

THE FAIRTAX: GOOD FOR TAXPAYERS, GOOD FOR BUSINESSES, GOOD FOR THE ECONOMY

The national debate over taxation is shifting from the question of *whether* to alter our current tax system to the question of *how* to alter it. Today, polls indicate that a large majority of Americans are extremely frustrated with the current federal income tax system. The income tax discourages personal savings and investments by taxing capital gains, dividends, and interest earned. Wage earners struggle under the burden of a very regressive payroll tax. The income tax is complex...so complex that no one, not even the experts, truly understands it. Moreover, for the tax to be enforced, the taxpayer must sacrifice significant privacy. As a result, our citizens are governed by needlessly burdensome tax laws that they cannot understand, and that are, intrusive, complex, costly and often invisible.

The tremendous undertaking of replacing the income tax will require the American people to put aside partisan politics to arrive at a consensus on how our government should tax its citizens. Any new system of taxation must fairly and efficiently distribute the burden of funding our government, promote economic growth, present less of a compliance burden, and offer every American better economic opportunity.

Americans for Fair Taxation, a 501(c)(4) non-profit, non-partisan organization, believes that replacing the current tax system with a single rate, federal sales tax with no exceptions and no exclusions, on all final goods and services will best meet this challenge. Research has shown that the "FairTax," as proposed by Americans for Fair Taxation, is a fair and progressive system of taxation that will increase economic growth, investment, capital formation, and the creation of jobs and savings¹.

The FairTax

The FairTax involves three specific actions:

- Passage of legislation that repeals the income tax, the payroll tax in its entirety, the estate tax, the gift tax, the capital gains tax, the self-employment tax, and the corporate tax.
- Passage of legislation that installs a single rate, national sales tax on all new goods and services at the point of final purchase for consumption; and that provides for a universal rebate in an amount equal to the sales tax on essential goods and services.
- Adoption of a constitutional amendment to repeal the 16th Amendment and to prohibit income taxes.

Reps. John Linder and Colin Peterson have introduced legislation (H.R. 2525) that would repeal the current tax system and enact the FairTax as a replacement.

¹ The Economic Impact of Taxing Consumption, Dale W. Jorgenson, Ph.D., Harvard University, Testimony before the Ways and Means Committee, March 27, 1996; The Economic Impact of Replacing Federal Income Taxes with a Sales Tax, Laurence J. Kotlikoff, April, 15, 1993, Cato Institute Policy Analysis; The Economic Impact of Fundamental Tax Reform, Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995; The Economic Impact of the National Retail Sales Tax, Dale W. Jorgenson, Harvard University, November, 1996; Replacing the U.S. Federal Tax System with a Retail Sales Tax: Macroeconomic and Distributional Impacts, Laurence J. Kotlikoff, December, 1996.

Fairness

Throughout the history of our country our citizens and government have had an objective to increase every American's chance to achieve economic independence by providing greater opportunities to share in our country's growth and prosperity. The FairTax will help us achieve this goal. Americans will be better off under the FairTax. Every taxpayer will be subject to the same sales tax rate with no exceptions and no exclusions; but those least able to share in the cost of government will carry no federal tax burden at all². Under the current system, the more your income is derived from wages, the more you are affected by payroll taxes. In addition, under the FairTax, no one will pay a tax on the cost of essential purchases, and those who demonstrate their greater ability to pay by consuming more, will pay more taxes.

Today, a family of four with an income of just \$22,500 pays 10 percent of their income in federal taxes. A family earning \$45,000 pays 16 percent of their income in federal income and payroll taxes. Under the FairTax a family of four earning \$22,500 (even spending all of their income) would pay no federal taxes at all, and the same family of four earning and spending \$45,000 would pay an effective tax rate of only 11.5 percent tax on their taxable purchases. (See Table 1).

2000 Law, Taxes Including Employee Portion of OASDI and HI							FairTax	
Family Income	FUTA (Federal Unemployment Tax)	OASDI (Social Security)	HI (Medicare)	Income Tax	Total Tax	Effective Tax Rate	Sales Tax	Effective Tax Rate
\$22,500	N.A.	\$1,395	\$326	\$593	\$2,314	10%	\$0	0.0%
\$45,000	N.A.	\$2,790	\$653	\$3,968	\$7,410	16%	\$5,175	11.5%
\$67,500	N.A.	\$4,185	\$979	\$8,006	\$13,169	20%	\$10,350	15%
\$90,000	N.A.	\$4,724	\$1,305	\$16,831	\$22,860	25%	\$16,525	17%

Table 1: The standard deduction for joint returns (\$7,350) and four personal exemptions (\$2,800 each) were assumed for calculating the values in this table. Taxpayers with itemized deductions would have lower effective tax rates. Taxpayers with higher incomes are more likely to itemize. The effective tax rate under the income tax reflects the tax rate divided by total income. For purposes of calculating the effective tax rate under the FairTax it was assumed that the family spends all income earned and saves nothing. (Payroll tax definitions: FUTA is the Federal Unemployment Tax Act, OASDI is Old Age Survivor Disability Insurance, HI is Hospital Insurance.)

Most economists, however, consider that it is really the *employee* that pays the matching *employer* portions of Social Security and Medicare withholding taxes and the FUTA tax through *lower wages*. If we make this assumption, the burden of the income tax system on taxpayers becomes even more dramatic. A family of four earning \$22,500 annually pays 20 percent of their income in federal taxes (compared to paying no federal taxes under the FairTax) and a family earning \$45,000 pays 25 percent of their income in federal taxes (compared to 11.5 percent under the FairTax). (See Table 2). Under the FairTax, Americans will have more control over the timing and the amount of taxes they pay, and an enhanced opportunity to improve their financial condition.

² Examining a Change to a National Retail Sales Tax Regime: Impact on Households, Joseph Kahn and Associates, Stanford University.

2000 Law, Taxes Including Employee & Employer Portion of OASDI and HI							FairTax	
Family Income	Futa (Federal Unemployment Tax)	OASDI (Social Security)	HI (Medicare)	Income Tax	Total Tax	Effective Tax Rate	Sales Tax	Effective Tax Rate
\$22,500	\$434	\$2,790	\$653	\$593	\$4,469	20%	\$0	0.0%
\$45,000	\$434	\$5,580	\$1,305	\$3,968	\$11,287	25%	\$5,175	11.5%
\$67,500	\$434	\$8,370	\$1,958	\$8,006	\$18,767	28%	\$10,350	15%
\$90,000	\$434	\$9,449	\$2,610	\$16,831	\$29,323	33%	\$15,525	17%

Table 2: This table reflects effective tax rates assuming that it is the employee that pays the employer portion of Social Security and Medicare payroll tax withholding through lower wages. The standard deduction for joint returns (\$7,350) and four personal exemptions (\$2,800 each) were assumed for calculating the values in this table. Taxpayers with itemized deductions would have lower effective tax rates. Taxpayers with higher incomes are more likely to itemize. The effective tax rate under the income tax reflects the tax rate divided by total income. For purposes of calculating the effective tax rate under the FairTax it was assumed that the family spends all income earned and saves nothing. (Payroll tax definitions: FUTA is the Federal Unemployment Tax Act, OASDI is Old Age Survivor Disability Insurance, HI is Hospital Insurance.)

Our current tax system is also unfair because it is highly responsive to political influence on behalf of special interest groups. Average taxpayers without the means or organization to influence tax policy are at a clear disadvantage. The inextricable relationship between the tax code and lobbyists is evidenced by the fact that more than half of Washington lobbyists are registered on tax matters. Under the FairTax, there are no exceptions and there are no exclusions...there are no loopholes to be exploited by special interests. Under the FairTax all taxpayers will have an equal voice.

Simplicity

A fundamental notion of fairness is that citizens should be able to comprehend the laws that affect them. However, current tax law is beyond the comprehension of most taxpayers, including many of those who devote their entire professional lives to it. The current tax code fills more than 2,000 pages of documents; the regulations covering implementation of the tax code more than 12,000 pages; and, court rulings on IRS regulations occupy another 200,000 pages.³ So complicated is the current tax system that the IRS estimated that in 1985 taxpayers spent an estimated 5.43 billion hours yearly to comply with it.⁴ The number was estimated to be 10.2 billion in 1995.⁵ The FairTax is simple: one single rate, with no exceptions and no exclusions, collected at the point of purchase. The simplicity of the FairTax means that tax planning is now within the reach of the ordinary taxpayer, who can choose when and whether to pay federal taxes by deciding when to make purchases and whether to buy new or used products.

Efficiency

In addition to the taxes on income that we pay, we also pay the cost of payroll and corporate taxes that are embedded in every product that we purchase. Businesses pass their costs on to consumers in the

³ Ax the Tax, Steve Moore, Paul Craig Roberts, Lawrence M. Stratton, Jr., National Review, Vol. 47, No. 7, Page 38(5).

⁴ Development of Methodology for Estimating the Taxpayer Paperwork Burden, Arthur D. Little, published by the Internal Revenue Service, June 1988.

⁵ Statement of James L. Payne, Ph.D., Testimony before the Ways and Means Committee, June 6, 1995.

form of higher prices.⁶ But the burden to the consumer doesn't stop there. We also pay for the cost of complying with the tax code. So complicated has the tax code become that it's estimated that taxpayers spend about \$225 billion annually⁷ – 27.2 percent of total income tax revenues and 3.1 percent of the Gross Domestic Product – in order to comply with it. That is equivalent to nearly a \$1,000 tax on every American. Massive amounts of our national wealth are consumed merely by measuring, tracking, sheltering, documenting and filing our annual income. The twin burdens of time and money required for record keeping, tax form preparation, calculating and funding estimated payment schedules, and tracking income and expenses will be eliminated. The FairTax will generate the same amount of revenue as the current tax system, but at a much lower cost. The number of tax filers would drop from an estimated level of 117.5 million to an estimated 14 million, a 79% reduction. Compliance costs under the FairTax will fall to \$10 billion.⁸ By some estimates, this would be annual net savings to the economy of \$215 billion.

Economic Impact

Slow economic growth and economic stagnation have a adverse impact on low wage earners. 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 income tax retards economic performance by creating a significant bias against saving and investment through double, triple and even quadruple taxation. Under the FairTax, what you earn will be what you take home. Americans will be able to save more and invest more. The FairTax will dramatically increase investment levels compared to levels that would have been achieved under the current income tax system.⁹ Increased savings will stimulate investment and productivity and the economy will grow more rapidly, creating demand for workers and improving job opportunities. Because taxes on capital will be removed, foreign capital will flow into the United States, creating businesses and jobs. U.S. products competing abroad will be free of the hidden costs of taxation – estimated at between 20% and 30% of the total product cost¹⁰ – while the FairTax will be collected on foreign products sold in the United States. Virtually all economic models project a much healthier economy under the FairTax.

Summary

The ever-increasing taxpayer demand for a simpler, fairer, more efficient, and less intrusive system of taxation is building daily. The FairTax will deliver these benefits to the American people, and more.... more government accountability for taxpayer dollars, a tax system which is less susceptible to being manipulated by special interests, and perhaps most importantly, tax relief for those who are most in need.

⁶ The Economic Impact of Taxing Consumption, Dale W. Jorgenson, Ph.D., Harvard University, Testimony before the Ways and Means Committee, March 27, 1996. "The Economic Impact of Fundamental Tax Reform, Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995. The Economic Impact of the National Retail Sales Tax, Dale W. Jorgenson, Harvard University, November, 1996.

⁷ Compliance Costs of Alternative Tax Systems II, Arthur P. Hall, Ph.D., Senior Economist, The Tax Foundation, Special Brief, House Ways & Means Committee Testimony, March 1996.

⁸ Ibid.

⁹ The Economic Impact of the National Retail Sales Tax, Dale W. Jorgenson, Harvard University, November, 1996, Replacing the U.S. Federal Tax System with a Retail Sales Tax: Macroeconomic and Distributional Impacts, Laurence J. Kotlikoff, December, 1996.

¹⁰ The Economic Impact of the National Retail Sales Tax, Dale W. Jorgenson, Harvard University, November, 1996.