Suggested Proposal

Submitted by

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To

The President's Advisory Panel on Federal Tax Reform
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I. Description of Proposal.

A consumptive tax that abolishes all federal income taxes, including personal, gift, estate, capital gains, alternative minimum, Social Security/Medicare, self-employment, and corporate taxes, and replaces them all with one simple, visible, federal retail sales tax. A consumptive tax dramatically changes the basis for taxation by eliminating the root of our problem: Taxing income. A consumptive tax taxes us only on what we choose to spend, not on what we earn. It can be designed to raise the same amount of revenue as the government now collects through the Income Tax (revenue neutral). This type of consumptive tax is a fair, efficient, and an intelligent solution to the frustration and inequity of our current tax system.

- **The tax base:** the final point of purchase of new goods and services for personal consumption. Used items are not taxed. Business-to-business purchases for the production of goods and services are not taxed.

- **Exemptions, deductions, credits and exclusions:** no exemptions! Exempting items by category is neither fair nor simple. Respected economists have shown that the wealthy spend much more on unprepared food, clothing, housing, and medical care than do the poor. Exempting these goods, as many state sales taxes do, actually gives the wealthy a disproportionate benefit. Also, today these purchases are not exempted from federal taxation. The purchase of food, clothing, and medical services is made from after income tax and after payroll tax dollars, while their purchase price hides the cost of corporate taxes and private sector compliance costs. Exempting one product or service, but not another, opens the door to the army of lobbyists and special interest groups that plague and distort our taxation system today. Those who have the money will send lobbyists to Washington to obtain special tax breaks in their own self-interest. This process causes unfair and inefficient distortions in our economy.

- **Tax rate(s):** careful research indicates that 23 percent does the job of: (1) raising the same amount of federal funds as are raised by the current system, (2) paying a universal rebate for the cost of living at the poverty level, and (3) paying the collection fees to retailers and state governments. Unlike some other proposals, this rate has been independently confirmed by several different, non-partisan institutions across the country.

- **Distribution of the tax burden (including provisions for relief for low-income individuals):** all valid Social Security cardholders who are U.S. residents would receive a monthly rebate equivalent to the tax paid on essential goods and services, also known as poverty level expenditures. The rebate would be paid in advance, in equal installments each month. The size of the rebate would be determined by the Department of Health & Human Services' poverty level multiplied by the tax rate. This is a well-accepted, long-used poverty-level calculation that includes food, clothing, shelter, transportation, medical care, etc.

- **Treatment of charitable giving:** Charitable contributions depend on one factor more than any other: The health of the economy (not tax benefits). As a wide range of economists agree on the economic expansion the a consumptive tax delivers, charitable contributions benefit also.

  For all of the money that pours into churches every Sunday and into a broad range of charities every day, only the 30 percent who itemize get any tax benefit. The other 70 percent have given and keep giving with no tax benefit whatsoever.

  The FairTax allows people to make charitable contributions out of pre-tax dollars. Thus those generally less affluent taxpayers who do not itemize see their cost of charitable giving go down under a consumptive tax.

  Finally, the wealthy make decisions on charitable giving based on the cause. Once they have determined the cause is worthy, their contribution is structured to maximize the gift and minimize the tax. But the intention to give comes first; taxes simply determine the structure – rarely the amount – of the gift.

- **Treatment of home ownership:** a consumptive tax would have a positive effect on residential real estate far beyond this narrow question. Today's homeowners, if they itemize (and 70% do not), pay their interest with post-Social Security/pre-income tax dollars. They then pay their principal with post-SS/post-income tax dollars. Those who do not itemize get no advantages at all. Under a consumptive tax, all homeowners make their entire house payment with pre-tax dollars.

  With a consumptive tax, mortgage interest rates fall by about 25 percent (about 1.75 points) as bank overhead falls; this is a huge savings for consumers. For example, on a $150,000, thirty-year home mortgage at an interest rate of 7.00 percent, the monthly mortgage payment would be $999.12. On that same mortgage at a 5.25 percent interest rate, the monthly payment would be $830.01. Over 30 years, the 1.75-percent decrease in interest rates in this instance would result in a $60,879 cost savings to the consumer.

  Finally, first-time buyers save for that down payment much faster, as savings are not taxed. Under a consumptive tax, home ownership is a possibility for many who have never had that option under the income tax system. Lower interest rates, the repeal of the income tax, the repeal of all payroll taxes, and the rebate mean that people have more money to spend, and have an increased opportunity to become home owners.

- **Collection method(s):** Retail businesses collect the tax from the consumer, just as state sales tax systems already do in 45 states; the FairTax will simply be an additional line on the current sales tax reporting form. Retailers simply collect the tax and send it to the state taxing authority. All businesses serving as collection agents will receive a fee for collection, and the states will also receive a collection fee. The tax revenues from the states will then be sent to the U.S. Treasury.

- **Treatment of businesses:** Corporations are legal fictions that have not, do not, and never will bear the burden of taxation. Only people pay taxes. Corporations pass on their tax burden in the form of higher prices to consumers, lower wages to workers, and/or lower returns to investors. The idea that taxing a corporation reduces taxes on, say the working poor, is a cruel hoax. A corporate tax only makes what the working poor buy more expensive, costs them jobs, lowers their lifestyle, or delays their retirement. Under a consumptive tax, money retained in the business and reinvested to create jobs, build factories, or develop new technologies, pays no tax. This is the most honest, fair, productive tax system possible. Free market competition will do the rest.

  With a consumptive tax everyone, including businesses of every size, can plan their operations with precision instead of guess work. Business no longer has to factor in tax consequences when making decisions. The market is open to every size business, not just the businesses who can afford the high cost of compliance with our present incomprehensible tax code.

II. **Impact of Proposal Relative to Current System:**

- **Simplicity (including transparency and stability):** a consumptive tax with one rate is inherently simple. It is completely transparent because the tax payer can see exactly how much tax is being paid on each transaction. This type of consumptive tax is also inherently stable. In fact, consumption is a more stable source of revenue than income. A recent study by American Farm Bureau economist Ross Korves shows the FairTax base was less variable than the income tax base. Why? Because during difficult times due to loss of a job or an inability to work, people may not have as much income, or may have no income at all. They borrow funds or use savings. They may not have earnings, but they still continue to consume.

- **Fairness:** This proposal is fair, and in fact, much fairer than the income tax. Wealthy people spend more money than other individuals. They buy expensive cars, big houses, and yachts. They buy filet mignon instead of hamburger, fine wine instead of beer, designer dresses and expensive jewelry. The FairTax taxes them on these purchases. If, however, they use their money to build job-creating factories, finance research and development to create new products, or fund charitable activities (all of which help improve the standard of living of others), then those activities are not taxed.

- **Economic growth and competitiveness:** With the penalty for working harder and producing more removed, Americans are free to keep every dollar they earn, and a new era of economic growth and job creation is unleashed. Hidden taxes are history, Americans are able to save more, and businesses invest more. Capital formation, the real source of job creation and innovation, is facilitated. Gross domestic product (GDP) increases by an estimated 10.5 percent in the first year alone. The proposal raises the economy's capital stock by 42 percent, its labor supply by four percent, its output by 12 percent, and its real wage rate by eight percent.

  As U.S. companies and individuals repatriate, on a tax-free basis, income generated overseas, huge amounts of new capital flood into the United States. With such a huge capital supply, real interest rates remain low. Additionally, other international investors will seek to invest here to avoid taxes on income in their own countries, thereby further spurring the growth of our own economy.

- **Compliance and administration costs:** the heavy compliance costs of the income tax are like an anchor holding back economic growth. *We have nothing to show for the $250 billion (three Iraq wars worth) that we spend each year measuring, tracking, sheltering, documenting, and filing our annual income.* With a consumptive tax, this anchor would be removed.

I. **Transition, Tradeoffs and Special Issues.** The description of the tax reform proposal should include an explanation of any special issues or considerations, such as the tradeoffs that would be required, favorable/unfavorable treatment of particular industries or sectors within the economy, or the impact of transition from our current system to the proposed system.

A consumptive tax would eliminate many of the present jobs associated with compliance with the Income Tax. There will, of course, still be some people who are involved in sales tax return preparation and sales tax administration under a consumptive tax, but many fewer than those involved with the income tax today. Those tax preparers, tax lawyers, and Internal Revenue Service employees, who are typically well educated and well equipped with transferable skills, will have to find other, more productive work. The projected 10.5 percent growth in the economy during the first year of a consumptive tax will provide plenty of new jobs. These valuable labor and capital resources can be employed more productively – for example, in following the money trails left by terrorist, drug, and other criminal enterprises, rather than in tracking every American wage earner.

Everyone will have to think about taxes in a different way. Income – what we earn – will no longer have to be documented, measured and kept-track-of for tax purposes. The only relevant measure of our tax liability will be the amount we choose to spend on final, discretionary consumption. Tax-related issues will suddenly be a lot simpler and more straightforward than they used to be. The aggravation and anxiety associated with "April 15th" will disappear forever after passage of the this proposal. This proposal is not new – most Americans come into contact with such taxes daily, since 45 states currently use them to collect state revenues. It is easier to switch from an income tax to this system than it is to switch from gallons to liters or from feet to meters! Of course, those who depend on the structure and complexity of our current system (e.g., tax lobbyists, tax preparers, and tax shelter promoters) will have to find more productive economic pursuits. However, everyone will have enough advance notice to adjust to the new system.