Allen Buckley
5192 Forest View Court
Mableton, GA 30126

April 22, 2005

The President's Advisory Panel on
Federal Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

Re: Tax Reform

Dear Sirs and/or Madams:

I am writing to supplement the comments that I mailed on March 3, 2005. Please consider the enclosed article in your analysis regarding the Fair Tax.

Thank you.

Sincerely,

Allen Buckley

Allen Buckley

THE FAIR TAX

The Bush Administration recently announced its intentions to revamp the U.S. tax system. One of the proposals under consideration is H.R. 25, the so-called "Fair Tax" proposal. This article analyzes several selling points of the Fair Tax.

1. **The Fair Tax Is Fair.** Individuals will differ on what is "fair" in a tax system. Similarly, individuals will differ on what is fair in an economic system.

The main objective of the Fair Tax is to change the system of taxation from one that taxes income to one that taxes consumption. The Fair Tax would replace the individual income tax, corporate income tax, estate and gift tax and FICA tax (i.e., Social Security and Medicare taxes) with a single retail sales tax at a rate of 29.9 percent of the price of a good or service. The revenue from the Fair Tax would need to pay for virtually all federal government expenses, including Medicare and Social Security. (The Bill states that the rate is 23 percent, but that rate is gross of the tax.) Thus, a $1 taxable transaction would produce tax of 30 cents.

Advocates of the Fair Tax say that the income tax system reduces savings and investment by taxing "income multiple times." However, the income tax system taxes income only once. Earnings on amounts earned are potentially taxed thereafter.

The Fair Tax would significantly reduce the taxes of virtually all wealthy persons. Corporations would pay no income tax. Compared to the current system, some poor people would come out ahead under the Fair Tax, while others would come out behind.

Consider an individual who earns $3,000,000 in salary and $1,000,000 in interest and dividends. The person likely pays in excess of $1,200,000 of tax for a year under the current system. If the person spends $200,000 in a year, the person's tax would be $58,800 under the Fair Tax. (If the individual chose to live an average person's life and spend $50,000, he/she would pay $14,950 of tax for the year.) Thus, if the bill is "revenue neutral," as it supporters allege, some persons must pay more tax to make up for reduced taxes on wealthy individuals and elimination of taxes on corporations.

As drafted, some elderly persons would pay more tax under the Fair Tax. Virtually everyone else would pay less tax than they currently pay. This benefit leads to Point #2.

2. <u>The Fair Tax Is Revenue Neutral</u>. The Fair Tax is not revenue neutral. This factor probably is the most significant drawback of the Fair Tax. The foregone taxes listed above produce a substantial amount of tax revenue. According to the Joint Committee on Taxation, a nonpartisan arm of the federal government, the tax rate would need to be 59.5 percent for the first five (5) years of application in order for the bill to be revenue neutral relative to 1999 revenue. (The rate was calculated in connection with H.R. 2525, the predecessor to H.R. 25. There is little difference between the two bills. The study noted that the rate is conservative, because the current system's evasion rate was utilized, while the evasion rate of a sales tax is substantial when the rate exceeds 10 percent.) Due in large part to anticipated evasion, the Brookings Institute believes that the rate would need to exceed one-hundred percent (100%) in order to be revenue-neutral. Thus, it should be obvious why virtually everyone is a winner under the Fair Tax, with the 29.9 rate.

the tax. They allege that the net price of goods would essentially remain the same, but we'll eliminate all income taxes, FICA taxes and the estate and gift tax. If this allegation were true, we would all be fools for not having changed to the Fair Tax years ago. It is not true.

There are embedded taxes of the current system in many goods and services. Much of these taxes are FICA taxes. However, unless employees' pay is reduced by their share of the FICA tax (i.e. 7.65%), it is difficult to see how the cost of any item or any service would be reduced by 20 percent. Furthermore, many products such as gasoline carry excise taxes that would not be reduced if the Fair Tax was implemented. Also, consider the massive trade deficit (i.e., Chinese goods) and imported oil. There are no imbedded taxes, or virtually no imbedded taxes, in these goods. Reductions in prices of purely American-made goods would not be significant enough to impact the trade deficit. (The average Chinese manufacturing laborer earns less than $1 per hour.) Most of the costs of homes relate to raw materials, land and, often, labor by illegal immigrants. Thus, embedded taxes in homes are not significant.

The Fair Tax would apply to many purchases by state and local governments. Those governments currently do not tax services. However, as they would collect the Fair Tax, they would begin taxing services to cover their increased costs. (The Bill is drafted so that states will tax services.)

4. <u>The End Result Is Equitable</u>. Good or bad, the most significant equity implication of the Fair Tax probably is a shift much of the tax burden from wealthier individuals and corporations to middle class and elderly citizens.

7. The Fair Tax Will Prevent Evasion. The Fair Tax would produce as much or more evasion than the current system.

Under the current system, significant evasion exists. Income that is in the form of wages, interest income, dividend income and capital gain income is virtually always reported and the tax thereon is virtually always paid. However, evasion exists mainly in the area of businesses where significant cash revenue is produced. Charitable deductions are also abused. The Fair Tax would prevent these two types of evasion.

On the flip side, a significant black market would be created to evade the Fair Tax. Consider the number of people going to Canada to purchase prescription drugs at lower prices. Slap a 60 percent tax (or even a 30 percent tax) on goods sold in the U.S. and watch a black market flourish. The result would not be good for U.S. retailers, but it would be good for Mexican and Canadian retailers. In anticipation of evasion, the Fair Tax bill includes an "800 number" provision whereby people can report cheaters. (Question: If there is no IRS, whom would one call?)

Consider the mom and pop retailers of the U.S. Many of them are getting clobbered by chains such as Wal-Mart. They can't buy in bulk, so they can't compete. But, they could keep two sets of books, charge lower prices and pocket some of the sales tax to compete. No IRS – no stopping it. (I've seen this happen in practice with respect to an excise tax on diesel fuel.)

8. The Fair Tax Would Cause The Economy To Boom. The Fair Tax would have positive and negative effects on the economy.

Giving people more take-home pay gives them more money to spend. Applying a 60 percent tax (or even a 30 percent tax) to a sale of a good or service will discourage spending. Given the dismal savings rate of would be experienced under the current system. The situation of the poor would be about the same, as some working poor people currently receive refundable tax credits that can cause them to receive money from the IRS. Under a revenue-neutral rate, the middle class and the elderly would pay more tax than they currently pay.

11. <u>The Fair Tax Would Allow States To Tax Mail Order And Internet Sales</u>. Institution of the Fair Tax would not have any implications to state taxation of mail order and internet sales. Constitutional law principles dictate when states may collect taxes, and the Fair Tax would not impact those principles.

12. <u>Elimination of the Estate Tax Helps Small Businesses Compete With Large Companies</u>. Currently, only individuals with a net worth in excess of $1,500,000 are subject to the estate and gift tax. For a husband and wife, the exemption total is $3,000,000. The individual exemption increases to $2,000,000 in 2006, and to $3,500,000 in 2009. There is no estate and gift tax in 2010. The exemption is currently scheduled to be $1,000,000 in 2011 and thereafter. So, individuals owning truly small businesses ordinarily aren't subject to the tax. (I personally believe that the current estate and gift tax exemption should be increased and the rate should be lowered.)

<u>Conclusion</u>. In some ways, the grass is greener under the Fair Tax. In other ways, it is not. Primarily due to its complexity, the current system aggravates people. And, no one likes to pay taxes. The Republicans are in large part responsible for the complexity. Through the Fair Tax initiative, many of them wish to use the complexity as a mechanism to shift the tax burden to the middle class and elderly persons. Significant simplification of the income tax system would be a better long-term play.