

FREQUENTLY ASKED QUESTIONS

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”). We are working hard to help economists reach consensus about the revenue neutral tax rate. To this end, we have utilized some of the best academic minds in the country, from Harvard to MIT. Economists estimate that the FairTax rate would be 23-26 percent tax-inclusive (between 30-35 percent 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 the FairTax’s estimate neither the lowest nor the highest. Predicting revenues 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 percent 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 one of us 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 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 percent (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), 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 percent plus the lowest income tax bracket rate of 10 percent amount to a combined marginal tax-inclusive rate of at least 25.3 percent (or 36.3 percent tax exclusive). Those in the 27 percent income tax bracket today (many middle-income Americans) pay a combined 42.3 percent (73.3 percent tax exclusive). That means they must earn \$174.60 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. 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.

2. ISN'T 23 PERCENT TOO HIGH FOR A SALES TAX?

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 both spending and 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.

3. WHAT WILL BE TAXED?

The FairTax is a single stage tax, meaning it will tax only the sale of 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.

4. 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 income tax, the capital gains tax, the payroll tax, the corporate income tax, the self-employment tax, the gift tax, and the death tax.

5. HOW WILL THE REBATE WORK?

Consumers will receive, in equal monthly installments, an annualized rebate on poverty level spending. 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.

(see the chart on the next page)

FAIRTAX REBATE AMOUNTS FOR CALENDAR YEAR 2003

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 \$3,140 per household member. Thus, a married couple with two children would be protected by the rebate from tax on the first \$24,240 per year that they spend.

		Single Person	Single Person	Single Person	Married Couple	Married Couple	Married Couple
Family Size	HHS Annual Poverty Level ¹	FairTax Annual Consumption Allowance	Annual Rebate	Monthly Rebate	FairTax Annual Consumption Allowance	Annual Rebate	Monthly Rebate
1	\$8,980	\$8,980	\$2,065	\$172	\$8,980	\$2,065	\$172
2	\$12,120	\$12,120	\$2,788	\$232	\$17,960 ²	\$4,130	\$344
3	\$15,260	\$15,260	\$3,510	\$293	\$21,100	\$4,853	\$404
4	\$18,400	\$18,400	\$4,232	\$353	\$24,240	\$5,575	\$465
5	\$21,540	\$21,540	\$4,954	\$413	\$27,380	\$6,297	\$525
6	\$24,680	\$24,680	\$5,676	\$473	\$30,520	\$7,020	\$585
7	\$27,820	\$27,820	\$6,399	\$533	\$33,660	\$7,742	\$645
8	\$30,960	\$30,960	\$7,121	\$593	\$36,800	\$8,464	\$705

¹ Federal Register: Feb. 7, 2003 (Vol. 68, No. 26, pp. 6456-6458)

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

6. 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 poverty level and the universal rebate. They are simply not exempted by name. Exempting items by name or category may seem like a good idea, but that approach would neither be fair nor simple, and it would not efficiently help low-income individuals. Respected economists have shown that the wealthy spend much more on food, clothing, housing, and medical care than do low-income individuals. 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 hairsplitting choices, which would, inevitably, open the door for future complexity, special interest, and the development of exceptions. Lobbyists have been successful in weaving a 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 food, clothing, and medical services are not exempt from federal tax today. These essential expenditures are purchased with after-income tax and after-payroll tax dollars. And, like everything else we buy, they include hidden federal taxes.

7. 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 percent (tax-inclusive) today. Even the very lowest income tax bracket is 10 percent and all wage earners pay 7.65 percent in payroll taxes. That's 17.65 percent tax-inclusive (and 23 percent tax exclusive) right there! If you are self-employed, you pay the full 15.3 percent self-employment tax, which makes the rate 35.3 percent (36.3 percent 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 percent 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>
The FairTax	23.0 %	29.9 %
10% Income Tax plus Payroll Tax	25.3 %	33.9 %
27% Income Tax plus Payroll Tax	42.3 %	73.3 %

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

8. WHAT DOES TAX-INCLUSIVE MEAN AND WHY IS THE FAIRTAX EXPRESSED AS SUCH?

All tax rates are expressed as a fraction: 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: tax paid / (base on which the tax was imposed minus the 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: tax paid / 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 percent (tax-inclusive) or 25 percent (tax-exclusive)?

The FairTax 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 FairTax 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 FairTax 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).

9. 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.

10. 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.

11. 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.

12. HOW WILL THE TAX BE COLLECTED?

The FairTax system will work in a very similar, mechanical way to 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 which 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 percent of the revenue collected for their efforts.

13. 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 elsewhere. 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 gives imports an advantage against U.S.-produced goods. We can do better, and we must. The FairTax addresses and fixes each of these problems.

14. 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 by building job-creating factories, financing research and development to create new products, or funding charitable activities, for example, then those activities will not be taxed.

15. 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, low-income people 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 percent - a rate much lower than the income and payroll tax burden they bear today. Moreover, slow economic growth and recessions have a disproportionately adverse effect 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.

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

Yes, 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 \$4,130 (assuming he is married and has no children and the year is 2003). His effective tax rate will be 22.96 percent.

Let's look at a middle-income married couple with no children under the FairTax. If they spend \$30,000, they will pay \$2,770 net of their rebate for an effective tax rate of 9.2 percent. The effective tax rate increases as spending increases, but will never exceed 23 percent (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 \$2,126 in income taxes for a total of \$4,421 in taxes (14.7 percent). 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 percent). Viewed in this way, this couple is paying \$6,716 (22.4 percent) 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 9.2 percent under the FairTax. Today, under the income tax system, they have an effective tax rate of at least 166 percent more than the FairTax rate!

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 nearly 8 percent in payroll taxes, but another 20 percent in hidden income and employer payroll taxes buried into the cost of every product they buy.

17. 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 percent for seniors, compared to 65 percent on average). The home is often the largest asset and gains are likely to be in the range of 20 percent.

18. 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.

19. 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 percent-25 percent 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 percent, and the removal of these costs will force prices down even lower.

20. 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 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. As such, when we pay \$20 plus 23 percent of \$20, assuming the prices do not go down, we are no worse off than under the present system and probably better off.

21. 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 nor goods should be given tax preference. Competition, not politics, should determine the price of goods and services.

22. 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.

23. 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.

24. 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 taxes on those savings. Today, savings must normally be accumulated after tax. Mortgage interest rates will fall by 25 percent-30 percent (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 percent, the monthly mortgage payment would be \$1,112.64. On that same mortgage at a 6 percent 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 current income tax system.

25. 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 percent 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 percent 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 percent-13 percent increase in the GDP after passage of the FairTax¹; similarly, Boston University economist Laurence Kotlikoff predicts a 7 percent-14 percent increase.² Charitable contributions will be more tax-advantaged than today. Most taxpayers today cannot deduct their contributions to charity; only the relatively few (28 percent) 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 percent 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 for the 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 percent payroll taxes and 28 percent income taxes are taken out). The contribution is still \$100, but the government wants its share first.

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 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.

27. 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 percent 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.

28. 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.

29. 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 percent. The FairTax will raise the economy's capital stock by 42 percent, its labor supply by 4 percent, its output by 12 percent, and its real wage rate by 8 percent. 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.

30. 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 percent. 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.

31. WHAT WILL HAPPEN TO INTEREST RATES?

First, interest rates will drop quickly by approximately 25 percent 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.

32. 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.

33. 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.

34. 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.

35. 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.

36. HOW WILL THIS IMPACT U.S. COMPETITIVENESS IN FOREIGN TRADE?

Since all U.S. exporters will immediately see an average 20 percent 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.

37. 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.

38. WHAT ABOUT TAX EVASION UNDER THE FAIRTAX?

Almost 40 percent 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 percent 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.

39. 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 carrier 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.

40. 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 in the

country, Florida and Texas, have relied on sales taxes instead of income taxes. We should not wait for others to take a lead just because no other nation has a FairTax system. 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.

41. 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 the fact 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.

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.

42. 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.

43. 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. In addition, following enactment of the FairTax, proponents will pass a constitutional amendment prohibiting an income tax.

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

Proponents of the FairTax are fiercely bipartisan. 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 to 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.

45. 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.

46. 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.

47. 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. Congressman Sam Johnson has introduced legislation in Congress to propose such a repeal of the 16th Amendment.

48. 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 percent and probably 15 percent 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.

49. 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 percent.

50. 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 percent. Third, all other industrialized countries, except Australia and Japan, have a much larger tax burden than the U.S., which requires higher rates.

51. 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 structures 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.