



## **FairTax FAQ's**

### **How is the Social Security system affected?**

Like all federal spending programs, Social Security operates exactly as it does today, except that its funds come from a broad, progressive sales tax, rather than a narrow, regressive payroll tax. Employers continue to report wages for each employee, though, to the Social Security Administration for the determination of benefits. The transition to a reformed Social Security system is eased while ensuring there is sufficient funding to continue promised benefits.

Meanwhile, Social Security/Medicare funds are no longer triple-taxed as under the current system: 1) when payroll taxes are initially withheld; 2) when those withheld payroll taxes are counted as part of the taxable base for income tax purposes; and 3) when the promised benefits are finally received.

### **Is there any provision in the FAIRtax bill to prevent both an income tax and a sales tax?**

The short answer is that there is no provision in the FairTax bill (HR 25) that would prevent having a national sales tax and the income tax. However, the FairTax legislation does three things that effectively dismantle the income tax: (1) it abolishes the IRS, (2) it repeals all statutory language having to do with taxing income and payroll (i.e., the Internal Revenue Code), and (3) it eliminates the filing of annual income tax returns to the federal government for over 140 million Americans. The 16th Amendment does not "require" an income tax, it only "allows" one, and the FairTax will have broken that egg in a million pieces. It would be extremely difficult to put that egg "back together again." Once the FairTax is enacted it would be an extremely daunting task for Congress to make people start filing income tax returns again. There would be a public uproar. Once the American public has experienced the freedom from filing income tax returns it's hard to imagine them tolerating going back. Furthermore, the sponsors of the FairTax are totally dedicated to the permanent repeal of the income tax. No current supporter of the FairTax would support the FairTax unless the entire income tax is repealed. There is a separate bill, HJR 16, which repeals the 16th Amendment to the Constitution but it must go through a different adoption process than HR 25. HJR 16 has to be passed by a two-thirds vote of members of both the House and the Senate and be approved (or ratified) by



three-fourths of state legislatures (38). We are currently laying the organizational groundwork for this push and have already started the educational process at the state level. Finally, the reality is that we already have both an income and a type of sales tax today. All of our U.S. produced goods and services are burdened with an “embedded” tax due to the cascading of income and payroll taxes paid by U.S. employers to the U.S. Treasury at every step of production. Of course, these costs are passed on to the ultimate payer, the customer. It’s fair to call these embedded taxes a “sales tax” because we pay it every time we buy any goods or services — we just don’t see it. The FairTax eliminates these embedded taxes, resulting in a single-rate national sales tax visible to all.

**Is the FAIRtax progressive? Do the rich pay more and the poor pay less as a percentage of their spending?**

Absolutely. The poor actually pay less than zero-percent retail sales tax on their spending. Much like with the earned income tax credit of today, the prebate may give them more money than they actually spend on retail taxes. Especially if they are frugal and buy mostly used products. On the other hand, the wealthy approach a maximum of 23-percent retail sales tax on their spending.

**Since business purchases are not taxable, how does the FAIRtax keep individuals from pretending to have a business so they can buy things tax-free?**

The FairTax has several features that make it difficult and very risky for persons to have a scam business in order to purchase items tax free. First, in order for any person to purchase items tax free for business purposes, the business has to be a registered seller and possess a registered seller certificate issued by the state sales tax authority. Registered sellers are expected to file monthly or quarterly sales tax returns with the state (depending on sales volume). The certificate enables the business to purchase tax free from wholesale vendors, but the vendor must retain a copy of the registration certificate to justify not having collected tax on the sale. When a business purchases items for business use from a retail vendor, they have to pay the tax on the purchase and take a credit against the tax due on their monthly sales tax return. They must keep invoices/receipts to document what they purchased and the amount of the purchase. They might also make note of the purpose of the purchase on the invoice.



Also, as registered sellers, they are subject to the possibility of being audited by the state. During such an audit, they will have to produce the invoices for all the "business purchases" that they did not pay sales tax on and will have to be able to show that they were bona fide business expenses. If they cannot prove this, then they will have to pay the taxes that should have been paid when the items were purchased, plus interest and penalties. The probability of being audited will be much greater than it is under the current system with its over 140 million tax filers. Under the FairTax, there will be less than 20 million businesses that will be filing sales tax returns and thus subject to the possibility of being audited. Thus, the probability of tax cheats getting caught will be much greater than it is today, making tax evasion riskier than it is today. Additionally, while the FairTax has much stronger taxpayer rights than does the current tax system, the FairTax legislation provides for a number of fines and penalties for noncompliance. It also authorizes a mechanism for reporting tax cheats and obtaining a reward. An example would be 1-800-TAX-CHET.

Another potential scam would be to have a "fake" family business in order to buy things for family members tax free. The FairTax has a specific provision to prevent this. Although it does not prohibit businesses from providing taxable property or services as gifts, prizes, rewards, or as remuneration for employment, the gift, reward, etc. is considered to be the conversion of property or services from business use to personal use and is therefore taxable. Likewise, there is a similar provision to prevent abuse of employee discounts. Under the FairTax, employer-provided employee discounts over 20 percent are taxable. The term "employee discount" means an employer's offer of taxable property or services for sale to its employees or their families for less than the offer of such taxable property or services to the general public. If the employee discount amount exceeds 20 percent of the price to the general public, then the sale of such taxable property or services by the employer to the employee is considered the conversion of property or services to personal use and is subject to tax. The taxable amount is the amount by which the discount exceeds 20 percent of the price to the general public.

**I know the FAIRtax rate is 23 percent when compared to current income taxes. What will the rate of the sales tax be at the retail counter?**

30 percent. This issue is often confusing, so we explain more here.



When income tax rates are quoted, economists call that a tax-inclusive quote: "I paid 23 percent last year." For every \$100 earned, \$23 went to Uncle Sam. Or, "I had to make \$130 to have \$100 to spend." That's a 23-percent tax-inclusive rate.

We choose to compare the FairTax to income taxes, quoting the rate the same way, because the FairTax replaces such taxes. That rate is 23 percent.

Sales taxes, on the other hand, are generally quoted tax exclusive: "I bought a \$77 shirt and had to pay that same \$23 in sales tax." This is a 30-percent sales tax. Or, "I spent a dollar, 77¢ for the product and 23¢ in tax." This rate, when programmed into a point-of-purchase terminal, is 30 percent.

Note that no matter which way it is quoted, the amount of tax is the same. Under an income tax rate of 23 percent, you have to earn \$130 to spend \$100.

Spend that same \$100 under a sales tax, you pay that same tax of \$30, and the rate is quoted as 30 percent.

Perhaps the biggest difference between the two is that under the income tax, controlling the amount of tax you pay is a complex nightmare. Under the FairTax, you may simply choose not to spend, or to spend less.

### **What will we experience in the transition from the income tax to the FairTax?**

Everyone will have to think about taxes in a different way. Income — what we earn — no longer has to be documented, measured, and tracked for tax purposes. The only relevant measure of our tax liability is the amount we choose to spend on final, discretionary consumption. Tax-related issues are suddenly a lot simpler and more straightforward than they used to be. The aggravation and anxiety associated with "April 15th " disappears forever after passage of the FairTax. The FairTax is not new — most Americans come into contact with sales taxes daily, since 45 states currently use them to collect state revenues. It is easier to switch from an income tax to the FairTax 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.

Job creation booms. Residential real estate booms. Financial services boom. Exports boom. Retail prospers. Farming and ranching prosper. Churches and charities prosper. Civil liberties are enhanced. In short, it is difficult to imagine the far-reaching, positive effects of this change. Though this tax policy is exactly what our Founding Fathers counseled us to do with the Federalist Papers and the Constitution.

### **What about value-added taxes (VATs), like they have in Europe and Canada? Are they not consumption taxes?**

While VATs are also consumption taxes, and better than income taxes, the FairTax is not a VAT. A VAT works very differently. It taxes every stage of production. It is much more complex and is typically hidden from the retail consumer. Second, in industrialized countries that have a VAT, it coexists with high-rate income tax, payroll, and many other taxes that, in some instances, have led to marginal tax rates as high as 70 percent. Third, all other industrialized countries, except Australia and Japan, have a much larger tax burden than the U.S., which requires higher rates and makes tax administration much more difficult. Lastly, a VAT is a lobbyist's dream, allowing them to install their loopholes unbeknownst to the purchaser. A retail sales tax, in contrast, is a lobbyist's nightmare, applied as it is under the bright lights of the retail counter.

### **Are gaming activities taxed under the FAIRtax?**

Yes, gaming activities are taxed under the FairTax; however, given the impracticality of taxing the purchase of lottery tickets or casino chips and the like, the tax is levied on the establishment running the gaming operations. The FairTax legislation (see excerpt below) requires a gaming establishment to register as a gaming sponsor. The tax is imposed on the gaming sponsor and must be remitted by the 15th day of each month for the gaming services sold during the prior month. The tax is computed by multiplying 23 percent times the gross receipts for gaming services received by the gaming business minus the sum of total gaming payoffs to chance purchasers and any other gaming taxes. Example: Offtrack betting is a gaming activity. The offtrack betting business pays taxes equal to 23 percent of its gross receipts for gaming activities (the total amount bet) minus the sum of the prize money paid to winners plus any state gaming taxes paid.

Under the income tax, casinos, etc. are already paying tax to the government for net profits and the employer share of payroll taxes, which go



away under the FairTax. Their compliance costs would decrease under the FairTax as well. Finally, people who gamble will have more gross take-home pay under the FairTax and big winners will not have to pay tax at the time of winning. So this is a win-win for all.

Below is the section of the FairTax bill, HR 25, specifying the taxation of gaming activities.

#### SEC. 702. GAMING ACTIVITIES.

(a) REGISTRATION- Any person selling 1 or more chances is a gaming sponsor and shall register, in a form prescribed by the Secretary, with the sales tax administering authority as a gaming sponsor.

(b) CHANCE DEFINED- For purposes of this section, the term `chance` means a lottery ticket, a raffle ticket, chips, other tokens, a bet or bets placed, a wager or wagers placed, or any similar device where the purchase of the right gives rise to an obligation by the gaming sponsor to pay upon the occurrence of (1) a random or unpredictable event; or (2) an event over which neither the gaming sponsor nor the person purchasing the chance has control over the outcome.

(c) CHANCES NOT TAXABLE PROPERTY OR SERVICE- Notwithstanding any other provision in this subtitle, a chance is not taxable property or services for purposes of section 101.

(d) TAX ON GAMING SERVICES IMPOSED- A 23-percent tax is hereby imposed on the taxable gaming services of a gaming sponsor. This tax shall be paid and remitted by the gaming sponsor. The tax shall be remitted by the 15th day of each month with respect to taxable gaming services during the previous calendar month.

(e) TAXABLE GAMING SERVICES DEFINED- For purposes of this section, the term `taxable gaming services` means-

(1) gross receipts of the gaming sponsor from the sale of chances, minus

(2) the sum of-

(A) total gaming payoffs to chance purchasers (or their designees); and

(B) gaming specific taxes (other than the tax imposed by this section)

imposed by the Federal, State, or local government.

#### **How will this plan affect compliance costs?**

It is estimated that Americans spend at least \$265 billion a year to comply with the tax code — nearly \$900 for every man, woman, and child in America. That is greater than the current federal deficit (\$205 billion).

Billions of dollars in compliance costs are wasted each year, and we have nothing of value to show for this expenditure — not one single productive



service or product is added to our nation's wealth. It is estimated that the FairTax dramatically cuts such compliance costs, perhaps as much as 95 percent.

### **How does the income tax affect our economy?**

How does dragging an anchor affect the speed of a ship? Our entire economy is not dependent on the income tax. Instead, our economy is held back by the income tax. There was no income tax for the first 124 years of our history — that's more than half the time we have existed as a nation. A study by the Government Accountability Office estimated that the federal tax system imposed efficiency costs on the U.S. economy of two to five percent of GDP. Under the FairTax, within ten years average Americans will be at least 10 percent and probably 15 percent better off than they would be under the current system. That translates to an increase of \$3,000 to \$4,500 per household, per year.

### **Why is it necessary to have a constitutional amendment?**

It is not the intention of this plan, or the desire of the American people, to end up with both a federal income tax and a federal sales tax. The objective is to ensure that one is replaced by the other, not added on top of the other. By repealing the 16th Amendment with companion legislation, we close the door on an income tax for generations to come. Further, the FAIRtax legislation has a seven year sunset clause to ensure Congress accomplishes repeal of the 16th Amendment.

### **How does the FAIRtax affect government spending?**

The public must remain vigilant to ensure that the economic gains caused by the FairTax benefit the people and the causes they deem worthy. However, it is easier to determine if your elected representatives are acting in your best interest. Legislators can more easily be held accountable for their decisions. For the first time in decades, it is simple to see whether a politician is advocating an increase in taxes or a restraint on government spending as the economic pie gets bigger. This is not the case today.

### **What assumptions have been made about government spending?**

The FairTax Plan is devised to be revenue neutral for the first year of operation. It raises the same amount of revenue as is raised by current law. After the first year, revenue is expected to rise because of the growth generated by this plan. At that time the American people, the Congress, and



the president will have to decide whether to lower the tax rate or to spend the additional revenue.

### **Is the FAIRtax just another tax scheme?**

The FairTax has nonpartisan support from people in all walks of life. From both major parties and several third parties. Its supporters need only have one common belief: That it is a fairer, simpler, more efficient way to raise federal revenue. The FairTax delivers these benefits to all American people and more. More government accountability for taxpayer dollars, a tax system that is less susceptible to being manipulated by special interests, a tax system that will make it easier — not harder — for the average person to get ahead, and perhaps most importantly, a tax system that provides real, honest, and transparent tax relief for those who need it most.

### **Could we end up with both the FairTax and an income tax?**

No current supporter of the FairTax would support the FairTax unless the entire income tax is repealed. Moreover, concurrent with the repeal of the income tax, a constitutional amendment repealing the 16th Amendment and prohibiting an income tax will be pushed through Congress for ratification by the states (filed as HJR 16 in the 110th Congress).

### **Can Congress just simply raise the rate once the FAIRtax is passed into law?**

Yes, of course Congress can raise the FairTax rate just as it could raise the flat tax rate or can and does raise the income tax rate. And if we in the grass roots allow them to do it, shame on us!

However, the FairTax is highly visible. And because there is only one tax rate, it will be very hard for Congress to adopt the typical divide-and-conquer, hide-and-disguise strategy employed today to ratchet up the burden gradually, by manipulating the income tax code. Ultimately, the tax rate will be dictated by the size of government. If government gets larger, higher tax rates will be required. If government shrinks relative to the economy, then the tax rate will fall. Federalist 21, by Alexander Hamilton, is a great read on the futility of government raising a consumption tax too high, and thus reducing revenues.

### **What about the flat tax? Would it be better and easier to pass?**

The flat tax and the FairTax share some important similarities. They are both flat-rate taxes that are neutral with respect to savings and investment. The



flat tax, however, retains the invasive income tax administration apparatus and can easily revert to a graduated, convoluted mess, as it has many times over many years.

Very few people really understand the flat tax. Its authors will tell you it is a consumption tax that uses the income tax system for implementation. Only an academic or government bureaucrat would dream up a consumption tax that needs the invasive income tax apparatus for its application, when one can simply have a retail sales tax and reduce the bureaucracy by 90 percent or more! In addition, a large part of the burden of the flat tax — the business tax — will remain hidden from people in the retail price of goods and services.

In contrast, the FairTax is simple, easy to understand, and visible. It cannot be converted into an income tax.

Under a flat tax, individuals would still file an income tax return each year similar to today's 1040 EZ. While this is a simple postcard, the record keeping required to fill in the blanks is still long and burdensome. Under the FairTax, individuals never file a tax return again, ever! Under the flat tax, the payroll tax would be retained and income tax withholding would still be with us. Under the FairTax, the payroll tax, which is a larger and more regressive tax burden for most Americans than is the income tax, is repealed. Under the FairTax, what you earn is what you keep. No more withholding taxes; no more income tax.

Notwithstanding flat tax proponents' honorable intentions, income tax reform has been less than a success in the past. Congress has tried to reform the income tax again and again, with the result being greater complexity and, generally, higher rates. The problem is the income tax, and it is time to stop tinkering with it.

Flat tax supporters have made major political attempts to pass their reform, including the efforts of former Majority Leader Dick Armey and presidential candidate Steve Forbes, and yet their efforts have not progressed politically for several years. With every debate, the flat tax loses grassroots and congressional support to the FairTax. It is time to junk the entire income tax system and start over with a tax system that is more appropriate for a free society and better able to meet the needs of the information age.

**What other significant economies use such a tax plan?**



Two of the largest economies in the world rely almost solely on sales taxes: Florida and Texas. Many civilizations in history have relied solely on transaction-based consumption taxes: A percentage of a grain shipment in exchange for a safe harbor. Even a cursory study of history shows that nation/states that relied on consumption taxes flourished and prospered, supported democracies/republics, had expanding economies, and high levels of civil rights for their citizens. The exact opposite is true for empires that relied on income/poll/head taxes. These taxes were used to support despots, eventually collapsed the economies in which they were applied, and sundered civil rights.

The sales tax is a familiar tax, being a major source of revenue in 45 states and the District of Columbia. It is true, however, that no post-industrial nation, until now, has ever repealed its income tax and replaced it with a federal retail sales tax. However, England did repeal its detested income tax upon the defeat of Napoleon and enjoyed the fastest, longest expansion of its economy in its long history. An expansion that ended only with the — you guessed it — re-imposition of an income tax.

No other country has a system of government like ours, and no other country has led the world in so many fields as ours. It was France and Germany that forced the imposition of a VAT in addition to income taxes across the European Community. Shall we follow France's lead?

In contrast, we can observe the Irish Miracle that stems from their refusal to join the EU members in imposing high tax rates and their choice to follow their own path on taxation. Thus, we should simply strive to have the best tax system, period.

### **Can the FairTax really be passed into law?**

Do women have the right to vote in this country? Did we pass Prohibition? Did we repeal it? Do Civil Rights guarantee freedoms far beyond the lunch counter and mass transit? Do free-market economies dominate Eastern Europe, peoples once under the boot of communism? All these were grassroots efforts that affected significant changes in our nation and the world. Is the current income tax system any less a yoke around the necks of otherwise free peoples? We think not.

Passing the original 16th Amendment and the income tax wasn't easy and repealing the income tax and the 16th Amendment won't be easy either.



That is why the FairTax has undertaken to build a grassroots movement and grassroots alliances to support the effort. When the FairTax generates unprecedented economic growth in the first few months of its effective date, citizens nationwide will make it clear to Washington that they want to make the change permanent. But this will only happen when the American people rally behind the effort, throw off the yoke, and demand rectification of 90 years of wrongs done by the income tax.

### **Does the FAIRtax improve compliance and reduce evasion when compared to the current income tax?**

The old aphorism that nothing is certain except death and taxes should be modified to include tax evasion. Tax evasion is chronic under any system so complex as to be incomprehensible. As a percentage of gross domestic product (GDP), tax evasion in 2001 is beyond 2.6 percent, compared to 1.6 percent in 1991. This represents over 16 percent of taxes due. Almost 40 percent of the public, according to the IRS, is out of compliance with the present tax system, mostly unintentionally due to the enormous complexity of the present system. These IRS figures do not include taxes lost on illegal sources of income with a criminal economy estimated at a trillion dollars. All this, despite a major enforcement effort and assessment of tens of millions of civil penalties on American taxpayers in an effort to force compliance with the tax system. Disrespect for the tax system and the law has reached dangerous levels and makes a system based on taxpayer self-assessment less and less viable.

The FairTax reduces rather than increases the problem of tax evasion. The increased fairness, transparency, and legitimacy of the system induces more compliance. The roughly 90-percent reduction in filers enables tax administrators more narrowly and effectively to address noncompliance and increases the likelihood of tax evasion discovery. The relative simplicity of the FairTax promotes compliance. Businesses need answer only one question to determine the tax due: How much was sold to consumers? Finally, because tax rates decrease, tax evasion is less profitable; and because of the dramatic reduction in the number of tax filers, tax evaders are more easily monitored and caught under the FairTax system.

### **How does the FAIRtax affect illegal immigration?**

The FairTax replaces the federal income and payroll tax system with a national retail sales tax plus a prebate which makes spending up to the



poverty level tax free. This means that those living at the poverty level will pay a FairTax rate of zero percent. A person spending twice the poverty level would pay a spending tax rate of 11.5 percent; a person spending three times the poverty level would pay an effective rate of 17.3 percent, and so on.

The FairTax will, for the first time, tax undocumented workers who now evade U.S. income and payroll taxes. Under the FairTax, all persons living in the U.S. pay taxes, whether they are here legally or illegally.

Under our current tax system, many non-citizens do not pay income and payroll taxes, even though they are here earning wages and are legally required to do so. They may also be receiving benefits in the form of health care, education, roads, and much more. Under the FairTax, both lawful and unlawful residents will pay taxes when they purchase goods and services for consumption here; however, only lawful residents are eligible to receive the FairTax prebate which effectively eliminates taxes on spending up to the poverty level.

Unlawful residents will be paying a rate of 23 cents on every dollar spent since they are not eligible for the FairTax prebate. The only way to get the prebate and not pay taxes on the purchase of essential goods and services is to become a lawful resident. In this way, the FairTax helps promote legal immigration by ensuring that only lawful residents receive the prebate. It also ensures that unlawful residents contribute to the cost of providing services they receive.

The FairTax brings jobs back to America by allowing companies to operate on our soil tax free rather than paying the current corporate income tax of 35 percent. Under the FairTax, various economists have predicted higher economic growth ranging from 7 to 14 percent over the current system, more jobs, and higher wages. Such growth will create jobs for American citizens and legal immigrants.

### **What about border issues?**

It is unlikely that "shopping across the border" in Canada or Mexico will result in any cost savings to the consumer. Remember, the FairTax is revenue neutral and therefore price neutral. This means the relative cost of retail goods and services after the FairTax remains very close to the same levels found in the marketplace today. With regard to interstate competition,



since all states have the same federal sales tax rate, the federal sales tax is not an incentive to cross state lines to avoid the tax.

### **How are state tax systems affected, and can states adequately collect a federal sales tax?**

No state is required to repeal its income tax or piggyback its sales tax on the federal tax. All states have the opportunity to collect the FairTax; states will find it beneficial to conform their sales tax to the federal tax. Most states will probably choose to conform. It makes the administrative costs of businesses in that state much lower. The state is paid a one-quarter of one percent fee by the federal government to collect the tax. For states that already collect a sales tax, this fee proves generous. A state can choose not to collect the federal sales tax, and either outsource the collection to another state, or opt to have the federal government collect it directly. If a state chooses to conform to the federal tax base, they will raise the same amount of state sales tax with a lower tax rate — in some cases more than 50 percent lower — since the FairTax base is broader than their current tax base. States may also consider the reduction or elimination of property taxes by keeping their sales tax rate at or near where it is currently. Finally, conforming states that are part of the FairTax system will find collection of sales tax on Internet and mail-order retail sales greatly simplified.

### **What will happen to 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 FairTax 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 the FairTax.

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.

### **Should the government tax services?**

Service providers are not exempt from the income tax today, and should not be exempt from the FairTax. Services now account for well over one-half of the gross domestic product (GDP). Neither consumption of services nor consumption of goods should be tax preferred. And it is economically foolish not to tax the fastest growing segment of our economy. Competition, not politics, should determine what goods and services cost.

### **Why not just exempt necessities from the FAIRtax instead of providing for a rebate?**

The prebate is the most equitable and most efficient way to make the FairTax progressive. If the FairTax were to exempt necessities, the tax rate would have to be 20 percent higher than the FairTax rate with a prebate.

### **Does the FAIRtax tax used items?**

The FairTax does not tax “used” goods but it is important to note that HR25 has a legal definition of the term “used”. This is necessary to ensure that items are taxed only once and to prevent tax cheating.

Under the FairTax, for an item to be considered “used” it must be:

- (1) purchased before the FairTax is enacted, or
- (2) the FairTax on the item must have been previously paid.

Let’s look at (1) above. Assume that Joe bought a new car in January of 2012. Let’s further assume that the FairTax went into effect on Jan. 1, 2013. Since Joe owned the car before the enactment of the FairTax, it is considered a “used” car. It has the taxes from the existing tax system embedded in its price. Therefore, when Joe sells that car to Bill, Bill will not owe tax on the transaction.

Now, let’s consider (2) above. The most common example is that Joe buys a new car for personal use and pays the FairTax on it. If Joe then sells his car to Bill, there would be no tax on it because the tax had already been paid. Let’s look at another example. Assume that Joe owns a flower shop business



and buys a van to use when making deliveries to his customers. No tax is charged on purchases for business purposes so that the FairTax on goods sold to consumers does not double tax, or put a tax on a tax.

If Joe decides to sell the van to his friend Bill (who is not in business) for use as his personal vehicle, then it would be a taxable sale to Bill. Why? Because Joe did not pay tax when he bought the van for his flower shop. Since no FairTax has been previously paid on that van, it is not considered used and the sale to Bill would be taxable.

If later, Bill decided he did not like driving a van and sold it to someone else, it would not be a taxable sale. Why? Because the tax had been previously paid (when Bill bought it from Joe) making the item "used"; and not subject to tax.

### **How does the FairTax affect wages and prices?**

Americans who produce goods and earn wages must pay significant tax and compliance costs under the current federal income tax. These taxes and costs both reduce after-tax wages and profits and are then passed on to the consumers of those goods and services in the form of price increases. When the FairTax removes income, capital gains, payroll, and estate and gift taxes, the pre-FairTax prices of these goods and services will fall. The removal of these hidden taxes may also allow wages to rise. Exactly how much prices will fall and wages will rise depends on market forces. For example, in a profession with many jobs and too few to fill them, wages will likely increase more than in fields where there are too many employees and not enough jobs.

### **Is the FairTax fair?**

Yes, the FairTax 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.



## **Why is the FAIRtax better than our current system?**

Our present tax system is one of the reasons that people are finding it so difficult to get ahead these days. It is one of the reasons the next generation may not have a standard of living as high as this generation. Cars replaced the horse and buggy, the telephone replaced the telegraph, and the FairTax replaces the income tax. The income tax is holding us back and making it more difficult than it needs to be to improve our families' standard of living. It makes it needlessly difficult for our businesses to compete in international markets. It wastes vast resources on complying with needless paperwork. We can do better and we must.

## **How is the tax collected?**

Retail businesses collect the tax from the consumer, just as state sales tax systems already do in 45 states; the FairTax is simply 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 receive a fee for collection, and the states also receive a collection fee. The tax revenues from the states are then sent to the U.S. Treasury.

## **Is consumption a reliable source of revenue?**

Yes, in fact, consumption is a more stable source of revenue than income. The chart compares the yearly changes in the tax bases for the income tax (adjusted gross income — AGI) and the FairTax (personal consumption expenditures — PCE) for years 1974 to 2004. PCE has always grown from year to year, whereas AGI dropped from 2000 to 2001 and from 2001 to 2002 — two years in a row. The higher growth rates of AGI in boom years result in overspending and then when the economy slows down either budget cuts are needed or, what is more often the case, taxes are raised or the budget deficit increases.

## **How does the FairTax affect Social Security reform?**

FairTax.org is a one-issue organization: Tax replacement. However, its proposal does benefit any Social Security reform proposal. The FairTax.org plan does not change Social Security benefits or the structure of the Social Security system. All it does is replace the current revenue source (narrow, regressive payroll taxes) with a new revenue source (broad, progressive sales taxes paid by all consumers).



Additionally, research shows that consumption is a more stable revenue source than income. If Social Security is reformed or privatized in a way that reduces the government's need for revenue, then the FairTax rate can be reduced. For example, if a mandatory private savings program is implemented where people must save ten percent of their income and Social Security benefits are curtailed, then the FairTax rate can be reduced just as payroll taxes would be reduced.

### **Does the FAIRtax rate need to be much higher to be revenue neutral?**

The proper tax rate has been carefully worked out; 23 percent does the job of: (1) raising the same amount of federal funds as are raised by the current system, (2) paying the universal rebate, and (3) paying the collection fees to retailers and state governments. Unlike some other proposals, this rate has been independently confirmed by several different, nonpartisan institutions across the country. Detailed calculations are available in the research section.

### **Is the 23% FAIRtax higher or lower when compared to the income taxes people pay today?**

Most people are paying that much or more today — much of it is just hidden from view. The income tax bracket most people fall into is 15 percent, and all wage earners pay 7.65 percent in payroll taxes. That's 23 percent right there, without taking into account the 7.65 percent employer matching! On top of that, you have to add in the business taxes and associated compliance costs passed on to consumers in higher prices.

### **Effective tax rates vs. stated tax rates**

Because the 23-percent FairTax rate of \$0.23 on every dollar spent is not imposed on necessities, an individual spending \$30,000 pays an effective tax rate of only 15.5 percent, not 23 percent. That same individual will pay 17.3 percent of his or her income to federal taxes under current law.

### **Why not just exempt food and medicine from the tax? Wouldn't that be fair and simple?**

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.

Finally, 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 and must be stopped.

### **How does the prebate work?**

Under the FairTax, all Americans consume what they see as their necessities of life free of tax. While permitting no exemptions, the FairTax (HR25/S122) provides a monthly universal prebate to ensure that each family unit can consume tax free at or beyond the poverty level, with the overall effect of making the FairTax progressive in application. There is no marriage penalty as the couple gets twice the amount that a single adult receives.

While everyone pays the same tax rate at the cash register, the prebate results in effective tax rates (annual taxes paid divided by annual spending) that increase as the level of spending increases a progressive tax rate structure. For example, a person spending at the poverty level has a 0% effective tax rate, whereas someone spending at twice the poverty level has an effective tax rate of 11.5%, and so on.

### **Exactly what taxes are abolished?**

The FairTax is replacement, not reform. It replaces federal income taxes including personal, estate, gift, capital gains, alternative minimum, Social Security, Medicare, self-employment, and corporate taxes.

### **What is taxed?**

The FairTax is a single-rate, federal retail sales tax collected only once, at 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. A prebate makes the effective rate progressive.



How does the FAIRtax affect income tax preparers, accountants, and many government employees?

There are, of course, still some people who are involved in sales tax return preparation and sales tax administration under the FairTax, 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 the FairTax will provide plenty of new jobs.

But the heavy compliance costs of the income tax are like an anchor holding back economic growth. We have nothing to show for the \$265 billion (greater than the current federal deficit — \$205 billion) that we spend each year measuring, tracking, sheltering, documenting, and filing our annual income. Surely 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.

### **Will corporations get a windfall with the abolition of the corporate tax?**

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 the FairTax Plan, 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.

### **Does the FAIRtax burden the retail industry?**

All businesses are tax collectors today. They withhold income and payroll taxes from their employees. Moreover, the vast majority of retail businesses operating in states with a sales tax (45 states currently use a sales tax) are already sales tax collectors. Under the FairTax, retailers are paid a fee equal



to one-quarter of one percent of federal sales tax they collect and remit. In addition, of course, retailers no longer bear the cost of complying with the income tax, including the uniform capitalization requirements, the various depreciation schemes, and the various employee benefit and pension rules. Finally, the economic growth resulting from the aggregate, beneficial effects of dramatically lower income tax compliance costs and no payroll or income taxes, customers having substantially more money — the greatest influence on retail sales — and a reasonable fee for collecting the FairTax, all ensure that retailers do quite well.

### **How will the plan affect economic growth?**

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 FairTax as proposed raises the economy's capital stock by 42 percent, its labor supply by 4 percent, its output by 12 percent, and its real wage rate by 8 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.

### **What economic changes come at the retail level with the FAIRtax?**

Our baby boom generation has been trained to spend money before inflation eats it up or savings is taxed away. This group, for good or evil, will likely spend their initial pay raise. Others will recognize the advantages of savings and investment. There will be a whole new round of home refinancings. There will likely be a lot of interest in the actual cost of the federal government when consumers see their most recent contribution at the bottom of each retail receipt.

Since the FairTax plan is revenue neutral, the same amount of resources is extracted from the economy as is extracted under current law. These funds are, however, extracted in a less economically damaging way. Every known



economic projection shows the economy doing better, often much better, under the FairTax.

Because the economy grows, is more efficient and more productive, that means investment, wages, and consumption are higher than they are under the income tax.

### **How does this affect U.S. competitiveness in foreign trade?**

Because the FairTax is automatically border adjustable, the 17 percent competitive advantage, on average, of foreign producers is eliminated, immediately boosting U.S. competitiveness overseas. American companies doing business internationally are able to sell their goods at lower prices but at similar margins, and this brings jobs to America.

In addition, U.S. companies with investments or plants abroad bring home overseas profits without the penalty of paying income taxes, thus resulting in more U.S. capital investment.

And at last, imports and domestic production are on a level playing field. Exported goods are not subject to the FairTax, since they are not consumed in the U.S.; but imported goods sold in the U.S. are subject to the FairTax because these products are consumed domestically.

### **I'm in the military, how will the FAIRtax affect me?**

Under the FairTax, the purchase of goods at military exchanges and commissaries by consumers is taxable because the FairTax is a federal sales tax. The FairTax repeals the entire federal income tax and payroll tax system so military personnel would no longer have to pay tax on benefits of any kind and they would get their whole paycheck (no income tax withholding or payroll tax deductions would be taken out). Combat pay, for example, is not subject to the income tax but the soldier does have to pay Social Security and Medicare payroll taxes on these earnings. He/she may also have to pay taxes on retirement benefits/pensions. Under the FairTax all income, from any source whatsoever, is not subject to federal income taxes or payroll taxes.

Today, the reason why military personnel don't pay sales taxes on purchases from commissaries and exchanges is because the sales tax is levied by the state in which the base is geographically located, and states do not have the



authority to levy taxes on military installations under federal jurisdiction.

Nevertheless, purchasing goods at military exchanges is not actually tax free. Economic studies show that up to 20 percent of the cost of goods and services is due to embedded income and payroll taxes. They are part of the cost of doing business, so the business has to build them into its pricing structure in order to cover costs and stay in business.

Although the Fair Tax Act does not exempt purchases at military exchanges and commissaries, the FairTax prebate ensures that no military personnel pay taxes on the necessities of life. Each military household receives a monthly prebate check based on family size which pays the federal sales taxes on spending up to the poverty level. For example, a family of four will receive a monthly prebate check of \$525 at the beginning of the month (\$6,297 per year) which pays the FairTax on annual spending of \$27,380. Providing tax relief by means of the prebate makes tax enforcement much easier, and it keeps the tax rate as low as possible, whereas exempting various categories of items or persons would raise the tax rate about 4 percentage points for everybody.

### **What happens to tax-free bonds?**

Tax-free bonds are still tax free, though they are now directly competitive with corporate bonds. Under the FairTax, equities, treasuries, bonds, and other investments are all tax free. There is a one-time windfall in non-callable instruments, such as corporate bonds; this windfall also has a positive effect on callable instruments with some time remaining to the call date, including treasuries.

### **What happens to the stock market, mutual funds, and retirement funds?**

Investors prosper greatly under this plan, since corporations face lower operating costs and individuals have more money to save and invest. The reform significantly enhances the retirement savings and/or retirement spending power of most Americans. The purchase of stocks is considered a purchase for investment purposes and not personal consumption so they are purchased tax free. The service fees charged by the broker, however, are personal consumption and therefore subject to tax.

### **Are seniors taxed twice on savings, once when they saved it, and now again when they spend it?**



Simply put, the FairTax is a revenue-neutral proposal, raising no more money than does the current system. The FairTax only changes where the money is raised, not the amount.

Additionally, some erroneously believe that people who have invested in Roth IRAs will never pay taxes on this money again. They may not know it, but they are paying corporate income taxes, employer payroll taxes, plus the associated compliance costs that are hidden in the price of every retail purchase they make. Under the FairTax, these hidden taxes are driven out of retail prices. And note, they can determine the amount of tax they pay through their own lifestyle choices.

Furthermore, used goods are not taxed because they have already been taxed once — when they were new. Therefore senior citizens, like all Americans, do not lose purchasing power, but gain it instead. Moreover, the FairTax preserves the purchasing power of Social Security benefits, and seniors receive a monthly prebate so they don't pay taxes on the purchase of necessities. Tax-deferred investments get a one-time windfall. Savings invested in any long-term, income-generating asset such as a stock, real estate, or a long-term bond that can't be called, increase substantially in value. Finally, complex estate planning is an artifact of an earlier age.

### **What about senior citizens and retired people?**

As a group, seniors do very well under the FairTax. Low-income seniors are much better off under the FairTax than under the current income tax system.

Some erroneously believe that people who live exclusively on Social Security pay no taxes. They may not know it, but they are paying hidden corporate income taxes and employer payroll taxes whenever they buy anything. Under the FairTax, seniors pay \$0.23 out of every dollar they choose to spend on new goods and services.

Plus, seniors, like everyone else, receive a monthly prebate, in advance of purchases, for taxes paid on the cost of necessities which more than pays for all of the taxes they would pay if they received the average Social Security benefit amount and spent it all. If seniors choose to work, they are freed from regressive payroll taxes, the federal income tax on wages, and the compliance burdens associated with each. They pay no more hidden taxes on goods or services, and used goods are tax free. There is no income tax



on their Social Security benefits.

The income tax imposed on investment income and pension benefits or IRA withdrawals is repealed. Pension funds, IRAs, and 401(k) plans had assets of \$12 trillion in 2004. An income tax deduction was taken for contributions to most of these plans. All beneficiaries and owners of these plans expected to pay income tax on them upon withdrawal, but are not required to do so under the FairTax.

All owners of existing homes experience large capital gains due to the repeal of the income tax and implementation of the FairTax Plan. Seniors have dramatically higher home ownership rates than other age groups (81 percent for seniors compared to 65 percent on average). Homes are often a family's largest asset. Gains are likely to be in the range of 20 percent.

The FairTax makes the economy much more dynamic and prosperous. Consequently, federal tax revenues grow. This makes it less likely that federal budget pressures require Medicare or Social Security benefit cuts.

### **Is it fair for rich people to get the exact same FAIRtax rebate from the federal government as the poorest person in America?**

Let's look at a billionaire under the FairTax — if he spends \$10,000,000 dollars he pays a tax of \$2,300,000 and gets a prebate of \$4,697 (assuming he is married and has no children). His effective tax rate as a percent of spending is 22.95 percent.

Now, let's look at a middle-income married couple with no children under the FairTax — if they spend \$50,000, they pay \$6,803 net of their prebate for an effective tax rate of 13.6 percent. The effective tax rate increases as spending increases, but never exceeds 23 percent!

In contrast, if this same couple earns \$50,000 in wages today under the current tax system, they pay \$4,093 in income taxes and \$3,825 in payroll taxes for a total of \$7,918 in taxes (15.8 percent) — a tax burden 14.1 percent higher than under the FairTax. In addition, their employer pays another \$3,825 in payroll taxes. Most economists agree that the employer payroll tax is actually borne by employees in the form of lower wages. Looked at this way, this couple is paying \$11,743 (23.5 percent) in taxes today, which doesn't even include the hidden taxes they pay every time they make a purchase.



Finally, let's look at a low-income couple that spends at the poverty level under the FairTax — they pay no net FairTax at all. Today, under the income tax system, they not only pay 15 percent in payroll taxes, but they also pay hidden taxes — arising from corporate taxes, private sector compliance costs, and payroll taxes passed on to consumers and embedded in the price of everything they buy.

### **How does the FAIRtax protect low-income families and individuals and retirees on fixed incomes?**

Under the FairTax Plan, poor people pay no net FairTax at all up to the poverty level! Every household receives a rebate that is equal to the FairTax paid on essential goods and services, and wage earners are no longer subject to the most regressive and burdensome tax of all, the payroll tax. Those spending at twice the poverty level pay a tax of only 11.5 percent — a rate much lower than the income and payroll tax burden they bear today.

Under the federal income tax, slow economic growth and recessions have a disproportionately adverse impact on lower-income families. Breadwinners in these families are more likely to lose their jobs, are less likely to have the resources to weather bad economic times, and are more in need of the initial employment opportunities that a dynamic, growing economy provides. Retaining the present tax system makes economic progress needlessly slow, thus harming low-income people the most.

In contrast, the FairTax dramatically improves economic growth and wage rates for all, but especially for lower-income families and individuals. In addition to receiving the monthly FairTax prebate, these taxpayers are freed from regressive payroll taxes, the federal income tax, and the compliance burdens associated with each. They pay no more business taxes hidden in the price of goods and services, and used goods are tax free.

- See more at: <http://fairtax.org/faq#sthash.8VSp5OAB.dpuf>