Daniel Goldberg, professor of Tax Law at the University of Maryland, makes an important contribution to the debate over fundamental tax reform in his *The Death of the Income Tax: A Progressive Consumption Tax and the Path to Fiscal Reform*. Goldberg demonstrates a thorough command of his subject and his exposition is clear and lively. His book will reward readers, whether they are tax specialists or interested laymen, and whether or not they are persuaded to support replacing the income tax with his e-Tax.

I. OVERVIEW

The book is divided into two parts. Part One is “The Problem: The Income Tax Is Broken.” Part Two is “The Solution: A Progressive Consumption Tax.” Goldberg proposes the elimination of both the individual income tax and the corporate income tax. To replace them he proposes a two-tiered “e-Tax” (where “e” stands for “electronically-collected” at the point-of-sale) which has two components: a business tax and an individual tax. He acknowledges the large debt his e-Tax owes to both the Hall-Rabushka (2007) “Flat Tax” and the Bradford (2005) “X Tax.” Like the Flat Tax and the X Tax, his two-tiered e-Tax consists of a business value added tax (VAT) modified by a deduction for wages and an individual wage income tax. Under the Flat Tax or the X Tax, $E of wage income is exempt from tax. Under the Flat Tax, all wage income above $E is taxed at a single “flat” rate; under the X Tax, wage income above $E is taxed at graduated (rising) rates.
The main difference between Goldberg’s e-Tax and either the Flat Tax or X Tax is that Goldberg’s e-Tax business component is a “credit invoice” VAT that is electronically-collected at the point-of-sale, whereas the Flat Tax or X Tax business component is a “subtraction” VAT that is collected annually.

It is useful to separate Goldberg’s practical case for a credit invoice VAT that is electronically collected at the point-of-sale (rather than a subtraction VAT that is collected annually) from his broader case for replacing the individual and corporate income taxes with a business VAT modified by a deduction for wages, coupled with an individual wage income tax. His detailed practical case for an electronic point-of-sale VAT is extremely useful for VAT analysts and advocates who may not be persuaded by his broader case for replacing the income tax with his two-tiered e-Tax.

As Goldberg notes, the standard credit invoice VAT has had decades of proven practical experience in other economically advanced countries. The VAT is a key component of the tax system of virtually every economically advanced country except the United States. In the preface to their book, *The Modern VAT* (2001), International Monetary Fund economists Ebril, et al. wrote (p. xi) that “the rapid and seemingly irresistible rise of the VAT is probably the most important tax development of the latter 20th century, and certainly the most breathtaking … Today it is the key source of government revenue in over 120 countries.”

Many economists have presented the case for a VAT in the United States as an *addition* to the existing arsenal of taxes, including McLure (1987), Graetz (2002, 2008), Seidman (2004, 2006, 2013), Hines (2007), Burman (2009, 2013), Rogers (2010a, 2010b), Gale and Harris (2011, 2013), Gale and Brown (2013), Sullivan (2011), and Bartlett (2011). Sympathetic treatments of the case for implementing a VAT in any country are provided by Tait (1988), Ebril, et al. (2001), and Cnossen (2011). Goldberg’s case for an *electronically-collected* credit invoice VAT should be of great interest to any of these authors (as well as others), even if they do not accept his argument for replacing the income tax.

II. THE CASE FOR AN ELECTRONICALLY COLLECTED CREDIT INVOICE VAT

Before presenting Goldberg’s detailed case for an electronically collected credit invoice VAT, some background may be useful. A VAT can be implemented by either the credit invoice method or the subtraction method. An example illustrates the difference between the two methods. Consider a 10 percent VAT on a firm with sales of $10,000 and purchases from other firms of $4,000. Under a credit invoice VAT, the firm is taxed 10 percent of its sales ($1,000) but can claim a tax credit of 10 percent of its purchases ($400), if it has an invoice that demonstrates that the tax has been paid, so that its net tax payment is $600. Under a subtraction VAT, the firm subtracts its purchases from its sales to obtain a tax base of $6,000, and then pays a tax equal to 10 percent of this difference, which again is $600.
According to standard economic analysis, a VAT (whether credit invoice or subtraction) with tax rate $t$ is equivalent to a retail sales tax (RST) with the same tax rate $t$ (Seidman, 2009). Instead of collecting all the tax from the retailer, a VAT collects part of the tax at each stage of production. Because purchases from other firms include investment goods, a VAT allows a deduction for investment for each firm so that the VAT tax base equals value-added minus investment, which equals consumption; hence, a VAT is a consumption-based tax.

Under the credit invoice VAT, the firm must document that each item it purchased for $4,000 included a 10 percent VAT — it obtains the credit on an item only if its gets an invoice from its supplier documenting the tax the supplier paid on the item. Under the subtraction VAT, documentation of tax paid by suppliers is not required. Requiring documentation of tax paid by suppliers raises compliance costs but reduces evasion because auditors can cross-check suppliers and purchasers.

A credit invoice VAT represents a marked improvement over a turnover or gross receipts tax. Under a turnover tax, each firm is taxed on all of its sales, which causes multiple taxation (or tax cascading) when different firms operate at different stages of the production process. Converting a turnover tax to a credit invoice VAT remedies this multiple-tax (tax cascading) problem by allowing each firm a credit for tax paid at the previous stage by its suppliers. Decades ago many European countries converted their turnover taxes to credit invoice VATs.

A subtraction VAT is more closely related to a corporate income tax. Under a corporate income tax, each firm subtracts the cost of goods sold from its sales to obtain its income and then applies a tax rate to this difference. A corporate income tax can be converted to a subtraction VAT by no longer permitting subtractions (deductions) for labor costs, interest, or depreciation, but permitting a subtraction for the full purchase price of investment goods (immediate expensing).

A credit invoice VAT looks like a retail sales tax to consumers because the sales receipt shows consumers (or in principle can show) the rate of VAT paid. By contrast, a subtraction VAT does not look like a sales tax to consumers because the sales receipt does not show the VAT paid or the VAT rate.

Which form of VAT should the United States adopt if it chooses to utilize the tax? For several decades, many VAT advocates have emphasized one practical piece of evidence strongly favoring a credit invoice VAT: the use of the credit invoice method by virtually every other economically advanced (Organisation for Economic Co-operation and Development) country. Administrative methods for implementing a credit invoice VAT have been developed in these countries over a half century of experience. In their books on the VAT, both McLure (1987) and Tait (1988) strongly advised choosing the credit invoice VAT over the subtraction VAT, as did Ebril et al. (2001) of the IMF. Moreover, the credit invoice treatment of U.S. exports and imports would match the treatment of almost all of our trading partners.
With this background, let me turn to Goldberg’s detailed case for making a credit invoice VAT “electronically collected” which he argues would further strengthen the case for adopting a credit invoice VAT. In a section entitled “The Mechanics of Tax Collection,” Goldberg gives the following detailed exposition (pp. 201–203):

The above overview appears straightforward enough, but how would e-Tax really work in practice? This portion of the chapter will explain the day-to-day operation of e-Tax and how it makes use of the technology of modern commerce …

A credit VAT, the foundation of e-Tax, can be inexpensive, accurate, and virtually leak-proof in an economy in which money transfers take place electronically. To illustrate this point, consider customer Swoozy’s retail purchase of shoes from retailer Roy … When Swoozy’s debit card is swiped to make the purchase…the appropriate amount, including the VAT, would be automatically withdrawn from her account. The clearing bank, which handles the transaction electronically, would then make an automatic entry, debiting Swoozy’s account for the purchase price plus the VAT, crediting Roy’s account for the purchase price and crediting the government’s tax collection account for the VAT. All of these operations would be programmed to be part of the clearing bank’s normal operations …

If Swoozy chose to use a credit card instead of a debit card, the transaction would operate in much the same way from Swoozy’s and Roy’s points of view. The only difference would be that the clearing bank would charge Swoozy’s credit account for the appropriate amounts, thereby establishing a lending transaction rather than making an immediate withdrawal from Swoozy’s bank account …

At the business supply level, one would expect that payments would be made by other electronic means besides a debit or credit card, such as electronic funds transfers (EFTs). Indeed, even paper checks are now being cleared electronically and are thus best characterized as EFTs. Cash purchases at the noncriminal business level are rare, if existent to any extent, but could be dealt with in the manner described later in this chapter for cash retail purchases.

The numerical example discussed throughout Part II of this book will illustrate the mechanics of e-Tax’s tax collection. Swoozy’s retail purchase of shoes from Roy in the amount of $100 made by credit or debit card would be subject to a VAT. Assume a tax-inclusive rate of 20 percent, so that the stated purchase price would already include the $20 VAT. When Swoozy’s credit or debit card is used to make the purchase, an amount equal to the $100 purchase price would be charged to her credit account or subtracted from her bank account, depending on her choice of purchase card. At that time, the $20 tax portion of the charge would be credited immediately to a tax collection account of the federal government at the financial institution handling the electronic
bookkeeping. E-Tax would provide that the charge be bookmarked with the taxpayer identification number to identify the purchaser for credit. The financial institution’s tax collection account would be transferred either immediately or at the end of each day to the Federal Reserve account …

The transmittal of the VAT to the government is not the end of the process for Roy, the seller. Roy would be entitled to a credit on the VAT that he previously paid to his supplier, Manny, in the amount of $14, based on a purchase price of $70. That amount of $14 would have been paid automatically and electronically to the government by Manny on his sale to Roy.

Records of the seller’s allowable credits would be maintained because the financial institution would have previously reported — both to the seller and to the taxing authority — the VAT paid by the seller on its initial purchases. Each seller in the chain could retrieve its VAT credit by filing a claim for the VAT previously paid. The taxing authority would then credit the seller’s bank account with the amount of its allowable VAT credit …

For those purchases that were not made electronically (that is, not using EFTs, credit or debit cards, or checks — likely an insubstantial number of transactions today), some actual invoice audit and verification may be required … A similar issue arises with the seller’s reporting of its non-electronic sales receipts, which could be done when the sale is made or when the seller makes cash deposits to its financial institution.

Goldberg then devotes a separate chapter to addressing problems that confront an electronically collected credit invoice VAT, which addresses issues such as maintaining anonymity, the treatments of cash transactions and personal expenses, controlling tax cheating, and the treatment of financial institutions.

III. THE CASE FOR REPLACING THE INCOME TAX WITH AN E-TAX

The full title of Goldberg’s book is “The Death of the Income Tax: A Progressive Consumption Tax and the Path to Fiscal Reform.” He devotes the first half of his book to the case against the income tax, and the second half to his replacement for it, the e-Tax, which he calls a progressive consumption tax that consists of a credit invoice VAT modified by a deduction for wage income, coupled with a wage income tax on households. Goldberg fully acknowledges that his proposal is very similar to the Hall-Rabushka Flat Tax and the Bradford X Tax. Not surprisingly, his case for replacing the income tax with the e-Tax presents many of the arguments made by Hall and Rabushka, Bradford, and others. But Goldberg, a professor of tax law who has taught the income tax for many years, is able to present interesting examples from the legal and practical side of the income tax. Moreover, he writes in a lively clear style aimed at interested laymen (rather than only other law professors) and his book is filled with informative examples and novel expositions concerning practical problems with many provisions of the income tax.
I want to make three points that apply equally to the various proposals advanced by Goldberg, Hall-Rabushka, and Bradford: (1) their impact on progressivity, (2) the differences between a consumption tax and a labor income tax, and (3) the use of multiple taxes rather than a single tax to raise a given fraction of GDP as tax revenue.

First, many citizens have strong preferences about whether they want the progressivity of the federal tax system reduced, maintained, or increased. Replacing the income tax with an RST (retail sales tax), or a VAT, or a Flat Tax would reduce the progressivity of the federal tax system. Seidman (1997) presents the main numerical results of two studies by the Office of Tax Analysis of the U.S. Department of the Treasury demonstrating and measuring the reduction in progressivity that would occur with the replacement of the income tax with an RST (Toder, 1995) or a Flat Tax (U.S. Department of the Treasury, Office of Tax Analysis, 1996). The reasons for the reduction in progressivity are easy to understand. Replacing the current personal and corporate income taxes with either an RST or a VAT would reduce the progressivity of the federal tax system for affluent households because each has a single rate that would be lower than the current personal income tax rate on high-income households. The Flat Tax would reduce the progressivity of the federal tax system for affluent households because its single rate on households would be lower than the top rate under the current income tax and would apply to a household’s labor income but not its investment income. Replacing the income tax with an X Tax (which has graduated rates on wage income) might be able to maintain progressivity for households with very high wage income (President’s Advisory Panel on Federal Tax Reform, 2005), but would reduce progressivity for households with very high investment income.

Second, many economists (Bradford, 2005; McLure and Zodrow, 2007; Carroll and Viard, 2012) call a labor income tax “a consumption-based tax” or simply “a consumption tax.” These economists correctly point out that a labor income tax or a consumption tax, in contrast to a capital income tax, does not distort the trade-off between present and future consumption, and that the lifetime present values of the tax bases under the two systems are identical under certain circumstances. In this sense the two taxes are similar, and to emphasize this similarity these economists call them by the same name — “consumption-based taxes.”

But a labor income tax, such as the household component of the e-Tax, Flat Tax, or X Tax, does not look at all like a consumption tax to most citizens. People easily understand that a sales tax or a credit invoice VAT (where the VAT appears on the retail sales receipt) is a consumption tax and that people bear a burden that varies directly with their consumption spending. But try explaining to a non-economist that the individual wage income tax under the e-Tax, Flat Tax, or X Tax is really a consumption tax and watch the reaction. People sense the following important difference that many economists seem to ignore. Consider the “lazy heir” who inherits a fortune, spends lavishly every year on consumption, and never works. People can easily see that the lazy heir would bear a heavy burden under a sales tax or VAT, but would pay no household wage income tax under the e-Tax, Flat Tax, or X Tax — unless the taxes were modified to include a tax on inheritances.
More generally, the ordinary citizen is likely to look at the household wage income tax (under the e-Tax, Flat Tax, or X Tax) and ask: “Why is a household taxed only on its wage income but not on its investment income?” It seems likely that many citizens would regard this as extremely unfair. Most workers would ask: “Why are workers taxed on our wage income under our household tax while financiers are exempt from tax on their investment income under their household tax?” Although Hall and Rabushka, Bradford, and Goldberg would all argue that immediate taxation of all wage income is equivalent in present value terms to the explicit taxation of consumption, this rather esoteric argument is not likely to satisfy most workers.

Third, citizens are divided over whether federal spending and taxes should be gradually raised as a percentage of GDP over the next two decades in response to demographic changes and rising medical costs, or should instead be held constant or lowered as a percent of GDP. If a citizen supports gradually raising revenue as a percent of GDP, would it be better to do so using multiple taxes with moderate rates or a single tax with a high rate? Public finance textbooks teach that the efficiency cost of a tax generally rises with the square of the tax rate (Seidman, 2009), so there will often be a smaller efficiency cost if revenue is raised from a larger set of taxes on different bases that have moderate rates, rather than from a smaller set of taxes that have high rates. Intuitively, less deadweight loss is likely to be imposed on the economy by spreading the burden among a larger set of taxes on different bases rather than leaning heavily on a smaller set of taxes. Also, it may often be judged fairer to spread the burden among a larger set of taxes because any one tax may especially burden a particular population or behavioral group. From this perspective, it might be better to retain current taxes (the personal income tax, corporate income tax, and payroll tax) without raising their rates, and introduce a credit invoice (electronically collected) VAT to raise additional revenue (Seidman, 2013). Although a VAT itself is regressive, it would be possible to make the VAT moderately progressive by introducing a refundable VAT credit on personal income tax returns (Seidman, 2004, 2006, 2013). Also, rather than raising income tax rates, it would be possible to introduce a progressive consumption surtax that would included on personal income tax returns for households with very high consumption (Andrews, 1980; Seidman, 1997, 2006, 2013).

IV. CONCLUSION

Goldberg’s book is very useful for anyone interested in the implementation of a VAT. He makes a persuasive case that the most practical VAT is an electronically collected credit invoice VAT and provides an excellent detailed exposition of how a credit invoice VAT could be implemented electronically.

Goldberg’s book is also useful and rewarding for anyone interested in fundamental tax reform. He provides a clear exposition of the case for replacing the income tax with an e-Tax which, like the Flat Tax and the X Tax, is a two-tiered tax that consists of a business value-added tax (VAT) modified by a deduction for wages, coupled with an individual wage income tax. His e-Tax differs from the Flat Tax or X Tax by using
an electronically collected credit invoice VAT rather than a subtraction VAT collected annually. Although his exposition of his case for replacement is clear and lively, it is unlikely to persuade citizens who oppose reducing the progressivity of the federal tax system, who object to a household tax that is levied on wage income but not on investment income, and who support a gradual increase in federal taxes as a percentage of GDP in response to demographic changes and rising medical costs.

REFERENCES


