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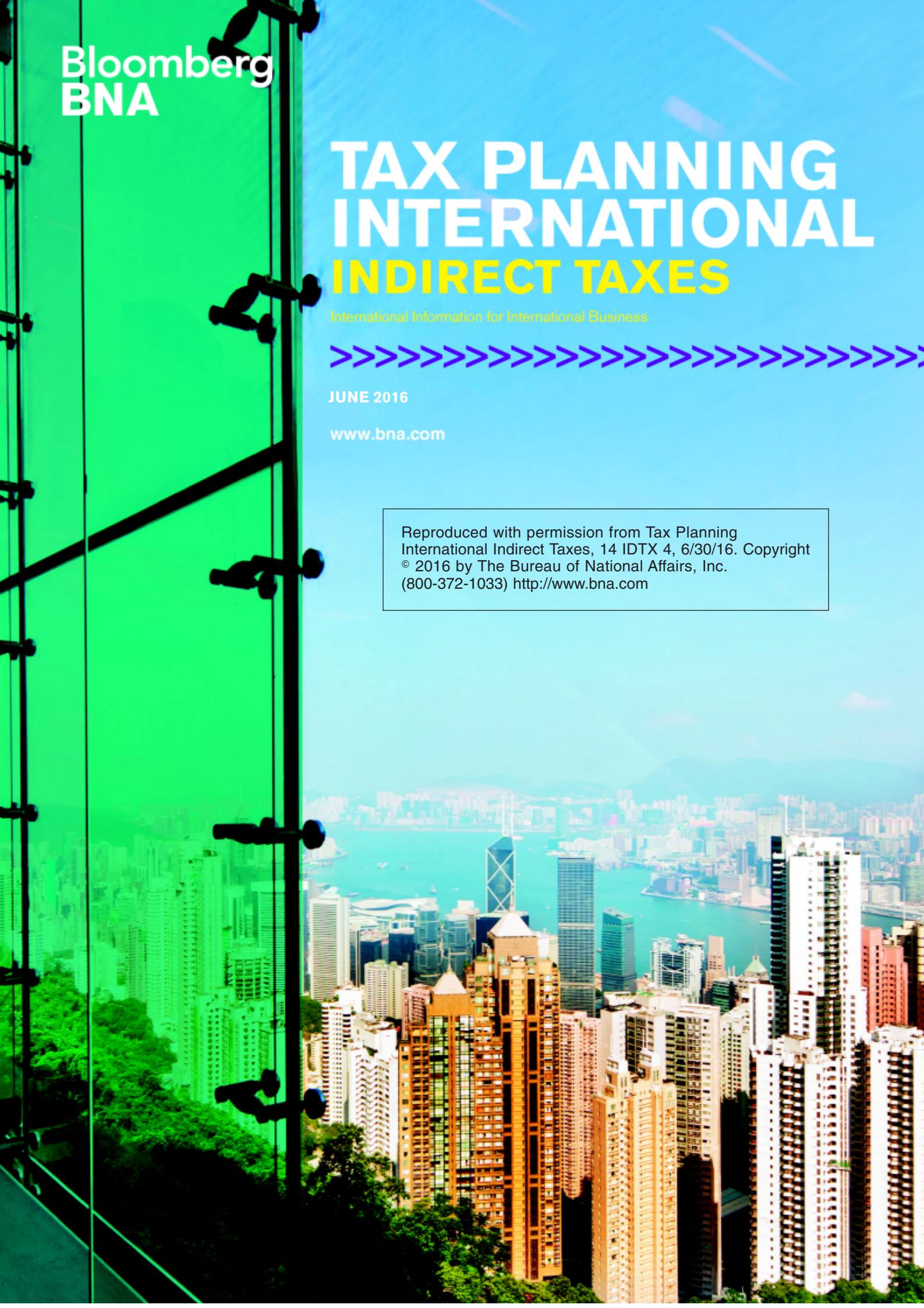
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Will the United States Implement a Value Added Tax?

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The question of whether a national consumption tax will ever be adopted in the United States continues to be debated. The background to the debate and the current arguments for and against are considered here.

The evident justice and utility of the foregoing maxims have recommended them, more or less, to the attention of all nations. All nations have endeavored, to the best of their judgment, to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both the time and the mode of payment, and in proportion to the revenue which they brought to the prince, as little burdensome to the people.

Adam Smith, *The Wealth of Nations* (1776)

It has been nearly 250 years since Adam Smith put forth his principles for a sound tax system. As the U.S. debates tax reform over the next several years, it is probably good to be reminded of them.

At the outset of the 20th century, the national and subnational governments in the U.S. were funded by four revenue sources: property taxes, excise taxes, customs duties and postal fees.¹ There were no significant personal or corporate income taxes or general consumption taxes levied on a broad range of goods and services. Customs duties and excise taxes on controlled or regulated substances accounted for 95% of all federal tax receipts, and property taxes and selective excise taxes comprised 85% of all state and local tax revenues.²

Of course, we live in the 21st century. In 2016, the story in the U.S. is quite different. The U.S. federal and subnational treasuries are fed today by a number of revenue sources, including broadly-based corporate and individual income taxes, payroll taxes, general sales and use taxes and property taxes, as well as a variety of severance taxes, excise taxes, customs duties, and other more narrowly-focused taxes.³

Change—even radical change—is thus possible. It just takes a unique alignment of factors.

In this article, we consider factors that contributed to radical changes in tax policy during the past century. We then take a brief look at perceived weaknesses of the current tax model in the U.S., following which we consider lessons learned from global trends in taxation. We then point to eight factors suggesting that the environment exists for radical U.S. tax law changes to occur in the present century. Greater reliance on consumption taxes may one day become a part of that anticipated change.

I. The Evolution of Economic Thought and Societal Attitudes About the Role of Government

Public spending increased dramatically in all modern industrialized countries during the 20th century. One commentator has observed that:

the ideas about what made for “good” tax policy emerged in the context of *both* the changing structure of advancing capitalism *and* the political demands placed on policy makers. In short, new ideas became possible—even necessary—as the economy changed and revealed new sources of revenue which simply could not exist in a pre-modern economy.⁴

Let’s test that theory against the geopolitical and economic backdrop of the 20th century.

The laissez-faire economics of the 19th century demanded little from government, possibly as an overreaction to the failures of the State in the 18th century. In a little-known book, John Maynard Keynes once wrote: “Almost everything which the State did in the eighteenth century in excess of its minimum functions

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was, or seemed, injurious or unsuccessful.”⁵ In the late 19th century, as a result, government expenditure in the U.S. approximated only seven percent of GDP, and it was not much higher in other developed countries.⁶

As the world emerged from the 19th century, however, fundamental change was afoot. The disciples of laissez-faire economics faced a challenge from Marxist ideas, which grew into a socialist movement in Europe so quickly that two renowned German economists of the time added redistribution of wealth to the list of legitimate and normal government functions. Public education and the infancy of social security, as examples, found roots, requiring lawmakers to begin rethinking the public revenue base.⁷

What really changed the world of taxation, though, was World War I. Military and war-related spending was substantial and had to be financed; governments acted to expand their tax policies to more broad-based activities and to expand their means for collecting revenue. Governments around the globe, including the U.S. government, grew comfortable with ways and means to raise revenue from taxes. Then, between World War I and World War II, the Great Depression exposed the need for government assistance for income security, health care, job creation and more. Of course, World War II followed shortly thereafter. Thus, in the 30-year period from 1915–1945, the world of tax policy changed dramatically, maybe even unexpectedly.⁸

However, when the post-World War II moment finally presented the opportunity to roll back the clock, reduce taxes, and return to laissez-faire policies, lawmakers and the wider society balked: “by the end of the 1940s, there was a widespread consensus . . . that the State now had a meaningful and appropriate role in managing the capitalist economy.”⁹ Laissez-faire was out; Keynesian economics was in, and Galbraith and others continued the progressive march into the future.¹⁰

So, today, the size of the public sector, the role of the government in the economy, and the composition of public revenues and expenditures is radically different than it was at the beginning of the 20th century.¹¹ Further, it was not enough simply to add additional programs; economists grew to believe that deficit spending was appropriate to accomplish this new and active role of government. Thus, many of these spending category increases benefited from the creation of public debt, which today requires increased spending on interest attributable to that debt. And, of course, debt has to be repaid. Now we see why tax revenues had to be raised and will likely continue to need to be raised for the foreseeable future. As Tanzi and Schuknecht put it: “[t]he growth of public expenditure from 1870 to the present time had to be financed.”¹²

It still does.

II. Perceived Weaknesses of the Current U.S. Model

Today, the federal income tax system consists principally of taxes imposed on the income of individuals and corporations. For individuals, the system employs a graduated rate structure, with the marginal rate rising from 10% to 39.6% (or higher under certain cir-

cumstances), depending on the taxpayer’s income. For corporations, marginal rates rise from 15% to 35%, depending on the corporation’s net income. Income earned by entities organized as “C Corporations” (corporations which are legally considered separate entities from their owners) is taxed under the corporate income tax. Business income earned by owners and members of various types of pass-through entities is taxed under the individual income tax.¹³ The federal tax structure also includes employment taxes, social security taxes, unemployment taxes, estate and gift taxes, excise taxes on certain goods and services (and often dedicated to trust funds to be used for specific purposes).¹⁴

In addition to federal taxes, state and local taxes make up a significant piece of the overall tax structure and burden in the U.S. State governments rely principally on individual and corporate income taxes (40% of state tax revenues in 2013) and general sales and use taxes (30% in 2013). Real and personal property taxes accounted for nearly 75% of all local tax revenues in 2013.¹⁵ In 2013, federal, state and local government receipts equaled about 28% of U.S. Gross Domestic Product.¹⁶

The clanging cymbal today is the near-unanimous call for corporate tax reform.¹⁷ The U.S. corporate income tax system is currently a “worldwide” system that taxes U.S.-resident multinational corporations on both U.S.-source income when earned and, as a general matter, foreign-source income when repatriated (with a credit for foreign income taxes paid). At the same time, the U.S. system taxes foreign-resident multinational corporations only on U.S.-source income. The U.S. statutory rate for corporate income taxes of roughly 40%, when state taxes are considered, is the highest among the Organization for Economic Co-operation and Development (“OECD”) countries and topped only by Chad and the United Arab Emirates among the rest of the world.¹⁸ The tax on U.S.-based multinationals when foreign-source income is repatriated is considered burdensome by many observers.

Concerns commonly expressed with respect to U.S. corporate income taxes can be summarized as follows:¹⁹

- The U.S. corporate income tax regime discourages investment in the U.S.
- The U.S. rules for taxing the income of U.S.-resident multinationals encourages firms to earn and retain profits overseas.
- The corporate income tax regime encourages U.S.-resident corporate taxpayers to shift their domicile outside the U.S. through so-called inversion transactions.
- Despite its high statutory rate, the U.S. tax system is inefficient in generating U.S. tax revenues from corporations, due to the complexity of the system, difficulties in measuring and sourcing income and expenses, and the abundance of tax preferences.
- The U.S. corporate income tax system was not designed for the modern global economy in which terms such as “residence” or “source” do not have much relevance to the way business is transacted.

- The U.S. corporate income tax system was not designed for an economy in which intangible assets play such an outsized role in the generation of business income.

The evolution we see in business today—in the midst of the “Second Machine Age” or the “Fourth Industrial Revolution”²⁰—is the modern-day parallel to the economic transformation that launched the “First Machine Age.” And it was precisely that transformation, combined with shifting societal expectations of government described earlier, that created the impetus for the dramatic shift in tax policy that the world witnessed in the 20th century.

As U.S. lawmakers consider ways to reform the corporate income tax and update it for the modern era, proposals should look for solutions that reduce long-term deficits, reduce bias in favor of overseas investments, and improve economic efficiency and eliminate deadweight costs.²¹ To the extent that additional revenue sources are required to pay for corporate tax reform, it might be ideal if such additional sources had collateral benefits, such as the potential help in modernizing and harmonizing U.S. subnational taxes, a fair portion of which were designed originally for a farming and mercantile economy and not for the services and intangibles economy in which we live today.

III. Lessons from Global Trends in Taxation

The search for the perfect system of taxation is ongoing; and evolution of tax policy occurs as geopolitical, economic, and societal dynamics change. History dictates that we should expect changes in tax policy, for rarely does the status quo last for an extended period of time.

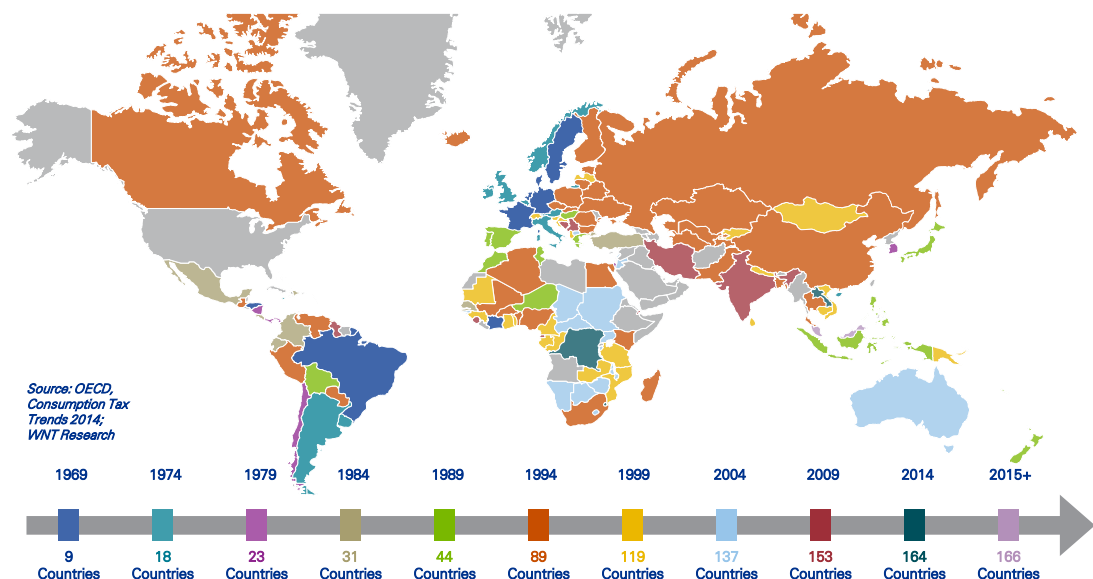
Since 1965, for example, the world has witnessed the spread of a value added tax (“VAT”) from a handful of countries to more than 160 countries by 2015. (See map below.)

As the Gulf States Cooperation Council prepares to introduce a VAT in the next few years,²² North Korea, Somalia, and the U.S. will be among the few remaining countries without a national-level VAT.

Meanwhile, as VAT covers the globe, corporate income tax rates have declined. A Tax Foundation

report found that between 2003 and 2015 the average corporate income tax rate (weighted by GDP) had declined from 35% to 30%; on an unweighted basis, the average rate dropped from 30% to 24%. The rate had declined in all regions of the world.²³ Representatives from the International Monetary Fund (“IMF”) have observed that the “rapid rise of the value-added tax (VAT) was the most dramatic—and probably most important—development in taxation in the latter part of the twentieth century.”²⁴ The development and evolution of the VAT and implementation across the globe permitted the public treasury to (a) modernize taxing systems, (b) broaden bases beyond “sin” categories first and then beyond tangible goods into services and intangibles as the services and software revolution took hold, and (c) eliminate, minimize or mitigate distortions caused by more primitive modes of taxation. Moreover, bodies like the IMF were able to persuade countries worldwide that VAT permitted revenues to be bolstered efficiently and, whether one agrees or not with the next point, equitably.²⁵ (The issue of regressivity is discussed later.) For now, though, we think it is indisputable that the sweep of the VAT across the globe and the concomitant worldwide reduction in corporate taxes are clear global phenomena, not just trends—phenomena which will and should influence debate in the U.S. as it considers tax reform for the 21st century.

This is not to say that a VAT is necessarily without consequences for the economy and does not present administrative and political challenges. Implementation of a VAT will increase the price of taxed goods and services and (depending on changes in the money supply) can induce inflation in the economy. This will likely reduce consumption and affect the level of economic output as well as revenue bases of governments tied to consumption. It will also have a differential effect across income groups (discussed further below) and can have a differential impact across age groups. In addition, a number of commentators have expressed concern that adoption of a VAT will fuel growth in the public sector.²⁶ On balance, however, economists tend to consider value added taxes and well-designed consumption taxes to be less distortive and problematic from an economic standpoint.²⁷



IV. Eight Factors that Suggest U.S. Tax Law Changes Will Occur in the 21st Century, With Potential to Sweep in a U.S. Federal-Level Consumption Tax

A. The Complexity of Entitlement Reform

It has been said that “Americans have grown to like bigger government, but they haven’t decided to pay for it yet.”²⁸ In the decade ahead, nearly half of anticipated spending growth is attributable to Social Security and Medicare alone; and much of the other half results from other health care programs and the interest on debt.²⁹

Entitlement programs are increasingly described by lawmakers and special interest groups in “rights” language, as in the “right to health care,” for example.³⁰ Moreover, even Congress itself uses semantics that convey the sense of a “right,” as in the classification of Social Security as “mandatory spending,” despite the fact that there are many levers that could be pulled (e.g., age requirements, means testing, and even definition of benefits) to accomplish changes in spending and reflect a more discretionary approach if policy makers chose to do so.

The simple truth is that lawmakers may prefer to be hamstrung by mandatory spending requirements because they know that societal expectations of the state to provide a quality of living have changed drastically over the past hundred years.³¹ From John Maynard Keynes’s implication in 1926, in his book *The End of Laissez-Faire*, that government should do things that individuals normally forget, fail or refuse to do, to John Kenneth Galbraith’s expression of support in *The Affluent Society*, for deficit spending to eliminate basic uncertainties in life and to combat the public poverty found in basic research, education, pollution control and more, to the improved quality and length of life throughout the 20th century, societal support for a larger role for government increased, slowed only during periods of economic turmoil in the late 20th century that caused a momentary (and slight) skepticism about government intervention.³²

One has to question whether there is a serious interest in returning the federal government to a balanced budget mentality. Voters would apparently rather have their benefits, as evidenced by the fact that the U.S. has experienced budget surpluses in only five years since 1961.³³ Ultimately, however, those benefits must be properly funded.

B. The Sheer Size of Accumulated Deficits

Finding the amount of the total federal debt is not a difficult proposition for the eager voter. It is, in fact, published in many different places.³⁴ Congress itself receives an annual “Budget and Economic Outlook” that describes the situation quite clearly;³⁵ and that report is publicly available with the use of a simple web search.

In the midst of an election year, however, clarity is often obscured by wish lists and terminology. The needs are indeed great—most candidates for President today assert that the U.S. is underspending in a variety of areas, such as technology, innovation, health care, infrastructure, education, urban develop-

ment, mental health, elder care, and even support of developing countries.³⁶ And the terminology is confusing: does the average voter know the difference between the terms “deficit” (annual shortfall of revenues to expenditures) and “debt” (level of accumulated deficits over time)?³⁷

Total federal debt eclipsed \$1 trillion only 35 years ago on October 22, 1981.³⁸ The total debt of the U.S. now exceeds \$19 trillion.³⁹ In only 35 years, the amount of debt held by the public has doubled, doubled again, doubled a third time, and has nearly doubled yet again a fourth time.

The total federal debt has two components. There is debt held by the public (in the form of U.S. Treasury notes and bonds) which in January 2016 totaled \$13.9 trillion. In addition to debt held by the public, the federal government has accumulated considerable amounts of “other” debt—that is, debt that is owed to various trust funds and other accounts from which current receipts have been borrowed to pay for current operations other than those for which the trust fund or account was established. The classic example is borrowing from the Social Security Trust Fund to pay for current spending.

By 2026, the Congressional Budget Office (“CBO”) projects debt held by the public alone to total \$23.8 trillion. When public and “other” debt are viewed together, the total debt of the federal government stands at more than \$19 trillion in 2016 and is expected to top \$29 trillion within a decade.⁴⁰ After taking 205 years to accumulate \$1 trillion in annual deficits, the pace of rising debt today is staggering.

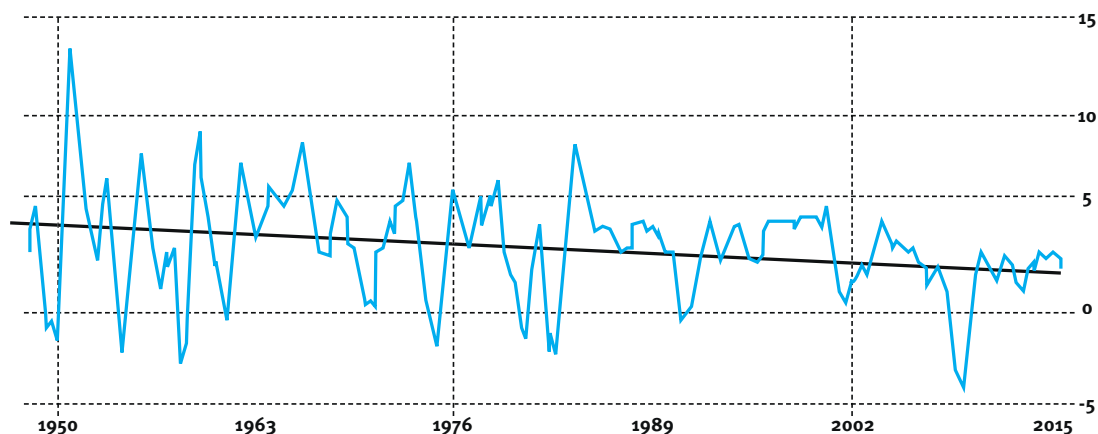
In addition to the absolute level of federal debt, the size of the debt relative to the economy is an important consideration. Under current budgetary conditions, federal debt held by the public will increase from about 75% of GDP in 2016 to over 86% a decade later. At that level, debt relative to GDP will be at the highest level since just after World War II and will be more than double the 50-year historical average of 39%.⁴¹ “Such high and rising debt would have significant consequences, both for the economy and for the federal budget. . . .”⁴²

It is hardly surprising then that “many economists think the rising debt [is] unsustainable.”⁴³ Some increased level of revenues or decreased level of spending will be necessary to prevent the level of outstanding debt from continuing to grow (and potentially reduce its size) relative to the economy. Given the current reliance on income taxes in the federal revenue system, some form of consumption tax is likely to be part of the conversation.

C. The Difficulty of Three Percent Annual Growth

Historically, the U.S. economy (measured as the change in real GDP) has grown at rates in excess of three percent over the long term.⁴⁴ Strong economic growth fuels revenue growth, eases the pressure on certain spending programs, and if the annual deficit is less relative to GDP than the change in GDP, the level of federal debt relative to GDP will decline over time. The three-percent benchmark, however, is proving elusive in the 21st century. The Bureau of Economic Analysis released data in February 2016 showing that the U.S. has been unable to achieve three percent

US GDP ANNUAL GROWTH RATE



SOURCE: WWW.TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

growth in real GDP in any year for a record ten straight years and in only two years since 2001.⁴⁵ Moreover, the President's Budget submitted by the Administration on February 2016 reflects assumed growth in real GDP of less than three percent in each of the next ten years.⁴⁶ In the past ten years, the average annual growth rate is less than two percent;⁴⁷ and, on a quarterly basis, growth has not reached the five percent level since Q2 of the year 2000.⁴⁸

The long-term trend line is revealing (see graph above).

If growth can no longer reasonably be expected to keep annual deficits under control, either spending will need to be curbed or new sources of revenue will need to be found.

D. Reduced Dependence on Corporate Income Taxes Outside the U.S.

Developed countries derive revenue from a variety of sources, including individual and corporate income taxes, social insurance taxes, consumption taxes, and property taxes. Over the past three decades, many countries have tried to reduce their reliance on corporate and personal income taxes in an effort to attract investment into their jurisdiction. The bulk of the actions have been aimed at reducing marginal corporate income tax rates. From 2003 to 2015, the worldwide average corporate tax rate has declined from 30% to 22.9%.⁴⁹

Incidentally, the phenomenon of reduced dependence on corporate income taxes is also evident in states within the U.S. Most states increased their reliance on income taxes from people instead of corporations over the past few decades.⁵⁰ In an op-ed piece in *The Wall Street Journal* in early 2015, Stephen Moore demonstrated that many states are seeking to reduce income taxes and, in several cases, to offset those changes by broadening their consumption tax bases or increasing consumption tax rates.⁵¹

Meanwhile, at the federal level, many have believed for years that corporate income tax reform is essential to U.S. competitiveness, as the declining corporate income tax rates across the globe have brought the relatively high U.S. federal rate of 35% (and its worldwide taxation approach) into sharp focus. When combined with the remaining state and local corporate tax burden, the rate rises higher than 39%—which is

higher than that in any of the other 34 member countries of the OECD.⁵² A Tax Foundation report found that in 2015, the U.S. had the fourth highest marginal corporate rate of 173 countries worldwide, behind the United Arab Emirates, Chad, and Puerto Rico.⁵³ High corporate income tax rates represent one of the factors that contribute to decisions by business enterprises to “invert” for perceived financial benefits that could accompany relocation of domicile.⁵⁴

The relatively high U.S. income tax rates are also reflected in the revenue mix in the U.S. when compared to other developed countries in the OECD. As shown in the table below, corporate and personal income taxes account for about 47% of state and federal revenues in the U.S., compared to only 33% among all OECD countries in 2013. By contrast, taxes imposed on goods and services (consumption taxes) comprise about 33% of OECD country revenues, but only 17% of federal and state tax receipts in the U.S.⁵⁵

The impetus for tax reform—both the ongoing tax reforms seen in state experiences already and the deferred (but oft-discussed) tax reform needed at the federal level—is strikingly similar. The question presented is simply stated this way: “How will we pay for reductions in corporate income taxes?”

The possibility that a solution could be found in a harmonized consumption tax has not escaped the attention of Capitol Hill.⁵⁶ Indeed, a federal-state, multi-stage consumption tax system could properly broaden existing consumption tax bases, encourage the lowest possible rate structure by such broadening, and enable entitlement reform and corporate income tax reform. Moreover, a properly constructed multi-stage consumption tax system would not tax business inputs and would provide no disincentives to investment or savings. It would, however, discourage con-

Composition of Government Tax Revenues, 2013

	U.S.%	OECD%
Taxes on personal income	38.7	24.8
Taxes on corporate profits	8.5	8.5
Social insurance contributions	24.2	26.1
Property taxes	11.3	5.6
Taxes on goods and services	17.4	32.7

Source: OECD, Revenue Statistics, Comparative Tables

sumption and affect household choices between work and leisure.⁵⁷ The solution to strengthening U.S. competitiveness, improving U.S. tax structure, and simplifying compliance, may be within reach if lawmakers are willing to think differently.

E. Increased Dependence on Technology in Tax Administration

In 2015, the U.K. tax authority, Her Majesty's Revenue and Customs ("HMRC"), announced plans to close 80% of its offices, in a sweeping change that would require the U.K. government to "do more with less."⁵⁸ By 2027, HMRC, under this plan, would close 137 of 170 offices. HMRC announced that it aims to have fewer staff in the future, as it emphasizes process automation and the use of modern technology to cut costs.

Revenue authorities around the world are using enhanced technology solutions to optimize revenue collections through risk analytics and higher compliance rates, reduce fraud and abuse, and provide new services and revenue streams.⁵⁹ As Niall Campbell put it recently, many revenue authorities are already taking steps to leverage data and analytics to solve three big issues: (a) closing the tax gap; (b) collecting and sharing information across borders; and (c) improving operational efficiency.⁶⁰ One commentator has even added that "[t]he VAT is likely the tax that has the greatest potential for substantial gains from the use of technology."⁶¹

Adam Smith published *The Wealth of Nations* in 1776, 240 years ago. Smith postulated four maxims to guide the sovereign in exercising taxing power. Under these guiding principles, taxes should be equitable, stable and transparent, convenient, and efficient.⁶² These principles have guided tax policy for over 200 years, and they are still expressed as ideal elements of a proper tax system. In fact, in March 2016, the House Ways and Means Committee published its report entitled *Background on Cash-Flow and Consumption-Based Approaches to Taxation*, in which it reiterated the four maxims this way:

First, does the tax system promote or hinder economic efficiency? That is, to what extent does the tax system distort taxpayer behavior? Does the tax system create a bias against the domestic production of goods and services? To what extent does it promote economic growth?

Second, is the tax system fair? Does the tax system treat similarly situated individuals similarly? Does the tax system account for individuals' different capacities to bear the burden of taxation?

Third, is the tax system simple? Is it costly for taxpayers to determine their tax liability and file their taxes?

Fourth, can the tax system be easily administered by the government and can it induce compliance by all individuals? Is enforcement costly?⁶³

The application of these four maxims requires, in our view, the consideration of the impact of technology on the four questions. With the ability today—occasioned by the rapid rise of the "Second Machine Age" (or the "Fourth Industrial Revolution") and the advent of the "Era of Big Data"—to affordably process and analyze huge amounts of data, it seems abun-

dantly clear and inevitable that tax policy in the 21st century will be significantly influenced by technological capability and evolution. Indeed, it seems readily apparent that tax policy in the 21st century will aim toward taxes that are able to be collected efficiently. That points toward the taxation of consumption.

F. The Efficiency of Consumption Taxes

As identified in the Ways and Means Committee report, there are at least two concepts of efficiency that are important to the design of a tax system.

In one sense, there is "administrative efficiency" or "collection efficiency," and in this sense, the efficiency of consumption taxation is readily apparent, particularly in a classic credit-invoice VAT/goods and services tax ("GST") system where taxes are collected in a multi-stage manner at the point of each sale along the supply chain for goods or services. This type of efficiency, in the 21st century, is fostered by the increased role of technology in the tax administration system, which we have discussed earlier in this article. With respect to this type of efficiency, we have concluded that the directional arrow points toward consumption taxes.

In the other sense in which "efficiency" is used, the focus is on the "economic efficiency" of tax systems; here, too, we find considerable scholarship tending to favor consumption taxes, especially the development of progressive consumption taxes, as the preferred method for the future, on account of their economic efficiency.⁶⁴

To economists and academics, "economic efficiency" relates to achieving an optimal allocation of resources across the production of various goods and services in a manner that minimizes waste and inefficiency. Taxes can reduce economic efficiency by reducing the rate of return on investment compared to a system with no taxation; the application of an income tax, for example, creates a gap between the gross rate of return generated by an investment project and the net rate of return the investor actually achieves (after the application of income taxes at business and individual levels). This gap or wedge can "reduce net returns to the point where marginal projects are not carried out."⁶⁵ Since a consumption tax does not create a direct link to the rate of return on business investment, it permits return on investment analysis that projects higher returns; and so the theory continues that "higher returns generate higher levels of investment and—as investment accumulates—higher levels of productive capacity . . . [which] in turn generates higher levels of output, employment and wages."⁶⁶ Consumption taxes also do not penalize savings, but do serve to reduce consumption of taxed goods and services.⁶⁷

Complementing the work of economists, Bill Gates has articulated the need for a progressive consumption tax to accommodate the rise of the automated world, and the need to incentivize the employment of people. In a meeting at the American Enterprise Institute, Gates is reported to have said:

I think tax structures will have to move away from taxing payroll. Technology in general will make capital more attractive than labor over time. Software substitution—whether it's for drivers or waiters,

nurses . . . it's progressing. And that's going to force us to rethink how these tax structures work in order to maximize employment given that capitalism in general over time will create more inequality, and technology over time will reduce demand for jobs, particularly at the lower end of the skill set. We have to adjust, and these things are coming fast. Twenty years from now, labor demand for lots of skill sets will be substantially lower, and I don't think people have that in their mental model. Economists would have said a progressive consumption tax is a better construct at any point in history. But what I am saying is that it's even more important as we go forward.⁶⁸

G. The Death of "Tax-Policy-Only" Regressivity Analysis

The biggest single objection to reliance on consumption taxes is that they tend to be regressive. Burman calls it the "Achilles' heel" of the consumption tax: people with lower income pay proportionately more of their income in tax than people with higher income.⁶⁹

Recently, the question of regressivity arose in the context of an indirect tax conference in Africa. In that instance, Timothy Gillis (co-author of this article) was struck for the first time by the answer that launched from his lips: "they are often regressive, but most of the world has decided that it doesn't matter."

Although consumption taxes may be regressive, particularly when viewed with a single-tax-focus-only lens, the experience of more than 160 countries simply cannot be ignored. The world has, in some sense, simply gone mad with VAT/GST enactments;⁷⁰ and the VAT/GST-coverage map of the world (see above) does not lie—the world is now awash in VAT and GST.

Some jurisdictions—even those with far more progressive reputations—have used credits, vouchers, targeted spending and other methods to mitigate impacts on low and moderate income households; or, in some cases, they have apparently decided that regressivity is merely a cost to be paid in exchange for efficiency in administration. After all, Adam Smith had four maxims of taxation; and fairness is only one of the four.

Virtually the entire world plunged into VAT within just over a generation (from 1965–2015), despite the cascading protests of voices opposed to VAT on regressivity grounds. How did that happen? Lawmakers and policy heads decided that, rather than any one tax, "it is the tax system as a whole, taken in conjunction with public spending policies, that affects poverty and fairness."⁷¹ This is why we call it "the death of tax-policy-only regressivity analyses".⁷²

H. National Consumption Taxes are Uncharted Waters in the U.S.

When one considers adoption of a national consumption tax in the U.S., there are two truths to consider.

First, to this point, general consumption taxes have been the province of states and local governments. Forty-five states and the District of Columbia impose a general retail sales and use tax, and these taxes constitute a significant source of local government revenue in over 30 states. General sales and use taxes account for 30% of all state tax revenues, and when state and local governments are considered together,

sales taxes represent about 23% of total tax revenues. State and local officials are concerned that this revenue source may be interfered with, or perhaps even dominated by, the federal government. This will pose some substantial political challenges to the adoption of a national consumption tax as well as some serious structural challenges in terms of attempting to harmonize national and sub-national consumption taxes.

The second truth to recall is that state retail sales and use taxes fall far short of the ideal in terms of being well-designed, efficient consumption taxes, and are not well-designed for the economy of the 21st century. Among the major flaws is the fact that the taxes are, for the large part, imposed largely on sales of tangible personal property and are generally not imposed on sales of services and intangibles.

In addition, sales taxes are imposed on a wide range of business inputs, rather than just final household consumption, as one would aim for in a well-designed consumption tax.

Finally, complying with state and local sales taxes is difficult because of differing tax bases across states and upwards of 10,000 individual local sales tax rates in the U.S.⁷³ Harmonizing state and local sales taxes with a well-designed national consumption tax could bring substantial improvements to the operation of sales taxes as consumption taxes as well as reducing the overall cost of compliance. While achieving such harmonization will require a significant effort on the part of policymakers at all levels of government, the benefits to the economy and governmental revenue structures should be considered.⁷⁴

V. Conclusion

Will the U.S. implement a VAT? Put simply, we do not know. But there are signs pointing in the possible direction of federal-level consumption taxes of one sort or another. The primary question appears to be one of timing.

First, the changes in societal norms and expectations of government during the 20th century, if unchanged, will require funding in the 21st century.

Second, the U.S. income tax system is overdue for reform, both at the individual and the business enterprise level. Perceived weaknesses in the current system are considered by many as creating an anti-competitive environment.

Third, the clear global trend in taxation favors the enactment of broad-based consumption taxes. If the U.S. prefers an "exceptional" approach, it will not be exceptional via the status quo; perhaps it can leapfrog the global trend toward VAT and discover the optimal progressive consumption tax.

Finally, at least eight factors:

- the complexity of entitlement reform;
- the sheer size of accumulated deficits;
- the difficulty of achieving three percent annual growth;
- the reduced dependence on corporate taxes across the globe;
- the increased use of technology in tax administration in the Era of Big Data;
- the administrative and economic efficiency of consumption taxes;

- the death of “tax-policy-only” regressivity analyses; and
- the desirability of reforming state and local sales taxes;

are all trends consistent with a future in which the U.S. may consider the enactment of federal-level, broad-based consumption taxes.

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NOTES

¹ Alan Schenck, *Radical Tax Reform for the 21st Century: The Role for a Consumption Tax*, 2 Chap. L. Rev. 133, 134 (1999) (citing Tax Institute of America, Federal-State-Local Fiscal Relationships 10 tbl.7 (1968) for data related to the year 1902).

² *Id.* See also U.S. Bureau of the Census, *Data Base on Historical Finances of State and Local Governments* available at http://www2.census.gov/pub/outgoing/govs/special60/Govt_Finances.zip.

³ In 2013 (latest year data is available), property taxes represented 31.3% of all state and local taxes, corporate income taxes accounted for 3.6%, personal income taxes accounted for 23.3%, and general sales and use taxes comprised 22.5%. Source: U.S. Bureau of the Census, 2013 Annual Surveys of State and Local Government Finances available at www.census.gov. In 2015, taxes on personal income represented 47% of federal receipts, corporate income accounted for 11%, and payroll taxes accounted for an additional 33%. Source: U.S. Congressional Budget Office, Updated Budget Projections: 2016 to 2026, March 2016 available at www.cbo.gov/publication/51384.

⁴ Sven Steinmo, “The Evolution of Policy Ideas: Tax Policy in the Twentieth Century,” *British Journal of Politics & International Relations* (April 2003), <https://www.researchgate.net/publication/227498697>.

⁵ Vito Tanzi & Ludger Schuknecht, *Public Spending in the 20th Century: A Global Perspective* (2000), at 4 (quoting Keynes’ “little known book”).

⁶ *Id.* at 5.

⁷ *Id.*

⁸ Of particular importance in the U.S. was the advent of the federal income tax which went from being non-existent in 1913 to representing 85% of total tax receipts in 1944. Source: U.S. Bureau of the Census, *Data Base on Historical Finances of State and Local Governments*.

⁹ Steinmo, above n. 4, at 213.

¹⁰ For additional details about the remainder of the 20th century, see Tanzi & Schuknecht, above n. 5, and Steinmo, above n.4.

¹¹ Tanzi & Schuknecht, above n. 5 at 23-49.

¹² *Id.* at 50.

¹³ An estimated 60% of business income flows through pass-through entities to the individual income tax. Source: William McBride, “America’s Shrinking Corporate Sector,” Tax Foundation Fiscal Fact No. 444, January 2015.

¹⁴ Joint Committee on Taxation, Background on Cash-Flow and Consumption-Based Approaches to Taxation (March 18, 2016), at 2.

¹⁵ U.S. Bureau of the Census, 2013 Annual Surveys of State and Local Government Finances available at www.census.gov.

¹⁶ U.S. Bureau of Economic Analysis, National Income and Product Accounts, Tables 1.1.5 and 3.1.

¹⁷ Eric Toder & Alan Viard, Corporate Tax Is Broken and Needs Major Surgery, Wall Street Journal’s Marketwatch (Aug. 6, 2014); Testimony of Eric Toder before the House Committee on Small Business, Tax Reform and Small Business, Tax Policy Center, (April 15, 2015) (“There is a growing consensus that the current system of taxing business income needs reform and bi-partisan agreement on some of the main directions of reform . . . The main drivers for reform are concerns with a corporate tax system that discourages investment in the United States, encourages US multinational corporations to retain profits overseas, and places some US-based multinationals at a competitive disadvantage with foreign-based companies, while at the same time raising relatively little revenue, providing selected preferences to favored assets and industries, and allowing some US multinationals to pay very low tax rates by shifting reported profits to low tax countries.”); Mihir Desai, The Trump-Obama Corporate Tax Reform Fail, The Wall Street Journal (March 6, 2016) (“[T]he US will need to join the rest of the G-7 countries and tax business income only once, in the country where it was earned.”).

¹⁸ Kyle Pomerleau, Corporate Income Tax Rates Around the World, Tax Foundation, October 1, 2015.

¹⁹ *Id.*

²⁰ Andrew McAfee & Erik Brynjolfsson, *The Second Machine Age: Work, Progress and Prosperity in a Time of Brilliant Technologies* (2014); Klaus Schwab, *The Fourth Industrial Revolution* (2016).

²¹ Chuck Marr & Brian Highsmith, Six Tests for Corporate Tax Reform, Center on Budget and Policy Priorities (February 24, 2012), <http://www.cbpp.org/research/six-tests-for-corporate-tax-reform>.

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²³ Kyle Pomerleau, “Corporate Tax Rates Around the World, 2015,” Tax Foundation, Fiscal Fact 483, September 2015.

²⁴ Liam Ebrill, Michael Keen, Jean-Paul Bodin and Victoria Summers, *The Allure of the Value-Added Tax*, Finance & Development (June 2002, Vol. 39, No. 2).

²⁵ *Id.*

²⁶ There are a number of articles and studies examining the economic impact and other issues affecting adoption

of a VAT in the U.S. See, for example, Government Accountability Office, “Value-Added Taxes: Lessons Learned From Other Countries on Compliance Risks, Administrative Costs, Compliance Burden and Transition,” GAO-08-566. April 2008; Congressional Budget Office, Effects of Adopting a Value Added Tax, February 1992; Robert Carroll et al., “The Macroeconomic Effects of an Add-on Value Added Tax, Prepared for the National Retail Federation, Ernst and Young, October 2010; and Eric Toder and Joseph Rosenberg, “Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes,” Urban-Brookings Tax Policy Center and the Economic Growth Program of the New America Foundation, March 18, 2010. See also various articles in *The VAT Reader: What a Federal Consumption Tax Would Mean for America*, Tax Analysts, 2011.

²⁷ William G. Gale and Benjamin H. Harris, “A VAT for the United States: Part of the Solution,” in *The VAT Reader: What a Federal Consumption Tax Would Mean for America*, Tax Analysts, 2011, pp. 64-82.

²⁸ Mark Steyn, Americans Vote for Big Government, but Don’t Want to Pay for It, *Investor’s Business Daily* (November 30, 2012 (“A majority of the electorate has voted itself a size of government it’s not willing to pay for.”))

²⁹ U.S. Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026*, January 25, 2016. See also Robert J. Samuelson, *The Dangerous Deficits Our Candidates Aren’t Talking About*, *The Washington Post* (January 31, 2016). Even with interest rates at historical lows, interest payments are expected to rise from \$223 billion annually to \$772 billion annually by 2025. To put that in context, the 2017 budget proposal submitted by the Administration this year totals only \$4 trillion.

³⁰ See, e.g., www.feelthebern.org (describing the candidate’s position on education and health care in rights and guarantees language).

³¹ Vito Tanzi & Ludger Schuknecht, *Public Spending in the 20th Century: A Global Perspective* (2000), at 3-23.

³² *Id.* at 9-19. See also Steven R. Weisman, *The Great Tax Wars* (2002), at 353-55.

³³ Robert J. Samuelson, On the Budget, America Needs More Straight Talk, *The Washington Post* (February 14, 2016).

³⁴ As one of many possible examples, see the Peter G. Peterson Foundation website at www.pgpf.org.

³⁵ See, for example, U.S. Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026*, January 25, 2016, p. 5.

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³⁸ David Stockman, Only Yesterday—How the Federal Debt Went from \$1 Trillion to \$18 Trillion in 33 Years, *David Stockman’s Contra Corner* (December 5, 2014) (Stockman points out that the \$1 trillion increase from \$17 trillion to \$18 trillion was accomplished in less than 365 days).

³⁹ Romina Boccia, *The U.S. Debt Just Exceeded \$19 Trillion. Here’s How We Got Here*, *The Daily Signal* (February 2, 2016) (Boccia points out that the total debt is more than \$58,000 per person, including children, in the U.S. today); Kimberly Amadeo, *The U.S. Debt and How It Got So Big* (February 3, 2016) http://useconomy.about.com/od/fiscalpolicy/p/US_Debt.htm.

⁴⁰ U.S. Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026*, January 25, 2016, p. 152.

⁴¹ *Id.*, p. 26.

⁴² *Id.*, p. 12.

⁴³ Robert J. Samuelson, *The Dangerous Deficits Our Candidates Aren’t Talking About*, *The Washington Post* (January 31, 2016).

⁴⁴ U.S. Bureau of Economic Analysis, *National Income and Product Accounts*, Table 1.1.1 at www.bea.gov. For example, from 1970-1999, the unweighted average change in real GDP was 3.05%.

⁴⁵ *Id.* See also Terence P. Jeffrey, U.S. Has Record 10th Straight Year Without 3% Growth in GDP, *CNSNews.com* (February 26, 2016).

⁴⁶ Office of Management and Budget, *Budget of the U.S. Government, Analytical Perspectives, Fiscal Year 2017*, February 2016, p. 12.

⁴⁷ Susan Jones, *Jeb Bush: Governments Should Grow No Faster than People’s Ability to Pay for It*, *CNS News* (June 17, 2015) (“If we grew at 2 percent, this so-called new normal that makes me queasy to even think about it, the demands on government will overwhelm us.”).

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⁴⁹ Kyle Pomerleau, *Corporate Income Tax Rates Around the World, 2015*, *Tax Foundation Fiscal Fact* (Sept. 2015).

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⁵² *Options for Taxing U.S. Multinational Corporations*, Congressional Budget Office (January 2013).

⁵³ Kyle Pomerleau, *“Corporate Tax Rates Around the World, 2015,” Tax Foundation, Fiscal Fact 483*, September 2015.

⁵⁴ See, e.g., William McBride, *Tax Reform in the UK Reversed the Tide of Corporate Tax Inversions*, *Tax Foundation* (October 14, 2014).

⁵⁵ Organization for Economic Cooperation and Development, *Revenue Statistics, Comparative Tables* at www.oecd.org.

⁵⁶ In testimony before the House Ways & Means Committee in 2016, all four witnesses—Michelle Hanlon, Professor of Accounting, MIT School of Management, Itai Grinberg, Associate Professor of Law, Georgetown University Law Center, Edward D. Kleinbard, Professor of Law, University of Southern California Gould School of Law, and Raymond Wiacek, Partner, Jones Day—responded to questioning from the Committee to the effect that the U.S. should consider a federal-level consumption tax as a part of tax reform. See *Hearing on the Global Tax Environment in 2016 and Implications for International Tax Reform* (February 24, 2016), <https://www.youtube.com/watch?v=0qUp3qsQ13E>.

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⁵⁸ Vanessa Houlder, *Four in Five Tax Offices to Close in Restructuring*, *Financial Times* (November 12, 2015).

⁵⁹ See, e.g., <http://www-01.ibm.com/software/websphere/industry/government/tax-revenue>.

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⁷¹ Liam Ebrill, Michael Keen, Jean-Paul Bodin, and Victoria Summers, The Allure of the Value-Added Tax, *Finance & Development* (June 2002, Vol. 39, No. 2).

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