

VAT in the USA

Summary

The main purpose of this paper is to assess why the United States has failed to integrate value-added taxes (VATs) into its tax systems in any significant way and instead continues to rely on retail sales taxes (RSTs) as a primary form of consumption tax. The significance of this question comes from the country's unique position as the only OECD member without a VAT despite their wide recognition by economists as a superior form of consumption tax compared to RSTs.

This paper briefly describes both the VAT and RST, their basic concepts, flaws and differences. Ideally, both of these forms of consumption tax should be economically equivalent and adhere to the same concepts of neutrality, equal application and broad coverage. Realistically, however, both often fail to meet these ideal standards. Nonetheless, the VAT is often claimed as the administratively superior tax. Having this background information about both consumption taxes makes it easier to understand discussions about the taxes in the other chapters and serves to emphasise even further the notion that the United States is globally distinct as a high-income country without a VAT.

Despite the perceived advantages of the VAT, many Americans view the tax unfavourably and hold the RST in higher regard. Commonly contributing to these beliefs are various misconceptions about these consumption taxes that often make VATs appear worse and RSTs appear better than they actually are. As seen in chapter three, these misconceptions include the perception of VATs as much more complex than RSTs, the belief that having a VAT means that rates will continually increase along with the size of the government, and the idea that VATs and RSTs work the same in practice – which they do not, as RSTs generally struggle to tax services while overtaxing business purchases. The misconceptions that Americans have about VATs and RSTs often play a role in discussions concerning the implementation of VATs, especially at the federal level. As a result, they help to block consumption tax reforms.

To further elaborate on why the U.S. has not adopted the VAT, the paper outlines the historical significance and development of consumption taxes in the federation. Beginning with the Constitution of the United States and America and the powers of taxation granted to Congress, it is shown that consumption taxes during most of U.S. history were limited to indirect taxes like import duties and excises. Direct taxes, which included income taxes until the early twentieth century, were intentionally limited in their application though the inclusion of the rule of apportionment. At roughly the same time as federal income taxes became constitutional and grew to be a primary source of federal income, the first RSTs came into effect at the state level. With a relatively light consumption tax burden at the federal level, consumption taxes have become the mainstay of state and local

governments who protect them against federal intrusion. This chapter also dismisses the notion that it would be impossible for the U.S. as a federal state to implement a VAT. Some of the most common arguments against the VAT in the United States are examined. Some of these are reinforced by misconceptions while others are not. Most, however, are reinforced by certain political beliefs and ideals. The assertions that the VAT is too regressive or too efficient, leads to inflation and would hurt the economy are some the common arguments. Others are based on the notions that consumption taxes should be subject to state control, that government spending is a bigger issue than consumption tax reforms or that interest groups interfere with reforms. Additionally, the lack of an appropriate “push” to adopt the VAT is seen as an explanation of why the U.S. has not yet achieved reform. All of these arguments and beliefs serve as obstacles to an American VAT in their own way.

The Constitution and actions of the Supreme Court of the United States also reduce the likelihood of an American VAT. The direct tax clauses – if recognised properly – can act as a barrier against a federal consumption tax because of the rule of apportionment of direct taxes. This would not be a problem for a pure, indirect VAT, but many conceptualised U.S. VATs are not pure and would likely be hindered by this requirement. Likewise, the Supreme Court, with its decision in *Quill Corp. v. North Dakota*, would make any nationally applied consumption tax much more difficult to enforce because of how it prevents states from collecting taxes on sales to other states.

The paper then highlights some of the most notable instances of the VAT being considered or proposed at the federal level. These attempts have failed for reasons relating to misconceptions of VATs and RSTs, constitutional limitations and the various political stances against the VAT as evidenced by previous chapters. However, the VAT has been more widely accepted at the state level. Two states – Michigan and New Hampshire – have or have had some form of VAT and numerous other states have either considered them or apply elements of them in other taxes. Overall, though, subnational VATs have not seen much success in the U.S. and the potential for meaningful reform lies at the federal level.

The answer to the main question of this paper – why the U.S. has not integrated the VAT in any significant way and instead retains RSTs – is a culmination of several factors. For one, historical developments, especially in the last century, have made consumption taxes largely unimportant at the federal level yet significant at the state level, and the states protect this power jealously. This has made a federal consumption tax harder to achieve but explains the experimentation with VATs at the state level, as states are free to pursue reforms at their own pace. Second, many Americans, including politicians, hold misconceptions of both the VAT and RST that generally make the VAT appear worse than it is. Lastly, political, economic, legal and circumstantial considerations have served as barriers to the implementation of a VAT, often directly resulting in the failure of congressional proposals.