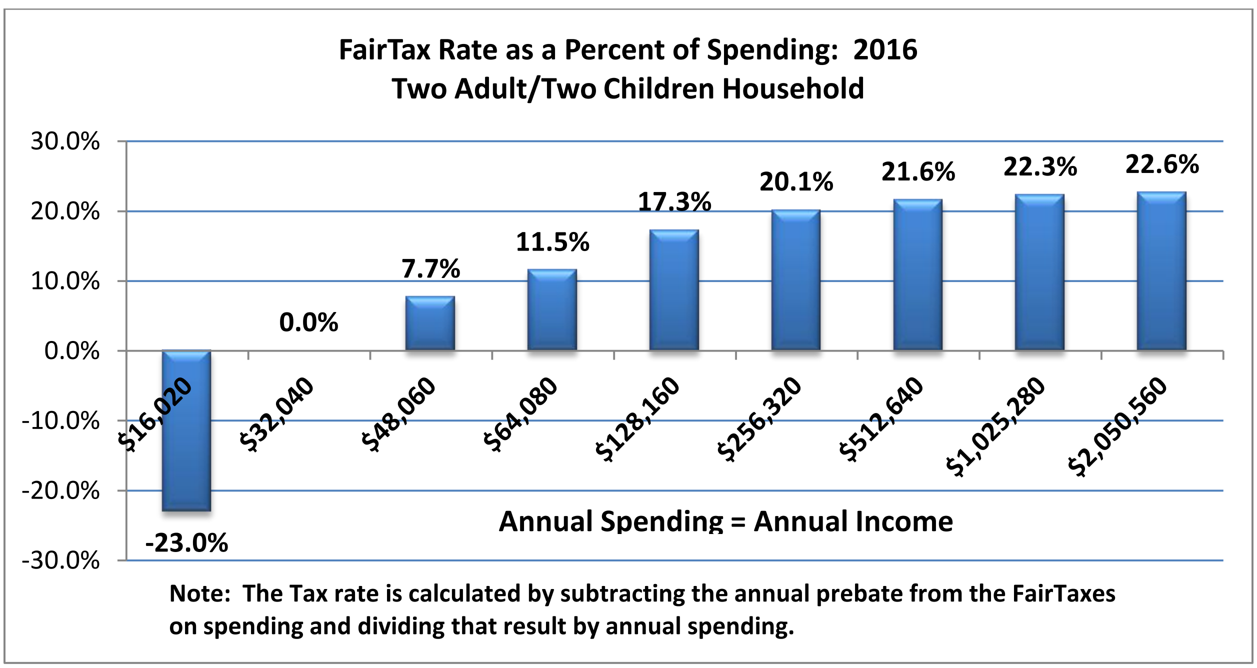
A FairTax® whitepaper

The FairTax prebate explained

Under the FairTax, all Americans consume what they see as their necessities of life free of tax. While permitting no exemptions, the FairTax (HR25 / S155) provides a monthly, universal prebate to ensure that each family unit can consume tax-free up to the poverty level, with the overall effect of making the FairTax progressive in application. This is not an entitlement, but a rebate (in advance) of taxes paid – thus the term prebate. Everyone pays taxes at the cash register.

Although everyone pays the same tax rate at the cash register, the chart below shows that the effect of the prebate is to increase the actual tax rate (annual taxes paid as a percentage of annual spending) as the level of spending increases, a progressive tax rate structure. For example, a two adult/two child family spending at the poverty level has an 0% effective tax rate because the annual prebate of $7,328 refunds all of the taxes they pay on their annual spending of $32,040. Whereas someone spending at twice the poverty level has an effective tax rate of 11.5%, and so on. Annual spending would have to reach fifteen million dollars to reach the statutory rate of 23%.



Calculation of the prebate: The monthly prebate check is calculated by multiplying the annual consumption allowance as measured by the Department of Health and Human Services poverty guidelines times the FairTax rate and dividing by twelve. Poverty level spending represents what it costs families of varying household size and composition to buy their necessities. The table below shows the monthly prebate amount for households of varying composition.

2016 FairTax Prebate Schedule

One-adult household				Two-adult household			
Size of Family	Annual Consumption Allowance	**Annual Prebate**	Monthly Prebate	Size of Family	Annual Consumption Allowance	**Annual Prebate**	Monthly Prebate
1 person	$11,880	**$2,732**	$228	Couple	$23,760	**$5,465**	$455
and 1 dependent	$16,020	**$3,685**	$307	and 1 dependent	$27,900	**$6,417**	$535
and 2 dependents	$20,160	**$4,637**	$386	and 2 dependents	$32,040	**$7,369**	$614
and 3 dependents	$24,300	**$5,589**	$466	and 3 dependents	$36,180	**$8,321**	$693
and 4 dependents	$28,440	**$6,541**	$545	and 4 dependents	$40,320	**$9,274**	$773
and 5 dependents	$32,580	**$7,493**	$624	and 5 dependents	$44,460	**$10,226**	$852
and 6 dependents	$36,730	**$8,448**	$704	and 6 dependents	$48,610	**$11,180**	$932
and 7 dependents	$40,890	**$9,405**	$784	and 7 dependents	$52,770	**$12,137**	$1,011

For families/households with more than 7 dependents, add $4,160 to the annual consumption allowance for each additional dependent (includes grandparents, children, adopted children or children under legal guardianship). The annual consumption allowance is based on the DHHS 2016 HHS Poverty Guidelines as published in the Federal Register, January 25, 2016. The annual prebate equals 23% of the annual consumption allowance.

Qualification: All qualified families are entitled to receive the monthly prebate. A “qualified family” consists of all family members sharing a common residence. Family members include an individual and his or her spouse, children and grandchildren, parents and grandparents. Children/students living away from home are considered family members if they are registered as a student for at least 5 months out of the year and receive at least 50 percent of their support from the family unit. Children of divorced parents are considered to be family members of the custodial parent. Incarcerated individuals are not eligible to be a member of a qualified family.

In order for a person to be counted as a member of the family for purposes of determining the size of the qualified family, a person must have a valid social security number and be a lawful resident of the United States. Unlike the Earned Income Tax Credit, the application/registration form that families who choose to receive the prebate must file is simple and straightforward. Those choosing not to register will not receive a prebate. The registration form requires only the following information:

1. the name of each family member who shares the residence;
2. the social security number of each family member;
3. the name of the family member to whom the monthly prebate check should be paid;
4. a sworn statement that all listed family members are lawful residents, that all family members sharing the common residence are listed, and that no family members are incarcerated;
5. the address of the shared residence; and
6. the signature of all family members 21 years of age and older.

Administration: The Social Security Administration (SSA) will send out the monthly prebate on or before the first day of every month. Prebate payments can only be made to persons 18 years or older. If a family wishes to designate more than one person to receive the prebate, then the prebate payment will be divided evenly among those persons designated. Example: two single people sharing the same residence would be able to each get a prebate check.

Registration renewal: After the initial registration, any qualified family that fails to renew its registration each year, within 30 days of the family determination date, will cease receiving the prebate 90 days following the failure to register. However, the family can file to get up to six months of missed prebate checks later (with no interest on missed payments). A possible method of assigning registration renewal dates would be on the birth date of the person filing the application. Thirty (30) or more days before the annual registration date, the sales tax authority is required to mail a proposed registration to each qualified family that simply needs to be signed and mailed back in if the family's circumstances have not changed.

Administrative Cost: In accordance with instructions from each qualified family, 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. (This method is already in use to provide other benefits from the federal government.) The National Taxpayers Union estimated that the cost of mailing monthly prebate checks via the U.S. Post Office would be approximately $262 million.[1] This represents the maximum cost for distributing the prebate. 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 99% of Social Security benefit payments were paid with direct deposit as of June, 2013.

Fraud Prevention: When the state sales tax authorities process the prebate applications they will validate all names and social security numbers against the SSA database. States already do this in relation to the administration of other state/federal cooperative programs such as unemployment compensation benefits and child support enforcement. They will also check for duplicate social security numbers being claimed by different households to prevent more than one household listing the same person as a household member. Any duplicate social security numbers will have to be resolved before the prebate payment is made.

It is unlawful to willingly and knowingly file a false prebate claim. HR25 provides for both civil and criminal penalties. The civil penalty is equal to the greater of $500 or 50 percent of the claimed annual prebate amount not actually due plus repayment of any falsely due prebate amounts. A criminal penalty of imprisonment for up to one year may also be imposed.

Fiscal Impact: The estimated number of households for 2015 is 124.6 million. Assuming 100 percent participation by all eligible households, the maximum cost of the prebate would be $589 billion. For comparative purposes, this amount is only 44 percent of total tax expenditures (standard deductions, personal exemptions, Earned Income Tax Credit, mortgage interest and charitable contribution deductions, and various other tax preferences and loopholes) doled out under the current federal income tax system that are repealed when the FairTax is enacted. For 2015, the total of all of these tax breaks is estimated to be $1.339 trillion.[2]

[1] Update of National Taxpayers Union estimate of January, 2013 to account for increase in number of households.
[2] Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government, Fiscal Year 2015,* at Tables 14-1 to 14-4, Feb. 2015.

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 16th Amendment. This nonpartisan legislation (HR 25 / S 155) 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.

Karen Walby, Ph.D., Director of Research, Americans For Fair Taxation, March 21, 2016.
(AFFT Documents\Papers on a specific subject\explanation of prebate)