

FairTax: Honest, Simple, and Transparent

In his article of February 23, 2007, Mr. Troy Neff argues that a national sales tax is worse than our current income tax system. However, Mr. Neff's advice is as flawed as the advice the IRS answer desk gives to taxpayers (about 50 percent of the time, according to the Treasury's inspector). Tax lawyers may now be awarded patents for the most creative loopholes, but that doesn't make the income tax the highest achievement of mankind. The FairTax national sales tax plan is a vast improvement.

Let me begin with his claim that sales tax advocates wrongly assert that a rate of 16 to 18 percent could raise the revenue now collected by the IRS. In fact, FairTax.org – the largest grassroots movement for the FairTax – asserts that a rate of 23 percent tax inclusive is needed to replace the individual and corporate income taxes, payroll taxes, and capital gains taxes levied today. That math is backed up by research conducted at Stanford to MIT to Harvard. More relevant, given all the loopholes which lobbyists and their congressional collaborators have been able to carve out, the sales tax base is actually double that of taxable income which means as high as it is, it lowers marginal rates. Middle-income taxpayers pay at least 43.4 percent today, and that is before corporate taxes and compliance costs disguised in the price of goods and services they buy are considered. The FairTax should not be faulted for its transparency.

Mr. Neff laments that the sales tax is, “in effect, a tax on personal consumption;” but that is precisely the point. The FairTax intentionally removes penalties on savings, investments, and exports to improve the economy of venues like Toledo, Ohio. And as for causing a recession, the nation's foremost public finance economists such as Laurence Kotlikoff of Boston University predict the capital stock of our nation would be 41.4 percent higher under the FairTax than the current system and wages 13.0 percent higher. Indeed, consumption is already taxed today, unless the Congress just snuck by a deduction against income and payroll taxes for the family vacation. Unfortunately, investment and exports are also taxed today.

Mr. Neff cites an alleged report by the congressional Joint Economic Committee (JEC) that a national sales tax is fatally flawed, but here again the facts are different. What the JEC actually said was that a “switch to a consumption-based tax system, as opposed to an income-based system, could improve efficiency and fairness and result in a simpler tax system ... [because] ... it removes the extra tax imposed on saving.” They added, “the current tax code penalizes work, saving, investment, and entrepreneurship [and that] tax changes that reduce these penalties will improve long-term economic growth.”

Mr. Neff predicts vast evasion, but fails to point out that each year \$400 billion in uncollected income taxes raise the tax each honest taxpayer must pay, despite the imposition of \$300 billion in compliance costs and more than 20 million penalties. Compliance improves under the FairTax because there are 86 percent fewer collection points, and taxpayers with less incentive and opportunity to cheat have a greater chance of getting caught if they do.

I would like to address many of his other errors, but you'll have to excuse me – I am too busy doing my own returns.

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This is the original article by Troy Neff:

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THE WALKING CURE

National sales tax complicates already difficult process

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Presidential candidates from both parties, and others, have proposed a national sales tax be enacted to replace the current income tax. They say a national sales tax would be much simpler than the current system, increase tax fairness and permit a shutdown of the IRS as it now exists.

However, all is not so green in the other pasture. A report by the Joint Economic Committee (JEC) of Congress says a national sales tax may be a fatally flawed proposal and just as bad as the system it's designed to replace.

Let's look at what these sales tax advocates want to do. They claim a tax of 16 to 18 percent could raise all of the revenue now collected by the IRS.

And the rate will have to be higher than that if the tax provides for exemptions. For example, investment outlays, exports and government purchases are almost certain to be exempt.

With these items excluded, a national sales tax becomes, in effect, a tax on personal consumption expenditures. Using this as a base would require a tax rate of at least 32 percent to replace current revenues. And, of course, this does not include any sales taxes that states impose.

What about being taxed on services, which are exempt from most states' sales taxes? If they enact this national tax, every time the plumber or electrician visits, a tax will have to be paid. The same is true for other services, such as doctor's visits, haircuts, taxi rides and funeral services.

The government report makes some strong arguments about why this type of tax would be bad, maybe even worse than the current IRS system. It says a national sales tax of 19 percent on everything sold would be required to equal current income tax revenues. Historically, it has proven difficult to impose a sales tax on services at the state level. Imagine trying to collect such a tax at the federal level.

No one making these kinds of proposals has answered: Who is going to collect this sales tax if there is no IRS?

Sales tax advocates suggest the federal tax can be piggybacked onto state sales tax collections. Bad idea. First of all, five states have no sales tax. They would have to put in place sales tax collection procedures they don't have. The rest of the states would have to add a whole new bureaucracy to collect and remit this federal sales tax.

It's estimated the extra cost of collecting federal sales taxes will create a new financial burden on states of at least \$12 billion.

Some states would exempt items taxed at the federal level and vice versa. In some states, food is exempt. In others, medicine is tax-free. And so on.

Think about the issues of business versus individual taxation. Would businesses get exemptions on the tax if they were to resell the goods? To avoid this double tax, producers, wholesalers and service providers will have to be given tax registration numbers allowing them to avoid paying the sales tax on inputs used in their businesses.

But this creates complications for retailers, as well as easy opportunities for evasion.

And what is to stop people from engaging in sham businesses simply to obtain a tax exemption? According to the JEC report, there will have to be a vast auditing procedure that could make today's IRS methods tame by comparison.

A national sales tax would give people an enormous incentive to consume as much as possible before the tax takes effect, drawing down savings and even going into debt to buy everything they could possibly need in the future.

Having done so, consumption after the tax takes effect will collapse, at least for a time. This could cause a recession.

What about payroll taxes? If the Social Security payroll tax is not eliminated along with the income tax, the IRS would still be required to collect it. If the payroll tax is eliminated, a drastic revision of the Social Security benefits system would be required, since benefits are currently linked to taxes paid, which, in turn, are linked to earnings.

Everyone agrees our current tax system stinks. Other possibilities, like a national sales tax, might be even worse.

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