ARE ALL CONSUMPTION TAXES CREATED EQUAL?

COMMENTARY ON: *THE SAGA OF UNFULFILLED BUSINESS INCOME TAX REFORM* BY HARRY L. GUTMAN

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INTRODUCTION

We have come full circle. In the 1990s, when Hank Gutman and I worked together on the Joint Committee on Taxation (JCT) staff, tax reform efforts focused on replacing all or part of the income tax with various types of consumption taxes.[1] Among the more notable of these efforts were the Danforth-Boren bill, a subtraction-method value-added tax (VAT) to replace the corporate tax;[2] Congressman Sam Gibbons' bill to use a subtraction-method VAT to replace the income and payroll taxes;[3] the Nunn-Domenici bill, a two-tiered consumption tax to replace the income tax;[4] the Armey-Shelby flat tax;[5] and former Ways and Means Committee Chairman Bill Archer's pledge "to rip the current tax code out by its roots" and replace it with a sales tax or a consumption tax.[6] These efforts stalled, and the reform focus has shifted more recently to competing versions of 1986-style reform proposals, which broaden the income tax base by eliminating tax expenditures and loopholes in order to lower rates.[7] However, because former Ways and Means Committee Chairman Dave Camp's fulsome version of this approach failed to garner political support,[8]

1. Consumption is defined as income less savings. Thus, a tax imposed on consumption, unlike an income tax, does not tax income that is saved (and the returns thereon), until it is consumed.

2. Comprehensive Tax Restructuring and Simplification Act of 1994, S. 2160, 103d Cong. (1994) (introduced by Sens. David Boren and John Danforth).

3. Revenue Restructuring Act of 1996, H.R. 4050, 104th Cong. (1996) (introduced by Rep. Sam Gibbons).

4. USA Tax Act of 1995, S. 722, 104th Cong. (1995) (introduced by Sens. Pete Domenici, Sam Nunn, and Bob Kerrey).

5. Freedom and Fairness Restoration Act of 1995, H.R. 2060, 104th Cong. (1995) (introduced by Rep. Dick Armey); Freedom and Fairness Restoration Act of 1995, S. 1050, 104th Cong. (1995) (introduced by Sen. Richard Shelby). Republican presidential candidate Steve Forbes had a similar campaign proposal. For a description of the mechanics of the flat tax, see *infra* notes 16–18 and accompanying text.

6. Kathy Sawyer, *House GOP to Hold Tax Reform Summit*, WASH. POST (Apr. 2, 2000), http://www.washingtonpost.com/wp-srv/WPcap/2000-04/02/106r-040200-idx.html [http://perma.cc/F8WA-99PG]; Michael Berryhill, *Archer's Way*, HOUS. PRESS (Apr. 11, 1996, 4:00 AM), http://www.houstonpress.com/news/archers-way-6571756 [http://perma.cc/XV7K-SMWZ].

7. *See* Tax Reform Act of 2014, H.R. 1, 113th Cong. (2014) (introduced by Chairman Dave Camp); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011) (introduced by Sens. Ron Wyden, Dan Coats, and Mark Begich); Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. (2007) (introduced by Chairman Charles Rangel); Press Release, Max Baucus, Chairman, Senate Fin. Comm., Baucus Unveils Proposals for International Tax Reform (Nov. 19, 2013), http://www.finance.senate.gov/chairmans-news/baucus-unveils-proposals-for-international-tax-reform [http://perma.cc/L5X9-TKK5]; Nat'l Comm'n on Fiscal Responsibility & Reform, Co-Chairs' Proposal (Nov. 10, 2010) (draft document), http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/CoChair_Draft.pdf [http://perma.cc/S6QX-6DKJ] (chaired by Erskine Bowles and former Sen. Alan Simpson).

8. Chairman Camp's plan provided full legislative detail about the base broadening that would

attention (at least of some) appears to be swinging back to a consumption-based approach.[9]

In his article, Hank suggests that this was inevitable and appropriate because all of the 1986-style tax reforms were "half measures" that failed to address the rate differential sufficiently and neglected to change "incentive[s] to move profits abroad."[10] Certainly, as Chairman Camp's proposal demonstrated, any efforts to broaden the income tax base and lower rates on a revenue-neutral basis would be fraught with a number of political and practical difficulties, including the treatment of pass-through entities, the adverse effects on capital-intensive businesses, and having to "address issues that Congress avoided in its development of the comprehensive and much-praised [Tax Reform Act of 1986]."[11]

Channeling Winston Churchill,[12] Hank suggests that we, as Americans, will eventually do the right thing with respect to tax reform, but only after exploring and exhausting all other options. He believes the obvious solution is for us to adopt a proposal similar to Senator Ben Cardin's bill, using a credit-invoice VAT to provide the revenue needed to reduce the U.S. corporate income tax rate to 15%.[13] As Hank notes, such a move would be consistent with the worldwide trend of declining corporate income tax rates and increasing VATs.[14] Others are proposing even more dramatic reforms to replace all or part of the income tax with various types of consumption taxes.

In an effort to help advance the tax reform cause and ensure that we explore and exhaust all options, this Article will briefly explain the differences among the various consumption tax options and will then address several of the more significant questions that policymakers must weigh in deciding whether to adopt a consumption tax reform approach and which approach to choose.

need to be done to reduce rates in a revenue-neutral fashion. This helped identify the likely winners and losers in a 1986-style tax reform package. When Chairman Camp released his proposal, House Republican leaders refused to endorse it, and it did not advance further. *See* Russell Berman & Bernie Becker, *Boehner Scoffs at Tax Reform Vote*, THE HILL (Feb. 26, 2014, 11:11 AM), http://thehill.com/homenews/house/199300-boehner-lowers-expectations-on-tax-reform [http://perma.cc/2L4T-TEEK].

9. *See, e.g.*, American Business Competitiveness Act of 2015, H.R. 4377, 114th Cong. (2016) (introduced by Rep. Devin Nunes); Progressive Consumption Tax Act of 2014, S. 3005, 113th Cong. (2014) (introduced by Sen. Ben Cardin); TAX REFORM TASK FORCE, HOUSE REPUBLICANS, A BETTER WAY: TAX (2016) [hereinafter A BETTER WAY]; JAMES B. RENACCI, SIMPLIFYING AMERICA'S TAX SYSTEM (2016), http://renacci.house.gov/_cache/files/7eeb81fe-f245-42c0-8de4-055ebf4c12e9/sats-white-paper.pdf [http://perma.cc/4BA2-SL8C].

10. Harry L. Gutman, *The Saga of Unfulfilled Business Income Tax Reform*, 89 TEMP. L. REV. 267, 289 (2017).

11. John L. Buckley, *Tax Expenditure Reform: Some Common Misconceptions*, 132 TAX NOTES 255, 258 (2011).

12. Like several of my peers in the tax community in Washington, I am a proud graduate of Winston Churchill High School in Maryland.

13. *See* S. 3005.

14. *See* Ine Lejeune, *The EU VAT Experience: What Are the Lessons?*, *in* THE VAT READER 257, 260 (Tax Analysts ed., 2011).

I. CONSUMPTION TAX OPTIONS

As alluded to above, a number of alternatives exist for taxing consumption, most of which have been proposed at one time or another in the United States. The various alternatives are described briefly below.[15]

A national retail sales tax is imposed on the sales price of taxable goods and services to a retail end user.[16] This is generally accomplished by excluding sales for resale or property purchased that are incorporated in taxable property or services. Alternatively, business-to-business and household-to-household transactions may be excluded. This alternative is generally easier to administer but results in a narrower base. Certain end users (e.g., charities) may be exempt from the tax, and certain goods and services may be excluded (e.g., food and education).

A VAT is imposed on the "value added" at each stage of production and distribution of a good or service. There are two principal ways of computing and collecting a VAT: the credit-invoice VAT and the subtraction-method VAT.

The credit-invoice VAT is a transactions-based approach: a seller is required to collect tax (equal to the tax rate multiplied by the sales price) on each sale, whether to a business or a consumer. The seller is entitled to a credit for the VAT it has paid on purchases of goods and services used in its business. Typically, for compliance reasons, the credit is limited to the amount of taxes shown on a purchase invoice that includes both the seller's and the purchaser's names. Thus, at the end of an accounting period, the seller will remit to the government the cumulative amount of taxes it has collected on its sales, less the credit for cumulative taxes paid on its purchases (as reflected on invoices). This effectively limits the tax paid to the "value added" by the seller. The end consumer of a product or service does not receive a credit for tax paid on its purchases.

By contrast, the subtraction-method VAT is an accounts-based approach. The value added by each business is determined at the end of each accounting period based upon the difference between the aggregate value of its sales of taxable goods and services, and the aggregate value of its purchases of taxable goods and services. The tax rate is applied to this difference to determine the tax liability for the relevant period. A subtraction-method VAT typically does not require an invoice to take a deduction for business purchases, although this could be required to improve compliance. Absent any differences in tax rate, exceptions, compliance, and enforcement, a credit-invoice VAT and a subtraction-method VAT should result in the same amount of tax ultimately

15. For a more detailed discussion of the various types of consumption tax proposals, see STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW AND CONSUMPTION-BASED APPROACHES TO TAXATION 23–24 (Comm. Print 2016) [hereinafter STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW].

16. *See, e.g.*, Fair Tax Act of 2015, H.R. 25, 114th Cong. (2015) (introduced by Rep. Rob Woodall) (proposing to replace most federal taxes with a national retail sales tax). A national retail sales tax would be similar in effect to the general sales taxes imposed by most states and many local governments.

collected (i.e., the tax rate multiplied by total value added in the economy).

Three variants on a subtraction-method VAT have been proposed as reforms in the United States. The first is commonly referred to as the "flat tax." Originally created by two Stanford University economists, Robert Hall and Alvin Rabushka, and later popularized by House Majority Leader Dick Armey and Republican presidential candidate Steve Forbes, the flat tax would replace the income tax completely with a consumption-based system. The business tax base would be the same as in a subtraction-method VAT scheme except that businesses would also be permitted to deduct their wage and other compensation payments to employees.[17] Wages and other compensation would instead be taxed at the individual level (at the same rate applicable to businesses). This approach allows for a standard deduction at the individual level, which provides some relief for low-income taxpayers through an effective exemption for a specified amount of consumption, making the tax somewhat "progressive" at the low end of the income distribution.[18]

The second alternative is the X tax conceived by the late David Bradford, a former Treasury Department official and Princeton University economist.[19] The X tax is identical to the flat tax except that it would apply multiple rate brackets to compensation income taxed at the individual level in order to provide even greater progressivity.

Absent the standard deduction (in both the flat tax and the X tax) and the difference in rates employed by the X tax, these two alternatives would, in theory, collect the same amount of tax as a pure subtraction-method VAT. Taxes would continue to be imposed at the same rates on wages but would be remitted by households rather than at the business level.

The third alternative, the business cash flow tax, recently has garnered the most attention. It is the approach espoused by Alan Auerbach, a well-respected economist at the University of California, Berkeley, and put forth in the recently released the House Republican *A Better Way* proposal.[20] The business tax base generally would be the same as the flat tax and the X tax (i.e., a subtraction-

17. *See, e.g.*, ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX 55–56 (2d ed. 1995); Freedom and Fairness Restoration Act of 1994, H.R. 4585, 103d Cong. (1994) (introduced by Rep. Dick Armey).

18. In simple terms, progressivity refers to a system where low-income taxpayers pay a smaller proportion of tax on their income than is imposed on taxpayers with higher incomes. Like other consumption-based systems, the flat tax is actually regressive at higher ends of the income distribution because no tax is imposed on income from savings.

19. *See* David F. Bradford, *A Tax System for the Twenty-First Century*, *in* TOWARD FUNDAMENTAL TAX REFORM 11, 13–17 (Alan J. Auerbach & Kevin A. Hassett eds., 2005); DAVID F. BRADFORD, FUNDAMENTAL ISSUES IN CONSUMPTION TAXATION 5–6 (1996) (describing a consumption-based subtraction-method VAT for businesses); DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 329–34 (1986).

20. *See* A BETTER WAY, *supra* note 9; ALAN J. AUERBACH, A MODERN CORPORATE TAX 7–16 (2010) [hereinafter AUERBACH, A MODERN CORPORATE TAX]; *see also* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 167 (2005) (proposing a destination-based business cash flow tax referred to as the "Growth and Investment Tax Plan" or the "GIT").

method VAT with a deduction for wages and other compensation). Unlike those two approaches, however, the business cash flow tax proposed by both Auerbach and the *A Better Way* proposal would not replace the individual income tax. Thus, unlike the flat tax and the X tax, the return to savings (e.g., interest, capital gains, etc.) would continue to be taxed at the individual level as income (albeit at reduced effective tax rates).

SUMMARY TABLE OF PRINCIPAL TYPES OF CONSUMPTION-BASED TAX SYSTEMS[21]

Type of consumption tax	***Base***	***Collection level***	***Transaction or accounts based***	***Destination or origin***[22]
Retail sales tax	Retail sales revenue	Business	Retail transactions	Destination
Credit-invoice VAT	Sales revenue less credit for taxes paid on business purchases (as shown on invoices)	Business	All transactions	Destination
Subtraction-method VAT	Sales revenue less business purchases	Business	Accounts	Destination or origin
Flat tax	Sales revenue less business purchases + wages/wages taxed at individual level	Business/ individual (wages)	Accounts	Origin
X tax	Sales revenue less business purchases + wages/wages taxed at individual level	Business/ individual (wages)	Accounts	Destination or origin[23]
Business cash flow tax	Sales revenue less business purchases + wages	Business/no tax on wages[24]	Accounts	Typically, destination

21. This table is derived from a similar table prepared by the American Bar Association (ABA) in ABA TAX SYS. TASK FORCE, A COMPREHENSIVE ANALYSIS OF CURRENT CONSUMPTION TAX PROPOSALS 205 (1997).

22. As discussed more fully below, some consumption taxes typically are imposed on a destination basis rather than an origin basis (like our current corporate income tax). *See infra* notes 91–94 and accompanying text. A destination-based system imposes a tax on the value of consumption that occurs in a country, regardless of whether the consumed goods or services are produced at home or abroad. An origin-based system imposes tax only on goods or services produced in the home country.

23. To comply with the General Agreement on Tariffs and Trade (GATT), an X tax would likely have to be origin based. *See* David A. Weisbach, *Does the X-Tax Mark the Spot?*, 56 SMU L. REV. 201, 218 (2003).

24. While there is no separate tax on wages as in the flat tax or the X tax, it should be noted that both Auerbach and the *A Better Way* proposal would maintain the individual income tax. *See* AUERBACH, A MODERN CORPORATE TAX, *supra* note 20, at 13; A BETTER WAY, *supra* note 9, at 16–17.

Other forms of consumption taxes include a personal expenditures tax and an addition-method VAT,[25] but these are not widely used or proposed.

While these consumption tax approaches generally all apply to similar bases (as shown above), their differing mechanics can affect (1) what they are chosen to do or replace, (2) the ability to provide exceptions or relief, (3) compliance and administration, (4) progressivity and incidence, (5) transparency, and (6) whether the tax should be destination or origin based. Each of these issues will be discussed in turn.

II. What Is the Primary Purpose for Adopting a Consumption Tax?

Probably the most important question in determining whether to adopt a consumption tax and which one to adopt is: what is it being implemented to do?

As evidenced by the various proposals that have been made in the United States, the choices are myriad. A consumption tax has been proposed as an additional revenue source, as a potential brake on health care spending,[26] as a means to lower corporate rates, as a replacement to the corporate income tax,[27] as a partial replacement to the individual and corporate tax together with a payroll tax rebate,[28] as a means to simplify compliance and enforcement, and as a full replacement for the income tax.

Typically, the purpose for adoption of a consumption tax has the greatest influence on the type of consumption tax that is chosen. If, as Hank suggests, the consumption tax is being used as an additional revenue source or as a partial replacement to the corporate income tax, it is more likely that a transactions-based approach—either a credit-invoice VAT or retail sales tax—would be adopted to avoid imposing a second accounts-based business tax on top of the corporate income tax. This has been the case in virtually every other Organisation for Economic Co-operation and Development (OECD) country,[29]

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25. The individual tax component of the two-tiered tax system proposed in Senate Bill 722 by Senators Nunn and Domenici was a personal expenditures tax. S. 722, 104th Cong. (1995). This tax was accomplished by providing taxpayers with an unlimited savings-allowance deduction from taxable income. Under the addition method, tax is imposed on the aggregate amount of a taxpayer's inputs not purchased from other taxpayers, including wages, interest, and profits.

26. *See* Leonard E. Burman, *The Tax Reform that Just Won't Die [and Shouldn't]*, MILKEN INST. REV., May 2014, at 17, 21.

27. *See, e.g.*, S. 2160, 103d Cong. (1994).

28. *See* S. 3005, 113th Cong. (2014); MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES 199–213 (2008) [hereinafter GRAETZ, 100 MILLION UNNECESSARY RETURNS]; Michael J. Graetz, The "Competitive Tax Plan" Updated for 2015, at 9 (Nov. 21, 2013) [hereinafter Graetz, The Competitive Tax Plan] (presentation given at the National Tax Association).

29. According to the Tax Policy Center:

> Many countries have attempted to implement national retail sales taxes or variants, such as wholesale-level taxes or "ring" taxes (retail sales taxes with exemptions for businesses "in the ring"). But not for long. In 1967, 19 Organisation for Economic Co-operation and Development (OECD) countries had some form of wholesale, retail, or turnover tax. By 1995, all had converted to value-added taxes (VATs) that collect revenue at each stage of

as the JCT staff recently found that over 140 countries have adopted a credit-invoice VAT to supplement their income tax system.[30] One potential downside to this type of approach is that it imposes an additional set of burdens and costs for taxpayers and the Internal Revenue Service (IRS) by forcing them to administer two different tax systems.

The choice of consumption tax is less clear, however, if the purpose is to replace either the corporate income tax or the individual income tax. There is no international example upon which to base the decision—no other OECD country has used a consumption tax to replace either its corporate or individual income tax.[31]

The political optics may be better if the corporate income tax is replaced with another business-accounts tax, like a subtraction-method VAT or business cash flow tax, rather than a tax imposed on consumer transactions[32]:

> Some claim that a subtraction-method system is more likely to survive the political process than a credit-method system because it can be described as a gradual reform of the current system. At first glance, the only differences between a subtraction-method consumption tax

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> production. Developing countries have also largely abandoned retail sales taxes in favor of VATs.

Briefing Book: What Is the Experience of Other Countries with National Retail Sales Taxes?, TAX POLICY CTR., http://www.taxpolicycenter.org//briefing-book/what-experience-other-countries-national-retail-sales-taxes (last visited Feb. 15, 2017) [http://perma.cc/62C8-3A7J].

30. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 23. The Japanese consumption tax is often referred to as a subtraction-method tax system. However, it is actually a hybrid of a subtraction-method and a credit-invoice system—it is annual accounting based like a subtraction-method VAT but has enforcement features that are similar to a credit-invoice VAT (e.g., a credit mechanism for VAT previously paid on purchased inputs). *See* Itai Grinberg, Symposium, *Where Credit Is Due: Advantages of the Credit-Invoice Method for a Partial Replacement VAT*, 63 TAX L. REV. 309, 316 n.13, 320–21 (2010).

31. *See* Reuven S. Avi-Yonah, *The Report of the President's Advisory Panel on Federal Tax Reform: A Critical Assessment and a Proposal*, 59 SMU L. REV. 551, 554 (2006).

> The reason for this phenomenon is simple: The income tax is needed to tax the rich. . . . [N]o consumption tax can tax unconsumed wealth, and unconsumed wealth needs to be taxed in a democratic polity to enable the government to achieve some degree of control over the economic, social, and political power of the rich. Thus, both a personal income tax and a corporate income tax are necessary tools of private power regulation in a modern society.

Id.

In a speech to Tax Executives Institute (TEI) in 1993, Hank stated that two countries—India and Sri Lanka—had attempted to replace their income tax with a personal consumption tax, but they abandoned the efforts after brief trials. Afterwards, Sri Lanka attempted to reinstitute the personal consumption tax, "but once again abandoned the tax because (according to Sri Lanka's [M]inister of [F]inance) it was deemed 'unworkable and impractical in an economy like that of Sri Lanka.'" *Concurrent Resolution on the Budget for Fiscal Year 1996: Hearing Before the S. Comm. on the Budget*, 104th Cong. 357 (1996) (statement of Hank Gutman).

32. Bradford chose the X tax rather than a personal expenditure tax because "he felt that having part of the tax collected at the business level was politically necessary." *See* Daniel Shaviro, *Tax Policy Colloquium, Week 9: Alan Viard's "Progressive Consumption Taxation: The Choice of Tax Design"*, START MAKING SENSE, (Apr. 3, 2013, 2:22 PM), http://danshaviro.blogspot.com/2013_04_01_archive.html [http://perma.cc/9BMR-96ST].

> and a corporate income tax are expensing and the loss of interest deductions. These are major changes, but in political circles these changes may seem minor relative to the perceived sea-change of repealing the corporate income tax and replacing it with a credit-method VAT assessed at the cash register.[33]

On the other hand, choosing an accounts-based approach rather than a credit-invoice VAT would make the United States an outlier relative to other OECD countries and would make coordination between our consumption tax and other countries' credit-invoice VATs more difficult.[34] According to Itai Grinberg, "[U]sing the credit method makes it more likely that worldwide credit-method norms will be adopted."[35] He further contends that the adoption of an accounts-based business consumption tax makes it more likely that special exceptions and other undesired features of our corporate income tax will remain in place.[36]

Whether these special exceptions remain or others should be included relates to two other articulated purposes of a shift to a consumption tax: improving savings and efficiency and simplifying our tax system. It is often argued that our current income tax, by imposing a tax on investment income, discourages savings and encourages present consumption. Because a consumption tax exempts the normal return on saving from tax, a shift from an income tax to a consumption tax is often thought to increase savings levels. However, there are several reasons why this may not be the case and why any positive effects of a shift from an income tax to a consumption tax by the United States may be muted.

First, economic studies to date have disagreed over the extent that taxpayers respond to changes in the after-tax return to saving. "[S]ome studies find that personal saving responds strongly to increases in the net return to saving, while others find little or a negative response."[37] While you would expect people to save more when the after-tax return to saving is higher, there is a countervailing effect:

> When the rate of return increases, you have to sacrifice less current consumption to achieve any particular level of future consumption. Most people don't save because they like saving per se but because they want a higher level of future consumption. This motive can actually cause people to save *less* when the rate of return increases.

33. Itai Grinberg, *Implementing a Progressive Consumption Tax: Advantages of Adopting the VAT Credit-Method System*, 59 NAT'L TAX J. 929, 936 (2006).

34. Proponents often argue that tax reform is necessary to make our corporate tax system, with its high tax rate and worldwide base (with deferral), less of an outlier. For example, in speaking about tax reform generally, then-General Electric Tax Director John Samuels wrote, "We should not be increasing U.S. tax isolationism, but instead narrowing the gap between our tax system and those of the rest of the world." John M. Samuels *American Tax Isolationism*, 123 TAX NOTES 1593, 1599 (2009).

35. Grinberg, *supra* note 33, at 936.

36. *See id.*

37. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 50.

> Effectively, the higher rate of return makes it possible to consume more both now and later.[38]

Second, our current income tax is already a hybrid system that because of several exemptions or special treatment of capital income, acts like a piecemeal consumption tax in many ways (and in some cases, provides more favorable treatment of capital investment than a consumption tax provides).[39] According to recent statistics, about four-fifths of all interest income is excluded or deferred through pensions, life insurance policies, and tax-exempt bonds.[40] Over half of all dividend payments are exempt or deferred,[41] and the rest are taxed at reduced rates. And, obviously, the taxation of capital gains is a mishmash. Capital gains are not indexed for inflation (but can be deferred until realization), generally are taxed at lower rates than ordinary income, and can avoid income tax entirely if held until death. Capital gains may also be exempt or deferred under a number of tax-favored investment vehicles available under the current tax code.

Third, consistent with the experience of other countries, it seems unlikely as a political matter that any consumption tax adopted in the United States would fully replace the current income tax system or that any consumption tax adopted would remain pure.[42] Consequently, efficiency or savings benefits from shifting to a consumption tax system may be reduced or eliminated. For example, if exclusions are provided that favor certain activities or encourage certain types of consumption, they could affect efficiency (and saving).

With respect to simplification, it is generally simpler not to tax capital income than to tax it. However, this will impact progressivity (as discussed below)[43] and could actually adversely affect retirement savings and other important sectors, such as housing.[44] Moreover, the real world experience with VATs adopted in the European Union (EU) and elsewhere is that they have significant complexities of their own, generally caused by deviations from an "ideal" VAT.[45] These include multiple rates, exemptions, denials of deductions, taxation of service income, and compliance concerns with border adjustments.[46] The United Kingdom's VAT, for example, has been described as complex and

38. LEONARD E. BURMAN & JOEL SLEMROD, TAXES IN AMERICA: WHAT EVERYONE NEEDS TO KNOW 110 (2013).

39. The combination of interest deductibility and various forms of accelerated depreciation under current law can be a greater incentive for investment than expensing without an interest deduction under a consumption tax. *See infra* note 81 and accompanying text.

40. *See, e.g.*, JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 34–35 (4th ed. 2008).

41. *See id.*

42. *See supra* note 31 and accompanying text.

43. *See infra* Section V.

44. *See generally* Julie Roin, *The Consequences of Undoing the Federal Income Tax*, 70 U. CHI. L. REV. 319 (2003).

45. SLEMROD & BAKIJA, *supra* note 40, at 250–52.

46. See *infra* Parts III–IV for a description of the complexity added by these types of adjustments and exclusions.

"almost unintelligible."[47] Also, it is not clear that adoption of a VAT would significantly reduce the current compliance gap.[48] In 2005, in preparing estimates for the Breaux-Mack tax reform panel, the Treasury Department projected that a U.S. VAT would have a similar compliance gap (roughly 15%) to the current tax system.[49]

The remainder of this Article will focus on the other questions that policymakers would need to answer to determine the appropriate form of a consumption tax. For the reasons discussed above, these questions are more likely to be relevant if policymakers choose to replace the corporate income tax or our entire income tax system.[50]

III. WHAT ADJUSTMENTS DO POLICYMAKERS WANT TO MAKE?

When economists and policymakers espouse the virtues of a consumption tax, they generally compare a pure consumption tax with our current income tax, which (let's just say) is less than pure. Certainly, like an income tax, "the most efficient VAT is one that has a minimum amount of exclusions."[51]

Unfortunately, in a political environment, it is very unlikely that any consumption tax will remain pure. As in the other countries that have adopted a VAT, policymakers will likely provide, initially or subsequently, special treatment for various goods, types of services or industries, and classes of taxpayers. This is typically accomplished in two different ways: zero rating (or special rates) and exemption.

Zero rating means, like it sounds, that a zero rate is imposed on the sale of the good or service. While the seller is not required to collect or remit tax, it is treated as a taxpayer and allowed to receive rebates for taxes paid on its inputs (in the case of a credit-invoice VAT) or to deduct its purchases and claim a loss if purchases exceed zero-rated sales (in the case of a subtraction-method system).

By contrast, while an exemption means that tax need not be collected, an

47. Alan Sinyor, *VAT: A Contextual Approach*, TAX ADVISER, Dec. 2004, at 18, 18.

48. The compliance gap (also referred to as the "tax gap") is generally defined as the difference between the taxes actually owed and the taxes collected. *See* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 3–4. Typically, it is divided into three components: nonfiling, underreporting, and underpayment. IRS, THE TAX GAP 1 (2005), http://www.irs.gov/pub/irs-utl/tax_gap_facts-figures.pdf [http://perma.cc/4QUE-EKWX].

49. *See* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 202.

50. Whether it makes sense to replace the corporate tax or the income tax is beyond the scope of this paper. Among the issues that would need to be examined in making this decision are the effects on fairness and progressivity, whether consumption tax proponents' claims regarding increased savings and investment are valid given the hybrid nature of our current income tax, the effect on various important sectors (e.g., health care, pensions, housing) of eliminating various aspects of the income tax, and administrative practicality and enforceability. *See* Roin, *supra* note 44; Michael Keen & Stephen Smith, *VAT Fraud and Evasion: What Do We Know, and What Can Be Done?* 5 (Int'l Monetary Fund, Working Paper No. 07/31, 2007) (explaining that because "information obtained in enforcing commodity taxes . . . may be helpful in enforcing the income tax (and vice versa)," there may be reasons to have both types of taxes).

51. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 27.

exempt seller is not treated as a taxpayer and is not entitled to refunds of taxes paid (in the case of a credit-invoice VAT) or refunds for losses with respect to its purchased inputs (in the case of a subtraction-method system). In addition, under a credit-invoice VAT, the purchaser of an exempt good or service generally receives no credit for any VAT paid (on prior sales of the good or service). This can result in a cascading of the tax.[52] However, under a standard subtraction-method VAT, the purchaser would be permitted to deduct the cost of the good or service even though the seller would not be including the amount of the sale as subject to tax. Consequently, no cascading of tax would occur.

Because of these differences in the treatment of adjustments between the two types of systems, the JCT summarized the choice facing policymakers in providing such adjustments as follows:

> [T]o the extent exclusions are provided, zero rating is preferable to exemption and the credit-invoice method is more amenable to zero (or multiple) rating because the credit-invoice method allows the character of the good or service (and the appropriate tax treatment) to be determined at the time of sale. The resulting invoice documents such determination contemporaneously. However, to the extent exemptions are preferable to zero rating (*e.g.*, if one wanted to provide administrative relief for small businesses that provide goods and services at an intermediate stage of production or distribution), the subtraction method may be preferable to the credit-invoice method in order to avoid the cascading of the VAT.[53]

In either case, these types of adjustments can lead to complexity and anomalous (and sometimes humorous) results. For example, VAT tribunals in the United Kingdom had to rule that roller coasters and hot-air balloons did not constitute public transportation, which was zero-rated.[54] Similarly, hot food was exempt from tax, so convenience stores and sandwich shops installed microwaves to heat sandwiches (and the like) to avoid tax.[55] For administrative convenience, the zero rating of children's clothing in the United Kingdom VAT was based on the size of clothes. As a consequence, big children—but not small adults—were subject to tax.[56]

Finally, a picture may be worth a thousand words regarding the potential complexity of a VAT. This flowchart comes from an English VAT compliance handbook regarding lettings (i.e., leases or rentals)—the handbook contains several other similar charts.[57]

52. Cascading generally refers to the levying of tax on items that have already been taxed without a deduction for the tax that has previously been paid.

53. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 27.

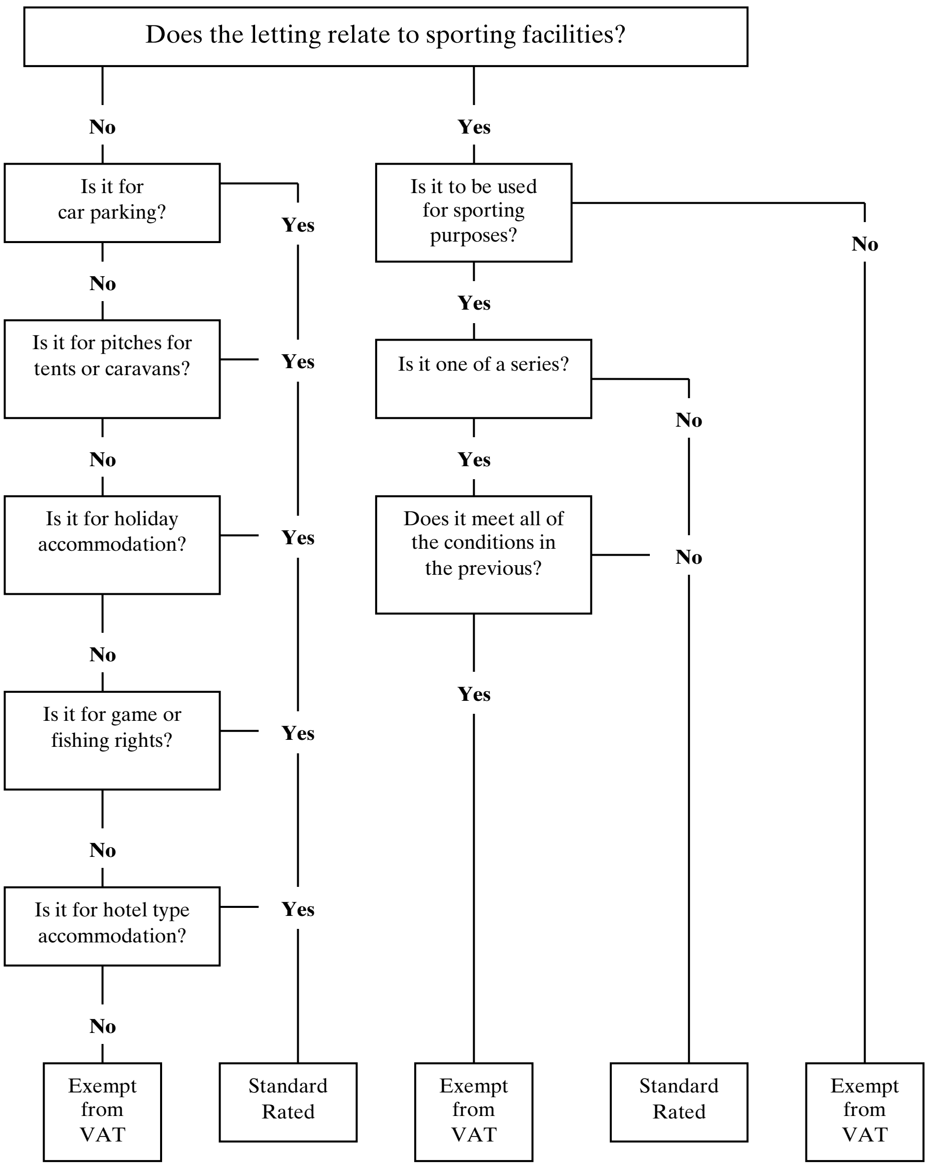
54. CENT. BEDFORDSHIRE COUNCIL, VAT GUIDE 31 (2011).

55. Irwin M. Stelzer, *A Tax that Mainly Adds Complexity: The Pitfalls of a VAT*, THE WKLY. STANDARD (Dec. 14, 2015), http://www.weeklystandard.com/article/2000077 [http://perma.cc/C5FX-7B7E].

56. *See id.*

57. *See* CENT. BEDFORDSHIRE COUNCIL, *supra* note 54, at 39.

FLOW CHART FOR LETTINGS



IV. What Are the Effects on Compliance and Administration?

There are tradeoffs among compliance, collection, and ease of administration within the various consumption tax proposals. Because it is imposed at all stages of production and distribution, the VAT is generally considered better than a sales tax from a compliance and enforcement standpoint. With a sales tax, if a retailer fails to collect tax or pay over tax collected, the government is out the entire tax on the sales price. Also, it is sometimes difficult to distinguish a final retail sale (which is taxed) from a sale for resale (which is exempt).[58] By contrast, in a VAT, there generally is no need to distinguish between types of sales. Moreover, if a seller fails to collect or pay over the tax collected, the government only loses the amount of tax attributable to any value added by the seller. The amount of tax attributable to other levels of production and distribution would still be collected.

With respect to the two types of VATs, the credit-invoice method is generally considered better for compliance because of the invoice requirement imposed for credit purposes. This aids in "self-enforcement because the incentive for sellers to underreport sales to reduce tax liability may be checked by the incentive of purchasers to have such sales reported at their full price in order to receive full VAT credits."[59] No similar check and balance exists in a standard subtraction-method system or at the retail level in a credit-invoice VAT. However, the effectiveness of this self-enforcement check in a credit-invoice system may be overstated if audit enforcement does not track invoices.[60]

There may be administrative preferences as to which consumption tax to adopt based on whether the corporate tax remains in place or not. For example, as has been the experience in other countries, a credit-invoice VAT is likely to be preferred if the corporate tax were not being replaced to avoid imposing the burden of two annual accounts-based taxes on businesses. On the other hand, if the VAT is replacing the corporate tax, some argue that a shift to a subtraction-method system may be easier administratively for both taxpayers and the IRS. As an annual accounts-based approach, a subtraction-method system will rely on books, records, and systems already in place for corporate income tax reporting, avoiding new taxpayer burdens and administration costs for the IRS.[61] However, the JCT staff points out that this may only be the case "where the taxable base is designed to match existing taxpayer records."[62]

58. The sales tax has the advantage, however, of reducing the points of collection for ease of administration.

59. Staff of Joint Comm. on Taxation, 114th Cong., Background on Cash-Flow, *supra* note 15, at 60.

60. *See* Keen & Smith, *supra* note 50, at 7 ("[W]hile traders have an incentive to ensure that their suppliers provide them with invoices that the authorities will accept as establishing a right to refund or credit, they have no incentive—unless specific requirements to this end are imposed—to ensure that tax has actually been paid: for this reason, . . . the notion that the VAT is self-enforcing is ultimately 'illusory.'" (citation omitted)).

61. *See* Staff of Joint Comm. on Taxation, 114th Cong., Background on Cash-Flow, *supra* note 15, at 60.

62. *See id.*

As discussed in Section III, if adjustments to tax are provided, a credit-invoice system is a preferable means of providing a zero rating, while the subtraction-method system avoids cascading in the case of exemptions.[63]

Finally, for purposes of designing a consumption tax, the determination of where services are "consumed" is a difficult and complex question that can depend on numerous factors, including (1) the kind of service provided, (2) whether the customer is in business, (3) where the customer is located, and (4) whether the service is carried out on a fixed installation or good. To illustrate, try to determine where "use" occurs if an architectural firm has two of its offices, one in the United States and one in Canada, collaborate on a design project for a customer in the United Kingdom regarding a building located in France. Special rules are needed to determine where the services are consumed, and such rules are often particularly elaborate with respect to international transportation, communications, and digital services.

V. WHAT ARE THE AVAILABLE MEANS TO HELP MAINTAIN PROGRESSIVITY?

It is interesting that polling and economic studies have indicated that much of the public support for a consumption tax historically comes from the misinformed belief that it will be more progressive than the current system.[64] However, Hall and Rabushka, in their famous book on flat taxes, wrote, "Now for some bad news. It is obvious mathematical law that lower taxes on the successful will have to be made up by higher taxes on average people."[65] Because the wealthy tend to save at a greater rate than others, any tax system that exempts the return to saving will favor them disproportionately (relative to an income tax). Also, any increase in retail prices caused by a move to a consumption tax will impose greater harm on lower-income households.[66]

Various steps can be taken to address these concerns. Adjustments can be made, as described in Section III above, to zero rate or exempt certain types of necessities, such as food or health care. A mechanism for providing a low-income allowance, similar to the current Earned Income Tax Credit (EITC), could be developed, although this would be easier to implement if the individual income tax or wage tax remains in place.[67] Finally, several of the consumption tax approaches, such as the flat tax and the X tax, were specifically developed to be less regressive than pure consumption taxes by providing a standard deduction

63. *See supra* notes 47–52 and accompanying text.

64. *See* SLEMROD & BAKIJA, *supra* note 40, at 71–74.

65. ROBERT E. HALL & ALVIN RABUSHKA, LOW TAX, SIMPLE TAX, FLAT TAX 58 (1983).

66. Gary Hufbauer argues that monetary policy can control whether adoption of a consumption tax "causes prices to rise." GARY CLYDE HUFBAUER, FUNDAMENTAL TAX REFORM AND BORDER TAX ADJUSTMENTS 13 (1996). For a further explanation of the effect of monetary policy on potential price increases, see *infra* notes 84–85 and accompanying text.

67. *See, e.g.*, Progressive Consumption Tax Act of 2014, S. 3005, 113th Cong. (2014) (introduced by Sen. Ben Cardin); HUFBAUER, *supra* note 66, at 13 n.16; Graetz, The Competitive Tax Plan, *supra* note 28, at 9.

or a progressive rate structure on wages.[68]

It is important to note that any concerns about progressivity will depend significantly on the purpose for adopting the consumption tax. If, as Hank and others have suggested, the consumption tax is only a partial replacement for the income tax, the retention of the income tax may help to reduce any distributional concerns. For example, Columbia Law School Professor Michael Graetz has proposed imposing a VAT and using the proceeds to reduce the corporate rate, to provide a $100,000 income tax exemption for joint filers ($75,000 for heads of household; $50,000 for single filers), and to provide a payroll tax credit for lower-income taxpayers.[69] Thus, by providing the payroll tax credit and leaving the individual income tax system in place for upper-income taxpayers, he attempts to address the regressivity issues arising from adopting a VAT. Also, these concerns could be mitigated or eliminated entirely if the VAT or other consumption tax is used to fund a progressive benefit, like social security or health care.[70]

VI. DOES THE INCIDENCE OF THE TAX DIFFER BASED ON THE TYPE OF CONSUMPTION TAX?

Much of the literature tells us that the incidence of a consumption tax is on consumers.[71] This is, of course, true, but it is overly simplistic and does not really tell us much, as we are all consumers. This also would likely pose a political barrier for proponents who want to replace the corporate tax, in whole or in part, with a consumption tax. As Hank points out, "[P]oliticians will be loath to take on an issue that will be presented by opponents as a tax increase on consumers for a simultaneous tax reduction for business."[72]

Fortunately, as Hank notes, the story is more nuanced. Let me try to further develop the discussion of incidence in his article, starting with the current corporate income tax. Until recently, the incidence of the corporate income tax was very unsettled, and the debate is still ongoing.[73] However, because of new economic research, the JCT staff and the Treasury Department have recently revised their approaches and now distribute the corporate tax between owners of capital and labor.[74] For example, the JCT staff "follows the middle range of the current economic literature by assuming that 25 percent of corporate income taxes are borne by domestic labor and 75 percent are borne by owners of

68. The X tax provides greater flexibility to address concerns about progressivity across all income levels. Because their rates are flat, both VATs and the flat tax have a "lack of flexibility . . . for obtaining progressivity in the middle- and upper-income ranges." Jane G. Gravelle, *The Distributional Case Against a VAT*, *in* THE VAT READER, *supra* note 14, at 102, 111.

69. *See* Graetz, The Competitive Tax Plan, *supra* note 28.

70. *See* Burman, *supra* note 26, at 20–23.

71. *See, e.g.*, *Briefing Book: Who Would Bear the Burden of a VAT?*, TAX POLICY CTR., http://www.taxpolicycenter.org/briefing-book/who-would-bear-burden-vat (last visited Feb. 15, 2017) [http://perma.cc/GZ8H-4WYA].

72. Gutman, *supra* note 10, at 305.

73. JOINT COMM. ON TAXATION, 113TH CONG., MODELING THE DISTRIBUTION OF TAXES ON BUSINESS INCOME 4 (Comm. Print 2013).

74. *See id.* at 10–19.

domestic capital."[75] Interestingly, the JCT staff assumes that "none of the burden of corporate income taxes flows through to consumers."[76]

While the JCT staff pamphlet does not offer much of an explanation for its findings, the Tax Policy Center (TPC), which recently reached a similar conclusion, provides greater detail.[77] According to TPC, the corporate tax is borne 40% by the normal return to capital and 60% by the supernormal return to capital.[78] The burden on the supernormal return to capital is assigned solely to shareholders. Because of international capital mobility, however, TPC believes that roughly 50% of the burden on the normal return to capital will be shifted from the owners of all corporate capital to labor.[79] As a result, while labor has no direct burden because wages are deductible from the corporate income tax, TPC believes that labor indirectly bears 20% of the corporate tax burden (i.e., one-half of the 40% borne by the normal return to capital).[80]

So, the question is: How would this analysis change if we replaced all of the corporate income tax with a subtraction-method VAT? The primary differences between a subtraction-method VAT and the current corporate income tax are the elimination of the wage deduction, allowing an immediate deduction for the cost of capital investment (expensing) in lieu of accelerated depreciation (combined with the elimination of the interest deduction), and the potential border adjustments.[81] It appears from the economic literature described above that elimination of the wage deduction would impose a burden on labor and that expensing would eliminate any burden on the normal return to capital (i.e., owners of capital and labor).[82] Taken together, under this economic analysis, these two effects seemingly would cause an overall shift of burden from the owners of corporate capital to labor. A similar shift would occur if the replacement for the corporate income tax were the flat tax or the X tax, although the shift of burden to labor likely would be somewhat less because of the standard deduction and progressive rates in the X tax.

This analysis would be somewhat different if a business cash flow tax were adopted to replace the corporate income tax.[83] In this case, the primary

75. *Id.* at 8.

76. *Id.*

77. *See* JIM NUNNS, TAX POLICY CTR., HOW TPC DISTRIBUTES THE CORPORATE INCOME TAX 10 (2012).

78. *See id.* at 1. A supernormal return is the return on capital investment in excess of the normal return on an investment with similar risk.

79. *See id.*

80. *See id.*

81. For a discussion of the potential border adjustments, see *infra* Part VIII.B.

82. For some capital-intensive businesses, the tradeoff of getting full expensing in exchange for losing the interest deduction and accelerated depreciation (including bonus depreciation) will be negative. This could impact both the shift in incidence analysis, as well as any dynamic scoring effect, of adopting full expensing.

83. The analysis assumes no other moving parts and a revenue-neutral package with the changes described below. The incidence analysis will change if there are other moving parts. For example, the House Republican *A Better Way* proposal makes a number of other changes to the individual income tax, as well as a significant rate reduction on business income. TPC does not score the package as

differences would be allowing expensing (in lieu of accelerated depreciation) combined with the elimination of the interest deduction and potential border adjustments. The wage deduction would continue, and thus, unlike a subtraction-method VAT, there would be no shift of burden to labor.[84] Because of expensing, the burden would be eliminated from the normal return to capital, and thus the burden of the tax would be borne entirely by the supernormal return to capital (i.e., shareholders).

CHART ON BURDENS OF VARIOUS TAXES

Burden	***Corporate income tax***	***Subtraction-method VAT***	***Flat tax and X tax***	***Business cash flow tax***
Labor		X	X	
Normal return to capital (borne by labor and owners of capital)	X			
Supernormal return to capital (borne by shareholders)	X	X	X	X

The burden on labor of a consumption tax can be reflected in general price increases in the economy or in reductions in nominal wages. Which of these occurs will depend upon the Federal Reserve's (Fed) monetary policy.[85] According to the JCT staff, this distinction is irrelevant to most wage earners "because they face the same reduction in buying power whether their nominal

being revenue-neutral over the long run. These factors can change the distributional consequences significantly, both in the short run and the long run.

84. Auerbach explains this as the system being "equivalent to the combination of . . . [a] broad-based consumption tax . . . [with an] equal rate subsidy to payroll." The result "is a tax on consumption from sources other than wages and salaries." Alan Auerbach, Destination Based Cash Flow Tax (July 14, 2016), http://www.taxpolicycenter.org/sites/default/files/destination-based-cash-flow-tax-proposal-and-development_0.pdf [http://perma.cc/9F5H-UJ5K].

85. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 57.

> The VAT represents a "wedge" between the prices consumers pay and the prices producers receive. If the Fed did not allow consumer prices to rise when the VAT was introduced, the wedge would mean that producer prices would have to fall at all stages of production and distribution of goods and services, reducing nominal incomes by the amount of the VAT. This means that payments to labor and capital would have to fall by the amount of the VAT.

See ERIC TODER, JIM NUNNS & JOSEPH ROSENBERG, TAX POLICY CTR., IMPLICATIONS OF DIFFERENT BASES FOR A VAT 17 (2012).

wage falls or the prices they face increase."[86]

Additional questions will need to be further examined with respect to the effects of replacing a corporate tax with a consumption tax on incidence. First, to what extent are prices or current wage rates already affected by the current corporate tax and how much will they shift? Second, while the distinction between the two may be irrelevant on a macroeconomic basis, are there sectors of the labor force that will suffer more from falling wages than increases in general prices (and are there sectors that could suffer from both)? Finally, in addition to monetary policy, could the form of the VAT affect whether a price increase occurs as opposed to an effect on wages or profits? For example, while economic theory would say it doesn't matter, several business people I have spoken with believe it may be easier for a business to pass on a consumption tax to consumers through price increases if it is transparent, like under a credit-invoice VAT. Of course, they acknowledge that this will be affected by competitive pressures as well.

VII. DO POLICYMAKERS WANT THE TAX TO BE TRANSPARENT TO CONSUMERS?

The visibility of the tax may differ between a credit-invoice VAT and a subtraction-method system. Under the credit-invoice method, the seller would be required to state the amount of VAT on invoices in order for a business purchaser to be able to claim credit for the tax paid. In most countries that employ a credit-invoice system, the amount of VAT is also shown on sales invoices to the consumer. However, because consumers cannot claim VAT credits with respect to their purchases, some countries have chosen to disallow disclosure of the VAT amount on retail sales invoices, meaning sellers must determine whether a purchaser is an end user before providing an invoice. Also, some argue that the fact that sales taxes and credit-invoice VATs are paid daily throughout the year helps to hide the overall taxpayer burden, because few taxpayers monitor their overall taxes paid.[87]

By contrast, the subtraction method does not generally require a seller to state the amount of tax applicable to a particular sale on the sales invoice.[88] Consequently, a subtraction-method VAT is often referred to as a "hidden" tax, and consumers are less likely to be aware of the amount of tax.[89] Thus, in choosing a consumption tax, policymakers will need to determine how

86. STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 57. Taxpayers may not be completely indifferent because of the progressive rate structure and income-based incentives of the current individual income tax system.

87. *See, e.g.*, WHITNEY AFONSO, MERCATUS CTR., THE CHALLENGE OF TRANSPARENCY IN TAXATION 2–4 (2015), http://www.mercatus.org/system/files/Afonso-Transparency-Taxation-MOP.pdf [http://perma.cc/X4UU-N8XS].

88. The Japanese have adopted a hybrid system that more closely resembles a subtraction-method VAT, but it has features of a credit-invoice system as well. *See* Grinberg, *supra* note 33, at 933–34.

89. *See* Alan D. Viard, *Another Proposal for a Hidden VAT*, AM. ENTERPRISE INST.: AEIDEAS (October 29, 2015, 4:22 PM), http://www.aei.org/publication/another-proposal-for-a-hidden-vat/ [http://perma.cc/7WDF-9BAM].

transparent they want the tax to be.

According to the JCT staff and as shown above, "policymakers have latitude in determining the visibility (or lack thereof) of the tax [by changing features] under either method."[90] Consequently, because of this flexibility, the transparency factor alone (while important) is unlikely to be determinative of the method chosen.

VIII. SHOULD THE CONSUMPTION TAX BE DESTINATION BASED?

One of the biggest decisions in choosing a consumption tax is whether it will be imposed on a destination basis or an origin basis. As explained by the Breaux-Mack tax reform panel report, "The former treats all domestic consumption equally, while the latter treats all domestic production equally."[91] Under a destination-based system, the aggregate tax base is the value of consumption that occurs in a country, whether or not the consumed goods or services are produced at home or abroad. To effectuate this, border adjustments are made that exempt exports from tax (often through rebates) and impose tax on imports either directly or by denying a deduction for their purchase to the importer.[92] By contrast, an origin-based system will impose tax only on goods or services produced in the home country. Thus, exports of goods and services are subject to tax, while imports are exempt.

A shift to a destination-based corporate tax system would be a sea change for the United States, which "has vigorously pursued the taxation of residents' economic activity outside the United States" for over a century.[93] Proponents of a destination-based system argue that given our globalized economy where corporate residency and production factors are highly mobile, we need to shift our tax base to factors that are less mobile, like domestic consumption, to foster a less avoidable and more efficient tax system.[94] On the other hand, we would be ceding the right to tax foreign income from value-creating activities in the United States. This raises at least two questions. First, is it fair for exporting corporations to avoid all U.S. tax when using domestic resources, workers, and infrastructure to generate income from abroad? Second, because we have

90. *See* STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND ON CASH-FLOW, *supra* note 15, at 28.

91. PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 167. The Breaux-Mack tax reform panel recommended using a destination basis to implement its business cash flow tax. *Id.* at 167–68.

92. A destination-based, subtraction-method tax system often will generate greater deductions and potential losses than an income-based system. This is particularly true for a business cash flow tax with its deduction for wages. Because its deductible inputs often exceed its taxable outputs, a company that is a net exporter will frequently generate losses. Policymakers will need to determine the best manner to allow recognition of those losses. For example, the Breaux-Mack tax reform panel would not have allowed refunds for losses but would have allowed carryforwards with accrued interest. *See id.* at 166–67.

93. William B. Barker, *A Common Sense Corporate Tax: The Case for a Destination-Based, Cash Flow Tax on Corporations*, 61 CATH. U. L. REV. 955, 963 (2012).

94. *See, e.g.*, *id.* at 978.

relinquished our right to tax such income, would other countries react to this change by adopting similar tax systems or otherwise increasing taxes on U.S. companies with respect to such income?

In determining whether and how best to adopt a destination-based system, policymakers will need to consider a number of issues regarding border adjustments, including any purported impact on competitiveness; the potential impact on American wealth; compliance, administration, and coordination with foreign tax systems; the effect on imports; and the legality of border adjustments under trade agreements.

A. The "Border Adjustment Fallacy"

It is often thought that the border adjustments in a destination-based consumption tax system would encourage exports and reduce imports. This is one of the principal arguments made by consumption tax proponents—that it will reduce our trade deficit and improve competitiveness.[95] This, however, according to most economists, is a "fallacy."[96] According to the JCT staff,

> [E]conomists have long held that there is no direct effect of a VAT on the volume of exports or imports. . . . [T]he imposition of a tax on imports—equal to that imposed on goods produced domestically—and a similar tax rebate on exports is intended to maintain a level playing field between domestic and foreign producers . . . .[97]

Moreover, economists believe that any competitive effects will be countered by adjustments in the relevant foreign exchange rates.[98] Thus, Auerbach concludes that because border adjustment does not provide incentives for trade or capital flows, the "[i]mpact of tax reform on trade balance and investment must come through other channels."[99]

As discussed further in Part VIII.D, however, there are legitimate questions about how exchange rates would adjust and whether border adjustments in a

95. For example, in introducing his VAT proposal, Representative Gibbons said that it would help to "level the playing field" with overseas competitors who already have border-adjusted VATs and would promote the United States' international competitiveness. Sam Gibbons, *A Proposal for a New Revenue System for the United States Incorporating a Value-Added Tax*, TAX NOTES TODAY, Mar. 11, 1993, LEXIS, 93 TNT 98-46; *see also* A BETTER WAY, supra note 9, at 28.

96. Alan D. Viard, *Border Tax Adjustments Won't Stimulate Exports*, AM. ENTERPRISE INST. (Mar. 2, 2009), http://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/ [http://perma.cc/A4T6-VH9E]. Alan Viard points out that if border adjustments did actually permanently increase exports, "it would be an economic disaster rather than an economic triumph. . . . We would suffer a permanent reduction in our standard of living." *Id.*

97. STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT ON INTERNATIONAL COMPETITIVENESS OF REPLACING THE FEDERAL INCOME TAX 97 (Comm. Print 1996) [hereinafter STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT].

98. *See id.* "[I]f a temporary price advantage is created by a tax change, this will alter the demand for the dollars and the demand for the foreign currencies necessary to purchase traded goods and services. The resulting change in exchange rates should eliminate the temporary price advantage." *Id.* at 102.

99. Alan J. Auerbach, Univ. of Cal.–Berkeley, How Border Adjustments Do Matter, and How They Don't, (Dec. 2, 2005) [hereinafter Auerbach, How Border Adjustments Do Matter].

subtraction-method system would lead, in some business sectors, to potential adverse effects on imports.

B. *The Effect of Border Adjustments on Existing Wealth*[100]

If policymakers want to adopt a destination-based consumption tax, they would need to consider the potential shift of wealth from American owners of assets to foreign investors that would result from the dollar appreciation that economists say border adjustments would cause.[101] According to Bob Carroll and Alan Viard,

> A border adjustment also has profound transitional effects on asset values, effects that have drawn surprisingly little attention. The border adjustment brings into the tax base the consumption of Americans financed by their existing foreign assets and removes from the tax base the consumption of foreigners financed by their existing American assets. . . . The appreciation of the dollar reduces the dollar-value of Americans' foreign assets and increases the foreign-currency value of foreigners' American assets.[102]

Carroll and Viard conclude that this wealth shift, based on current data, could be several trillion dollars, which "would dwarf the efficiency gain from tax reform" and "would actually be a gift to the world" as their "VATs are gifts to the United States."[103]

The largest beneficiaries of this wealth shift are likely to be the Chinese government, which holds large amounts of U.S. debt and assets, and foreign multinationals with U.S. subsidiaries. By contrast, U.S. multinationals with large foreign subsidiaries, other U.S. investors with significant foreign holdings, and debtors with dollar-denominated debt will be harmed. Proponents for a destination-based system are likely to counter that this ignores the effects of any potential U.S. growth in investment on the value of U.S. assets held by Americans. At best, the macroeconomic effects of a wealth shift of this

100. While my focus is on the wealth effects caused by border adjustments, there are other potential (and more obvious) adverse wealth effects caused by a shift to a consumption tax that policymakers will need to consider. For example, if prices will increase as a result of adopting a consumption tax, depending upon how the Fed reacts to adoption of the tax, the purchasing power of owners of preexisting capital and those on fixed incomes (e.g., nonindexed private pensions) could be harmed. Other similar issues include the effects on existing owners of depreciable assets and owners of existing financial assets. Policymakers will need to determine the extent to which transition rules should be provided to reduce this impact. While inclusion of transition rules may improve equity, they will reduce any efficiency gains of switching to a consumption tax. Also, the need for transition relief may be reduced or eliminated to the extent the consumption tax is replacing the income tax, in whole or in part.

101. For a fuller discussion of the effect of border adjustments on exchange rates, see *infra* Part VIII.D.

102. ROBERT CARROLL & ALAN D. VIARD, PROGRESSIVE CONSUMPTION TAXATION: THE X TAX REVISITED 110 (2012). Auerbach reaches a similar conclusion. He also finds a potential adverse effect on U.S. revenue from border adjustments of $750 billion because the "U.S. net international investment position is negative," meaning we will have to "run [future] trade surpluses . . . to service this liability." *See* Auerbach, How Border Adjustments Do Matter, *supra* note 99.

103. CARROLL & VIARD, *supra* note 102, at 111.

magnitude are highly uncertain.

C. Compliance, Administration, and Coordination with Other Systems

A significant advantage of a destination-based system cited by proponents is that it reduces or eliminates the transfer pricing issues that exist under the current income tax.[104] Because border adjustments limit the tax base to domestic consumption, "the prices established for cross-border transactions are irrelevant, and there are no opportunities to use transfer prices to minimize tax liabilities."[105] By contrast, the same (or even greater) incentives to "overcharge for imports and undercharge for exports" would continue to exist in an origin-based consumption tax.[106]

On the other hand, a destination-based system may be more susceptible to false claims and fraud. Because of border adjustments, taxpayers will attempt to claim that inputs were not imported (when in fact they were) and that sales are exports (when in fact they are not). According to International Monetary Fund (IMF) economists Michael Keen and Stephen Smith, "[I]t is the zero-rating of exports that has proved the feature most vulnerable to fraud . . . . The difficulty with zero-rating exports is that it not only breaks the VAT chain but does so 'at a particularly vulnerable spot: the interface of domestic and foreign tax administrations.'"[107] Also, if a destination-based system is adopted, an enforcement mechanism will need to be adopted to account for direct sales by foreign sellers to domestic consumers[108] and to prevent a potential "round-tripping loophole."[109] For example, an excise tax could be imposed on direct-to-consumer sales; however, if the experience with state sales and use taxes is any guide, this will be difficult to enforce. Thus, if border adjustments are adopted, effective mechanisms will need to be developed to ensure that deducted inputs have not been imported, that export sales have actually been made to purchasers abroad, and that foreign sales directly to U.S. consumers bear the tax.

104. Transfer pricing establishes the price for goods and services sold between members of the same multinational group or other related parties. *See* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 169. While the price is supposed to be set on an arm's-length basis under 26 U.S.C. § 482, there are incentives to overstate the cost of imports and undercharge for exports under the current income tax. *Id.* at 169–70. A destination-based tax system may eliminate these incentives but may create other mechanisms for profit-shifting to avoid tax. *See infra* note 109 and accompanying text.

105. *Id.* at 169.

106. *Id.* at 170; *see also* Grinberg, *supra* note 33, at 943 n.40.

107. Keen & Smith, *supra* note 50, at 12 (quoting Richard T. Ainsworth, *Carousel Fraud in the EU: A Digital VAT Solution*, 42 TAX NOTES INT'L 443, 445 (2006)) (examining the problems of fraud and evasion in the EU VAT, some of which would not apply in the United States).

108. *See* Weisbach, *supra* note 23, at 212.

109. For example, a domestic member of a group sells a manufactured good to its foreign affiliate (or foreign intermediary). The sale is not subject to tax because it is an export sale. The foreign affiliate or intermediary then sells the good directly to a U.S. consumer. Unless an effective enforcement mechanism is created, this on-sale by the foreign affiliate or intermediary is likely to avoid tax. Thus, the U.S. manufacturer may avoid tax that would have been imposed had it sold directly to the U.S. consumer.

Also, replacement of our corporate tax or income tax system will require us to rethink how we coordinate our system with foreign tax systems. Because a credit-invoice VAT would conform more closely with global norms, it may be easier to coordinate a credit-invoice VAT with the tax systems of other countries to avoid double taxation and double nontaxation. However, regardless of which consumption tax system is adopted as a replacement, we will likely have to renegotiate our tax treaty network. As the JCT staff notes, an issue arises "whether a treaty that was negotiated when both of the countries had comparable tax systems would be still applicable and desirable if the United States replaced its current income tax system with a vastly different tax system (e.g., a consumption-based tax system)."[110]

Among the issues that would potentially need to be rethought under existing treaties are (1) whether the permanent establishment rules need to be changed or scrapped in a shift to a destination-based system, (2) whether foreign countries will refuse to give credit for U.S. taxes because the system is no longer an income tax, and (3) whether reduced withholding rates and deductions for payments to the U.S. continue to be respected. Until these and other similar issues are resolved under each existing treaty, taxpayers will face considerable uncertainty. Needless to say, renegotiation of our existing tax treaty network with over sixty countries will be timely and cumbersome.

D. Effect on Imports

A destination-based, subtraction-method system may impose real or perceived barriers to imports. Because the border adjustments would deny deductions for the cost of imported inputs, while domestic purchases would remain deductible, businesses would seem to have an incentive to purchase their inputs domestically, absent an effective change in exchange rates or relevant prices. These issues are exacerbated when the subtraction-method system provides a deduction for domestic wages at the business level, like the X tax and business cash flow tax.

These effects can best be illustrated by a simple example. Assume that the corporate income tax will be replaced by a 20% subtraction-method system. A domestic manufacturing company (Manufacturer) needs raw materials for its production and can purchase similar grade materials from a producer in either Canada or the United States for $100x. In addition, the Manufacturer needs refinements to the raw materials that will cost $75x in labor costs, either in Canada or the United States. Finally, assume that Manufacturer sells its finished product for $300x solely in the United States. The table below shows an example of the disparate treatment under the subtraction-method system of imported inputs versus domestically produced inputs (with a deduction for domestic wages).

110. *See* STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT, *supra* note 97, at 110.

Example	***Subtraction-method VAT–domestic input***	***Subtraction-method VAT–imported input***	***Business cash flow tax – domestic input***	***Business cash flow tax – imported input***
Sales	300	300	300	300
Inputs	(100)	(100)	(100)	(100)
Wages	(75)	(75)	(75)	(75)
Pretax earnings	125	125	125	125
Deduction for inputs	(100)		(100)	
Deduction for wages			(75)	
Taxable amount	200	300	125	300
U.S. tax	(40)	(60)	(25)	(60)
After-tax earnings	85	65	100	65

Under a credit-invoice system, because the tax is transactions based and generally transparent, it seems more likely that Manufacturer would be able to pass the $60 overall tax (i.e., $20 on the imported input plus a net of $40 on the sale) onto the consumer (similar to a sales tax). In that case, Manufacturer would be indifferent whether to buy its inputs domestically or abroad. By contrast, because a subtraction-method system is accounts based and hidden, it seems less apparent that Manufacturer would be able to pass the tax through in prices to the consumer. Manufacturer would not be indifferent to where it acquires its inputs. Buying imported inputs would reduce Manufacturer's after-tax earnings by an additional $20 because the $100 cost of the imported inputs would be nondeductible.[111] As shown in the chart above, the allowance of a wage deduction in a business cash flow tax or an X tax exacerbates these effects. The ability of the U.S. producer to deduct wages while the wage cost embedded in the import is nondeductible enlarges the relative tax benefit from domestic production (in the example, by an additional $15) and provides an additional potential barrier to imports.[112]

As the example shows, unless and until there is an effective exchange rate or price adjustment, Manufacturer has an incentive to buy domestically produced inputs to maximize its own after-tax earnings. Thus, at least in the short run, the subtraction-method seems to create a distortion in Manufacturer's

111. It is important to note that the system as a whole achieves parity because the domestic input seller pays $20 in tax on the same $100 that Manufacturer is deducting.

112. In an X tax, and possibly in a business cash flow tax, wages would be taxed at the individual level.

purchasing choice that disadvantages imports.

Many economists believe that these effects will neutralize over time by changes in the exchange rate. According to economic theory, the value of the Canadian dollar relative to the U.S. dollar should decline by 20%, exactly offsetting the denial of the deduction on the imported input and Canadian wages.[113] As a result, in the long run, Manufacturer will make the same after-tax earnings if it imports its business inputs or buys them from a domestic producer and incurs domestic wage costs.

Even if this may be true in theory, there are a number of potential situations that policymakers should consider where exchange rate adjustments may not fully or immediately resolve these trade barrier concerns. In these situations, the only ways for importers to recover the additional tax cost of border adjustments would be to raise prices to their customers or to pay less to foreign suppliers, which may or may not be possible depending on the competitive circumstances.

First, it is unclear whether these adjustments would be instantaneous. It may take time for exchange rates to adjust to changes in trade flows. In fact, because of the possibility that such adjustments would not happen as quickly as economic theory predicts and concern about the potential "undue burden on imports and importers," the Breaux-Mack tax reform panel recommended a four-year transition period for its border adjustments under the proposed Growth and Investment Tax Plan (GIT).[114]

Second, a number of cases exist where foreign currencies or prices of commodities are pegged to the dollar and thus may not be flexible, in the short or long term, for exchange rate adjustment. The most notable example is probably the Chinese yuan, which has been pegged to the dollar on an on-again, off-again basis.[115] Also, it is not clear how the Fed would respond to potentially significant appreciation in the dollar or how other central banks or governments would react to depreciation in their currencies. These effects would require management. Also, several commodities like gold and crude oil are traded in international markets using standard dollar-denominated prices.

Third, assuming exchange rates adjust to offset the effects of border adjustments across the economy as a whole, these changes would be general in nature and would not account for differences between industry sectors or business circumstances. A sector that was impacted more heavily than the economy as a whole could remain disadvantaged. For example, in the case of a business cash flow tax, an industry with a labor-intensive production process would more likely remain affected with barriers to importing. The Treasury

113. Denying a deduction at a 20% rate means that the after-tax cost of an import is 25% greater than the after-tax cost of a domestic input (e.g., a domestic input of $125 costs the same after tax as a foreign input of $100). Thus, for an exchange rate adjustment to fully neutralize this effect, the relevant foreign currency would have to decline by 20% relative to the dollar (conversely, the dollar would have to appreciate by 25% relative to the foreign currency).

114. PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 173.

115. Linette Lopez, *A Perfect Example of How China Confuses Wall Street to No End*, BUS. INSIDER (Feb. 16, 2016, 11:25 AM), http://www.businessinsider.com/chinese-yuan-peg-to-dollar-and-basket-of-currencies-2016-2 [http://perma.cc/9JUN-RMMW].

Department acknowledged this potential problem in a 2007 report on business competitiveness, cautioning that despite exchange rate adjustments, "[t]here could, however, be effects on specific sectors or industries within the economy."[116]

Also, while there may be some sectors where tax considerations play a role in production location, many sectors have foreign supply chains for nontax business reasons. Certain inputs (such as raw materials) are either not available in the United States or are imported for pretax economic reasons (e.g., cheaper labor, source of supply). In a subtraction-method VAT or business cash flow tax, border adjustments would seem to disproportionately impact these industries when there is no domestic alternative to imports. The question is whether and how quickly prices would adjust to offset any such effects.

Fourth, it is important to note that in several recent proposals, such as the GIT and the *A Better Way* plan, the border tax adjustment for imports is not equivalent to the adjustment for exports.[117] To avoid having the government write large refund checks to net exporters, those plans do not provide export rebates but rather merely allow carryforward of losses with interest. This disparate treatment could affect the exchange rate adjustment that theoretically should occur with full border tax adjustments.

Finally, a number of other factors affect exchange rates that could have countervailing effects. These include interest rates, levels of inflation, growth in public debt, economic capacity, and political and economic stability.

E. World Trade Organization (WTO) Legality

Even though they are imposed on similar economic bases, the choice among destination-based consumption taxes may have different results under our trade agreements. The General Agreement on Tariffs and Trade (GATT) imposes several limitations on the ability to provide border adjustments to a tax. First, as indicated in the GATT's "Illustrative List of Export Subsidies," relief of any "direct" tax (under a border adjustment) will constitute a prohibited export subsidy.[118] For this purpose, a direct tax is a tax imposed on all forms of income, wealth, and ownership of property, whereas an indirect tax generally is any tax imposed directly on goods or services.[119] Second, while relief of an indirect tax through a border adjustment generally would be allowed, the amount of the rebate cannot exceed the amount of tax levied on the same good or service when sold for domestic consumption.[120] Finally, the border adjustment applicable to

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116. OFFICE OF TAX POLICY, U.S. DEP'T OF THE TREASURY, APPROACHES TO IMPROVE THE COMPETITIVENESS OF THE U.S. BUSINESS TAX SYSTEM FOR THE 21ST CENTURY 34 (2007).

117. *See* A BETTER WAY, *supra* note 9, at 27–28; PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, 168–71.

118. *See* Agreement on Subsidies and Countervailing Measures Annex 1(e), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14, 47 [hereinafter ASCM].

119. *See id.* Annex 1, 1869 U.N.T.S. at 47 n.58.

120. *Id.* at Annex 1(f), 1869 U.N.T.S. at 47.

imports is subject to "national treatment" requirements, generally requiring that imported and domestically produced goods and services be treated equally once the foreign goods have entered the market.[121]

Like a retail sales tax, border adjustments are allowed under GATT with respect to a credit-invoice VAT. This is because it is clearly an indirect tax, rebates cannot exceed taxes actually paid on the exported product or service (because of the credit mechanism), and taxes on imports will not exceed the tax imposed on similarly priced domestic products.[122]

Whether border adjustments are allowable with respect to a subtraction-method system is less certain. Some argue that because the tax base of a subtraction-method VAT is equivalent to that of a credit-invoice VAT, they should be treated the same under GATT.[123] Because neither tax is based on income, they argue that neither should be considered a direct tax. However, others contend that unlike a credit-invoice VAT, a subtraction-method VAT is an accounts-based tax that is not levied directly on transactions. Thus, it is a direct tax and cannot be border adjusted under GATT.[124] Unfortunately, there does not appear to be a clear answer. What the JCT staff wrote years ago remains true today: "[B]ecause there are no pure subtraction-method VATs . . . there have been no GATT challenges or test cases with respect to the legality of subtraction-method border adjustments" to settle the question.[125] Another difference is the potential for excess rebating that exists with a standard subtraction-method VAT. Because the amount of deductions by a purchaser is not contingent upon tax being paid by the seller, the refund to the exporter could exceed taxes paid on the exported product, which could be viewed as an illegal export subsidy under GATT.

It appears more likely that border adjustments would not be allowed under GATT with respect to a business cash flow tax. Because the tax resembles a corporate income tax, several commentators believe it "would likely be treated as a direct tax if challenged at the WTO."[126] Also, the fact that an exporter under the business cash flow tax would be allowed to deduct the amount of its labor costs could cause the resulting rebate to exceed taxes paid on the exported goods, thereby violating GATT.[127] Finally, it seems likely that national treatment requirements will be violated because a deduction would be allowed for wages for work performed in the United States but not with respect to

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121. *See, e.g.*, General Agreement on Tariffs and Trade art. III, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S 194.

122. The GATT Working Party agreed that a retail sales tax and credit-invoice VAT were equivalents despite the "fractioned collection" process on the latter.

123. *See, e.g.*, STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT, *supra* note 97, at 114; *see also* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 171 (making similar arguments with respect to a business cash flow tax).

124. *See* STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., IMPACT, *supra* note 97, at 114.

125. *Id.* at 76.

126. *See, e.g.*, Grinberg, *supra* note 33, at 941 (citing Victoria P. Summers, *The Border Adjustability of Consumption Taxes, Existing and Proposed*, 12 TAX NOTES INT'L 1793 (1996)).

127. *See id.* at 941–42.

imported goods.[128]

Because of these potential concerns, the Breaux-Mack tax reform panel, in proposing a business cash flow tax (i.e., the GIT), did not count the $775 billion in revenue raised from its border adjustment provisions in setting its rates "given the uncertainty over whether border adjustments would be allowable under current trade rules, and the possibility of challenge from our trading partners."[129]

By contrast, the House Republican *A Better Way* proposal, in advocating for a similar business cash flow tax, provides that its border adjustments would be "consistent with the WTO rules regarding indirect taxes."[130] Consequently, unlike the GIT, the *A Better Way* proposal relies on the revenue raised from its border adjustment provisions to offset its projected cost.

Others have argued that, despite concern over GATT illegality, we should adopt a subtraction-method consumption tax and should either "renegotiate or withdraw from the GATT."[131] By proposing a credit-invoice VAT, Hank's approach would avoid any dispute over GATT legality and potential need for renegotiation, while still addressing any purported need to level the playing field against overseas competitors.

CONCLUSION

There has been widespread consensus for several years that tax reform is needed—but opinions diverge as to its goals and means. For tax reform to happen, it will require, as Hank suggests, strong presidential and congressional leadership and support from both the business community and the public at large. This leadership and support likely will only occur if there are agreed-upon achievable goals and a clear articulation of how tax reform will further those goals.

Hank has outlined a tax reform approach that establishes a clear and necessary goal (i.e., lowering our corporate income tax rates) and a means of getting there by adopting a credit-invoice VAT. This reform would make our system less of an outlier and would move us closer to international norms. Use of consumption taxes to reform our system has long been part of the policy and political debate. It is time for policymakers to seriously consider and determine whether and to what extent consumption taxes should be part of the solution to help reform our structure.

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128. The ABA Task Force found that "allowing a payroll tax credit for work performed in the United States against the USA tax . . . while not allowing an equivalent credit with respect to imported goods might violate national treatment requirements." ABA TAX SYS. TASK FORCE, *supra* note 21, at 224.

129. PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, *supra* note 20, at 172.

130. A BETTER WAY, *supra* note 9, at 28.

131. Weisbach, *supra* note 23, at 203; *see also* Jim Tankersley, "*The Whole Chessboard": A New Document Reveals Donald Trump's Economic Strategy in Detail*, WASH. POST: WONKBLOG (Sept. 25, 2016), http://www.washingtonpost.com/news/wonk/wp/2016/09/25/the-whole-chessboard-a-new-document-reveals-donald-trumps-economic-strategy-in-detail/ [http://perma.cc/DRB3-Z7EB]. Others have argued that it will take years for the WTO to resolve any trade dispute; however, individual countries could retaliate more quickly.