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THE VALUE-ADDED TAX:
EXPLORING WHETHER SPAIN'S VAT COULD WORK IN THE UNITED STATES

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ABSTRACT

The United States currently faces rising deficits and a large and looming national debt. Speculation abounds on whether rating agencies will downgrade the US from its coveted top rating due to questions regarding the sustainability of the current fiscal policy. There are many different theories and proposals circulating to address this issue, and one of them is to implement a European-style value-added tax (VAT). In order to maintain the current level of governmental spending, and ideally to pay for a reduction of national debt as well, it is evident that additional tax revenue must be raised, and value-added taxes have had much success in raising significant revenue for governments all around the world.

The purpose of this thesis is to explore the research question “Would Spain’s value added tax system work in the United States?” This text contains an overview of the particulars surrounding a value-added tax, including its history, the basic concepts, an example, the possible calculation and administration methods, its benefits, and its drawbacks.

There are several reasons a value-added tax is seen as attractive for the US, and these are presented and explored. Also explored are the various barriers to implementation that exist. Particular attention is paid to the general perceptions regarding value-added taxes in the United States, and the prevalent fear that implementing a value-added tax would lead to a larger and more spendthrift government. Finally, a conclusion is presented - while there are many positives associated with a possible U.S. VAT, the numerous barriers to implementation are likely to impede a VAT, especially until such a time that the popular perceptions of the tax become more favorable.

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<u>Introduction</u>

"The emergence of VAT as an important and elastic source of revenue over the last four decades is unparalleled in the history of taxation" (Kamineni). The first value-added tax can be traced back to France. This VAT was first introduced in France in 1954, but was not mandatory until 1968 (GAO 2008 p. 9). The European Union (EU) passed the first two VAT Directives in April of 1967 which established the basics of the consumption tax, but left the particulars up to the member states ("VAT General Overview"). In May of 1977, the Sixth VAT Directive established uniform coverage for the member states to coordination the VAT. Spain, as a member of the European Union, must follow the VAT Directives promulgated by the EU, in the management of their VAT. For this reason, much emphasis is placed on a value-added tax as administered in Europe, with details particular to Spain interspersed throughout. Spain's particular value-added tax is called the IVA (*Impuesto sobre el Valor Añadido*), and is administered by the State Tax Agency (*Agencia Tributaria)*, under the auspices of the Ministry of Economy and Finance (*Ministerio de Economía y Hacienda*). Spain is composed of seventeen Autonomous Communities (*Communidades Autónomas*), which are somewhat similar to our states in the United States. Spain's most recent IVA Handbook states that the national government is in charge of collecting the IVA, but it remits half of the receipts attributable to a particular Autonomous Community to that Community (España).

According to an OECD estimate, approximately 136 countries, including most major economies other than the United States, utilize some sort of value-added tax. The VAT has been described as "the Mata Hari of the tax world - many are tempted, many succumb, some tremble on the brink, while others leave only to return, eventually the attraction appears irresistible" (Kamineni). The same wordsmith, Alan A. Tait, formerly of the International Monetary Fund (IMF), states later in his book <u>Value-Added Tax: International Practice and Problems</u> that that "the history of taxation reveals that no other tax that has swept the world in some thirty years from theory to practice, that has carried along with it academics who were dismissive and countries that once rejected it."

Value-Added Tax Overview

Explanation

A value added tax is a tax on consumption, and as such it is similar, but not equivalent, to a sales tax. In the United States a sales tax is a tax levied on the final price of goods or services. Each state has the ability to institute their own sales tax on the goods that are sold within the state. There is no national sales tax in the United States; it is completely up to the individual states to decide whether or not to implement a sales tax and to determine the rate. Some cities, usually only the larger metropolises, also levy a supplementary sales tax. In addition, some states do not levy sales tax on essential items, such as food and clothing. Each business collects sales tax on its sales and remits the tax to the appropriate state or local government. Sales tax is not remitted to the federal government.

Unlike a sales tax, a value added tax (VAT) is not levied solely on the final sale of the good or service to the consumer, rather it is levied throughout the production process. A VAT is a national tax levied on each stage of the production process. Unlike a sales tax, it is not added on top of the price at the register, but rather is already included in the price listed at a retail store, and so it is also called a "hidden tax," especially by its critics. As a sales tax is a flat tax levied on the price of every sale and separately listed on the receipt, it is very easy to understand (especially since Americans have much experience with it). Also unlike a sales tax, the tax is assessed on every sales transaction, even business to business transaction, and so every business, not just retailers, has to charge the tax and remit it to the government (GAO 2008 6).

In most developed countries of the Organization for Economic Co-operation and Development (OECD), except Japan, the VAT is calculated using the credit-invoice method (GAO 2008 6). Under this method, businesses apply the tax rate to their sales figure, but then they take a credit for the VAT they paid on the inputs purchased from other businesses (evidenced on purchase invoices). The difference between the VAT collected and the VAT paid on input purchases is remitted to the government. In the end, "the final consumer ultimately bears the economic burden of the tax" and a VAT and retail sales tax (RST) of an equivalent percentage would produce the same amount of revenue. A major difference, though, is that the number of businesses collecting tax is significantly greater under a VAT, because all businesses selling a taxable good or service would be required to collect the VAT, not just retailers. Due to this, however, businesses are relieved of the burden of verifying the whether customers really are businesses, and therefore not charged sales tax.

Two other methods of calculating a VAT are the subtraction method and the addition method, but they are not as widely used as the credit-invoice method. If a VAT is calculated using the subtraction method, the difference between the value of the output and the cost of the input is multiplied by the tax rate to arrive at the amount of VAT to be collected on the transaction (Kamineni). The addition method sums all the value-adding components (such as wages, salaries, overheads, etc.) and multiples the sum by the tax rate to determine the amount of VAT to be collected.

Example

A value added tax is a bit more confusing than the retail sales taxes Americans are accustomed to in the United States, and perhaps is better explained with an example. Farmer A grows and harvests peanuts and sells them to companies that make peanut butter. Suppose he lives in a region where there is a 10% value added tax. If he sells the peanuts to PB Manufacturer B for $1,000, he pays the government the $100 in value added tax and gives documentation to PB manufacturer as evidence. PB Manufacturer B then makes the peanuts into to peanut butter, packages it, and sells it to Wholesaler C for $2,500, which includes a VAT of $250. PB manufacturer takes a credit of $100 for the VAT already paid on the product, and sends $150 to the government, and gives documentation to Wholesaler C. Wholesaler C sells all the peanut butter to Retailer D (who is having a peanut butter festival and needs a lot of peanut butter) for $3,000, takes a credit of $250 for the VAT already paid, sends the government $50, and gives Retailer D documentation that evidences this. Retailer E sells all the peanut butter to the tourists visiting the festival for a combined $4,000. Retailer E takes a VAT credit of $300, and sends $100 to the government.

VAT Preferences

While theoretically the most efficient, neutral, and effective value-added tax would be a simple single percentage tax levied uniformly on everything, in practice such a simple VAT is rarely implemented. Countries decide for social policy reasons to incorporate exemptions, exclusions, and reduced rates, which generally increase complexity, decrease revenue, and increase compliance risks and administration costs (GAO 2008 p. 25). These types of preferences are not limited solely to a value-added tax, they also are associated with retail sales taxes and income taxes. In additional, while most preferences increase administration costs, some actually serve to decrease it (GAO 2008 p. 18). For example, thresholds that excuse businesses under a certain size serve from collecting VAT serve to lessen the compliance burden on both the businesses themselves and on the taxing authority. Likewise, most countries exempt certain financial services and real estate transactions, which limits the difficult administrative burden of calculating the value-added in those situations, because these items are inherently difficult to tax. Financial services and insurance are usually considered problematic to tax because it is hard to differentiate between the consumption portion of value-added in a financial transaction and the return on investment portion of value-added characteristic of these financial transactions (GAO 2008 p. 23). Real estate and other long-lasting assets are present taxation problems under a VAT, because "long-lived assets, such as residential housing, are a mix of consumption, as the residence is currently lived in, and savings, as the residence provides future housing consumption" (GAO 2008 p. 24-25). One way to measure VAT efficiency is through the OECD's C-efficiency ratio (CER) (GAO 2008 p. 26). The CER is calculated by dividing total VAT revenues actually received by theoretically attainable VAT revenues (national consumption times the country's standard VAT rate), and is expressed as a percentage. Since the CER measures how much of the potential VAT is collected, it is a measure of how much tax preferences and noncompliance reduces the efficiency of the VAT.

Exemptions, Exclusions, and Thresholds

There are various design choices for a VAT related to tax base, such as choosing which goods and services to exempt, choosing which goods and services to exclude (called zero-rating), and choosing which businesses to exempt from collecting VAT (through the use of business size thresholds). For goods and services that are exempt, businesses do not collect VAT on their sale, but they still pay VAT on the inputs used to produce the exempt goods and services, and they are not eligible credits to recover that VAT already paid. Some generally exempted goods and services are legal aid, medical care, and education. The European Union specifically mandates that member states exempt certain financial transactions (GAO 2008 p. 53). Spain itself also exempts education, certain cultural activities, and resale of property, among other items ("Spanish Tax Rates"). Exempted goods and services effectively only eliminate the VAT on the last stage of production; VAT is still paid on production inputs, and is not recovered by the business, so this VAT is still passed on to the final consumer. Exempted goods also have the downside that, since VAT is not levied on their sale, businesses that use exempted goods as an input have previously paid VAT as a portion of the exempted product's cost, but they cannot take a credit for any of that VAT paid when they sell their product, essentially taxing VAT already included in the price and created tax cascading. The Government Accountability Office describes tax cascading as "when an exempt good or service is later used in the production of a taxable good or service, leading to a tax being levied on a tax" (GAO 2008 p. 54). Another difficulty arises when a business uses shared inputs, such as computers, to make both exempt and taxable services. In such a case businesses must allocate what percentage of the VAT on shared inputs is used for taxable goods in order to properly claim the VAT credit (GAO 2008 p. 53).

To avoid these downsides associated with exempting, goods and services can be excluded, which is referred to as zero-rating. Businesses apply a VAT rate of zero when selling zero-rated goods and services, essentially collecting no VAT on sales just as with exempted sales, but under zero-rating businesses are able to receive a refund for the VAT paid on inputs. This avoids tax cascading issue associated with exemptions. Goods and services that are generally zero-rating include child care, groceries, and children's clothing. Spain has two types of "exemptions": "limited exemptions" (*exenciones limitadas*), exemptions as defined above, and "full exemptions" (*exenciones plenas*), which is what we have defined here as zero-rating (España). Spain's zero-rating is only applicable to exports.

Another preferential treatment is the use of business thresholds. The taxing authority specifies a minimum level of sales a business must have before being required to collect VAT on their sales. This reduces the regulatory burden on small businesses. This, of course, also reduces the total tax revenue received, but overall this is a small segment of total VAT revenue, and a segment with disproportional high administrative costs relative to tax revenue. In Spain, however, there is no threshold to exempt small businesses (European Commission, "Annex 1"). Unlike other VAT preferences, thresholds can actually decrease administrative costs and compliance burden, since smaller companies usually have a relatively higher burden with complying with the VAT than their larger counterparts. The U.S. Government Accountability Office reports that "a high threshold can eliminate a large amount of VAT administrative costs while retaining much of the VAT revenue" (GAO 2008 p. 28). While implementing thresholds seems to bestow a boon on small businesses, many small businesses will voluntarily register even though they are below the threshold (for example, in Australia, one-third of VAT registered businesses are below the threshold). Small enterprises choose to register as a matter of necessity to stay competitive - "many larger companies will only conduct business with other VAT-registered businesses to make record-keeping easier" (GAO 2008 p.29).

Multiple Tax Rates

A further design choice is to implement multiple tax rates for different categories of goods. For example, necessities are charged reduced VAT rates, while luxury goods are charged higher VAT rates. Spain charges three levels of VAT rates: a standard rate (*tipo general*) of 18%, a reduced rate (*tipo reducido*) of 8%, and a super-reduced rate (*tipo superreducido*) of 4% ("Spanish Tax Rates"). The super-reduced rate applies to "items considered to be of basic and primary need," such as bread, milk, cheese, fruits, vegetables, medicines (for humans), prosthetics, books, and newspapers, among other items ("Spanish IVA Explained"). The reduced rate applies to food in general (other than those taxed at 4%), sodas, prescription glasses and contact lenses, farm animals, agricultural products, funeral services, hotels, restaurants, and hairdressing, among other items. Finally, the standard rate, which is the general rate, applies to everything not specified as taxable at another rate or exempted, such as alcoholic beverages, tobacco, television, and entertainment devices.

While it might seem reasonable to have tax preferences to combat the perceived regressivity of the VAT, "…tax officials and VAT experts said that complexity increases administrative costs and compliance burden and creates opportunities for noncompliance" (GAO 2008 p. 27). Preferences add complexity to the tax code, which leads to more time and money being needed to audit returns and educate businesses. Preferences, while good in theory can be extremely hard to understand and manage. Take groceries for example. In many countries, basic groceries are either zero-rated, or taxed at a reduced rate; in Spain, as mentioned above, they are taxed either at the reduced rate of 8% or the super-reduced rate of 4%, depending on what category the food falls into. In Canada basic groceries are zero-rated, but basic groceries do not include snacks. Determining what counts as a snack can be a complicated question. "These distinctions between goods are not always intuitive. Changes in ingredients, packaging, and temperatures can lead to different VAT treatments" (GAO 2008 p. 27). For example, again with

Canada, salted peanuts are taxable while non-salted are not; buy less than six donuts and they are taxable, more than six and they are not. As you can see, determining what tax category goods belong to can be difficult. "Businesses that sell groceries have the additional burden of correctly categorizing their sales and face the compliance risk of charging the wrong VAT rate on their sales" (GAO 2008 p. 27). However, it is not just grocery stores that have the additional burden of characterization, other retailers also share this burden. For example, in England, children's clothing is zero-rated while adult clothing is taxed at the standard rate; while these does not sound too complicated on the surface, drawing the line between adult and child's clothing can be more difficult than immediately apparent. This has led to some rather arbitrary categorization rules, such as bra's under a certain size being zero-rated, while bras over a certain size are taxable (Stelzer).

Exports and Imports

Another issue to keep in mind with a VAT is the treatment of exports and imports. Exports are usually zero-rated (termed *exenciones plenas* in Spain), meaning companies charge no VAT on exports, but they can file for a refund of the VAT paid on inputs used to produce the exported product. This treatment is perceived to promote exports. As for inputs, they are charged VAT at the receiving country's appropriate rate upon importation. Some countries have import deferral programs that allow registered approved importers to pay VAT on imports on regular payment intervals instead of paying VAT immediately upon the arrival of each individual shipment (GAO 2008 p. 32). This reduces the compliance burden on importers, allowing them to aggregate VAT payments on several shipments, hopefully after the goods were sold so as to not impose a further cash flow burden on the importer. Implementing an import deferral programs also decreases the VAT administration costs of the taxing authority, because there are then a lesser number of individual payments and paperwork submissions to process. It is worth keeping in mind that this program is usually not available to all importers: "businesses must apply for this program, and use of the deferral scheme is limited to businesses with an established history of compliance with the tax administration agency" (GAO 2008 p. 32). For this reason, were a VAT to be implemented in the United States, the taxing authority might not choose to implement this type of program immediately due to a lack of VAT history, and therefore both the compliance burden on importers and associated administration costs for the taxing authority could be even higher in the early years than for other VAT countries.

Benefits of a Value-Added Tax

Economically Neutral

Economists consider the major benefit of a value-added tax to be that it is an "economically neutral" tax. The Government Accountability Office says "A tax is said to be 'neutral' if it does not change the relative prices of goods and services" (GAO 1989). Economic theory assumes that economies operate most efficiently when all decisions are made purely on the basis of prices derived from the market; therefore tax neutrality is a desirable outcome when designing a tax system. A value-added tax is considered to be economically neutral because it does not create a preference between capital and labor. Payroll taxes, for example, are considered by many to make the cost of labor more expensive (some people on the other hand, believe that payroll taxes are either passed on to employees themselves or to the ultimate consumer and as such are not borne by the business at all, but such a discussion is beyond the scope of this thesis). Because labor is relatively more expensive, it is thought that businesses then have an incentive to prefer capital over labor, which would then lead to investing in equipment that reduces the need for labor, for example. A VAT is economically neutral because it avoids creating these sorts of preferences. A 2008 study by the Organization for Economic Cooperation and Development (OECD) analyzed the effect of different taxes on countries' economies and concluded that of the taxes studied, corporate income taxes are the most detrimental for growth, followed by personal income taxes, and then ultimately consumption taxes ("America the Uncompetitive").

Encourages Savings

Another benefit often touted by proponents of a VAT is the fact that a consumption tax is thought to encourage savings, or at the very least is not biased against savings. VATs generally tax most goods and services, but financial services are extremely hard to tax on the basis of value added; for this reason, in many countries financial services are not taxed by a VAT (GAO 2008). Due to this preferential tax treatment, savings are seen to be relatively more attractive under a VAT. This is in direct opposition to the incentives created by the income tax. "Under an income tax, when a family saves more its tax burden increases, due to the tax on interest" (GAO 1989).

VAT advocates claim that by removing the bias against savings, a VAT would encourage savings which would in turn stimulate the economy. There is no clear consensus, however, on whether such an outcome would actually come to pass. A 1998 analysis from the U.S. International Trade Commission (ITC) indicated that implementing a consumption tax, such as a VAT, would likely increase capital investment in the United States from abroad (Rankin, "To VAT"). The benefit is tempered by fact that the increase would most likely be temporary; regardless, the ITC concluded that such an increase would improve productivity, thereby improve national economic welfare. Despite some proponents assertions that a VAT would be good for the U.S. with respect to international trade, the ITC experts concluded that a instituting a VAT would be "unlikely to have a long-run effect on the overall U.S. trade balance." On the whole, the ITC determined that a VAT would have a general "positive impact on U.S. Gross domestic product and wage rates." Another benefit of a VAT as compared to an income tax is that it avoids complications such as determining depreciation and capital gains (GAO 2008 p. 2).

Revenue Raising Effectiveness

One of the clearest reasons for the value-added tax's widespread application is its sheer effectiveness at raising revenue, and, given the current high budget deficits in the United States, some believe the country needs more tax revenue. "The general position of the VAT proponents is that the long-term costs of meeting the Medicare and Social Security obligations of a rapidly aging population, coupled with the need to reduce the federal debt and reform the income tax, require an additional federal revenue source." (Duncan). In theory, the base for a VAT can be as large as the consumption component of the gross domestic product. Even exempting a few vital goods and services (for example, groceries and health care), estimates for each percentage point of a US VAT range from $50 billion to $100 billion. In addition, consumption spending does not fluctuate as much as income; therefore, a VAT would be a much more constant and predictable source of revenue than the income tax is. Furthermore, a consumption tax would cover a broader base than our current income tax; everyone consumes something, but only half of U.S. citizens pay income tax (Rove). Another benefit to a VAT is that while the tax burden is eventually borne by the consumer, businesses collect the tax and remit it to the government, minimizing the number of parties the tax body has to deal with and avoiding "issues related to collecting taxes from individuals" (GAO 2008 p. 2). A VAT "has the enormous virtue of raising large revenues at a low economic cost - discouraging less economic output per $1 raised than any other tax that economists know of" ("Bartlett").

Self-Enforcing

Another factor in a VAT's effectiveness is the fact that it is seen to be self-enforcing. While there are a few ways to calculate VAT (the subtraction method, the addition method, and the credit-invoice method), the vast majority of VATs implemented around the world follow the credit-invoice method, because this is the method mandated for inclusion in the European Union ("VAT General Overview"). In the credit-invoice method each consumer business along the production process receives an invoice from the seller from which they are buying business inputs. This invoice lists the amount of VAT already paid on the input. To be able to take a credit for the VAT already paid on inputs, both the business consumer and the business seller must be registered in the VAT office, the business seller must have collected VAT on the sale to the business consumer, the business consumer must have record of this on a VAT invoice, and the business buyer must have record of the price at which he eventually sold final product to the final consumer and the VAT collected on that transaction. If the seller business is not registered with the VAT office and does not collect VAT on its sales, the business consumer cannot take a credit for the VAT already paid in the production process (GAO 2008). This creates an incentive for VAT registered businesses to do business only with other VAT registered businesses. For this reason, even when small firms are exempted from having to register with the VAT office and collect VAT, many of these small firms voluntarily choose to register in order not to limit the market for their goods and services.

The self-enforcement attribute of a VAT can be contrasted with a retail sales tax (RST). With a VAT the tax is collected at each step of the production process and remitted to the government, and records of what the appropriate tax should be are maintained and distributed along the way in the form of invoices. "Invoices allow tax administrators to track taxes owed the government" (GAO 1989). This serves as a deterrent against tax evasion, as a means of enforcing and auditing the levy of the tax, and as an incentive to deal only with those who also collect VAT. Because the tax is levied on the value added during each step of the process and remitted to the government at each step, even if tax is evaded during one of the production stages, the government still receives more tax revenue than it would in the case of a RST where a retailer did not collect or remit sales taxes on the sale of a good to a final consumer (in which case the government would receive no tax revenue from the good, because a RST is only levied on the sale of the good to the final consumer; with a VAT, on the other hand, the government would still receive the VAT collected at the other various stages of production). The tax evasion possibility under a VAT can also be favorably contrasted with the tax evasion possibilities under a personal income tax (Miller). To avoid paying income tax, a criminal could conceivably be paid "under the table" and not report this income to the IRS, thereby reducing government tax revenues. Under a VAT however, even criminals make the majority of their purchases at law-abiding retailers, which would responsibly charge VAT on the purchases and timely remit the tax revenue to the government.

Criticisms of a Value-Added Tax

Regressivity

One of the major arguments against a value added tax is the tax's perceived regressivity. The United States tries hard to levy taxes so that those who are in a better position to pay the tax are assessed a great portion of tax than those who are less able to endure the tax burden. This is the hallmark of a progressive tax system, demonstrated for example in the tiered rates of the United States income tax, wherein the higher income a person has, the higher the rate of tax assessed on the individual. Regressivity in tax is just the opposite - a tax is said to be regressive when those less able to afford it pay a greater portion of their income in tax than those more able to afford it. The value-added tax is seen as regressive because lower-income individuals use more of their earnings for consumption than higher income individuals. Proponents of a value-added tax argue the degree of regressively can be mitigated through the use of exemptions, zero-rating, preferential rates, and tax credits. These solutions, however, have their drawbacks, as previously mentioned; they reduce the tax base, thereby reducing the revenue-raising capabilities of the VAT, and increase the complexity, thereby increasing the administration costs.

According to the Tax Policy Center, however, payroll taxes are more regressive than value-added taxes, so replacing payroll taxes with a VAT could help to make the U.S. Tax system less regressive (Crook). Furthermore, Democratic senator Ernest Hollings of South Carolina stated, with regards to a 1994 VAT proposal, that while a value-added tax "does fall disproportionately on lower income brackets," it is "not nearly as regressive as interest costs on the national debt" (Rankin, "VAT Rears"). He argued that the public debt has an inflationary impact on the economy, and therefore disproportionately burdens the poor to a greater extent than a value-added tax would, provided that the VAT would be used to reduce the national debt and its associated interest costs.

A value-added tax would increase the prices of goods and services without a corresponding increase in wages. Therefore the average family's purchasing power would decrease. Consumers would then have to put off purchases longer, especially purchases of high-ticket items, in order to be able to pay for them. In the short-term this decrease in consumption would hurt retailers, further stressing a sluggish economy (Miller). Lower income individuals, especially individuals on fixed incomes such as senior citizens, would have the highest burden to bear as a result of VAT (Norquist). They would see their purchasing power decrease considerably. Likewise, all Americans would see purchasing power reductions, leading to a reduction in the U.S. standard of living.

Additionally, while economic theory states that instituting a VAT will have only a one-time effect on prices, correspondent with the imposition of the new tax, one article asserted that European experience indicated otherwise (Banks, "Oh!"). The article then stated that marketing departments tend to set prices at the familiar 95 and 99 price terminations. He then hypothesized that businesses would take advantage of the higher, atypical prices that would accompany a VAT, and further increase prices, rounding the prices up to attain more familiar price terminations.

The burden of a VAT in the United States would also fall disproportionately on senior citizens, especially if it replaced or reduced the personal income tax, as many advocate (Miller). Senior citizens, living on a fixed income and savings that they already paid taxes on, and unlikely to earn more wages on which to enjoy any potential income tax reduction, would then have to pay taxes on their consumption on top of the income taxes already paid. This implies a sort of double taxation, and it would lead to an unaffordable cost-of-living increase. Given that social security benefits are adjusted for cost-of-living, there is the concern that a VAT "would feed through into government cost-of-living adjustments and become, all in all, a price ratchet" (Banks, "Oh!").

Too Good at Raising Revenue

One of the most cited criticisms of the possibility of instituting a VAT in the United States is seemingly paradoxical: It is argued that the value-added tax is *too* good at raising revenue. Generally speaking, a tax is meant to raise revenue for the government, so one might think that a tax that achieves its purpose well is a good thing, but apparently this outcome is a concern for Americans. The value-added tax is a broad base tax on almost all goods and services, and as such it has massive revenue-raising potential. Irwin Stelzer of the Hudson Institute has estimated that every percentage point of a VAT rate would raise about $100 billion each year (Stelzer). Americans for Tax Reform, on the other hand, have estimated that every percentage point of a VAT would raise about half that (Norquist), but $50 billion annually per percentage point is still a massive amount, especially considering some proposals call for a U.S. VAT as high as 18% ("Europe's VAT Lessons"). While some proposals being thrown about are for a small VAT, between 5 and 9%, critics argue that the tax will not stay at such low levels, but instead the government will increase the VAT whenever they need more revenue. And with such an easy "fix," why bother to minimize expenditures in the first place, critics argue. The Wall Street Journal has also stated that they "worry about a VAT turning into a runaway money machine for the government" ("America the Uncompetitive") and that the "VAT is one reason the government swallows such a large chunk of GDP in Europe." ("The Abolitionist").

Popular concerns include that it will be too easy to raise revenue with a VAT, that it will be too easy to raise the VAT to raise even more revenue, and that this ease will induce the government not only to continue massive spending, but also to raise spending even further. Some people may believe that this line of thinking comes a little too close to Chicken Little yelling about how the sky is falling, but critics point to the European example. The VATs as originally introduced in Europe started low and have increased to near 20% in many cases (there is a requisite minimum 15% VAT to even be in the European Union). Spain's particular experience also exhibits the trend of increasing VAT rates. The first VAT in Spain was introduced in 1986, had a standard rate of 12% in 1990, a standard rate of 16% in 2000, and a standard rate of 18% in 2010 (Sullivan). VAT critics argue that the tax has contributed to the increase in government size in European countries over the past fifty years. They worry that the same thing could happen here in the United States. One commenter stated that he wonders "whether opening the door to a value-added tax…isn't making a long-term deal with the devil in order to solve the current economic mess" ("Two Cheers").

While it is well-known that correlation does not equal causation, "VATs are associated with both higher overall tax burdens and more government spending" (Mitchell, "VATs Mean"). In 1965, before the VAT took root in Europe, average taxes as a percentage of GDP in the EU-15 (the first 15 countries to join the European Union: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom) was fairly close to that of the United States: 27.7% of GDP in the EU-15 compared to 24.7% of GDP in the U.S. This drastically changed by 2006 though: U.S.'s tax burden as a percentage of GDP had risen to 28%, but the average for EU-15 has leaped ahead to 39.8%. Government spending, as opposed to tax revenue, as a percentage of GDP also demonstrates a widening gap over the same time period between the countries that have the VAT and the country without a VAT (almost the lone contender for that title): U.S.'s percentage increased from 28.3% of GDP to 35.3% of GDP, while the EU-15's percentage increased drastically from 30.1% to 47.1%. VATs in Europe have not even resulted in less government borrowing, another cited possible example of a VAT ("Europe's VAT Lessons"). From the 1980s through 2005, deficits were usually higher in Europe than in the United States; by 2005, per Organization for Economic Co-operation and Development (OECD) data, debt averaged 50% of GDP in Europe while U.S. debt as a percentage off GDP came in slightly under 40%.

One of the reasons opponents are against the VAT, and one of the reasons opponents believe it will be too easy to raise a VAT once implemented, is because the VAT is considered a hidden tax. It has been called "a stealth tax that raises huge amounts of revenue but shows up only in higher prices for consumers… It's silent but deadly" ("The Abolitionist"). A sales tax in the United States shows up on your receipt as a separate line item, clearly specifying the amount of sales tax being paid on the transaction. This is not always the case under a value-added tax system; VATs are generally included in the quoted price of goods and services and not listed separately on receipts.

Additionally, critics contend that "a VAT is by its nature hidden, because no one files a tax return" (Christian & Robbins, "The Dangers"). A tax return shows your total aggregated income, and shows the total income taxes that you have due and have paid on that amount. This makes the amount of income tax paid per year very transparent, and it makes it quite simple to calculate your effective tax rate. A VAT does not have the same transparency. Business are easily able to calculate the VAT they have paid, because these amounts are listed on the VAT invoices used to as credits against VAT they remit to the taxing authority, but the VAT paid is rarely so transparent for consumers. Most retailers list prices with the VAT already included. Obviously, a consumer could research the VAT percentage applicable to their transactions, and then work backwards to determine the amount of value-added tax they paid on the transaction, but it would seem unlikely to expect a consumer to put forth that extra effort, especially if it is not immediately apparent that they are actually paying tax on the transaction. VAT opponents say this leads to a situation where the government can easily raise the VAT raising without garnering much notice, because consumers will only see a price increase and blame it on "greedy businessmen" ("It's No Wonder").

The greater public spending and taxation in Europe is also cited as a reason "for lower levels of income growth and job creation" ("Europe's VAT Lessons"). In the United States, 45 million jobs were created in the period of 1982 to 2007, while less than 10 million jobs were created in Europe. According to the Bureau of Labor Statistics, U.S. economic growth over the same time period was also one-third faster than European economic growth. Along this vein, opponents worry that the imposition of a value-added tax in the United States will place a further burden on the economy, which may halt the recovery: "On its way out of the recession, the economy may encounter a VAT blocking its way" (Christian & Robbins, "The Dangers").

Economist Martin A. Sullivan set out to refute these fearful assertions in a recent article (Sullivan). Attempting to answer the titular question "Was the VAT a Money Machine for Europe?", he found that European VAT increases were accompanied by income tax increases, payroll tax increases, and *reductions* in excise and sales taxes. He calculated that about 38% of average European tax level increases could be traced back to VATs, but when you take into consideration the accompanying decline in excise and sales taxes, "only about 8 percent of the huge expansion in European taxes can be attributed to the VAT." Even if a VAT were responsible for the burgeoning tax levels in Europe, Mr. Sullivan asks why the same result would be inevitable here as many commentators seem to think. Mr. Sullivan points to our northern neighbor as an example of a VAT done right and proof that a VAT does not have to be a harbinger of government expansion. In Canada, the Goods and Services Tax (GST; their version of a VAT) replaced a less efficient sales tax in 1991, and bucked European convention by being highly visible for the end consumer. The GST was unpopular and widely debated, rather like the possibility of a VAT in the United States. Unlike Europe's example, the GST rate has decreased over the years, first to 6% in 2006, and then to 5% in 2008. Also unlike Europe's example, taxes as a percentage of GDP has also decreased since the implementation of their VAT, from 36% in 1990 to 33 percent in 2007. Mr. Sullivan argues that a VAT implementation in Europe could follow in the positive footsteps of Canada rather than the welfare-state progression of Europe.

Unfamiliar to the U.S.

Another obstacle with the VAT is that it would be a completely new tax for the United States. Even with U.S. multinationals value-added taxes are not always familiar: "because VAT is rarely identified as a separate item in U.S. Accounting systems, however, it assumed an almost invisible status and slipped under the radar for a long time" (Walsh). Most developed countries with a VAT previously had an earlier broad based consumption tax. The United States has not. This lack of familiarity will translate to greater administration needs and costs, everything from teaching businesses what it is and what to do, to hiring many more revenue workers to handle VAT administration and compliance. A recent GAO report studying VATs in other countries stated that the tax took between 15 to 24 months to implement abroad, and this was in countries that had already had the experience with and the infrastructure in place for a national consumption tax (GAO 2008 p. 5).

"Some sectors of the economy, specifically financial services, insurance, real estate, and second hand goods, are inherently difficult to tax under conventional value-added tax (VAT) rules" (GAO 2008 p. 53). Going from no national consumption to a VAT can exacerbate these difficulties. To address the issue of second-hand goods, some countries use a margin scheme, under which VAT is paid on the difference between the selling price and the fair market value of the property on the date VAT was originally introduced (GAO 2008 p. 55). Under such a margin scheme, VAT is then paid only on the value added during the period the value-added tax has been in force. Margin schemes of these types are especially used to tax the sale of pricey used goods, such as art and antiques.

With respect to real estate there are also several problems (GAO 2008 p. 55). Since a VAT is meant to tax consumption, it is inherently difficult to tax real estate, which is partially current consumption and partially saving, or investing currently for future consumption. Another difficulty with assessing a VAT on real estate appears during initial VAT implementation. Some countries, for example Australia, have chosen to tax new residential housing at the standard VAT rate, but exempt the resale of existing housing. This has led to disproportionate increases in the prices of new houses, which induced the Australian government to institute a grant system to compensate for the increase in housing prices. The Canadian government has a similar housing credit that partially refunds VAT amounts paid on new housing and capital improvements. The housing market in the United States is already down due to the economic downturn, and the price gap between new and existing homes has tripled since 2006 as a result of all the foreclosures (Andriotis). Implementing a VAT could further exacerbate this price gap, putting additional stress on a housing and construction market that cannot bear it.

Implementation

According to the GAO, implementation of a value-added tax in the United States would likely involve "multiple agencies, the development of new policies and processes, and hiring of additional staff" (GAO 2008 p. 40). As previously mentioned, unlike most other developed countries that have implemented a VAT the United States does not already have the infrastructure of a previous national consumption tax to build upon. In the countries examined in the GAO report, the multiple agencies involved in VAT implementation varied by country, but usually included the Customs Agency (in charge of managing imports), the department in charge of VAT policy, the treasury department, and the department of social security and/or public welfare (to manage efforts to offset the regressivity of the tax). During implementation the countries studied "gave agencies specific responsibility for monitoring the transition and its impact on consumer pricing. These offices worked to ensure businesses did not artificially inflate prices to take advantage of uncertainly during implementation" (GAO 2008 p. 40)

Another vital implementation task is the creation and evaluation of test forms and returns. It is important to develop and test the forms early in the implementation process, because they are needed for effective business VAT education. While the countries examined in the GAO study already had personnel in place to administer the VAT, they also needed to hire and train a significant number of additional personnel. Many of these new staff members were needed only for initial educational efforts (to be on hand for customer questions, to present seminars, to write instructional and reference literature), but adding a new tax obviously entails hiring additional personnel to administer it. The GAO has indicated that VAT implementation took between 15 and 24 months in the various countries studied. In Canada, a good deal of the planning and initial work was actually started in the two years before the legislation was passed.

"Before entities subject to VAT requirements can be expected to comply, they must know what those requirements are and what they mean to specific economic and industry sectors" (GAO 2008 p. 41). For this reason, countries implementing a VAT must expend significant time and effort to develop comprehensive outreach and education ventures. Some of the strategies that have been employed by other countries include: targeting major players in various industries and enlisting them to help educate others; providing VAT education classes for the accounting industry; and assisting small businesses directly (for example, through help-lines, and one-time tax credits) and indirectly (for example, through grants to community groups and organizations). Governments indicate that industry partnerships are especially helpful at transition, not only for educating businesses, but also for receiving feedback from businesses on concerns they have regarding the VAT. Education efforts are vital, but costly; Australia spent approximately $464 million on education endeavors during transition, and Canada spent $98.5 million (GAO 2008 p. 42-43).

Compliance

While one of the perceived benefits of the value-added tax is its perceived self-enforcement, that is not to say that there are no compliance issues that the taxing authority will have to deal with. The Government Accountability Office reported in a 2008 report that all VATs they surveyed had compliance risks which generated administrative costs. Additionally, as the VATs increased in complexity, they also increased in administrative burden, because there exists "the incentive to avoid tax by misclassifying goods or services as exempt or excluded" (GAO 2008 p. 4-5). There are two main categories of compliance risk for VAT: underpaying taxes owed on sales, or overstating taxes paid on input purchases (GAO 2008 p. 13). Significant compliance issues include refund fraud (business with taxable sales less than taxable purchases are entitled refunds), missing trader fraud (in which a dishonest individual sets up business for the sole purpose of collecting VAT on sales, and then disappears), and carousel fraud (a complex type of fraud where criminals take advantage of export exemptions to sell a product back and forth across a border to abscond with VAT refunds) (GAO 2008 p. 56 & 57).

Other compliance risks include failed businesses (a business fails before remitting VAT collected to the government), underreporting cash transaction (the business either charges less or no VAT on cash sales, or underreports the sales and keeps the VAT collected), misclassifying purchases (a business claims tax credits for personal purchases, not business input purchases), fraudulent invoices (a business creates or alters a VAT invoice to pad the amount of input tax they will take as a credit to VAT collected), and export fraud (since VAT is not levied on exported goods, and exporters take a credit for the amount of tax they paid on inputs, a dishonest business creates fraudulent export invoices and takes credits on goods not actually exported). In a GAO study, all countries analyzed "devoted a significant amount of resources to audit activities and all used a risk-based audit selection approach in the administration of their VAT" (GAO 2008 p. 29). A risk-based audit selection approach involves automated procedures that compare thresholds, industry averages, and past VAT dealings with current VAT submissions. Since fraudulent refunds are one of the major compliance risks with a VAT, refund requests are met with a high level of scrutiny. According to Canadian tax administrators, the recovery rate for paid fraudulent refunds is close to zero; accordingly, in many countries preventing fraudulent refunds is the chief enforcement concern. "A VAT's reliance on credits and refunds makes the tax more susceptible than an income tax or RST to the compliance risks of fraudulent refund claims" (GAO 2008 p. 14). Compliance risks are not limited to VATs, of course; complex depreciation rules can leave room for misclassification, intentional and unintentional, of assets under an income tax; and under a RST a seller must determine whether the purchaser is truly exempt from sales tax. Jean-Luc Peyret of the French National Association of Financial Managers and Directors claims that VAT fraud is estimated at 13% in Europe, while sales tax fraud in the United States is estimated to be around 40% (Cheney).

Administration Costs

As with any tax, there are administration costs associated with a value-added tax. These costs include those for processing returns, educating businesses, and auditing and enforcing activities (GAO 2008 p. 15). In two treasury studies in the 1980s, it was estimated that a simple, single-rate VAT (the least expensive type of VAT to implement) would cost almost $1 per $100 collected in revenue, and would necessitate 20,000 extra personnel members (Banks, "Oh!"). This can be contrasted with the Internal Revenue Service collection costs from the same time period of approximately $0.60 per every $100 collected. In a 1993 report, the Government

Accountability Office estimated that over 70% of yearly administration cost would be related to compliance activities. However, studies also show that collection costs for a VAT are approximately half collection costs for an income tax. "According to European Commission officials, VATs in Europe cost between 0.5 percent and 1 percent of VAT revenue collected to administer" (GAO 2008 p. 15).

Estimated compliance rates are not widely available, but over the five-year period between 2002 and 2007, the United Kingdom estimated a VAT tax gap between VAT receipts and estimated true VAT liability of between 12.4% and 16.1% of the estimated true VAT liability (GAO 2008 p. 34). Other EU countries have not made such detailed inquiries into the possibility of a VAT gap, but on the whole a tax gap of around 10% is estimated. This can be contrasted with a total 17% gross tax gap that was estimated for the United States in 2001.

Integrating tax administration and compliance for a country's various taxes could benefit both tax administrators and businesses by reducing the amounts of paperwork a company must file with various agencies and by increasing the amount of data auditors have access to (GAO 2008 p. 33). But, like many ideal situations, an integrated tax administration has not been achieved in the countries studied by the GAO. One limitation can be software - as different taxes frequently mean different legacy computer systems that are incompatible with each other. Since United States has had no previous national consumption tax, we would be starting from scratch, and it could perhaps be possible to create a computer system that that would integration with the IRS and Custom's systems, but it's likely that both the IRS and Custom's systems would need a major overhaul to be able to integration VAT functioning. Another limitation to integration is the differences between the taxes with respect to personnel needs - "skill sets required by VAT auditors and income tax auditors are different, making separate audits sometimes a more practical approach" (GAO 2008 p. 33).

The Congressional Budget Office (CBO) has estimated that the implementation of a VAT would cause at least $4 billion dollars of compliance costs for businesses, and $1.5 billion in collection costs for the government (Banks). Taking these costs into consideration, the CBO has indicated that a VAT would be an inefficient way to raise relatively small amounts of revenue, and indeed would only become efficient at a VAT rate of 15%. Going from no national consumption tax to a VAT of 15% would be a hard sale on the American people, especially in tough economic times such as these.

Compliance Burden

The compliance burden under a VAT, as with other taxes, "is mostly driven by record-keeping requirements, filing frequency requirements, and time and resources to deal with audits" (GAO 2008 p. 16). It has been estimated that businesses with less than $50,000 in sales face a compliance burden of approximately 2% of sales, while businesses with over $1 million in sales face a compliance burden that could be as low as 0.04% of sales. This indicates that compliance costs are disproportionately burdensome on small businesses. In many countries with a VAT, monthly returns are due, which entail significant record-keeping requirements ("US Taxpayers"). Considering that there 27.5 million businesses operating in the U.S. in 2009, this could translate to 330 million VAT returns annually (if there is no exclusion for small businesses), which would necessitate considerable administrative capacity to process. In Spain, while there is exclusion for small businesses, monthly returns are only due for those businesses with sales exceeding 6,010,121 Euros (European Commission, "VAT Rates Applied"). There are additional costs associated with multi-national businesses, because they need to know the rates and rules for each country they operate in. Of course, internationally businesses already have these additional costs regardless of whether the United States decides to implement a VAT, and should the US implement a VAT, they may actually be in a better position than their US only peers because they already have the record-keeping infrastructure in place and are familiar with the workings of a VAT.

The GAO indicates that the compliance burden on businesses may be somewhat offset by the facets of the value-added tax (GAO 2008 p. 17). Because businesses retain the VAT collected on sales until remitting it to the government at the end of government-specified reporting periods, this increases businesses' cash flow between collection and remittance. Indeed, a 1994 study by the National Audit Office in the United Kingdom indicated that this cash flow benefit "reduced the overall gross compliance burden by almost 40 percent" (GAO 2008 p.17). Other proponents of a VAT have actually suggested the increased record-keeping requirements could in fact benefit businesses, especially small businesses, because they force improved accounting and record-keeping, which benefits the businesses.

Conflict with State and Local Sales Taxes

While the United State has not had a national consumption tax, citizens have long been familiar with state and local retail sales tax, which vary greatly from place to place. These sales taxes are a great revenue raiser for state and local governments, and state officials have some concerns that a national VAT would eat into their tax base (GAO 1990). "States are likely to resist federal adoption of a VAT because they will presumably view it as intrusion on a revenue source that to this point has been the province of States and localities" (Duncan). Some proponents of the VAT respond that the federal government could impose and administer a national VAT that could relieve the states of the burden of administering their sales tax - the federal government would charge a hirer rate, remit a portion to the states, and the states would receive all the benefits of a VAT without having to deal with any of the administration difficulties. The difficulty inherent in that scenario, however, is how to deal with the various differences in sales taxes between, and even within, states. Here in Pennsylvania we are all familiar with paying 6% sales tax on goods, but no sales tax on groceries and clothes. New York, our dear northern neighbor, on the other hand has a base sales tax of 4%, to which whatever amount the local county and/or locality wishes to get is added, which is how New York City ends up with a sales tax of 8.875%, which is assessed on clothing but not groceries ("Sales and Use Tax"). So how would the federal government manage these many differences? If they keep them, it would be an administration and enforcement nightmare not only for the government but also for businesses.

One commenter also pointed out that adding a 20% VAT (or even an 18% VAT such as in Spain) on top of the states sales tax would turn almost every other country into "a potential sales tax haven" ("A VAT Would"). The commenter expressed that he already paid a 9.75% sales tax in Los Angeles, so adding an 18% or 20% VAT on top of that would push the consumption taxes paid there higher than the standard VAT rate in Hungry (27%), which is the highest VAT rate in the EU (European Commission).

According to the GAO, "Canada's experience administering a national VAT along with a variety of provincial VATs and sales taxes demonstrates that multiple arrangements in a federal system are feasible, but increase administrative costs and compliance challenges for both the governments and businesses. Businesses, particularly retailers in provinces with a sales tax face greater compliance burdens than those in other provinces because they are subject to dual reporting, filing, and remittance requirements" (GAO 2008). On the other hand, if they force states to accept the same tax base and exceptions as the hypothetical federal VAT, they have to deal with perhaps infringing on state sovereignty and states' desires to match their tax system specifically to the needs of their constituents.

VAT as Supplement to, not a Replacement for, Income Taxes

Even the rather anti-VAT Daniel Mitchell of the Wall Street Journal has admitted that a VAT "would not inflict as much damage as our internal revenue code, with its multiple layers of tax on income that is saved and invested" (Mitchell, "VATs Mean"). However, he then stresses that such arguments are irrelevant because a VAT is not going to *replace* the income tax, rather it would be *in addition* to the current tax system, massive warts and all. The U.S. Government Accountability Office in a 2008 report on VAT in other countries pointed out that not only does every OECD country that has a VAT also have income taxes, but also that "personal and corporate income taxes account for a larger percentage of total revenues than a VAT in all of the study countries" (GAO 2008 p. 9). Indeed, income taxes as a percentage of GDP in EU-15 increased from 8.8% of GDP in 1965 to 13.8% of GDP in 2006, compared with the United State's increase over the same time period of 11.9% to 13.5% (Mitchell, "VATs Mean"). While many proposals for a value-added tax in the United States build on the assumption that it would be replacing another tax, such as the corporate income tax and/or the personal income tax, empirical evidence suggests that this assumption is completely unfounded and entirely unlikely. A 2009 letter to the editor regarding a proposed VAT in the United States said it best:

"Replace? Does someone actually believe that one tax will end and be replaced with a different, better tax? Look to Europe again and you will see that it is always another additional tax; politicians find the math for subtraction too difficult. Taxes are to politicians what crack is to an addict; they never can stop and too much is just right." ("What Tax Do You Think VAT Will End?")

Despite these cynical statements on the likelihood of a VAT being a replacement for, rather than an addition to, an inferior tax, many commentators labor under the ideal assumptions that the VAT would take the place of or lessen the burden of a different tax. Many point out that the corporate income tax in the United States is the second highest in the Organization for Economic Co-Operation and Development (OECD). Attention is called to the double-taxation inherent in a corporate income tax: the corporation is taxed on its income, and then shareholders are later taxed on corresponding dividends and capital gains, a situation that is said to "retard and misalign investment" (Boskin). Michael Boskin, a professor of economics at Stanford University also stresses that "the corporation is a legal entity; only people pay taxes." He explains that while corporate income taxes would be borne entirely by shareholders in an isolated economy, the U.S. economy is not isolated; therefore, "taxes tend to be borne by the least mobile factor of production" - labor. Accordingly, the corporate tax burden in excess of that of other countries "will eventually be borne by workers." Some postulate that if a decrease in the corporate income tax accompanied the implementation of a value-added tax, the United States would be able to attract more businesses, which would boost our economy (Cheney). Nobel Laureate Robert Lucas went so far as theorize that discarding both the corporate and personal income taxes and replacing them with a VAT would further increase real GDP and future wages, at little cost (Boskin).

A Survey of U.S. VAT Proposals in the News

The idea of implementing a European-style value-added tax in the United States has been bounced around a good deal in the last 40 years, but it "has found little support from either [political] party, business groups, or the public at large" ("US Taxpayers"). Favorable opinion, held by businesses, politicians, and the general public, would be necessary to pass a VAT for the United States. I combed through periodicals from the past two decades, looking for value-added tax mentions, in order to get a picture of the public opinion regarding value-added taxes. Generally speaking, popular opinion of a value-added tax has not been all that popular. Instead, VATs are seen as the taxes "that feed Europe's welfare states" and "[hurt] the global competitiveness of European companies"("Pandora's Trade War"). A 1994 article stated that "Serious federal consumption tax initiatives seem to resurface in Washington every two or three years" and this assertion was supported by a wealth of articles from the past twenty years (Rankin, "VAT Rears"). I have summarized below the basic opinions, and insightful observations, from the articles surveyed.

1990s

In 1992, Forbes mentioned a Center for Strategic and International Studies (CSIS) report advocating a consumption tax as the "hottest idea" in tax reform (Banks, "Tax"). The article specified that it was not a VAT being advocated, but that any form of consumption tax will have a VAT as a competitor. A 1993 article amusingly titled "Oh! Vat a Mess it Will Be" stated that the Clinton administration was considering a 5% to 10% VAT to pay for a proposed health care system (Banks, "Oh!").

Adding a national consumption tax was a popular proposal in 1994 - one bill proposed instituting a blanket 5% VAT, which would pay for health care reform, while another bill proposed "a close relative of the VAT," a business activity tax to be assessed at a staggering 14.5% (Rankin, "VAT Rears"). The article also mentioned a proposal that states replace their current business taxes with individual state value-added taxes (which sounds like a sure recipe for massive headaches, with interstate commerce and the associated VAT refunds, which would create opportunity for carousel fraud, which, as previously mentioned, is a major compliance issue in the European Union). Retail industry lobby groups were cited as emphatically opposing these types of proposals.

2000s

The possibility of replacing the United States income tax with a value-added tax was again mentioned in the Wall Street Journal in 2002 ("World-Wide"), along with the qualification that "any overhaul that contentious isn't likely to take shape much before 2004 elections." The author of a 2003 Letter to the Editor was an advocate of a VAT for a rather unique reason, almost the flip-side of the regressivity complaint ("Letters to the Editor: It's Obvious: We Need A New Tax System."). The author argued that "the progressive tax system undermines the sense of public responsibility of millions of Americans" who do not pay, or pay little income taxes. Since tax policy does not directly affect these people, they have less incentives to involve themselves in the issue. The author argues that a VAT would be borne by all Americans, everyone contributing to keep the government running, and would have the added bonus that those who do pay income taxes would "have as much incentive as any other American to keep the tax rate as low as possible," thereby possibly bringing about the additional benefit of increased civic participation.

In August, 2004, House Speaker Denny Hastert's autobiography was published, in which he ruminated on the idea of replacing all income taxes with a national sales tax or a value-added tax as exists in Europe ("The Abolitionist"). The article was all for that…but said it was very unlikely: "If we were designing a tax code from scratch, we'd agree that a consumption tax is preferable. But until someone abolishes the 16th Amendment to the Constitution, we're not likely to end up with a sales tax replacing the income tax. Instead we'll get both, if not a first then eventually." ("The Abolitionist") In December of 2004, a Fortune article titled "Tax advice for Mr. Bush: Consider the VAT" asserted that "the time has come for the U.S. to seriously consider a national VAT" in light of the ballooning federal deficit. Under the dramatic sub-heading "Conservatives work to quash value-added taxes," a 2005 article disclosed that Congress, specifically the House Ways and Means Committee, was once again considering a value-added tax (Harwood). Another proposal to replace the corporate income tax with a value-added tax was brought up in 2008, this time by Senator Jim DeMint of South Carolina and Representative Paul Ryan of Wisconsin, both Republicans ("America the Uncompetitive").

During the Obama Administration

The next time a new value-added tax proposal was mentioned in print media was in June 2009. Senate Budget Committee Chairman Kent Conrad asserted that a VAT must be discussed in connection with tax reform. In an ideal world, entitlement reform would also be addressed; as the population ages Medicare, Medicaid, and Social Security will continue to balloon the federal budget. These increasing expenditures need to be met with increasing revenues, which makes a broad-based, high revenue-raising tax like the VAT attractive. On the other side, it is argued, as previously mentioned, that a VAT should be avoided for this very reason - increasing governmental revenues without reform will merely serve to enforce governmental expenditure increases, leading to a higher percentage of GDP being gobbled up in taxes and a less-healthy economy.

In response to the previous article, "VATs Mean Big Government," there were a number of letters to the editor. One commenter was also opposed to a VAT, specifically for the reason that it is a "stealth tax." He argued that "If VAT goes up — as it does all the time — the consumer merely sees a price increase. So the politicians raise taxes and the taxpayers blame 'greedy businessmen' for price increases. It's a nice scam, but one we should not allow into the country" ("It's No Wonder"). Another commenter was in favor of a VAT, arguing that "a VAT is exactly what this country needs." That commenter's reason related the fact that half the country does not pay federal income tax, and therefore does not feel the bite of paying for the federal government's public expenditures. The commenter argued that a VAT would be a "well-deserved lesson in basic economics," educating the constituency that you have to pay for what you spend, and hopefully would "generate a call for the return of sanity in public government spending."

In the next round of letters to the editor, still responding to the aforementioned article, one commentator tried to refute the claim that the VAT is a hidden tax, saying that "It is not necessary for VAT to be hidden, unless the law specifically states that it cannot be listed separately" ("America Should Consider"). From my personal experience in Spain, I did not see the IVA (Spanish VAT - Impuesto sobre el Valor Añadido) separately listed on any of the purchases I made. The commenter also mentions that a VAT is a much more economically neutral tax than an income tax, and for that reason "should be seriously considered by the federal authorities." Another commenter, "familiar with the Canadian version of the odious VAT," the Goods and Services Tax (GST), claimed that VATs are a "cash cow for bloated government waste" and stated another nickname for a GST is "Grab, Snatch and Take" ("America Should Consider").

Another June 2009 article highlighted "the mismatch" between government spending and tax revenue; federal revenues as a percentage of GDP were 18%, as opposed to 20%, 10 years earlier, while budget deficits are much greater "than anyone expected" (Altman). The author expressed as predication that Congress would be contemplating a VAT in the following year to address these growing deficits, and perhaps a bipartisan deficit reduction commission "may be necessary to create sufficient support for a VAT."

The next mention of VAT followed in early August, with the habitual remark that Obama's advisers may be considering a VAT to address the budget deficits (Moore). Again, in September there was more talk of Washington considering a VAT, "given the perceived need for significant additional tax revenue to shrink future fiscal deficits" (Feldstein). The author of this article is opposed to a VAT for the usual reasons, including its regressivity and potential to induce increased government spending. The article adds the unique criticism that a VAT would reduce "the reward for work and entrepreneurship by adding a tax to the prices of all goods and services," which is a reasonable conclusion, but applicable to any additional tax, by no means limited solely to a VAT, which, as mention previously, is considered as the most economically neutral tax. Another criticism of introducing a VAT mentioned is that it would be "grossly unfair" to those, especially senior citizens, who would now face an unexpected tax on their lifetime savings.

Another September article again highlighted an Obama advisor's suggestion to consider a value-added tax (McKinnon, "U.S. News: Group"). The Center for American Progress, headed by Obama adviser John Podesta, was the most recent to advance the idea of instituting a consumption tax. Taking the opposite stance, the group Americans for Tax Reform is cited as an opponent to such a proposal. The White House did not respond to the author's request for comment on the VAT proposal. House Speaker Nancy Pelosi was the next to publicly muse on the possibility of a VAT, highlighting its ability to raise revenue to pay for public health-care ("Ms. Pelosi's VAT"). In her PBS appearance Ms. Pelosi pointed out the current healthcare costs for Medicare and Medicare are paid for through employment taxes under FICA (Federal Insurance Contributions Act); both the employer and the employee pay these taxes, but the cost (at least for the employer portion) is eventually borne by the final consumer of the good. This means that prices are higher because a portion of public healthcare costs are included in the price. Some argue that this makes our prices higher than goods from countries with a VAT, because prices for our goods include these costs, and then VAT is added on top of this already higher price when our goods are imported into countries with a VAT, producing tax cascading and hurting the competitiveness of American goods abroad. One commenter succinctly explained it this way: "Currently, a Mercedes imported the U.S. Receives a 19% refund of its VAT. The sales price does not include most German social taxes, while General Motors must compete having paid both medical and retirement benefits. For Boeing to ship to Germany it must pay the VAT, so that the price of its planes must include both American and German benefits" ("A VAT Would").

An October 2009 article again commented on Ms. Pelosi's VAT musings, adding that "even Alan Greenspan is on board, albeit reluctantly" and Paul Vocker, the former Federal Reserve Chairman and White House economic adviser, could also come to support a VAT. The authors, Ernest Christian, lawyer and co-author of The Value-Added Tax: Orthodoxy and New Thinking", and Gary Robbins, chief economist at the Center for Strategic Tax Reform, also refute some of the conventional wisdom regarding value-added taxes. They state that "The VAT is so slippery that academics here and abroad do not agree on who pays this seemingly magical tax. Some economists still deceive themselves with the old notion that a VAT is simply a tax on consumers." They dismiss the accepted truth covered earlier that a consumption tax is ultimately borne by the consumers, contending that modern economists in the U.S. believe that consumers bear only about half of a VAT, through higher prices and fewer product options. They assert that the other half of a VAT is borne by the owners and employees of companies subject to a VAT, due to "market forces," which are not explicitly defined. With respect to a VAT's massive revenue-raising potential, the authors contend this would not necessarily be a good thing: "America and its economy would be radically changed — and not for the better."

Another piece in November once again commented on Ms. Pelosi's VAT musings, emphasizing the many benefits of a VAT, including its efficiency and the fact it taxes consumption rather than savings (Cheney). The article also includes a rather interesting idea from Syracuse University's Leonard E. Burman regarding economic responses to the implementation of a VAT that could aid businesses: "…it would even serve as a stimulus. If you said that a VAT was going to take effect next year, you'd give consumers a powerful incentive to buy things now. If you phase it in over a couple of years, you can repeat that trick over and over again for a while." A rather unique plan, and perhaps possible given that GAO reports indicated that implementation of a VAT have taken 15-24 months in countries that already had a national consumption tax, so implementation in the United States will likely take longer since we do not already have the same infrastructure. Another academic quoted in the article, Michael Graetz of Columbia University, proposed that a VAT of 10 to 14 percent could offset a decrease in the corporate income tax to an internationally competitive rate and furthermore could eliminate the personal income tax for taxpayers that make less than $100,000 per year while accompanying the rate reduction for those in higher tax brackets. The article, while stressing the benefits of a VAT, cautioned that "the political question of introducing Americans to a new tax is likely to make the debate over health-care reform look like a sandbox squabble… The political implications are huge and complex, but so is the current American tax system. Back in 1991, serious consideration was given to instituting a VAT and was defeated." Past history suggests that a current VAT proposal would likely be defeated again.

On February 19, 2010, President Obama signed an executive order to form the Bipartisan National Commission on Fiscal Responsibility and Reform ("The VAT Commission"). This commission is supposed to find a way to balance the budget. Given the prediction that tax increases are on the way despite the President's campaign promises not to increase taxes on those earning less than $250,000 per year, a VAT is likely to be suggested to raise the additional revenue. For this reason the Wall Street Journal quipped that the "real name for this exercise should be the VAT commission."

In April, 2010, Irwin Stelzer of the Hudson Institute wrote that "the emerging consensus in Washington" was that the United States needs to implement a value-added tax to combat the distressing fiscal situation, with the Congressional Budget Office (CBO) predicting U.S. National debt as a percentage of GDP to reach by the end of the decade (Stelzer). Actually, the Treasury Department figures showed that national debt as a percentage of GDP surpassed 100% barely a year later in August of 2011 ("U.S. Debt"). Mr. Stelzer projected that every percentage point of VAT would raise tax revenues of $100 billion; meaning a VAT at the Spanish standard rate of 18% would rake in $1.8 billion "other things being equal, which they probably won't be, since higher, tax-inclusive prices will dampen spending and some products will be exempt." Particular attention was paid in the article to the administrative difficulties administering a tax with preferential rates for certain goods and services, especially the characterization of goods and services into tax groups. A warning is given that a VAT "confers enormous power on faceless bureaucrats" because they are the ones to write the regulations that determine whether a good is fully taxed, taxed at a reduced rated, or tax-exempt, where the later two designations confer a competitive advantage on goods and services. Mr. Stelzer asserted that European manufacturers put great effort into managing the tax treatment of their products at the expense of making the products in the most efficient manner, contributing to "Europe's lagging productivity and increasing inability to compete in world markets."

Former Federal Reserve Chairman and White House economic adviser Paul Volcker was the next to make waves in the news media for speaking about the possibility of a U.S. value-added tax ("Volcker on the VAT"). On April 6, 2010, Mr. Volcker stated that a VAT "was not as toxic an idea" as it had been, and both a VAT as well as some sort of energy tax needed to be considered as methods of raising tax revenue. Mr. Volcker's comment was again mentioned in the news the following week, accompanied by an explanation on value-added taxes ("Europe's

VAT Lessons"). The explanation stressed that while a consumption tax does less economic harm than an income tax in principle, in execution a VAT has rarely replaced or even reduced the income tax. In the United States, the people advocating a VAT in the news were not suggesting it replace the income tax, "in fact, they want income tax rates to rise." The nonpartisan Tax Foundation is referenced as calculated that balancing the budget, as of 2010, would necessitate an 18% VAT at minimum. The article closed with the warning that the higher tax burden needed in Europe to finance their entitlement systems has lead to a lower standard of living for their residents.

On April 15, 2010, Republican Senator John McCain introduced an resolution amendment stating that "It is the sense of the Senate that the Value Added Tax is a massive tax increase that will cripple families on fixed income and only further push back America's economic recovery" ("The Toxic VAT"). It passed 85 in favor, 13 opposed, and 2 abstentions ("U.S. Senate"). A March, 2010, Rasmussen Poll also found that 60% of Americans are against a value-added tax, and only 22% are in favor ("The Toxic VAT"). Six days after Senator's McCain's denouncement of a VAT, President Obama admitted in an interview that he was open to the idea of a value-added tax, saying that it "is something that has worked for some countries" and that it "would be novel for the United States" ("Obama Floats a VAT").

Stanford University economics professor Michael Boskin has written various times of the economic advantages of a broad based consumption tax over corporate and personal income taxes (Boskin). In a 2010 editorial he cautioned that a VAT, used to considerably increase tax revenue instead of replacing a less efficient tax, would erode the standard of living over the long-term. He argued that "a VAT should only be on the table if it is not only revenue-neutral but accompanied by serious spending control." Considering that almost half of Americans pay no income taxes, there is the fear that this will lead to a continuing spiral of increasing income taxes since more and more voters will not be paying for the rise in government spending that they are advocating. A VAT, not highlighted on a receipt and not aggregated on a tax return, would make the tax burden less apparent and could acerbate such a spending spiral. Mr. Boskins ends the editorial expressing the need for tax reform and the warning that "eventually structural drags, from our antiquated tax code to massive public debt, will impede investment and economic growth."

Leo Hindery and Michael Lind of the New America Foundation next wrote about a U.S.

VAT in May of 2010 (Hindery & Lind). They argued that America needs a VAT, posthaste. Their proposal was that the U.S. institute a small VAT, perhaps of 5%, and accompany it with reductions in payroll taxes and corporate income taxes, which could make the tax system fairer and more efficient while promoting job creation and stimulating the economy. To avoid a massive upswing in taxation, the authors asserted that coordination would be necessary between the states and federal government to reduce state sales tax and perhaps create a revenue sharing system for the VAT, but they did not expound on how such a system would work and be implemented, nor did they elaborate on the many politically complications inherent in trying to intrude on a traditional state revenue base. They also cautioned that a VAT would not act as a panacea - escalating government expenditures would have to be tackled first and foremost.

The Business Roundtable, an association of U.S. CEOs, was reported in July 2010 as stating that they would consider the idea of a VAT, provided the corporate income tax was reformed and decreased ("U.S. Weighs"). Retailers, however, were still cited as being mostly against a value-added tax due to the expectation that high prices will slow consumer spending, especially among the middle class. The article also referenced yet another revenue estimate, which calculated that a 5% VAT would raise $161 billion annually, adjusting for preferences. A VAT was projected to face considerable opposition, given the anti-tax climate of the time, and one of the highest hurdles was surprisingly seen to be politicians themselves: "Folk wisdom in Washington holds that every government that has ever created a VAT has been voted out at the next election."

The Debt Reduction Task Force of the Bipartisan Policy Center released a report in November of 2010 titled "Restoring America's Future." The report included a great number of fleshed-out tax reform proposals, including simplifying and reducing the personal and corporate income taxes, cutting expenditures, and introducing a value-added tax. The group titled their proposed value-added tax "The Debt Reduction Sales Tax" (DRST, not to be confused with RST, the abbreviation for a retail sales tax). Unlike conventional state sales taxes, the DRST is laid out as a broad-based tax on the value-added of almost all goods and services (including necessities). It would follow the invoice credit method, and be consistent with "international practice" to confirm with international trade agreements. The Debt Reduction Task Force advised using Australia, Canada, and New Zealand as a guide, because their more recently adopted VATs are very broad based, which allow a lower rate to attain a significant tax revenue, with few exemptions, which cause many administration and compliance issues. They propose a "modest" DRST of 6.5%, which is estimated to raise roughly half a trillion dollars, based on 2010 consumption (Duncan). Each percentage point itself of DRST is estimated to raise about $78 billion.

In a July, 2011, Op-Ed, Harvard University economics professor Robert Barro advocated expansive tax reforms, including the implementation of a value-added tax (Barro, "Robin Hood"). He estimated that a U.S. VAT of 10% could raise about 5% of GDP each year. Ernest Christian and Gary Robbins, mentioned above, estimated in August of 2011 that each $1 trillion of VAT revenue raised "would cost the private economy at least $2 trillion," half in taxes and half in reduced GDP (Christian & Robbins, "A Value-Added Tax"). They also added the customary warnings that a VAT, once introduced, is unlikely to stay low, and the perceived regressivity will lead to a smorgasbord of exceptions and subsidies.

Conclusion

Predictions are mixed on whether the United States will implement a VAT any time soon. A July, 2010, Wall Street Journal survey of 53 economists showed that over half of those surveyed (28 economists) did not believe the United States would introduce a value-added tax in the following decade (Izzo). Though some economists consider a VAT as one of the few options to cut deficits, adverse political pressure was cited as being too strong to overcome. A 2010 Rasmussen survey found that 66% of Americans believe the nation's tax burden is too high (Rove). Given this opinion, it is unlikely that the American public will stand for a new, broad-based tax with the potential to greatly raise government tax revenue. Especially considering the earlier survey that found that 60% of Americans are against a value-added tax ("The Toxic VAT").

Politicians at several levels are not all that enamored of the value-added tax either. Besides the whole conflict between the state and the federal governments associated with the implementation of a national consumption tax, federal politicians just plain fear for their jobs should they try to introduce a value-added tax. It is rumored that no government that ever introduced a VAT has ever been reelected. However, VAT proponents add that although the politicians may be replaced, the replacements never repeal the VAT. Nevertheless, considering Senator McCain's 2010 passed resolution amendment stating that "It is the sense of the Senate that the Value Added Tax is a massive tax increase that will cripple families on fixed income and only further push back America's economic recovery" ("The Toxic VAT") and Representative Eric Cantor's 2010 comment that many congressmen would not support a VAT-style tax because it would be too closely associated with the welfare states of Europe (Paletta), it would appear that politicians are not yet ready to risk political suicide to implement a VAT here in the United States.

Despite this political climate, others still predict that a VAT is a possibility, though probably not before the 2012 elections. Piet Vandendressche, Tax Global Managing Partner for Deloitte, is one of those who see a VAT in the U.S.'s future ("US Taxpayers"). He was cited as advising companies to prepare for a U.S. VAT, though he conceded it was unlikely to pass before the 2012 elections. Presidential candidates, however, are already bringing up the possibility of a VAT, though. At the beginning of 2012, presidential hopeful Mitt Romney stated that a value-added tax might be an appropriate measure, specifically in conjunction with other tax reductions (Mitchell, "Will Republicans"). Another Republican presidential contender, Herman Cain, advocated a VAT in his 9-9-9 tax plan. Republican Representative Paul Ryan, Chairman of the House Budget Committee, has also included a VAT in his fiscal reform proposal. Daniel Mitchell of the Cato Institute is on record as forecasting that were President Obama to try to introduce a VAT to pay for his social agenda, it would not pass. He insisted that Republicans would oppose a VAT as a rule were it to be advocated by the President, but he thought a VAT might stand a chance were a Republican to propose it in conjunction with a corporate tax cut (Mitchell, "Will Republicans").

It has been said that "America now has the worst of all worlds: high corporate tax rates, but also lots of loopholes passed by Congress at the behest of favored businesses" ("America the Uncompetitive"). This both decreases the amount of corporate income tax revenue the government receives and places a large compliance burden on businesses who must now hire many tax accountants to decode the exceedingly complicated Internal Revenue Code and find as many loopholes as possible to take advantage of. Instead of a VAT though, it might seem prudent to start with the current tax system and reform it, removing many of the exceptions and special treatments that decrease tax revenue.

Personally, as for a conclusion on the possibility of a VAT, I believe Mr. Rankin said it best: "In the final analysis, the prospects for a national consumption tax may depend less on economic analyses than one overriding intangible factor: whether or not American taxpayers are so fed up with the current income tax system that they are willing to switch to a radically different approach" (Rankin, "To VAT"). Are we so fed up? Time will tell.

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