



A FairTaxSM White Paper

Why the FairTax is good for young and low-income families

There are several reasons why the FairTax (HR 25), a proposal to replace the current income tax system with a highly progressive, revenue-neutral, federal retail sales tax, will benefit low-income, often young families. And those on fixed incomes for many of the same reasons.

The FairTax is the only plan that completely “untaxes” the poor and also dramatically lowers tax rates on young, low-income families living above the poverty level. The FairTax achieves this result by:

- (1) Eliminating all federal payroll withholding taxes, allowing wage earners to take home their entire paychecks – it's the full paycheck plan. Social Security taxes, the most regressive tax of all, are no longer withheld from paychecks.
- (2) The FairTax also ends the income tax system, so paycheck-to-paycheck families have no income tax withheld. Neither do they have to keep records, file returns to get their refunds, hire preparers for complex earned income tax credit (EITC) forms, or defend themselves against EITC-targeted IRS audits.
- (3) The FairTax allows every family to purchase necessities tax free via a rebate system that exempts all spending up to the poverty level, as determined by the Department of Health and Human Services.
- (4) The FairTax ends the sham of corporate taxes – government can levy taxes on business, which will collect and remit them, but never pay them. Business “pays” such taxes by raising prices to consumers, lowering the wages paid to workers, or by lowering dividends paid to shareholders. The FairTax removes these hidden taxes.
- (5) Used products are not taxed, allowing these consumers yet another means to reduce their tax burden on spending above the poverty level.

The FairTax is a revenue-neutral proposal, raising no more or less tax than the current system. In addition, used products, used cars, homes, etc., are not taxed under this legislation. Only the FairTax honestly and transparently achieves the goal of completely untaxing America's low-income strata up to the poverty level.

The FairTax is a discretionary tax.

The FairTax provides individuals with the maximum choice over what to do with their income: They can consume it (and pay taxes) or save it (and pay no taxes). If one chooses to consume for personal benefit beyond the necessities of life, one pays a tax. If one does not, but chooses



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instead to save and invest for education, a home or a better retirement, one defers consumption and the tax. Unlike current law, the FairTax is not biased towards consumption. It encourages young families to save and invest. If we had enacted a FairTax ten years ago, according to Dr. Jorgenson, we would each be ten percent better off today.

Save faster under the FairTax.

Since the FairTax does not tax savings and investment and makes the payment of the tax largely elective, it enables young families and new homebuyers to save for their purchase faster. Why are individuals able to save so much faster under the FairTax? First, the FairTax removes the enormous disadvantage to savings and investment under our income tax system. Today, savings and investment income is greatly disadvantaged. Wage and salary income is included in the income tax base when it is earned originally. If that income is consumed, the benefits of consumption go untaxed. However, if what is left of the wages and salaries is saved (for example, for a new home), the earnings are taxed as the income from that investment is generated. Then, if the income-producing asset, such as a stock or bond, equipment or real property interest is sold for more than it was purchased, the benefit of the capital investment – the capital gain – is taxed a third time. If these investments are inherited, they are taxed yet again. A principal advantage the FairTax has over an income tax, therefore, is that a down payment can be saved without fighting against the cascading taxes on savings. Furthermore, since you keep 100 percent of your paycheck, you only have to earn \$100 to save \$100. Under today's income/payroll tax system, most people have to earn at least \$121 to save \$100.

Education is not taxed.

An equally important feature of the FairTax and its impact on young families is its treatment of education. The FairTax exempts education at all levels (primary, secondary, and graduate), recognizing that education is an investment in our nation's intellectual capital and is every bit as important as our investment in physical capital. Education is often a large expense for young families.

The FairTax *creates* jobs, not *destroying* them as our income tax system does.

The FairTax additionally benefits lower-income families through increased economic growth. Slow economic growth or recessions have a disproportionately adverse impact on the poor and low-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. The FairTax dramatically improves economic growth and improves wage rates, while retaining the present tax system needlessly delays economic progress.

In addition, the FairTax eliminates approximately \$265 billion dollars in compliance costs (more than the \$248 billion federal budget deficit in 2006!), an annual savings in excess of \$2,300 for every household in America. These are funds that could be spent on a better education for our children, for a home, or for a better retirement.



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Ending the fiction of corporate taxes

Corporations do not pay taxes – people do. When a corporation is taxed, any one or all three of the following pass-throughs occur in some measure:

- If competition allows, the corporation will raise the price of its goods or services by the amount of the tax and the cost of compliance. These costs are hidden in the price of every good or service bought in or exported by our country. Even those corporations that may legally zero their taxes still have compliance costs to pass through. But who do these hidden premiums really hurt? Who can least afford the increased cost? It's the low-income/fixed-income citizens we set out to protect when we taxed corporations in the first place.
- But what if strong competition (perhaps Wal-Mart) will not allow pricing to absorb the entire cost of taxes/compliance? What is the next corporate move? Many will then reduce the cost of labor by laying off employees. And who is most likely to lose their jobs? It is our low-income friends again. New research shows that high corporate taxes depress average manufacturing wages. Based on data for 70 countries over 22 years, higher corporate tax rates lead to lower wages, with a 1.0 percent increase in corporate tax rates associated with a 0.7 to 0.9 percent drop in wage rates. This implies that if the average domestic corporate tax rate decreased from 35 to 25 percent (a 28 percent decrease), average wages would increase by more than 25 percent.¹
- Now, assume prices are as high as they can be and labor costs are as low as they can be, and there are still taxes/compliance costs to pay. What do corporations do? Lower profits to their shareholders.

For a mom-and-pop business, that means a leaner, lesser lifestyle for Mom and Pop. That means later or no retirement. For Wall Street, that means union pension funds experience lackluster performance when invested in domestic corporations. This may not be a big concern for the low-income, working poor, but that certainly puts a double whammy on the working class because of fewer jobs and threatened pensions. And then there are the undue burdens placed on our fixed-income retirees. Yet again, the very groups we set out to protect with corporate income taxation are those we punish most.

In summary, the FairTax is the only complete tax reform plan that honestly, transparently, and comprehensively untaxes (up to the poverty level) those struggling to climb the American ladder of success. See also our white paper for fixed-income and other retirees.

¹Hassett, Kevin A. and Aparna Mathur, "Taxes and Wages," American Enterprise Institute, AEI Working Paper #128. June 2006; quoted in statement of Alliance for Competitive Taxation to House Ways & Means Committee, June 22. The 25 percent figure equals 0.9 times 28.



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What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans For Fair Taxation (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

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