

Why We Need the FairTaxSM

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It is no secret that our system of taxation in the United States is fatally flawed. It is unfair, witheringly complicated, and practically incomprehensible to all but a few “tax professionals”. Moreover, it creates an overwhelming sense of alienation from our government, which we perceive as a huge adversarial entity, reaching greedily into our pockets. This is no way for people in a democracy to feel about their government! Clearly, to carry out its agenda, whatever that may be, government must have a way of generating revenue. But the long-entrenched practice of taxing *income* has left us with a tax code so unwieldy, so byzantine, so *oppressive* that it profoundly disturbs the quality of life for all its citizens. Even those who may escape owing taxes per se can’t escape the hair-tearing aggravation of simply having to prepare and file a tax return each year. And these problems are systemic—they’re inherent in the Income Tax. No amount of tweaking can fix them. What’s needed is a real overhaul of the system, a dramatic new approach to the problem of how to finance Government. The FairTax, a bipartisan plan embraceable by Democrats and Republicans alike, represents the brightest hope for such reform.

The FairTax Bill (HR25) essentially calls for the elimination of all income, payroll, Social Security, Medicare, estate, and gift taxes, and replacing them instead with a National Sales Tax at the retail (consumptive) level. The rate of this tax would be set so as to make it *revenue-neutral*. That is, it would generate the same amount of revenue as our current income-based tax system. Aside from its “fairness”, the beauty of the FairTax is its simplicity. If you *buy* something as the final consumer of the thing—a pack of gum, a pair of swimming trunks, or a Boeing 747—you’ll pay a federal sales tax on it. Of course, that will add a little to the final cost of the item. But if people now get to keep their entire paycheck with no deductions ever withheld, if they never have to pay tax on what they earn, or even file a tax return ever again, that’s a trade-off most people would be happy to make.

The implications of such a shift would be staggering. For one thing, it would widen the tax base to include all consumers, even the so-called “underground economy”—drug dealers, prostitutes, and others, who earn and spend money in our society but don’t report their income or pay taxes because their earnings are *illegal*. These “deadbeat” taxpayers would now have to pay their fair share of tax like everybody else...because they buy clothes, cars, and toilet paper just like the rest of us. And whatever you buy, you’ll pay tax on! Their tax contribution alone would be a pretty good argument in favor of the FairTax. But there are so many other good reasons why a consumption tax like the FairTax is infinitely better than an income tax.

What We Tax, We Discourage...

The FairTax represents a bold step forward in the way we think about taxation. At the heart of it is the notion, that **it makes more sense to tax consumption than to tax income**. It is a fundamental truism that whatever we tax, we discourage. So if we tax *income*, it will have an inhibitory effect on people’s enterprise. Isn’t it a disincentive to working harder, if a large part of the income derived from such effort must be given up in taxes? Is this something desirable for our society, to discourage enterprise? No, ideally we want to encourage our citizens to be as hardworking and enterprising as possible! On the other hand, if we tax *consumption* instead of income, it will discourage consumption. Again it doesn’t *stop* consumption (people will still buy and consume what they need or want), but it will tend to encourage thrift and savings. Is this what we want as a society? Well, yes! It is exactly what we want! It’s what we need, especially at this time.

The FairTax Is a Progressive Tax

There is a general consensus in our society that the Rich should pay a greater portion of the tax burden than the Poor. Assuming we want to create such a *progressive* tax system, how do we measure “rich” and “poor”? Is *income* the best measure of wealth? Consider Mr. Frugal who earns \$500,000 a year but lives very modestly, spending only say \$25,000 annually of his substantial income. Now consider Mr. Lavish who earns \$250,000 a year (half of Mr. Frugal’s income), but he spends almost all of it on every indulgence that strikes his fancy. Which of the two are “richer”? Well, Mr. Frugal has more money in the bank. But Mr. Lavish certainly *experiences* more of what wealth feels like. Why? Because he **spends** his money more! Mr. Frugal does not. Mr. Frugal experiences essentially the same level of affluence as someone earning and spending \$25,000 a year. And yet under our current tax laws, he would generally owe much more in taxes than Mr. Lavish, simply because his enterprise creates more *income*. This is neither *fair* nor *progressive* nor does it *benefit* society in general. Mr. Frugal’s enterprise and hard work should not be “rewarded” with a bigger tax bill simply because they earn him more money which he squirrels away in a bank. Until he starts spending that money, he’s not really deriving much *benefit* from his “wealth”. Mr. Lavish should pay more taxes than

Mr. Frugal, because he *enjoys* his wealth more—by spending it more extravagantly. The point here is this: **The true metric of affluence is not how much we *earn*, it's how much we *spend*!** Because it's only when we *spend* our money that we get to experience the benefit of our wealth! Taxing income discourages enterprise itself. It's not something we should seek to do as a society. But that's precisely what our Income Tax does. Taxing *consumption* makes a lot more sense. It should also be noted that by saving his money in a bank and not spending it, Mr. Frugal actually helps to make more capital available to entrepreneurs, which ultimately expands the economy and creates more jobs. Society as a whole is much better served by a system that encourages thrift and savings over waste and spending. The FairTax does just that.

The Entrenched "Culture" of Taxation

The bureaucracy and inefficiency in administering the current tax system is another compelling argument in favor of the FairTax. Tracking income for every citizen of this country is a hopelessly impractical task. There are too many ways to hide or disguise income, not to mention the cases where earnings might simply have been innocently or unintentionally forgotten. The resources wasted in trying to enforce compliance with the tax laws are truly staggering, not only on the government side with the IRS, but also on the private side as well, with ubiquitous tax advisors, tax preparers, attorneys, accountants, and other auxiliary services that comprise the so-called Tax Industry. It's true, if the FairTax were enacted, there would be some serious economic displacement of workers currently employed in this significant sector of our economy. With no need for an individual or corporation to ever file a tax return, calculate salary withholdings, or prepare for an audit, many of these workers would be out of a job. Consider, however, that these people don't contribute anything of real value to the economy or society-at-large, other than to advise people how to avoid paying taxes! (And what kind of convoluted "benefit to Society" is that?!!) These workers just sustain an antiquated and hopelessly inefficient tax system. If a much better tax system that requires far fewer people to administer is available, isn't Society much better served in the long run if these workers are migrated into other vocations that might actually contribute to the GNP? The FairTax does not require a huge IRS-type bureaucracy. Monitoring sales on the retail level and requiring retailers to send in the taxes collected (as they already do now with state sales tax) is much simpler than the herculean task of monitoring the earnings of every man, woman, and child in the country and requiring them to file and pay their income taxes. The simplicity of a retail sales tax would make it very difficult for retailers to cheat without being caught. The IRS could be replaced by an organization a small fraction of its current size.

Imagine...

So with the FairTax, there'd be far greater administrative efficiency, less cheating, wider inclusion of all citizens in the tax base, and significant cost savings realized by businesses throughout the economy. Indeed, **the FairTax fixes almost all systemic problems associated with the Income Tax!** Imagine an economy where corporate decisions are based entirely on whether something makes sense from a *market* point of view, not so-called "tax considerations". Imagine the competitive advantage our products would enjoy both here and abroad if the costs associated with corporate income tax were eliminated as a price element. Imagine the influx of capital into this country as foreign corporations rushed to bring their operations here to enjoy that same competitive advantage. There'd be jobs, growth, opportunity, and above all, a sense of relief from the crushing burden of having to annually account for ourselves to our government. Indeed, imagine a system where our lives don't have to stop each year around April 15th while we tear our hair out trying to maneuver through our tax returns. April 15th would become just an ordinary day, like any other...

Protecting the Poorest Among Us

A sales or consumption tax is inherently a *progressive* tax—the Rich will pay more because they spend more; the Poor will pay less because they spend less. But there are legitimate concerns that, even though the wealthy will certainly pay more tax in absolute dollars, poor people, who often must spend everything they earn just for basic necessities, will end up paying a greater *portion* of their modest incomes on tax. Well, the FairTax bill has a built-in feature that shields the less affluent from any adverse effects of the sales tax. It's called the Family Consumption Allowance, commonly referred to as the *Prebate*. It works like this: The government sets and maintains guidelines as to what level of income constitutes the "poverty line"—i.e., what it costs to afford the bare necessities of life. In 2005, for example, for a family of four, this was determined to be \$19,758 a year, *exclusive* of any consumption tax that would be paid, or \$25,660 a year, *inclusive* of the tax. Under the FairTax, if that entire \$25,660 were spent during the year, presumably on basic necessities, \$5902 of it would constitute the amount of consumption tax paid ($23\% \times 25660 \approx 5902$). The FairTax provides that every family of four in the United States would automatically receive \$5902 rebated back to them over the course of the year, or more accurately, "pre-bated" (ahead of time), in the form of a monthly check for approximately \$492 ($5902 \div 12 \approx 492$). So every family of four would receive this \$492 prebate check each month. There's no "poverty requirement" to qualify; every family of four gets it, regardless of income. For a family of one, it's figured to be \$183 per month; and for each dependent child, it works out to around \$62 (again, based on data for the year 2005). These monthly checks will compensate taxpayers for

the taxes paid on basic necessities. In other words, under the FairTax, we only pay tax on spending over and above the essential expenditures of life. This will insulate the poorest among us from having to pay any tax at all, and indeed some may find the monthly payments afford them an actual surplus.

The Analysis Has Been Done...

The FairTax Bill is one of the most thoroughly researched pieces of legislation ever introduced. Economists at Harvard, MIT, Stanford, Rice and Boston University, as well as several private economics research foundations, were all consulted on the FairTax. They've studied it, constructed elaborate computer models, run sophisticated simulations, analyzed results, and come to the definitive conclusion that a National Sales Tax, as an alternative to the Income Tax, would create almost incalculable positive effects on the National Economy. The authors of the FairTax bill, in consultation with the economists from these institutions, have chosen a very conservative "worst-case" initial inclusive tax rate of 23% to guarantee that the Sales Tax would be revenue-neutral *from the outset*, yet it would still preserve the Prebate that reimburses consumers for the taxes paid on baseline necessities. Although 23% is the initial rate specified in the bill, it is believed that this figure is probably too high, and there is provision for the tax rate to be very quickly adjusted down from this initial figure if swelling treasury surpluses start to indicate that we've overshot the mark of revenue-neutrality.

There is disagreement as to how low this rate could fall. It is estimated that on average, 22% of the cost of a retail item represents the cost for the manufacturer, wholesaler, and retailer of that item to comply with the income tax laws. (And less than half of that actually ends up in government coffers—the rest is wasted in red tape and paperwork, maintaining a staff, keeping records, reporting earnings, deductions, withholdings, etc. to the imperious IRS.) Imagine if tax compliance were eliminated as a cost in the supply chain of manufactured goods. Competition would force manufacturers to pass those savings along to the consumer. Consider a widget that now costs \$1.00. If the widget maker no longer had to report or pay any tax on income, it would cost them 22% less to bring the product to market. So instead of a dollar, the item could sell in the store for \$.78, before any taxes were added on ($\$1.00 - .22 = .78$). The tax on such an item would be 23 cents, for a total cost to the consumer of \$1.01. Now how was that figured? Well the rate represented by that 23 cents of tax can be characterized in two ways—exclusively or inclusively. In *exclusive* terms, the 23 cents is 29.87% of the pure cost of the item, *exclusive* of the tax (29.87% of $.78 = .23$). So the *exclusive* rate of the FairTax is 29.87%. Alternatively, you can think of that 23 cents as 23% of the total cost of the item--*inclusive* of the tax (23% of $1.01 \approx .23$). So the *inclusive* rate of the FairTax is 23%. It's the same tax, just two different ways of describing the rate. If you figure the rate *exclusively*, with respect to just the pre-tax cost of the item itself, it's 29.87%. If you figure it *inclusively*, with respect to the total cost of the item, it's 23%. Income tax rates are generally figured inclusively. (If you make \$100,000 and you pay \$30,000 in income tax, you figure you've paid 30% in tax, right?) So to compare apples-to-apples, we usually quote FairTax rates inclusively too—23%. In any case, the out-the-door cost of the widget would be around \$1.01—only 1% more than we're paying right now! And in exchange, we get to keep all the money we earn, never have to pay income tax or file a tax return ever again, **and** receive a Prebate check every month to compensate for the consumption taxes paid on basic necessities! Is that a trade-off worth making? Most would say, absolutely!

No one knows for sure what the final savings would be. There is no way to estimate all the secondary effects from the efficiencies that would result from the FairTax. When a company no longer needs to maintain a team of tax accountants working in "Legal" (all they'd really need is one or two people to keep the books for their internal purposes), how much cheaper could they then sell their widgets? And really, do all those tax specialists add anything of value to the widget? No, their sole purpose is just to guide the company through the minefield of corporate taxation! Once these efficiencies take hold and propagate through the economy, increasing productivity and lowering costs, there's no telling how much cheaper the cost of goods out-the-door may end up, *even with the FairTax added on*. **And if we made it the practice that items priced in a store would carry the final, out-the-door cost to consumers (i.e., inclusive of all sales tax), the whole burden of paying taxes would become virtually painless and transparent!** We'd just get used to the idea that the cost of items we buy in the store also includes a little something to keep the government afloat, and we'd accept that—because now, *we get to keep all the money we earn!* There'd be a lot more positive feeling toward the government and its relationship with us.

It's time...

When properly explained, there is virtually no counter-argument to the FairTax. Yet its elegance and practicality have been ignored by politicians and pundits alike for way too long. As we witness the rancorous divisions taking place now over deficits and debt, spending and revenues, those of us who understand the FairTax can only watch in horror as our so-called "leaders" dither back and forth over loopholes and marginal tax rates, trying to "fix" a hopelessly flawed and inefficient income tax code, when in fact, there is a much better way to go...the FairTax. Please stop ignoring this obvious solution to our nation's fiscal problems.