

April 4, 2007

The Honorable Hillary Rodham Clinton
United States Senate
476 Russell Senate Office Building
Washington, DC 20510

Subject: H. R. 25, The FairTax

Dear Senator Clinton:

Thank you for your letter of November 20, 2006. In that letter you expressed a number of the usual issues regarding the impact of the FairTax. I have attempted to address your concerns and specifically refute the sources upon which you rely, especially the Brookings Institution Report that erroneously establishes a 60 percent rate. I believe that after analyzing and understanding the FairTax, you will find that your misgivings are unfounded and that the FairTax meets your tax reform objectives of simplicity and progressivity. I would also direct your staff to the FairTax Web site (www.FairTax.org) that provides the empirical research to substantiate my statements which address your doubts.

Simplicity. In 2010, the total number of U.S. returns is estimated to be 249,688,100. In FY 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 owed. In 2003, Americans were assessed 28,767,480 civil penalties (19.1 million for the individual income tax alone). Consider as well that income taxes are collected in the course of a coercive and even brutal examination of virtually every aspect of every taxpayer's life. Each taxpayer, furthermore, is obliged by law to keep accurate records of his income and deductions, and then painstakingly and truthfully to fill out and submit the very forms that detail his life. And this is a lot of obliging. For FY 2005, individuals filed 131 million returns, partnerships filed 2.5 million, and corporations filed about 6 million for a total of 224 million returns.

The FairTax is vastly simpler than the existing system. Individuals who are not in business need never file a tax return again in their lives. Under the FairTax, businesses need only track their sales to consumers. By contrast, today businesses must comply with a wide variety of complex rules regarding inventory (including the uniform capitalization rules); complex rules regarding capital cost recovery (including tracking for each asset its basis using sometimes three different depreciation schedules for regular tax, alternative minimum tax, and earnings and profits purposes); complex rules regarding pensions and other qualified plans; complex rules regarding employee benefits; complex rules regarding passive loss limitations; a myriad of rules regarding qualified dividends and capital gains; complex rules regarding income sourcing, expense allocation, and separate foreign tax credit baskets for international tax purposes; and so on.

State and local taxes. The state and local tax deduction is not available to low- and moderate-wage earners. It is exclusively available to the more prosperous minority of taxpayers who itemize. It allows taxpayers to pay their state and local income and property taxes with pre-income tax (but after-payroll tax) dollars. By contrast, the FairTax allows *all* taxpayers (including those who do not itemize) to pay those taxes with *entirely* pre-tax dollars (dollars that have not been subject to income, payroll, or sales tax). Thus, the FairTax provides all Americans the benefits of state and local tax reductions now available only to those who itemize under the current tax system.

Tuition. Only under the FairTax (and not current law), education is treated as an investment in human capital and is not taxed. Under the current system, most taxpayers today have to pay their tuition with after-tax dollars. Only a very few can take advantage of complex rules to limit the income tax they must pay with respect to income used to pay tuition. Thus, under the FairTax there is no sales tax imposed on primary, secondary, or university tuition, and all taxpayers may pay tuition entirely free of any tax. If the current system were to be made to encourage education as the FairTax does, then an amendment would be required to allow a much broader deduction against income and payroll taxes.

Progressivity and household necessities. The FairTax provides each family with a prebate monthly in advance that protects all families from paying sales tax on the necessities of life. Every household is exempt from taxes on spending up to the poverty level and married couples receive an extra amount to prevent a marriage penalty. Thus, a couple with two children receives a prebate of \$6,297 per year, allowing them to consume \$27,380 free of tax and reducing the effective tax rate on a family spending \$54,760 to 11.5 percent. In contrast, all families today – even the poor – pay 15.3 percent in payroll taxes (which are repealed by the FairTax). The FairTax is the only tax reform plan that entirely eliminates taxes for the poor because it is the only tax reform plan that repeals the high and regressive payroll tax. Thus, your concerns about the impact of the FairTax on low-income Americans and the poor are misplaced.

The tax rate. The Brookings Institution study you cite did not analyze the FairTax when it erroneously concluded that the FairTax would impose a 60 percent rate. It finds that a sales tax plan invented by Bill Gale, the study's author – a dedicated sales tax opponent – with an extremely narrow, loophole-ridden tax base would require such a high tax rate. Objective studies find that the FairTax rate, depending on the year, is revenue neutral at a 23 to 25 percent tax rate. For example, a recent study by the Beacon Hill Institute at Suffolk University and Laurence Kotlikoff of Boston University and the National Bureau of Economic Research found the FairTax revenue-neutral rate to be about 23.5 percent in 2007. See "Taxing Sales Under the FairTax: What Rate Works?" *Tax Notes*, Vol. 113, No. 7, November 13, 2006. The debate between Laurence Kotlikoff and Bill Gale about this very subject took place on February 28, 2007 at the American Enterprise Institute. Mr. Gale was asked to retract his erroneous math. Whether he is willing to admit his error is one consideration, but the fact remains that the base of the FairTax is almost twice that of taxable income – allowing for a lower marginal rate. Of course, that effective rate is zero or less for the poor.

Stagnating blue-collar wages. The current tax system punishes U.S. manufacturers by imposing very high taxes on U.S. producers – both workers and businesses – and imposes no appreciable tax on goods and services imported into the U.S. The current tax system, therefore, places U.S. producers at an approximately 20 percent price disadvantage when competing against foreign manufactured goods in the U.S. or in export markets. Therefore, the continued loss of high quality, high-paying manufacturing jobs to foreign companies should come as no surprise. Furthermore, by placing U.S. firms at such a large disadvantage, the tax system forces U.S. firms to hold down U.S. wages in order to compete effectively even if they are much more efficient than foreign firms. If they do not contain U.S. wages or outsource, then they will go bankrupt. The FairTax addresses this huge inequity by taxing U.S. goods and foreign goods sold in the U.S. alike and by eliminating the advantage accorded by the current tax system. Furthermore, the FairTax imposes no tax on U.S. exports. This will enable U.S. firms and workers to compete more effectively with their foreign counterparts (all of whom receive similar treatment on their exports by their countries' value-added tax or goods and services tax).

Savings from compliance cost reductions inure to the middle class. Compliance costs are significant, regressive, and growing. The Tax Foundation estimates taxpayers spent over \$265.1 billion dollars in 2005 and will spend over \$482 billion a year by 2015 complying with the code. The Tax Foundation'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 the \$110.7 billion.

I hope you and the appropriate representatives of your Senate office and presidential campaign will make the effort to analyze properly the FairTax in light of these facts. To that end, more detailed studies which address the concerns you have raised and others can be found on FairTax.org. In addition, I understand that economists and researchers on the FairTax team can provide you with detailed briefings at your earliest convenience. Given your reputation for rigorous and fair debate of the issues, I feel confident that you will reevaluate your position on the FairTax.

Sincerely,

Jeff Decker

In the spirit of full disclosure, Senator Clinton's letter to Mr. Decker is attached below. This is the "standard" letter that apparently is sent by the senator's office to all constituents who have written requesting her position on and support of the FairTax. Quite a few have responded to her standard letter with answers to her concerns, however, they simply receive the standard letter as her second and third response.

Dear Mr. Decker:

Thank you for taking the time to write to me. Your concerns regarding the Fair Tax Act of 2005 (S.25) are important. There are many concerns that the tax code in its current form is too complicated and that it should be made simpler and fairer but also more progressive and fiscally responsible. Nevertheless, I am concerned that the Fair Tax Act would not achieve these objectives.

The Fair Tax Act of 2005 seeks to eliminate the income tax, employment tax, estate tax and gift tax, replacing all of that federal revenue with a national sales tax on all consumer purchases. I am concerned that this bill could result in a more regressive tax policy that disadvantages middle and working-class families who would be deprived of benefits such as the child tax credit, the state and local tax deduction, the college tuition tax deduction and other important tax benefits while having to pay a greater share of their income to purchase household necessities. Moreover, in order to generate as much revenue as the current tax system, according to the non-partisan Brookings Institution, the national sales tax rate would have to be somewhere around 60%.

Thank you again for sharing your concerns regarding these important tax reform issues with me. Please be assured that I will keep your views in mind regarding the Fair Tax Act as this issue is debated in the Senate. For more information on my commitment to fiscal responsibility and a simpler, more progressive tax code, please visit <http://clinton.senate.gov>.

Sincerely,

Senator Hillary Rodham Clinton