Optimal VAT Threshold(s)[*]

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Abstract

A popular element of a Value-Added Tax (VAT) tax system is the existence of threshold, the requirement, that is, of firms to register for VAT after their economic activity (turnover) exceeds a given level. This paper revisits the issue of VAT threshold, and seeks answers to a) what is the actual optimal level of the threshold? and b) is the optimal VAT threshold across the chain of production uniform or not and so different sectors should be treated differently along the production chain? It is shown that capturing production interdependencies along the production chain gives rise to different policy prescription regarding the size of the threshold, than the one that is popular amongst tax authorities.

Keywords: VAT notches; VAT thresholds.

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