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VAT and The Great Tax Swap

President Obama and his advisers are hinting that they may ask Congress to supplement the existing corporate and personal income taxes with a national Value-Added Tax (VAT) - a tax on consumption. The reaction has been quick, venomous and misleading.

Missing in that criticism is any recognition that VAT-based tax discrimination in the global trading system is a major cause of our large and expanding trade deficits and is costing the United States millions of jobs as U.S.-based corporations shift their production to countries with a VAT.

My proposal herein is simple. Eliminate the existing U.S. personal and corporate income tax system altogether and replace it with a VAT -- a great tax swap of historic proportions.

One argument against such a swap is that it would require the repeal of the 16th Amendment, which is wrongheaded since the 16th Amendment gives Congress the power to levy an income tax, but does not mandate that it do so.

Several VAT critics are also arguing that while the VAT is efficient, fair, and effective, it would, however, raise too much money, too easily and thus encourage the purchase of more public services. They seem to like the existing chaos and inefficiency.

And indeed, there is already much about the U.S. Tax Code to hate, not the least of which is its complexity and sheer size -- a 24-megabyte computer download that fills 7,500 letter-size pages at 60 lines per page.

The administrative compliance costs to the U.S. economy, moreover, are enormous, with the General Accountability Office (GAO) estimating that it consumes approximately one percent of the gross domestic product annually ($145 billion in 2009). The Cato Institute, a Washington-based think tank, estimates that the U.S. "tax army" of accountants, lawyers, and computer experts includes more than 1.2 million tax preparers and processors.

The present system also has vast non-compliance. The IRS estimates that the difference between what taxpayers paid and what they should have paid in 2001 was $345 billion, which was 17 percent of federal revenue that year. Put another way, cheaters evade paying about one of every six dollars of taxes due the federal government.

For many VAT critics, their goal is not to define the method by which the U.S. government raises taxes or to improve its efficiency but to slash revenues as a means of cutting government, or "starve the beast."

The profit and loss statements of the General Electric Corporation also illustrate why there is an intense corporate opposition to the VAT. In the three-year period 2007-2009, GE had revenues of $511 billion, a net income of $51 billion, but paid only $1.1 billion in taxes -- barely 2 percent of their earnings. For tax purposes, GE also accrued a tax loss of $4.2 billion for the years 2007 and 2008. Under VAT, GE would pay much more.

As all this suggests, the present system is vastly unfair. At the top end, for instance, Wall Street's multi-billion-dollar-a-year hedge fund owners pay only a 15 percent tax on their profits. At the lower end of the economic scale, almost 47 percent of Americans pay no federal income tax whatsoever.

The VAT is comprehensive but applies only to that portion of value added that each party makes to the completion and sale of the product or service. In practice, the system is simple, perfect for modern computerized accounting, allows taxpayers to know their tax liability and helps the government better anticipate revenues. Cheating is difficult, easily spotted, and thus limited. Consumers pay the VAT automatically when they buy something. There is no April 15 tax day. Only consumption is taxed. All that is left over is yours.

But everyone pays something because everyone consumes something. Other nations pursue fairness with lower VAT rates on food, medicine and housing.

Beyond simplicity and ease of compliance, a VAT is compatible with global trade rules while the present U.S. tax system is not. This is of immense importance.

Under the rules of the World Trade Agreement, nations that use a VAT can rebate those taxes on exports and impose an equivalent amount on imports. Thus, other nations are able to subsidize their exports sold in the United States, while imposing a tariff-like VAT on U.S. imports into their countries.

In 2007, the 153 other nations with a VAT provided $230 billion in rebates for goods exported to the U.S., and imposed $125 billion of import taxes on U.S. made goods sold in their countries. Their products got a VAT-created competitive advantage here and there.

Changing the U.S. tax system from one based on corporate and personal incomes taxes to one based on a VAT is a unilateral way for the U.S. to eliminate this discriminatory foreign tax treatment.

The longer we delay making this great tax swap the more jobs we will lose and the more it will cost us to keep our corrupt, inefficient and flawed approach to taxes.