



Cruz's Ostensible VAT Still Riles Some Conservatives


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Republican presidential candidate and Texas Sen. Ted Cruz sells his replacement for corporate income taxes as a business flat tax that would spur the economy and protect American jobs. But some conservatives still aren't buying, calling it a thinly veiled VAT that could eventually fund an expansion of social welfare spending.

And with Cruz's delegate count in the Republican primary race making him perhaps the only viable alternative for conservatives concerned about Donald Trump's electability, friendly-fire critiques of the Texas senator's tax plan are all the more pressing.

Foremost among those critics is economist Chris Edwards of the Cato Institute, who was one of the first to label Cruz's business tax a VAT, even as the candidate bent over backwards to deny it. "I hate it. I think it was a giant mistake by Cruz and his advisers. And you can quote me on that," Edwards told Tax Analysts.

When Cruz unveiled his tax plan  in October 2015, he said his business tax would replace the corporate income tax with a 16 percent tax on net business sales -- gross sales minus expenses and capital investments.

Edwards, writing soon afterward on the websites of the Cato Institute and the *National Review*, wondered why such a "gifted [spokesman] for free markets" and controlling government spending could have gotten part of his tax plan so wrong. (Cato article: <http://goo.gl/z5s0jx>.)

That Cruz's tax would be a VAT and would be embedded in products sold to consumers is undeniable, Edwards told Tax Analysts. "The Cruz VAT directly counters conservative tax principles regarding transparency and limitation of government," he said. "The Cruz VAT would be a giant, hidden burden on Americans that would be far too easy for future, liberal politicians to raise. My hope is that Cruz recognizes his error, goes back to the drawing board, and releases a 2.0 version that is a traditional flat tax, not a VAT."

The conservative-oriented Tax Foundation has similarly called Cruz's proposal "a subtraction-method VAT."

Cruz's campaign staff did not respond to requests for comment.

Cruz in Debates


When the matter came up in a Republican presidential debate on February 13, Cruz told CBS correspondent Major Garrett: "Now Major, the business flat tax that is in my tax plan is not a VAT. A VAT in Europe is a sales tax. The business flat tax is not a sales tax. It is a tax of 16 percent [applied] fairly and evenly across the board on all business."

And in a March 3 debate, he portrayed his business tax as "border adjustable" and a way to protect jobs in key industrial states like Michigan. Cruz said it would mean "all exports are entirely tax free and all imports pay the 16 percent business flat tax," making for a "32 percent differential."

But economist Kyle Pomerleau of the Tax Foundation said that was misleading. "Border adjustability does not act like a tariff," he said. "When [Cruz] says that it will benefit exporters, he is misrepresenting the function of a border adjustment. A border adjustment is simply a way for a VAT to hit only domestic consumption. Any perceived tax benefits would be offset entirely by changes in the [currency] exchange rate."

And Dean Baker, co-director of the liberal-minded Center for Economic and Policy Research, said of Cruz's job protection claim, "I think that is kind of silly." He added, "The currency [rate] swamps that."

Baker added that VATs are "very regressive" but that in Europe they are a supplement to income taxes rather than a replacement for them and are used to fund "progressive policies" such as healthcare.

And the Urban-Brookings Tax Policy Center, in a footnote accompanying its analysis  of Cruz's tax plan, said: "We disagree with popular belief . . . and do not think a VAT would improve the competitive position of the United States, whether or not the tax was border adjustable. In addition, border adjustability is well established under international law for credit-invoice VATs, but not for subtraction-method VATs like the one in the Cruz plan."

Other Conservatives Supportive

Still, Cruz is not without his defenders, one of which is economist Stephen Moore of the Heritage Foundation, who consulted Cruz on his idea. "If the conservative tradition is for taxes that are fair, efficient, and pro-growth, it's hard to find anything that beats this," Moore told Tax Analysts. He added, "This is the right tax base." He also said it would "raise a lot of money" to enable lower rates.

Further, Moore praised the border-adjustable aspect. "That's what makes this saleable to workers," he said.

Economist Curtis Dubay, also of the Heritage Foundation, defended that aspect as well. "We should be doing it now," Dubay said. "It levels the playing field for our businesses both at home and abroad. It would help our businesses compete better in foreign markets." It also would "create jobs and raise wages here in the U.S." by increasing sales of American products, he said.

And Dubay said Cruz's tax is in keeping with evolving Republican philosophy of moving toward greater reliance on consumption taxes. "It is in the mold of the Hall-Rabushka flat tax," he said, referring to Hoover Institution economists Robert Hall and Alvin Rabushka, who gained notoriety for the flat tax in an oft-cited 1981 op-ed in *The Wall Street Journal*.

Dubay added that the Cruz plan is in the mold of a business transfer tax (BTT) variously proposed by House Speaker Paul D. Ryan, R-Wis., at the time House Ways and Means Committee chair, and by former South Carolina Sen. Jim DeMint, who is now president of the Heritage Foundation.

"Cruz calls his BTT a business flat tax," Dubay said. "The BTT would allow expensing, be territorial, and have a border adjustment. These are all policies conservatives want in a business tax system."

But Cruz's challenge, Dubay said, "has been selling the idea of having an income tax and a consumption tax together."