A FairTax® whitepaper

Administration of the FairTax

Does the FairTax Really Abolish the IRS?

In a word, YES. The FairTax, unlike a flat income tax, eliminates the IRS both symbolically and literally. For an orderly end to the income tax system, the IRS is phased out within 3 years of the effective date of the FairTax, HR25/S155. A phase out period is necessary allow the collection and audit of the final year of income taxes and payroll taxes. At the end of the three year period, HR 25 provides that appropriations for the Internal Revenue Service shall not be authorized after the end of fiscal year 2019.

But the FairTax also eliminates not just the IRS as an institution, but all that is encompassed by the federal enforcement apparatus and its heavy hand. When people conceptualize the IRS, they see all it entails – compliance costs, burdens, and privacy intrusions. In 2014, the IRS has embroiled its citizens in more than 71,113 litigation actions, with 77 of 100 involving small businesses. Taxpayers sustained 2.0 million levies. Consider for example, that in 2010, the IRS assessed 40,357,481 Americans $25.6 billion in civil penalties ($13.1 billion penalties for the individual income tax alone) simply to enforce a system to fund government.[1] There has got to be a better way.

The FairTax wholly exempts individuals from ever having to file a return. Business-to-business transactions are fully exempt; businesses that serve other businesses neither collect nor pay taxes. Retailers, most of which already collect state sales taxes (in the 45 states that have them), are provided a an administrative credit for collecting the FairTax and remitting it to their state sales tax authority. Even if all approximately 25 million business establishments in the U.S. were retailers, the number of tax filers would decrease by 86 percent (we could expect the number of businesses remitting the FairTax to be far less).

The failure to eliminate either the IRS or the symbol of compliance costs it represents is the reason the flat tax and other tax reform plans cannot be considered permanent reform.

If not the IRS, then who?

The FairTax will be administered as a federal-state cooperative effort. Chapter Four of the FairTax legislation lays out the parameters of the system. (A section by section summary appears at the end of this paper.)

The Case for Federal-State Cooperative Administration of the FairTax. The simplicity and efficiency of the sales tax is what has caused its spread from its inception in 1932 in Mississippi to 45 states and Washington, D.C. Today, 98 percent of the U.S. population is covered by state

[1] 2014 IRS Data Book.

or – in the case of Alaska – local sales taxes. Over seventy years, state sales tax authorities have amassed great expertise in the administration and collection of sales taxes, performing these activities much more efficiently than could be done by a centralized agency of the federal government. In 2012, state sales tax authorities collected $245 billion in sales taxes and over $315 billion when local sales taxes are included.[2]

Thus, a strong case exists for the state administration of a federal sales tax. State governments already have the administrative structure and databases necessary to implement a national sales tax. Utilization of this existing structure to implement the FairTax will substantially lower the "startup" costs and reduce the timeline associated with the implementation of a national retail sales tax compared to what there would be if implementation were done by the IRS which has zero experience in the administration of general sales taxes.[3]

Federal-state cooperative tax collection programs already exist, a noteworthy example is the federal-state unemployment compensation program. The federal unemployment tax provides the revenues to fund the administration of the program. However, the states are fully responsible for the administration, collection and enforcement of state unemployment taxes which fund unemployment benefits. The states collect the taxes and transmit the revenues to the US Treasury unemployment benefits trust fund. The USDOL Office of Unemployment Insurance is responsible for providing oversight and policy guidance to the Federal-State unemployment compensation program to ensure conformity and substantial compliance of State law, regulations, rules, and operations with Federal law. The USDOL Office of Unemployment Insurance oversees federal and state activity in the unemployment trust fund. It determines administrative fund requirements and provides money to states for proper and efficient administration, sets broad overall policy for administration of the program, provides technical assistance, and monitors state performance.

Likewise, to provide federal oversight, the FairTax creates an Office of Revenue Allocation in the Treasury Department to monitor enforcement of the FairTax by the states, to resolve disputes between states and a place to appeal enforcement actions. The Secretary of the Treasury is given the authority to promulgate regulations, to provide guidelines, to assist states in administering the FairTax, to provide for uniformity in the administration of the tax, and to provide guidance to the general public.

The FairTax also allows the Administering States to keep one-quarter of one percent of the federal sales taxes it collects and remits timely to the US Treasury – an annual total of $7.5 billion. A study by the Beacon Hill Institute showed that the costs to administer the federal-state FairTax taxation system would be significantly lower than the cost to administer the existing federal income tax system it replaces.[4] A letter from the Office of the Comptroller, State of

[2] US Bureau of the Census, 2012 Census of Governments, *Finance --- State and Local Government Summary Report*, Appendix Table A-1.
[3] Dronenburg, Ernest J. SAFCT: State Administered Federal Consumption Tax: The Case for State Administration of a Federal Consumption Tax, paper presented at NYU Annual State and Local Taxation Conference, New York, Nov. 30, 1995.
[4] David G. Tuerck, Paul Bachman, and Alfonso Sanchez-Penalver, "Tax Administration and Collection Costs: The FairTax vs. the Existing Federal Tax System," The Beacon Hill Institute at Suffolk University, September, 2007.

Texas, to Americans For Fair Taxation, states that the one-quarter percent administration fee would more than cover the costs to the State of Texas to administer the FairTax within the state.

How would it work?
Administering States would enter into a cooperative agreement with the U.S. Treasury Department governing the administration of the FairTax by such state. Such an agreement includes provisions for the speedy transfer of tax monies collected, contact persons, dispute resolution, information exchange, confidentiality, and taxpayer rights. States that do not have a state sales tax or states that do not want to administer the FairTax have two options: They may contract with another state that has a state sales tax to administer the tax, they may contract with the federal government to administer the tax or they may do nothing and the federal government will directly administer the FairTax within that state. If a state is collecting the FairTax on behalf of another state, both states and the federal government must sign the agreement.

Each state may choose whether or not to conform its state sales tax base to the FairTax base; however, doing so enables the conforming states to collect state sales tax on sales made by remote sellers outside the state to a destination within that state. According to the National Conference of State Legislatures, states will lose an estimated $23.3 billion in 2012 from the current Supreme Court prohibition against collecting sales tax from online and catalog purchases. The FairTax allows conforming states to capture this revenue.

What About the Prebate?
Administration of the FairTax prebate by the federal-state cooperative system would also be far simpler than administering the Earned Income Tax Credit, other tax credits, or deductions under the current system – far cheaper and far less intrusive. The cost to administer the prebate is miniscule compared with the combined compliance costs and administrative burden of the income tax. The States will receive and process the prebate applications and maintain a database of qualified households; most of the states can use their list of state income tax filers as a starting point. When the state sales tax authorities process the prebate applications they will validate all names and Social Security numbers against the Social Security Administration (SSA) database. States already do this in relation to the administration of other state/federal cooperative programs such as unemployment benefits and child support enforcement.

In accordance with instructions from each qualified family, the SSA will provide the prebate in the form of a paper check via U.S. Mail, an electronic funds transfer to a bank account, or a "smartcard" that can be used much like a bank debit card—already in use by states to provide the federal Supplemental Nutrition Assistance Program (SNAP) to qualified residents. The National Taxpayers Union estimated that the cost of mailing monthly prebate checks via the U.S. Post Office would be approximately $260 million.[5] To the extent the SSA uses electronic funds transfer/direct deposit and "smart card" technology; this amount would be reduced substantially. According to the SSA, Office of the Chief Actuary, over 92% of social security benefit payments were paid with direct deposit in 2011. All SNAP benefits are now being issued via EBT. States already work with contractors to procure their own EBT systems for delivery of SNAP and other state-administered benefit programs.

[5] Update of National Taxpayers Union estimate to account for first class postage increase and an increase in the number of households.

The estimated number of households for 2015 is 124 million. Assuming 100 percent participation by all eligible households, the maximum cost of the prebate would be $587 billion. For comparative purposes, this amount is less than one-half of the amount of tax expenditures (standard deductions, personal exemptions, Earned Income Tax Credit, mortgage interest and charitable contribution deductions, and various other tax preferences) doled out under the current federal income tax system that are repealed when the FairTax is enacted. For 2014, the total of all of these tax breaks is estimated to be $1.2 trillion.[6]

SECTION BY SECTION SUMMARY: CHAPTER 4—FEDERAL AND STATE COOPERATIVE TAX ADMINISTRATION

Chapter 4 of the FairTax legislation (HR 25/S 155) provides for collection of the FairTax by state sales tax authorities and specifies how the federal government and the states jointly administer the tax.

SEC. 401. AUTHORITY FOR STATES TO COLLECT TAX.

The FairTax on the use or consumption of goods and services within a particular state is administered by that state, if that state is an Administering State.

An Administering State includes any state which has a state sales tax, and that enters into a cooperative agreement with the U.S. Treasury Department governing the administration of the FairTax by such state. Such an agreement includes provisions for the speedy transfer of tax monies collected, contact persons, dispute resolution, information exchange, confidentiality, and taxpayer rights. Administering states are required to submit taxes collected to the US Treasury within five days after receipt. To ensure timely transmission, an interest rate of 150 percent of the federal short-term rate must be paid on amounts remitted after the due date. Administering States are allowed to retain one-quarter percent of the FairTax receipts remitted timely.

States that do not have a state sales tax or states that do not want to administer the FairTax have the following options: They may contract with another Administering State to administer the FairTax in their state, they may contract with the federal government to administer the FairTax or they may do nothing and the federal government will directly administer the FairTax within that state. If an Administering State is collecting the FairTax in another state, both states and the federal government must sign the agreement. States such as California, Texas and Florida have large and sophisticated tax administration infrastructures that could handle the tax receipt processing for nearby states.

If an administering state, on a regular basis, has failed to timely remit FairTax receipts to the U.S. Treasury, has breached the cooperative agreement, or has failed to cure deficiencies within a reasonable time period, the U.S. Department of the Treasury may revoke the authority of that state to administer the FairTax within its borders. This would be subsequent to a decision by a U.S. District Court within that state. A state that has had its administering authority revoked

[6] Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government, Fiscal Year 2015* (Mar. 2014) at Tables 14-1 to 14-4.

cannot reapply to be an administering state for at least five years after such revocation. After eight years, the state will be regarded without prejudice as eligible to again become an administering state.

SEC. 402. FEDERAL ADMINISTRATIVE SUPPORT FOR STATES.
The Secretary of the Treasury is required to administer a program to facilitate information sharing among the administering states. The Secretary shall facilitate or be a member of a compact of the states for the purpose of facilitating the taxation of interstate purchases.

Each state may choose whether or not to conform its state sales tax base to the FairTax base. The FairTax encourages states to do this, authorizing the Secretary of the Treasury to enter into an agreement with the conforming states which enables the conforming states to collect state sales tax on sales made by sellers without a particular state to a destination within that state. Example: If Florida and Texas decide to conform their state sales tax bases to the FairTax, then internet or mail order sales from Texas to residents of Florida are subject to the Florida sales tax. Currently, the U.S. Supreme Court has ruled that states cannot collect state sales taxes on most internet or mail order sales to their residents. In, 2008, the revenue losses to states from this prohibition are estimated to be between $21.5 billion and $33.7 billion.

The Secretary of the Treasury is given the authority to promulgate regulations, to provide guidelines, to assist states in administering the FairTax, to provide for uniformity in the administration of the tax, and to provide guidance to the general public.

SEC. 403. FEDERAL-STATE TAX CONFERENCES.
To ensure state feedback into the federal – state cooperative system, the Treasury Department is required to host a conference each year with the sales tax administrators from the various administering states to evaluate the condition of the national sales tax system, to address issues of mutual concern, and to develop and consider proposals to improve the tax system.

SEC. 404. FEDERAL ADMINISTRATION IN CERTAIN STATES.
The federal government will administer the FairTax directly in States that are not Administering States or that have not elected to have another State administer the FairTax within its borders.

SEC. 405. INTERSTATE ALLOCATION AND DESTINATION DETERMINATION.
The FairTax or national sales tax is a destination-principle tax. Rules are required to clearly determine under what conditions a sale is taxable in the U.S., and in which state the sale occurred. Taxes collected shall be allocated to the state that is the destination of the taxable property or service.
The following list specifies the destination of the sale for different types of goods or services:

- Tangible personal property (goods) – where the property was first delivered to the purchaser
- Real property – where the property is located
- Other property – the location of the residence of the purchaser
- Services – where the use or consumption of the services takes place
- Telecommunications services – the location of the residence of the purchaser

- Domestic transportation services – the destination of the trip
- International transportation services – the taxable service amount shall be 50 percent attributable to the United States destination or origin. So 50 percent of an international flight to or from the United States is taxable.
- Electrical service – the location of the residence of the purchaser
- Financial intermediation services – the residence of the purchaser
- Rents paid for the lease of property – where the property is located while in use
- Rental of vehicles less than one month – where the vehicle was originally delivered to the renter or lessee
- Rental of vehicles greater than one month – the location of the residence of the renter or lessee

The Secretary of the Treasury is required to establish an Office of Revenue Allocation to arbitrate any disputes between states regarding the destination of sales for purposes of allocating sales tax revenue among the states. States objecting to such determinations of this office may request judicial review in any federal court of competent jurisdiction. The court shall use “abuse of discretion” for the standard of such review.

SEC. 406. GENERAL ADMINISTRATIVE MATTERS.

The Secretary of the Treasury and each Administering State may employ such persons as necessary for the administration of the FairTax and may delegate to employees the authority to conduct hearings, prescribe rules and regulations, and perform other such duties.

In the event that the Secretary of the Treasury and any Administering State have issued inconsistent rules or regulations, those issued by the Secretary of the Treasury shall govern.

No government ruling related to the FairTax can take effect until 90 days have elapsed after its publication in the Federal Register – a federal government publication which provides notice to the public of proposed rule changes.

The Secretary of the Treasury will invite the Chief Counsel for Advocacy of the Small Business Administration to comment on the impact on small businesses of any proposed FairTax regulation. The Chief Counsel for Advocacy will have 30 days to submit his comments. If such comments are received, the Secretary will consider them and discuss them in the preamble to the regulation.

The FairTax is subject to “The Small Business Regulatory Enforcement Fairness Act” and the “Regulatory Flexibility Act” as a small business regulatory safeguard.

SEC. 407. JURISDICTION.

Federal and state authorities have concurrent jurisdiction but the federal authorities have the power to override state authorities in connection with the federal sales tax. For example, the purchase of a car by a state resident is subject to the state sales tax in the state where the sale occurred and that same purchase is also subject to the federal sales tax (FairTax).

What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16^{th} Amendment. This nonpartisan legislation (HR25/S155) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans for Fair Taxation® (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

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