



**A FairTax<sup>SM</sup> Rebuttal**  
**of Steve Forbes' book entitled *Flat Tax Revolution***

**Forbes issue:** “I believe, though, the flat tax is preferable, not least because it could more easily, readily be enacted than a national sales tax...” p. 80.

**Response:** Whether or not a tax plan is politically viable is an empirical question ultimately decided by the American electorate, and not by anyone’s opinion. Mr. Forbes’ political prognosis is not only one man’s opinion, but is disproven by the electorate’s dwindling support for the flat tax. Over its twenty-year history, the flat tax idea has not only failed to capture the imagination of the American people, but has nearly faded into the annals of U.S. tax policy history. With only five sponsors in the House, the flat tax supporters in Congress could not achieve a quorum in the smallest congressional subcommittee.

Mr. Forbes’ prognostication is also disproven by the ascendancy of the FairTax plan. The evidence suggests that Americans want true, sustainable reform. The FairTax plan is endorsed by almost ten times as many members of Congress as Mr. Forbes’ flat tax. Indeed, while the flat tax is supported by an outspoken billionaire, the FairTax is supported by one of the largest grassroots movements ever assembled in the history of the U.S. and by many state and national associations that represent real Americans, including the American Farm Bureau Federation (with a description of the FairTax in its policy book), many state farm bureaus (which support the FairTax by name), and the National Small Business Association, among many others. The flat tax has not only fallen flat with the American people, it is actually opposed by such bodies as the U.S. Chamber of Commerce.

**Forbes issue:** “Before a sales tax is put in place, we must first repeal the Sixteenth Amendment to the Constitution, which allows Washington to impose the income tax.” p. 80.

**Response:** To begin with, this is a technically incorrect statement, as the FairTax can be enacted without repealing the 16<sup>th</sup> Amendment. But Mr. Forbes is also wrong in implying that the FairTax might coexist with an income tax. That is impossible.

Consider what would happen even in the absence of repealing the 16<sup>th</sup> Amendment. It is inconceivable that taxpayers will return to an income tax when they have experienced the joy of not filing tax returns and of receiving their entire paycheck. Nor would it be possible for the U.S. to simply revive the income tax in the unlikely event that Mr. Forbes correctly forecasted Americans would want to. The income tax is not just held in place by the institution of the IRS, which would be abolished, but by an elaborate support system of accountants, software, schools, forms, and apparatuses, all of which are fully dismantled under the FairTax.



Second, in making this statement, Mr. Forbes diverts attention from the fact that the entire income tax apparatus he professes to fear would have to remain intact under his flat tax. In truth, while the flat tax has some of the benefits of a consumption tax, it attempts to co-opt public support *because* it masquerades as an income tax. If the flat tax is not actually enacted side by side along with capital gains, death, and income taxes, then it is likely the flat tax would simply disintegrate into an income tax within a span of only a few years. History serves as a model for the futility of such schemes. Several months after the Tax Reform Act of 1986 was enacted – the last great experiment in flattening rates – more than 500 individual pieces of legislation to deform the code further were introduced. Viewed with this reality, the flat tax is simply illusory reform; temporary at best. Indeed, flat tax proponents have already lost the battle for true reform. Consider for example, the statement of Senate flat tax champion Arlen Specter who suggested that the flat tax allow a deduction for mortgage interest and charitable contributions, in the first of what would be a long line of assaults against the base. Before even being referred to the tax-writing committees, he argued the proposal should retain many of the complexities to curry the political favor of lobbyists.

And consider that Mr. Forbes fails to take into account the unfavorable experience of other countries that have adopted similar ideas. In their book, the developers of the flat tax refer to it as a VAT (see Hall, Robert E. and Alvin Rabushka, *The Flat Tax*, Second Edition, Stanford, California: Hoover Institution Press, 1995, pp. 109-111 for a discussion of how the flat tax is a value-added tax). Noted economists refer to it as a VAT or as a VAT variant, which taxes labor value added at the individual level and capital value added at the business level. Without exception, VATs (whether they be credit-invoice VATs common in Europe or subtraction-method VATs like the flat tax) have coexisted happily for many years in Europe, side by side with income, death, and capital gains taxes, ensuring that those nations extract the maximum level of resources from their citizenry. Mr. Forbes offers no protection against the flat tax becoming yet another alternative minimum tax.

Mr. Forbes' criticism is misplaced because – while there can exist no guarantee that the flat tax will not be enacted along with an income tax – the FairTax is the sole reform plan that can require elimination of the federal income tax and its infrastructure. Indeed, the flat tax *requires* the continuation of the 16<sup>th</sup> Amendment for its implementation. The requirement of a two-thirds majority of Congress to alter the plan is, of course, illusory because that statutory protection against tax increases can itself be defeated by a simple majority. The only true protection is through a constitutional amendment, and the only plan that offers that protection is the FairTax.

**Forbes issue:** “Potential snags are immediately obvious: What is the definition of new? What constitutes a business? Let’s say you sell stuff on eBay; one can imagine people justifying a sales-tax exemption on a slew of items that may or may not really qualify.” p. 81.

**Response:** By this statement, Steve Forbes implies not only that such definitions are complex and matters of first instance, but that they are somehow tantamount to the level of complexity experienced by taxpayers today. He is wrong on both counts.



To begin with, the FairTax does define both what is new and what is a business. Under Sec. 2, entitled Definitions, *used property* means “property on which [the FairTax] has been collected and for which no credit has been allowed under section 203 [which permits a credit for goods exported from the United States].” Property that was held for a business purpose is defined in section 102(b) as property “purchased by a person engaged in a trade or business and used in that trade or business -- (1) for resale, (2) to produce, provide, render, or sell taxable property or services, or (3) in furtherance of other bona fide business purposes.” The definition of a trade or business is one made today, and made in every state that administers a sales tax. But perhaps most ironically, it is a term raised 22 times in the Forbes bill, including in Sec. 60B and 60C, which are the main thrusts of the “tax imposed on *business activities*” and the “tax on noncash compensation provided to employees not engaged in *business activity* (italics added).”

A more honest statement is that no properly designed tax system can avoid drawing a distinction between business and nonbusiness expenses or inputs, and this is as true for the flat tax as for the income tax. Forbes’ plan permits a deduction for business inputs, defining them in part as “(i) the amount paid for property sold or used in connection with a business activity, [in Sec. 60B].” Our current complex tax system defines trade or business in thousands of sections, and allows a deduction for ordinary and necessary trade or business expenses in section 162 of the Internal Revenue Code. The FairTax likewise recognizes that business-to-business transactions cannot be taxed. A tax system that fails to distinguish between a business’s expense or input and one for nonbusiness purposes would be a cascading or turnover tax that taxes each transaction along the chain of the economy. Such a tax would decimate small firms.

As for the distinction between new and used goods, the Forbes bill fails to distinguish between old and new goods because it contains no transition rule about the hidden costs of taxes now buried in goods and services – or any transition rules for that matter. The FairTax draws this distinction because it does not want to tax Americans on goods and services already subject to tax today. Forbes’ flat tax avoids that problem by ignoring the problem.

In summary, Mr. Forbes’ point is largely to draw attention to definitions that must be made in any tax system, and away from the fact that both his flat tax and the income tax depend on many more definitional distinctions and have far more gray areas than the FairTax.

**Forbes issue:** “The [FairTax] plan’s fixed rebates favor those who live in low-cost areas. ... Consequently a carpenter living in a metro area like San Francisco would receive a rebate that was smaller in proportion to his income than his counterpart living in a low-cost-of-living region like Mississippi.” p. 82.

**Response:** The FairTax does not alter the rebate for geographical variations in salary or cost of living, but then neither the flat tax nor the income tax today alters the amount of their individual exclusion or the rate of either the payroll or wage tax based on where the payer of the tax resides. If Mr. Forbes believes that it is proper to scale the FairTax rebate based on the residence of the taxpayer, then he should scale his exclusion and the payroll tax in the same manner as he implies the FairTax rebate should be scaled. Three-quarters of Americans pay more in payroll taxes than income taxes, and they are the bottom three-quarters of wage earners.



The answer is that while such a change might be needed to counter the regressive effects of the payroll tax under the Forbes flat tax on wages and jobs, it would add needless complexity with respect to the FairTax. The generous FairTax rebate holds taxpayers harmless against taxes otherwise imposed on the necessities of life.

As an added note, the Bureau of Labor Statistics reveals that “carpenters” in Mississippi and California earn a median income of \$45,390 and \$26,570 respectively. Under the flat tax each would pay more in tax than under the FairTax even if they were to consume their entire income.

**Forbes issue:** “Rebates don’t correspond to income. No matter how much money you make, you’d still get the same rebate in the mail each month. Poor taxpayers might resent that their well-off counterparts are getting the very same amount they are.” p. 83.

**Response:** That Bill Gates does not have to pay tax on his first \$16,000 worth of purchases under the FairTax, but does on the next millions of dollars of purchases, is unlikely to anger the poor. The poor taxpayer pays sales tax on 0 percent of their spending, compared to the more than 99 percent of spending experienced by Bill Gates. This is clearly much better than today, when tax shelters routinely shield Bill Gates from taxation.

To be consistent, Mr. Forbes should again point out that the flat tax neither scales its tax rate nor its exemption level, and in fact continues to exempt high wage earners (those earning more than \$90,000) from the FICA portion of the payroll tax (12.4 percent). Bill Gates would receive personal exemptions under the flat tax. Wealthy individuals who need not earn wages are not taxed directly on their income; however, wage earners pay both the wage tax and the value-added tax buried in the price of goods and services their labor produces.

**Forbes issue:** “The plan opens the door to encroaching entitlements. There’s also the danger that the rebate under the national retail sales tax would morph into something resembling a traditional government entitlement. There would be political pressure to increase the rebates and to then differentiate between people of various incomes. Do we want to enact something like the NRST that would still force us to maintain massive government spending and a none-too-small bureaucracy? In the final analysis, the rebate would become a de facto entitlement program.” p. 83.

**Response:** Nothing could have spawned a greater bureaucracy than the income tax with its maze of deductions, exemptions, exclusions, and loopholes. Not only have the compliance costs created whole industries, but the loopholes have created economies built on tax dependencies that distort the free market. In the bureaucracy just to enforce the tax code, we waste more than \$265 billion today, representing over 6 billion hours spent by individuals, businesses, and nonprofits complying with the federal income tax code. That’s equivalent to a work force of over 2,884,000 people. And more people than work in the auto industry, the computer manufacturing industry, the airline manufacturing industry, and the steel industry combined. The flat tax will only temporarily reduce that bureaucracy until the loopholes and complexity



creep back into the system faster than the more than four lobbyists per member of Congress can find their way to Capitol Hill.

But more importantly, the massive size of the government and its high growth relative to the private sector is due in large measure to the hidden nature of the income tax that is continued under the Forbes flat tax. Today, about 40 percent of taxpayers don't even pay the income tax, and those that do cannot possibly see the full cost of the government, of the income tax, and of compliance costs buried in the price of goods and services they buy. These hidden costs would not diminish under the flat tax, but the costs of the federal government will become painfully obvious under the FairTax. The simplicity and the transparent nature of the FairTax is the citizens' best protection against bureaucratic runaway.

**Forbes issue:** "Putting the program in place would mean a new, high cost bureaucracy. A national retail sales tax would require establishing a dedicated government bureaucracy tasked with implementing the rebate program—with its various processes of taxpayer registration and verification, not to mention the payment system itself, generating layers of government paperwork. The cost of such a rebate program would be as much as \$500 billion dollars. NRST advocates confirm that the rebate program would add 10 percent to 13 percent to the base sales tax rate. The IRS monster would eventually be reborn." p. 83.

**Response:** Nothing could be further from the truth. Here, Mr. Forbes is mixing up two issues: The costs of administering the FairTax rebate, which holds taxpayers harmless against taxes on purchases of the necessities of life, and the administration costs of the FairTax. As for the administration costs, the FairTax eliminates the need for individuals to file returns whatsoever, disposing of 118 million returns filed today and the accompanying 8 billion forms and instructions. Indeed, the FairTax was found to reduce compliance costs by an estimated 95 percent, according to the nonpartisan Tax Foundation, who generously found the flat tax would cost twice as much to implement. The cost savings under the FairTax stem partly from the fact that states collect the FairTax along with state sales taxes (the states already have tax systems in place) and simply forward the money to the federal government. As for the rebate, administering the rebate checks is far less complex than administering the income tax or the exemption under the flat tax; indeed, the data for its administration could be done on a laptop computer today.

**Forbes issue:** "The NRST would devastate the market for new homes. By taxing new homes at 30 percent, the NRST would constitute a significant disincentive for new home buyers, who are key drivers of economic growth. People would seek to avoid the tax by purchasing existing homes. Competing with a used-housing market that featured prices 25 percent or more lower than new housing would devastate builders across the nation. Many would be forced out of business." p. 83.

**Response:** The short answer is that new homes are taxed today because their price reflects taxes imposed on the timber companies, the architects, the general contractors, the trades, and even the banks when interest is paid. And the price reflects the fact that a homebuyer can only pay for a home with what is left over after payroll and income taxes extract their share from the paycheck.



But on a deeper level, it is important to understand that the FairTax actually makes homes – both new and used – more affordable to a greater number of homebuyers than would the flat tax or the current income tax, and benefits the industry as a whole. Of course, under the FairTax used homes are not taxed, because used homes were already taxed when the house was built and improved upon. By not taxing used homes, the FairTax provides an equitable transition rule that the flat tax ignores. But the nontaxation of used homes under the FairTax also benefits the two-thirds of new homebuyers who use the proceeds of used home sales to provide the down payment for their new home purchase.

To understand how both new and used homes are advantaged more than under the flat tax or the income tax it emulates, consider the fact that the main expense of a home is mortgage interest, and that the FairTax allows mortgage interest to be paid with both pre-income-tax and pre-payroll-tax dollars. Mr. Forbes' flat tax in its pure form does not allow for a mortgage interest deduction at all, but instead requires struggling homebuyers to pay interest only with what remains after the flat tax and payroll taxes have extracted their sizeable combined levy of 32.3 percent (15.3 percent payroll tax and 17 percent flat tax on wages). Even today, the mortgage interest deduction is only permitted for servicing the interest on mortgage debt by itemizing homeowners – *and then does not allow a deduction against payroll taxes*. Finally, the FairTax further benefits home ownership by enabling homebuyers to save the down payment without swimming against the tide of taxation.

To put these advantages in real terms, consider the wages a family must earn to purchase a new \$153,800 home *today*. Assuming a 27-year term and mortgage rate of 6.0 percent, FairTax.org calculates that the average homebuyer pays an additional \$157,139 in interest and must earn \$377,790 before taxes to pay off that home. Under the FairTax, he or she needs to earn at least \$65,691 (or -17.4 percent) less. A buyer of a previously owned home, of course, needs to earn \$265,959 (\$153,800 + \$112,159 interest) under the FairTax or 70 percent of what he or she would need to earn today.

In order to match the power of the FairTax for encouraging home ownership, both the flat tax and the current tax system would have to at the very least (1) allow all taxpayers to fully deduct the purchase of used property against income and payroll taxes, (2) expand the MID so that it permits a deduction against payroll taxes, and (3) fully untax returns on savings used to buy homes.

**Forbes issue:** “NRST proponents point out that eventually the prices of new homes would come down and old ones go up. They fail to account for the shock this would bring to the housing market before stabilization occurs.” p. 84.

**Response:** This is not what FairTax.org argues, nor do their economists. FairTax.org posits that to the extent demand for used homes increases relative to new homes – which is what Mr. Forbes implies – their price would have to increase. This is a simple function of supply and demand. But FairTax.org also believes that there would be little or no shock because the sales tax-inclusive price of new homes will not rise dramatically since the income tax and payroll taxes are repealed and those taxes represent part of the cost recovered by homebuilders when they sell new



homes. What is more important for home sales is the fact that Americans are able to buy those homes with lower interest rates as mortgage rates fall towards municipal bond rates, pay that mortgage interest with their entire paychecks before taxes are taken out (unlike the income and flat tax), not have to pay hidden taxes buried in the price of new homes (as homebuilders do not pay tax), and pay the principal on those homes at a lower effective tax rate. The FairTax is a recipe for a home buying boom.

**Forbes issue:** “The tax would raise the already soaring cost of college tuition by 30 percent. College tuition, whose sky-high price is already straining the resources of most families, would be among the goods and services to be taxed by the NRST. There is no way any parent facing college tuitions would want to see a national sales tax enacted.” p. 84.

**Response:** This is totally incorrect. The FairTax does not tax tuition. The FairTax does not tax tuition because it draws no distinction between investment in human capital and investment in plants or equipment. Rather, the FairTax treats education as a personal investment in our nation’s intellectual capital. By way of example, under the flat tax a taxpayer would have to earn \$14,771 in order to afford \$10,000 in tuition costs. Under the FairTax, paying a \$10,000 tuition bill requires earnings of \$10,000. This can be contrasted with the flat tax which requires struggling families to pay tuition with what remains after the flat tax on their earnings.

**Forbes issue:** “The NRST would stifle the online industry. The Internet owes its growth, in part, to its status as a little regulated, tax-free zone. The national retail sales tax would stifle this industry with its comprehensive tax blanket covering both goods and services. Goods sold over the Net are not liable to sales tax if the buyer does not live in a state where the seller has a physical presence. A nationwide sales tax would, by definition, tax consumer transactions on the Internet. There would be no more tax-free purchases via Amazon.com.” p. 84.

**Response:** This statement is wrong for several reasons, not the least of which is that it is based on the premise that treating two similarly situated businesses differently is meritorious. Horizontal equity is something a tax system should strive to achieve, not shun, no matter how influential the lobbyists may be for direct marketing associations. The FairTax allows online and bricks-and-mortar stores to compete by the same rules as Internet companies are permitted. This is a good thing because it resolves a problem that has long unfairly pitted local small retailers against virtual retailers, and eliminates once and for all the artificial distinction of taxing only certain participants in the marketplace based on the fact that they have a physical presence. The FairTax brings greater uniformity to the state systems, and that is a good thing for equity and for local jobs.

Second, Mr. Forbes seems to assume that Internet companies are not taxed today under the federal tax system. The Internet is anything but a “tax-free zone.” Internet retailers still pay their corporate income taxes and payroll taxes (both of which the flat tax would leave in place). Forbes fails to point out that the only tax-free zone under the flat tax is for foreign-produced goods sold to Americans. And this at a time when the U.S. trade deficit is at record levels.



Perhaps worse yet, is the more subtle point Mr. Forbes misses: Both the flat tax and the income tax will create the need for far more intrusive regulation in the future. Taxation of income on such a massive scale as contemplated by the income tax and flat tax will require tax collectors to track, record, and verify flows of income. The difficulty of enforcing the income tax (a tax based on a complicated legal concept of income, deductions, credits, exclusions, deferrals, exemptions, and allocations) only worsens in the Digital Age where income can move around the world at the speed of light. The Internet has made tax evasion an increasingly popular sport. Tax policymakers have an obligation to transcend the impassioned rhetoric that has characterized the shallow debate over Internet taxation to address the very real problems that the income tax system will increasingly bring to electronic commerce on the movement of “income” as opposed to “goods” around the world.

If the U.S. continues to rely on taxing mobile income multiple times, financial regulation must be increased so that global transactions are monitored, and new treaties will have to be negotiated so that collection agencies throughout the world can assist us in collecting multiple taxes on savings and investment. Americans, already weary of the degradation of taxpayer rights, will have to be willing to relinquish their right to financial privacy to foreign taxing authorities. Non-U.S. Internet companies with no physical presence in the U.S. must be willing to freely exchange information with the U.S. government. In fact, the OECD (with full European support and tacit U.S. support) already plans to develop new information technology capabilities that will permit both the “detection of suspicious on-line transactions and verification of the customer” and “ensure that electronic commerce technologies, including electronic payment systems, are not used to undermine the ability of revenue authorities to properly administer tax law.” All of this is made possible by tax systems based on the income tax.

**Forbes issue:** “The tax is unfair in times of recession. In a down economy, when you may be earning less, you’d still be hit with the 30 percent tax when purchasing goods and services. Though you may be spending less, a certain portion of these expenditures, such as for your mortgage and other essentials, remains fixed. You’d still have to pay a 30 percent tax on them at a time when you might not be able to afford it. In contrast, the flat tax is based on how much you earn. If you’re making less in a bad down economy, you pay less tax. It’s a more flexible, accommodating system.” p. 84.

**Response:** Applying the logic of Mr. Forbes, the federal government should pass steeply progressive marginal rates that presumably lower the incidence of taxation when earnings fall during hard times. However, taxing income is the same as taxing work and productivity. And while the flat tax taxes wages, it does not help those struggling in a recession by continuing to impose regressive payroll taxes and continuing the hidden tax buried in the price of goods and services everyone must buy. The FairTax solves the problem of economic cycles in the simplest manner: By not taxing anyone on the necessities of life. And the FairTax helps foster greater prosperity by reducing marginal rates and removing the drag on economic growth imposed by taxing income. That means fewer recessions and greater prosperity.

**Forbes issue:** “The plan encourages redundant, inappropriate taxation of business. When a company buys, say, a sheet of steel to make a product, it is not supposed to pay sales tax on that



material; yet many small outfits end up mistakenly paying anyway. Forty percent of state sales taxes improperly fall on business inputs... This extra unfair layer of taxation reduces a business's profits. Many fear this unfortunate phenomenon of so-called cascading taxation will be exacerbated by national sales tax." p. 84.

**Response:** Business-to-business transactions are not taxed under the FairTax, any more than those transactions are taxed under the flat tax. More importantly, however, the FairTax is designed to do something about problematic state laws that improperly tax business inputs other than simply observe that fact. The FairTax provides a guiding template for state systems to correct the inequities and economic drag by adoption of the federal tax base.

But while this response dispenses with Mr. Forbes' direct criticism, the scenario he advances allows us to raise an additional related point against the flat tax. Under the flat tax, as today, we provide a substantial tax advantage to imports and foreign-produced goods that places all U.S. producers at a disadvantage. The reason for this is that we permit imported goods to enter our shores tax free, and gain a competitive advantage against American-produced goods courtesy of the federal government. And when U.S. producers seek to export U.S. products, foreign nations impose VATs on those products when they enter their markets. The advantage afforded foreign producers is approximately equivalent to 17 cents on the dollar, and is one reason America is running a trade deficit that is unsustainable. With each passing year, manufacturing is a smaller and smaller part of the overall economy. The value of all goods manufactured in the United States was roughly 30 percent of the value of all goods and services in the economy in 1953. It was 25 percent in 1970, 20 percent in 1982 and it fell below 15 percent in 2001. The share of the U.S. labor force working in the manufacturing sector fell over the same period from more than 26 percent to about 10 percent. And America is running a trade deficit that is about 7 percent of GDP, in every major good with nearly every nation. The FairTax addresses this problem by taxing imports the same as U.S.-produced goods, and by forgiving the tax on exports. The flat tax exacerbates this problem by continuing to allow China, Mexico, Canada, and Europe this unfair advantage.

It is time we made the foreign goods pay their freight by taxing them at exactly the same level as U.S. goods are taxed. Enabling fair competition isn't protectionism, it's self-preservation. When American producers can compete with foreign producers both at home and overseas without a hand tied behind our back, all Americans win. For this reason, the American Iron and Steel Institute supports the very border-adjustable system that the FairTax provides.

**Forbes issue:** "Collecting the tax using existing state apparatus, as some advocates propose, may not work. Each state has distinctions in what can be taxed. In some states groceries are taxed; in others, they are not. Some states tax newspapers and magazines; in other states these items are exempt. Some states tax clothes; others do not. Introducing a national sales tax is not a matter of piggybacking on preexisting sales tax systems. It would require a unique, uniform system across all fifty states." p. 85.



**Response:** This reason recommends the FairTax strongly. The FairTax would be the catalyst for the states to clean up their inefficient, illogical patchwork system of political favoritism. There is an incentive for states to become “conforming states” not present under the flat tax.

But in addition, the states only have the option to collect the FairTax; the federal government is not dependent upon them to do so. The Secretary of the Treasury may administer the tax imposed by the FairTax under several scenarios, such as where the state has failed on a regular basis to timely remit taxes collected, or simply determines it is in the best interest of the citizens of the United States that the administering state's authority to administer the tax imposed by this subtitle be revoked.

**Forbes issue:** “Sales taxes increase tax evasion. Experience shows that sales taxes face major enforcement problems when rates go beyond 10 percent. Studies have concluded that when governments attempt to enforce a retail sales tax at the level proposed with the NRST—30 percent—evasion picks up dramatically. Enforcement becomes a battle against sophisticated avoidance tactics. According to the Organization for Economic Co-operation and Development, ‘Governments have gone on record as saying a retail sales tax of more than 10 percent to 12 percent is too fragile to tax evasion possibilities...’” p. 85.

**Response:** Not only is there a complete absence of evidence to support this statement, but the evidence suggests the statement is opinion based on biased support for the income tax. FairTax.org has traced the origins of the OECD statement cited by Mr. Forbes to Vito Tanzi, former director of Fiscal Studies at the International Monetary Fund, who simply offered this opinion in a 1995 Brookings forum where he stated, “The general view...is that 10 percent may well be the maximum rate feasible under an RST.” However, Mr. Tanzi’s statements have no foundation in scholarly research or experience except unsubstantiated opinion. Mr. Forbes merely adds his voice to the echo chamber.

Economic studies demonstrate instead that the FairTax would actually have higher compliance rates at lower cost. In fact, Dr. Arthur Hall estimated that the costs to comply with a national sales tax would be as low as 1.0 percent of collections, 20 percent lower than the flat tax (Hall, Arthur P., “Compliance Costs of Alternative Tax Systems,” *Tax Notes*, Vol. 71, No. 8, May 20, 1996, pp. 1081-1089).

This largest portion of the tax gap (the difference between taxes paid and owed) is attributable to non-fraud, and that is largely dependent on the number of taxpayers and the level of confusion, both of which diminish under the FairTax. Under the FairTax, the only question asked of retailers is “how much did you sell to consumers?” The increased transparency of the system induces more compliance because it increases the likelihood that tax evasion is uncovered. And the roughly 90-percent reduction in filers enables tax administrators to address instances of noncompliance more effectively.

These studies focus on the fact that the FairTax improves upon all known factors that bear upon compliance, even if we are looking only at outright evasion. FairTax.org agrees that marginal rates are important to stymie evasion, but that is precisely why compliance increases.



Marginal tax rates under the FairTax are the lowest they can be under any revenue-neutral tax system; cheaters profit less from cheating. In short, tax collectors focus enforcement resources on far fewer taxpayers, using consistent and vastly simpler forms, with far fewer opportunities to cheat, diminished incentives to do so, and a far greater chance of getting caught if they do. That is why research based on the facts shows the FairTax will have a much higher compliance rate than the current system, despite Mr. Forbes' opinion to the contrary.

But there is also empirical evidence. State sales taxes are enforced with so much less evasion and with lower compliance costs that it should literally embarrass proponents of an income tax system.

**Forbes issue:** “The plan’s business exemption will encourage tax avoidance. You’ll see a rush of eligible and ineligible people seeking to declare themselves ‘businesses’ in order to qualify for the NRST’s business exemption. Licenses and exemption certificates for phony businesses would be rampant.” p. 85.

**Response:** Violating a known legal duty is not ‘avoidance,’ it is a criminal act called tax evasion and it carries severe penalties today and under the FairTax. Under any tax system, including the flat tax, individuals can improperly declare themselves sole proprietors and stimulate artificial business deductions or inputs. What would prevent a taxpayer under the flat tax from claiming a purchase used for personal reasons was actually a business expense? This is a problem of enforcement common to all tax plans, and the 45 states with sales taxes also have that same issue today, and they are able to police who is a real business and who is not.

**Forbes issue:** “The national retail sales tax puts retailers in the unfair position of policing their customers. Retailers would have to determine, for example, whether the lumber a customer just bought is really meant for business resale—or for fixing up the customer’s kitchen. ‘It is not in the best economic interest of retailers to be especially suspicious of exemptions; questions may cause loss of a profitable sale, and only the government gains when the questions are asked,’ writes John Mikesell in *Tax Notes*. Yes, the NRST would penalize cheating, but that only would affect those who were caught. The best solutions to tax evasion are preventive, not merely punitive. And the NRST only offers a punitive approach.” p. 85.

**Response:** The retailer charges tax on everything unless the business presents the proper tax certificates and the proper paper trail is created. The retailer does not have to play tax policeman.

**Forbes issue:** “Political obstacles to the NRST may be too great. Passing the NRST would require a huge mobilization of political resources—far greater than those needed to pass a simple flat tax. To work as intended, the national sales tax would require the repeal of the Sixteenth Amendment, which would be difficult and time-consuming.” p. 87.

**Response:** We have a duty to do what’s right, not what is easiest. Sure, it would be a lot easier to pass bills that only partially fixed a bad problem, but this is a bad reason not to try and pass a real solution.



**Forbes issue:** “A flat tax has all the principle [sic] benefits of a national sales tax without its chief liability: enforcement and evasion difficulties. A flat tax would be fairer and simpler than a national sales tax. Under a flat tax, for example, everyone would get the same exemptions. It would also be more efficient, because there’s a system already in place that is a proven tool in collecting the huge amounts of revenue. It’s not that the national sales tax is all bad. It’s just that we can reform the current code faster, and better, with a flat tax.” p. 88.

**Response:** A flat tax does share two attributes of the FairTax, at least before it denigrates into an income tax. The flat tax reduces marginal rates and it does tax income only once as a consumption tax (i.e., a variant of a VAT). However, it does not share many other salient attributes. It is not revenue neutral. It retains the IRS and the entire complex and corrupted income tax apparatus. And while it permits all taxpayers to file a short tax form, the vast majority of taxpayers do that today with the Form 1040EZ. It ensures the average American continues to be a tax collector and a taxpayer. It taxes education and tuition. It retains the onerous payroll taxes that provide a drag on upward mobility. It fails to adopt a border-adjusted tax system, ensuring that U.S. products are placed at a huge competitive disadvantage to foreign products. It continues to hide the taxes in the price structure of goods and services sold. It does not untax the poor on the necessities of life. It does not protect Americans against another income tax, much like the alternative minimum tax today coexists with the income tax. And perhaps most importantly, still, even its dubious benefits are not sustainable for long. The flat tax will soon denigrate into the income tax it was intended to replace.

**Forbes issue:** “The NRST would unnecessarily inflate the cost of government to you, the taxpayer. The National Retail Sales Tax would also apply to purchases made by the government. The Pentagon, for instance, would even pay a 30 percent levy on the cost of an aircraft carrier. Think of all the supplies and equipment Uncle Sam buys. The tax would raise the cost of government in America by literally hundreds of billions of dollars. Who would ultimately foot this spiraling bill? You, the taxpayer—possibly in the form of an even higher tax rate. Some experts say that the national sales tax rate would have to rise to about 60 percent in order to account for the combined effects of higher cost of government and evasion tactics. Governments—federal, state, and local—don’t pay sales taxes now and aren’t likely to pay a national sales tax. Which means that the rest of us will likely foot the bill for that shortfall.” p. 86.

**Response:** Government employees and government contractors are taxed today. Failure to tax government under a sales tax would dramatically increase the size of government. Moreover, failing to tax consumption through government would create a large artificial incentive to consume through government rather than buying goods and services from government.



A FairTax rebuttal of *Flat Tax Revolution*

**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 16<sup>th</sup> 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](http://www.FairTax.org) or call 1-800-FAIRTAX.

DRM/km 2-9-06

(AFFT Documents\Papers on a specific subject\A FairTax rebuttal of Flat Tax Revolution)