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**[www.fairtax.org](http://www.fairtax.org)**

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# The FairTax Is Within Reach

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There's one thing upon which every American can agree: our federal tax system is a disaster. It's too intrusive, too complex, and too costly. It discourages saving. It penalizes entrepreneurs and wage earners alike. It actually penalizes us for trying to achieve what we greatly value in this country-economic independence. As Americans, we not only have the right to complain but we also have the right to change that system. The FairTax<sup>SM</sup> offers the best means of doing so.

The FairTax is a non-partisan proposal that will abolish all federal income taxes, including payroll, self-employment, income, capital gains, corporate and death taxes, and replaces them all with one simple, visible, federal sales tax. It will dramatically change the basis for taxation by eliminating the root of the problem-the tax on income. The FairTax will tax us only on what we spend, not on what we earn. It will not raise any more or less revenue. It is designed to be revenue neutral. The FairTax is a fair, efficient, and intelligent solution to the frustration and inequity of our current tax system. This booklet will give you the facts. Please take a few moments to read it, so you can see for yourself why the FairTax is the right choice for America. The FairTax is the only tax reform plan that:

- lets workers keep their entire paycheck and retirees keep their entire pension without taxes taken out;
- closes all tax loopholes;
- frees individuals from ever again filing a tax return;
- abolishes the IRS and ends all audits of individual taxpayers;
- eliminates all hidden federal taxes that are currently buried in the price of goods and services;
- brings accountability to tax policy by revealing the true cost of taxes;
- lets American-made products compete fairly against foreign competition; and
- allows every family to buy the basic necessities tax-free.

The FairTax has been introduced in the U.S. House of Representatives (as H.R. 2525) with an equal number of Democrat and Republican sponsors from diverse backgrounds and geographic regions.

## **How Did We Get Into This Mess?**

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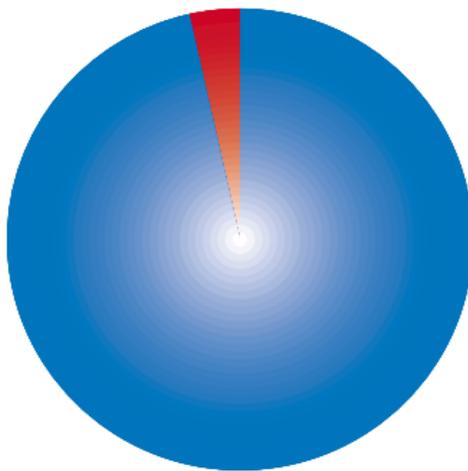
An amendment to the U.S. Constitution was required to legalize the income tax. This was needed because a direct tax on citizens was contrary to the basic values of this country and was not something intended by the founding fathers. In fact, it was only under very exceptional circumstances that the first version of the income tax could be imposed-wartime. To provide a brief history, the first federal income tax was proposed in 1815, but soundly defeated. Half a century later, in 1862, the federal government finally resorted to an income tax to aid in financing the Civil War. That tax had rates of 1.5% - 5%, but applied only to upper income individuals. The tax was allowed to expire after the war. Soon thereafter, however, there was an attempt to implement a flat income tax on individuals at a rate of 2%. In 1894, this attempt was struck down by the Supreme Court, on the grounds that a direct tax of this nature was repugnant to the constitutional requirement under Article 1 that a tax be apportioned among the states on the basis of population. The Court's decision prompted the push for the 16th Amendment that would authorize the imposition of the individual income tax. The amendment was deemed ratified February 25, 1913. In that same year, Congress swiftly enacted an income tax on individuals, starting at 1% and ending at 6% on very high incomes with large personal exemptions. Corporations were taxed at a rate of 1%.

From its humble beginnings, the income tax has grown like a cancer. The tax code has spread into a complex, costly maze of paperwork and bureaucracy with top rates at 35% on corporations and 39.6% on individuals, in addition to a 15.3% payroll tax. It costs \$8 billion annually just to operate the IRS and pay its approximate

116,000 employees. However, citizens and businesses pay the greatest costs - \$225 billion is spent just to track and document taxable income and expenses, to defend against audits and to try to understand our obligations. These are collectively called “compliance costs.”

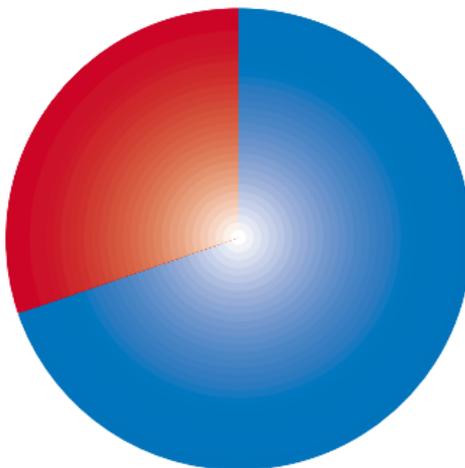
The FairTax will eliminate the complexity and injustice of our current tax system by replacing it with a simple federal sales tax on new goods and services.

### 1998 IRS Budget & Compliance Costs



- 1998 IRS Budget: \$8 Billion
- 1998 Compliance Cost: \$225 Billion

### No more tax returns for individuals



- 70% More Likely to Support a Federal Sales Tax Without a Tax Return
- 30% Not More Likely to Support a Federal Sales Tax Without a Tax Return

The FairTax will:

- Replace the individual federal income tax.
- Eliminate all payroll taxes (Social Security and Medicare taxes), including self-employment taxes. Current Social Security and Medicare benefits will not change.
- Eliminate corporate taxes.
- Eliminate all death and capital gains taxes.

## How Do We Get Out of This Mess?

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- Make the direct taxation of individuals' income unconstitutional as was originally intended.
- Provide an annualized rebate on expenditures up to the poverty level to ensure that no American pays taxes on basic necessities.
- Give individuals a choice to spend their paycheck on their own consumption (and be taxed) or to save it, invest it, give it to charity or spend it on education (and not be taxed).
- Allow families to save more for any purpose: retirement, home ownership or to meet educational expenditures.
- Advance the American dream of home ownership by making homes more affordable.

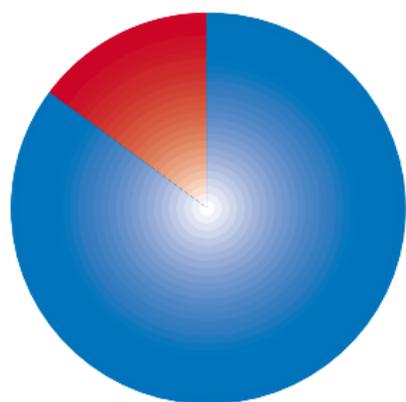
## What Will the FairTax Achieve?

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### FAIRNESS

The FairTax treats all taxpayers equally because every citizen will be taxed at the same rate on what he or she spends. Those who consume more will pay more tax, and those who choose to save or invest will pay less tax. Of course, we benefit others when we save and invest because we have enabled our resources to be used for loans, jobs and production. All loopholes, exceptions, and shelters will be eliminated - making our tax system more equitable and straightforward. It will totally eliminate tax on savings and investment.

## No more loopholes



- 85% More Likely to Support a Federal Sales Tax Without Loopholes
- 15% Not More Likely to Support a Federal Sales Tax Without Loopholes

## SIMPLICITY

Paying federal taxes will be even simpler than paying state sales taxes today. The FairTax will apply to all purchases of new goods and services only once, at the point of final retail sale (i.e., at the cash register).

- No individual tax returns, tables, or schedules, and no individual taxpayer audits will be necessary. There will be absolutely nothing for individuals to track or file for tax purposes.
- The FairTax will be automatically applied to new goods and services you buy and will appear clearly on your sales receipt.
- Used items will not be taxed, nor will purchases made by businesses.
- The retailer, who will receive an administrative credit for collecting the FairTax, will simply deliver the tax to the state taxing authority just as retailers in 45 out of 50 states do today.
- The tax authority will then send the funds to the U.S. Treasury. Politicians will no longer be able to use the tax code to favor or unfavor goods and services or to reward or punish behavior to benefit special interests.

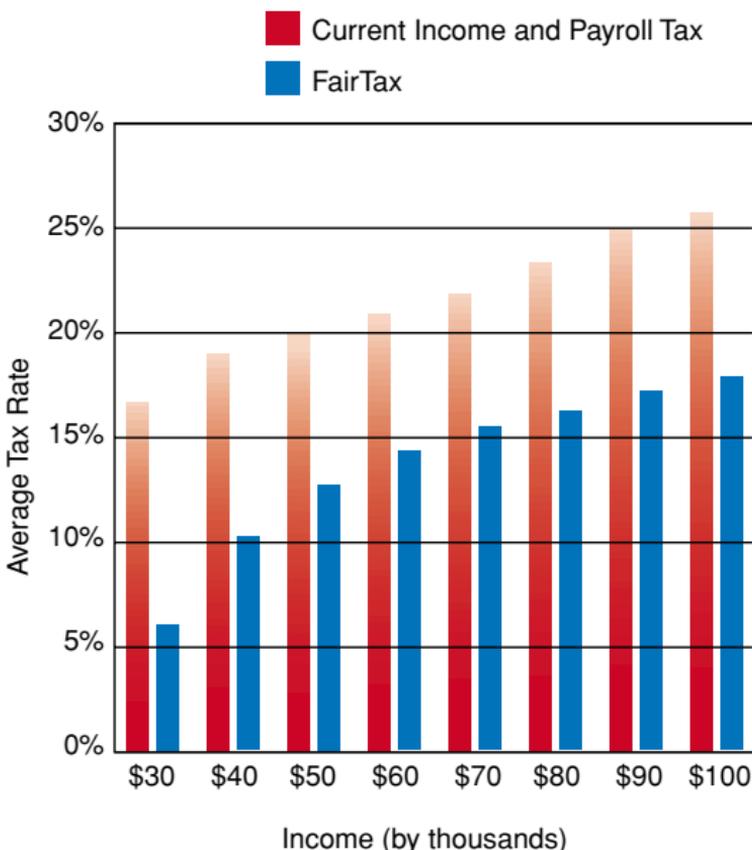
## LOWER EFFECTIVE TAXES FOR THE AVERAGE PERSON

Today, the average working person has only one choice if she or he wants to legally reduce the amount of taxes they pay. They must earn less.

The FairTax does not force taxpayers to make this choice. It puts taxpayers in control of their own money. Taxpayers can keep 100% of their paycheck, pension and Social Security benefits. They can choose when and how much tax to pay by choosing when and how much to spend. If a taxpayer chooses to buy a luxury car over an economy car, he or she will pay more in tax. The FairTax will give all Americans greater control over the timing and amount of tax they pay and a greater opportunity to improve their financial situation, save for retirement and pay for their children's education.

Under the FairTax, the amount of federal taxes most taxpayers' pay will be far less than what they pay under the current income and payroll tax system. With the growth that will come from an increase in real wages, less tax revenue will be required as a function of the national productivity. Money and aggravation spent on filing tax returns and interpreting the morass of tax laws will be fully eliminated for individuals.

### EFFECTIVE TAX RATES OF AN AVERAGE FAMILY OF FOUR AT DIFFERENT INCOME LEVELS



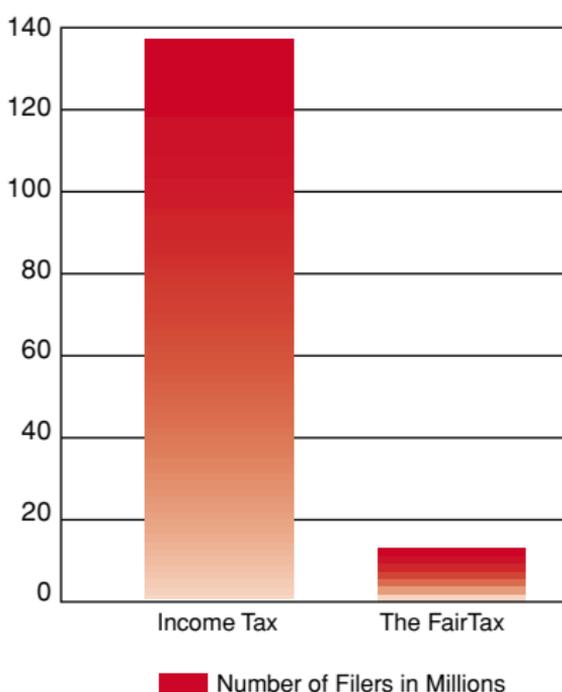
(Assumes a two-earner family that spends all its income, with both spouses earning similar income from wages only.)

Even if we assume away any growth, we assume the taxpayer spends everything he or she earns, and we assume no compliance cost savings, most taxpayers would still be better off. To illustrate the effective tax rate, let's take a couple with combined wages of \$30,000. They pay \$2,295 in payroll taxes (the employee share of the 15.5% payroll tax) and \$2,558 in income taxes for a total of \$4,853. When you add the rest of the payroll tax, which their employer withholds from their paycheck, the total tax they pay soars to \$7,148. That's more than a 20% effective rate on their income (measured on a tax-inclusive basis). Under the FairTax, that couple would receive an annual rebate of \$3,841. Even if they spend every penny they earn, their sales tax bill (including the rebate) would be \$3,059 or just 10.2% (measured on the same tax-inclusive basis). It would be even less if they chose to save any of their income for any purpose whatsoever (for retirement, for a home, for their own education, for their children's education) or if they chose to donate it to charity.

### THE LOWEST POSSIBLE MARGINAL TAX RATE OVERALL

The FairTax replaces all the revenue from current income and payroll taxes with the lowest average marginal rate of any tax reform plan. That

**Number of tax filers  
under the income Tax & the FairTax**



is because the base on which the FairTax is imposed is far broader than the base of the income tax. Moreover, because the FairTax is a single rate, it levels the peaks and valleys of the current tax fluctuations in income year-to-year, in order to apply a consistently low rate.

The rate is designed to be revenue neutral. Americans for Fair Taxation believes the FairTax should be set at a rate that would be required to maintain the same level of government expenditures that are now funded under our current system. FairTax intentionally makes no decisions about the level of government spending. This rate will maintain levels of spending, provide a monthly tax rebate so that no American pays taxes on the purchase of necessities, and compensate retailers for their collections costs. The FairTax is revenue neutral and will neither raise nor lower the overall tax burden we pay.

In this respect, it stands in contrast to other reform plans. Most tax reform plans seem to confuse tax cuts (how much we collect) with tax reform (how we collect the revenue). Their proponents hope that tax cuts will attract more supporters. However, tax costs and tax reform are really two separate issues, and tax reform should pass muster on its own. The FairTax is designed to improve the fairness, competitiveness and efficiency of the method of collection, and not to change the amount collected.

While the FairTax plan does not cut government, it is important to understand that two factors will encourage efficient government. First, the rate will fall because of an improved economy.

### Which paycheck stub would you rather have?

<b>Gross Pay</b>	<b>\$765.00</b>
Federal Income Tax	111.86
Employee's FICA-Social Security	47.43
Employee's FICA-Medicare	11.09
<b>Net Pay</b>	<b>\$594.62</b>

<b>Gross Pay</b>	<b>\$765.00</b>
Federal Income Tax	0.00
Employee's FICA-Social Security	0.00
Employee's FICA-Medicare	0.00
<b>Net Pay</b>	<b>\$765.00</b>

Second, Americans will be better equipped to determine if a tax cut is needed when they can see for the first time how much they really pay. By removing hidden taxes imposed upstream, eliminating withholding on income and making federal taxes visible on each sales receipt, taxpayers might exert downward pressure on the government. One of the reasons why taxes are at record levels in the U.S. today (and even during a period when legislators claim they have lowered taxes) is because many taxes are not visible to the consumer.

## **PRICE STABILITY**

One might ask, that all sounds good, but won't the sales tax just make prices go up, making goods less affordable? No, a comprehensive sales tax won't raise after-tax prices. Today, companies pass their tax and compliance costs on to consumers. They have to do so in order to cover expenses and make a net profit. Taxes are a big part of the expenses.

With the FairTax, businesses will no longer pay any federal taxes. They will no longer have to devote money and manpower to compliance. They won't pay hidden tax on the purchases they make (today they pay hidden taxes on supplies and raw materials used to develop the final product or service). Hence, this expense will vanish.

Of course, retailers will naturally want to keep the extra profit. However, in today's market many of the largest retailers operate on a margin of less than 1%. Retailers will be compelled by competitive pressures to keep prices lower to reflect the lower tax costs they experience, or face competitors that will. The FairTax allows them to maintain their current profit margins without increasing their prices. In fact, Dr. Dale Jorgenson, chairman of the Economics Department at Harvard University, projected an average producer price reduction of 20% in the first year after adoption of the FairTax. He estimates tax-inclusive prices (the price of the good or service after the FairTax is applied) will stay about the same as they are today.

## **LOWER TAXES THROUGH HONESTY IN THE COST OF GOVERNMENT**

Although the FairTax is not an upfront tax cut, over the long run, taxes can be expected to decline at a larger rate than under other reform plans. The FairTax adds integrity to the tax system by revealing taxes now hidden (but paid by all of us).

The FairTax is easy to see and track. The amount you pay in tax will be clearly printed on every sales receipt, so monitoring and controlling your tax burden will be much easier. The FairTax will do away with complex and confusing tax laws that nobody - not the members of Congress who write the law (the lobbyists in many cases), the IRS officials who enforce the law, nor the taxpayers who are forced to live under it - can fully understand. When Americans see the taxes they actually pay, there will be greater pressure for efficiency in the government. Eventually, this will ensure more governmental accountability and lower taxes.

## **HIGHER COMPLIANCE WITH FEWER CHEATERS**

The IRS estimates that about 40% of American taxpayers are out of compliance with the tax system (largely because they can't understand the tax code in order to comply with it). However, there are also a large number of people who cheat. The FairTax will reduce the level of cheating since the total number of tax filers will fall from 134 million to about 15 million, with almost 90% fewer returns to check and fewer points of collection to track. Therefore, monitoring and enforcing our taxes will become more thorough and efficient. In addition, since it is estimated that approximately 90% of the total taxes collected by the FairTax will be collected by the largest of tax filers (retail businesses), the opportunity to evade the FairTax will be far less than under any form of income tax.

## **LOWER COMPLIANCE COSTS**

Americans spend at least \$225 billion annually complying with the income and wage taxes. An estimated 19% - 33% of the total revenue raised by the income tax system and 2% - 3.5% of the Gross Domestic Product is simply wasted each

year on all of the various aspects of compliance. Under the FairTax, individuals will never again have to file a return or have any contact with the IRS. Business compliance costs would decline by an estimated 95%. Individual compliance costs would be reduced to zero.

## **EQUALITY**

More than half of all lobbying at the federal level concerns the income tax system. The FairTax will thereby put an end to all exceptions and exclusions, diminishing the need for lobbyists and special interests, while ensuring the tax system applies to everyone equally.

## **NO TAXES ON NECESSITIES**

The FairTax removes taxes on necessities through a carefully designed rebate system. Consumers will receive, in equal monthly installments, an annualized rebate on expenditures up to the poverty level. The amount of the rebate takes into account household size and the government poverty level, as determined by the U.S. Department of Health and Human Services. Those spending at or below the poverty level for their family's size will pay no sales tax since it will be rebated each month. (See an example of the FairTax rebate amounts for calendar year 2000 in the FAQ's.) This rebate effectively ensures that no American - regardless of income - will pay taxes on basic necessities. For this reason, the FairTax is commonly said to "untax the poor."

Collectively, senior citizens will benefit from the FairTax. Prices will not increase at the cash register, and seniors, like all citizens, will receive a monthly rebate indexed to inflation to help offset the tax they pay on necessities. And they will no longer pay tax on Social Security benefits they receive or on investment income from retirement accounts and pension benefits. In addition, seniors who own their homes can sell their homes tax-free. Finally, with the FairTax, a family farm, a business or any other asset can be passed on to future generations or charitable organizations intact and tax-free because death taxes will be abolished. If income is not consumed, it is not taxed.

## **NO TAXES ON EDUCATION EXPENDITURES**

Education is the best means for the vast majority of people to improve their economic position. It is the most reliable means that people have to invest in themselves and improve their earning potential. Yet the tax system today penalizes people who invest in education, virtually doubling its cost.

Only the FairTax would remove this impediment to upward mobility. No other tax reform plan would do so. The FairTax is the most education friendly of any tax reform proposal and is much more supportive of education than current law. The FairTax embodies the principle that investments in people (human capital) and investments in things (physical capital) should be treated comparably. Today, in order to pay \$10,000 in college or private school tuition, a typical middle-class American must earn \$15,540 prior to the deduction of federal income taxes and employee payroll taxes. Relatively, the amount one must earn to pay the \$10,000 is really more like \$20,120, once employer and state income taxes are taken into account.

The FairTax does not tax education expenditures. Education can be paid with pre-tax dollars. Thus, under the FairTax, a family will need to earn \$10,000 to pay \$10,000 in tuition, making education much more affordable. The FairTax will make education about half as expensive for American families, as compared to today's costs.

## **A BOOST FOR AMERICAN EXPORTS**

Our current tax laws are very counterproductive for trade. They put American companies at an unfair disadvantage when facing world competition. As our goods are shipped around the world, they contain our costly tax system, which makes these goods less price competitive. At the same time, most of our toughest competitors have learned to remove their "value added taxes" from exports, and then successfully complain about the small export incentives Americans provide.

To make matters even worse for our U.S. companies, the imports that eliminate American jobs escape almost all of our income taxes. Not only do we penalize American exports, but we reward

the very imports that eliminate American jobs by not taxing them. Under the FairTax, American goods and imported goods would both be taxed at the same rate when sold in the American marketplace. And because the FairTax does not tax exports, it repeals the job-killing taxes that artificially raise the costs of American products relative to foreign products.

## **ECONOMIC GROWTH**

With the FairTax, every wage earner will have more take-home pay to spend, save and invest, supporting economic growth in every way. Work, savings and investments will no longer be penalized. Savings and investments will grow because citizens will no longer pay taxes on their investment income, including earnings from life insurance investments. The resulting increased savings will expand the pool of funds available for lending and will in turn bring down interest rates.

With the elimination of the payroll tax and related compliance costs, the cost of doing business in this country will drop dramatically. The United States will be the only country in the world with a zero rate of tax on income, ensuring it becomes the most attractive place for foreign companies to locate facilities and create jobs. Capital lost to foreign investment will be repatriated to our shores and foreign investment will increase in American plants and facilities.

## **MAXIMIZES PRIVACY**

The title of this brochure points out that April 15th will be just another spring day. This is because no individual will ever file another tax return and disclose the details of his or her financial life to the federal government. The FairTax also contains strong taxpayer rights provisions, including provisions establishing a strong taxpayer protection office and provisions that would force the government to reimburse taxpayers for lawyers' fees in disputes, unless the government was able to establish that its position was substantially justified.

## **MAXIMIZES UPWARD MOBILITY**

For Americans not fortunate enough to have been born wealthy, to marry into wealth, or to

find a winning lottery ticket, income from wages is the only vehicle of transport to a more prosperous life. Yet the current tax system penalizes working Americans by taxing them on every additional dollar they earn. In fact, our income and payroll tax system targets those who try to improve their quality of life by disproportionately penalizing those that must increase their income to survive.

Since the FairTax doesn't impose a tax on wages, it removes the regressive tax burden and enhances one's opportunity to gain upward mobility.

## **CONSTITUTIONAL PROTECTION FOR TAXPAYERS**

The FairTax proposal includes a constitutional amendment to ban Congress from taxing income. This would eliminate the possibility of Americans paying both sales taxes and income taxes, and ensures that the FairTax is a permanent replacement for our current tax system.

## **Frequently Asked Questions**

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### **1. WHAT IS THE REQUIRED FAIRTAX MARGINAL RATE?**

Because tax policy influences economic growth, assumptions we draw about the salutary effects of the FairTax are critical to determining the rate needed to replace the revenue lost from income, payroll, self-employment, capital gains and death taxes (to be "revenue-neutral"). FairTax is working hard to help economists reach consensus about the revenue neutral tax rate. To this end, FairTax has hired some of the best academic minds in the country, from Harvard to MIT. FairTax's economists estimate that the FairTax rate would be 23-26% tax-inclusive (between 30-35% tax-exclusive) to be "revenue-neutral". Some academicians say that the rate would actually be lower when the enormous potential for economic growth is unleashed, especially over time. Others say higher. But at this point, the rate might best be expressed as a range, with FairTax's estimate neither the lowest nor the highest. Predicting revenues even from today's system is just as problematic since revenues fluctuate yearly and the estimators have often been quite wrong.

Whatever the FairTax rate has to be to achieve revenue-neutrality, in a macroeconomic sense, this is largely an academic or technical question. This is because the FairTax will neither raise nor lower the overall tax burden of all U.S. citizens as a whole. Also, 23% is the maximum marginal tax rate, not the “effective” rate. The rebate, the exemption for education, the exemption for charity, and of course, the exemption for all income not consumed, ensures that the “effective” rate is much lower. In other words, under the FairTax individual taxpayers could pay less or more than today, depending on their behavior. People who are thrifty and save a lot could pay less, while people who do not save and who were taking advantage of every possible loophole and deduction under the current system, could pay more. The actual FairTax rate is simply what is required to raise the taxes we now pay in an honest, visible manner. More than ever each will be able to control our own tax bill by our spending and saving patterns.

Even though the FairTax is designed to raise the same amount of money as the present tax system, some perceive the FairTax-estimated marginal rate to be too high when compared to the present system or other tax reform plans. However, other tax reform plans which claim to have lower rates keep existing payroll taxes of more than 15% (a flat tax on wages). Moreover, every alternative actually increases the share of federal taxes hidden in the prices of goods and services we must buy. Finally, some critics like to change the FairTax plan into something it is not (usually by adding exceptions exclusions and loopholes), and then re-calculate the rate on a new set of rules.

When examined closely, the FairTax revenue neutral rate is considerably less than today’s marginal rates. Today, payroll taxes of 15.3% plus the lowest income tax bracket rate of 15% amount to a combined marginal tax-inclusive rate of at least 30.3% (or 43.5% tax-exclusive). Those in the 28% income tax bracket today (many middle-income Americans) pay a combined 43.3% (76.4% tax exclusive). That means they must earn \$176.40 to have \$100 left after tax to spend at the store or

to save. Today, we face much higher tax rates than we would under the FairTax.

Indeed, the FairTax average marginal rates must be lower than the current tax system. This is a result of two factors. First, the FairTax has a broader tax base than the current tax system. Because the tax is imposed on a broader base of tax (a base with no exceptions and loopholes like today), the rate can be lower. Second, it has a single tax rate.

Those that still perceive the marginal rate of the FairTax as too high should not direct their criticism at the FairTax. They are really criticizing the painful visibility of the actual tax burden we all pay. The FairTax simply makes visible what we now pay in the form of hidden taxes. The FairTax abolishes these hidden taxes, and replaces them with visible taxes. If the rate is perceived as too high, we have only two choices: write to our members of Congress and tell them to lower taxes, or bury our heads in the sand and pretend we are not already paying these taxes today. If enough do the former, taxes will be lowered as government is forced to become more efficient.

## **2. WHAT WILL BE TAXED?**

The FairTax is a single stage tax, meaning it will only tax the sale of all new consumer goods and services at the final point of purchase. Used items will not be taxed. Business-to-business purchases for the production of goods and services will also not be taxed.

## **3. EXACTLY WHAT TAXES WILL BE ABOLISHED?**

The FairTax will replace all federal taxes except excise taxes, which are typically small and meant for particular purposes. The FairTax will repeal and replace the individual federal income tax, including capital gains, payroll, corporate income, self-employment and death taxes.

## **4. HOW WILL THE REBATE WORK?**

Consumers will receive, in equal monthly installments, an annualized rebate on expenditures up to the poverty level. The size of the monthly rebate will be determined by the government's published poverty level for a particular

household size, multiplied by the tax rate. In general, the household size will be declared by annual return under standard jurat (penalties of perjury) and these declarations will be cross-checked with valid Social Security records, death records and other means.

### FairTax Rebate Amounts for Calendar Year 2000

The FairTax provides to each household a rebate to prevent the imposition of sales tax on necessities. The rebate is equal to the sales tax rate times the federal poverty level plus an extra amount in the case of married couples to prevent a marriage penalty. The annual tax-free spending allowance increases by \$2,900 per household member. Thus, a married couple with two children would be protected by the rebate from tax on the first \$22,000 per year that they spend.

Family Size	HHS Annual Poverty Level <sup>1</sup>	Single Person	Single Person	Single Person	Married Couple	Married Couple	Married Couple
		FairTax Annual Consumption Allowance	Annual Rebate	Monthly Rebate	FairTax Annual Consumption Allowance	Annual Rebate	Monthly Rebate
1	\$ 8,350	\$ 8,350	\$ 1,921	\$ 160	\$ 8,350	\$ 1,921	\$ 160
2	\$11,250	\$11,250	\$ 2,588	\$ 216	\$16,700 <sup>2</sup>	\$ 3,841	\$ 320
3	\$14,150	\$14,150	\$ 3,255	\$ 271	\$19,600	\$ 4,508	\$ 376
4	\$17,050	\$17,050	\$ 3,922	\$ 327	\$22,500	\$ 5,175	\$ 431
5	\$19,950	\$19,950	\$ 4,589	\$ 382	\$25,400	\$ 5,842	\$ 487
6	\$22,850	\$22,850	\$ 5,256	\$ 438	\$28,300	\$ 6,509	\$ 542
7	\$25,750	\$25,750	\$ 5,923	\$ 494	\$31,200	\$ 7,176	\$ 598
8	\$28,650	\$28,650	\$ 6,590	\$ 549	\$34,100	\$ 7,843	\$ 645

<sup>1</sup> Federal Register: Feb. 15, 2000 (Vol. 65, No. 31, pp. 7555-7557)

<sup>2</sup> The annual consumption allowance for a married couple without children is two times the annual consumption allowance for a one-person household.

## 5. WHY DOESN'T THE FAIRTAX EXEMPT FOOD AND MEDICINE FROM THE TAX?

Food and medicine are exempted, in fact, because they are part of the necessities of life and are included in the determination of the universal rebate level. They are simply not exempted by name. Exempting items by category may seem like a good idea, but that approach would neither be fair nor simple, and it would not efficiently help the low-income. Respected economists have shown that the wealthy spend much more on food, clothing, housing, and medical care than do the low-income. Exempting goods by category would then give the wealthy a disproportionate benefit. For example, if we simply exempted clothing, basic clothing would be exempted as well as high-end suits.

We would not want to impose the requirement on retailers of determining what to exempt. And we do not want legislators to make these hair-splitting choices, which would, inevitably, open the door for future complexity, special interest and the development of exceptions. Lobbyists have been successful in weaving the web of complexity in our tax laws. Exceptions are not only unfair and result in higher tax rates, they also

inefficiently distort economic decisions. This is one reason the flat tax and other tax plans modeled after the income tax will not succeed as a permanent replacement.

Remember also that the purchase of these products is not exempt from federal tax today. The purchase of food, clothing and medical services must generally be made from after-income tax and after payroll tax dollars. And, like everything else we buy, they already include hidden federal taxes.

## 6. HOW DOES THE MARGINAL RATE OF THE FAIRTAX COMPARE WITH THE CURRENT SYSTEM?

When most of us think of tax rates, we think in terms of what economists refer to as the marginal rate, which is the rate at which the last dollar of income or expenditure is taxed. The FairTax marginal rate is lower than the combined rate of the income and payroll taxes.

Let us consider current rates. Most people are experiencing rates much higher than 23% (tax-inclusive) today. Even the very lowest income tax bracket is 15% and all wage earners pay 7.65% in payroll taxes. That's 23% (tax-inclusive and 30% tax exclusive) right there! If you are self-employed, you pay the full 15.3% self-employment tax, which makes the rate 30.3% (43.5% tax-exclusive). The employer's portion of the payroll tax helps to hold your wages down, thus, lowering your salary by the amount of payroll tax that employers have to pay. On top of this, you have to add in all of the taxes embedded in the goods you buy (another 20% - 35% of the price).

Here is a side-by-side comparison of the percent of tax a person would pay annually:

	<u>Inclusive</u>	<u>Exclusive</u>
Income Tax plus		
Payroll Taxes	43.3%	76.4%
The FairTax	23.0%	29.9%

When you consider all taxes, no tax proposal has a lower rate than the FairTax!

## 7. WHAT DOES TAX-INCLUSIVE MEAN AND WHY IS THE FAIR TAX EXPRESSED AS SUCH?

All tax rates are expressed as a fraction of the amount of taxes paid divided by something, usually the base of the tax. Presentation of a rate of tax on a tax-exclusive basis simply means that the rate of the tax is expressed as the tax paid over a base determined after the tax was already imposed (for example, taxable income under our personal income tax system that is net of the tax). In other words, a tax-exclusive rate would be defined as:  $\$ \text{ tax paid} / (\$ \text{ base on which the tax was imposed} - \$ \text{ tax paid})$ . The rate therefore reflects the ratio of taxes paid to what is left in the base, such as taxable income.

On the other hand, defining the rate of tax on a tax-inclusive basis simply means that the rate of tax is expressed as the tax paid over the base before the tax has been imposed. In other words, a tax-inclusive rate would be defined as:  $\$ \text{ tax paid} / \$ \text{ base on which the tax was imposed}$ . Since the base of the tax before the tax is imposed is always more than the base after tax, expressing the tax in a tax-exclusive way will always yield a higher rate.

Here is an example:

An individual earns \$1,000 and pays \$200 in taxes (under either an income tax or a sales tax) but spends the remaining \$800 on a stereo. Although the taxpayer will pay the same amount of taxes (\$200) out of the same amount of pre-taxed income (\$1,000), a question arises as to how the rate should best be expressed? Is the tax rate 20% (tax-inclusive) or 25% (tax-exclusive)?

The Fair Tax is expressed on a tax-inclusive basis. We have chosen this method because we want to be truthful when we compare the rate of the Fair Tax with the rate of the taxes it will replace. In making comparisons between alternative taxing systems, it is important to ensure that these comparisons are consistent, fair in terms of expectations and are well explained. The Fair Tax plan seeks to ensure that the consumer knows that apples are being compared to apples, and that the rate of the sales tax is properly being measured using the same scale for the income

and sales taxes. The only means to do so is to ensure that a tax-inclusive rate (our current income tax system) is compared with a tax-inclusive rate (the FairTax).

## **8. HOW WILL THE SOCIAL SECURITY SYSTEM BE AFFECTED?**

Like all federal spending programs, Social Security will operate exactly as it does today, except that its funds will come from the federal sales tax-the FairTax-which is, in fact, a more stable funding source. Employers will continue to report wages for each employee to the Social Security Administration for the determination of benefits. There will be no changes in who receives benefits or how much they receive.

## **9. HOW DOES THE FAIRTAX IMPACT EFFORTS TOWARD SOCIAL SECURITY REFORM?**

The FairTax neither encourages nor discourages Social Security reform efforts. It does not change Social Security benefits or the structure of the system. It simply replaces the current revenue source (payroll taxes) with a new revenue source (the FairTax revenues). If Social Security is reformed or privatized in a way that reduces the government's need for revenue, then the FairTax rate can be reduced.

## **10. IS CONSUMPTION A RELIABLE SOURCE OF REVENUE?**

Consumption is a more stable source of revenue than income. A recent study shows that for the years 1959 to 1995, the consumption base was less variable than the income tax base. Why? Because during difficult times due to unemployment or an inability to work, real wages may not rise; however, people continue to consume.

## **11. HOW WILL THE TAX BE COLLECTED?**

The FairTax system will work in a very similar, mechanical way as the sales tax system now present in 45 states. Retail businesses will collect the tax from the consumer at the point of sale and remit it to the state taxing authority who will then remit it to the U.S. Treasury. The FairTax will simply be an additional line on the current sales tax reporting form. In some cases, businesses that sell services will have to begin collecting sales tax for the first time. All states and businesses collecting the federal sales tax will receive an administrative credit of 1/4 of 1% of the revenue collected for their efforts.

## **12. WHY IS THE FAIRTAX BETTER THAN OUR CURRENT SYSTEM?**

Our current tax system may be one reason many people find it difficult to get ahead. The income and wage taxes hold us back and make it difficult to improve our quality of life. The current system stymies upward mobility. It wastes hundreds of billions of dollars in resources that could be better spent. It lacks integrity since it hides taxes. It fertilizes the ground for lobbyists to grow new loopholes. It encourages evasion. It wastes vast resources on needless compliance efforts. It discourages savings. It makes it unnecessarily difficult for our businesses to compete in international markets. It hurts exports. It advantages imports against U.S.-produced goods. We can do better, and we must. The FairTax addresses and fixes each of these problems.

## **13. IS THE FAIRTAX REALLY FAIRLY DISTRIBUTED?**

Yes, the FairTax is fair - much fairer than the income tax because it is based on what one spends over a lifetime, not on what one earns in a given year. There is no fairer measurement of a person's ability to pay than his or her ability to consume over the course of their lifetime. Wealthy people spend more money on themselves than do other individuals. They buy expensive cars, big houses and yachts. They buy filet mignon, fine wine, designer dresses and expensive jewelry. The FairTax will tax them on these purchases. If, however, they use their money to invest in others, for example to build job-creating factories, finance research and development to create new products, or fund charitable activities (all of which help improve the standard of living of others), then those activities will not be taxed.

## **14. HOW DOES THE FAIRTAX TREAT LOW-INCOME FAMILIES AND INDIVIDUALS?**

The FairTax untaxes low-income people - something no other tax reform plan can claim. Under the current tax system, the low-income pay federal taxes hidden in the prices of everything they buy. As much as 25 cents out of every dollar they spend today goes to pay hidden corporate income and payroll taxes that businesses pass on to the consumer in the form of higher

prices. The FairTax abolishes all these hidden taxes. Under the FairTax, low-income people at or below the poverty level will pay no federal taxes at all. Every household will receive an annualized rebate on expenditures up to the poverty level, and wage earners will no longer be subjected to the most regressive and burdensome tax of all, the payroll tax. Those spending at twice the poverty level will pay a tax of only 11.5% - a rate much lower than the income and payroll tax burden they bear today. Moreover, slow economic growth and recessions have a disproportionately adverse affect on lower-income families. Breadwinners in these families are more likely to lose their jobs, are less likely to have the resources to weather bad economic times and are more in need of the initial employment opportunities that a dynamic, growing economy provides. The FairTax would dramatically improve economic growth and wage rates.

#### **15. IS IT FAIR FOR THE WEALTHY AND THE LOW-INCOME TO RECEIVE THE SAME FAIRTAX REBATE AMOUNTS FROM THE FEDERAL GOVERNMENT?**

Yes, because the dollar rebate means far less to the wealthy as a percentage of their overall income. The objective is to exempt all necessities of life for everyone. Let's look at a billionaire under the FairTax. If he spends \$10 million on himself (as opposed to charity or investment) he will pay a tax of \$2,300,000 and get a rebate of \$3,841 (assuming he is married and has no children and the year is 2000). His effective tax rate will be 22.97%.

Let's look at a middle-income married couple with no children under the FairTax. If they spend \$30,000, they will pay \$3,059 net of their rebate for an effective tax rate of 10.2%. The effective tax rate increases as spending increases, but will never exceed 23% (or the current revenue-neutral tax rate). However, this same couple, if they earn \$30,000 in wages today under the income tax, will pay \$2,295 in payroll taxes and \$2,558 in income taxes for a total of \$4,853 in taxes (16.2%). In addition, their employer would pay another \$2,295 in payroll taxes. Most economists think that the employer payroll tax is actually borne by employees in the form of lower wages

(note that if the income were from self-employment, it would be the full 15%). Viewed in this way, this couple is paying \$7,148 (23.8%) in taxes today, which doesn't include compliance costs or the hidden taxes they pay every time they make a purchase. Therefore, a middle-income married couple with no children will have an effective tax rate of 10.2% under the FairTax. Today, under the income tax system, they have an effective tax rate of at least 133% more! Finally, a low-income married couple at or below the poverty level will pay no federal tax at all under the FairTax. Today, under the income tax system, they not only pay 15% in payroll taxes, but another 20% in hidden income and employer payroll taxes buried in the cost of every product they buy.

## **16. WHAT ABOUT SENIOR CITIZENS AND RETIRED PEOPLE?**

Like everyone else, seniors will receive a monthly rebate that will hold them harmless against the tax imposed on necessities. The income tax imposed on Social Security benefits, investment income, pension benefits, IRA withdrawals and life insurance investments will be repealed. And, of course, the death tax will be eliminated as well. In 1994, retirement plans were valued at assets of \$6.5 trillion and an income tax deduction was taken for contributions to most of these plans. Although all beneficiaries and owners of those plans expected to pay income tax on them upon withdrawal, they will not be required to do so after passage of the FairTax.

Seniors will also benefit from the sale of their existing homes since neither capital gains from the home sale nor the sale of the used home will be taxed. Seniors have higher home ownership rates than other age groups (81% for seniors compared to 65% on average). The home is often the largest asset and gains are likely to be in the range of 20%.

## **17. WILL SENIORS BE TAXED TWICE ON SAVINGS LIKE THEY ARE TODAY?**

No, seniors will not be taxed twice on savings under the FairTax. Tax-deferred investments will be completely tax-free; and, if their savings are invested in any long-term income-generating asset such as stocks, real estate, or a long-term bond

that can't be called, their assets will increase substantially in value. If further relief is needed, Congress can build protections into the plan.

### **18. WHY WILL PRICES FALL AND BY HOW MUCH?**

All goods and services already contain hidden costs of the current tax system embedded in their prices. When these embedded taxes are removed, prices will come down 20% - 25% in the first year after the adoption of the FairTax, according to Dr. Dale Jorgenson, chairman of the Harvard University Economics Department. In addition, the FairTax will lower compliance costs by an estimated 95%, and the removal of these costs will force prices down even lower.

### **19. SHOULD THE GOVERNMENT TAX MEDICINE AND HEALTH CARE?**

Medicine and health care are taxed today. We all pay these taxes - they are buried in rising health care costs.

How are these costs buried in the price? Companies that invent and make medicine all pay payroll and income taxes as well as spend hundreds of billions of dollars to comply with the income tax. They recover these costs by passing them on to consumers. Consumers just don't see it on the price tag because it is rolled into the price of the goods. Of course, we must pay for these items with the dollars remaining after the government has taken its share of taxes from us. When most of us receive a paycheck, we actually get only the net remaining after taxes. Therefore, when we buy \$20 of medicine we had to earn between \$25 and \$40 dollars of income to net the \$20. Therefore, when we pay \$20 plus 23% of \$20, assuming the prices do not go down, we are no worse off than under the present system and probably better off.

### **20. SHOULD THE TAX PLAN TAX SERVICES?**

We should make no exceptions. Service providers pay the income tax today and should not be exempt from the FairTax. Services now account for well over one-half of the Gross Domestic Product (GDP). It would be unfair and economically unwise to tax only goods. Neither the consumption of services or goods should be

given tax preference. Competition, not politics, should determine the price of goods and services.

## **21. HOW WILL THE FAIRTAX IMPACT INCOME TAX PREPARERS, ACCOUNTANTS AND MANY GOVERNMENT EMPLOYEES?**

There will, of course, be some people who are involved in tax return preparation and tax administration under the FairTax (for retailers), but a smaller amount than those involved with the income tax today. Most income tax preparers, tax lawyers and Internal Revenue Service employees will have to find other work. After adopting the FairTax, the economy will prosper, thus creating more jobs, which will help absorb these workers.

## **22. THE HOME MORTGAGE DEDUCTION HAS HELPED SPUR HOME OWNERSHIP. WOULDN'T THE FAIRTAX ELIMINATE THAT DEDUCTION?**

Income tax deductions only have value because they reduce income tax liability. Under the FairTax, there will be no tax liability to offset, because individual taxpayers will no longer pay taxes on their income. There will be no need for tax deductions because income is irrelevant. Homebuyers won't be disadvantaged, however. In fact, they will be greatly advantaged over current tax law. The home mortgage interest deduction exists only to ensure taxpayers can pay interest with pre-income tax dollars. That is why it permits a deduction against income for income tax purposes. However, the mortgage interest deduction provides no deduction against payroll taxes, which is what most first-time homebuyers pay the most. Hence, homebuyers must pay interest with the money left over after payroll taxes. Under the FairTax, interest is completely untaxed. Homebuyers can pay for mortgage interest with both pre-income and pre-payroll tax dollars, more than doubling this benefit.

## **23. WILL SHIFTING THE TAX FROM INCOME TO SPENDING HELP PEOPLE SAVE FOR A HOME?**

Yes. Homebuyers will be able to save for a down payment without having to do so against an avalanche of tax on those savings. Today, savings must normally be accumulated after tax.

Mortgage interest rates will fall by 25% - 30% (about 2 points) as interest income falls towards the tax-free bond rate (neither interest payments nor interest income is taxed). This will be a huge savings for consumers. For example, on a \$150,000, 30-year home mortgage at an interest rate of 8%, the monthly mortgage payment would be \$1,112.64. On that same mortgage at a 6% interest rate, the monthly payment would be \$907.64. The two-point decrease in interest rates in this instance would result in a \$73,800 cost savings to the consumer. And used homes are not taxed at all. Under the FairTax, home ownership will be possible for many who may never have that option under the income tax system.

#### **24. HOW WILL CHARITABLE GIVING BE AFFECTED?**

Last year, Americans donated more than \$100 billion to charities, churches, foundations and other humanitarian causes. When considering the effects of shifting to the FairTax, we must be careful to ensure the continuing ability of charities to perform their essential role of facilitating charitable acts. Charitable giving can be expected to rise under the FairTax for two reasons: higher economic growth and a greater tax advantage for giving. Raising income growth has more to do with boosting charitable contributions than any tax incentive. It has been said by researchers that as the fortunes of the country go, so go the contributions to philanthropic causes. In fact, after years of analysis, we can be more specific: as the Gross Domestic Product changes, so goes approximately 2% of the total value of the goods and services to philanthropic causes. Total philanthropy as a percentage of GDP has held steady at around 2% for at least two decades. Because of the importance of the relationship between giving and income, slight shifts in GDP represent considerable dollars in charitable giving. Work by Harvard economist Dale Jorgenson shows a quick 9% - 13% increase in the GDP after passage of the Fair Tax<sup>1</sup>; similarly, Boston University economist Laurence Kotlikoff predicts a 7% - 14% increase.<sup>2</sup> Charitable contributions will be more tax-advantaged than today. Most taxpayers today cannot deduct their contributions to charity; only the relatively few (28%) who itemize may deduct their

contributions. When donors can itemize, the charitable deduction allows them to contribute before income taxes are taken out, but not before payroll taxes are taken out. Hence, a self-employed individual who is in the 28% tax bracket and who wants to contribute \$100 will have to first earn \$128. The government will take \$28 in payroll taxes off the top. He will then get a deduction equal to \$100. Under the FairTax, if he wants to contribute \$100, he only needs to earn \$100.

For those generally less-affluent taxpayers who do not itemize, the cost of charitable giving will actually decrease under the FairTax because they will be able to make contributions from pre-tax dollars. Charitable contributions will therefore rise. If no deduction is allowed today, an individual making a \$100 contribution will first have to earn \$176 (since \$100 is what remains after 15.3% payroll taxes and 28% income taxes are taken out). The contribution is still \$100, but the government wants its share first.

## **25. WILL CORPORATIONS GET A WINDFALL WITH THE ABOLITION OF THE CORPORATE TAX?**

Only people will pay taxes. Currently, corporations pass on their tax burden in the form of higher prices to consumers, lower returns to investors, and lower wages to workers. Under the FairTax, if income earned in a corporation by owners is spent on personal consumption, the FairTax is paid. But, if the money is retained in the business and reinvested to create jobs, build factories, or develop new technologies, no tax is due and the overall economic environment of businesses will improve.

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1 Jorgenson, National Tax Research Committee. See also, "The Economic Impact of Fundamental Taxing Consumption", Dale W. Jorgenson, Testimony before the House Ways and Means Committee, March 27, 1996 and "The Economic Impact of Fundamental Tax Reform", Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995.

2 Kotlikoff, National Tax Research Committee. See also, "The Economic Impact of Replacing Federal Income Taxes with a Sales Tax", Laurence J. Kotlikoff, April 15, 1993, Cato Institute Policy Analysis.

## **26. WILL THE FAIRTAX BE A BURDEN TO THE RETAIL INDUSTRY?**

Retail businesses act as tax collectors today. They withhold income and payroll taxes from their employees and the vast majority of retail businesses operating in states with a sales tax (45 states currently use a sales tax) are already sales tax collectors as well. Under the FairTax, retailers would receive an administrative credit equal to 1/4 of 1% of the federal sales tax they collect and remit. In addition, retailers would no longer need to bear the cost of complying with the income tax, including the uniform capitalization requirements, the various depreciation schemes and the various employee benefit and pension rules. Finally, the aggregate, beneficial effects of dramatically lower income tax compliance costs, no income taxes, no payroll taxes on workers and a reasonable fee for collecting the FairTax will assure that retailers will do well.

Some large retailers that rely on sales of imported goods may protest. This is because imported goods will have to compete with American manufactured products for the first time on a level competitive playing field. Lobbyists also have a vested interest in preserving their jobs and the status quo. But the consumer will still benefit.

## **27. HOW WILL STATE TAX SYSTEMS BE IMPACTED, AND CAN STATES ADEQUATELY COLLECT A FEDERAL SALES TAX?**

No state would be required to repeal its income tax or piggyback its sales tax on the federal tax. All states will have the opportunity to conform their sales tax to the federal tax and collect the combined state and federal sales tax. Most states will probably choose to conform. It will make the administrative costs of businesses in that state much lower. The state will receive an administrative credit from the federal government to collect the federal tax. For states that already collect a sales tax, this credit will prove generous. A state can choose not to collect the federal sales tax and either outsource the collection to another state, or opt to have the federal government collect it directly. If a state chooses to conform to the federal tax base, they will be able to raise the

same amount of state sales tax with a lower tax rate since the FairTax tax base is broader than their current tax base.

Finally, conforming states that are part of the FairTax system will, for the first time, be able to collect sales taxes on out-of-state mail order sales into their state. A specific panel on state administration experts recently appeared before the House Ways and Means Committee for hearings on whether or not the FairTax could be complied with at the state level. All witnesses unanimously agreed that it could be enforced at high levels.

## **28. HOW WILL THE PLAN IMPACT ECONOMIC GROWTH?**

Once the penalty for working harder and producing more has been removed, and Americans are free to keep every dollar they earn, a new era of economic growth and job creation will be unleashed. Americans will be able to save more, and businesses will be able to invest more. Capital formation, the real source of job creation and innovation, will be facilitated. GDP will increase by an estimated 10.5%. The FairTax will raise the economy's capital stock by 42%, its labor supply by 4%, its output by 12%, and its real wage rate by 8%. U.S. companies and individuals will be able to repatriate, on a tax-free basis, income generated overseas according to Dale Jorgenson. As a result, new capital will flow into the United States to invest in plants, facilities and jobs. Additionally, other countries will likely seek to invest here in the U.S. to avoid taxes on income in their own countries, further spurring the growth of our own economy.

## **29. WILL THE FAIRTAX CAUSE A RECESSION?**

No, the FairTax will not cause a recession. Consumers will not stop buying goods and services. Prices will not go up by the amount of sales tax. In fact, the tax-inclusive prices of products will very likely remain close to what they are today.

Income and payroll taxes are embedded in the price of everything we buy today, and when the income tax is repealed, prices will drop by an estimated 20%. Prices will be reduced even further due to lower compliance costs. Since the FairTax is revenue neutral, the same amount of

resources will be extracted from the economy as is extracted under current law. Every known economic projection shows the economy doing better (not worse) under a consumption tax like the FairTax. Because the economy will grow and become more productive, investment, wages and consumption will be higher than they would have been under the income tax.

### **30. WHAT WILL HAPPEN TO INTEREST RATES?**

First, interest rates will drop quickly by approximately 25% after passage of the FairTax. Interest rates include compensation to the lender for the taxes that they must pay on interest you pay them. This is why taxable bonds bear a higher interest rate than tax-exempt bonds. When the tax on interest is removed, interest rates will drop toward today's tax-exempt rate.

Second, under the current system, savings and investments are taxed. Under the FairTax, savings and investments will not be taxed at all. As Americans save more money, the pool of funds in lending institutions will grow, thereby causing the cost of borrowing funds to drop.

### **31. WHAT WILL HAPPEN TO THE STOCK MARKET, MUTUAL FUNDS, AND RETIREMENT FUNDS?**

Investors will prosper greatly under this plan. Corporations will face lower operating costs and individuals will have more money to save and invest. Furthermore, a sales tax will increase the expected future return on assets through the expected decrease in interest rates. The replacement of the present tax system with the FairTax will cause the stock market to appreciate. Lower interest rates mean that the present value of the future income that a corporation is expected to earn will increase. Thus, lower interest rates cause stock prices to rise. This type of reform will significantly enhance the retirement savings of many Americans.

### **32. WHAT WILL HAPPEN TO TAX-FREE BONDS?**

Tax-free bonds will continue to be tax-free. On the other hand, all stocks, bonds, and other investments will be tax-free as well.

### **33. HOW WILL LIFE INSURANCE BE IMPACTED BY THE FAIRTAX?**

Many individuals invest in whole life insurance policies. Currently the savings component that is built up from this investment is the only element that benefits from an income tax since those earnings are tax-deferred. However, those earnings are still taxable when savings are drawn down or paid out. Under the FairTax, those earnings are tax-exempt.

### **34. WHAT WILL THE IMPACT BE ON EDUCATION COSTS UNDER THE FAIRTAX?**

Education expenditures will not be taxed under the FairTax and can be paid with pre-tax dollars. Essentially, money that would have been deducted for income tax and payroll tax would now be made available to pay for education costs. For many people, education is the best means of improving one's earning potential. The FairTax will remove all tax impediments, thus making education more affordable for more people.

### **35. HOW WILL THIS IMPACT U.S. COMPETITIVENESS IN FOREIGN TRADE?**

Since all U.S. exporters will immediately see an average 20% reduction in their production costs, they will experience an immediate boost in their competitiveness overseas. American companies doing business internationally will be able to sell their goods at lower prices. In addition, U.S. companies with investments or plants abroad will be able to bring home profits from overseas without the penalty of paying U.S. income taxes, resulting in more U.S. capital investment.

And at last, imports and domestic production will be put on a level playing field. Exported goods will not be subject to the FairTax, since they will not be consumed in the U.S. However, imported goods sold in the U.S. (unlike the present income tax) will be subject to the FairTax because these products will be consumed domestically.

### **36. WILL THERE BE A PROBLEM WITH CROSS-BORDER COMPLIANCE?**

It is unlikely that “shopping across the border” in Canada or Mexico will result in any cost savings to the consumer. Remember, the tax-inclusive prices of goods and services after passage of the FairTax will remain very close to the same levels that can be found in the marketplace today. With regard to interstate competition, since all states will have the same federal sales tax rate, the federal sales tax will not be an incentive to cross state lines to avoid the tax either.

### **37. WHAT ABOUT TAX EVASION UNDER THE FAIRTAX?**

The old aphorism that nothing is certain except death and taxes should be modified to include tax evasion. Tax evasion has increased by 67% during the past 11 years. As a percentage of Gross Domestic Product (GDP), tax evasion has reached 2% compared to 1.6% in 1991. Tax evasion continues to be in the range of 22% - 23% of income taxes collected. Almost 40% of the public, according to the IRS, is out of compliance with the present tax system, mostly due to the enormous complexity of the present system. These IRS figures do not include the nearly \$200 billion in taxes lost on illegal sources of income. Despite a major enforcement effort and assessment of over 34 million civil penalties in 1997 on American taxpayers, disrespect for the tax system has reached dangerous levels. This calls into question the sustained viability of a system based on taxpayer self-assessment.

The FairTax is likely to reduce rather than increase the problem of noncompliance. Of course, there will be some perplexed taxpayers. The relative simplicity of the FairTax will eliminate mistakes. Businesses will need to answer only one question to determine the tax due: How much was sold to consumers? Individuals have no further responsibility under the FairTax. There will be no more shelter games to play. Finally, increased fairness, transparency and legitimacy of the system will induce more compliance from cheaters. The roughly 90% reduction in filers will enable tax administrators to more narrowly and effectively address non-compliance, which will

increase the likelihood that tax evasion will be uncovered. Because tax rates will decrease, tax evasion will be less profitable; and because of the dramatic reduction in tax filers, tax evaders will be more easily caught under the FairTax system.

### **38. HOW WILL THE INTERNET BE AFFECTED?**

The technological innovations of the 21st Century are in stark contrast to our outdated tax system that resembles the information age's equivalent of the passenger pigeon. The Internet is heavily taxed today. Investors in Internet companies are taxed on their income multiple times. The investors are taxed when they invest. The companies are taxed on their earnings, which results in lower profits, higher priced goods or lower wages to workers, because they must pay state and federal income tax on the income from those goods and services. The shareholders are taxed on their dividends and capital gains. Internet company employees are taxed heavily on their wages with both payroll and income taxes. Internet companies are taxed again when they buy goods and services since producer prices reflect hidden taxes imposed upstream. This is driving Internet business offshore.

Perhaps worse, the income tax will soon force substantial regulation of the Internet. Without substantial intrusions into our financial privacy and without heavy regulation, the Internet will make an already precarious tax system totally voluntary. In the digital age, income can be moved around the world at the speed of light (or rather a keypunch). In this environment, anyone who has the desire to, can escape taxation. The FairTax national retail sales tax will help to neutralize tax policy so that economic decisions over the vitality of the Internet will not be based on Congress' choice of winners and losers. The FairTax will harmonize rules so that the Internet is not doubly taxed, but can compete head-to-head against brick and mortar retailers.

The FairTax will help to head-off onerous tax regulations that will be required if the income tax remains in place.

### **39. NO OTHER COUNTRY IN THE WORLD HAS EVER TRIED SUCH A PLAN, WHY SHOULD WE?**

The sales tax is not unfamiliar to us or to the world. It is a major source of revenue in 45 states and the District of Columbia. Moreover, no country in the world relies exclusively on the system we now have - an income and payroll tax system. However, two of the largest economies of the world, Florida and Texas, have relied on sales taxes instead of income taxes. But that no other nation has a FairTax system, should not make us wait for others to take a lead. No other country has led the world in so many fields as ours. There is no particular reason we should follow other countries' lead on tax matters. We have learned much about the most efficient, least intrusive and most economically sound means to collect revenue. We should strive to have the best tax system, period. It is also important to note that, if the U.S. were to adopt such a plan, most other countries would have to follow suit or lose vast investment to our shores.

### **40. WHAT ABOUT THE FLAT TAX? WOULD IT BE BETTER AND EASIER TO PASS?**

The flat tax and the FairTax share some important similarities. They are both single-rate taxes, which are neutral with respect to savings and investment. They would both ensure productivity gains by lowering marginal rates and by eliminating punitive taxes on savings and investment. However, there are important differences. Despite that it has been around for about 20 years, many of its supporters don't recognize that the flat tax is essentially a VAT (Value Added Tax), which is the same form of tax that has grown peacefully side-by-side with income and death taxes in much of the world. While it provides an immediate tax cut as an incentive for support, a large part of the burden of the flat tax - the business component - will remain hidden from people. It is this hidden aspect of the flat tax that will cause the tax to creep upwards in burden. The FairTax is simple, easy to understand and visible.

The flat tax retains the complete administrative apparatus of the income tax and can easily revert to a graduated income tax. Already, exceptions are

being made to the flat tax proposals as the few members of Congress who support the plan seek to appease would-be supporters. Almost assuredly, it will erode back into an income tax, but worse, it will be an income tax with a much broader base (meaning that the amount of taxes will eventually increase). Notwithstanding flat tax proponents' honorable intentions, we should not ignore history. Congress has tried to reform the income tax again and again. The problem is the income tax itself, and it is time to stop tinkering with it.

The FairTax cannot be converted into an income tax and has the additional assurance of repealing the 16th Amendment. Under a flat tax, individuals would still file an income tax return each year similar to today's 1040 EZ. Under the FairTax, individuals would never file a tax return again, ever! Under the flat tax, the payroll tax would be retained and income tax withholding would still be with us. Under the FairTax, the payroll tax, which is a larger tax burden for most Americans than the income tax, would be repealed. Under the FairTax, what you earn is what you keep. No more withholding taxes and no more income tax. Moreover, the tax will be electable. The choice will not be between working less or getting paid less; it will be between spending and not spending. It is time to junk the entire income tax system and start over with a tax system that is more appropriate for a free society.

#### **41. CAN CONGRESS RAISE OUR TAXES UNDER THE FAIRTAX BY RAISING THE RATE?**

Congress could raise our taxes under the FairTax just as it could raise our taxes under the flat tax or the income tax. However, it would be much harder to do so. Under any other tax plan Congress can raise taxes without the rate being visible. It can adopt the typical divide-and-conquer, hide-and-disguise strategy routinely employed today to gradually ratchet up the tax burden by manipulating the tax code. Under the FairTax, Congress would have to raise the rate on everyone at the same time in a very public action, like a postage stamp increase. It is harder

to raise taxes on everyone when they can easily see the tax increase.

#### **42. COULD WE END UP WITH BOTH THE FAIRTAX AND AN INCOME TAX?**

No, the FairTax is designed only as a replacement for the entire income tax system. The FairTax includes a constitutional amendment prohibiting an income tax.

#### **43. IS THE FAIRTAX A CONSERVATIVE TAX SCHEME OR ALIGNED WITH ANY ONE POLITICAL PARTY?**

Proponents of the FairTax are fiercely bi-partisan. The FairTax has support across the political spectrum with people of all ages and from all walks of life. Its supporters need only have one common belief: that it is a fairer, simpler, more efficient way to raise federal revenue. The FairTax will deliver government accountability of taxpayer dollars, a tax system that is less susceptible to being manipulated by special interests and a tax system that will make it easier for the average person to get ahead. Most importantly, the FairTax is a tax system that will provide tax relief for those who are most in need - not those who provide the most in political contributions.

#### **44. WHAT ASSUMPTIONS HAVE BEEN MADE ABOUT GOVERNMENT SPENDING?**

The FairTax is to be revenue neutral for the first year of operation. It will raise the same amount of revenue as is raised by current law. After the first year, revenue is expected to rise because of the economic growth generated by this plan. At that time, the American people, Congress, and the President will have to decide whether to lower the tax rate or to spend the additional revenue.

#### **45. HOW WILL THE FAIRTAX IMPACT GOVERNMENT SPENDING?**

The public will need to remain vigilant to ensure that the economic gains caused by the FairTax benefit the people and the causes they deem worthy. Citizens will more easily be able to determine if their elected representatives are acting in their best interest. Legislators will more easily be held accountable for their decisions. For

the first time in decades, it will be simple to see whether a politician is advocating an increase in taxes or a restraint on government spending as the economic pie gets bigger. This is not the case today.

#### **46. WHY A CONSTITUTIONAL AMENDMENT?**

It is not the intention of this plan, or the desire of the American people, to end up with both a federal income tax and a federal sales tax. The objective is to ensure that one is replaced by the other - not to add one on top of the other. A constitutional amendment to ban Congress from taxing income will achieve this goal.

#### **47. ISN'T OUR ENTIRE ECONOMY BUILT AROUND THE INCOME TAX?**

No, our economy is not built around the income tax. Rather, our economy is held back by the income tax. There was no income tax for the first 124 years of our history - that's more than half the time we have existed as a nation. Under the FairTax, within 10 years the average American will be at least 10% and probably 15% better off than he or she would be under the current system. That translates into an increase in income of \$5,000 every year for the typical two-income household.

#### **48. HOW WILL THIS PLAN IMPACT COMPLIANCE COSTS?**

It is estimated that Americans spend at least \$225 billion a year to comply with the tax code - that's \$850 for every man, woman, and child in the country. Billions of dollars in compliance costs are spent each year and we have nothing of value to show for this expenditure. It is estimated that the FairTax will dramatically cut compliance costs, perhaps by as much as 95%.

#### **49. WHAT ABOUT THE VAT (VALUE ADDED TAX)?**

The FairTax is not a VAT. VATs work very differently. VATs tax every stage of production. They are much more complex and are typically hidden from the taxpayer's view. Second, in industrialized countries that have a VAT, it co-exists with high-rate income taxes, payroll and many other taxes that in some instances cause marginal tax rates as high as 70%. Third, all other industrialized countries, except Australia and Japan, have a much

larger tax burden than the U.S., which requires higher rates.

#### **50. WILL THE TRANSITION FROM THE INCOME TAX TO THE FAIRTAX BE DISRUPTIVE AND DIFFICULT?**

Everyone will have to think about taxes in a different way. What we earn will no longer have to be documented, measured and tracked for tax purposes. The only relevant measure of our tax liability will be the amount spent on final, discretionary, personal consumption. Tax-related issues will suddenly be a lot simpler and more straightforward. The aggravation and anxiety associated with April 15th will disappear forever with the FairTax. The sales tax is not new - most Americans come into contact with it daily, since 45 states currently use it to collect state revenues. In fact, it should be easier to switch from a federal income tax to a federal sales tax system than it is to switch from gallons to liters, or from feet to meters! Of course, those who depend on the structure and complexity of our current system (i.e., tax lobbyists, tax preparers and tax shelter promoters) will have to find alternative economic pursuits. However, everyone will have enough advance notice to adjust to the new system.

# About Americans for Fair Taxation

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Americans For Fair Taxation is a 501(c)4 non-profit, non-partisan organization dedicated to replacing our federal income tax system with a simple, single rate federal sales tax on the final purchase of new goods and services. Established in 1995, Americans for Fair Taxation is headquartered in Houston, Texas, and is supported by volunteers all across the country.

Our mission is:

- To support sound economic research to measure the benefits of the FairTax to the American people and the U.S. economy.
- To support the education of citizens and community leaders about the FairTax.
- To support media communications to make the benefits of the FairTax known to the public.

Now that you have the facts, we need your time, your financial support, and your voice. The choice is yours.

To contact us or to join, call 1-800-FairTax.

Contributions are not tax deductible because the group is involved in advocating this legislation.

For more information on the FairTax, visit:  
<http://www.fairtax.org>

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