Value Added Tax (VAT)

4. Value Added Tax (VAT)¹

Since this proposal replaces personal income taxes with expanded payroll taxes, and since payroll taxes directly benefit the individual, i.e., National Health Care, Social Security, and Public Education, it is imperative that a small, broad based 5% Value Added Tax (VAT) be instituted to help fund other aspects of government.

What is a VAT?

"A value-added tax (VAT) is a <u>consumption tax</u> placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale. The amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed." ² It is currently in use in over 160 countries including every economically adanced nation except the United States.³

How the VAT works

A VAT is levied on the <u>gross margin</u> at each point in the manufacturing-distribution-sales process of an item. The tax is assessed and collected at each stage, in contrast to a sales tax, which is only assessed and paid by the consumer at the very end of the <u>supply chain</u>.¹

"Say, for example, Dulce is an expensive candy manufactured and sold in the country of Alexia. Alexia has a 10% value-added tax. Here is how the VAT would work:

- 1. Dulce's manufacturer buys the raw materials for \$2.00, plus a VAT of 20¢—payable to the government of Alexia—for a total price of \$2.20.
- 2. The manufacturer then sells Dulce to a retailer for \$5.00 plus a VAT of 50¢ for a total of \$5.50. However, the manufacturer renders only 30¢ to Alexia, which is the total VAT at this point, minus the prior VAT charged by the raw material supplier. Note that the 30¢ also equals 10% of the manufacturer's gross margin of \$3.00.
- 3. Finally, the retailer sells Dulce to consumers for \$10 plus a VAT of \$1 for a total of \$11. The retailer renders 50¢ to Alexia, which is the total VAT at this point (\$1), minus the prior 50¢ VAT charged by the manufacturer. The 50¢ also represents 10% of the retailer's gross margin on Dulce." ⁴

VAT vs National Sales Tax

Theoretically, the 5% VAT called for in this proposal, and a 5% National Sales Tax would bring in the same amount of revenue. However, in practical terms this is not the case. Since a retail sales tax is collected only once, which is at the consumer's point of purchase, and since the laws governing the collection of this tax are easily avoided by small businesses, many retailers do not fully comply with this obligation. Sometimes they choose to collect the tax and pocket it completely, or send in a lesser amount, or choose not to collect the tax in the first place. Therefore, the VAT, with its built-in mechanism for compliance is a far superior process for collecting tax revenue.

¹ In this proposal, the VAT is not applied to property (residential and commercial), speculative financial instruments (stocks, bonds, commodities, etc.), the sale of a business, gasoline, education, State and Local Government, Medicaid, Medicare, and National Health Care.

 $^{^2} https://www.investopedia.com/terms/v/valueaddedtax.asp\#:\sim:text=A\%20value\%2Dadded\%20tax\%20(VAT)\%20is\%20a\%20consumption\%20tax,that\%20have\%20already\%20been\%20taxed.$

³ https://www.taxpolicycenter.org/briefing-book/what-vat

⁴https://www.investopedia.com/terms/v/valueaddedtax.asp#:~:text=A%20value%2Dadded%20tax%20(VAT)%20is%20a%20consumption%20tax,that%20have%20already%20been%20taxed.

How the VAT will impact our society

Generally speaking, the wealthy already have enough money to easily absorb the modest price increases the VAT will have on the goods and services they purchase. Therefore, they will hardly notice it.

However, this will not be the case with the poor. Since the poor have very little money to begin with, and since the products and services they purchase will now be more expensive, their lives will be more negatively impacted than the well-to-do.

To remedy this situation, an annual cash payment of \$250 per adult, and \$100 per child (up to a maximum of three children) has been instituted for those families that earn less than \$25,000 per year. In this way, the regressive nature of the VAT has been softened on those that are most affected by it.

After adjusting for the effect this tax will have on the production of goods and services, **The VAT** will bring in \$250 billion annually.⁵

⁵ https://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/THP_15WaysFedBudget_Prop10.pdf