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**EVALUATING THE CONTROVERSIAL ISSUE OF THE VALUE-  
ADDED TAX**

by

Jacqueline L. Ferrin

A Project Submitted To The  
Faculty of the School of Food, Hotel and Travel Management  
At  
Rochester Institute of Technology  
in Partial Fulfillment of the Requirements  
for the Degree  
of  
Master of Science

June 1997

**ROCHESTER INSTITUTE OF TECHNOLOGY**  
**School of Food, Hotel and Travel Management**  
**Department of Graduate Studies**

**M.S. Hospitality-Tourism Management**  
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Presentation of Thesis/Project Findings

Name: Jacqueline L. Ferrin Date: 6/12/97 SS#: \_\_\_\_\_

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## ABSTRACT

The purpose of this study was to introduce the value-added tax to many of us who have never heard these words. This study also encourages the United States to change the tax laws to introduce a value-added tax into the United States.

Proposals of the value-added tax include: reducing the federal deficit, achieving global competitiveness, and to fund a national health care program. All of these issues are of top concerns of the federal government.

By introducing the growing industry of Travel and Tourism, it is demonstrated how this industry could help the federal government achieve some of the proposed issues on how to use the money from the value-added tax if implemented.

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## CHAPTER 1

The American Heritage Dictionary, (1994) defines a value added tax as "a tax on the estimated market value added to a product or material at each stage of its manufacture or distribution, ultimately passed on to the consumer." An idea that is gaining popularity in the United States is the consumption tax. The basic rule is simple: income is only taxed when spent, not when it is saved (Walker, 1993). All savings and investments are deductible. If earnings; such as interest and dividends, from savings and investments are saved or reinvested, then the earnings are not taxed. Savings and investment, and earnings on them are taxed only when they are liquidated and spent or consumed.

Consumption taxes can take many different forms. This research focuses on value added taxes. Value added taxes have become the international tax of choice among consumption tax regimes. During the last decade, both developed and developing nations have enacted major tax reforms. Coincidentally, these nations have shifted the tax base from a heavy reliance



on income to a balance between income and consumption. The majority of new consumption taxes tend to be based on the value added to goods and services (Gasser, 1990).

A consumption tax could take the form of a value added tax of the type commonly found in Europe; a retail sales tax (RST), a business transfer tax, a specific commodity tax (excise tax), or the existing income tax in the United States, which has been referred to as a cash flow income tax or consumed income tax (Chiu and Siegel, 1989).

Value added taxes can be separated into two different types: Income style and Consumption style. To calculate the tax under a income style value added tax, each firm in the production and distribution process deducts its raw material purchases, but not capital equipment purchases, from its total sales and applies the tax rate to this base. Depreciation on capital goods is deducted from total sales. By requiring depreciation calculations, questions arise concerning the proper depreciation periods and methods. However, there is controversy whether an asset is immediately

deductible as a current expense or whether it is a depreciable capital expenditure (Chiu and Siegel, 1989).

Under a consumption style value added tax all business purchases are deductible. This style of value added tax is simpler to administer and neutral between capital and labor for three reasons: no distinction needs to be made between capital and current expenditures, no depreciation calculations have to be made, and lastly all factors of production are taxed at the same rate (Chiu and Siegel, 1989).

Under a consumption style value added tax, there are three different ways to calculate tax liability. The first is the addition method. Under this method, a firm calculates its liability by adding together its wages paid, rent, interest expense and profit, then applying the tax rate to this sum. This style is usually associated with an income type value added tax. It is possible for a taxpayer to be subject to the tax without having any income because components of the tax base include expenses (Hume, 1993).

A second method of calculating a consumption style value added tax liability is the sales subtractive method. To calculate the tax base under this method, a firm adds together all sales and subtracts all purchases. A Business Transfer Tax generally refers to a value added tax administered by this method. The sales subtractive method does provide the easiest way to calculate the value added tax liability, opponents argue that it is too inflexible to implement (Chiu and Siegel, 1989).

The last and most common form of calculating a value added tax is the credit subtractive method. Under this method a firm calculates its tax liability by applying the tax rate to each individual sale and subtracting all taxes previously paid on purchases. A credit subtractive method value added tax is very similar to an Retail Sales Tax (RST). The only major difference is that a RST is collected and remitted at only one stage of the production/distribution process, whereas the value added tax is multistage. Because the credit subtractive method is the most flexible of the three methods, it has been the method most often chosen.

A value added tax can be based on either a destination principle or an origin principle. Under the destination principle, a good or service is taxed where it is sold and presumed consumed. With this principle, the value added tax is imposed on imports but not exports. Under the origin principle, a good or service is taxed by the jurisdiction in which the value is added. With this principle, imports are not taxed but exports are. Figure 1 on the following page shows which countries use which method. It is obvious they all use the destination principle for the same reason. That reason being, why use the origin principle and tax yourself on exports that you ship out of your country when you have the choice to tax the imports that are coming into your country. As a general rule, countries want to export more than they import.

If the current tax code was replaced with a new tax code based on new rules, Americans would compute how much they owed the government by April 15 this way: Each individual or family would add up all income including wages, interest, dividends, capital gains, and gifts and subtract or deduct from total income the amount of money saved or invested that year. Only the remainder of the income that was spent or consumed would be

taxed. Savings and investment could be held in many different forms; passbook accounts, IRA's, pension funds, and stocks and bonds. All of these would be tax deductible until spent.

The United States is entering the twenty-first century with an out-dated tax system built before World War I, and our savings habits have changed. In the 1960's, Americans saved nearly ten cents of every dollar they earned. As a percentage of gross national product, our country saves and invests less than most industrialized countries. This has caused our standard of living and our global competitiveness to decrease. The new tax system must be brought into the 1990's to take into account these new procedures, and increase our standard of living and global competitiveness.

<u>COMPARISON OF VAT TYPES</u>		
<u>COUNTRY</u>	<u>DESTINATION PRINCIPLE</u>	<u>ORIGIN PRINCIPLE</u>
EUROPEAN ECONOMIC COMMUNITY	YES	NO
CANADA	YES	NO
JAPAN	YES	NO

FIGURE #1

## CHAPTER 2

According to the World Travel and Tourism Council (WTTC), the travel and tourism industry is one of the world's largest and fastest growing industries (WTTC, 1993). The World Travel and Tourism Council is a global coalition of officers from all sectors of the industry including; transportation, accommodations, catering, recreation/cultural, and travel service activities. The goal of The World Travel and Tourism Council is to convince governments of the enormous contribution of travel and tourism to a national and world economic development. The World Travel and Tourism Council promotes expansion of travel and tourism markets and eliminates barriers to growth of the industry (WTTC, 1993). Barriers may include location, lack of infrastructure and superstructure.

In 1992, the World Tourism Organization (WTO) formalized its definition of tourism as the activities of persons traveling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business, and other purposes (WTTC, 1993). Travel and

tourism can also be described as the personal consumption of transportation, accommodations, catering/retail, recreation/cultural services, and travel related services by people everywhere.

While government has been slow to recognize the travel and tourism's positive role in economic growth, they have not ignored its potential to produce tax revenues. Many forms of taxes on travelers were originally imposed to generate revenues for use in upgrading travel facilities (airports, highways, etc.) and services. Revenues from such forms of taxes have grown as the industry has grown, often producing surplus revenues for future development of travel facilities and services. Taxing authorities have come to better recognize the tax revenue potential from the travel and tourism industry (Fujii, Khaled, Mak, 1985). Therefore; travelers have been identified as ideal candidates for taxing authorities. To cite an example of surplus revenue, we can look at the passenger facility charge; PFC. Government legislation has been enacted which will allow authorized airports to impose a passenger facility charge for each revenue passenger enplaned at each airport (Fujii, Khaled, Mak, 1985). The monies collected will be used in financing airport related projects. Currently two hundred



forty six airports in the United States charge passengers a \$3.00 PFC to depart each airport. Including all of the busiest international airports such as: JFK, LaGuardia, Newark, Chicago, San Francisco, Miami, Washington Dulles, and Boston. Many of the airports initially saw this charge as a way to pay for improvements to each airport and to pay for facilities available to travelers. However, with the increase in air travel within the past ten years a surplus in money is now available.

Special taxes on away from home lodging services are often viewed as a painless way to raise revenue to build convention centers, purchase assets for use by tourists, or promote local tourism. However, a special hotel tax is often collected for other purposes, such as general support of the government, or even for no purpose specifically designated at the time of the imposition of the tax. Because taxes are paid largely by businesses indirectly or by people who are on vacation, these groups are perceived as being price-insensitive (Mak, 1988).

The travel and tourism industry has grown dramatically in the past few years, and is continuing to grow. The potential tax revenues from this

industry are proven from past taxes imposed on travelers. Therefore, travelers have been identified as ideal candidates for taxing authorities. By suggesting to impose a valued added tax in the United States, the travel and tourism industry could alone generate a great deal of income that the United States government could use to reduce the ever growing federal deficit, or finance a health care program.

## CHAPTER 3

Value added taxes have never received strong political support in the United States. To date the United States Congress has not seriously debated the possible enactment of a federal value added tax. Interest in consumption taxes, has manifested since 1943, when it was suggested that World War II be financed by a federal retail sales tax. In recent years there have been eight major proposals in Congress regarding implementing a value added tax (Lundholm, 1993).

### ABA MODEL STATUTE (1989)

In 1989 the Committee on value added tax of the American Bar Association Section of Taxation published a Model Statute and Commentary for a value added tax system in the United States (Lundholm, 1993). This model was a culmination of twenty years of work in this field. The American Bar Association has not taken a position on the adoption of a value added tax, but the Section of Taxation funded the Model Statute

project to prepare the Section to present its views on a valued added tax to Congress should Congress ever seriously consider the adoption of a value added tax.

In designing the Model Statute, the Committee was guided by four principles:

1. The tax should be imposed on a broad tax base to permit the adoption of the lowest possible rate.
2. The tax should provide horizontal equity among consumers and should be neutral with respect to consumer choices.
3. The value added tax should not be levied on the same value added to products or services more than once.
4. The Model Act should include only basic value added tax rules.

The American Bar Association has established a resolution that if Congress decides to implement a value added tax, the tax should be a European style credit method tax. Therefore, the Model Statute is a credit method destination principle value added tax.

The Model Statute imposes liability for the value added tax on the seller. Tax invoices must be issued by the seller. Like the majority of other value added tax systems, imports would be taxable upon entry into the United States.

If the value added tax is enacted in the United States, the transitional rules accompanying the tax will probably be much simpler than those that accompanied other valued added tax systems because a United States value added tax will not be replacing another broad based federal consumption tax (Lundholm, 1993). The only transition rules in the Model Statute will pertain to an effective date and a rule governing sales executed before the tax's effective date.

In conclusion, the Model Statute is broad in scope in order to make the tax as neutral as possible. It is designed as an ideal tax. The American Bar Association Committee is currently considering whether such a broad based tax can be administered by the government with ease and complied at a reasonable cost (Lundholm, 1993).

#### ULLMAN PROPOSAL: H.R. 7015 (1980)

H.R. 7015 was introduced by Representative Al Ullman (chairman of the House Committee on Ways and Means) on February 2, 1980. It was intended to reform the Internal Revenue Code of 1954 and was known as the "Tax Restructuring Act of 1980." This bill was the first extensive value added tax bill proposed in the United States. It not only would have implemented a credit-method value added tax, but also included individual income tax rate reductions and related adjustments to personal income, reductions in FICA tax with a portion of value added tax revenues dedicated to the Social Security Trust Fund, corporate income tax rate reductions, savings incentives, depreciation reforms and a limitation on growth of federal spending.

The value added tax was structured as a credit-method, destination principle, tax exclusive value added tax levied at the rate of ten percent. As with all credit-method value added taxes, a credit would be allowed for all taxes paid. Any excess credit would be treated as an overpayment and could be refunded.

The Ullman value added tax was a credit-method value added tax modeled after the European system. Like the European Community value added taxes, the seller would be legally liable for issuing an invoice for the tax. The invoice would have to contain the name and identification number of the seller, the name of the purchaser and the amount of tax imposed. No credit would be allowed without an invoice to verify the amount of credit (Lundholm, 1993).

#### **ROTH PROPOSAL: S. 1102 (1985)**

On May 8, 1985, Senator William V. Roth introduced S. 1102, which was titled "Business Transfer Tax Act." This tax would have imposed a five

percent tax on the net business receipts of taxpayers. The Business Transfer Tax is a subtraction method value added tax.

Senator Roth's Business Transfer Tax was proposed during the time Congress was discussing major tax reform. This tax reform turned into be the Tax Reform Act of 1986. According to Senator Roth, a good tax reform plan should include all of the following: lower individual marginal tax rates, major personal savings initiatives to eliminate the double taxation of individual savings, not increase the cost of capital to American businesses, be revenue neutral, and make the Internal Revenue Code simpler and fairer.

Senator Roth's reasons for introducing the Business Transfer Tax were the following:

1. It would be possible to lower marginal tax rates, thereby encouraging productive investment and economic growth.
2. It would improve the balance of trade.



### 3. It would create jobs.

The Business Transfer Tax is a straight forward tax in regards to simplicity and ease of administration. The only opposing effect to this tax would be that it does not replace any tax, therefore; taxpayers would face additional forms.

The biggest debate regarding the Business Transfer Tax focuses on the payroll tax credit. FICA tax is frequently criticized for being regressive, which leads to replacing the payroll tax with a more progressive levy.

Questions arise whether the Business Transfer Tax would be more progressive and if so, would it be progressive enough to make a difference.

If the payroll tax is regressive, public opinion surveys reveal that people regard it as fairer than the income tax. Therefore, if the government wanted to replace certain taxes because of their equity problems, the payroll tax would apparently not be at the top of the list (Lundholm, 1993).

## HOLLINGS I PROPOSAL: S. 442 (1989)

On February 23, 1989, Senator Ernest F. Hollings introduced S. 442, which would have imposed a value added tax and established a trust fund in the Department of the Treasury restricting the use of value added tax revenue to deficit and debt reduction. This bill was titled "The Deficit and Debt Reduction Act of 1989," which is quite similar to the 1980 Ullman proposal.

The Hollings proposal called for a basic credit-method value added tax with invoices required. The rate of tax would be set at five percent. As with the majority of tax credits value added taxes, the seller would be liable for the tax and would be required to give the purchaser a tax invoice stating specific items.

The only major difference between the Hollings proposal and the European Community style value added tax is the dedication of the revenue raised by the valued added tax to the "Deficit Reduction Trust Fund."

## HOLLINGS II PROPOSAL: S. 169 (1991)

A second value added tax bill was introduced by Senator Hollings on January 14, 1991. Entitled "The Deficit and Debt Reduction Act of 1991," this bill was based on the ABA Model Statute.

Under S. 169, a credit-method value added tax would be levied at a five percent rate. Like the Model Statute, the bill leaves a number of questions unanswered. A major concern would be the taxation of financial services and insurance contracts. The S. 169 would tax these services but does not say how.

As with Hollings I, all revenue generated under the proposal would be used to reduce the deficit and pay for administrative costs.

## SCHULZE I PROPOSAL: H.R. 4598 (1986)

On April 15, 1986, Congressman Richard T. Schulze introduced "The Business Alternative Minimum Tax Act of 1986." In addition to imposing a subtraction method value added tax, the proposal would repeal the corporate minimum tax and revise the capital cost recovery provisions. There was to be a seven percent tax levied on the sum of net business receipts plus customs value and duties and any other duties imposed on imports (Lundholm, 1993).

Unlike all value added tax systems in place today, if expenses exceeded receipts in any given year, the taxpayer would carry forward the amount of excess as a business expense of the next taxable year instead of receiving a refund for the tax paid on those expenses.

An unusual feature of Schulze I was the tax imposed on imports would be treated as an expense. Expenses exempted would include specified employer costs, interest and dividends, taxes, charitable contributions, and items exempted from Business Alternative Minimum Tax. Without

consideration of its economic effects, this tax appears to have some negative elements. If the United States were looking for simplicity in administration and compliance, the Business Alternative Minimum Tax would easily be rejected.

#### SCHULZE II PROPOSAL: H.R. 3170 (1991)

Congressman Schulze introduced a revised value added tax bill on August 1, 1991. This new proposal was entitled "The Uniform Business Tax Act." It would be similar to the Business Alternative Minimum Tax Act, but the rate would be increased from seven percent to nine percent. The Uniform Business Tax would repeal the corporate income tax and credit the tax payable by an unincorporated business against individual income taxes (Lundholm, 1993). This proposal changes a business's tax system from one based on income to one based on value added.

According to some analysts, if the United States desires to align its tax system with those of its major trading partners, a balanced system of both income taxes and value added taxes is required.

## DINGELL PROPOSAL: H.R. 16 (1991)

Representative John D. Dingell introduced a value added bill on January 3, 1991. This was entitled "The National Health Insurance Act." The majority of this bill deals with setting up a national health care program, which would be funded by a five percent value added tax. This value added tax would be based on the European system, a credit-method, invoiced based, destination principle tax.

Like the majority of value added tax system, the Dingell system would impose legal liability for the tax on the seller who would be required to issue an invoice. The main question raised by the bill is whether the United States should adopt a national health care program.

In concluding this chapter, each of these proposals have been rejected for one reason or another. Many of these proposals look to be a money making machine for the federal government. Americans, in general, are afraid of change. Changing the tax system of the United States would require

preparing and training Americans on this new system. Obviously, this would cause confusion amongst Americans, however; it has been successful in other countries. As Senators and Congressmen continue to propose changes to our current tax system, the possibility exists that one day one of the proposals will be accepted upon by Congress, and the United States will have a new tax system.

## CHAPTER 4

There have been many debates and proposals regarding value added tax, however; they have never received strong political support in the United States. Recently, value added consumption taxes have attracted more attention. Following are three reasons for the renewed interest:

1. To provide additional revenues to reduce the federal deficit.
2. To formulate a tax system more compatible with international practices, and achieve a more competitive position in the global marketplace.
3. To fund a national health care program.

Value added taxes incite widely divergent and strongly held opinions. Most people appear to be either entirely for this type of tax or entirely against it. Very few people seem to be in the middle. The proponents of the tax make the following arguments for the tax:



**\* The value added tax is an economically neutral tax and will improve economic efficiency.**

**\* The value added tax is needed to coincide with the growing international market. The majority of our trading partners have a value added tax, and to better position American firms to compete internationally the United States needs a value added tax.**

**\* The value added tax will help increase the national savings rate since it is neutral between the decision to save or consume.**

**\* The implementation of a value added tax will allow marginal income tax rates to be lowered or provide additional tax revenues for federal programs.**

**\* The value added tax can be applied to a broad tax base.**

**\* The value added tax can generate revenues to help lower the federal budget deficit or fund a national health care program.**

- \* The value added tax will contribute to the simplification of the tax system.

The opponents of the value added tax argue the following:

- \* The tax is extremely regressive.
- \* The value added tax is a money machine that will discourage spending restraint on the part of legislators.
- \* Value added tax is inflationary.
- \* A value added tax will be economically harmful because it is considered an invisible tax.
- \* A value added tax is expensive in terms of administration and compliance costs.

\* A value added tax will encroach upon state and local government revenue bases.

Anytime an existing tax is changed or a new tax is implemented the effects on tax policy issues must be considered. Some of the major issues that need to be considered include: administrative and compliance costs, breadth of tax base, and who will bear the economic burden of the tax (Belkaoui-Kiahi, 1992).

## ADMINISTRATION AND COMPLIANCE COSTS

An issue of great concern to the taxpayers and the government is the administration and compliance costs of implementing and maintaining a value added tax. Is this tax to be a major or minor revenue source is the first question that needs to be answered. The system chosen should not be so administratively demanding that it undermines the benefits of the tax (Turnier, 1988).

The only study on administrative costs on the implementation of a value added tax in the United States was undertaken by the Department of Treasury in 1984. The Treasury estimated that a value added tax would require 20,000 additional employees and a \$700 million budget. The Treasury also estimated that this tax could yield \$24 billion for each percentage point of tax rate. Comparing the administrative costs with a three percent tax rate of \$72 billion in revenue would be less than one percent or approximately \$.97 per \$100 of tax revenue (Turnier, 1988).

Figure 2 on the following page illustrates the administration costs of value added taxes by countries. Obviously, these costs are so little compared to the revenue generated by such a tax, it is hard to understand why the United States has not followed other countries in implementing this tax.

## BREADTH OF TAX BASE

The easiest value added tax would impose one tax rate on all goods and services. As of today, there has been no tax proposal anywhere in the world

<u>ADMINISTRATION COSTS OF VAT'S BY COUNTRY</u>			
<u>COUNTRY</u>	<u>ADMINISTRATION COSTS</u>	<u>ADMINISTRATION COSTS</u>	
		<u>AS A % OF REVENUE</u>	
BELGIUM	\$101.7 million	1.09%	
DENMARK	\$ 57.2 million	.69%	
FRANCE	\$224.2 million	.40%	
GERMANY	NOT AVAILABLE	NOT AVAILABLE	
GREECE	NOT AVAILABLE	NOT AVAILABLE	
IRELAND	\$ 21 million	1.08%	
ITALY	NOT AVAILABLE	NOT AVAILABLE	
LUXEMBOURG	NOT AVAILABLE	.99%	
NETHERLANDS	NOT AVAILABLE	NOT AVAILABLE	
PORTUGAL	\$ 16.1 million	1.0%	
SPAIN	NOT AVAILABLE	NOT AVAILABLE	
UNITED KINGDOM	\$294 million	.91%	
CANADA	\$ 1.7 billion	NOT AVAILABLE	
JAPAN	\$153 million	4.0%	

FIGURE #2

that requires all firms to collect a value added tax. It is doubtful that the United States would impose such a tax (Turnier, 1988) .

Dan Rostenkowski, Chairman of the House Ways and Means Committee, has stated that "a true value added tax proposal would emerge from Congress looking like a lace doily...." Referring to a tax with a lot of holes or exemptions to it, that looks worthwhile but not really worth the energy that will be put into it.

The Congressional Budget Office has estimated that a broad-based three percent value added tax would raise \$72 billion a year, excluding housing, food and medical care (Turnier, 1988).

## WHO BEARS THE BURDEN OF TAX

The most controversial and significant question posed by a value added tax is who will bear the ultimate burden of the tax. A distinction must be made between who collects and remits the tax and who bears the burden of the tax. In all value added tax systems in place around the world, it is the

businesses or vendors that are responsible for the calculation, collection, and remittance of the tax. Payment is not made directly by the consumer to the government. It is made in stages by the intermediaries in the production and distribution process. Figure 3 illustrates the value added tax process.

# HOW THE VAT WORKS

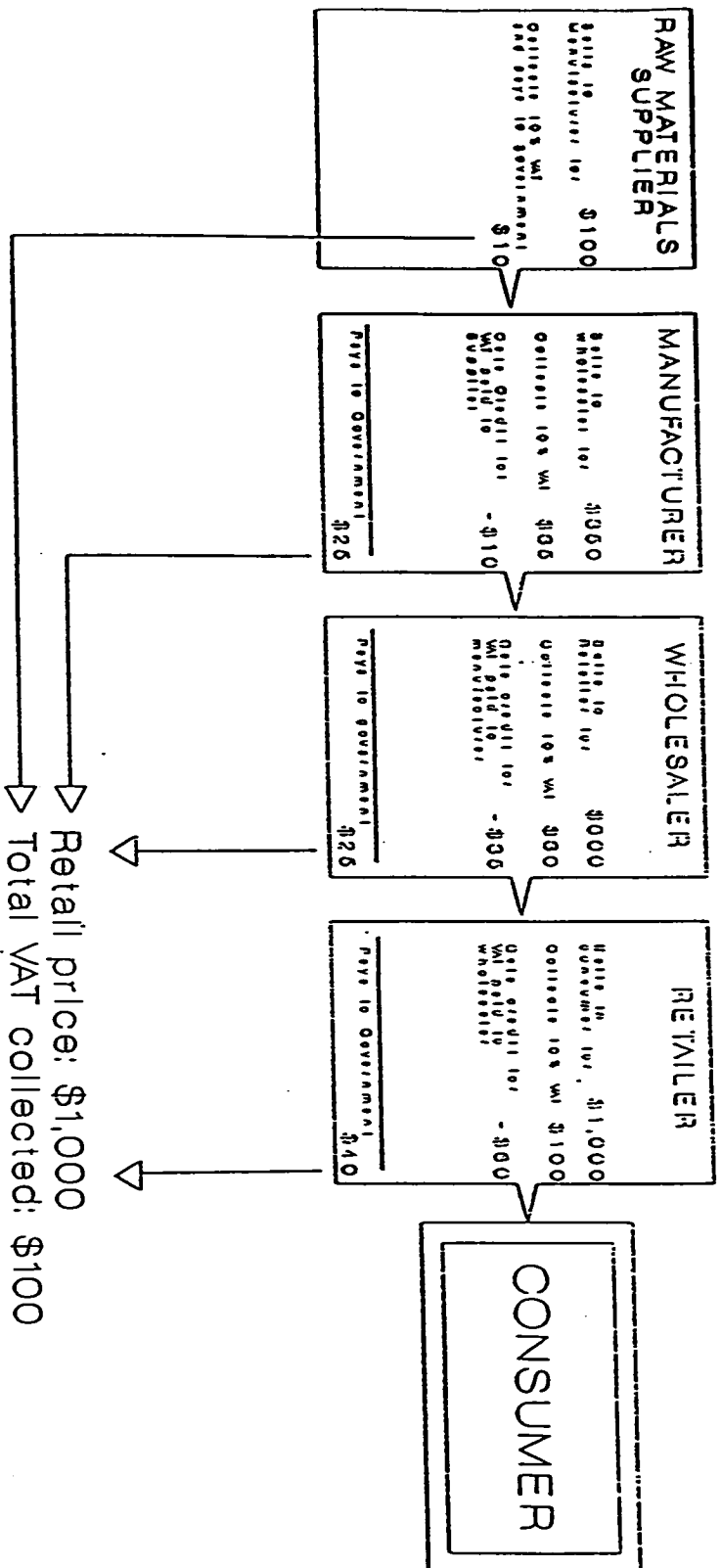


FIGURE #3



## CHAPTER 5

If a value added tax were to be implemented in the United States, some additional issues would need to be addressed. Including, state government concerns, trade implications and the effect of the value added tax on United States competitiveness, and the possible effect of the tax on the economy.

In 1990, the General Accounting Office issued a report based on a survey of state tax policy makers and state tax administrators. These state respondents opposed the implementation of a federal consumption tax. The concern that was voiced repeatedly was the intrusion of the federal government on the States' tax base by imposing a value added tax. Forty five states currently impose a retail sales tax. Many of these retail sales tax's are combined with county, or city sales taxes. On average these taxes account for thirty one percent of the state tax revenue (McLure, 1991). During the last decade, state and local governments have lost federal revenue and have seen reductions in federal grant funds (McLure, 1991). Growing public opposition to increases in property taxes has left state

officials feeling they have very few options to increase revenue for their state. If a value added was implemented in the United States, the States' feel this tax would impair their revenue generating ability.

A second concern is that the implementation of a federal consumption tax would force the States into adopting the same tax base as the federal government (Pechman, 1989). Most States use their sales tax to implement social or economic policies or achieve an economic advantage over other States competing for businesses to locate within their borders. To be forced to conform to this tax would be viewed as a loss of government independence (Pechman, 1991).

A third concern is the potential for taxpayer confusion between state and federal consumption taxes. The States fear that many difficulties will arise when taxpayers and consumers attempt to cope with differing tax rates and tax bases. Retailers may have problems determining which items are subject to the state retail sales tax. State officials feel the addition of another system would add confusion over which items are taxable under each system.

Other concerns raised by the state officials relate to the overall tax effect such as: regressivity of the tax, use of revenue, increased inflation, and cost of compliance and administration (Sandford, 1991).

Before any federal consumption tax could be enacted, state concerns would have to be addressed. Many analysts believe the major concern over intrusion can be solved if a federal consumption tax were compensated with provisions attractive to state governments. The General Accounting Office came up with the following ideas that would compensate the state governments concerns: sharing consumption tax revenue, requiring the federal government to pay a larger share of federally mandated social programs, allowing States to add on a percentage to the consumption tax and furnish the States with their portion, and requiring out of state vendors to collect and remit sales taxes on mail order sales. The implementation of a value added tax would make it difficult for States to raise additional revenue from sales taxes. Another possibility to address state concerns would be to use revenue from a consumption tax to eliminate all federal

excise taxes. Therefore, there would be no competition for excise tax revenues.

The largest difference between the current income tax and a value added tax is the inclusion of wages and fringe benefits paid to employees in the tax base. Also included in the value added tax base is the payment of interest and dividends. Receipts of interest, dividends and wages, and gains on the sale of capital assets not used in conducting business are excluded from the tax in order to avoid double taxation. This makes the value added tax more conducive to savings and investment when compared to an income tax because the value added tax does tax the return from capital.

The final major economic concern is what effect the implementation of a value added tax might have on inflation. Because inflation is affected by a large number of variables, any answer would be speculative.

President Bill Clinton will not make a decision on whether he will enact a value added tax to finance a national health care program. President Clinton is quoted as saying, "Almost every advanced country that I know of

that we compete with, all the European countries, Japan, and Canada have a national sales tax. They call it a value added tax (Hume, p.37).” President Clinton also states that he did not propose it right now because it is a radical change in the tax system of the United States. He also states the value added tax is something to look at in the years ahead.

Repeated reports surfaced from the health care reform task force headed by President Clinton's wife, Hillary Clinton, that the value added tax was being discussed as a way to finance the proposed health care program. The Press secretary and the Communications director have repeatedly denied that the President's wife has proposed this tax to finance a health care program. However, the President would only say that he has not made a decision as yet. President Clinton also stated, "We are in a global economy in which government, the people, and the private sector have to work together...We have to work together to have economic policies that encourage investment over consumption, so we can always be competitive (Hume, p.37).” President Clinton is said to have one profound belief, that belief is in government. That leads to a search for ways to finance it, which leads to the value added tax or other taxes.

## CHAPTER 6

Perhaps the best way to estimate the efficiency of a value added tax is to review the tax systems of two of our major competitors to determine why they switched to a value added tax system.

Figure 4 illustrates a comparison of value added tax rates amongst the European Community, Canada, and Japan. This figure describes the date the value added tax was implemented, the rate at which the value added tax was set, the abbreviation or name of the tax, and the taxes on consumption as a percentage of total taxes. To date no country has withdrew a value added tax system in place (Whalley, 1992). One can only conclude that if a tax system has not had any proposed changes in the past thirty years it must be working for that country. Many of these systems have been in affect since the late 1960's and early 1970's.

Reviewing the reasons Japan and Canada implemented their value added tax systems and how they chose to overcome certain problems is important

### Comparison of VAT Rates

	Date Implemented	Standard Rate (%)	Abbreviation of Name	Taxes on Consumption as a Percentage of Total Taxes
Belgium	1-1-71	19	TVA	24.9
Denmark	7-3-67	22	MOMS	34.1
France	1-1-68	18.6	TVA	29.4
Germany	1-1-68	14	USt	25.2
Greece	1-1-87	16	FPA	45.4
Ireland	11-1-72	21	VAT	42.0
Italy	1-1-73	19	IVA	28.0
Luxembourg	1-1-70	12	TVA	25.2
Netherlands	1-1-69	18.5	BTW	25.9
Portugal	1-1-86	17	IVA	48.1
Spain	1-1-86	12	IVA	30.5
United Kingdom	4-1-73	17.5	VAT	31.2
Canada	1-1-91	7	GST	50.1
Japan	4-1-89	3	JCT	12.6

FIGURE #4

in considering why and how a value added tax could be implemented in the United States. Japan's and Canada's experiences are important because these two countries are two of our largest trading partners and the two most recent industrialized countries to implement a value added tax system.

In Canada the federal value added tax which is known as the GST (Goods and Service Tax) was chosen. The major reason for choosing this system was the flexibility it offered in the treatment of selected goods and services (Smith, 1991). The GST is not an add on tax, but a replacement tax. The tax that was replaced was the FST (Federal Sales Tax). In 1990, the Canadian government concluded the FST has major flaws that could not be easily corrected.

First, the FST impaired competitiveness because it was buried in the price of all goods and services. Therefore, it was a indirect charge on all of Canada's exports. Second, the FST had a narrow tax base. Approximately one third of Canada's goods and services were subject to the FST. Finally, the FST was too complex for businesses to comply with and for the government to administer.



According to the Canadian government, the GST is an integral part of its agenda for securing Canada's economic future. The GST tax reform is intended to achieve the following three objectives:

1. Contribute to the deficit reduction effort and ensure Canada can continue to pay for programs and services Canadians value.
2. Completing changes necessary to ensure Canada can compete effectively in the world economy.
3. Improve the overall fairness of the tax system.

Canadians have typically paid higher taxes at the provincial and federal levels. In return for higher taxes they generally have lower after tax expense on social obligations such as education and health.

In Japan the tax reform committee of the Liberal Democratic Party proposed three reasons why a tax reform was needed in Japan. First, a new

tax was needed to spread the tax burden more evenly amongst taxpayers.

Second, a tax reform was needed to change the balance of direct and indirect taxes. Lastly, the need for extra revenue to reduce the budget deficit (Akimasa, 1990).

The Japanese value added tax system is the only system based on books of account rather than transactions (Akimasa, 1990). No major form of indirect taxation was replaced. The tax was promoted as the second step of the country's tax reform. The first step was to revamp the income tax system by lowering rates and broadening the base in order to make the system more equal.

The Japanese Consumption Tax (JCT) took only three months from enactment to implementation. The following reasons explain why and how this implementation occurred so quickly: There was pressure from the government to require businesses to pay the JCT accurately the first time, tax officials received training on the JCT and had previously worked with accounts so they could be trained in a short period of time, and the

government made several public announcements and instruction sessions were held so the public had a high level of understanding of the new tax.

It is obvious that Japan, Canada and the United States have similar concerns regarding national debt, overall competitiveness, health and wellness programs, and fairness of the tax system. If Japan and Canada can modify their tax systems to acquire their desired goals, why can't the United States follow and change the tax system to attain their goals? By examining the way Japan implemented their new tax system in three short months; the United States could very easily have a new and improved tax system in place before the next century. It seems logical to look at other tax systems in place around the world to determine which is best for the United States.

## CHAPTER 7

The popularity of consumption taxes has grown tremendously in the past few decades. With the need to reduce income tax rates, many countries around the world are looking into implementing a value added tax system. The most recent introductions of value added taxes in New Zealand, Canada, and Japan have been accompanied by a reduction in income tax rates.

With renewed interest in providing additional revenue to reduce the federal deficit, to formulate a tax system more compatible with international practices, and to fund a national health care program; the United States has been considering a value added consumption tax for some time now.

The United States is entering a new century with a tax system that was built over eighty years ago. During these years, savings and investments habits have changed due to inflation, interest rates, and the everchanging economy. The United States needs to change its tax system to

accommodate the changing needs of the economy and its people. If the United States would allow each individual or family to add up all wages, interest, gifts, and capital gains and deduct the total amount of money that was saved or invested that same year, Americans would pay less income taxes than they are now.

The travel and tourism industry has proven in the past it can generate an overabundance of tax revenue. Hotel and airports have designated a special tax on travelers to pay for travel facilities and services. Revenue from these taxes have grown as the travel and tourism industry has grown, producing a surplus of revenue. If a surplus is available, would it not be reasonable to suggest a portion of this revenue go to reduce the federal deficit? If the deficit is reduced, less borrowing would occur and interest rates would decline.

In recent years, Congress has put forth eight proposals regarding implementing a value added tax in the United States. All of these eight proposals were rejected. Many of these proposals look to be a money making machine for the federal government. Changing a tax system will

not be an easy task for Senators and Congressmen; however, with much preparation and training one day a new tax system will be in place in the United States.

President Clinton has mentioned he has considered a value added tax system for the United States, however; now is not the time to make a radical change in the tax system. He has also stated it is something to look at in the future. Reports have surfaced that the President's wife Hillary Clinton has suggested that the value added tax be discussed as a way to finance the proposed health care program. All of these reports have been denied by the President.

Reviewing how and why other countries implemented a value added tax system is the best way to determine how to go about implementing a value added tax system in the United States. Japan and Canada are two of our largest trading partners and the two latest countries to enact a value added tax system. By viewing their accomplishments and mistakes the United States could foresee problems and solve them before they occur.

Every year around election time, candidates say they will acquire a reduction in taxes. Every kind of tax including federal taxes, property taxes, state and county imposed taxes will be reduced. But what we do not see is any reduction in taxes. Maybe it is time for the United States to try a different tax system. Japan and Canada changed their tax systems within the past seven years and their economies are improving. These countries are saving and investing more money than the United States. It is time for a change in the tax system of the United States, and the value added consumption style tax is just what America needs.

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