Another proposal for a hidden VAT

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October 29, 2015

Following Senator Rand Paul's lead, Senator Ted Cruz has released a tax reform plan that includes a substantial value added tax (VAT).

Cruz's plan would abolish the payroll and self-employment tax, the corporate income tax, and the estate and gift tax, and would also slash individual income tax rates to a flat 10%. The plan would recoup part of the revenue loss by adopting a 16% VAT, slightly larger than Paul's proposed 14.5% VAT.

Republican presidential candidate Senator Ted Cruz speaks at the North Texas Presidential Forum hosted by the Faith & Freedom Coalition and Prestonwood Baptist Church in Plano, Texas October 18, 2015. REUTERS/Mike Stone.

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Like Senator Paul (and Herman Cain in 2011), Senator Cruz shies away from the V word. In his Wall Street Journal op-ed, he calls his VAT a "Business Flat Tax." Rather than saying that each business would pay tax on its value added, he says that it would pay tax on its "gross receipts from sales of goods and services, less purchases from other businesses, including capital investment" – a precise, but not very transparent, definition of value added. As the Tax Foundation and a Cato Institute scholar point out, Cruz's proposed tax, like Paul's proposed tax, is a "subtraction-method value added tax."

Scaling back the income tax system and instituting a VAT would have advantages and disadvantages. Thanks to their VAT revenue, the Paul and Cruz plans achieve deeper income tax cuts, with smaller revenue losses, than other Republican presidential candidates' tax plans. A VAT is much more growth-friendly than the income tax because it does not penalize saving and investment. However, it places more of the tax burden on those who are less well off. And, giving the government another major revenue source might make it harder to restrain entitlement spending growth.

The concern about spending growth is heightened because Paul's and Cruz's proposed VATs would be hidden from public view – their plans do not include either of the two steps that can be taken to make VATs visible to the public.

A VAT can be split into a business cash flow tax and a wage tax, with the wage tax collected as an employee payroll tax that shows up on workers' pay stubs. Or, the total VAT collected from businesses along the production chain can be listed as a separate line item on the final customer's receipt, the way state and local retail sales taxes are listed. But, the Paul and Cruz plans would collect the VAT from businesses without listing it on customer receipts, ensuring that neither workers nor consumers would ever see the tax.

If the United States is to have a VAT, it should be adopted in the light of day, not snuck through as a "business tax." And, once adopted, its tax burden should be made visible to the American people, who have a right to know the full cost that they're paying for their government.