

# NATIONAL REVIEW

## Ted Cruz's and Rand Paul's Strange Embrace of the VAT

**The senators are right to want tax reform — but hiding the cost of government is not reform.**

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Senators Ted Cruz and Rand Paul are strong advocates of limited government. They are gifted spokesmen for free markets, and they are heroes for taking on the GOP establishment on issues such as overspending and civil liberties.

That is why their embrace of the value-added tax (VAT) in their presidential campaigns is so baffling. VATs are the revenue engine of big-government welfare states, not a proper funding source for the small federal government that both senators favor for America.

Cruz and Paul propose to rip up the current tax code and replace it with individual income taxes at low, flat rates — Cruz at 10 percent and Paul at 14.5 percent. Their plans would repeal the estate tax and corporate income taxes, while reducing the overall tax load. So far, so good.

But then we come to the VAT, which the candidates hide behind innocuous names — “business flat tax” for Cruz and “business transfer tax” for Paul. Actually, Paul’s title is accurate, because these taxes would “transfer” trillions of dollars into government coffers unseen by most citizens. The tab for taxes collected from businesses is ultimately passed through to individuals in the form of lower wages, reduced dividends, or higher prices. So for transparency, the best thing would be to scrap business taxes altogether, and collect the full tax load from individuals at a flat rate. That way, people could accurately perceive the full cost of government.

It is true that the VATs proposed by Cruz and Paul have modest rates — 16 and 14.5 percent, respectively. The problem is not the rates, but the tax bases. VATs have huge bases. That’s because — unlike income taxes — they do not allow businesses to deduct employee compensation when calculating the taxable amount. So both labor income and capital income are taxed at the business level under VATs.

The result would be that tax revenues from businesses under the Cruz and Paul VATs would be enormous. While the plans would abolish the corporate income tax (CIT), the new VATs would have corporate tax bases at least four times larger than the CIT. So every rate increase in the

VAT that future politicians might push would raise vastly more than the same rate increase on current business income taxes.

I share Cruz and Paul's passion for major tax reform, but we should not hide the huge cost of the government from the people. Federal spending currently costs 21 percent of the nation's gross domestic product. So a simple flat tax on individuals at a 21 percent rate would more accurately convey the cost of government to the public.

By dropping individual tax rates to 10 and 14.5 percent with big exemptions, Cruz and Paul would be creating a mirage of cheap government. Those low "prices" for government would raise the demand for it — people would clamor for more subsidies from Washington. Like Cruz and Paul, I want cheap government, but the way to actually get it is to slash spending.

The VAT issue comes down to where we want to tax labor income, which is a huge base. Because Cruz and Paul shift much of the collection to businesses, more of the tax burden gets hidden from citizens and voters. For the Cruz plan, the Tax Foundation estimates that 71 percent of total taxes in coming years would come from the hidden business VAT, while just 22 percent would come from the individual income tax. By contrast, if the individual income tax is not reformed, it will raise about 50 percent of total federal revenues in coming years.

Furthermore, Cruz and Paul would abolish the 15 percent federal payroll tax. Currently, that levy is partly hidden from workers in the tax's "employer half." But the solution to that transparency problem is to change the administration of the tax so that the full amount is visible on workers' paystubs, which is where the burden already falls in reality.

If the government is going to take our money, it should mug us on the street in broad daylight, rather than sneak into our homes at night and burglarize us unnoticed. The VAT would encourage more burglary. Cruz and Paul want smaller government, but down the road, other politicians looking to shore up entitlement programs will say, "They could be financed with just a small tax increase on businesses." But each "small" increase in the VAT rate would transfer huge amounts of additional cash from the private economy to the government.

Cruz and Paul deserve credit for thinking big on tax reform, but they should remember the H. L. Mencken line, "Democracy is the theory that the common people know what they want, and deserve to get it good and hard." If the common people want government spending, then the tax system ought to make them feel the full cost "good and hard."

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