

Understanding the Fair Tax

What you should know to
promote the passage of the
Fair Tax Act of 2009

September 26, 2009



History of the U.S. Tax System



- For most of our nation's history, **individual taxpayers rarely had any significant contact with Federal tax authorities** as most of the Federal government's tax revenues were derived from excise taxes, tariffs, and customs duties.
- In **1913**, 36 States had ratified the 16th Amendment to the Constitution. In October, Congress passed a **new income tax law** with rates beginning at 1 percent and rising to 7 percent for taxpayers with income in excess of \$500,000. Less than 1 percent of the population paid income tax at the time.
- The entry of the United States into **World War I** greatly increased the need for revenue and Congress responded by passing the **1916 Revenue Act**. The 1916 Act raised the lowest tax rate from 1 percent to 2 percent and raised the top rate to 15 percent on taxpayers with incomes in excess of \$1.5 million. The 1916 Act also imposed taxes on estates and excess business profits.

Source: U.S. Treasury

History of the U.S. Tax System



- Driven by the war and largely funded by the new income tax, by **1917** the Federal budget was almost equal to the total budget for all the years between 1791 and 1916. Needing still more tax revenue, the **War Revenue Act of 1917** lowered exemptions and greatly increased tax rates.
- **Another revenue act was passed in 1918**, which hiked tax rates once again, this time raising the bottom rate to 6 percent and the top rate to 77 percent. These changes increased revenue from \$761 million in 1916 to \$3.6 billion in 1918, which represented about 25 percent of Gross Domestic Product (GDP).
- Prior to **World War II**, increasing defense spending led to the passage in **1940** of two tax laws that increased individual and corporate taxes, which were followed by another tax hike in 1941. By the end of the war the nature of the income tax had been fundamentally altered.

Source: U.S. Treasury

History of the U.S. Tax System



- **Tax Reform Act of 1986**, which brought the top statutory tax rate down from 50 percent to 28 percent while the corporate tax rate was reduced from 50 percent to 35 percent. The number of tax brackets was reduced and the personal exemption and standard deduction amounts were increased, relieving millions of taxpayers of any Federal income tax burden. However, the Act also created personal and corporate Alternative Minimum Taxes.
- In **1990** the Congress enacted a **significant tax increase** featuring an increase in the top tax rate to 31 percent. The Congress enacted a second major tax increase in **1993** in which the top tax rate was raised to 36 percent and a 10 percent surcharge was added.
- By **2001**, the total tax take had produced a projected unified budget surplus of \$281 billion, with a cumulative 10 year projected surplus of \$5.6 trillion. Consequently, the **Congress halted the projected future increases** in the tax burden by passing the Economic Growth and Tax Relief and Reconciliation Act of 2001.

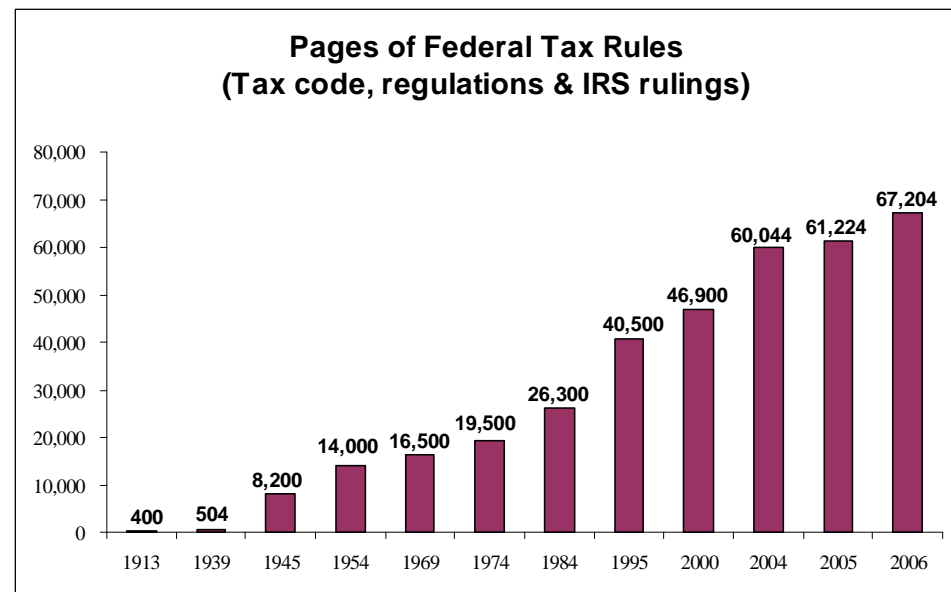


History of the U.S. Tax System

Federal Tax Revenue as compared with Gross Domestic Product

Year	GDP*	(FTR) Total Revenue*	% of GDP
1800	480	11	2%
1810	700	10	1%
1820	700	19	3%
1830	1,010	27	3%
1840	1,560	24	2%
1850	2,560	49	2%
1860	4,350	65	1%
1870	7,740	430	6%
1880	10,400	367	4%
1890	15,100	464	3%
1900	20,600	670	3%
1910	33,400	875	3%
1920	88,400	7,380	8%
1930	91,200	4,830	5%
1940	101,400	7,000	7%
1950	293,800	43,527	15%
1960	526,400	99,800	19%
1970	1,038,500	192,807	19%
1980	2,789,500	517,112	19%
1990	5,803,100	1,032,090	18%
2000	9,817,000	2,025,460	21%
2008	14,264,600	2,524,330	18%

* \$Million not adjusted for inflation

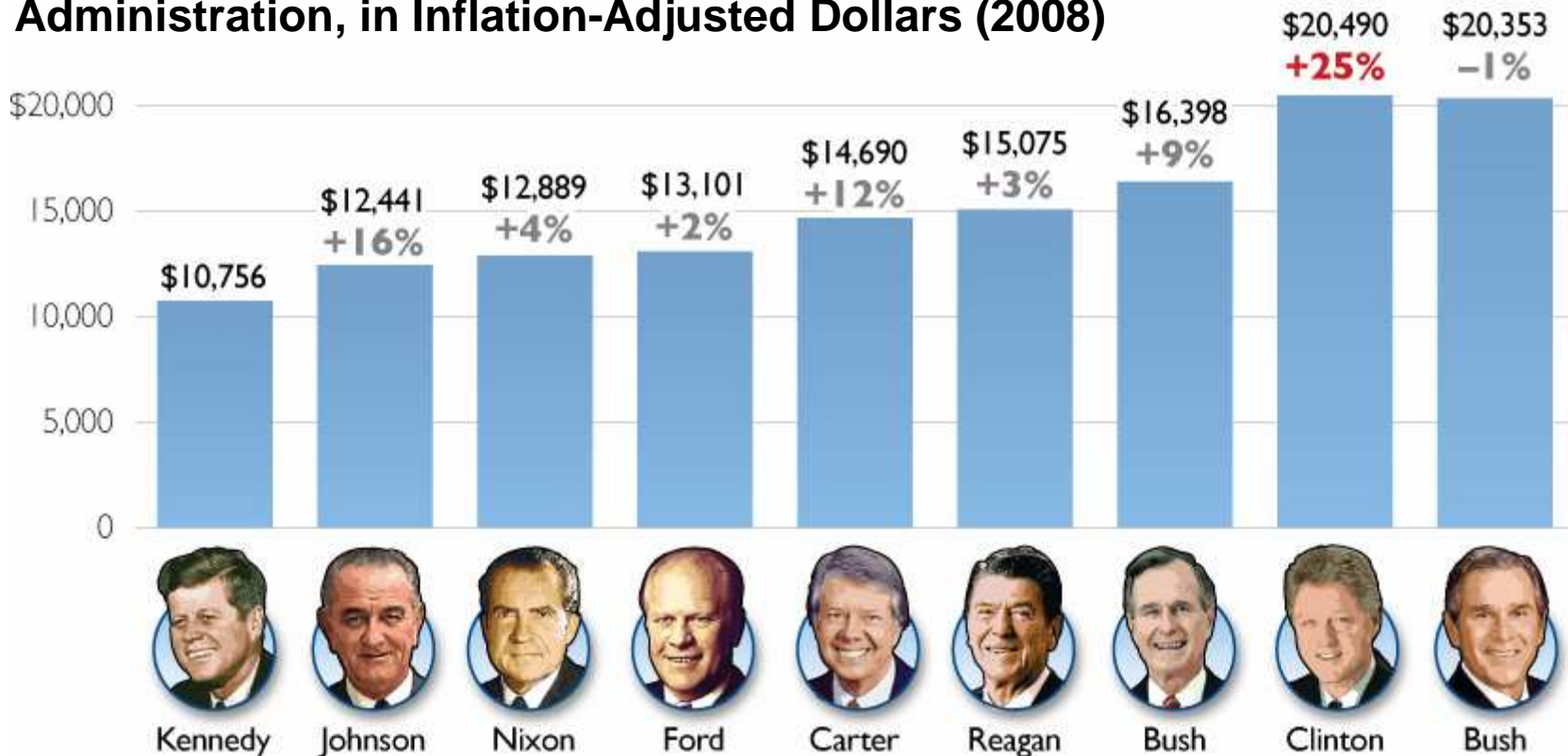


“The hardest thing in the world to understand is the income tax.”

— Albert Einstein

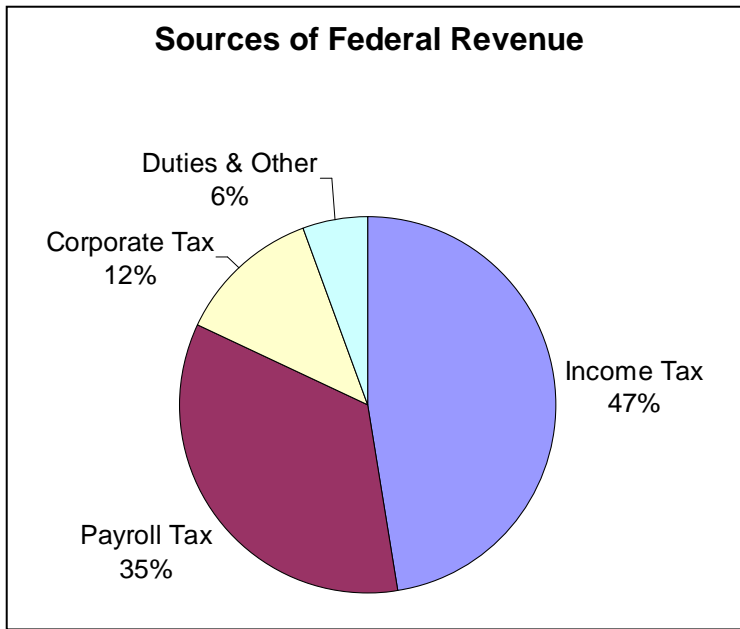
History of the U.S. Tax System

Average Federal Revenue per Household, by Administration, in Inflation-Adjusted Dollars (2008)



Source: The Heritage Foundation

Federal Tax Revenue - Today



At an estimated \$300B per year, the cost of Federal tax compliance represents another 14% slice in the chart above.

We've compromised many of our Founding Fathers' fundamentals for taxation, now adopted by AFFT (FairTax.org):

- Consumption taxes are the oldest form of taxation for many good reasons.
- Consumption tax rates are self-limiting.
- Consumption taxes, throughout history, have enhanced civil liberties and more.
- Direct taxes (income taxes/poll taxes/head taxes), throughout history, have been the tools of tyranny.
- Uniformity of taxation wards off special interest manipulation.

With an accumulated U.S. national debt approaching \$12 billion (30% held by other countries), we've clearly lost our way. Government growth and spending is hidden by limited accountability, our complex tax code, artificial propping-up of segments of our economy in trouble. There is no end to the troubled cycle in sight...

Fair Tax Basics



The Fair Tax plan is a comprehensive proposal that replaces all federal income and payroll based taxes with 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 neutrality, and, through companion legislation, the repeal of the 16th Amendment.

The Fair Tax Act (HR 25, S 296) is nonpartisan legislation. It 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.

- Enables workers to keep their entire paychecks
- Refunds the tax on purchases of basic necessities
- Brings transparency and accountability to tax policy
- Allows American products to compete fairly
- Enables retirees to keep their entire pensions
- Closes all loopholes and brings fairness to taxation
- Ensures Social Security and Medicare funding
- Abolishes the IRS

Fair Tax Basics



- **Creates jobs where the current system destroys jobs.** By stripping out hidden federal income taxes and compliance cost, the Fair Tax makes U.S. goods more competitive overseas and more affordable at home, thereby sharply increasing job creation while sharply reducing our trade deficit.
- **Gives you your whole paycheck.** No federal withholding! What you earn you get.
- **Eliminates Social Security withholding.** The most regressive tax of all, while ensuring the system fulfills its promise to one generation without being a terrible burden on the next.
- **Eliminates the corporate taxes and cost of compliance** hidden in both wholesale and retail prices.
- **Dramatically lowers effective tax rates** for lower- and middle- income: a prebate covers taxes up to the poverty level.

Fair Tax Basics



- **Allows families to save** more and faster for home ownership, education and retirement.
- **Expands the tax base** to include elements of our economy which never see the light of day for taxation. This lowers the burden on individuals historically in compliance with the tax code.
- **Encourages attainment of citizenship** for undocumented immigrants in order to qualify for the tax prebate.
- **Allows homeowners to pay their entire home mortgage payment with pretax dollars**, a great improvement over the current home interest deduction.
- **Frees up time wasted** on filling out cumbersome and inscrutable IRS forms throughout the economy to the tune of \$300 billion (about three percent of GDP).
- **Raises the same amount of revenue** for the federal government (revenue neutral).

Fair Tax Basics



- 2009 Monthly Prebate based on family size

Single Adult Household

Family Size	Annual Consumption Allowance	Annual Prebate	Monthly Prebate
1 Person	\$ 10,830	\$ 2,491	\$ 208
and 1 Child	\$ 14,570	\$ 3,351	\$ 279
and 2 Children	\$ 18,310	\$ 4,211	\$ 351
and 3 Children	\$ 22,050	\$ 5,072	\$ 423
and 4 Children	\$ 25,790	\$ 5,932	\$ 494
and 5 Children	\$ 29,530	\$ 6,792	\$ 566
and 6 Children	\$ 33,270	\$ 7,652	\$ 638
and 7 Children	\$ 37,010	\$ 8,512	\$ 709

Two Adult Household

Family Size	Annual Consumption Allowance	Annual Prebate	Monthly Prebate
Couple	\$ 21,660	\$ 4,982	\$ 415
and 1 Child	\$ 25,260	\$ 5,810	\$ 484
and 2 Children	\$ 28,860	\$ 6,638	\$ 553
and 3 Children	\$ 32,460	\$ 7,466	\$ 622
and 4 Children	\$ 36,060	\$ 8,294	\$ 691
and 5 Children	\$ 39,660	\$ 9,122	\$ 760
and 6 Children	\$ 43,260	\$ 9,950	\$ 829

Fair Tax History



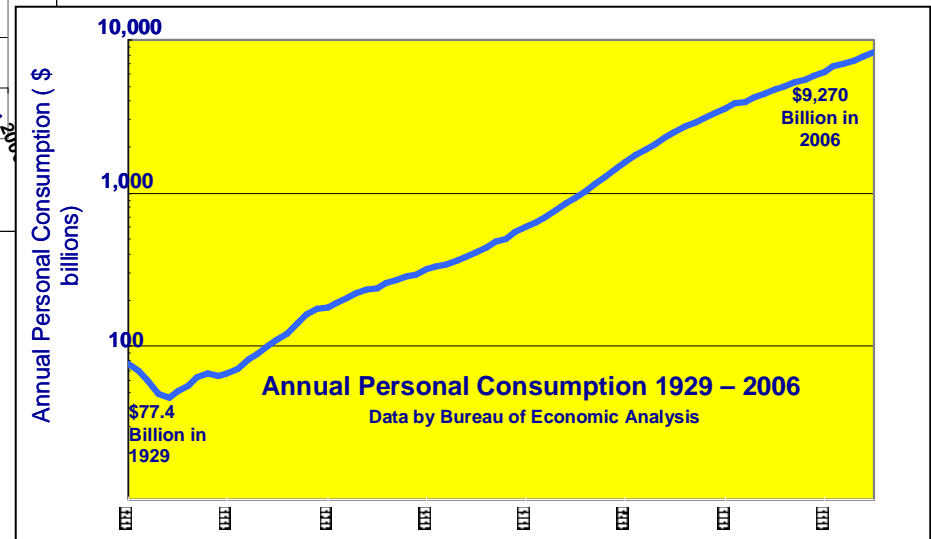
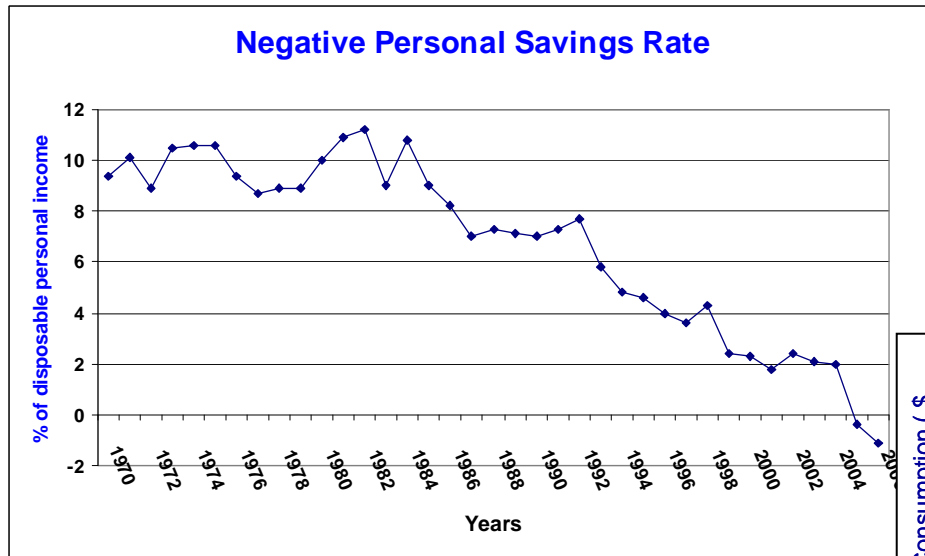
- John Linder first introduced the Fair Tax Act (H.R. 2525) on July 14, 1999 to the 106th United States Congress and has reintroduced a substantially similar bill in each subsequent session of Congress
- The bill attracted the following Congressional sponsorship since its inception:
 - 56 House and Senate cosponsors in the 108th Congress (H.R. 25/S. 1493)
 - 61 in the 109th Congress (H.R. 25/S. 25)
 - 76 in the 110th Congress (H.R. 25/S. 1025)
 - 60 in the 111th United States Congress (H.R. 25/S. 296)
- It has not received support from the Democratic leadership, which now controls Congress
 - Democratic Representative Collin Peterson of Minnesota and Democratic Senator Zell Miller of Georgia cosponsored and introduced the bill in the 108th Congress, but Peterson is no longer cosponsoring the bill and Miller has left the Senate
 - In the 109th–111th Congress, Representative Dan Boren has been the only Democrat to cosponsor the bill
- A number of congressional committees have heard testimony on the Fair Tax, but it has not moved from committee since its introduction in 1999

Macro Economic View of Fair Tax



- For Business and Trade
 - Price shifts will substantially increase demand for U.S. goods and services in all markets
 - Manufacturing comes home to the U.S.
 - Foreign corporations contribute to U.S. economy by locating offices and facilities here
 - Good jobs return to our economy
 - U.S. assets parked offshore are repatriated
- For the Nation
 - A more efficient and fair way to collect taxes
 - Provide same revenue to Federal Government
 - Funds Social Security and Medicare, eliminating the looming problem of insolvency
 - Substantially improves trade deficit, budget deficit and U.S. status as a debtor nation

Macro Economic View of Fair Tax



Business View of Fair Tax



- Eliminates payroll and corporate income taxes which are embedded at each level of the U.S. supply chain, making more room for the following:
 - Capital investment
 - Employment
 - Employee benefits
 - Pricing reductions
- No tax on Business to Business production costs
- Taxes Business and Government consumption
- Generally, not too difficult to implement due to existing procedures for collecting state and local sales tax



Individual View of Fair Tax

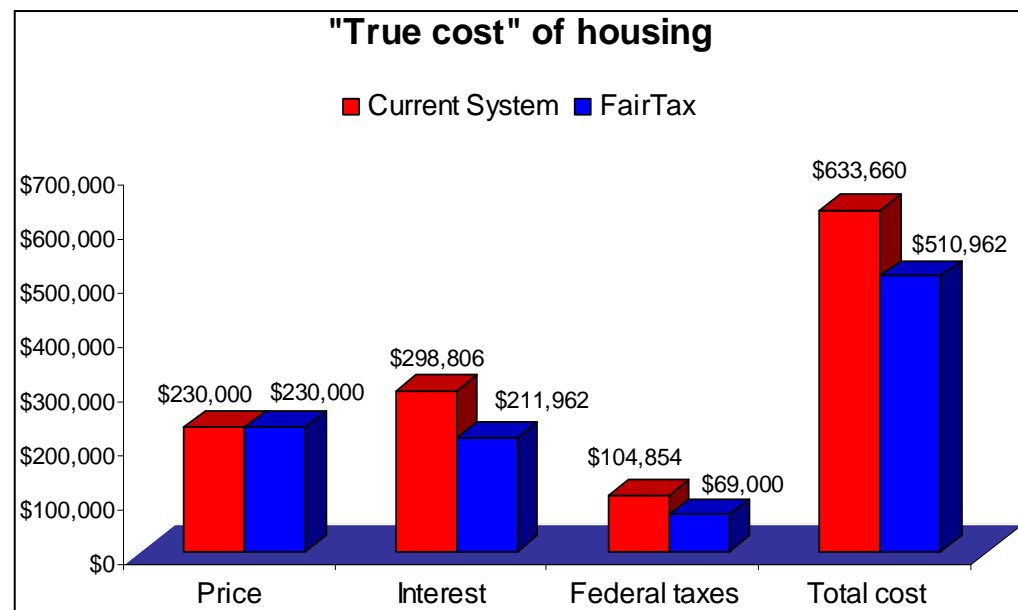
- Replaces mandatory federal income taxes with a voluntary tax on consumer purchases of new goods and services
 - No taxes are collected on used items
 - Educational expenses are not taxed
- The Fair Tax eliminates these mandatory taxes:
 - Personal income taxes
 - Estate taxes and gift taxes
 - Alternative Minimum Tax (AMT)
 - Capital Gains Taxes
 - Self-Employment Taxes



Individual View of Fair Tax

Housing, Mortgage and Charitable Deductions

- Deductions are not needed, because you don't pay any income tax.
- Taxpayers must itemize to take advantage of mortgage interest deduction and charitable deductions – only 30% do.
- Everyone will pay mortgage payments with pre-income tax AND pre-payroll tax dollars.



Fair Tax Objections



- "The 23% rate is misleading. It's actually 30%"
 - No one is trying to mislead the public. The 23% (*inclusive*) rate is presented to allow for a comparison to the current income tax. If comparing the Fair Tax to common sales tax, the 30% (*exclusive*) rate is appropriate.
- "It's not enforceable and evasion will be rampant"
 - More than 80% of all tax returns are eliminated under the Fair Tax. What remains are retail outlets collecting the Fair Tax. Sales tax revenue collection and compliance controls are already in place for most of the U.S.
- "It will not be revenue neutral at 23%"
 - The Fair Tax rate of 23% has been thoroughly researched to provide all the revenues now collected under both the income tax system and through FICA payroll taxes. Reports otherwise are largely based on President Bush's Advisory Panel on Tax Reform which declared the rate would have to be much higher. This panel quietly devised their own national consumption tax which they loaded with the exemptions and deductions they felt were "politically realistic"

Fair Tax Objections



- "The Fair Tax is not politically viable"
 - Great public policy changes do not happen easily. We believe, however, in the promise of the Founding Fathers that this is a nation, "of, by and for the people". In the last year we have seen more Congressional co-sponsors come on board faster than ever before. We have seen five of eight GOP candidates and one Democratic candidate embrace the FairTax. With increased media coverage, as at least one candidate has made this a central plank of his campaign, more and more Americans have come to understand the powerful benefits the FairTax offers the nation.
- "The Fair Tax is regressive and shifts the tax burden onto lower and middle income people"
 - The FairTax actually eliminates and reimburses all federal taxes for those below the poverty line. This is accomplished through the universal prebate and by eliminating the highly regressive FICA payroll tax. Today, low and moderate income Americans pay far more in FICA taxes than income taxes. Those spending at twice the poverty level pay a FairTax of only 11.5 percent -- a rate much lower than the income and payroll tax burden they bear today.

How Does the Fair Tax Get Passed



- To become law, the bill will need to be included in a final version of tax legislation from the U.S. House Committee on Ways and Means, pass both the House and the Senate, and finally be signed by the President
 - Opposition needs to be overcome in Congress (House and Senate)
 - Presidential support needs to be established
 - Education and pressure need to come from the constituency where opposition exists.



Current Public Opinion

- A plurality of Americans would support a national sales tax if it meant getting rid of the federal income tax:
 - 43% favor that trade-off, but 38% are opposed
 - Pluralities of Republicans and unaffiliateds like the idea, while a plurality of Democrats are against it
 - Forty-eight percent (48%) say a national sales tax is fairer than an income tax while 26% hold the opposite view
 - The sales tax is viewed as fairer by 52% of Republicans, 44% of Democrats and 49% of unaffiliateds

Closing Thought



“The income tax is bad because it has robbed you and me of the guarantee of privacy and the respect for our property that were given to us in Article IV of the Bill of Rights. This invasion is absolute and complete as far as the amount of tax that can be assessed is concerned. Please remember that, under the 16th Amendment, Congress can take 100% of our income anytime it wants to.

I believe that a better way to raise revenue not only can be found but must be found, because I am convinced that the present system is leading us right back to the tyranny from which those, who established this land of freedom, risked their lives, their fortunes and their sacred honor to forever free themselves....”

- T. Coleman Andrews
Commissioner of Internal Revenue, 1953-1955