National Retail Federation®
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Submission for the Record

to the

House Committee on Ways and Means

on behalf of

The National Retail Federation

in conjunction with the

Hearing to Examine the Burdens Imposed by the Current Federal Income Tax System and the Need for Reform

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Rachelle Bernstein
Vice President
Tax Counsel

National Retail Federation
325 7th Street, N.W.
Suite 1100
Washington, D.C. 20004
(202) 783 – 7971
bernsteinr@nrf.com

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As the world's largest retail trade association, the National Retail Federation's global membership includes retailers of all sizes, formats and channels of distribution as well as chain restaurants and industry partners from the U.S. and more than 45 countries abroad. In the U.S., NRF represents the breadth and diversity of an industry with more than 1.6 million American companies that employ nearly 25 million workers and generated 2010 sales of $2.4 trillion.

Summary of Comments

Members of NRF believe that the most important aspect of any tax reform measure is its impact on the economy and jobs. The U.S. economy is coming out of the worst recession since the Great Depression, but economists predict that economic growth may continue to be slow because of high unemployment, which will also continue to depress consumer spending. It is vitally important that any tax reform measure do no harm to our economy, which is likely to remain fragile for several years to come.

Consumer spending represents two-thirds of GDP. During the past few years, consumer confidence has hit its lowest levels since records have been kept, and consumer spending has dropped precipitously. One of the most harmful things that could be done to our economy at this time would be to place a direct federal tax on consumption.

NRF believes that a reform of the income tax, by providing a broad base and low rates, will bring the greatest economic efficiency and will not cause the economic dislocations inherent in the transition to a consumption based tax system. Reforms of the income tax could be designed to eliminate some of the major complications in the current Internal Revenue Code and stimulate economic growth, without causing major economic dislocation.

NRF also opposes using tax reform as a guise to fund increases in government spending, as would be true if the United States adopted a value added tax (VAT) in addition to the current income tax system. NRF believes policymakers need to be forced to make choices with respect to how taxpayer dollars are spent, rather than being provided with a money machine to finance entitlements and other government programs.

Reform of the Income Tax

NRF supports income tax reform that would broaden the income tax base and lower the income tax rates. The elimination of many special deductions and credits in exchange for lower rates will bring about a more economically efficient tax system that is simpler for taxpayers and will ease enforcement.

Reform of the corporate tax system is particularly important. The United States has the second highest corporate tax rate in the OECD. In a global economy, higher U.S. corporate tax rates

serve as a disincentive for investment in the United States. The U.S. corporate tax rate needs to be lowered to make us more competitive, and the lower rates should be paid for by eliminating various tax preferences in the Internal Revenue Code. Lower tax rates reduce the incentives for entering into tax motivated business strategies. Lower rates combined with the elimination of various tax preferences will cause businesses to structure transactions to their most productive use, rather than spending inordinate amounts of resources on tax planning

Consumption Taxes

Whenever fundamental tax reform is considered, policy debates generally turn to whether the United States should move from its current income-based tax system to a consumption-based tax system or to a hybrid tax system, which would impose a value added tax (VAT) in addition to the income tax, similar to the European model. NRF opposes the adoption of a consumption tax because it would have a chilling effect on our already weak economy.

Consumption taxes can be imposed in various ways including a National Retail Sales Tax (NRST), Value Added Tax (VAT), Flat Tax, and consumed income tax. Economists generally agree that the economic impact of various forms of consumption taxes is similar, although the application of the taxes may differ.

In 2010, Ernst & Young and Tax Policy Advisors conducted a study for NRF on the Macroeconomic Effects of an Add-on VAT enacted for deficit reduction. The study found that following the enactment of a VAT, the economy would lose 850,000 jobs, GDP would decline and retail spending would decline. By contrast, the study found that following the enactment of comparable deficit reduction through a reduction in government spending, the economy would add 250,000 jobs, GDP would increase and there would be a much smaller drop in retail spending. A copy of the NRF study can be found at www.nrf.com/VAT.

An earlier study,[1] prepared for the NRF Foundation by PricewaterhouseCoopers, examined the impacts of replacing the income tax with a consumption tax (either an NRST or a Flat Tax). The study concluded that although replacing the income tax with a consumption tax might bring *long-term* economic growth, there could be very harmful short-term and mid-term economic results.[2] The study also found that the economic growth that occurred during the ten-year modeling period was relatively modest compared to the disruptions to the economy during the transition years. Specifically, the study found that following the enactment of an NRST, the economy would decline

[1] PricewaterhouseCoopers LLP, *Fundamental Tax Reform: Implications for Retailers, Consumers, and the Economy*, April 2000. A copy of the study can be found at: http://nrf.com/modules.php?name=Documents&op=viewlive&sp_id=3965

[2] The PwC model was developed specifically to analyze tax reform plans. It combined microsimulation models for individual and corporate income taxes with a macro-economic forecasting model, which allowed it to provide short-term trantransition results on an annual basis. Id at p. 119.

for three years, employment would decline for four years, and consumer spending would decline for eight years. The study found that following the enactment of a Flat Tax, the economy would decline for five years, employment would decline for five years and consumer spending would decline for six years. Given the fragile state of the current economy, the United States cannot afford to see further declines in consumer spending for several more years.

In addition to the overall impact of consumption taxes on the economy, retailers are particularly concerned with the impact of consumption taxes on our customers. Consumption taxes are highly regressive and will raise the tax burden on lower and middle-income Americans. This occurs because lower-income households tend to spend a higher portion of their incomes, so they will pay a higher tax relative to income level under a consumption tax than will upper income households.

Consumption taxes also impose an unfair tax increase on senior citizens. Senior citizens generally live off of previously-taxed earnings that they have saved from their working years. They now are at a stage where they consume far more than they earn. An increase in the tax burden on consumption would be extremely difficult for seniors.

A consumption tax, whether as a replacement to the current income tax system or as an addition to the income tax system, will not meet President Obama's goal to not impose higher taxes on Americans with less than $250,000 a year of income.

A federal consumption tax will also wreak havoc with state budgets. Forty-five out of fifty states depend on sales taxes as a major source of revenue. In fact, much of the current short fall in state budgets is as a result of the sharp decline in consumer spending, and hence sales tax collections, during this weak economic period. If a consumption tax is added at the federal level, it will be far more difficult for the states to increase sales taxes to address budget short falls.

Enforcement issues are likely to increase if the federal government adopts a consumption tax either in addition to the current income tax or as a replacement to the current income tax. Studies have shown that when the rate of tax on consumption exceeds certain levels, tax evasion grows. The level of tax on consumption that would be imposed if a federal tax were added to state and local sales taxes would probably exceed these levels. They certainly would be exceeded if a federal consumption tax were to replace the income tax.

Adding a bureaucracy within the Internal Revenue Service to enforce a federal consumption tax will necessitate large start up costs, as well as additional ongoing costs to operate.

Adding a federal consumption tax to the income tax will also greatly increase the overall level of complexity of our tax system. Complications will result because of the differences between the federal sales tax base and state and local tax bases. The dual tax system may be particularly

burdensome for small businesses, which have enough trouble meeting the burdens of collecting and remitting payroll and income tax withholdings.

Conclusion

We urge the Committee to move forward with corporate income tax reform that will lower tax rates and broaden the tax base. The United States currently has the highest corporate income tax rate in the developed world, which hampers the ability of U.S. companies to compete and deters business investment in the United States. This type of tax reform will simplify administration of the tax system and encourage economic growth without shifting the burden to those that can least afford to pay.

Transitioning to a consumption tax system will lead to a decline in the economy and a loss of jobs for many years. Given the impact that weak consumer spending is having on the ability of the U.S. economy to recover from the Great Recession, we urge the Committee to reject any tax reform measures that would impose a direct tax on consumer spending.