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- FAIRtax
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As we listen to the continuing debate on tax reform, there is a growing agreement that a tax system that primarily taxes what we spend (consumption) rather than what we earn (income) will create faster economic growth than our present income tax and payroll tax system.

WHAT IS A TAX?

The Oxford English Dictionary defines tax in this way: *A compulsory contribution to state revenue levied by the government on workers' income and business profits or added to the cost of some goods, services, and transactions.*

It is obvious that money paid to the state reduces the amount of money available to individuals or businesses.

WHAT IS A GOOD TAX SYSTEM?

Former Treasury Secretary William Simon had this to say, "The nation should have a tax system that looks like someone designed it on purpose." What would be the characteristics of the best tax system? Here are some:

- The least detrimental to the economy
- Simple and fair
- Easiest to pay and collect
- Generates sufficient revenues with low administrative costs
- Least intrusive on its citizens
- Transparent so all see the taxes

Our present tax system has NONE of the above characteristics. Not one. So it is no surprise that few disagree that our present income tax and payroll tax system is an overly complicated mess. Most people concur with Ronald Reagan when he said, "The taxpayer—that's someone who works for the federal government but doesn't have to take the civil service examination."

The Internal Revenue Code and its accompanying regulations, rules and court interpretations encompasses over 75,000 pages. It is generally acknowledged to be impossible to truly understand all of its complexities, and it provides numerous unclear provisions that allow taxpayers and IRS agents to reasonably disagree over the treatment of expenses and income. This is why it is common to have different tax preparers, using the same taxpayer data, reach very different conclusions as to the amount of federal income tax legally owed.

All of this complexity leads to enormous costs. In The Economic Burden Caused by Tax Code Complexity written by Arthur B. Laffer, Ph.D., Wayne H. Winegarden, Ph.D., & John Childs, the authors concluded, “We estimate that the annual compliance cost of the U.S. tax code for income taxes alone is approximately $431.1 billion. These annual expenditures could be directed toward productive activities, but are currently being wasted.” Their study also found that if the tax system complexity burden were reduced by 90 percent, the historical average annual economic growth rate of 3.2 percent would increase to 4 percent. Over 10 years, the U.S. economy would become approximately $1.6 to $1.8 trillion larger making the U.S. about $5,200 to $6,000 wealthier per person in the 10th year following a major tax simplification.

ALL TAXES REALLY ARE TAXES ON CONSUMPTION

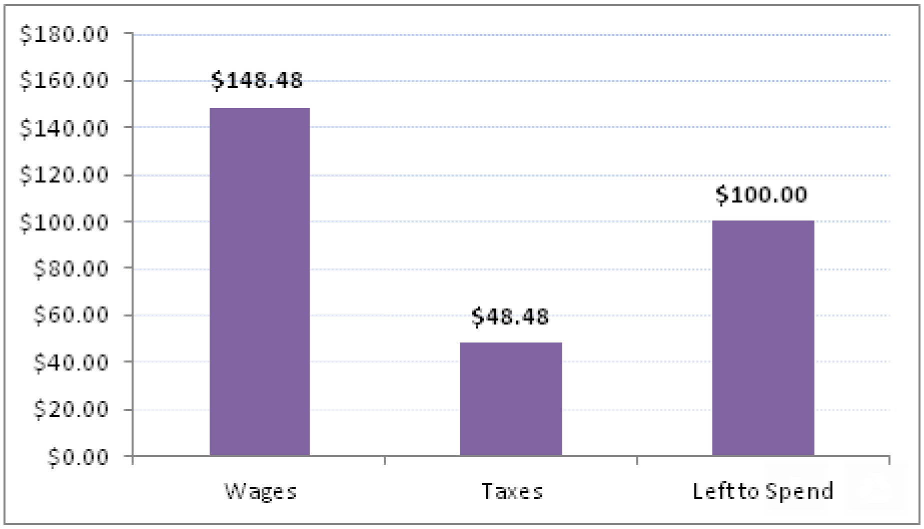
Why do people work and save or invest money? Generally, it is to enable them to consume either now or in the future.

We have to pay rent or mortgage payments. That is consumption. We have to purchase food and clothing. That is consumption. We purchase a car or a bicycle. That is consumption. We contribute money to our church or to our favorite charity. That is consumption. We save or invest money for future consumption, for example, to pay for college for our children and to have money for retirement. When we leave money to our children, they are ultimately going to spend that money on consumption.

THE CURRENT SYSTEM PRE-TAXES CONSUMPTION

The present federal income tax/payroll tax system effectively pre-taxes your consumption. This means that the tax is removed from your pay before you get it. Then when you make purchases for consumption you are not taxed again.

The funds available for consumption are reduced by the amount of the taxes. For a person in the 25% tax bracket, the following chart illustrates that you would have to earn $148.48 in order to have an additional $100 left to spend.



On an annual basis, a single wage earner, for example, would have to earn $3,739 per month in order to have $3,000 left in to spend, a difference of $739 per month (as calculated on the Net to Gross Paycheck Calculator).

THE U.S. GOVERNMENT HAS FAVORED PRE-TAXING CONSUMPTION

In 1913, the Sixteenth Amendment was ratified and income tax legislation was enacted. The original income tax legislation required withholding of income taxes at the source—like we do now. However, this provision was repealed in 1917, and people who owed federal income taxes paid them during the following year in quarterly installments. When the Social Security Act was passed in 1935, it required payroll taxes to be collected at the source but not income taxes.

When World War II started, it was determined that the federal government needed to collect more money and needed to increase the number of people being taxed. As a way to obtain the increased income tax payments, the Current Tax Payment Act was signed into law on June 9, 1943, and income taxes were again withheld at the source. Many agree that withholding has allowed the federal government to collect much more in income taxes, and to use the income tax code in many ways not directly associated with raising revenue.

The History of the U.S. Tax System, prepared by the U.S. Treasury, recognized this fact about income tax withholding. *However, it has also greatly reduced the taxpayer's awareness of the amount of tax being collected, i.e. it reduced the transparency of the tax, making it easier to raise taxes in the future.*

A CONSUMPTION TAX THAT TAXES AT THE TIME OF CONSUMPTION

The other primary type of consumption tax is levied at the time of consumption, when income is spent not when income is earned. Taking into account only federal taxes, a person making $100 receives the entire $100. Assuming the same 25% tax rate, when they decided to use their funds to consume goods or services, only $75 is available for consumption because $25 is paid in taxes at the time of purchase.

THE TWO PRIMARY METHODS OF TAXING AT THE TIME OF CONSUMPTION

(1) Value-Added Tax (VAT)

Virtually all of our trading partners have VATs. Twenty-one countries have a VAT with a rate of 20 percent or more. Simply explained, each stage of production of a product is taxed based on the "value added" to the product. If the tax rate is 20%, the following is a simple example of how the VAT would be charged on the chair that you purchase at the furniture store.

First, the saw mill sells the wood to the chair maker for $50. The saw mill pays VAT of $50 X 20% or $10. Second, the chair manufacturer builds the chair and sells it to a wholesaler for $150. The chair maker pays VAT of 20% of the $100 of value added which is $20. Then the wholesaler sells the completed chair to the furniture store for $250. The wholesaler pays VAT of 20% of the $100 of value added which is $20. Then the furniture store sells the chair to a consumer for $350. The furniture store pays VAT on the $100 of value added which is $20.

As shown in the table below, this results in a total tax of $70 or 20% of the $350 sales price, but it is collected at each stage of the production.

Business Type	Selling Price (tax included)	Value Added	Tax at 20%
Saw Mill	$50	$50	$10
Chair Maker	$150	$100	$20
Wholesaler	$250	$100	$20
Furniture Store	$350	$100	$20
Total		$350	$70

One of the problems of the VAT is that each step of the process requires a VAT return to be filed, and an agency similar to the IRS to enforce it. It is also likely that the price of the chair, in our example, was $70 higher than it would have been without the VAT because each person in the line of production had to increase their selling price by an amount sufficient to pay their costs including the amount of the VAT.

(2) Retail Sales Tax

A retail sales tax, currently used by 45 states, is only charged at the time the product is sold to the ultimate consumer. Using the above example of the chair, no taxes are paid until the chair is sold to the consumer. Assuming the same tax rate of 20%, the cost to the consumer would be $350: $280 for the chair plus $70 in tax.

Retail Sales Tax Proposals

Prior to the income tax being enacted in 1913, the federal government relied primarily on excise taxes, tariffs and duties. Excise taxes are paid on the purchase of a particular product, like gasoline, by the consumer of the gasoline.

According to the CQ Researcher at the Library of Congress, a national retail sales tax was seriously considered in 1862 to help finance the Civil War. In 1921, Congress debated a national retail sales tax, but it was not passed. In 1932, Congress again considered a national retail sales tax, but it was not adopted.

In the mid-90's, Congressmen Dan Schaefer (CO) and Billy Tauzin (LA) introduced a national retail sales tax bill to replace the income tax but not the Social Security payroll tax. In 1999, John Linder (GA) introduced the FAIRtax.

Introduced in 2015 by Congressman Rob Woodall (GA), with 72 co-sponsors in the House, the FAIRtax eliminates all income and payroll taxes, and the estate and gift tax, and replaces them with a national retail sales tax of 23%.

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- See more at: https://fairtax.org/articles/all-taxes-are-taxes-on-consumption#sthash.my12tQ2w.dpuf