

How Could We Improve the Federal Tax System?

Would a national retail sales tax simplify the tax code?

NATIONAL RETAIL SALES TAX
9/12

Q. Would a national retail sales tax simplify the tax code?

A. It would for individuals, but not as much for businesses and enforcement authorities.

Constructed as a flat-rate consumption tax with a universal demogrant (cash payment) for needy families, the proposed national retail sales tax contains many features that make taxation simpler. Most individuals would no longer need to keep tax records, learn the fundamentals of tax law, or even file returns. Only sole proprietorships, partnerships, and S or C corporations that make retail sales would have to file. And the complexity of filing a return would decline dramatically, even for these taxpayers.

But a national retail sales tax could create new areas of complexity, for example, in administering the proposed demogrant that returns part of the revenue to millions of households, and in enforcing the tax code to ensure that personal and business consumption are not mixed.

DEMOGRANTS

In many proposals, the demogrant that would accompany a national retail sales tax would likely be based on the existing federal poverty guidelines, which rise less than proportionally with the number of family members. For example, in 2016, single individuals fell beneath the federal poverty level if their annual incomes were less than \$11,880. This number rose by \$4,140 for each additional family member. Thus, the federal poverty level for a family of four in 2016 was \$24,300, roughly twice the level for an individual. Basing the demogrant on the federal poverty level would thus create incentives to conceal family relationships to claim the demogrant for more than one individual in a family.

ADMINISTRATION

It is also unclear how the demogrants would be administered or even which agencies would be responsible for determining eligibility and monitoring claims. Thus, compliance and administrative costs could be significant.

TAX AVOIDANCE AND EVASION

Another area of complexity stems from the threat of tax avoidance and evasion. The most likely way that people would try to avoid the tax would be by disguising personal consumption as business activity, as business-to-business transactions would not be taxed.

For example, individuals might register as firms or purchase goods for personal use with a business certificate. Or employers might buy goods for their workers in lieu of wages. Ensuring that all business purchases are not taxed and that all consumer purchases are would require all businesses to record their transactions, even though only retailers would actually have to remit the tax. Some proposed tax plans

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deviate from a pure retail sales tax by requiring that taxes be paid on many input purchases and that vendors file explicit claims to receive rebates on their business purchases. Such requirements would raise compliance costs further.

EVIDENCE

Some related evidence on the potential extent of these problems comes from the experience with state-level “use” taxes, under which taxpayers are obliged to pay taxes on goods purchased in other states. One analyst described the current enforcement of such taxes as “dismal at best.”

Further Reading

General Accounting Office. 1998. [Potential Impact of Alternative Taxes on Taxpayers and Administrators](#). Washington, DC: General Accounting Office.

Murray, Matthew N. 1997. [“Would Tax Evasion and Tax Avoidance Undermine a National Retail Sales Tax?”](#) *National Tax Journal* 50 (1): 167–82.