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## Small Bras and the Value-Added Tax

Taxing consumption sounds easy. Wait until government starts to carve out the political exceptions.  
By [IRWIN STELZER](#)

So we are to have a European-style value-added tax (VAT). That's the emerging consensus in Washington as people come to recognize the reality of the deep financial hole into which the Obama administration has dug us.

The Congressional Budget Office reckons we will be Greece by the end of the decade, owing the world—mostly the Chinese—a sum equal to 90% of our gross domestic product. The rating agencies are warning that our AAA rating is at risk. The bond vigilantes are saddling up.

No surprise the administration's first step has been to soak the rich, using the health bill to increase taxes on capital gains, interest and dividends by high-income earners, to be followed by an increase in their marginal income tax rates to 39.6% from 35% (and their long-term capital gains rate to 20% from 15%) by year's end.

Every percentage point in tax would bring in \$100 billion per year. European-level rates of 20% would net the U.S. Treasury \$2 trillion, more than enough to cover the deficit—other things being equal, which they probably won't be, since higher, tax-inclusive prices will dampen spending and some products will be exempt.

The tax sounds simple, but don't be fooled. Because both upper- and lower-income families pay the tax at an equal rate, the VAT is considered regressive; that is, it hits the poor harder than the better-off. So it is the practice in countries such as Britain to exempt food, which lower-income families spend a greater proportion of their income on. The technical term is "zero rating," meaning that exempt items are taxed at a "zero rate."

However, wait until the folks at the IRS get their hands on the regulations for the application of the new tax. They will undoubtedly turn to their more experienced British counterparts for guidance.

"Food of the kind used for human consumption," to a British bureaucrat, is something "the average person, knowing what it is and how it is used, would consider it to be food or drink; and it is fit for human consumption. . . . The term includes . . . products like flour, which, although not eaten by themselves, are generally recognized food ingredients . . . [but] would not usually include . . . dietary supplements, food additives and similar products, which, although edible, are not generally regarded as food."

And so, in the United Kingdom, according to the regulations of Her Majesty's Inland Revenue Service, crackers made from tapioca starch carry no tax; prawn crackers made from cereals do. Frozen yogurt that needs to be thawed before eating is zero rated, frozen yogurt bears the tax. Get it? If you don't, too bad—Her Majesty's tax collectors are not in the habit of offering an explanation for their regulations.

Food for animals creates other problems. If it is "suitable for all breeds" it is taxed, but if "it is held out for sale exclusively for working dogs" it is not, unless, of course, "it is biscuit or meal," in which case it is taxed.

So dog food for "sheepdog breeds" is taxed, but dog food for "working sheep dogs of any breed" is not; food for greyhounds is taxed, food for "racing greyhounds" is not. This may be the only tax in Britain that favors work over leisure.

Clothing also presents a problem for the British tax man. Two problems, actually.

First, what is clothing? Well, sailors' lifejackets are clothing because they "have the form and function of clothing," but "buoyancy aids" are not. Second, since children's clothing is zero-rated, what fits into that category?

Bras up to and including size 34B; body stockings that measure no more than 27½ inches shoulder to crotch; babies' shawls but not

"mother-and-baby shawls intended to wrap around both mother and child." There's more, lots more, but you get the idea.

This process of writing regulations for the VAT man when he cometh is more than merely amusing. For one thing, it confers enormous power on faceless bureaucrats.

They can hand a competing product the advantage in the U.K. of a price 17.5% lower (in Sweden it's 25%) than a close substitute. That invites both lobbying and corruption and sheer, inexplicable arbitrariness. Get your "sweetened dried fruit" deemed to be "held out for sale as snacking and home baking" and your product will bear a tax and have to compete on grocers' shelves with zero-rated "sweetened dried fruit held out for sale as confectionary/snacking." Peddle your sandwiches "as a general grocery item" and consumers pay no tax, but offer them as "part of a buffet service" and the VAT man wants his 17.5%.

Manufacturers twist and turn and juggle their product specifications and processes, not to find the most efficient way of making things but the surest way of obtaining a zero rating. The resulting inefficiencies cannot be measured accurately, but they certainly contribute to Europe's lagging productivity and increasing inability to compete in world markets.

For a long time conservatives favored some sort of VAT, on the theory that it is better to tax consumption than jobs. But that support was based on the theory that taxes on incomes would be reduced to offset the increase from VAT.

That is not to be, given the preferences of the Obama team and the state of the nation's finances. But what is to be is the reason liberals love VAT: It is easy to raise the rate, a bit at a time, unnoticed by the voters—just as a frog put into a pot of boiling water will immediately try to jump out, but placed in cold water that is only gradually heated it may not notice until it's too late.

So there is a VAT in our future, and like other taxes, it will have unfortunate consequences. Since there is world-wide experience with this tax, none of those consequences can be deemed "unintended"—they are already out there for all to see.

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