FEDERAL NON-INCOME TAXES

An Examination of Selected Revenue Sources
FOREWORD

Despite the Revenue Acts of 1962 and 1964, we are far from the goal of an equitable tax system that will provide adequate revenue and offer the least possible impediment to efficient operation of the economy at a high rate of investment and growth.

The immediate tax problem before Congress is to decide on changes in the excise tax structure. For the long run, basic questions regarding the degree of reliance on income taxes and the role of non-income taxes in the Federal system will remain after any action this year on excises.

This study examines various possibilities for use of non-income revenue sources. What taxes might be substituted, in whole or in part, for existing levies? What has been the experience in other countries with important kinds of taxes not now used by the Federal government in the United States? What are the effects of such taxes? How much revenue might they yield?

As part of the background for such an analysis, this study includes a history of Federal excises and examines the role of excises in the Federal tax system.

Elizabeth Deran, Senior Research Analyst, had primary responsibility for the research and drafting of the portions of this study dealing with alternative taxes. George Bishop, Director, Federal Affairs Research, had primary responsibility for the research and drafting of Section III dealing with the present excise tax system.

The Tax Foundation is a private, non-profit organization founded in 1937 to engage in non-partisan research and public education on the fiscal and management aspects of government. Its purpose, characterized by the motto, "Toward Better Government through Citizen Understanding," is to aid in the development of more efficient and economical government. It serves as a national information agency for individuals and organizations concerned with problems of government expenditures, taxation, and debt.

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CONTENTS

FOREWORD ......................................................................................................................... (i)
SUMMARY ............................................................................................................................... (v)

I. PAST AND PRESENT USE OF NON-INCOME TAXES .................................................. 1
   Taxes Related to Business Activities ........................................................................ 1
   Taxes at the Personal Level ....................................................................................... 6
   Non-tax Revenue Sources .......................................................................................... 8

II. ECONOMIC EFFECTS OF TAXES ............................................................................... 10
   Incidence ....................................................................................................................... 10
   Equity and Social Welfare .......................................................................................... 12
   Resource Allocation ..................................................................................................... 15
   Rate of Growth and Level of Production and Employment ...................................... 16
   Problems of Administration and Compliance .......................................................... 18

III. FEDERAL EXCISE TAXES ......................................................................................... 20
   History of Excise Taxes ............................................................................................... 20
   The Present Excise Tax Structure ............................................................................... 27
   The Role of Excises in the Federal Tax System ......................................................... 34

IV. TURNOVER AND SALES TAXES ............................................................................... 44
   Multi-stage Turnover Tax ............................................................................................ 44
   Single-stage Turnover Taxes ...................................................................................... 45
   Incidence of a Turnover Tax ....................................................................................... 46

V. THE VALUE-ADDED TAX ............................................................................................ 47
   Problems of the Value-added Base ............................................................................ 47
   Economic Effects of the Value-added Tax .................................................................... 48

VI. THE EXPENDITURE TAX ............................................................................................. 54
   Advantages of the Tax ................................................................................................. 54
   Shortcomings of the Tax ............................................................................................. 55

VII. REVENUE POTENTIAL OF THE TAXES .................................................................. 58
   Retail Sales Tax ............................................................................................................ 58
   Manufacturers Sales Tax ............................................................................................. 59
   Wholesalers Sales Tax ................................................................................................. 60
   Value-added Tax .......................................................................................................... 60

VIII. COMPARATIVE EVALUATION OF THE TAXES .................................................... 62
   The Criteria ................................................................................................................... 62
   Which Tax Is "Best"? ..................................................................................................... 66

APPENDIX I
   Revenue Estimating Methodology .............................................................................. 68

APPENDIX II
   Effects of Excise Taxes on Prices and Factor Incomes .............................................. 70

(ii)
LIST OF TABLES

TABLE | PAGE
--- | ---
1. Proposed Surtax Schedule for Expenditure Tax, 1942 | 7
2. Expenditures on Commodities Subject to Retail Sales Tax as a Percentage of Gross Income, Net Income, and Disposable Receipts, by Net Income Class, 1960 | 14
3. Allocation of Growth Rate of Total Real National Income among the Sources of Growth | 17
4. Total Compliance Cost Compared to Gross Receipts | 19
5. Federal Tax Collections by Source, Selected Periods 1792-1963 | 21
6. Federal Excise Tax Rates on Selected Items, as of December 31, Selected Years 1913-1963 | 23
7. Federal Excise Tax Collections by Type of Tax, Net of Refunds, Fiscal Years 1964-1966 | 28
8. Family Expenditure by Type as a Percent of Family Income by Income Class, 1960-61 | 32
11. Estimated Excise Tax Burden for Urban Families Reporting Expenditures on Selected Taxable Items by Income Class, 1960-61 | 39
13. Analysis of the Basis of the Michigan Business Activities Tax All Industry Summary | 50
16. Estimated Base and Yield at 5 Percent of Manufacturers Sales Tax, Selected Years, 1964-1967 | 59
17. Estimated Base and Yield at 5 Percent of Wholesalers Sales Tax, Selected Years, 1964-1967 | 59
20. Evaluation of Potential and Existing Federal Taxes on Basis of Selected Criteria | 63

EXHIBIT
1. The Individual Spendings Tax Table | 56

FIGURE
1. Estimated Revenue from Existing Taxes and Selected Alternative Taxes, 1965 | 61
SUMMARY

The deficiencies of present income and excise taxes, relatively tolerable at low rates, can become oppressive at the high rates prevalent in today's tax structure. Alternative forms of taxation also have disadvantages. Their deficiencies, however, cannot be written off as obviously worse than those of current Federal taxes. The advantages and disadvantages of alternative non-income taxes need examination in detail, and that is the purpose of the present study.

Several types of taxation, not now used at the Federal level, are significant in the fiscal structure of other countries as well as in some U.S. state tax systems. These include the turnover or gross receipts taxes levied on sales at several, or sometimes all, stages of production and distribution. Single stage commodity taxes are feasible at any of three levels of sales: manufacturers, wholesalers, and retailers. In recent years, the value-added tax, a sophisticated variation of the turnover tax, has attracted much attention. At the personal level, a quite different kind of tax is possible, namely a tax based on personal expenditures but levied on the individual.

Economic Effects of Taxes

The major economic effects of most taxes fall into one or more of five categories: problems of incidence, resource allocation, equity, growth, and stability.

The basic problem of incidence involves serious difficulties of definition and analysis. Effects of a given tax differ from industry to industry depending on pricing practices, degree of competition, cost conditions, and institutional rigidities.

The traditional analysis of the incidence of excise taxes indicates that the burden of excises is generally shifted forward to consumers. However, the "classical" analysis was a partial approach to the problem—it dealt with the effects of a tax in a single market or industry and assumed that effects in other sectors of the economy could be neglected. For an excise tax that affects a significant portion of the whole economy, an aggregate approach that will include repercussions in sectors of the economy not directly subject to the tax is called for. It has been shown that under certain conditions an excise tax may be shifted backward to suppliers of productive resources in all sectors of the economy.

The extent to which a tax may be shifted forward or backward requires further theoretical and empirical work.

The question of equity introduces additional difficulties. How can we define those conditions under which taxpayers are in similar circumstances and therefore should be treated in the same way for tax purposes? How can we find acceptable ways of differentiating among taxpayers in different circumstances? There are no easy answers to these questions.

One problem of equity concerns the degree of regressivity or progressivity in the distribution of the tax burden. Attempts to estimate the distribution of the burden of taxation rest on largely untestable assumptions about the incidence of taxation. However, on the assumption that much of the burden of sales and excise taxes is shifted to consumers, data are available to estimate the burden of such taxes. If a typical retail sales tax is related to disposable receipts of families (all money receipts available for consumption after personal taxes) the burden of such a tax tends to rise relatively from low to middle income levels. Over middle ranges of in-
come, sales taxes appear to be approximately proportional.

The issue of taxing the poor, however, needs to be distinguished from regressivity. Some family incomes are so low that any tax, whether proportional, progressive, or regressive, would be a heavy burden. One solution to this problem is to provide tax credits or income tax refunds to minimize the burden from a tax on consumption.

Taxes must also be evaluated from the point of view of their effect on the allocation of resources. Except in special cases, taxes should be designed to be neutral in their effects on different kinds of industry or different ways of employing resources.

In recent years, there has been increasing preoccupation with the effects of taxation on economic growth, employment, and prices. Taxes influence the amount of saving as well as the use made of such savings. Excises and income taxes probably have a substantially different effect on savings and investment.

Excise and sales taxes have generally been considered to have greater stability of yield than income taxes. Recent evidence at the Federal level, however, suggests that existing excises have about as much automatic stabilizing effect (per dollar of revenue) as the individual income tax, though not as much as the corporation income tax.

A number of administrative and compliance considerations affect the desirability of different kinds of taxes. In general administrative and compliance costs tend to be high when the number of taxpayers filing returns is large, when identification of taxpayer and taxed items is difficult, when exemptions are numerous, when taxpayers’ records are inadequate, and when there is a differentiated rate structure. Unfortunately, data on compliance costs of taxation are meager and generally unsatisfactory.

Federal Excise Taxes

The history of Federal excises is largely one of wartime levies which for the most part were removed in intervening peacetime periods. Another kind of emergency, the depression of the 1930’s, produced a more or less permanent set of excise taxes.

The present excise tax system has several well recognized characteristics. The first is that rates vary substantially as a percentage of retail price—from 40 percent in the case of distilled spirits to about 4 percent for some manufacturers’ excises.

The second characteristic is that selected items only are taxed. Such selectivity means that many closely competing goods and services are left untaxed. When one commodity is subject to a tax of 10 percent or more, while competing commodities or services are exempt, discrimination is serious.

The third characteristic is that the selected items represent about one-fifth of total personal consumption expenditures and that the selection of items is such as to mitigate the burden on low income groups. The items subject to Federal excise taxes generally are less important in the budgets of low income families than the average for all families.

Excises have obviously played an important part in the Federal tax system—providing a major portion of revenues before the introduction of the income tax, and a substantial amount today along with individual income, corporation income, and estate and gift taxes. Excises have played special wartime roles in checking inflation and in helping to divert resources from less essential to more essential uses.

In peacetime excises can serve several purposes. First, they can and do provide significant amounts of revenue. Second, some excises play a special role as user taxes. Third, a number of excises serve regulatory purposes.

Finally, excises can serve as a partial alternative to higher income taxes. The crucial decisions over the use of excise taxes involve judgments of the effects of excises as compared with those of income taxes. The study examines the major economic effects of existing excises.
Turnover and Sales Taxes

The most serious deficiency of the turnover tax is its pyramiding effect. When the tax is applied at an early stage of production, the tendency is for the amount of the tax embodied in the price of the product to increase in direct ratio to the number of stages through which it must pass to reach the final consumer.

As a result, the total tax on different commodities will vary widely with differences in the number of transactions required for the commodity to reach the consumer.

The chief advantage of the multiple-stage turnover tax is that it will raise a given amount of revenue at a lower rate than any other transaction type tax.

A single-stage turnover tax has important advantages over a multi-stage turnover tax.

With a wholesalers tax the number of taxpayer firms is relatively small. Also it is relatively easy to apply a differentiated rate structure at the wholesale level, and the definition of taxable items is relatively simple.

The major problem of the wholesalers tax is the determination of taxable value. Quantity discounts and direct sales from manufacturers to retailers raise difficulties.

A manufacturers sales tax runs into similar problems of determining the tax base when the manufacturer provides wholesale or retail distribution services.

A retail sales tax is subject to different shortcomings. It largely avoids the problems of valuation and pyramiding. However, because it applies to large numbers of relatively small establishments, with typically casual record-keeping practices, administration of the tax may be costly. On the other hand, because of its broader base, it yields large amounts of revenue at relatively low rates. In the United States, the fact that the states rely heavily on the retail sales tax reduces its potential for Federal use.

The Value-added Tax

The basic concept of the value-added tax is simple. Value-added may generally be defined as total sales receipts of a firm less payments to other firms for goods and services. Alternatively, value-added is equal to the sum of wage, interest and rent payments to individuals, plus profit.

The value-added tax has the advantage of making allowance for taxes paid at earlier stages of the productive process. This advantage is not without its price, for computation of the value-added tax base is not so simple a matter as often implied.

In practice the definition of the tax base involves difficulties because of exempt transactions and exempt types of organizations, deductions for depreciation and other purposes. Borderline cases of inter-firm transactions sometimes leave a good deal of doubt concerning which firm contributed the value-added.

Two major alternatives for handling depreciation are the “consumption type” tax and the “income type” tax. Under the consumption type, the full cost of capital equipment is deducted from the tax base in the year of purchase. Under the income type, depreciation deductions of the sort now allowed under the income tax are made over the life of the capital equipment. Under the consumption concept the firm making heavy capital outlays has a smaller tax base in the initial outlay years, but a larger tax base in subsequent years. Like accelerated depreciation under the income tax, this form of value-added tax would be more favorable to investment than the income type of tax.

The problems of the incidence of the value-added tax are difficult. The initial impact of such a tax would probably vary considerably from one type of business activity to another because the ratio of value-added to gross receipts differs substantially from industry to industry.

On the whole, the value-added tax offers the most potential for use at the Federal level. It is levied broadly on all
business activities and should have a minimum of distorting effects on the economy. Because it has a broad base, a low rate can yield substantial revenue. It avoids many of the problems associated with the turnover or single stage sales taxes. The feasibility of tax has been proved by its use in France and in Michigan. Moreover, it would help to increase the competitiveness of American export industries; these industries now operate under relatively heavy income tax burdens which cannot be deducted for export purposes. A value-added tax, like excises, can be rebated on exports.

One of the arguments offered against the value-added tax is that businesses are subject to tax whether or not they are operating at a profit. Moreover, it is argued, the value-added tax does not differentiate between the new business and the established business. If the value-added tax were introduced as a partial substitute for the corporation income tax, unincorporated business subject to the value-added tax would not enjoy the offsetting benefit of a corporate rate reduction.

The Expenditure Tax

A progressive tax on personal expenditures levied on the individual, it is argued, has two advantages over an income tax. The first is that savings are exempt, which is an advantage from the point of view of those who consider the income tax as a double burden on savings, as well as from the point of view of those who would like to see the tax system offer fewer obstacles to savings, investment, and growth.

The second advantage is that an expenditure tax falls on all personal expenditure whether financed out of current income or not. Many argue that expenditures represent a better index of ability to pay than does income as defined for tax purposes.

An expenditure tax, however, would raise serious administrative and compliance problems. The reporting form proposed by the U.S. Treasury in 1942 for such a tax required computations comparable to those of the individual income tax. Moreover, the report form assumed something approaching balance-sheet accounting on the part of the individuals.

Revenue Potential of the Taxes

The study estimates the revenue potential of the taxes examined. The major revenue estimates at existing levels of national income and output compare with revenues of present taxes as follows:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Revenue (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present corporation income tax</td>
<td>24.6</td>
</tr>
<tr>
<td>Present excise taxes (including trust fund taxes)</td>
<td>14.5</td>
</tr>
<tr>
<td>Retail sales tax (at 5%, food exempt)</td>
<td>14.0</td>
</tr>
<tr>
<td>Wholesalers sales tax (at 5%, food exempt)</td>
<td>10.2</td>
</tr>
<tr>
<td>Manufacturers sales tax (at 5%, food exempt)</td>
<td>8.0</td>
</tr>
<tr>
<td>Value-added tax (at 5%, agriculture and service industries exempt)</td>
<td>17.3</td>
</tr>
</tbody>
</table>

Comparative Evaluation of the Taxes

A rough evaluation of different taxes can be made on the basis of such criteria as effects on equity, resource allocation and growth, economic stability, revenue potential, administrative and compliance costs. Wide agreement could probably be found in rating different taxes according to each of these criteria taken separately. However, putting together all of these tests to arrive at an over-all evaluation necessarily involves value judgments concerning the relative weights to be assigned to different criteria.

The study provides a summary evaluation of existing and alternative taxes using the various criteria mentioned above and making explicit the major economic considerations relevant to policy decisions.
PAST AND PRESENT USE OF NON-INCOME TAXES

This section examines various kinds of non-income taxes which are not used at the Federal level in the United States but are, or have been, levied in other countries. These include manufacturers, wholesalers, and retail sales taxes, the value-added tax, and the expenditure tax. Non-tax devices such as lotteries and new or increased user charges also are considered.

TAXES RELATED TO BUSINESS OPERATIONS

Several types of taxes imposed on business activities are at present, or at one time or another have been, part of the fiscal structure of various European nations. As a consequence, considerable material has been amassed on practical problems encountered in connection with each type, and the typical form has more or less crystallized. The problems and such answers as are known will be discussed in later sections; this section will be confined to a brief description of each tax and some indication of experience with it in foreign countries or at the state level in the United States.  

Turnover Tax

The turnover or gross receipts tax is an impost levied on sales at several, or sometimes all, stages of the productive and distributive process, generally at the same rate each time.

In varying form, the multiple-stage tax has appeared in many countries and periods of history. The most notorious is the medieval *alcabala*, castigated by Adam Smith and by Spanish writers as the primary reason for the decline of Spanish industry and commerce. One writer finds precursors of the modern turnover tax in levies imposed by ancient Rome and 14th century France.

The turnover tax has been an important feature of the tax structure of several European nations in contemporary times. Belgium, Italy, Austria, Luxembourg, and the Netherlands currently employ the gross receipts tax. The latter three countries were forced to introduce the German version, a flat rate tax covering virtually all transactions, during the World War II Nazi occupation. Interestingly, both Austria and Luxembourg have retained the German tax basically unchanged, and the Netherlands continues to rely on this type of tax, even though modified considerably. The original version of the German tax was introduced during World War I (in 1916) to supplement borrowing as a measure of war finance. This tax, imposed at 0.1 percent on all commodity transfers, yielded relatively small revenues and was replaced in 1918 by a more comprehensive tax which covered

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2. The tax structures of other occupied countries were left essentially untouched, since only Austria, Luxembourg, and the Netherlands were scheduled to become united into a "greater Germany."
all but a few transactions, at a rate of 0.5 percent (raised in 1919 to 1.5 percent).

In 1940, at about the same time that the turnover tax was being introduced in the Netherlands and Luxembourg, it was being abandoned in Norway, which had adopted the tax during the depression of the 1930’s. A peculiar feature of the Norwegian tax was that it applied to all sales except those by manufacturers, i.e., it was levied primarily at the wholesale and retail levels. Revenue pressures early in 1940 resulted in an increase of the original rate from 1 to 2 percent, but the uneven burden of the multi-stage tax became unduly onerous and resulted in its repeal before the year ended.

The Philippines once imposed a form of turnover tax. Introduced in the early 1900’s as a tax on business receipts at ½ to 1 percent, it applied to sales by manufacturers, wholesalers, and retailers. The rate was increased to 1 percent in 1915, raised to 1.5 percent in 1923, and continued in force until the multi-level tax was abandoned after World War II.

Although a gross receipts tax has never been enacted at the Federal level in the United States, during the period 1935-1941 several bills providing for transactions taxes, or gross income taxes, were introduced in connection with proposals for old-age pensions. While some were dutifully evaluated by Congressional committees, only one came to the floor of the House (in 1939) for a vote—to be defeated.

Several states and municipalities impose gross receipts taxes. These include the states of Hawaii, Indiana, Washington, and West Virginia, and the cities of Albuquerque, Los Angeles, New York, Philadelphia, Phoenix, Pittsburgh, Portland (Oregon), and St. Louis.

**Manufacturers Sales Tax**

Single-stage commodity taxes are feasible at any of three levels: sales by manufacturers, wholesalers, and retailers. A current example of the manufacturers sales tax is found in Finland, where a 20 percent tax is levied on most of such sales. The Finnish Parliament, however, is considering a revision which would substitute an 11 percent tax at the wholesale stage on the total sale price, and at the retail stage on the value added only.

Canada has levied a manufacturers sales tax since 1923, when it was instituted as a replacement for a turnover tax. Introduced at 6 percent, the tax was gradually lowered to 1 percent by 1930 because of widespread opposition. Deficits resulting from the depression, however, led the government to increase the rate to 4 percent in 1931, 6 percent the following year, and 8 percent in 1936. By 1938, the manufacturers sales tax was providing nearly one-third of Canada’s total revenue. Nonetheless, it was not until after World War II that the government defended the tax as a desirable one. The rate was raised to 10 percent in 1951, and to the present 11 percent in 1959. Exemptions have been introduced gradually over the years, so that, in general, the present tax does not apply to food, fuel, and producers’ goods.

**Wholesale Tax**

Taxes levied at the wholesale stage, i.e., on sales to retailers, have been used with some success for a number of years in Switzerland, Australia, New Zealand, and the United Kingdom. The tax in the latter country, known as the “purchase tax,” is of particular interest since it consists of a system of highly differentiated rates currently ranging from 10 to 25 percent. For example, furniture and

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3. Severance taxes on extractive industries are imposed by several states but are not considered here as possible sources of Federal revenue.

4. Reduced rates are imposed on sales by manufacturers of certain industrial machinery, fuel oil, coal, and coke; a rate of 10 percent applies to restaurants and enterprises engaged in repair work.

5. A. P. Mills, assistant director of the Excise Tax Administration of the Canadian Department of National Revenue, pointed out at the Tax Institute Symposium held in Washington, October, 1963, that over the years there has been a gradual erosion of the originally broad base of this tax. Exemptions added since the introduction of the tax include, for example, many producers’ goods, most food, specified medical articles, books and other educational and religious articles, and all export items.
clothing are taxed at 10 percent, soft drinks and ice cream at 15 percent, and automobiles, cameras, television sets, and cosmetics at 25 percent of their wholesale price. The term "purchase tax" stems from the fact that the tax is levied on purchases made by retailers, rather than sales by wholesalers.

Retail Sales Tax

A third level at which single stage commodity taxes may be levied is retailing. Such taxes have become increasingly common in the states, and 37 states plus the District of Columbia now impose general retail sales taxes at rates varying from 2 percent in 10 states to the high of 5 percent enacted by Pennsylvania in 1963.

Even though the Federal government has never imposed a general sales tax, the possibility of such a tax has generated enthusiasm at various times. Flurries of proposals for a general sales tax, accompanied by considerable public interest, arose during the Civil War, and in 1917-1922, 1932-1933, and 1942-1943. In the two decades since 1943, proposals for a sales tax have recurred from time to time.

Value-added Tax

The value-added tax is a sophisticated variation of the turnover tax. Like the usual turnover tax, it is levied at each successive stage of the productive process on the basis of the value of the commodities sold. But, unlike the ordinary turnover tax, it makes some concession to taxes previously paid on the commodities, through the device of taking the economists' concept of "value added" as the appropriate basis. Obviously, those portions of the value of a commodity contributed at an earlier stage of its production already would have been taxed under a multi-stage system—the steel in an automobile, for instance, would have been taxed before it was purchased by an automobile manufacturer for further fabrication processes, and the paper in a book before it was bought by the printer. The increased value of the steel when shaped into an auto and the paper when bound into a book is essentially the portion which a value-added tax attempts to reach. For example, a publisher might spend $5,000 (including tax) for the paper, ink, and other supplies with which he plans to print some books. These raw materials, when transformed into books, might sell for, say, $50,000. In other words, as a result of the operations performed on the paper, etc., the selling price increases by approximately $45,000. A value-added tax would apply at the printing stage only to the additional $45,000. The original $5,000 worth of goods on which tax already has been paid would not be taxed again.

Value-added in the case of an individual firm, ignoring the depreciation problem, equals (a) the sum of payments of wages, interest, and rent to individuals, plus the firm's profit, or alternatively, (b) total sales receipts minus expenditures to other firms. For the economy as a whole, value added is the sum of total wages paid, profits earned, and interest and rent paid to individuals.

The value-added tax is found today in Michigan and France and seems likely to be introduced in other European countries. It also is associated with Japan. In the latter country, however, it existed as essentially little more than a theoretical concept. Recommended in 1949 by the American mission under Professor Carl Shoup, it was envisaged as a major element in a new Japanese tax system. The proposal was adopted, but it was not enforced and finally was repealed in 1954.

The French experience, on the other hand, has been quite different. Success with the tax has been so notable that the
French tax has been considered as a model for adoption by various other nations, notably Germany (which is introducing it) and Great Britain (which has decided against it). It has been praised generously by Professor Shoup, who has said of it that "France now possesses by far the most refined and economically neutral type of general indirect tax in the Western world."

The French tax, known as the TVA (taxe sur la valeur ajoutée) was enacted in two stages during late 1953 and early 1954. As presently constituted, it applies only to sales by manufacturers and wholesalers. In addition all services rendered as a commercial activity are liable for the tax.

The tax, collected from the buyer and shown separately on each bill, is at a specified percentage of the price of the item. But the seller is not necessarily liable for the full amount he collects; he is allowed various deductions, including the amount of tax on added value which has been included in the price of materials or components used in his manufacturing or wholesaling activities. He may also deduct service tax previously paid, as well as TVA included in the price of such assets as his plant (but not non-industrial buildings, vehicles, or movable property). Thus the tax the final seller actually remits to taxing authorities is generally only a fraction of the tax listed on the customer's invoice, since each earlier seller has already paid portions of the tax.

The French TVA system has a relatively complex rate structure with the net effect of making the system progressive throughout most of its range. Certain commodities, some obviously considered necessities, are exempt altogether. These include farm products, bread, milk and newspapers. Specified food products in common use—such items as wheat flour, sugar, chocolate, chicory—are subject to a 6 percent rate. A 10 percent rate applies to such commodities as 1, water, gas, electricity, oil products, soap, canned vegetables, and books. The normal rate of 20 percent applies to items not explicitly taxed at other rates. The tax is increased to 25 percent for a prescribed group of luxury goods, but this rate can be reduced to 23 percent if the firms export a given percentage of their products. This latter group includes jewelry, furs, cosmetics, photographic equipment, and watches. Other "luxury" goods (washing machines are an example) are taxed at 23 percent.

Germany, following the example of France, appears likely to become the second European country to transform its turnover tax into a value-added tax. In February, 1964, the Government sent a bill to Parliament proposing a value-added tax. This bill had been accepted in a draft stage by the cabinet in July, 1963, and subsequently submitted for review and suggestions to parliamentary committees and trade, industrial, and professional organizations. Although it may be amended, the bill is expected to be enacted, probably with an effective date of January 1, 1966. A rate of 10 percent is proposed in substitution for the present turnover tax rate of 4 percent in general. There has been some discussion, however, of graduated rates on an industry basis. It has been proposed that in those industries where value added is a relatively large portion of total value, as is the case, for instance, in farming and service industries, a lower rate would apply; a rate of 5 percent has been suggested for professional fees, food, and various agricultural products.

10. Retail sales are subject to a local tax at an effective rate, for most items, of 2.73 percent; an effective rate of 9.29 applies to certain services, entertainment, restaurant meals, and furnished living accommodations. Whole- salers may elect to be subject to the local tax in lieu of the TVA, on a non-reversible basis. For many years the government has considered abolishing the local tax and extending TVA to retail transactions, but there has been considerable opposition to the move.
The Michigan form of the value-added tax, known as the Business Activities Tax (BAT) was not introduced as a replacement for another form of turnover tax or an attempt to improve the fiscal structure of the state, but rather was the unexpected result of a battle over the introduction of a state corporation income tax.

Although the Michigan tax initially was considered an emergency tax, when due to expire in 1955 it was made permanent. The rates have been increased in three stages, from a basic rate of 0.65 percent of adjusted receipts to the present level of 0.775 percent of adjusted receipts; public utilities are taxed at lower rates. In determining actual burdens, however, the deductions and exemptions provided are more significant than rates.

The BAT is levied on all persons engaged in business activities, including the rendering of professional and other services. Unlike the French tax, it applies to transactions at all levels, including retail sales. The first $12,500 of adjusted receipts, however, are not taxable. Moreover, various forms of business, such as insurance companies, banks, trust companies, building and loan associations, pari-mutuel betting, and nonprofit organizations, are taxed under special legislation and are exempt from the BAT. Various deductions are permitted in arriving at the taxable base: proceeds from sales of capital assets, repayment of debts, cash discounts, income taxes paid, interest and rents paid, and depreciation or amortization of real property. The minimum deduction is 50 percent of gross receipts, and taxpayers with relatively high payrolls have the further advantage that they may reduce their taxable base in accord with a formula based on the ratio of payroll to gross receipts.12

As a consequence of the many exemptions and deductions, the Michigan Business Activities Tax is by no means a pure value-added tax. The BAT nonetheless retains many of the characteristics of a true value-added tax.

There has been considerable dispute, in this country at least, as to the proper classification of the value-added tax. Lock, Rau, and Hamilton describe the dilemma in the case of the Michigan tax as follows:

Indubitably the value-added tax is a new species, but to what genus or family does it belong? The statute title reads 'certain specific taxes on income.' At the time of passage, the tax was commonly called the business receipts tax. To counteract that label, the Department devised the present title. Nevertheless the Commerce Clearing House treated it as a sales tax and inserted it next to the Indiana gross income tax in its classification. The Bureau of the Census wanted to classify it as a business license, but the statute contains no licensing provision. In consternation the Bureau has listed it as 'other taxes,' an unclassifiable mongrel.

The weight of academic opinion, definitely, is that the value-added tax is a species of sales tax.13

Nonetheless, the Michigan tax has been classified legally as an income tax. Classification was extremely important, since in general the courts have not allowed gross receipts taxes to be imposed on receipts accruing from interstate commerce, while they have treated income taxes much more leniently. The most important case trying this issue was Armco Steel Corporation v. Department of Revenue, 359 Mich. 430 (1960). After prolonged litigation, both the lower court and the Michigan Supreme Court upheld a tax assessment made on Armco, identifying the BAT as a form of income tax.

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1. When his payroll exceeds 50 percent of gross receipts, the taxpayer may deduct, in addition to the minimum, 10 percent of gross receipts or one-half of the payroll in excess of 50 percent, whichever is smaller. For example, a manufacturer with gross receipts of $40,000, deductions of $6,500, and payroll of $28,000, would be allowed a minimum deduction of $20,000, plus $4,000 for his relatively large payroll expenditure, even though his computed deductions amount to only $6,500.


The United States Supreme Court declined to review the decision.

The adoption of a system of value-added taxation was recommended by American scholars as early as 1917. Professor T. S. Adams urged that a variation of the value-added tax (plus a personal expenditure tax, at progressive rates above $5,000 expenditures) be substituted for the tax on corporate and personal incomes. A bill introduced in the Senate in 1921 closely paralleled Professor Adams' ideas. The value-added tax has also been proposed, but not instituted, in New York and Alabama.

**TAXES AT THE PERSONAL LEVEL**

New taxes which might be imposed directly on individuals are rarer than those feasible for businesses. One such levy, the expenditure tax, has received relatively little popular support. Another type, a tax based on net personal wealth, probably cannot be considered a practical possibility for the U.S.

*The Expenditure Tax*

The one form which has been suggested, the expenditure tax, is based on a very old idea, but has rarely been put into practice. Yet its case was impressively argued 300 years ago by Hobbes, it was admired by John Stuart Mill, and it was advocated by such eminent economists as Marshall, Pigou, Irving Fisher, and Luigi Einaudi. Mill, in fact, argued for the expenditure tax at length before the British Select Committee on Income and Property Tax of 1861. Nicolas Kaldor, the British economist, has observed, "There can be few ideas in the field of economics which are so revolutionary in their implications and yet can look back on so respectable an ancestry."15

An expenditure or spendings tax, which at first blush may be confused with a general retail sales tax, would be levied on individuals and consequently can allow for personal exemptions and deductions. It also might be progressive relative to spending. The rate of tax might increase, by some specified ratio, in proportion to the total amount of spending by the individual or family unit during a particular tax period, presumably the calendar year. Progression might be accomplished by a graduated rate, taxing successive units of spending at ever increasing rates. Personal exemptions also introduce a form of progression, even when the tax itself is at a flat rate (i.e., 10 percent on $2,000 with one exemption of $500 equals an effective rate of 7.5 percent; with two exemptions, 5 percent, etc.).

Irving Fisher, writing in 1937, tackled the problem of the practicality of the spendings tax and presented a scheme based on the principles of double-entry bookkeeping. In 1942, the same year that the Fisher book on the expenditure tax16 was published, the U. S. Treasury proposed such a tax as a measure of wartime finance. Opposition was immediate and unanimous, and the Senate Finance Committee rejected the proposal by a vote of 12 to 0.

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