281416&seq=526.
[26] The maximum rates for Family Support were introduced at $36 for the first child and $16 for subsequent children. Family Support was reduced by 18 cents for each dollar earned above $14,000 gross annual family income.
[27] The Guaranteed Minimum Family Income required at least 30 hours a week of work for a two-parent family and 20 hours a week of work for a one-parent family. For families with one child, the guaranteed family income was scoped at $250 a week and increased by $22 per additional child (including Family Support and Family Benefit). Where the family income was less than this amount, a tax credit would be allowed in order to make up the difference for each week in which the taxpayer was a “full-time earner”.
[28] New Zealand, Parliamentary Debates, House of Representatives, vol. 490, 12 July-28 July 1988, 5566, https://babel.hathitrust.org/cgi/pt?id=uc1.31158013000053&seq=582.

assistance. Groups receiving various forms of existing Government payments also received increases in their payments from 1 October 2010[29].

6.2 Singapore

The scope of Singapore's GST system drew inspiration from jurisdictions that had implemented a VAT/GST, in particular New Zealand's single-rate structure. Leading up to the introduction of GST on 1 April 1994, a White Paper on the Goods and Services Tax was issued on 9 February 1993, with the Singapore Government concluding that introducing a clean GST system with few exemptions and offsetting the impact of GST on low-income households by other measures would be more efficient[30]. Instead of applying exclusions to the tax base, the GST charged by public healthcare and education providers would be absorbed by the Singapore Government. The effect of GST on food prices was also predicted to be reduced in part due to Singapore's high GST registration threshold of SGD 1 million (~£594,601), which effectively exempted small food retailers from GST.

Aside from the absorption of GST on public healthcare and education, the Singapore Government also announced an offset package to cushion the impact of GST on the lower-income group. The package included rebates on personal income tax, reductions in corporate and personal tax rates, suspension or reduction of other existing consumption taxes, increases in personal income tax relief, rebates on conservancy charges for public housing, rebates on property tax capped at owner-occupied properties within a certain annual value, an increased allowance for pensioners, increases in public assistance grants, and an agreement with public transport providers to absorb GST partially[31]. These offsets were estimated to cost the Singapore Government more than the estimated GST collection in the first year, and the White Paper stated that most households, including most lower-income households, would be better off after the GST was introduced.

To mitigate GST becoming a scapegoat for profiteering and cost increases, a Committee on Profiteering and Inflation ("COPI") was activated. At the Budget debate on 16 March 1995[32], the Singapore Government recounted the steps taken to ensure price stability. Prior to GST implementation, the COPI met with key suppliers of essential goods to ensure supplies would be adequate to meet speculative demand and there would be no shortages leading to price increases. It also advised suppliers that any price increase relating to GST should not exceed the GST rate. As a result, price increases were generally lower than the GST rate. Consumer education was stepped up, with price watch surveys published in the media regularly to increase awareness of the need to shop for the best bargains as well as discourage retailers from increasing their prices unreasonably. A hotline was also set up for consumers to complain if there were instances of unreasonable price increases attributed to GST implementation. Errant traders were publicised to generate public pressure on such businesses[33].

In Singapore, subsequent rate increases have all been paired with offset packages. For example, in the 2007 GST rate increase from 5% to 7%, all adult Singaporeans received cash in annual instalments for four years (termed as "GST credits"), with the quantum dependent on the person's

[29] New Zealand Parliament, Taxation (Budget Measures) Bill - First Reading, accessed 12 January 2025, https://www.parliament.nz/mi/pb/hansarddebates/rhr/document/49HansD_20100520_00000250/taxation-budget-measures-bill-first-reading.
[30] Singapore Parliament, White Paper on the Goods and Services Tax, (Singapore: Ministry of Trade & Industry and Ministry of Finance, 1993).
[31] Charles Aeng Cheng Lim, Yew Kwong Leung and Huey Min Chia-Tern, Goods And Services Tax - The Law and Practice, (2002), 16.
[32] Singapore Parliamentary Debates, Vol. 64, Sitting No. 5, (16 March 1995), accessed 24 February 2025, https://sprs.parl.gov.sg/search/#/topic?reportid=004_19950316_S0002_T0003.
[33] For example, a warning was given by the Inland Revenue Authority of Singapore to a shop for advertising that GST had been paid by the shop instead of the customer during a sale period before the GST implementation date. The advertisement's headline claimed: "GST On Us. Gain City $25,000 GST Saving". Accessed 6 April 2025, https://eresources.nlb.gov.sg/newspapers/digitised/article/straitstimes19940312-1.2.7.6.

assessable income and the annual value of his home. Senior citizens received an additional amount. The Singapore Government also gave property tax rebates for two years, utility and maintenance fee rebates to households living in public housing, increased the financial assistance to lower-income families with children and pensioners, and topped up various funds to assist the lower-income. Altogether, these offsets would allow an average Singaporean household (i.e. those living in a 4-room public housing flat) to receive seven years of the additional GST paid, with the lowest-income households receiving 16 years of the additional GST paid[34].

Linking GST with permanent GST Vouchers

After the offset package for the 2007 GST rate increase ended in 2011, Singapore went a step further to create a permanent GST Voucher ("GSTV") scheme in 2012, which directly linked some of the country's wealth transfers to the tax and provided assurance to the public that GST would not negatively affect the lower-income. The Goods and Services Voucher Fund Act was enacted in 2012 to establish the GSTV Fund and its administration, including the purposes[35] for which monies in the GSTV Fund can be used, demonstrating the government's commitment to making the GSTV a permanent feature of Singapore's fiscal system and to provide greater certainty of payments which will otherwise be subject to budget availability[36].

The GSTV has 4 components, and eligibility for each component and the amount of benefits distributed depend on factors like annual income, property value, and the size of the public housing unit:

- GSTV – Cash provides lower-income Singaporeans with cash for immediate needs and is paid every year;
- GSTV – MediSave[37] provides senior Singaporeans aged 65 and above with a top-up to their national medical savings account and is also paid every year;
- GSTV – U-Save provides rebates to lower- and middle-income households living in public housing to offset their utility bills every quarter; and
- GSTV – Service and Conservancy Charges ("S&CC") Rebate (a new permanent component added in 2022) offsets the maintenance fees of eligible Singaporean households living in public housing every quarter.

Monies for the GSTV - Cash component are credited to an eligible person's bank account. For those that do not have a bank account, an initiative known as GovCash allows individuals to withdraw their government benefits in cash from cash machines across the country, using face verification technology to authenticate users and requiring a unique payment reference number received by mail.

The Singapore Government committed[38] that the permanent GSTV would fully offset the GST paid by the lower half of retiree households, and a significant amount for many retirees in the upper half.

[34] Singapore Parliamentary Debates, Vol. 82, Sitting No. 10, (15 February 2007), accessed 6 April 2025, https://sprs.parl.gov.sg/search/#/topic?reportid=016_20070215_S0003_T0001.
[35] Section 4(1)(a) of Singapore Goods and Services Tax Voucher Fund Act 2012 provides that one of the purposes of the fund is to provide financial assistance (including cash grants, grants-in-aid, rebates, reliefs, subsidies and credits) under a public scheme to such natural persons as may be prescribed, in order to mitigate the impact of the goods and services tax on their living expenses.
[36] Ministry of Finance, 'Second reading speech on The Goods And Services Tax Voucher Bill at The Parliament', (14 November 2012), accessed 1 May 2025, https://www.mof.gov.sg/newspublications/speeches/Second-Reading-Speech-By-Mrs-Josephine-Teo-Minister-of-State-For-Finance-And-Transport-On-The-Goods-And-Services-Tax-Voucher-Bill-at-The-Parliament-14-Jan-2012.
[37] Medisave is a national medical savings scheme which helps individuals put aside part of their income into their Medisave Accounts to meet their future personal or immediate family members' hospitalisation, day surgery and certain outpatient expenses.
[38] Ministry of Finance, Budget Statement 2012, accessed 2 February 2025, https://sprs.parl.gov.sg/search/#/topic?reportid=019_20120217_S0004_T0001.

For other lower-income families without elderly members, the GSTV would also offset about half of their total GST bills.

From 2018 to 2020, the permanent GSTV scheme offset an average of 84% of the annual GST payable by the bottom 20% of Singaporean households, on a per household member basis[39]. This excludes all other benefits provided to the lower-income through other welfare schemes and subsidies. For the middle-income, benefits are provided through the U-Save and S&CC Rebate components, as over 80%[40] of Singapore's resident population resides in public housing.

Both New Zealand and Singapore demonstrate how a single-rate VAT system with limited exclusions can be achieved through careful policy design and comprehensive social benefits. Singapore's approach to directly linking the tax with a permanent voucher scheme has also helped to ensure long-term public acceptance, while providing targeted assistance to lower- and middle-income households in a way that is both transparent and administratively efficient. Their experiences highlight that public acceptance of VAT changes relies heavily on transparent communication and adequate compensation especially for the vulnerable groups.

7. MITIGATING DISTORTIONS FROM EXEMPTING FINANCIAL SERVICES

In most countries including the UK, financial services are exempt from VAT due to difficulties in ascertaining the value-add of the supply. The exemption of financial services however gives rise to several problems, first of which is tax cascading issue. As financial institutions are not able to recover the input tax incurred to make exempt supplies, the irrecoverable input tax may be embedded in the value of the exempt financial services and passed on to their customers. As the customers are not able to recover the embedded tax in the financial inputs as their input tax, tax on tax may arise if the customers uses the financial inputs to make taxable supplies. Second, to minimise the costs of irrecoverable input tax, financial institutions may be incentivised to substitute in-sourced services for out-sourced services, thus leading to economic distortions. Third, the complexity of the requirement to perform input tax attribution and apportionment, often compounded by the varied and intricate business activities of the financial institutions, lead to substantial compliance costs.

Other than the complexities in valuation, financial services are not fundamentally different from any other taxable services and should likewise be subject to VAT. But as it would require further studies to determine an appropriate VAT taxation model for financial services, the paper instead looks to Singapore and New Zealand for inspiration on possible policy options that can mitigate distortions and compliance costs from exempting financial services.

While Singapore also exempts financial services[41], it limits the scope of exemption to financial services where valuation is truly complex[42] by taxing financial intermediation services. Financial intermediation services subject to tax include any services consisting of arranging, broking, underwriting or advising on any financial services that are provided in return for a brokerage fee,

[39] GST Vouchers' Offset of GST Paid by Lower Income Households, Parliament Sitting, 11 May 2021, accessed 6 April 2025, https://sprs.parl.gov.sg/search/#/sprs3topic?reportid=oral-answer-2459.
[40] Housing Development Board ("HDB"), 'Public Housing – A Singapore Icon', accessed 6 April 2025, https://www.hdb.gov.sg/cs/infoweb/about-us/our-role/public-housing-a-singapore-icon.
[41] Financial services are exempt under section 22 of the GST Act 1993 if they fall within the description specified in paragraph 1 of Part 1 of the Fourth Schedule to the Act.
[42] However, certain fee-based services remain exempt if they fall within the description of financial services exempt under paragraph 1 of Part 1 of the Fourth Schedule to the GST Act 1993. An example is banks charges relating to the operation of current, deposit or savings account.

commission or similar consideration[43]. New Zealand, on the other hand, exempts most financial intermediation services, other than services relating to provision of advice on financial services[44]. The narrower scope of exemption of financial services in Singapore relative to other jurisdictions mean that financial institutions in Singapore generally have higher input tax recovery rates.

To mitigate tax cascading, New Zealand allows zero-rating of financial services supplied to a VAT-registered customer ("B2B supplies"), provided that not less than 75% of the customer's supplies relate to taxable supplies in a given 12-month period[45]. This is allowed as an option to the providers of financial services, and is not mandatory. In contrast, Singapore addresses the tax cascading issue by allowing deduction of input tax incurred on exempt financial supplies made to VAT-registered businesses[46]. The input tax deduction is allowed only upon approval by the Comptroller, or as directed by the Comptroller for use, such as for a particular business sector. While this has the same effect as zero-rating exempt financial supplies to VAT-registered businesses, unlike New Zealand, Singapore's measure does not have the additional condition that the registered businesses must make certain level of taxable supplies.

In a novel move to alleviate compliance costs for banks, Singapore leverages industrial-wide statistics collated by the Monetary Authority of Singapore ("MAS") to compute and prescribe an annual fixed input tax recovery rate ("FITR") for banks, with a different fixed rate for each banking licence type[47]. The formula for computing the FITR incorporates the value of exempt financial supplies made to VAT-registered businesses in the numerator, thus enhancing input tax deduction for the banking sector while mitigating tax cascading concerns. For ease of compliance, banks simply pool all their input tax, effectively treating all their input tax as residual in nature, and multiply by the FITR, to compute the amount of deductible input tax. While banks that prefer to perform their own attribution and apportionment of input tax are also allowed to do so[48], the vast majority prefer to adopt the FITR for its simplicity and perceived equity, since most banks will apply the same rate. Though the accuracy of input tax claims is less precise, a fixed rate significantly simplifies administration and compliance for the tax authorities and businesses. As industrial-wide income statistics are used to compute the fixed rate, revenue loss is mitigated since the higher input tax recovery outcome of one bank would be somewhat offset by the lower recovery of another.

Section III: Broadening UK VAT Base and Measures for Financial Services

8. BROADENING VAT BASE WITH TARGETED SOCIAL TRANSFERS

VAT is commonly viewed as a regressive tax because lower-income households spend a larger portion of their income and pay proportionately more VAT than higher-income households. VAT regressivity is therefore often measured by comparing the VAT burden relative to income (also known as the VAT-to-income ratio). It is however also recognised that the VAT-to-current income

[43] GST Act 1993, para 3(1) of Part 3 of the Fourth Schedule.
[44] Financial services are exempt under section 14(1) of the GST Act 1985, while the term 'financial services' is defined in section 3 of the Act.
[45] GST Act 1985, s 11A(1)(q) and (r).
[46] GST (General) Regulations, reg 30(2).
[47] Banks in Singapore are licensed by the MAS as full banks, wholesale banks or merchant banks, and are allowed to carry out the permissible activities as set out in regulations for the respective licence type.
[48] The FITR was previously accorded to the banking sector on the understanding that all banks will apply the fixed rates. However, with effect from 1 April 2025, the banks are allowed to choose between applying the FITR or performing their own input tax attribution and apportionment.

ratio may paint a misleading picture of VAT regressivity as it does not account for savings which would be spent and subject to VAT in the future[49]. As such, measuring VAT burden relative to expenditure may provide a more insightful estimate of the distributional impact of VAT[50].

Using both the VAT-to-income and VAT-to-expenditure ratios, we estimate[51] and compare the effectiveness of Singapore's broad GST base paired with targeted social transfers, with the UK's system of reduced rates and exemptions, in addressing VAT regressivity across households by income quintile.

Figure 1: VAT-to-income ratio

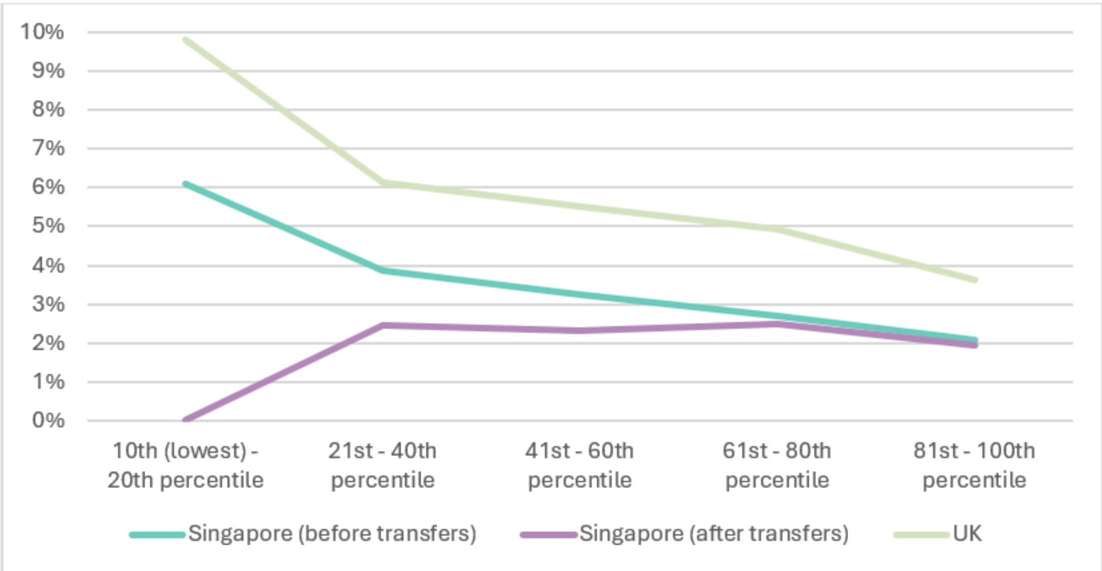
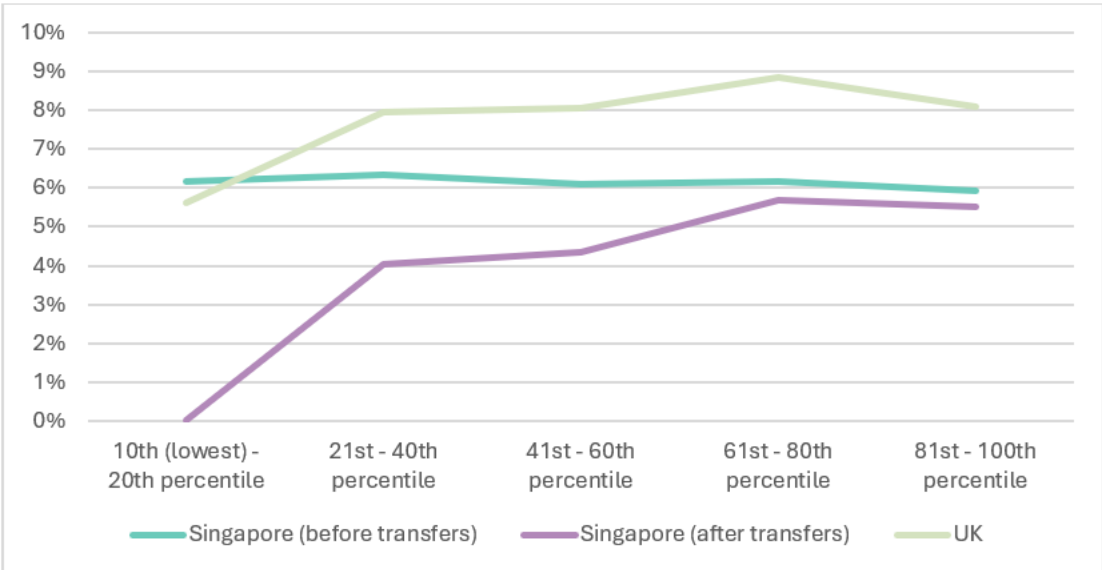


Figure 2: VAT-to-expenditure ratio



Based on the estimated VAT-to-income ratio, the UK VAT system appears to be regressive – lowest income households have the highest VAT-to-income ratio of about 10% compared to 4% for the highest income households. The VAT-to-expenditure ratio however is generally progressive, with the VAT burden of the bottom 20% of households (by income) estimated to be at 5.6% of their

[49] Stuart Adam, David Phillips and Stephen Smith, 'A retrospective evaluation of elements of the EU VAT system', (2011).
[50] Alastair Thomas, Reassessing the regressivity of the VAT, OECD Taxation Working Papers No. 49, (2020).
[51] The figures presented are the authors' estimates derived from desk-based analysis and publicly available data. Refer to Table A in the Appendix for a summary of the computation methodologies and datasets referenced.

total expenditure compared to 8% for the top households. This is a sensible outcome as lower-income households spend proportionally more of their income on essential goods and services like food and power. Thus, the current VAT system design does promote progressivity to some extent.

In Singapore, the VAT-to-income ratio before GST transfers displays a regressive trend similar to the UK's. Highest income households have the lowest VAT-to-income ratio of about 2%, and the ratio increases as we move down the income quintiles with the lowest income households having the highest VAT-to-income ratio at about 6%. Post-transfers, the VAT-to-income ratio becomes generally progressive albeit dipping slightly at the highest income household group.

Singapore's GST system is also progressive when GST burden is viewed in comparison to expenditure, with the VAT-to-expenditure ratio peaking at about 6% for the higher-income households which correspondingly have higher expenditures. The effects of the GST transfers are most apparent for households in the lowest 10th to 40th income percentile – notably, the bottom 20% of households (by income percentile) do not pay any GST after the GST offset and absorption measures.

Overall, the VAT to income and expenditure ratios post-transfers evidence the effectiveness of Singapore's GST policy design to ensure that the measures addressing the regressivity of GST, which most keenly impacts the lower-income households, are delivered in a targeted manner to the intended recipients without also subsidising the GST burden of the high-income households.

Broadening the UK VAT base

While the broadening of the VAT base can be used as a revenue-raising measure, our ensuing analysis and discussion will assume a broadened VAT base that is not aimed at increasing net VAT revenue. Therefore, the reform measures considered below are designed to preserve the total net VAT revenue at the financial year ("FY") 2022-23 level of £159.75 billion.

Similar to New Zealand and Singapore's approach, the VAT reform in the UK can take the form of broadening the VAT base to remove the reduced rates and exemptions on essential and merit goods and services. The additional revenue generated from removing these existing reliefs, which are currently enjoyed across all income levels, could instead be redirected as VAT transfers targeted at specific income groups.

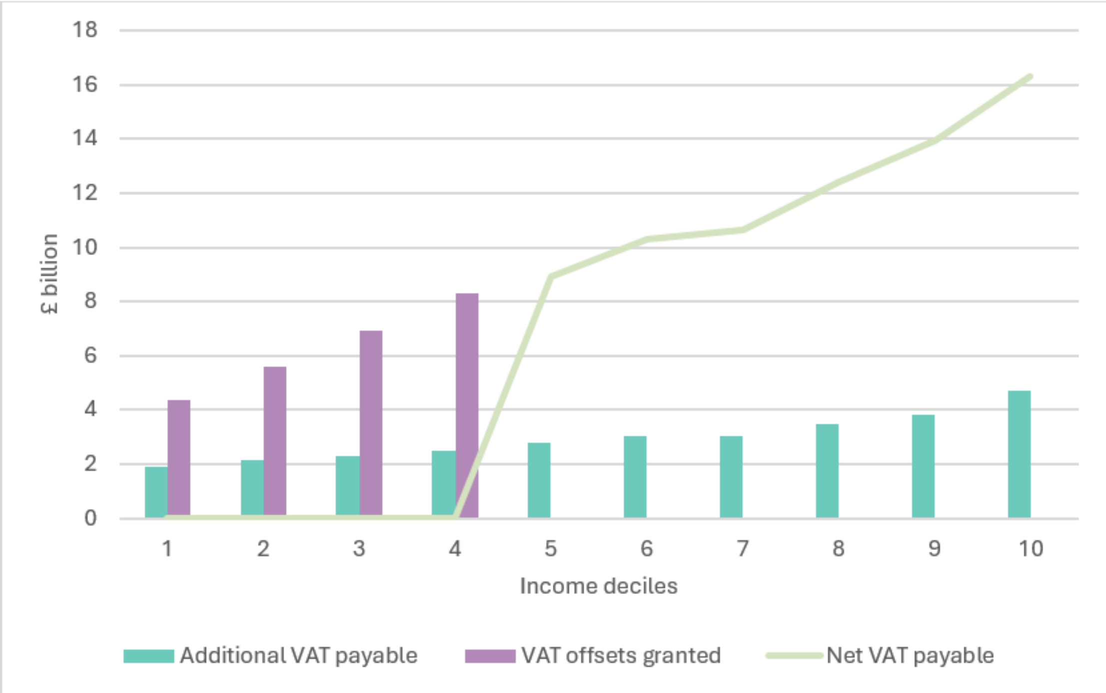
Based on the total net VAT revenue and costs of providing reliefs[52] for reduced rates and exemptions for FY2022-23, it may be possible to abolish the existing reliefs and apply a broad-based reduced standard rate of 15% without experiencing any revenue loss to the Exchequer. This would however mean that regressivity as measured based on VAT-to-income ratio would worsen as the lower-income group would be proportionally more impacted by the imposition of VAT on essentials. To improve progressivity, we recommend pairing the base-broadening with the introduction of a targeted social transfer similar to Singapore's GSTV scheme to directly offset the VAT burden of the lower-income households, where the issue of VAT regressivity is most pertinent.

At a high level, our modelling[53] estimates that with a broad-based VAT rate of 18%, the additional VAT revenue of £26.1 billion could fully offset the total annual VAT payable by households in the

[52] Costs of providing reliefs are retrieved from HMRC's non-structural cost estimates and structural cost estimates for VAT, released on 7 December 2023. While the authors note that the costs of providing reliefs do not necessarily represent the actual gain to the Exchequer should the reliefs be abolished (e.g. due to additional behavioural effects), for the purpose of our desk-based analysis, these costs represent a reasonable estimate of the amount of VAT that would be collected in absence of the reduced rate and exemption reliefs.
[53] Refer to the Appendix for a summary of the computation methodologies and datasets referenced.

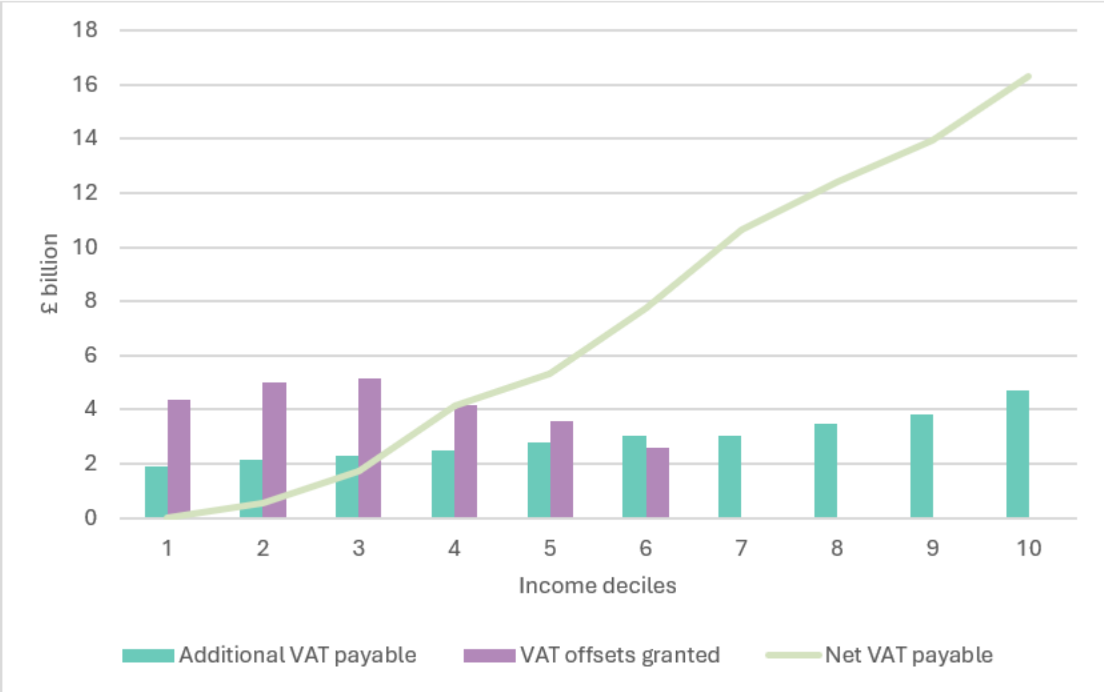
lowest four income deciles, or fully offset the additional annual VAT payable by households up to and including the 9th income decile, with a surplus of about £1.09 billion.

Figure 3: Annual household VAT burden at 18% VAT rate with full offset of annual VAT payable by lowest 40% income percentile



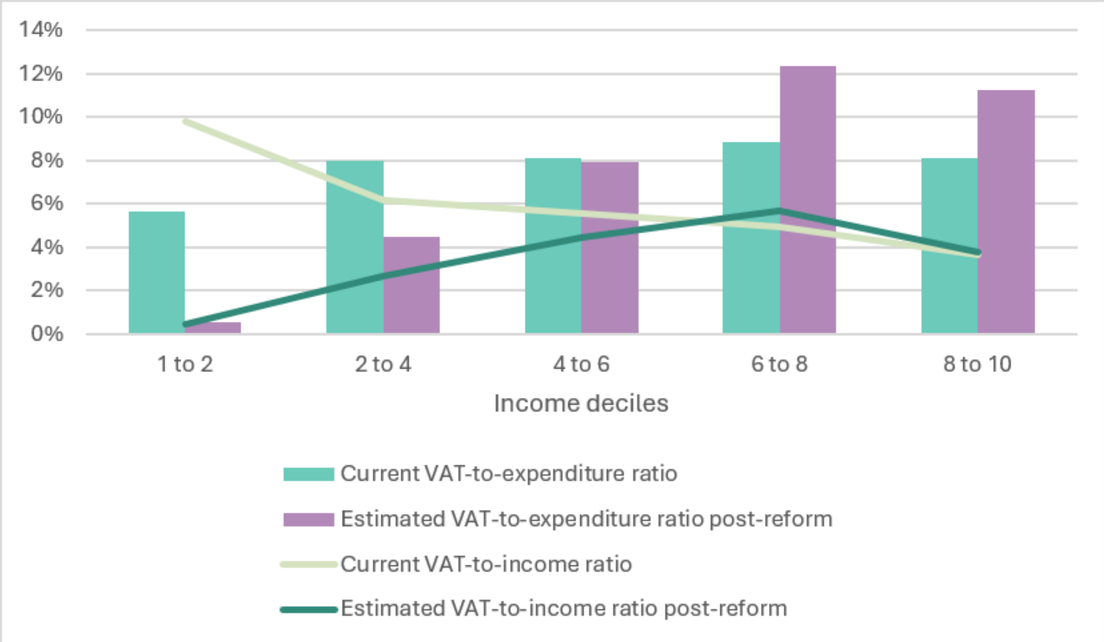
Alternatively, the VAT offsets can be designed in a tiered manner based on income decile, with higher offsets granted to the lower-income and middle-income groups. For instance, tiered VAT offsets ranging from 25% to 100% of the total annual VAT burden can be granted to households in the 1st to 6th income deciles using the additional VAT revenue raised, with households in the 1st and 2nd income deciles receiving a full or almost full offset of their total VAT payable.

Figure 4: Annual household VAT burden at 18% VAT rate with tiered offsets of VAT payable by lower-income and lower- to middle-income households



The standard rate, level and design of the VAT offsets, as well as the scope of the intended recipients of the VAT transfers, can be calibrated to meet the broader social and distributional goals of the government. While our modelling shows a standard rate of 18%, the rate can be lowered, but not lower than the rate of 15%, to maintain the same VAT revenue, with corresponding adjustments to the level of VAT offsets, if the goal were to spread the benefit of a lower VAT rate more widely. The main point is that the base-broadening measure, paired with direct VAT transfers, can be an alternative to the use of reduced rates and exemptions in addressing the regressivity of VAT. In fact, an added benefit of direct VAT transfers is that the measure can be targeted at specific income groups where the effects of VAT regressivity is most poignant, to deliver greater progressivity in a more efficient manner. This is illustrated in Figure 5 – assuming a tiered offset system is adopted, we recompute the VAT to income and expenditure ratios for comparison against the ratios under the current VAT system.

Figure 5: Current and post-reform VAT to income and expenditure ratios



Compared to the current VAT system, the progressivity as measured by the VAT-to-expenditure ratio will improve significantly for the lower-income households owing to the targeted VAT offsets. For the other income groups, the incidence of VAT borne will be proportional to the level of expenditure.

Similarly, progressivity based on the VAT-to-income ratio will improve for households in the lowest to middle income quintiles while remaining slightly regressive at the highest-income household groups. The regressivity can be further addressed through other policy measures such as adjusting the income tax rates for the higher income tax bands.

In conclusion, a broadened VAT base with lower single VAT rate, coupled with targeted VAT offsets, has the potential to improve progressivity and overall efficiency of the VAT system. Moreover, the economic distortions, high compliance and administrative costs as well as lobbying pressures associated with reduced rates and exemptions discussed in Section I would be less of an issue with a broadened VAT base. The measure also allows the extent of VAT transfers and taxation to be adjusted in a more specific manner in terms of the level of transfers and the scope of the intended recipients, thus providing greater policy space to support the overall social and distributional goals of the UK tax system.

9. POLICY OPTIONS FOR FINANCIAL SERVICES

If the rationale underpinning exemption of financial services lies with the difficulty in identifying the charge for the services, then the defence for exempting fee-based financial services where the separate charge is readily identifiable stands on weak ground. One option is to tax all fee-based financial services, but that option may invite avoidance behaviour of substituting fee for margin in the pricing of financial services. Another option is to follow the Singapore's way of taxing financial intermediation services. Since financial intermediation services are generally provided for a fee, this option has the advantage of capturing most fee-based financial services. The downside however is that financial services rendered for a fee can still be exempt if the nature of the services fall within the scope of exemption. Moreover, to the extent that certain financial services remain exempt, the definitional issue of what constitutes exempt or taxable financial services persists.

Nonetheless, short of taxing all financial services, the UK would have to weigh the pros and cons of each option, in deciding the way forward. As for the options to mitigate the tax cascading issue, both the zero-rating measure adopted by New Zealand and the input tax deduction measure adopted by Singapore in respect of B2B exempt financial supplies offer promising solutions. In comparison, the New Zealand's measure is more targeted at addressing the tax cascading issue by confining the zero-rating treatment to financial services supplied to registered customers making predominantly taxable supplies. At first glance, Singapore's measure may seem overly generous without similar condition on the level of taxable supplies made by the customers. This would inadvertently allow deduction for input tax on B2B exempt financial supplies that are used as inputs by the customers to make exempt supplies, where tax cascading is not even a concern. However, on closer scrutiny, the input tax deduction in Singapore is allowed only in respect of residual input tax, but not input tax directly attributable to the making of B2B exempt financial supplies. This is because the input tax deduction rule was conceived in conjunction with the design of the FITR for the banking sector, and generally applied in special input tax recovery methods accorded to other financial institutions, where all input tax are treated as residual in nature. Arguably, the cutback on direct input tax deduction would somewhat offset any unintended deduction of residual input tax.

While New Zealand's zero-rating treatment is more targeted, Singapore's input tax deduction rule seems less onerous on the financial institutions – they are only required to determine the VAT registration status of their customers, and need not go the second step of determining the customers' level of taxable supplies. Recognizing the compliance difficulty in obtaining information from the customers in relation to their level of taxable supplies, New Zealand allows the financial institutions to rely on the ANZSIC[54] codes, to determine if the customers meet the taxable supplies threshold. Similarly, for ease of compliance, Singapore, allows financial institutions to adopt a 50%[55] proxy for the proportion of their B2B exempt financial supplies, if they do not wish to determine the VAT registration of their customers. Ultimately, whether in New Zealand or Singapore, financial institutions would have to weigh the compliance costs against the benefits of the zero-rating or input tax deduction measure, before making the election or application for the respective measure. Whichever measure the UK chooses, it is important to recognise the inherent compliance costs and allow the measure as an option, as well as consider the use of appropriate proxy information in lieu of obtaining specific information from the customers.

It is undeniable that financial institutions such as the banks incur substantial compliance costs in performing attribution and apportionment of their input tax. Singapore mitigates this through prescribing a fixed recovery rate for the banking sector, and at the same time, allow those who wish to compute their own deductible input tax an option to do so. Whether UK can implement a similar compliance saving measure depends on the availability of industrial-wide statistics as well as whether consensus can be reached with the sector on the method to compute the fixed recovery rate. As the fixed recovery rate represents the average recovery rate of the particular sector, it is meaningful only if vast majority of the financial institutions in the sector come on board. If the option to compute their own deductible input tax remains, potential cherry-picking concerns

[54] ANZSIC stands for Australian and New Zealand standard industry classification and are used in New Zealand and Australia for the production and analysis of industry statistics. For details on the use of ANZSIC codes for the purpose of zero-rating B2B exempt financial supplies, see IRD, 'GST Guidelines for Working with the New Zero-rating rules for Financial Services', Tax Information Bulletin, Vol. 16, No. 10 (November 2004), https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/tib/volume-16---2004/tib-vol16-no10.pdf?modified=20200329214341&modified=20200329214341.

[55] In the absence of information on the VAT registration status of the customers, the 50% proxy represent equal sharing of revenue risk and compliance savings between the Comptroller and the financial institution. The proxy is reasonable in view of the high registration threshold as well as exemption from registration rule for businesses making predominantly zero-rated supplies in Singapore. For use of the 50% proxy for the banking sector, see IRAS, GST: Special input tax recovery method for banks, (6 March2024), https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguide_special-input-tax-recovery-method-for-banks_first-edition_v1-0.pdf?sfvrsn=12040a98_4.

may arise, since financial institutions are likely to choose the option that benefits them most[56]. This would mean that those that opt for the fixed recovery rate are likely to have actual effective recovery rate that is lower, after taking into account the compliance costs associated with computing their own deductible input tax. Since the tax administrations are not privy to the information financial institutions would have that allows them to compute their actual effective recovery rate, the latter would always have the upper hand in determining which option to adopt. To mitigate the revenue risk arising from potential cherry-picking and information asymmetry, appropriate adjustments can be incorporated into the formula in computing the fixed recovery rate.

Section IV: Offsets Package and Public Support

10. DESIGN OF OFFSETS PACKAGE

In the earlier section, the paper has discussed the options available to the UK to broaden its VAT base, which would not only bring down the standard rate, but also enhance the progressivity of the VAT through targeted social transfers. However, any reform to broaden the VAT base should be bundled with appropriate mitigating measures to cushion the impact on affected suppliers, workers and consumers at large.

For the suppliers, those who are already subject to the standard VAT rate would enjoy the benefit of a lower rate. Whether they would pass on the saving of the rate reduction to the consumers through lower prices would depend on various factors such as price elasticity of the products and market competitiveness, but where they do, the consumers would benefit too. For sectors facing tight employment, the workers may also stand to benefit through higher wages, should the employers share the tax saving with them. Barring other cost factors, the rate reduction would be a boon to the hospitality and tourism industry, and would enhance its international competitiveness against jurisdictions with higher VAT rates in the region.

However, suppliers who used to enjoy the reduced VAT rate would have to consider whether to pass on the higher rate to the consumers through higher prices, or absorb the increase in the rate, which would then eat into their profit margin. The impact on the suppliers would vary across different sectors, with those in sectors facing higher price elasticity and stiffer competition more impacted than others. Where price is elastic, an increase in prices would reduce consumption, which may in turn lead to job losses in labour-intensive sectors[57]. For highly competitive markets, suppliers may not be able to increase prices; hence, the rate hike would translate into higher business costs, which could again lead to job losses or even business closures. To cushion the impact on suppliers and workers, appropriate transitional measures can be put in place. For example, the rate hike can be staggered over a few years, or vouchers can be distributed to consumers to encourage them to buy from affected suppliers[58]. For displaced workers, job

[56] The use of industrial-wide statistics to compute an average fixed recovery rate rests on the assumption that any revenue loss from one taxpayer with actual lower recovery rate would be offset against any revenue gain from another with actual higher recovery rate. Once an option is granted, the assumption no longer holds. This is because those that adopt the fixed rate are likely to have an actual rate that is lower than the fixed rate, whereas those that choose to compute their own recovery rate are likely to have an actual rate that is higher.
[57] De la Feria, n 18, 169.
[58] For example, Singapore introduced the CDC Vouchers Scheme in 2020 to help Singaporean households defray their cost of living and support heartland merchants affected by Covid-19 pandemic. Subsequent tranches of CDC vouchers have been issued in 2021 to 2025, which can be used at participating supermarkets and heartland merchants.

matching services or training grants can be provided to equip them with new skills that would facilitate their transition to new jobs.

On the other hand, where the price is inelastic or where the suppliers choose to pass on the higher rate to the consumers through higher prices, the consumers would bear the full brunt of the rate hike. While the transitional measures for the suppliers as discussed earlier would also mitigate the impact on the consumers, the lower-income group may be vulnerable to the immediate impact of the rate hike, especially on essential items. The design, including the timeliness of delivery, of the targeted VAT transfers is therefore important in protecting the vulnerable from the inflationary effect of the rate hike. The GSTV scheme in Singapore has proven to be simple and efficient, but a more advanced tool to facilitate redistribution would be to leverage real-time technology and digital payment mechanism to refund VAT to eligible individuals at the point of expenditure[59].

If the UK is not ready to adopt real-time technology any time soon, then the Singapore model may offer some solutions. The VAT offsets can take the form of a cash component to be disbursed to eligible households on a periodic basis. A higher frequency of disbursement would better alleviate any potential cash flow issue of lower-income households, hence disbursing on a monthly basis would be preferred over a quarterly basis. The VAT offsets can also take the form of direct offsets at the point the expenditure is incurred. For instance, the UK could consider working with utilities providers to directly offset the VAT on utility bills, based on housing types or other readily available information to identify the lower-income households.

As in any VAT rate hike, opportunistic suppliers may seek to profiteer from the VAT reform by increasing the prices of their products in excess of the VAT increase. As a result, consumers will end up bearing price hikes beyond the intended policy outcome. To combat such profiteering behaviour, a committee similar to the COPI in Singapore can be established to nudge suppliers towards fair practices and publicly name the errant ones to exert public pressure on them.

Table 1: Offset measures to address impact of VAT base-broadening

Impact of VAT base-broadening	Offset measures
Suppliers	• Stagger the VAT rate increase • Distribute vouchers to consumers to encourage them to purchase from affected suppliers
Workers	• Provide job matching service for displaced workers • Provide training grant to equip displaced workers with essential skills to transit to new jobs
Consumers	• Timely disbursement of VAT credits to targeted households • Direct offset of VAT at point of expenditure for targeted households, by collaborating with suppliers or service providers • Set up anti-profiteering committee to combat profiteering behaviour by opportunistic suppliers

11. SOLICITING PUBLIC SUPPORT

[59] Rita de la Feria and Artur Swistak, Designing a Progressive VAT, (IMF, 2024).

To solicit public support, it is necessary to consider the political dynamics of tax reform. Presenting mere technical arguments for the VAT reform, while ignoring the political economy of tax policy, will not win the day. According to Rita de la Feria, the political dynamics can be framed as the interplay of various factors in a two-step process, comprising *comprehension* of the proposed tax reform as the first step, and *trust* in the proposed tax reform as the second step[60]. In the first step, often information asymmetry and low salience of VAT allow interest groups to fill the information gap with a fairness-centric narrative to propagate their agenda[61], by leveraging the equity delusion of base-narrowing measures. In the second step, the trust problem can be explained by cognitive dissonance, loss aversion, and status quo bias[62]. The public experience cognitive dissonance when technical arguments such as negative distribution effects of base-narrowing measures do not fit their intuitive concepts, while status quo bias presents itself when the benefits of the reform are perceived as uncertain[63]. Loss aversion is the tendency to prefer avoiding losses to acquiring benefits, and manifest itself in the distrust of a two-step policy where a benefit is removed as a first step, and a different benefit is attributed in the second step[64].

To combat the information asymmetry, it is not adequate to simply present the technical arguments, but a counter fairness narrative should be offered[65]. The narrative could focus on how the rich is benefiting under the current VAT regime, when the revenue foregone could have been used to help the poor. To make the narrative more relatable, media stories of how a typical low-income household could benefit from the VAT reform could be told. Timing the implementation of the reform is also critical. A gradual reform that removes concessions in stages, may lend itself to a comparative fairness narrative[66]. The interest groups are likely to put up a stronger resistance to a gradual reform, as they may be willing to forgo preferential tax treatment if all concessions are removed, but less likely to do so in isolation[67]. Hence, a broad reform is preferred over a gradual one. To increase the public's trust, the time lapse between the removal of the reduced rates and exemptions and the targeted social transfers should be shortened. In other words, real-time offset of VAT at the point of expenditure, or if not, higher frequency of disbursement of VAT cash offsets would help reinforce trust in the reform. To ensure that the offset measures are not lost in the narrative, giving it a short and catchy label would help the public associate the measures with the reform.

The technical arguments for the VAT reform may be overwhelming, but so is the immediate impact of the reform on affected stakeholders such as the suppliers, workers and consumers at large. For some suppliers, the reform may mean further erosion into their profit margins, placing them at risk of insolvency or business closure. For workers, the reform may mean potential loss of livelihood, and for some consumers, it may mean being not able to afford certain essential goods or services. Adopting a social empathy[68] perspective in policy formulation, by seeking to understand the unique circumstances of various stakeholders and their unique concerns, would help inform the design of the offsets measures. This involves deep engagements with stakeholders, through interviews and open dialogues, to hear their stories and how the reform may potentially impact them. A well-designed reform package that takes into account the lived experiences of stakeholders would go a long way in getting their buy-in.

[60] De la Feria and Walpole, n 12, 657.
[61] Ibid., 660.
[62] Ibid., 662
[63] Ibid., 663.
[64] Ibid.
[65] Ibid., 665.
[66] Ibid., 666.
[67] Ibid.
[68] Elizabeth A. Segal, 'Social empathy: A model built on empathy, contextual understanding and social responsibility that promotes social justice', Journal of Social Service Research 37(1), (2011), 266−277.

Yet engaging the stakeholders does not stop at just hearing their stories, but also invites them to contribute meaningfully to the policy design. The engagement should not merely be a platform to explain the policy that has already been decided and to seek feedback only to endorse the decision, that is, the DAD ("Decide-Advocate-Defend") model commonly employed in public communication[69]. Instead, public inputs may be sought before deciding on the final policy parameters, especially in the areas where stakeholders' diverse experiences, skills and knowledge can be leveraged to find the way forward. While technical expertise may be required in reforming the VAT system to enhance its progressivity and efficiency, stakeholders may be able to offer novel solutions to the design of the form and delivery of the offsets package. On how to design the public discourse to solicit stakeholders' inputs, the SHEDD model, which is an extension of the Coordinated Management of Meaning ("CMM")[70] theory, can serve as a useful guide[71]. The SHEDD model consists of five phases and is an acronym for the five phases[72]:

- getting *Started* – To get support from decision makers or stakeholders who may be able to influence the public discourse, and to enlist and train facilitators for focused group discussions.
- *Hearing* all the voices – To ensure that public discourse is sufficiently open and inviting for people to speak freely, yet structured to avoid discordant arguments, careful attention is given to selecting and framing the topic for a dialogue.
- *Enriching* the conversation – To deepen the discussion of the selected topic, facilitated focused group discussions may be held, with the objective of hearing from each other and hearing the stories behind the expressed views.
- *Deliberating* the options – Through facilitated discussions, participants evaluates the pros and cons of each option and rank-orders the desirability of the options or importance of the concerns. The results are then presented to the ultimate decision makers.
- *Deciding* how to move forward together – Once a decision is made, it is important to report back to the participants to demonstrate that the process is effective and their voice is heard.

The actual public discourse need not necessarily follow all the steps envisaged in the SHEDD model. The key takeaway is the bottom-up approach of seeking public inputs in policy formulation. Through the process, stakeholders should feel that they are heard, receive empathy for their pain points, and gain confidence in the public discourse. The final decision may not address all the concerns and interests of various stakeholders, but the process would hopefully facilitate respect for any disagreements. Engaging the stakeholders to co-create the policy parameters would also enhance collaboration and lend support to the VAT reform.

Section V: Conclusion

12. A CLEAR CALL FOR REFORM?

A multiple-rate VAT system with reduced rates and wide exemptions such as that of the UK is fraught with many difficulties. Overwhelming bodies of studies have demonstrated that the effect of reduced rates may not be passed down to the consumers, thus casting doubt on the underlying

[69] W. Barnett Pearce and Kimberly A. Pearce, 'Extending the Theory of the Coordinated Management of Meaning (CMM) Through a Community Dialogue Process', Communication Theory 10(4), (2000), 405−423.
[70] CMM is a communication theory which postulates that social worlds are created through human interactions and communication is the primary social process of human life. See W. Barnett Pearce and Vernon E. Cronen, Communication, Action and Meaning: The Creation of Social Realities, (New York: Praeger, 1980).
[71] Kimberly A. Pearce and W. Barnett Pearce, 'The Public Dialogue Consortium's School-Wide Dialogue Process: A Communication Approach to Develop Citizenship Skills and Enhance School Climate', Communication Theory 11(1), (2001), 105−123.
[72] Ibid.

social and distributional aims of the policy. Reduced rates and exemptions also give rise to economic distortions, high compliance and administrative costs, and lobbying pressures from various interest groups. The case for a VAT base-broadening reform is therefore clear and strong.

The paper then looks to New Zealand and Singapore, which have successfully implemented a broad-based single-rate GST regime. Pairing with targeted social transfers, both New Zealand and Singapore are able to deliver on the social and distributional goals without the complexity of differentiated rates. In particular, the GSTV scheme in Singapore is a simple and efficient tool in mitigating the regressivity of GST by offsetting the GST burden of eligible households in a tiered manner. Both New Zealand and Singapore have also introduced measures to address distortions arising from exemption of financial services. To address the tax cascading issue, New Zealand allows zero-rating of B2B financial services, subject to certain conditions, while Singapore allows deductibility of residual input tax attributable to B2B exempt financial services. Further, to address high compliance costs associated with attribution and apportionment of input tax, Singapore allows the banks to apply an annual fixed recovery rate.

Comparing the VAT to income and expenditure ratios between the UK and Singapore, it is evident that Singapore's GST system coupled with targeted social transfers is more effective in addressing the regressivity of the tax, without also subsidising the GST burden of the higher-income households. Postulating that the base-broadening reform is not aimed at raising revenue, the paper estimates that the VAT standard rate in the UK can be lowered to 18% to generate additional revenue to fully offset the total annual VAT payable by households in the lowest four income deciles, or fully offset the additional annual VAT payable by households up to and including the 9th income decile. Alternatively, the VAT offsets can be designed in a tiered manner based on income decile, with higher offsets granted to the lower- and middle-income groups. Therefore, a broadened VAT base with targeted social transfers has the potential to improve progressivity and overall efficiency of the VAT system, and at the same time remove the other distortions and complexities associated with reduced rates and wide exemptions. This also comes with the added benefit of greater policy space to adjust the level of VAT offsets and intended recipients, to support the overall social and distributional goals of the UK tax system.

In discussing the possible transplant of policy options relating to financial services in New Zealand and Singapore to the UK, the paper highlights the nuances of the respective measures and the implications for the UK. Whether or which measure is appropriate for the UK would much depend on how the policy makers weighs up the pros and cons of each measure, given the business and operating landscape of the financial sector in the UK.

Should the UK decide to proceed on broadening the VAT base, the reform should be bundled with appropriate offsets measures to mitigate the impact on affected suppliers, workers and consumers at large. To solicit public support for reform, it is imperative to consider the political economy of tax reform, and formulate measures to combat information asymmetry and increase public's trust. Adopting social empathy in the process of policy making that takes into account the lived experiences of stakeholders will enhance buy-in of the reform. In areas where stakeholders' diverse experiences, skills and knowledge can contribute to co-creating the policy parameters, a bottom-up approach in soliciting their inputs will also lend support to the reform.

The call for reform may be clear and strong, but the journey is no doubt arduous. The task though not impossible would take strong resolve on the part of the policy makers, and unwavering support from members of the public, who share the same conviction.

APPENDIX

Table A: VAT to income and expenditure ratios

Income quintiles	VAT-to-income ratio			VAT-to-expenditure ratio		
	Singapore (before transfers)	Singapore (after transfers)	UK	Singapore (before transfers)	Singapore (after transfers)	UK
10th (lowest) - 20th percentile	6.1%	0.0%	9.8%	6.2%	0.0%	5.6%
21st - 40th percentile	3.8%	2.5%	6.1%	6.3%	4.1%	7.9%
41st - 60th percentile	3.3%	2.3%	5.5%	6.1%	4.3%	8.1%
61st - 80th percentile	2.7%	2.5%	4.9%	6.2%	5.7%	8.8%
81st - 100th percentile	2.1%	1.9%	3.6%	5.9%	5.5%	8.1%

References and computation methodology

Preface: While we recognise that disposable income may be a more accurate basis to compute the VAT-to-income ratio (given that it represents the actual income available for consumption)[73] only information on gross household income was available for Singapore. Hence, gross income was used in computing the VAT-to-income ratio for a fairer comparison.

Singapore

Average household gross income is derived from the Singapore Department of Statistics ("DOS"), Average Monthly Household Employment Income (Excluding Employer CPF Contributions) Among Resident Employed Households by Deciles, 2023.

Household expenditure and GST burden per household are derived and estimated based on DOS, Average Monthly Household Expenditure Among Resident Households by Type of Goods and Services (Detailed) and Income Quintile (Household Expenditure Survey 2023).

The amount of GST transfers is estimated based on the Average Monthly Household Expenditure Among Resident Households by Type of Goods and Services (Detailed) for GST absorbed on public healthcare and education, and the estimated GSTV-Cash[74], GSTV-U-Save and GSTV-S&CC[75] received per household. Estimates for GSTV-Medisave disbursed to households across on income deciles are not available due to lack of publicly available information.

[73] Alastair Thomas, n 50.
[74] The average monthly employment income per employed household member is used as an estimate of the individual's annual income for GST-V cash eligibility, and is estimated based on DOS' Average Monthly Household Employment Income (Excluding Employer CPF Contributions) Among Resident Employed Households by Type of Dwelling and Average Number of Employed Persons Among Resident and Resident Employed Households by Type of Dwelling. In absence of data on the annual value of different dwelling types, it is assumed that all public (HDB) housing types do not have an annual value exceeding the GSTVCash eligibility threshold while private properties are assumed to have an annual value exceeding the eligibility threshold.
[75] It is assumed that all households residing in public housing qualify for the GSTV U-Save and S&CC rebates.

UK

Average annual household gross income and VAT paid are derived from the UK Office of National Statistics (“ONS”), “Effects of taxes and benefits on household income”, Table 2a: Average household incomes, taxes and benefits (£ per year) of all individuals by equivalised household disposable income quintile group, UK, 2022/23.

Annual household expenditure and VAT burden are estimated based on ONS, Detailed household expenditure by gross income decile group, Financial Year ending 2023.

Table B1: VAT receipts if existing reduced/ zero-rate and exemption reliefs are abolished

Data	(£ million)	*Reference*
Total VAT receipts	159,748	*ONS, Overview of VAT receipts by financial year, 2022-23.*
Add: Costs of non-structural reliefs	22,465	*HMRC, VAT non-structural cost estimates (December 2023), 2022-2023.*
Add: Costs of structural reliefs for: - **Betting and gaming and lottery duties** - **Burial and cremation** - **Education** - **Financial services and insurance** - **Health services**	24,300	*HMRC, VAT structural cost estimates (December 2023), 2022-2023.*
Total VAT receipts if above reliefs are abolished	**206,513**	

Non-structural reliefs
Costs of non-structural reliefs arising from the exception from compulsory registration for VAT for traders with taxable supplies below the registration threshold are excluded from the above, since this relief will not be changed under the proposed VAT reform.

Structural reliefs for financial services and insurance
It is recognised that the costs of structural reliefs for “Financial services and insurance” include life insurance, reinsurance and non-fee based financial services supplied to purchasers who are unable to recover VAT, had it been charged (i.e. mainly supplies to non-VAT registered consumers). Such services may remain exempt from VAT after the proposed reform. In absence of publicly available data to estimate the components remaining exempt, we have included the full amount in the computations. The additional VAT receipts are expected to be lower after excluding such exempt financial supplies.

Table B2: Annual household VAT burden based on a broad-based single VAT rate at 18% (in £ million)

Income deciles	Current VAT payable	Additional VAT payable	Increase/ decrease in net VAT payable - Full VAT offset for lower-income households	Increase/ decrease in net VAT payable - Tiered VAT offset for lower- to middle-income households
1	2,434	1,922	-2,434	-2,434
2	3,457	2,128	-3,457	-2,899
3	4,619	2,282	-4,619	-2,894
4	5,834	2,483	-5,834	-1,675
5	6,099	2,804	2,804	-757
6	7,241	3,041	3,041	470
7	7,606	3,045	3,045	3,045
8	8,946	3,477	3,477	3,477
9	10,088	3,834	3,834	3,834
10	11,610	4,689	4,689	4,689

Current and additional annual VAT burden are estimated based on ONS, Detailed household expenditure by gross income decile group, Financial Year ending 2023.

Tiered offsets are modelled based on the following VAT offsets for the lower-income to middle-income deciles:

Income deciles	VAT offset received
1	100% of total annual VAT payable
2	90% of total annual VAT payable
3	75% of total annual VAT payable
4	50% of total annual VAT payable
5	40% of total annual VAT payable
6	25% of total annual VAT payable

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