Macrothink Institute™

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

Tax Reform Consequent upon an Embedded Single-Rate Vat Just Might Prevent Injustice While Revivifying a Geriatric Uncle Sam

Emir Phillips,

JD/MBA MSFS, ChFC CLU is a student in the DBA Program at the Grenoble École de Management

E-mail: emirphil@yahoo.com

Received: May 30, 2015 Accepted: July 17, 2015 Published: August 24, 2015

doi:10.5296/jpmr.v1i1.7710 URL: http://dx.doi.org/10.5296/jpmr.v1i1.7710

Abstract

Economists and legislators have proposed many theories and plans for overhauling the corporate tax system (and the U.S. tax system as a whole); however, this Article argues that any viable proposal should begin with the enactment of a value added tax (VAT).

As a result of the IRC's unworkably complex corporate section, the United States economy has been hindered by high compliance costs and the loss of business overseas. Overall, a substantial federal VAT is the best option in terms of compliance and administration costs as well as reducing opportunities for federal tax evasion. But merely placing a VAT on top of the existing system would merely send us in reverse by further increasing the variable and substantial fixed costs of administration and compliance. A mere changing of the marginal rates or deduction rules would be insufficient to deal with the systematic problem caused by the yawning federal deficit and the arcane IRC. A VAT rate set too low would impose substantial costs per dollar of additional revenue. Thus, Congress should enact either a federal VAT (15%) capable of significantly reducing the federal deficit or none at all.

1. Introduction

At the most constitutional level, we have an elemental obligation to our Nation and our children: to responsibly fund our democracy. And yet, Congress has consistently refused either to pay for the government we have or to legislate a substantially smaller government. No longer can we utilize a tax system too monstrous to fairly finance what we are spending. The present tax system is not a sufficient money-machine. The federal government can no longer raise 17% in taxes and spend 21% of GDP. This aging Nation is on an unsustainable

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

fiscal path[1] and faces in 2009 dollar terms deficits of $1-to-$1.3 trillion each year (7-9% of GDP).[2]

All too soon investors' angst about future deficits will inevitably reach critical mass and ignite a financial crisis with calamitous effects.[3]This impending future is the best why to avoid substantial ongoing budget deficits.[4]Once interest payments dominate federal spending, investors will flinch at purchasing 30-year Treasury bonds as early as 2015, because when these bonds mature in 2045, Medicare, Medicaid and Social Security, will consume the entire federal budget, leaving nothing from which to pay interest.

The yawning deficit combined with the sheer numbers of elderly about to attain eligibility from Social Security and Medicare are conspiring our demise. Tax policies that promote economic growth and achieve economic efficiency while simultaneously maintaining distributional fairness are needed. Political and administrative realities, empirical evidence, and taxation theory, must coalesce with a sound appraisal of the current macroeconomic and international situation to birth a feasible set of proposals sufficiently attractive to be largely self-implemented.

Recent low rates of economic growth mandate any significant tax reform be structurally conducive to improving productivity; and thus, should be initiated with the enactment of a substantial federal value-added tax[5] (hereinafter referred to as the VAT). The ever-widening social safety net should not be financed by increased taxes on labor, whether in the form of income or payroll taxes since both Medicare and Social Security benefits accrue to the old, while the young disproportionately pay payroll and income taxes, making it unfair to transfer so many benefits from the young to the old.[6] Unlike payroll and income taxes, consumption taxes do not discourage work, the very foundation of productivity. The best viable solution is to enact a single rate (15-20%) broad-based federal consumption tax: more specifically, a value-added tax (VAT).

But the VAT cannot be mechanistically inserted into the world's largest economy as if part of a mathematical modelling equation instead of knowing that once applied, tax code meanings and objectives instantly change pervasively, get tangled with each other and ramify into the warren of corporate decision-making, cause myriad misunderstandings and misinterpretations, but also inspire the creation of competitive methods that can take part in revivifying the economic prowess of a geriatric Uncle Sam. Too many prior articles and sincere analyses of the VAT, whether an add-on VAT, partial VAT or multi-rate VAT were overly linear and logically atomized constructions that incessantly lead to spurious conceptual problems and unanswerable questions. VAT articles ad nauseam usually provide two dimensions, a linear progression of some sort of VAT begetting B begetting C and so on. A muddier but more pertinent VAT analysis considers complex, multi-directional factors that zip around in three dimensions colliding, reinforcing, negating, and colluding with other taxes until a hopefully organic economic playground coheres, perhaps at times giving us the rare privilege of peering into four dimensions. Newtonian tax reform does not incrementally ebb into an Einstein's tax dimensionality.

Not only must a linear mentality be de-emphasized for a more intuitive analytical process, but the present political methodology must also be made somewhat extinct if the next generation of Americans is to have any chance of artfully adapting into the impending future. Now is the time to evolve, not then, and the nigh zero-sum political game of cutting popular tax preferences in exchange for tax-rate reductions must give way to a potentially transformative tax agenda, more along the lines envisioned by Prof. Michael Graetz of Columbia University.[7]

The Graetz plan would enable the federal government to reap sufficient revenues without limiting economic potential. A tax on goods and services would substitute for much of the income tax, liberating most Americans from the trauma of having to file income taxes. This Article advocates we no longer rely on tax breaks as the solution to fix our economic and social problems. Tinkering around the edges, giving a tax break here and raising a rate there, as politicians have done for decades, and to continue to do so before the abyss to which we are blithely sailing amounts to what is now treasonous behavior.

Tax policy must evolve from gills to lungs, from cold-blooded to warm yesterday. Once the baby-boomer generation fully retires and collects Social Security and Medicare benefits, tax revenues will fall far short of garnering the requisite revenues to fund our government. By 2020 there will be 3.2 workers for every recipient of Social Security benefits, by 2040, 2.2 contributors per beneficiary.[8]Congress reducing the costs of the Social Security, Medicare, Medicaid programs will only give us a smidgen more time to adapt, and given national demographics, benefits reduction is not realistic or a sustainable solution. The requisite tax policy we need before Uncle Sam turns young again makes the Manhattan Project look like tic tac toe.

2. What to Do?

A VAT is a "consumption tax collected on a product whenever value is added at a stage of production and at final sale.”[9]The VAT due on any sale is a percentage of the sales price, but the taxable person is entitled to deduct from this percentage all tax paid at the preceding stage. Therefore, there is no double taxation; a tax is paid only on the value added at each stage. The final sale to the consumer bears the entire tax since there are no net taxes on sales between registered VAT businesses.[10]A VAT essentially works like a system of withholding for sales taxes where businesses are tax collectors, not tax payers.[11]Businesses "pay” VAT collected from customers and get a refund of any VAT paid to vendors or on imports."[12]When businesses do pay a VAT, the VAT would be recoverable if the business follows the proper procedures.[13]

A VAT does not eliminate compliance issues altogether. The United Kingdom lost nearly $18 billion to VAT fraud between June of 2005 and June of 2006.[14]Nonetheless, a U.S. VAT could help reduce the "tax gap", which is the difference between what taxpayers should pay and what they actually pay on a timely basis (estimated by the IRS to be more than $300 billion annually).

The Congressional Budget Office, using favorable assumptions, estimated that the costs of complying with a VAT could be as low as 10 percent of the compliance costs under the current corporate and individual income tax system. (European countries spend anywhere from two-thirds to four-fifths less on compliance than the U.S. in trying to administrate the income tax.)[15]

3. Justification for the Vat

Spending and taxation (fiscal policy) remain the government's most direct mechanism to redistribute income. Yet government spending is more able than taxation for redistributing income. Much of social justice embodies itself in the dynamic between public/government spending and income redistribution. Public capital diverted into developing the human capital of the poor, whether health or education, is an efficient and fair methodology to reduce income inequality over the long run.[16]It trumps taxation.

Taxation, however, is effective for gathering governmental revenue from which to redistribute income. With that in mind, Thomas Hobbes advocated consumption as a legitimate taxation base since citizens should pay tax on what they withdraw from society's limited resources (consume) as opposed to what they contribute to those resources from their labor (earn in income).[17]Essentially, the VAT is a tax on the income and wealth that households use to finance current and future consumption.[18]

By somewhat encumbering current and future consumption, and thereby encouraging savings, the VAT empowers the national economy by pooling liquidity for capital investment. The federal VAT prompts national savings since “under a consumption tax, the net return on income saved and invested is greater than under an income tax which taxes the return from savings as a form of income. With comparable tax rates, to forego consumption also forgoes payment of a consumption tax but does not forego payment of an income tax."[19]Thus, savings surge with a substantial single-rate VAT (15%) by which businesses can then invest this capital seed from which the Nation as a whole will garner in time an economic cornucopia.

An income tax irrigates consumerism. More specifically, under an income tax, unless the particular form of savings gets special treatment (putting one’s income in a retirement plan) the pretax return on savings is reduced by the tax rate. In other words, an income tax of 20 percent generally reduces a 10 percent pretax return on savings to 8 percent after tax. In contrast, the distinguishing characteristic of a consumption tax is that the pretax and after-tax rates of return on savings are identical; savers typically only get the full 10 percent pretax return, not after-income-tax. By taxing any monetary return from said savings, income taxes systematically favor current consumption over savings that could have been used to finance future consumption.

Thus, a federal income tax consequently reduces the national level of investing and saving in the economy. Yet this toxic by-product of income taxes will not compel Congress to vote in a 15% federal VAT. It really is primarily all about net tax revenue. At the end of the day, economic justification relies more on the present value of the tax proposal than upon anything else. OUGHT in modern times serves How Much? And to that Temple we must now go.

4. Is The Vat Really A Money-Making Machine?

A U.S. VAT could realistically tax about a third of the GDP, which would raise close to $50 billion per percentage point. If the United States adopted Europe's average VAT rate of 20%, the Treasury could raise $1 trillion per year in 2009 dollars.[20]Admittedly, it takes a country several years to enforce properly the VAT after implementing the new system.[21]This Article is advocating for a 15% VAT that taxes much more than the paltry European average of 33% of GDP and aims for an extremely broad-based VAT that would capture approximately 80% of U.S. GDP.

A broad-based 5% VAT (50-60% of U.S. GDP) could raise $355 billion in 2012 dollars, while still excluding expenditures on state and local government, charitable organizations, education, Medicaid and Medicare.[22]Since this Article is advocating for a single-rate 15% VAT, the raised net tax revenue would be nearly $1.1 trillion annually. Net tax revenue is critical since a VAT would reduce net business income, which would in turn diminish other revenues until declining tax receipts would offset approximately 27% of gross VAT revenues such that, a narrow-based 10% VAT would raise in revenue a little more than 2% GDP[23]while a broad-based 15% VAT would garner about 8-12% of GDP. These net tax funds must then be utilized towards 1) paying down the deficit, and 2) reducing both the income and corporate income tax to roughly 20%.

The bottom line is that VATs are utilized in over 150 nations and have consistently raised ample revenue with far weaker tax administrations than the IRS. If the VAT is indeed a particularly potent form of taxation, countries with a VAT would be expected to collect more total tax revenue, than those without (all else equal). At least for high income nations, this appears to be the case.[24]The VAT is a sufficiently ample money-machine to pull this nation out of the abyss toward which we presently speed. But is the VAT just and fair?

5. The Broader the Tax Base of A Tax the Better and More Just

Defining the tax base is critical. The more narrow the base, the higher the tax rate needed to raise certain revenue. And the higher the tax rate, the greater incentive to avoid or evade the tax. Subsequent tax evasion further erodes the tax base and hence the amount of public revenue spirals downward.[25] In order to keep a VAT tax rate as low as possible, the total universe on which the tax will be charged should cover nearly all goods and services. Similarly, a single tax-rate VAT would not prejudice saving choices.

A broad-based VAT would not prejudice relative prices among consumption goods and services. Consumers would not either veer purchases towards goods and services not covered by the VAT or shy away from taxable items levied by a higher VAT rate since the single-rate VAT would cover nearly the entire U.S. economy. Consequently, a single-rate VAT would also not bias corporate decision-making as to financing, new investments, or in taking a particular organizational form. Nearly all non-VAT tax proposals, and certainly higher income tax rates, would distort and artificially influence all of these choices. Thus, an extremely broad-based single-rate VAT that excluded only those goods and services too difficult to reach has much to offer in the way having corporate decision-making engage more in value-creation as opposed to tax avoidance or worse, evasion.

And yet, the VAT does distort certain choices. As with the payroll or income tax, the VAT would distort household choices between leisure and work. But if extremely broad and uniform, the VAT will not interfere with patterns of consumption (how consumers decide to divide their purchases among available choices), except for the choice between untaxed consumption (leisure) and taxed consumption. A walk in the park (free) and going to Disneyland would now be a more terse decision.

One of the most fundamental questions relating to VAT is the use of a uniform rate. Non-uniform, or multiple, rates and extensive exemptions definitively affect national patterns of production, distribution and consumption, thereby destroying neutrality, while also greatly increasing administrative and compliance costs. Yet despite this, VAT countries do often exempt certain products, like food or clothing, in an effort to alleviate the regressive VAT burdens to low-to-moderate income families, and some countries impose higher VAT rates on luxuries. This gives in to the common error of having taxation inefficiently try to solve social justice issues more suited to solutions from government spending (welfare), instead of more properly having a single VAT tax rate and greatly limiting exemptions which would further simplify VAT compliance and administration. That is long-term Justice. Congress should never forget that there are better ways to relieve the regressive impact of the VAT on lower-income families than by exempting food, clothing, and housing or worse, having multiple VAT tax rates.

In this area, European countries have done an extremely poor job since the percentage of consumption taxed in the Organization for Economic Co-operation and Development (OECD) is on average about 33-40 % of GDP.[26]The U.S. can do much better than this, and should aim to tax 80% of GDP by including all domestic consumption, except for education, services of state and local governments, charitable organizations and government-financed health care (Medicaid and Medicare). For example, under a credit-in-voice VAT, vendors to charitable organizations could exempt their sales, and claim invoice credits, just as with exports. Also exempt from the VAT base would be state and local sales taxes. If done as such, this broad VAT tax base would involve 70-80% of total U.S. consumption.[27]

There is one exemption that for simplicity sake makes sense. In conformity with the Graetz plan, all businesses with $100,000 annual gross income or less (which would account for approximately 65% of the 25 million businesses in the U.S.) would not file returns or pay the VAT.[28] This would reduce the number of VAT returns to approximately 9 million. Additionally, not only would the costs of compliance be greatly reduced but tax collectors would no longer have to chase after picayune amounts of tax. Large businesses are used to collecting VAT; they do so throughout the world. Collecting taxes from businesses, rather than from families, is a great administrative advantage of the VAT since most Americans would have nothing to do with the collection or enforcement of the federal VAT, even though they would pay the tax when they purchase goods or services. Not only would an exemption for small businesses relieve the tax collector from chasing after small amounts of tax, it

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

would have little effect on VAT revenues. When an exempt small wholesaler, for example, sells a product to a non-exempt retailer, the retailer will collect the full VAT on the sale to a consumer and will get no credit for taxes paid to the wholesaler, since the wholesaler was exempt.

6. Simplicity

Simplicity, at almost all cost, necessitates the VAT should not have multiple tax rates or too many exemptions even if by doing so the regressivity of the VAT would be lessened. Do not bite that Edenic apple, or we are lost. Regressivity must be handled by the expenditure side of the budget while progressivity should remain where best addressed, the income and estate taxes. To do otherwise is to doom this Nation.

Time and time again, VAT analysis involves holding up the VAT as an add-on with no other tax reform, or worse, modeling the VAT as a complete all-other-tax replacement panacea only to then discard it when that analysis reveals the VAT cannot simultaneously walk on water and balance the budget. All VAT proposals to fully replace the income tax, corporate and/or individual, were subtraction-based,[29] which were WTO-incompatible,[30] allowed a deduction for wages, while imports were exempt and exports were taxable. This last part was a deal-killer with businesses, and their lobbyists, since the business community felt not taxing imports would put them at an unfair competitive advantage. A destination-based[31] credit-invoiced federal VAT resolves these issues en toto.

A federal VAT is a powerful but limited tool. Frankly, it is a somewhat regressive money-machine that for simplicity sake must be kept broad-based and the inherent systematic toxicity from using the potency of a broad-based federal VAT should be ameliorated by a simplified income tax, which leaves roughly 50% of Americans with no need to file income taxes as well as a substantially reduced corporate tax to spur growth. But policy wonks have a modeling disdain for so many moving parts, and too often freeze viable solutions to maintain a supposed assumptive coherency that exists only upon the two-dimensionality of the page.

About as ludicrous and harmful as the VAT to replace all taxes is pendulum's other idea of a pure add-on VAT, with no other changes to the tax system. The pure add-on VAT has all of the dire consequences of over-taxation. It is evil, run from it. Government spending once financed with debt would subsequently be financed with the consumption-based add-on VAT, the brunt of which is imputed to consumers through increased consumer prices. Consequently, private consumption plummets, thereby reducing real wages, which causes the supply of labor to further diminish, and from the toilet into the sewer we go. This does not make the VAT the Anti-Christ (only if used as a pure add-on). If a federal VAT could both bring in revenue while enabling us to simplify the present Byzantine individual and corporate tax system, then contraire, perhaps, the VAT does deserve beatification.

We spent 20% of our wartime GNP to build an atomic bomb based on a German's theory. The economic destruction of America as we know it will happen between 2025-2040 if we even substantially stay on our present tax policy and government spending course. For nearly twenty-years now we have engaged in a war on terrorism having suffered less violent deaths

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

than from car accidents or overdose or suicide, or possibly even snake bites. The loss of time, energy, labor and any sense of national hope are careening toward oblivion, and it is a shame we need enemies with comparatively stone-age weaponry to motivate and unify our Nation to cohere into action. Truth is, it might already be too late. But if not, any viable plan will involve financial hardship, too often exploited by lobbyists and politicians, that only the work-ethic of the tin man, the courageousness of the scarecrow and the wits of the lion will suffice in a bewitched future threaded only by the VAT's yellow-brick road. Wake up, this isn't Kansas anymore.

Ironically, when advocates have wanted to use the VAT to replace the corporate income tax, the subtraction method has been advanced as the collection modality when both simplicity and the clear experience from other VAT countries vindicated the credit-invoice method long ago as the proper choice for VAT implementation.[32]Since the VAT revenue will enable a greatly simplified and reduced corporate income tax to spur economic growth instead of encumbering American competitiveness in the name of various, oftentimes conflicting, versions of Fairness, we must do just that: lower the corporate income tax to 15-20%.

7. Can Vat Revenue Justify Lowering the Corporate Tax

The primary gain in substantially lowering the U.S. corporate income tax[33]would be to lure significantly more investment. A lower corporate tax rate would also result in more reported U.S. profits. In the short term, if the VAT were at a lower rate than the current 35-39% corporate tax rate, American products would become cheaper and, thus, more desirable to consumers around the world.[34] Therefore, implementing a VAT will improve the United States' competitive position in the international marketplace.[35]

Presently, the U.S. corporate tax system has four major flaws: (1) is too complex; and (2) provides artificial tax enticements for U.S. companies to relocate real economic activity elsewhere and report profits in low-tax nations[36]; (3) puts U.S.-headquartered firms at a competitive disadvantage; (4) overall, raises relatively little revenue, given that the U.S. corporate tax rate is significantly higher than in most other advanced industrial nations.[37]

At to (1), the Byzantine complexities of the IRC have had a negative effect on government revenues from corporate taxes.[38]Corporate tax receipts have steadily declined over the past few decades as the IRC has become more complex and as more loopholes have become available for corporations to exploit."[39]During fiscal year 1960, corporate tax receipts totaled 4.2 percent of GDP, while in 2004 corporate tax receipts totaled only 1.6 percent-a decrease of 2.6 percent."' Profits earned by U.S. corporations in lower-tax foreign jurisdictions increased by 64% in recent years.[40]These income-shifting strategies cost the U.S. government approximately $60 billion per year.[41]The use of deductions and creative accounting methods complicates this system and lets U.S. companies lower their tax liability at the expense of the American taxpayer.[42]The U.S. tax code is "a patchwork of overly complex, inefficient, and unfair provisions that impose large costs on corporate business."[43]As the list of U.S. companies utilizing tax loopholes gets longer, less and less tax revenue is generated. No more would U.S. companies have an artificial incentive to both understate[44]the value of services and goods licensed or sold to them and overstate the value of services and goods purchased from foreign affiliates.

As to flaw (2), the placement of multinational corporate investments is quite sensitive to the local effective tax rate on corporate income.[45]Reducing the U.S. corporate income tax would encourage foreign-owned firms to invest more in the U.S. as well as also encouraging U.S. firms to switch from foreign investment to domestic,[46]as well as lessen the incentive to shift income within multinational firms to foreign affiliates.[47]This greater domestic investment would broaden the corporate income tax base, thereby offsetting somewhat the revenue decrease due to the lowering of the corporate tax rate. Real wages would rise from both the additional investment and from the decreased pretax returns to capital (less net income/retained earnings) since some of the tax reduction would shift from owners of capital to workers.[48]

The U.S. has the second highest combined federal-state corporate tax rate on earth.[49]With an average combined rate of 39.3%, the U.S. effective corporate tax rate is 50% higher than the average of all States in the OECD.[50]The U.S. corporate rate has remained virtually unchanged since the 1986 tax reform act. Over the same period, most OECD countries reduced their corporate tax rates substantially. Lowering the U.S. corporate tax rate would allay this imbalance. Admittedly, if in reaction, other nations also further reduced their corporate tax rate, the benefit to the U.S. would be largely diminished with a net effect of lost revenue for both OECD and U.S. treasuries. But this risk must be taken since a high corporate tax rate stunts a nation's economic growth and chokes its economy.[51]A study of fifty thousand companies in the European Union (EU) found that, when countries raise the marginal corporate tax rate by 1%, real wages decrease by 0.92%.[52]

By embracing identical tax rates under both the corporate and individual taxes, small corporations could be taxed on a flow-through basis. Small businesses would pay no corporate tax since their business income would be taxed directly to the owners individually. By qualifying for the $100,000 income tax exemption, the taxation of small-businesses would at long last be drastically simplified, or non-existent.

8. Vat Compliance Burdens and Administration

The VAT levies smaller administrative costs on tax enforcement agencies and smaller compliance burdens on taxpayers than income taxes. European VATs usually inflict compliance costs about 67-75% less than that of the U.S. income tax. This concurs with the U.S. Government Accountability Office (2008)[53]which cited studies from New Zealand and the United Kingdom finding that VAT administrative costs are less than an income tax since the VAT collection is only from business taxpayers. Most individual taxpayers are outside the system, and to further lower compliance and administrative costs, many countries exempt small businesses.[54]

The VAT structure also introduces an element of self-enforcement since if a business supplier is VAT-compliant, the recipient business being supplied will lose if not VAT compliant since VAT registration the recipient business to reclaim that tax. The VAT also prompts

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

self-enforcement on the other side of the ledger since if said recipient business's customer is VAT-compliant, the business yet again has an incentive to register and charge tax since that customer can reclaim the tax the business charges them, and along the way the business can reclaim the tax it has been charged on its own inputs. The VAT is a self-referential reality wherein enforcement is largely economically intuitive and self-reinforcing.

Another major concern with a VAT is how to administratively cure its inherent regressivity which raises tax burdens disproportionately more on lower income than on higher income taxpayers. Various means already exist to administratively mitigate VAT regressivity, such as exempting basic living necessities, but any such exemptions would also subsidize higher income taxpayers as well while making the VAT overly complicated. This option is overplayed worldwide and globally consistently underperforms.

The most obvious recourse to reduce the VAT's regressivity is to use multiple VAT rates. Yet there much better ways to justly redistribute income such as progressive income tax rates and targeted government spending, particularly as to education and health. Multiple rates also increases compliance and administrative costs, and create legal ambiguity through which VAT fraud via willful item misclassification can occur.[55] And so, despite the nigh political suicide in attempting to legislate a single-rate extremely-broad VAT, this Article is strongly advocating just that in order to greatly reduce administrative and compliance cost as well as curb economic distortions that would arise from a multiple-rate VAT.

A viable VAT mandates substantial tax reform, at minimum, as to individual and corporate income taxes with both individual and corporate AMT on the table as well. A VAT imposed at a 15% singe rate[56] could finance a complete exemption from filing any income taxes for families with $100,000 or less of income. For those who earn more than $100,000, the tax rate would be 20-25% and the return would be greatly simplified since most loophole-deductions would be eliminated.

9. Miscellaneous Vat Issues

While it is difficult to state how various deductions would fare under a 15% VAT system wherein corporate and individual income taxes were reduced to 20-25%, likely scenarios for the following deductions could ensue:

1) The deductions for home mortgage interest, charitable contributions, and large medical expenses would still be allowed.
2) Most income tax credits and allowances would be repealed.
3) Retirement savings plans and health insurance would still garner tax incentives for employers.
4) The deduction for state and local taxes would in all likelihood be repealed.
5) Capital gains could be taxed at the standard 15-20% rate.
6) Dividends would no longer be taxed, or marginally.

7) The corporate alternative minimum tax would be repealed. Businesses with annual gross income of less than $100,000 would be legally obligated to neither file corporate returns or collecting the VAT.

NOTE: This Article **strongly** asserts that corporate income taxes are the most detrimental to economic growth, followed by personal income taxes, then consumption taxes like the VAT, and finally property taxes on immovable property.[57]

10. Why Doesn't A Federal Vat Already Exist: It's Political Suicide

Although due to the ever-increasing deficit, U.S. interest in the VAT has surged, substantial opposition to the VAT remains. In 2010, the Senate passed by a 83-13 margin a nonbinding resolution opposing the introduction of a VAT. And earlier in 2005, the President's Advisory Panel on Federal Tax Reform refused to include a VAT as one of its recommended tax reform options.[58]

The Treasury Department has not supported the VAT and all previous successful tax reform efforts in the U.S. have been strongly supported by the Treasury Department. The 1969 and 1976 tax reforms were essentially drafted by Treasury and the 1986 reform grew out of a three-volume report drafted by Treasury economists.[59] And so, restoring the Treasury's central role in tax policy is a necessary precondition for meaningful VAT-led tax reform.

Presently, the VAT tax reform has no consensus among tax experts on where to begin. Politically, both parties dislike the VAT for no good reason. Conservatives in particular seem to forget that there is a long history of conservative support for consumption taxes. In his Leviathan (1651), Thomas Hobbes noted that since consumption was what people removed from society while saving contributed to society's wealth; consumption was more justifiably taxed while savings should be tax-exempt.[60]

Alexander Hamilton, among others, also noted in Federalist 21 that taxing consumption was most consistent with freedom because the American people could more easily consume less than earn more:

> It is a signal advantage of taxes on articles of consumption that they contain in their own nature a security against excess. They prescribe their own limit; which cannot be exceeded without defeating the end proposed, that is, an extension of the revenue. When applied to this object, the saying is as just as it is witty, that, "in political arithmetic, two and two do not always make four." If duties are too high, they lessen the consumption; the collection is eluded; and the product to the treasury is not so great as when they are confined within proper and moderate bounds. This forms a complete barrier against any material oppression of the citizens by taxes of this class, and is itself a natural limitation of the power of imposing them.[61]

Alexander Hamilton was not alone in this view since it has been endorsed over the centuries by David Hume, John Stuart Mill, Alfred Marshall, Irving Fisher Nicholas Kaldor and still today, by many others.[62]

A VAT fully addresses a perennial conservative concern regarding the ever-increasing number of citizens who do not pay any federal income taxes (46% in 2011).[63]A broad-based VAT cannot easily be evaded if you consume/purchase almost any good or service in the U.S. economy. Additionally, the VAT is the philosophical origin of the flat tax,[64]which is still advocated by nearly every conservative tax reformer.[65] The flat tax is essentially a subtraction-method VAT with one additional feature. A businesses can subtract cash wages paid from the base amount from which the VAT is calculated.

Ultimately, the challenge in enacting a VAT is political. Yet a VAT serves Conservatives' demand for fiscal balance and Liberals' demand to expand social programs by garnering sufficient tax revenue to do so, making the VAT the only true current win-win in America's political zero-sum game.

11. Conclusions

Overall, a substantial federal VAT is the best option in terms of compliance and administration costs as well as reducing opportunities for federal tax evasion. But merely placing a VAT on top of the existing system would merely send us in reverse by further increasing the variable and substantial fixed costs of administration and compliance. A VAT rate set too low would impose substantial costs per dollar of additional revenue. Thus, Congress should enact either a federal VAT (15%) capable of significantly reducing the federal deficit or none at all[66]

Any enactment of a substantial VAT would involve substantial anticipatory effects prior to the implementation of the VAT. In Australia retail sales increased by 3.1% and it took 18 months for total retail sales to return to their pre-VAT levels even though the VAT replaced existing turnover taxes.[67]In Japan, in the year of its introduction, the VAT lowered spending growth by over 1%.[68]Yet a preannounced, phased-in VAT in addition to a lowered corporate and individual income tax rate could hasten economic recovery, or at least greatly mitigate any VAT shocks.

Admittedly, it is in the long run that the benefits of such a VAT would most likely occur while in the interim both the labor supply and consumption would initially decline. In particular, real asset values would also decline as a result of the VAT triggering a (one-time) price increase.[69]Additionally, while the VAT may lead to a one-time increase in prices, the VAT has not proven inevitably, or even usually, to result in continuing inflation. If the VAT were a source of additional revenue, higher prices would ensue, especially, but this could be a one-time event that would not lead to further inflation if the transition were phased-in over time.[70]In 29 countries (83%) the VAT did not affect the CPI or if so, it was only a one-time increase. Nonetheless, a significant federal VAT will result in important short-term changes in relative prices.[71]

It cannot be denied that the VAT is a regressive tax since the poor consume a higher percentage of their income than the well-to-do, and so are necessarily going to pay more VAT as a percentage of their income than the well-to-do. This is what makes the VAT a Political Hari-Kari despite the justness of substantially broadening the tax base. But the government could make the VAT more appealing to the American public by explaining how lower corporate taxes would result in increased capital inflow to the nation, which in turn would create new jobs and more tax revenue, lessening the tax burden on Americans. Finally, Congress should pledge not to raise the VAT rate from 15% and pledge to lower the VAT to 7-10% once spending and debt are down to sustainable levels.

Congress should enact a federal VAT in addition to, and not as a replacement of, the federal income tax, which itself would be modified by the introduction of the VAT.[72]Now is the time to implement a broad-based federal VAT. To wait for an economic crisis triggered by the federal deficit is plain treasonous since by then there will not be enough time to get the details right. A rushed VAT would be volatile and dangerous due to the many moving parts involved. A well-planned VAT takes 2-3 years to properly and fully implement. Introducing a VAT in a fragile economic environment would not only damn its possible long-term success but be so irresponsible as to amount to criminal negligence. A well-implemented VAT will not solve the country's fiscal problems; but given the deficit, and our national demographics and the faltering economy, it is our best bet. Other less grandiose tax reforms are conflicting and execute at cross-purposes, resulting in huge, miserable trade-offs. Before the impending crisis, we must see intimately the relatedness and the effects from that relatedness. There is only one guarantee, bits and pieces of isolated analysis will fail safely, incrementally, marginally. The sort of failure party politics thrives on.

Admittedly, the fixed start-up cost of the VAT cannot be underestimated and must be balanced with the long run expected efficiency of VAT collection. Tax collection is easier when the tax code is simplified. Tax code simplicity mandates the VAT not be fraught with too many exemptions and/or multiple tax rates. A single VAT rate systematically creates greater compliance, more simplicity and renders clarity to both taxpayers and businesses. Additionally corporate income tax rates must be lowered while corporate loopholes are forever closed.

Enacting a federal VAT will likely be politically unpopular, especially in the early stages of implementation since the price of goods will increase. Some of this price increase will be mitigated with the lowering of the corporate and personal income tax rate,[73]yet it is likely that Americans will experience an overall higher tax burden than they currently have. This is especially true for the forty-seven percent of American households that presently do not pay federal income taxes.[74]However, this effective increase is necessary if the United States is going to pay down its national debt to a sustainable level.

No tax reform of any sort will be beneficial unless Congress uses the increased tax revenue to tackle the ravenous deficit. The European Union and other nations took a good idea, the VAT, and fumbled it by not utilizing the VAT revenue wisely. Once the U.S. implements a VAT, the government needs to refrain from wasting the new tax revenue by creating new entitlements or implementing new social programs. Instead, the VAT money should be earmarked for paying down the national debt and making the already insolvent entitlements of Social Security and Medicaid solvent again.

VAT mis-expenditure is not the only Trojan Horse in D.C. VAT exemptions should be precluded, if possible, or de minimis, yet experience with both income and sales taxes in both Europe and the U.S. nearly guarantees that certain services and goods will be VAT exempt. This is most unfortunate. The more exemptions the VAT has, the more distortions and less tax revenue. A broad base better ensures adequate revenues; exempting goods for distributional and social reasons should be done by other means, not the VAT. It is so easy for politicians to look the hero by adding various exemptions, each one prompted by well-funded lobbyists. But a momentary hero is a traitor to both our unborn and any glorious future that might have been.

We are all after wonderment, when two, three or four tax reform pistons are all firing in unison. At this point we need more than simple addition. We need ignition, lift off, another moon ride. The goal here is to grab critical mass for a nuclear financial expulsion. If not, we need to learn Esperanto since after the next financial meltdown a world government will seem the only viable solution.

Acknowledgements

The author would like to thank Professor Lois Shelton at CSUN, the David Nazarian College of Business and Economics, for her help both professionally and personally. The author would also like to thank Valerie Sabatier, PhD - Deputy Director Doctoral School and DBA Program Director for Grenoble École de Management.

References

[1] Auerbach, A. J. & Gale, W. G. (2011). Tempting Fate: The Federal Budget Outlook. *Tax Notes 132*(4), 375-88.

[2] Auerbach, A. J., & Gale, W. G. (2009). *The Economic Crisis & the Fiscal Crisis: 2009 and Beyond.* Retrieved from http://www.taxpolicycenter.org[UploadedPDF/411843economic_crisis.pdf.

[3] Ball, L., & Mankiw, N. G. (1996). *What do budget deficits do?* (No. w5263). National Bureau of Economic Research.

Rubin, R. E., Orszag, P. R., & Sinai, A. (2004). *Sustained Budget Deficits: the Risk of Financial and Fiscal Disarray.*

Burman, L. E., Rohaly, J., Rosenberg, J., & Lim, K. C. (2010). *Catastrophic Budget Failure, 63*(3), NAT'L TAX J. 561, 571.

[4] Rubin, R. E., Orszag, P. R., & Sinai, A. (2004). *Sustained Budget Deficits: the Risk of Financial and Fiscal Disarray*.

[5] This is a realistic tax used by more than 120 countries on five continents.

[6] Braucher, J. (2004). Middle-Class Knowledge the Two-Income Trap: Why Middle-Class Mothers & Fathers Are Going Broke. Elizabeth Warren & Amelia Warren Tyagi. *Emory Bankr. Dev. J.*, *21*, 193-779.

[7] Graetz, M. J. (2008). 100 Million Unnecessary Returns: A Simple. *Fair, and Competitive Plan for the United States*.

Graetz, M. J. (2002). 100 million unnecessary returns: A fresh start for the US tax system. *Yale Law Journal*, 261-310.

[8] Friedman, B. M. (2006). The moral consequences of economic growth. *Society*, *43*(2), 15-22. http://dx.doi.org/10.1007/BF02687365

[9] *Value-Added Tax (VAT) Definition,* INVESTOPEDIA. Retrieved from http://www.investopedia.com/terms/v/valueaddedtax.asp (last visited October 21, 2014).

[10] Cait Murphy. VAT: Will the US. Adopt a Value-Added Tax?, CBS MONEY WATCH (Apr. 12, 2010). Retrieved from http://www.cbsnews.com/8301-503983_162-20001918-503983.html.

[11] Roger Bevan. *VAT in Europe: 7 Steps to Success,* EWEEK (Jan. 4, 2008). Retrieved from http://www.eweek.com/c/a/IT-Management/VAT-in-Europe-7-Steps-to-Success/.

[12] Id.

[13] Id.

[14] Keen, M., & Smith, S. (2006). VAT fraud and evasion: What do we know and what can be done?. *National Tax Journal*, 861-887. (Concluding that current VAT enforcement difficulties in the EU largely reflect circumstances that would not apply in the United States). http://dx.doi.org/10.17310/ntj.2006.4.07

[15] Slemrod, J. Testimony before the President's Advisory Panel on Tax Reform, Washington, D.C., Mar. 3, 2005. Retrieved from http://govinfo.library.unt.edu/taxreformpanel/meetings/pdf/030305_transcripts.pdf

[16] Gupta, S. (1998). *Should equity be a goal of economic policy?* (Vol. 16). International Monetary Fund.

[17] "What reason is there, that he which laboureth much, and sparing the fruits of his labor, consumeth little, should be charged more, than he that living idlely, getteth little, and

spendeth all he gets: Seeing that one hath no more protection from the commonwealth than the other?" T. Hobbes, Leviathan 184 (Dutton ed. 1914).

[18]Gentry, W. M., & Hubbard, R. G. (1997). Distributional implications of introducing a broad-based consumption tax. In *Tax Policy and the Economy, Volume 11* (pp. 1-48). MIT Press.

[19] Id. at 142.

[20] Bartlett, B. *Support the VAT,* FORBES.COM (Oct. 10, 2009). Retrieved from http://www.forbes.com/2009/10/22/republicans-value-added-tax-opinions-columnists-bruce-bartlett.html

[21] Reckon, L. L. P. (2009). Study to quantify and analyse the VAT gap in the EU-25 Member States. *Report for DG Taxation and Customs Union, September*. Retrieved from http://ec.europa.eu/taxationcustoms/resources/documents/taxation/taxcooperation/combatingtax-fraud/reckon report sep2009.pdf

[22] Toder, E., & Rosenberg, J. (2010). Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes. Tax Policy Center Publication. April 7. Retrieved from http://www.taxpolicycenter.org/publications/url.cfm?ID=412062

[23] Id.

[24] Keen, M., & Lockwood, B. (2006). Is the VAT a money machine?. *National Tax Journal*, 905-928.

Bartlett, B. (2010). The VAT and the Money-Machine Argument. *Capital Gains and Games Blog. April*, *10*. http://dx.doi.org/10.17310/ntj.2006.4.09

[25] Thirsk, W. (1991). Lessons from tax reform: an overview. World Bank.

[26] Ebrill, L., Keen, M., Bodin, J. P., & Summers, V. (2001). The modem VAT.*International Monetary Fund Washi ngton, DC*. The president's panel recommended that a VAT base should include about 60% of GDP. Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, Report of the President's Advisory Panel on Tax Reform (Washington, D.C.: Government Printing Office, (2005), 191-205, 249-255. Retrieved from http://www.taxreformpanel.gov/final-report, last visited Oct. 26, 2014

[27] Toder, E., & Rosenberg, J. (2010). *Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes.* Tax Policy Center Publication. April 7. Retrieved from http://www.taxpolicycenter.org/publications/url.cfm?ID=412062

[28] Graetz, M. J. (2002). 100 million unnecessary returns: A fresh start for the US tax system. *Yale Law Journal*, 261-310. http://dx.doi.org/10.2307/1562240

[29]The U.S. has been mesmerized with the subtraction method VAT due to its similarity in form to the current corporate income tax. Europe nearly exclusively utilizes the credit-method VAT primarily for enforcement and administrative reasons. For example,

unlike the credit method, the subtraction method cannot smoothly execute multiple tax rates (if such is ever needed) on different products. This inability by the subtraction method explains the credit method's near-universal prevalence.

[30] Fifty years of international VAT experience has vindicated the credit-invoice method, which unlike the subtraction method VAT, is WTO-compatible and transaction-based, so if need be can readily apply multiples rates and exemptions for specific goods and services.

[31] Additionally, the federal VAT should not be origin-based; but rather destination-based wherein the tax would be imposed in the nation where consumption occurs, as opposed to where production occurs. If the VAT is not a replacement for the income tax, wages would no longer be a tax deduction and the tax can be made destination-based.

[32] Graetz, M. J. (2002). 100 million unnecessary returns: A fresh start for the US tax system. *Yale Law Journal*, 261-310. http://dx.doi.org/10.2307/1562240

[33] In an income tax system, a corporate income tax prevents citizens from amassing tax-free profits inside corporations.

[34] Id. at 1323.

[35] Schenk, A. (1996). Plethora of Consumption Tax Proposals: Putting the Value Added Tax, Flat Tax, Retail Sales Tax, and USA Tax into Perspective. *San Diego L. Rev.*, *33*, 1281.

[36] www.taxpolicycenter.org accessed on December 4, 2014.

[37]Avi-Yonah, R. S., & Clausing, K. A. (2007). *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment.* Brookings Institution.

[38]J. Econ. Comm., 105th Cong., Reforming The U.S. Corporate Tax System To Increase Tax Competiveness 2 (2005) at 6.

[39] Id.

[40] Rubinger, J. L., & Sherman, W. B. (2005). Holding Intangibles Offshore May Produce Tax Benefits. *Tax Notes*, *106*(8).

[41] Id.

[42] Ezra Klein. *Our Dumb Corporate Tax System,* WASH. POST (Sept. 27, 2010). Retrieved from http://voices.washingtonpost.com/ezra-klein/2010/09/our-dumb-corporate tax system.html.

[43]J. Econ. Comm., 105th Cong., Reforming The U.S. Corporate Tax System To Increase Tax Competiveness 2 (2005) at 6.

[44]Particularly for any goods or services wherein it is difficult to ascertain a comparable "arms-length" price, such as unique intangibles.

[45] De Mooij, R. A., & Ederveen, S. (2003). Taxation and foreign direct investment: a synthesis of empirical research. *International Tax and Public Finance*, *10*(6), 673-693. http://dx.doi.org/10.1023/A:1026329920854

[46] Drucker, J. (2010). *Google 2.4% rate shows how $60 billion lost to tax loopholes.*

[47] Clausing, K. A. (2007). Corporate tax revenues in OECD countries. *International tax and public finance*, *14*(2), 115-133. http://dx.doi.org/10.1007/s10797-006-7983-2

[48] www.taxpolicycenter.org accessed on December 1, 2014.

[49] Hodge, S. A. (2008). US Corporate Taxes Now 50 Percent Higher than OECD Average. Fiscal Fact No. 136. *Tax Foundation, August*, *13*, 2008.

[50] Id.

[51] Johansson, A., Heady, C., Arnold, J., Brys, B., & Vartia, L. (2009). Tax and economic growth. *European Economy*, (1), 71.

[52] Pethokoukis, J. (Aug. 22, 2008). *20 Reasons to Kill Corporate Taxes,* U.S. NEWS & WORLD REP. Retrieved from http://money.usnews.com/money/blogs/capital-commerce/2008/08/22/20-reasons-to-kill-corporate-taxes.

[53] U.S. Government Accountability Office (2008). *Value Added Taxes: Lessons Learned from Other Countries on Compliance Risks, Administrative Costs, Compliance Burden, and Transition.* GAO-08-566.

[54] www.taxpolicycenter.org accessed on December 4, 2014.

[55] OECD, Consumption Tax Trends: VAT/GST and Excise Rates, Trends and Administration Issues 2008, p. 51.

[56] Some have found evidence of Laffer-type effects for the VAT and estimated a revenue-maximizing VAT rate in the EU of around 19 percent. Matthews, Kent (2003) 'VAT Evasion and VAT Avoidance: Is there a European Laffer curve for VAT?' *International Review of Applied Economics, 17*(1), 105-114.

[57] Johansson, A., Heady, C., Arnold, J., Brys, B., & Vartia, L. (2009). Tax and economic growth. *European Economy*, (1), 71.

Diamond, J. W., & Zodrow, G. R. (2013). Promoting Growth, Maintaining Progressivity, and Dealing with the Fiscal Crisis: CGE Simulations of a Temporary VAT Used for Debt Reduction. *Public Finance Review*, 1091142113499399.

[58]Diamond, J. W., & Zodrow, G. R. (2013).

[59] Treasury Department Report to the President. (1984). Tax Reform for Fairness, Simplicity, and Economic Growth.

[60] Jackson, D. (1973). THOMAS HOBBES'THEORY OF TAXATION. *Political Studies*, *21*(2), 175-182. http://dx.doi.org/10.1111/j.1467-9248.1973.tb01426.x

[61] Hamilton's witty saying originated with satirist Jonathan Swift, who also influenced a long line of tax theorists. Bartlett, B. (1992). Jonathan Swift: Father of supply-side economics?. *History of political economy*, *24*(3), 745-748.

[62]Hume, D., & Essays, M. (1985). Political, and Literary, ed. Eugene F. Miller (Indianapolis: Liberty Fund, 1985), 361.; Mill, J. S., & ASHLEY, S. W. J. (1909). Principles of Political Economy... Edited with an Introduction by WJ Ashley. Longmans & Company: 802-22; Alfred Marshall, "The Equitable Distribution of Taxation," in Pigou, A. C. (1912). Wealth and Welfare (1912); Fisher, I., & Fisher, H. W. (1942). Constructive income taxation: a proposal for reform. New York: Harper; Kaldor, N. (1955). An Expenditure Tax, 1955.; Viard, A. D., & Carroll, R. (2012). Progressive Consumption Taxation: The X-Tax Revisited. AEI Press.

[63]Johnson, R., Nunns, J., Rohaly, J., Toder, E., Williams, R., & Center, U. B. T. P. (2011). Why some tax units pay no income tax. *Urban-Brookings Tax Policy Center, July*.

[64]The flat tax was originally devised by Hoover Institution scholars Robert Hall and Alvin Rabushka.

[65]N. Gregory Mankiw, "Much to Love, and Hate, in a VAT," New York Times (May 2, 2010).

[66] www.taxpolicycenter.org accessed on December 1, 2014.

[67] Treasury, A. (2003). Preliminary assessment of the impact of The New Tax System. *Economic Roundup*, (1), 1-49.

[68]Horioka, C. Y., & Watanabe, W. (1997). Why do people save? A micro‐analysis of motives for household saving in japan. *The Economic Journal*, *107*(442), 537-552. http://dx.doi.org/10.1111/1468-0297.00176
http://dx.doi.org/10.1111/j.1468-0297.1997.tb00026.x

[69] Diamond, J. W., & Zodrow, G. R. (2007). Economic effects of a personal capital-income tax add-on to a flat tax. *FinanzArchiv: Public Finance Analysis*, *63*(3), 374-395.

Diamond, J. W., & Zodrow, G. R. (2008). Consumption tax reform: Changes in business equity and housing prices. *Fundamental tax reform: Issues, choices and implications*, 227-280.

[70] McLure, C. E. (1987). *The Value-Added Tax: Key to Deficit Reduction?* (pp. 45-46). Washington, DC: American Enterprise Institute for Public Policy Research.

[71] Tait, A. (1990). VAT revenue, inflation and the foreign trade balance. *Value added taxation in developing countries*, 17-31.

[72] Duncan, H., & Sedon, J. (2010). Coordinating a Federal VAT with State and Local Sales Taxes. *Tax Notes*, *127*(9), 1029-1038.

Journal of Public Management Research
ISSN 2377-3294
2015, Vol. 1, No. 1

[73] Bickley, J. M. (2011). Value-Added Tax (VAT) as a Revenue Option: A Primer. *Congressional Research Service*.

[74] David Leonhardt. *Yes, 47% of Households Owe No Taxes. Look Closer,* N.Y. TIMES (Apr. 13, 2010), http://www.nytimes.com/2010/04/14/business/economy/14leonhardt.html