

Dear Congressman Goodlatte:

Thank you for your thoughtful reply to my letter in support of the FairTax. You assert many points in your letter, however, nearly all perpetuate common misconceptions about the FairTax that I feel must be addressed. Consequently, I accept your invitation to continue our dialogue over this unique reform proposal in the hope that future letters may address these inaccuracies. Since the letter is quite long, allow me to better organize the issues with headings.

Economic growth is a certainty.

To begin with, you correctly assert that stimulation of economic growth – or rather reduction in the drag on economic growth we impose from our oppressive income tax system – is one of the key reasons for tax reform. But you incorrectly imply that only dubious economic benefit would flow from the FairTax when those benefits are not mere speculation, but certainty. To imply that the FairTax “may” and therefore “may not” lead to economic growth contradicts our nation’s foremost economic thinkers and casts doubt on the basis of any sound reform measurement, including the flat tax.

Congressman Goodlatte, growth may come from tax cuts, but growth in the context of true *revenue-neutral* reform results from: (1) reducing marginal rates (broadening the base), (2) eliminating multiple taxation of savings and investment, and (3) eliminating deadweight loss of inefficient loopholes. By taxing total consumption at a single rate without exception, the FairTax lowers average marginal rates more than any plan that does not double and treble tax savings or investment. In fact, the FairTax applies to a base (\$8.638 trillion) more than double that of current taxable income (\$4,202) and larger than the flat tax (\$8,507). For that reason, the average marginal rate under the FairTax is, by definition, lower than current law and the flat tax, and the economic growth unleashed by the FairTax is greater. Consider that the *flat tax* in comparison retains payroll taxes that impose a 15.3 percent wage tax on the first \$90,000 of earnings, which raises the average marginal rate in order to impose a double tax on labor value added. Three-quarters of Americans pay more in payroll taxes than income taxes.

Mainstream economists claim the FairTax will increase savings and investment, our capital stock, our productivity, and ultimately the real wages (and disposable income) of the U.S. worker. Work by Harvard economist Dale Jorgenson shows a quick 9 to 13 percent increase in the GDP after passage of the FairTax; similarly, Boston University economist Laurence Kotlikoff predicts a 7 to 14 percent increase. And the figures in these studies translate into more than economic abstraction. These figures show that the real effect of taxes – how long people must work to pay for the federal government – can be reduced. These figures also show that each day Congress delays passage of the FairTax further suppresses the prosperity and economic well-being of the American people and requires them to work harder to pay the costs of government, whatever those costs.

The concerns of The Heritage Foundation are political and not economic.

You note that you have some concerns about this proposal that are shared by The Heritage Foundation and, thankfully, the now disbanded President's Advisory Panel on Federal Tax Reform. Please understand that when you refer to the President's Advisory Panel on Federal Tax Reform – itself comprised of lobbyists – you refer to a group that never analyzed the FairTax plan, but rather a plan of their own creation. And even then, they did not deny the sizeable economic benefits from the flawed single-stage consumption tax they engineered. When you refer to the position of the Heritage Foundation, you are referring to Dan Mitchell – their spokesman on tax policy – who has written in favor of the FairTax as far back as ten years ago (See “Flat Tax or Sales Tax? A Win-Win Choice For America” by Daniel J. Mitchell, Ph.D., Backgrounder #1134, The Heritage Foundation, August 14, 1997) and testified in favor of the FairTax before the House Ways and Means Committee. He supports both the FairTax and the flat tax as low rate, consumption taxes. In his article, for example, he states:

Because plans for the Flat Tax and a national retail sales tax are so similar, lawmakers have no reason to champion one at the expense of the other. Advocates of tax reform should seek instead to highlight the benefits and similarities of the two plans and, when the opportunity arises, rally behind the one that has garnered more political and popular support. Both the Flat Tax and the sales tax would simplify the current tax code, boost income, stimulate the economy, and end the bias against savings and investment.

Dr. Mitchell's main disagreements over the FairTax are not based on concerns over economic growth. Like all mainstream economists, Dan Mitchell and Bill Beach of The Heritage Foundation (as well as AEI, Cato, and even Brookings) believe that a system which reduces marginal rates and stops the punishment we impose on savings and investment will create growth. Rather, Dan Mitchell's concerns stem from his belief (1) that because the flat tax hides the full cost of taxation along the chain of production, it would be more palatable to Members of Congress who don't believe the American people are prepared to see the full cost of their government, and (2) that without a constitutional amendment, the FairTax might coexist with an income tax, as sales taxes at the state level have done.

You should have greater political concerns about the flat tax.

Neither should “political” concern dissuade your support for the FairTax. To begin with, FairTax supporters find it disturbing that the main attribute of the flat tax is that it looks like the income tax into which it will quickly devolve. The FairTax is the most visible form of taxation by design, as it reveals the full, painful cost of the federal government and it should not be faulted for that reason. Hiding the tax as the income and flat tax (a form of VAT) do may enable taxpayers to bury their heads in the sand about the level of governmental costs, but it will not create the downward pressure on the size of government you profess to seek. For that very reason, it may encourage disintegration of the base. Consider Senator Specter's version of the “flat tax” which actually reinstated the mortgage interest deduction before it was introduced. If the realtors got their way before Senator Specter sent his “flat tax” to legislative counsel, how long do you think it would take before the rest of the corporate welfare lobbyists destroyed what remained of

the true reform aspects of the bill? The FairTax vests *everyone* with the interest of ensuring government is limited.

Turning to his point that the FairTax must be preceded by a constitutional amendment, I also disagree. When Americans experience a tax system that does not require returns, it is doubtful they will want to return. Nor is it possible the nation could revitalize the significant support apparatus needed to sustain the income tax: The IRS, the tax accountants, the tax lawyers, the schools, and the rest of the infrastructure. Our income tax is supported by its own bureaucracy, which the FairTax eliminates.

What lawmakers should be more concerned about is the false assurance of flat taxers that the statutory two-thirds majority requirement in their bill offers anything other than a Potemkin Village. In point of fact, that two-thirds requirement can legally – and would quickly – be overridden by a simple majority of Congress. And while flat tax supporters like to spread the fear that a single-stage consumption tax would be an add-on tax, policymakers should be more concerned with the fact that the flat tax itself would either devolve back into an income tax with a broader base and higher rates or coexist with income, capital gains, death, and payroll taxes.

Flat tax supporters who doubt this should look no further than statements made by the fathers of the flat tax. While many flat taxers shun the label of VAT, in their book Robert Hall and Alvin Rabushka (See *The Flat Tax*, Second Edition, Stanford, California: Hoover Institution Press, 1985, pp. 109-111) discuss how the flat tax is a VAT. Economists see the flat tax as a VAT that taxes capital value added at the business stage and labor value added at the individual stage. And VATs 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. Unlike the FairTax, there is absolutely nothing to prevent the flat tax VAT from coexisting with income, death, and capital gains taxes. I repeat: If the flat tax is not actually enacted side by side along with capital gains, death, and income taxes, then it is likely that the flat tax would simply disintegrate into an income tax within a span of only a few years.

This again is the reason you should support the FairTax. 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 instead of requiring the 16th Amendment for its implementation. We encourage you to support the FairTax and repeal of the 16th Amendment.

Enabling taxpayers to buy the necessities of life free from government tax is not an “entitlement.”

You have also stated you are “apprehensive” that the FairTax “prebates” would create a new entitlement program. I disagree. The prebate is meant to untax the poor, which may appear to be a novel idea but makes eminent sense. The prebate is meant to hold everyone harmless against the purchases which comprise life’s necessities. In fact, it is based on the FairTax rate times the poverty level. Today, with the combination of payroll taxes and hidden taxes buried in goods and services everyone buys, we all pay the

federal government before we have provided for our families. The government must then enact entitlements which channel those amounts back to American families in the form of welfare, standard deductions, exemptions and other means. Nobody should consider enabling Americans to pay for their own sustenance before meeting the desires of an overly bloated government to be an entitlement. And FairTax supporters do not see keeping their resources to meet life's minimal costs at the HHS poverty level to be the equivalent of an entitlement. What is an unnecessary entitlement, I might add, are the myriad loopholes benefiting the best lobbyists, none of which would go away permanently if a proposal like the flat tax or any one of the proposals recommended by the President's panel were passed.

If you are concerned about the FairTax rate, you must support hidden taxes.

You state further that you have misgivings about the proposed rate of the tax. However, if you have misgivings about the FairTax rate, then you are simply complaining about the size of the government or are inconsistent in your criticism of the FairTax relative to other consumption plans that have nearly identical bases (and smaller at that). As I noted, the FairTax base is double that of taxable income, and therefore the revenue-neutral rate would, by definition, have to be almost half that of the income taxes and payroll taxes combined. If the rate is too high, no matter what the rate has to be, what does that tell us about the hidden taxes the Congress has imposed on the American taxpayer? As I assume you do not support hidden taxes, would not a visible rate reduce the size of government by vesting everyone in the full tax system? The tax reform panel did do some rate analyses; however, they again failed to analyze the FairTax, and as is typical of the Office of Tax Analysis, performed their math in total secrecy, denying the ability of anybody to check their calculations. The truth of the matter is the FairTax rate does not have to be anywhere near 40 percent; if it were, the average marginal rate of the current system would be 80 percent.

The FairTax will have better compliance at lower costs.

You state further that a tax rate this high would encourage evasion – possibly as high as 30 percent evasion – which you assert is only 10 percent more than the current tax evasion rate. However, such an assertion is fraught with error. Economic studies demonstrate instead that the FairTax will actually have higher compliance rates at lower cost than either the flat tax or the income tax. 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 Foundation Special Brief before the House Ways & Means Committee, June 1995).

Much of the incredible \$345 billion dollar tax gap today is not based on evasion (which is defined as an intentional violation of a known legal duty), but rather mistakes and non-willful non-payment. But the level of confusion diminishes dramatically under the FairTax, where 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 more effectively instances of noncompliance.

Even if we look only at evasion, cheaters profit less from cheating because marginal rates are lower (the base is broader). In short, tax collectors focus enforcement resources on far fewer taxpayers, with far fewer opportunities to cheat, diminished incentives to do so, and a far greater chance of getting caught if they do. Today we impose nearly \$300 billion in compliance costs only to capture 75 percent of the income taxes owed. The FairTax reduces compliance costs while increasing compliance rates.

The FairTax untaxes the poor and reduces rates on the middle class.

You assert the FairTax would inequitably burden the poor. In particular, you state that, “while ‘prebates’ will help lower-income families purchase some necessities, a sales tax this high could still impose quite a burden on these families.” You further state that, “under current law, the average effective tax rate for the lowest 20% of individuals by income is 5% [which could] jump to 30% under a national retail sales tax.” And you add that, “[o]ther options for tax reform, such as a flat tax with an exemption, present many of the same benefits as the Fair Tax but provide more relief for low-income families.” Your assertions are incorrect at many levels.

First, because the FairTax untaxes consumption up to the poverty level, the FairTax literally “untaxes” the poor and makes the tax truly electable on consumption items. The same cannot be said for the flat tax which, like the income tax, imposes the regressive levy of payroll taxes on those who earn their income from wages and ensures that purchases continue to contain a hidden component of taxation and compliance costs imposed upstream. The middle class are especially hurt by payroll taxes under the flat and income taxes, which are imposed on the first \$90,000 of earnings for 2005 and drop to 2.9 percent after \$90,000 of earnings.

Second, before such an assertion is made, you should consider how retention of the current system reduces real wages and economic well-being, and therefore introduces its own regressive, distributional impact. Recent simulations under the present system show capital per unit of human capital declining 5.0 percent over the course of the century for an 18.0-percent decline over the long run in after-tax take-home pay. A switch to the FairTax will cause real wages to rise by 13.0 percent for an 18.0-percent difference in remuneration. By 2030 real wages under the FairTax will be 9.3 percent higher than they otherwise would be. The shift to the FairTax raises marginal labor productivity and real wages over the course of the century by 18.9 percent and long-run output by 10.6 percent. Under the FairTax, in the long run, low-income households experience a 26.7 percent gain, middle-income households experience a 10.9 percent gain, and high-income households experience a 4.7 percent gain.

Third, you should consider savings from compliance cost reductions that inure to the middle class. Compliance costs are significant, regressive, and growing. The Tax Foundation estimates taxpayers spent \$265.1 billion dollars in 2005 and will spend over \$482 billion a year by 2015 complying with the code. TF’s December 2005 study

(Special Report No. 138) showed taxpayers with less than \$50,000 of AGI pay over 54 percent of the total compliance cost to individuals – \$60.3 billion out of \$110.7 billion. TF estimates compliance cost reductions greater than with the flat tax.

But perhaps most importantly, you are wrong in applying an income tax metric. Flat taxers and FairTax proponents must agree that whether or not a consumption plan is “fair” should not be pre-ordained by imposing standards of distributional equity which frame the question by reference to an income tax. For instance, a Treasury Department study on income mobility showed current annual income was a poor proxy for whether the taxpayer is on average “high income,” “middle income,” or “low income. In the lowest quintile, a greater percentage of taxpayers moved to the fifth (highest) quintile over the ten-year period than remained in the first quintile. Alternatively stated, the poorest quintile were more likely after ten years to be in the richest quintile than the poorest. Policymakers should adopt the recommendations of the Council on Economic Advisors in framing the debate over distribution. And measure distribution as a function of improvement in real wages.

The FairTax does abolish the IRS actually and symbolically.

You state as well that, “the federal administrative burden for a national retail sales tax would likely be similar to the burden under the current system.” You state that a federal agency, “such as the IRS, would still be required to administer the tax and another agency to keep track of personal information such as family size that would be necessary to determine the size of the taxpayer's ‘prebate’”. You are incorrect again. Under the FairTax, unlike the flat tax, the IRS is eliminated both symbolically and literally. In point of fact, the FairTax is administered by state taxing authorities and does eliminate the IRS. The FairTax contemplates that the states, most of which have had more than 60 years of experience in the administration of the sales tax, will enforce the FairTax. Today, 98 percent of the population is covered by state or – in Alaska – local sales taxes. TITLE III— SEC. 301 provides as follows:

APPROPRIATIONS.—Appropriations for any expenses of the Internal Revenue Service including processing tax returns for years prior to the repeal of the taxes repealed by title I of this Act, revenue accounting, management, transfer of payroll and wage data to the Social Security Administration for years after fiscal year 2009 shall not be authorized.

But the FairTax doesn't just eliminate the IRS as an institution; it eliminates what the IRS represents. When people conceptualize the IRS, they see all it entails. They see compliance costs of nearly \$300 billion. In 2010, the total number of U.S. returns is estimated to be 249,688,100. For Fiscal Year 2003, the total information returns received was 1.313 billion; the IRS made 4.288 billion contacts and sent out 8 billion forms and instructions so taxpayers could attempt to know how much they owe. In 2003, Americans were assessed 28,767,480 civil penalties. They also see privacy intrusions. And they see a disintegration of civil rights.

The FairTax could hardly impose a burden “similar to the burden under the current system” when it wholly exempts individuals from ever having to file a return and eliminates 95 percent of the cost drivers under current law. Business-to-business

transactions are fully exempt; businesses that serve other businesses will neither collect nor pay taxes. Retailers, most of which already pay state sales taxes (in the 45 states that have them), are provided a credit compensating them for the costs of sales tax compliance. Even if all approximately 25 million business establishments in the U.S. were retailers, the number of returns would reduce 86 percent (we can expect the number of businesses remitting the FairTax to be far less).

The transition rules are contemplated and miniscule.

Finally, you state that a tax system of this nature poses problems of transition, “require[ing] many sectors of the [economy] to be forced to make sweeping changes in the way they do business.” Yes, Americans will have to get used to nearly \$280 billion in compliance cost savings. They will have to get used to not paying income or payroll taxes or any taxes before they have decided whether to invest that income (which is not taxed), pay for tuition (which is not taxed), buy a used home (which is not taxed), give to charity (which is not taxed) or consume it for themselves. Corporations will have to get used to paying no income or payroll taxes as well. Foreign producers will have to get used to competing on a level playing field with U.S. producers since they have long been given a free ride on taxation by the current system exempting foreign producers.

The FairTax plan is in fact the only plan that does not “dismiss these difficulties” as you assert it does. FairTax.org has spent considerable resources meeting with industries to seek to reduce transition costs. One of the largest transition rules is a delay between the date of enactment and the effective date. On the other hand, the flat tax, which you seem to prefer, totally ignores transition rules. For example, a business which buys inventory one day before enactment of the flat tax and sells it one day after enactment gets no deduction but must include the entire gross receipts in income for purposes of the flat tax (VAT).

You made the interesting analogy to going “cold turkey,” a phrase commonly applied to smokers or other addicts who kick the habit. The transition rules are not as hard as getting a smoker to quit, but they are equally necessary for the health of our economy. Today, the Congress is addicted to the income tax system as a political vice. Tax writers’ addiction to tinkering with the tax system will indeed be an addiction to break, but one that is necessary.

Congressman Goodlatte, I would like to make one final point. You stated that you share my view that the country is in desperate need of fundamental tax reform. I am thankful for that; however, the gist of that remark is repeated in the many letters which many fellow supporters of the FairTax receive from Members of Congress, including those who have given a lot less thought to the problems. We appreciate your efforts to abolish the current tax code to finally force Congress to fully confront reform. That may be important symbolism. However, in the end, sunseting the current code only identifies with people's problems, while offering no substantive solution. Most of the FairTax

supporters believe that it is time Congress moved beyond the platitudes about common concerns with the tax system.

You note that since the Fair Tax Act was introduced on January 4, 2005 and referred to the Ways and Means Committee, no further action has taken place. Actually, there has been significant action. FairTax.org, the largest taxpayer organization ever assembled in the history of this nation, continues to grow daily in both numbers and significance. There are now more than 50 members of the House that support the proposal.

If you do not support the FairTax, which lowers marginal rates more than any plan, untaxes the poor, places American producers on a level playing field with foreign producers, makes the cost of the government visible for the first time, reduces compliance costs more than any other plan, then what proposal do you think would be the best replacement of the income tax we have today?

With all due respect, the American people know you “feel their pain”. However, it is time for solutions, not empathy. We welcome your support for the FairTax because it offers that solution, and we stand ready to help you and your staff better understand the benefits of the FairTax over other competing plans. Your observation about the problems of the current system are accurate, but they can be best addressed through the FairTax.

To continue this dialogue, I welcome the chance to discuss the proposal with you in person.

Sincerely,

M. Evans

This is the letter sent by Congressman Goodlatte to Mr. Evans:

Dear Mr. Evans:

Thank you for contacting me regarding the Fair Tax Act. I appreciate hearing from you, and I share your belief that our country is in desperate need of fundamental tax reform.

In fact, I have twice voted to abolish the current tax code, and recently introduced legislation which will force Congress to address tax reform head on. My bill, the Tax Code Termination Act, is quite simple. It contains only two provisions. The first will abolish the Internal Revenue Code by December 31, 2009, and the second calls on Congress to approve a new Federal tax system by July of the same year. Passage of the Tax Code Termination Act will finally force Congress to fully confront reform of our tax

system.

As you may know, H.R. 25, the Fair Tax Act, was introduced by Representative John Linder of Georgia, and would abolish all federal income taxes, including capital gains taxes, payroll taxes, estate and gift taxes, and corporate and self-employment taxes and replace them all with a 23 percent national sales tax.

This proposal would dramatically change the basis for taxation in this country, taxing citizens only on what they spend, not on what they earn. There are a number of benefits to a tax system like that proposed in the Fair Tax Act. Representative Linder's bill would give individuals more flexibility in managing their own money, since their taxes would be dependent on their lifestyles. It would also reduce the costs of filing since most paperwork that is now associated with tax compliance would be eliminated. Finally, a retail sales tax would not tax normal returns to savings and investment and therefore may lead to economic growth. These are all attractive reasons to favor such a system.

While the benefits of the Fair Tax Act are appealing, I also have some concerns about this proposal. Many of these concerns are shared by the Heritage Foundation, a leading conservative think tank, and the President's Advisory Panel on Federal Tax Reform which was tasked with advising the President on options to reform the tax code to make it simpler, fairer, and more pro-growth.

One apprehension I have is that a national retail sales tax that uses "prebates" to achieve a degree of progressiveness would create a new entitlement program – by far the largest in American history. A program such as this would represent 42% of federal entitlement spending and exceed the size of Social Security, Medicare and Medicaid. It would cost approximately \$600 billion per year and make most American families dependent on monthly checks from the federal government for a portion of their income. Increasing the size and scope of government this dramatically is of great concern if you believe, as I do, in limited government.

I also have misgivings about the proposed rate of the tax. Even with favorable assumptions, it is estimated that a retail sales tax with a "prebate" program would require a tax rate of at least 34%, and likely higher over time if the base erodes due to exemptions. Additionally, by most accounts, a tax rate this high would encourage evasion, forcing the base rate even higher. No state or country has ever levied a retail sales tax at a rate even remotely close to 34% and the President's Panel estimated that with 30% evasion, only 10% more than the current tax evasion rate, the base rate of a retail sales tax would need to be close to 50%.

While "prebates" will help lower-income families purchase some necessities, a sales tax this high could still impose quite a burden on these families. "Prebates" would only

cover sales tax on the purchase of goods up to the poverty level – about \$20,000 for a family of four - leaving much of what a family of this size needs to be taxed at a rate that could be 40% including Virginia sales tax. Under current law, the average effective tax rate for the lowest 20% of individuals by income is 5%. This effective rate could jump to 30% under a national retail sales tax. Other options for tax reform, such as a flat tax with an exemption, present many of the same benefits as the Fair Tax but provide more relief for low-income families.

Additionally, the federal administrative burden for a national retail sales tax would likely be similar to the burden under the current system. A federal agency, such as the IRS, would still be required to administer the tax in order to ensure adequate collection of federal revenues and enforcement of the rules of the underlying tax. Indeed, two types of administrations would probably be needed, one to collect the tax and one to keep track of personal information such as family size that would be necessary to determine the size of the taxpayer's "prebate".

Finally, a tax system of this nature poses other problems such as the difficulties associated with the transition to the new system. For example, individuals who accumulated savings under the current system paid taxes on it. Yet under the proposed system they will be taxed again when they spend those savings. This could be especially worrisome to retirees. Also, a retail sales tax may place a disproportionate burden on small businesses. The President's Panel estimated that the cost to small retailers collecting the tax would be 6.5% of taxes collected, as opposed to less than one percent for larger businesses.

Also, with a transition to the Fair Tax, many sectors of the economy would be forced to make sweeping changes in the way they do business. Companies built their business plans while taking aspects of the current tax code into account. While I am confident companies could adapt in the long run and would be better off under a simpler tax system, the short-term affects of the transition could have some serious consequences to sectors of the economy like health care, construction, automobile, and computer industries. The proposed plan seems to dismiss these difficulties. A transition of "cold turkey" may sound simple but it doesn't take into account possible short-term damage to businesses fundamental to the overall health of the economy.

In reforming our nation's method of taxation, we must ensure that new reforms do not have negative economic consequences on the citizens and businesses that they are attempting to help. The Fair Tax Act has both positive and negative aspects. Rest assured I will keep your views in mind as Congress continues to debate the pros and cons of this important legislation.

The Fair Tax Act was introduced on January 4, 2005, and was referred to the House

Committee on Ways and Means. No further action has taken place. Rest assured I will keep your views in mind as this legislation moves through Congress.

You may be assured that spending and tax reductions will remain my highest priority for the 109th Congress and that I will continue to look for ways to simplify this needlessly complex tax process.

I appreciate you taking the time to contact me. I feel it is important to keep an open line of communication so I can best serve the interests of the 6th district. I hope you will continue to be in touch as the 109th Congress debates issues of importance to the United States.

Again, thanks for the benefit of your comments. Please feel free to contact me whenever I may be of assistance.

Sincerely,

Bob Goodlatte
Member of Congress