SHORT SUMMARY OF THE FAIRTAX ACT

Representatives John Linder (R-GA) and Collin Peterson (D-MN) introduced the FairTax as H.R. 2525 in the 106th and 107th Congress. They have reintroduced this landmark legislation as H.R. 25 in the 108th Congress.

Specifically, the FairTax Act would repeal:

- Individual income taxes (including capital gains taxes)
- Corporate income taxes
- All payroll taxes, including the Social Security and Medicare payroll taxes
- Self-employment taxes
- Estate and gift taxes

In place of these federal taxes, the FairTax would levy a 23 percent tax on the final sale of all goods and services. Exports and business inputs (i.e. intermediate sales) would not be taxed. The sales tax must be separately stated and charged.

The FairTax would provide every family with a rebate of the sales tax equal to spending up to the federal poverty level. The rebate would be paid in advance and updated according to the Department of Health and Human Services poverty guidelines. Based on the 2003 guidelines, a family of four would be able to spend $24,240 annually tax free. They would receive a monthly rebate of $465 each and every month ($5,575 annually). Therefore, no family would pay tax on essential goods and services, and middle income families would be effectively exempt from tax on a large portion of their annual spending.

Social Security and Medicare benefits would remain the same. The Social Security and Medicare trust funds would receive the same amount of money as they do today. The source of the trust fund revenue would simply be sales tax revenue instead of payroll tax revenue.

Collection would piggyback on the sales tax collection already collected by 45 states. All states would have the option of either collecting federal sales tax on behalf of the federal government in exchange for a fee or outsourcing to another state.

Strong taxpayer rights are incorporated into the FairTax. The burden of persuasion in disputes is on the government. A strong, independent conflict resolution office would be created. Taxpayers are entitled to professional fees in disputes unless the government establishes that its position is substantially justified.

OVERVIEW OF THE FAIRTAX

The FairTax Act

- Will repeal the income tax in its entirety, including all corporate and individual income taxes, payroll taxes, self-employment taxes, capital gains, and estate and gift taxes.
- Will impose a revenue-neutral national sales tax on all new goods and services at the point of final purchase for personal consumption. Business-to-business transactions and used products (which have already been taxed) are not subject to the sales tax. The FairTax is a highly progressive tax that provides a universal rebate in an amount equal to the sales tax on essential goods and services, so that no American pays taxes on the purchase of the necessities.

Development of the FairTax

The FairTax Act was developed over a three-year period involving extensive academic and market research. Two very different experimental tests demonstrated that the public will support the replacement of the entire federal income tax system with a national sales tax like the FairTax.

Only two weeks of educational advertising in three test markets produced large swings in favor of the FairTax in each of the three markets. Support increased across the three markets by 11% (to 51%) and opposition dropped 13% (to 40%) for a total 24-percentage point swing. In addition, "intense support" increased 9 percent (to 30%) and "intense opposition" declined 10% (to 23%). The swing in favor of the FairTax occurred in all sectors of the public regardless of partisanship, ideology, age, gender, income, or education.

Poll Results (November 1998)
A survey jointly conducted by a Democratic polling firm (The Mellman Group) and a Republic polling firm (The Wirthlin Group) revealed that:

- Americans have a high level of interest in tax reform and want Congress to act.
- Americans favor dramatic, not incremental, tax reform.
- Americans want tax fairness, not rate reduction, to be the core of the new tax system.
- Americans favor a national retail sales tax (FairTax) approach to tax reform.
- Americans like many features of the FairTax, but most of all they like the fact that loopholes and shelters will be closed, that savings won't be taxed, and that the tax won't hurt the poor and elderly.

An annual poll for National Small Business United (NSBU) conducted by Arthur Andersen showed similar results.

Academic Research

The FairTax research team, which consisted of leading economists from Harvard University, Stanford University, Rice University, Massachusetts Institute of Technology (MIT), the National Bureau of Economic Research, the CATO Institute, the Heritage Foundation, and the Argus Group, crafted and tested methods by which the desires of the public could be fulfilled.

The resulting plan, the FairTax, was found to be effective both from a public policy perspective (it is a sound, effective tax plan which will greatly help the economy as a whole as well as individual taxpayers), and from a marketing perspective (when informed about the plan, people embrace it at higher levels than the Flat Tax, the Shaefer/Tauzin sales tax plan, or the current tax system).

The Three Goals of the FairTax: Fairness, Simplicity, and Efficiency

Market research revealed that Americans want a tax system that fairly distributes the federal tax burden. Americans want a tax system that encourages and facilitates savings – savings for education, for a home, or for a more secure retirement. Americans want a tax system without loopholes, a system that is no longer subject to the influence of special interest groups. Americans believe that our tax system should be visible and transparent, so that those paying taxes can always see when and how much they are paying. Americans believe that taxes should be administered with the least possible burden of compliance on individuals, the least possible intrusion into individual lives, and the least possible collection costs to taxpayers and the economy.

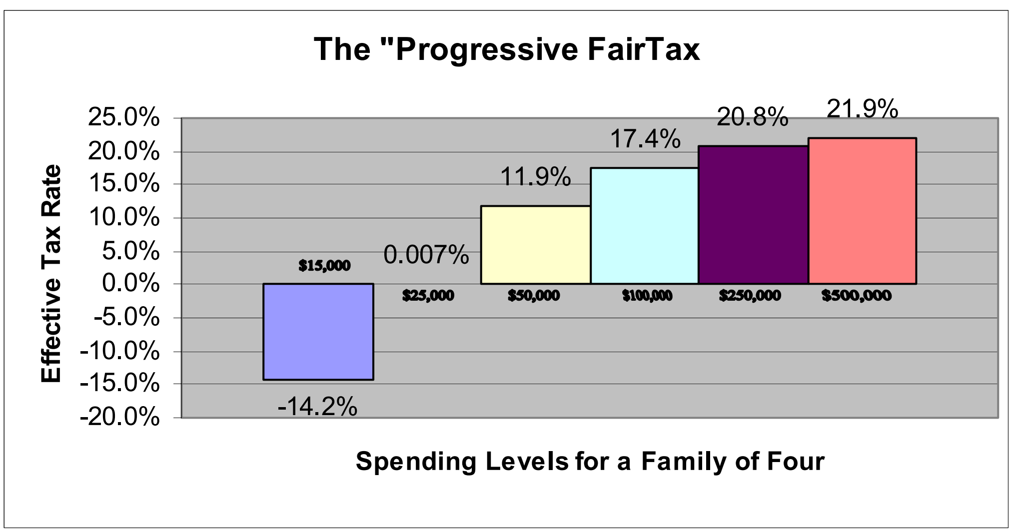
The FairTax meets each of these goals by eliminating the tax on productivity (the income tax) and replacing it with a consumption tax on discretionary spending – spending above the poverty level by family size. The FairTax is a highly progressive tax system that will fairly distribute the tax burden. It will "untax" the poor and lower effective tax rates on low- and middle-income tax families. The FairTax will increase our national savings rate. It will allow wage earners to bring home their entire paychecks and dramatically lower the costs of goods and services at the retail level by eliminating all hidden federal taxes, corporate income and payroll taxes that businesses pass on to consumers in the form of higher prices. The FairTax will eliminate tax loopholes and exceptions, the most resented feature of current income tax law (85 percent of taxpayers polled desire a tax system without loopholes that is not subject to special interest lobbying). The FairTax will be a highly visible, transparent tax system that requires the tax burden to be clearly printed on every sales receipt. Under the FairTax, the ordinary citizen will never come into contact with a federal agency for the purposes of collecting taxes again.

More About...

The Distributional Effects of the FairTax

FairTax supporters believe that the tax system should not be a burden to the poor or to the elderly living on low, fixed incomes. Thus, the FairTax rebate was created in part to eliminate the hidden tax that Americans now pay on the purchase of necessities. Under the FairTax, families living at the poverty level will pay no federal sales tax at all and those living under the poverty level will actually have negative tax rates. In fact, the FairTax is the only proposal, including current law, that completely "untaxes" the poor by (1) eliminating the payroll tax, a highly regressive tax that only targets wages, (2) eliminating hidden federal taxes, corporate taxes, income taxes, and payroll taxes that businesses pass on to consumers in the form of higher prices, and (3) assuring that no American pays taxes on spending up to the poverty level. The rebate feature of the FairTax assures its progressivity and, in fact, makes it as progressive as current tax law.

To illustrate the plan's progressive nature, we can examine the tax burden that a family of four will have at various annual income levels (or in this case, annual spending levels) if we assume they save nothing. A family of four that spends $12,120 per year will pay no federal sales tax at all. They will have a *negative* effective tax rate of -23% due to the rebate system. The rebate system assures that no American will pay taxes on the necessities of life. A family of four that spends $24,240 per year will have an effective tax rate of 0%; they will pay no federal sales tax at all. A family of four that spends $50,000 per year will have an effective tax rate of 11.9%; they will pay $5,925 in tax. A family of four that spends $100,000 per year will have an effective tax rate of 17.4%; they will pay $17,425 in tax. A family of four that spends $250,000 per year will have an effective tax rate of 20.8%; they will pay $51,925 in tax. And a family of four that spends $500,000 per year will have an effective tax rate of 21.9%; they will pay $109,425 in tax. Under the FairTax, those who spend more will pay more. However, those who choose to save, and thereby make their capital available for other people's productive use, will be able to lower their effective tax rates. (See chart below.)



The FairTax, which replaces the truly regressive payroll tax as well as the income tax, has a very progressive effect. It is much more beneficial for the poorest families than any other tax plan now in public debate, including the current tax code. And when the cumulative impact of the current income tax system and the current payroll tax are considered, the FairTax is as progressive as current tax law. Most importantly, each individual will have far greater latitude in deciding how much tax to pay and upward mobility will be enhanced.

Saving Rates

One of the worst long-term effects of our current tax system is its dramatic and negative impact on our national savings rate. The income tax, which encourages consumption and discourages savings, has led to the lowest national savings rate in the history of our country. As a result, millions of American families live paycheck-to-paycheck, literally only one paycheck away from disaster.

A low national savings rate slows economic growth and has a disproportionate adverse impact on the poor. 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 will dramatically improve economic growth and wage rates, making it easier for millions of American families to save for a better future for themselves and their children.

The FairTax is imposed only when we spend money on ourselves, not when we save or invest. Saving and investing creates economic wealth not only for ourselves, but also for others. Dale Jorgenson of Harvard University predicts that in the first year under the FairTax, invested capital will rise by 80% over projected levels under current law. Over the first decade of the FairTax, the savings rate will level off to 20% more than under the current system. This effect will result in a higher standard of living for both those who save (invest in others) and those who work for wages (because the market value of their work will be increased by investment). To put it another way, the value of pension and mutual funds will increase because their buildup is not taxed, and the level of real wages will rise because of the rise in real investment.

International Competitiveness and Job Creation

Under the FairTax, the United States will become the most attractive industrialized country in which to base production facilities because it will be the only nation with a zero rate of taxation on profits. American manufacturers will neither collect nor pay income tax. As a consequence, American overseas investment can be repatriated and direct foreign investment will flow to our shores.

The cost of capital will decline dramatically and American manufacturers will be 20 to 30 percent more competitive in the global marketplace due to the elimination of corporate income and payroll taxes. A 90 percent reduction in compliance costs will drive prices down even further. American firms will be much more likely to build plants in the United States and foreign firms will be more likely to find the United States a highly attractive place to build their plants to serve U.S. and foreign markets. The construction and operation of these new plants will generate relatively high-paying jobs with considerable multiplier effects on service industries.

Domestically produced goods will no longer bear the burden of embedded income and payroll taxes so American producers will export more. Imported products will bear the same sales tax burden as domestically produced goods. For the first time, exported and imported goods will have the same tax treatment. Imported goods will no longer be advantaged over domestically produced goods.

Efficiency and Evasion

Perhaps the most basic benefit of the FairTax system is that it simply costs far less – about $225 billion (90%) less – to collect the same amount of revenue as the income tax. Research shows that Americans spend an estimated $250 billion a year just complying with the current tax code. That's $888 per year for every man, woman, and child in this country or nearly $2,800 per family - $2,800 that will be better spent on education, a mortgage payment, or a more secure retirement.

No state will be required to repeal its income tax or piggyback its sales tax onto the federal tax, but 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 business in that state much lower. The state will be paid a fee by the government to collect the tax. For states that already collect a sales tax, this fee 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 federal tax base is broader than their current tax base.

The simplicity of the FairTax makes enforcement easier and evasion harder by allowing us to focus resources on fewer filers and by lowering the total number of tax filers from 212 million to only 14 million (retailers). By eliminating loopholes, the FairTax also keeps the tax base broad and marginal tax rates low, dramatically lower than any other tax proposal or current law. This reduces the potential gain from evasion and therefore reduces evasion temptation. It also makes evasion more discoverable. The elimination of exceptions reduces the need for so many lobbyists (more than half of registered lobbying in Washington, D.C. is tax code lobbying). In short, the FairTax saves us money not by collecting less in taxes, but by collecting the same amount in a more efficient way.

Price Stability

The research of respected Harvard economist Dale Jorgenson indicates that enactment of the FairTax will cause the cost of production in this country to fall by an average of 22 percent (15 to 35 percent depending on the industry). This makes sense because the FairTax will eliminate all of the federal income and payroll taxes embedded in the costs of goods and services today and impose them as a sales tax levied only on the purchase of new goods and services for personal consumption. And what if some manufacturers, in less competitive sectors of the economy, were able to pocket some of these cost savings? Consumers will have well over a trillion extra dollars due to the elimination of the payroll and income tax with which to pay the sales tax – in short, they will still be better off.

Because the FairTax will dramatically lower the cost of goods and services in this country, it will improve everyone's standard of living, regardless of income level.

Economic Growth

Almost all economists agree that consumption taxes are much more conducive to economic growth than taxes on production like the income tax. They also agree that complicated tax systems tend to create distortions in the market. With the FairTax, wage earners will have 100% of what they earn to spend, save, and invest, stimulating economic growth in every way. Savings and investment will grow because citizens will no longer pay taxes on their investment income. Increased savings will expand the pool of funds available for lending, and will help bring down interest rates. Similarly, because lenders will no longer have to build their tax burdens into the rates they charge borrowers, they'll be able to lower rates without losing money (to put it another way, interest rates will drop by the amount of the tax wedge, about 30% of current interest rates). Interest rates will be driven down even further by the influx of foreign capital seeking investment in a zero tax environment. In this climate of lower interest rates and higher real wages, Americans will see their standard of living increased substantially. Economic growth will disproportionately benefit the poor who are the first to be laid off in bad times and the last to be rehired.

Revenue Neutrality

We think that the way we collect taxes is a separate question from how much we collect in taxes. Therefore, the FairTax is imposed at a revenue neutral rate that will replace the revenue currently generated by the income tax, including all payroll taxes and capital gains taxes, estate and gift taxes, corporate income and self-employment taxes.