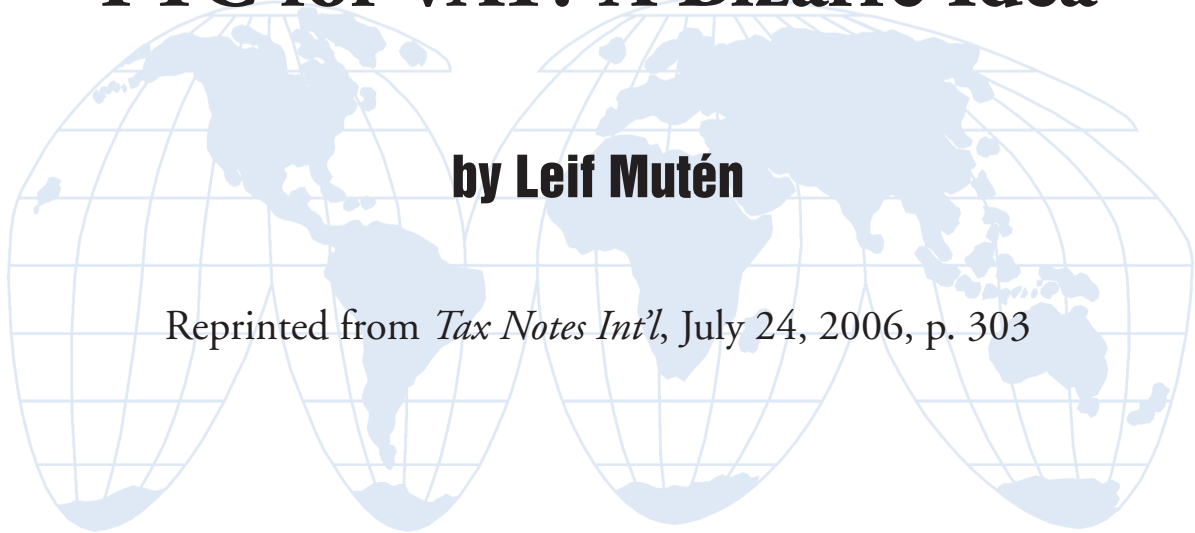


# FTC for VAT? A Bizarre Idea

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# Letters to the Editor



## FTC for VAT? A Bizarre Idea

To the Editor:

**I**n his recent viewpoint, Martin B. Tittle suggests that the United States introduce a modified territoriality. (For prior coverage, see *Tax Notes Int'l*, July 3, 2006, p. 41.) It would be realized in the form of granting a foreign tax credit for value added tax paid by U.S. corporations or their subsidiaries or permanent establishments abroad. The VAT FTC would be capped, with the cap to be gradually lifted in the future.

The only point on which I agree with the author is on page 42 where he spells out that his proposed “FTCs for VATs would throw a monkey wrench into the international trade law gears that maintain the distinction between direct and indirect taxes.”

On this latter point he echoes Gary Clyde Hufbauer, who has for a long time acted in the role of the parading soldier, putting the wrong foot forward but steadily maintaining that it is the whole regiment, not he, that is out of step. As I remarked to Hufbauer in this journal, the old argument on the destination principle for VAT being an export subsidy was dealt with as early as in 1964, when the OECD set up a committee of public finance professors (Richard Musgrave and Richard N. Cooper from the United States, Karl Häuser from Germany, Francesco Forte from Italy, A.J. van den Tempel from the Netherlands, and myself) that arrived at the conclusion that the traditional theory holds. (See *Tax Notes Int'l*, July 19, 2004, p. 249.) There is a difference between a tax like the VAT and a profit tax. The VAT, if not relieved on export, must be included in the dumping price, that is, the lowest possible marginal

price a producer can accept. The profit tax will not enter in the computation of the lowest possible dumping price.

Of course, depending on the market situation this distinction will not be absolute in the sense that all VAT is always shifted and no income tax ever shifted. It is, however, sufficiently clear to form the base of our WTO system.

The VAT is, what many Americans fail to notice, a consumption tax — a sales tax in a more rational form than the retail sales tax applied in the United States. The guiding idea for the imposition of VAT is that the tax burden on the final product should be the same, regardless of the number of production and distribution stages. The principle is for the VAT to be general, but zero-rating is applied on exports following the destination principle. Some domestic goods may be zero-rated, like prescription drugs. A U.S. pharmaceutical company with European subsidiaries and branches would get no relief at all from the system Tittle proposes, nor would one producing goods in one EU member state and selling them to distributors in another.

The article deals with the issue of who pays the VAT and how to bring proof that VAT has been paid. This overlooks cases like the reverse charge, where the seller in one EU country sells VAT exempt to a registered purchaser in another country, who reports the VAT on the delivery received and at the same time deducts the same amount as input tax. Tittle does not explain why the U.S. owner of the first firm should have to live without any FTC, nor how the purchaser, also U.S.-owned, could get an FTC for the first VAT charge if it has been taken away by his input tax deduction.

A good deal of foreign activities of U.S. corporations is in the financial sector. So far, the EU has failed to come up with a comprehensive VAT solution for that sector. It is hard to see how producers of taxable goods and services for the use of banks and insurance firms should be dealt with in Tittle's system. The owner of the supplier would maintain that he has suffered VAT, but so would the purchasing bank or insurance corporation that would in principle maintain that it is the real taxpayer.

The last thing the world needs is a monkey wrench in the international trade system. On the

contrary, we would fare better if the U.S. at last could join the club and introduce a proper VAT. Contributions like Hufbauer's and Tittle's do not bring us closer to this objective. ◆

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