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WHAT IS THE PROGRESSIVE CONSUMPTION TAX?

The Progressive Consumption Tax (PCT) would generate reasonable revenues by taxing the purchase of goods and services, rather than income. The PCT is modelled after the modern goods and services taxes of Organisation for Economic Cooperation and Development (OECD) countries—countries with advanced economies similar to that of the United States.

Like a sales tax, the PCT would tax the sale of most purchases at a single rate. Like many existing consumption taxes, it would employ a “credit-invoice” system. This means that the PCT is charged at each point of sale of a taxable good or service. Businesses are allowed a credit for any PCT previously paid on purchases used to produce or distribute the taxable good or service. Progressivity is maintained through a large income tax exemption for many U.S. taxpayers and a rebate provided to low- and middle-income households.

The PCT would be destination-based and border-adjustable. Any goods or services that are exported would not be subject to the tax and exporters would receive a credit for taxes previously paid on inputs. Imports of goods and services would be subject to the tax.

As introduced in the 114th Congress, the Progressive Consumption Tax Act sets the PCT at a single rate of 10 percent. The Joint Committee on Taxation has not yet estimated all of the budgetary and distributional effects of the Act. But, since the U.S. is a low-tax country compared to other advanced-economy countries, the final PCT rate – if any change is made – will likely be set at a rate well below the current OECD average (about 19 percent). A score by the Tax Policy Center of a similar plan by Professor Michael Graetz resulted in a revenue-neutral rate of 12.9 percent.

Income Tax Reforms– *Eliminated for most households; simplified for all*

Reasonable revenues generated by the PCT would be used to exempt most households from income tax liability and to lower the corporate income tax rate. The individual income tax would be simplified for all filers.

As introduced, the Act provides a significant income tax exemption, called a “family allowance,” of $100,000 for joint filers, $50,000 for single filers, and $75,000 for head of household filers.

For those who still have a tax liability, there will be three marginal brackets, set at 15, 25, and 28 percent for individuals whose income exceeds the family allowance amount. Since most households will no longer have an income tax liability, many of the individual income tax preferences in our current system are streamlined or removed, simplifying the income tax code. Four important tax benefits remain: (1) the charitable contribution deduction; (2) the state and local tax deduction; (3) health and retirement benefits; (4) the mortgage interest deduction.

In the current version of the Act, the corporate tax rate is set at 17 percent. Most of the tax code provisions that currently apply to corporations and pass-through business income remain the same. We would appreciate input from all stakeholders on this issue and on all aspects of the Act's income tax reforms.

Progressivity– *Protecting families from an unfair tax burden*

A cornerstone of the Progressive Consumption Tax Act is its progressivity. An often-heard criticism of goods and services tax systems is that they are inherently regressive—low- to middle-income households spend a greater percentage of their income than high-income households do, and so a consumption tax hits them harder.

The Progressive Consumption Tax Act directly counters this regressivity in two ways: (1) a significant income tax exemption for most American households, and (2) rebates to make up for the loss of tax benefits found in our current system that provide essential support for low- and moderate-income families.

The Act's new income tax exemptions, called "family allowances," are set at $100,000 for joint filers, $50,000 for single filers, and $75,000 for head of household filers. The family allowances are indexed for inflation.

PCT rebates would counteract the new consumption tax burden and would offset the loss of tax benefits like the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the Additional Child Tax Credit (ACTC). The goal of this legislation is to ensure a new system that is at least as progressive as our current tax system, so maintaining these resources for low- and moderate-income families is essential. The PCT rebates are based on earned income or adjusted gross income, family size, and filing status. As with benefits like the EITC, CTC, and ACTC, individuals and families that do not have an income tax liability would still be able to receive rebates.

Revenue "Circuit Breaker" – *Reasonable revenues*

Another criticism of consumption taxes is the concern that a tax like the PCT might be used to increase the revenue collected by the federal government without any controls. This concern is also addressed directly in the PCTA with a revenue "circuit breaker."

Under the PCTA, if PCT revenues as a percentage of the Gross Domestic Product (GDP) exceed 10 percent over the calendar year, then any excess revenue will be returned to all individual income tax filers, including those taxpayers who have filed for a PCT rebate. As introduced, the Progressive Consumption Tax Act returns a flat rebate to single and head of household filers, doubles that rebate for joint filers, and includes additional rebate money for filers with dependents.

A priority for PCT-based reform is to more reliably raise the reasonable revenues that are needed for real investments that benefit all taxpayers—such as investments in defense, health, education, and infrastructure programs. The PCT is not meant to be a means to quickly raise revenues while disregarding the effects of higher consumption taxes on U.S. families and employers.

Advantages– *Why such a big change?*

Our current tax code has been patched innumerable times since it was revised in 1986. It is not working fairly for all Americans or American-based businesses; it actually encourages businesses to relocate outside of the United States. The Progressive Consumption Tax Act will raise the reasonable revenues that we need to fund the programs that will grow the economy, make the U.S. a better place to do business and invest, and provide benefits and opportunities to those who need them the most.

The PCTA encourages saving. Under current law, families and individuals are taxed on earnings. Under the PCTA, most households would be exempt from any income tax and thus would be able to save tax free.

The PCTA enhances U.S. economic competitiveness. The U.S. corporate income tax rate would be lowered to 17 percent, encouraging multinational corporations to locate here, not abroad. OECD countries currently attracting U.S. multinationals often impose higher consumption and/or corporate tax rates than those envisioned under the PCTA.

The PCTA enhances U.S. trade competitiveness. Approximately 150 countries, including all OECD countries, have consumption or goods and services taxes that, like the PCT, can be adjusted at the border. Unlike the U.S., these countries can tax imports and subsidize exports by rebating their consumption taxes for exports—without violating current World Trade Organization (WTO) rules. These countries can agree to reduced tariffs under trade agreements; can still tax imports with their consumption taxes; and export their own goods without a full tax load. Because the PCT is border-adjusted and would be immediately considered WTO compliant, the U.S. would be able to maintain export and import tax parity in the same way as these other countries.

The PCTA reduces income tax compliance costs. Most households would not have an income tax liability under the PCTA—although they would need to provide key pieces of information to the Internal Revenue Service (IRS) in order to obtain their rebates. Businesses would necessarily be subject to new PCT reporting requirements. However, these reporting requirements will likely be similar to what many businesses may already comply with on the state and local level.

The PCT protects low- and middle-income families from an unfair tax burden. Through the family allowance and the rebate feature, the Progressive Consumption Tax Act aims to ensure that this new tax system is at least as progressive as the current income tax system.

What still needs to be done?– *Major open issues*

The Progressive Consumption Tax Act was originally introduced in the 113th Congress to provide an opening for discussion and a first opportunity to review legislative language for this type of comprehensive tax reform. Overall, the Act shows how a PCT can make our tax code fairer and more effective.

Since the introduction of the Progressive Consumption Tax Act, many policymakers, including in Congress, have become increasingly interested in moving to a border-adjustable consumption tax base. With any type of major tax reform, input from stakeholders will be critical, especially as Congress moves to consider comprehensive tax reform in 2017. Open issues and specific questions where input is needed on the Act are detailed in our Additional Input document. Also, note that the Act still needs to be fully estimated by the Joint Committee on Taxation for budgetary and distributional effects. That analysis—along with any other revisions—may change the rates outlined above.

If you have a suggestion on the Progressive Consumption Tax Act, or more questions, please email PCT@cardin.senate.gov. After a period of considering comments from stakeholders and fully analyzing its revenue impacts, the Progressive Consumption Tax Act will be reintroduced in the 115th Congress.