



Is Making Taxes “Fair” the Answer?

The current federal tax code found in the 20 volumes of Title 26, “Internal Revenue,” of the U.S. Code of Federal Regulations is a complex, intrusive monstrosity. With its progressive brackets (10, 15, 25, 28, 33, and 35 percent) and refundable tax credits, it is used to redistribute wealth while funding the interventionist welfare/warfare state. Since the surest way to return the size, scope, and cost of the federal government to its proper constitutional authority is to cut off its funding, there is no question that most of the tax code needs to be substantially eliminated and the rest radically overhauled. But could the cure offered by a tax-reform plan be worse than the diseased federal tax code it is designed to replace?

Gaining Momentum

Judging from its well-organized and highly vocal supporters, chief among tax-reform proposals would have to be the FairTax, a progressive national retail sales tax. The FairTax is the brainchild of three businessmen concerned about the crippling effects on the economy of the current federal tax code. After adopting the name “FairTax” for their tax-reform plan, they formed Americans for Fair Taxation in 1997 and enlisted Representative John Linder (R-Ga.) to introduce FairTax legislation in Congress. Linder first sponsored the “Fair Tax Act” in the House in July of 1999, and has reintroduced a FairTax bill at the beginning of every term of Congress since then.

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The current incarnation of Congressman Linder’s FairTax is H.R. 25, the “Fair Tax Act of 2007.” The bill has 70 cosponsors, including former presidential candidates Thomas Tancredo (R-Colo.) and Duncan Hunter (R-Calif.). Notably absent from the list of cosponsors is Representative Ron Paul (R-Texas), widely acknowledged as the taxpayer’s best friend because of his consistent voting record against unconstitutional spending. Although the FairTax bill is currently languishing in the House Committee on Ways and Means (as it does each time it is introduced), the FairTax itself has been in the news of late because of its support by two prominent individuals: Mike Huckabee and Neal Boortz. Former Republican presidential candidate Mike Huckabee was a vocal supporter of the FairTax during his presidential campaign. Radio talk-show host Neal Boortz is the author, with Congressman Linder, of the recently published *FairTax: The Truth, Answering the Critics* (2008), which is a sequel to their previously published *The FairTax Book* (2005).

The FairTax is a progressive, revenue-neutral consumption tax in the form of a national retail sales tax on all services and the final sale of all new goods. Services such as tuition and job-related training courses are exempt. All other services are subject to the FairTax, including medical procedures, funeral services, rent, and haircuts. Purchases for business or investment purposes are exempt. The FairTax is only levied on new goods, but the tax is absolute — nothing is exempt. This means that new construction, new cars, food, and all Internet purchases of new goods would be taxable.

The FairTax is designed to replace the personal income tax, corporate income tax, estate tax, gift tax, unemployment tax, alternative minimum tax, Social Security tax, and Medicare tax. Under the FairTax proposal, there would no longer be taxes on capital gains, interest, dividends, gambling and lottery winnings, self-employment earnings, or income of any kind. But there would also no longer be tax deductions for home mortgage interest, charitable contributions, casualty or theft losses, and medical expenses. Additionally, the FairTax does not eliminate tariffs, federal excise taxes, special federal taxes on things like airline tickets, or any state and local taxes.



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The FairTax system includes a monthly payment from the federal government to all households to reimburse them for the sales tax paid on basic necessities. The amount of this “prebate” is based on the government poverty level and family size. Initially, a family of four would receive a monthly rebate of \$525. The prebate is not in any way based on income; Bill Gates would even get it.

The appeal of the FairTax is quite obvious: no more complex tax code, no more taxes withheld from paychecks, no more 1040 forms, no more record keeping, no more compliance costs, no more business decisions based on tax consequences, no more social engineering with the tax code, no more IRS audits of individuals, no more April 15, etc. The prebate merely sweetens the deal.

Since the FairTax, like all current tax-reform plans, is revenue neutral, it is predicated on the supposition that any tax-reform plan must allow the federal government to raise the same amount of revenue that it does currently. This means that rather than lowering the overall tax burden of the American people, the total amount of taxes the federal government extracts from the citizens of the United States would be the same as it is now. All federal programs, all federal agencies, all federal projects, all earmarks, all pork-barrel spending — they would all continue just as now. Thus, Congress can continue its spending orgy while appearing to lower taxes. Put another way, the FairTax is meant to allow the federal government to confiscate the wealth of its citizens more efficiently. The FairTax also shifts the debate from how much wealth the federal government confiscates to the manner in which it is done.

The FairTax perpetuates the fallacy that the government has a right to confiscate a percentage of the value of each new good sold and every service rendered. This is no different than claiming that the government has a right to the portion of each American’s income that it takes under the current system. As the late economist Murray Rothbard explained:

The consumption tax, on the other hand, can only be regarded as a payment for permission-to-live. It implies that a man will not be allowed to advance or even sustain his own life, unless he pays, off the top, a fee to the State for permission to do so. The consumption tax does not strike me, in its philosophical implications, as one whit more noble, or less presumptuous, than the income tax.

The FairTax is also a highly progressive system — perhaps even more so than our current system according to FairTax advocate Neal Boortz. Thus, like the present system, it favors “the poor” over “the rich.” Although everyone would pay the same rate under the FairTax (when purchasing goods and services), many Americans would pay no taxes at all, and many more would have most of their taxes offset, thanks to the monthly prebate.

Tricky Diction

Mathematically, the FairTax just doesn’t add up. The stated rate of the FairTax is too low to achieve revenue neutrality, and the amount by which prices would fall under a FairTax system — because of the removal of the cost of taxes that are currently embedded in the price of all goods — has been grossly exaggerated.

The rate of the FairTax is always given as 23 percent. Sometimes the caveat is added that the rate is figured inclusively (the tax is included in the price of the product) rather than exclusively (the tax is added to the price of the product). But how many pick up on the caveat and how many are fully aware of the FairTax promoters’ sleight of hand in how they calculate the tax in practical terms?

Suppose you buy a \$1.00 item, though, admittedly, there’s very little you can buy these days for \$1.00. If a 23-percent tax is added to the cost of an item, you’d expect to pay a total of \$1.23. But that’s based



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on calculating the tax *exclusively* — *not* how the FairTax would be calculated. The FairTax would be calculated *inclusively*, meaning that 23 percent of the total cost of the item would have to be applied to the FairTax. For that to be the case, a \$1.00 item would actually cost \$1.30 when the FairTax is applied — the additional 30 cents (or 30 percent) being 23 percent of \$1.30.

Wouldn't it be simpler to understand if the FairTax were promoted as a 30-percent tax as opposed to a 23-percent tax that's calculated inclusively? Of course it would be, but it wouldn't be as marketable. Obviously, it is much easier to sell a national sales tax if the rate is "only" 23 percent. The fact remains, however, that under the FairTax system, everyone will pay an extra 30 cents on the dollar to purchase a new good or service regardless of whether he thinks the rate is 23 or 30 percent. And in spite of what the rate may in fact be, some economists don't think that either of these rates would be high enough to make the FairTax revenue neutral. The FairTax also artificially broadens the tax base by requiring governments to pay taxes on goods purchased and salaries paid. This results in the absurdity of the federal government paying taxes to itself.

Although it seems like the exchange of most federal taxes for the FairTax would lead to higher prices on all new goods and services because of the imposition of a national sales tax, FairTax proponents claim that the removal of embedded taxes would result in the prices of goods and services falling by enough to offset the amount of the FairTax imposed. However, this would not be the case. Advocates of the FairTax are correct that the current price of consumer products includes embedded taxes, but they are mistaken concerning their amount and their effect if removed. There are just not enough embedded taxes to be removed to offset the FairTax. Personal income taxes, which account for almost half of all federal revenues, are borne by consumers, not embedded in product costs. The FairTax would not eliminate any excise taxes embedded in the costs of goods. It is mainly corporate taxes and the employer share of social insurance taxes that are embedded taxes. And although we can be certain that retail prices will increase by 23/30 percent under the FairTax, we don't know with any certainty how much they will decrease after the embedded taxes in the price of goods are removed.

But, it could be argued reasonably by FairTax proponents that even if the costs of goods and services go up somewhat after the imposition of the FairTax, the combination of higher take-home pay (because of the elimination of withholding taxes), the prebate, and the elimination of the costs of complying with the tax code will result in a lower overall tax burden. Well, to begin with, this assumes that the stated rate of the FairTax would be high enough to achieve revenue neutrality — a very dubious proposition. Secondly, since state and local governments would have to pay taxes to the federal government under the FairTax, they would have to raise their taxes to cover the new taxes they would have to pay, thus increasing the overall tax burden. Thirdly, the federal government would have to come up with an additional half a trillion dollars to pay out the prebate. Since the prebate is not included in the federal budget right now, the overall tax burden would have to increase by the amount of the prebate. And then there are the extra billions of dollars that the federal government will need to pay the FairTax to itself. This means, of course, that the FairTax is not really revenue neutral at all. Finally, there won't be a great savings of tax-preparation dollars because the FairTax is only a federal tax, and states will still be forcing corporations and individuals to prepare returns.

Auditing the FairTax

Practically, there are a number of problems with the FairTax as well.

First, maintaining that the FairTax is a "fair" tax system, or one that is "fairer" than our current system, is highly subjective. As Boortz himself acknowledges in his new book on the FairTax: "Whether a tax



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system is 'fair' is a complicated economic and philosophical question, one that inevitably involves oversimplification and subjective judgment."

Second, FairTax proponents have made so many grandiose claims for the FairTax that it is hard to take them seriously. The FairTax, they say, will result in unprecedented economic growth, a tremendous increase in capital investment, substantially lower interest rates, the creation of millions of new jobs, the saving of Social Security and Medicare, the doubling of the economy within 15 years, and the greatest transfer of power away from the government ever seen. It is also claimed that the FairTax is voluntary since one could choose not to purchase a new good and therefore not have to pay any tax on it. But aside from the fact that one cannot purchase used food, the FairTax is a voluntary tax only in the sense that the present system is "voluntary": if one chooses not to earn any income under the current system then one doesn't have to pay any income tax. One must buy things as a matter of course to live in a modern society.

Third, the FairTax eliminates neither the 16th Amendment nor the federal tax code. Nor does it eliminate what is now called the IRS. To repeal the 16th Amendment would require another amendment. And contrary to the claims of FairTax promoters, calling the IRS by another name while redirecting its mission is hardly eliminating it. Just as the income tax would be replaced by the FairTax, so the IRS would be replaced by the "Sales Tax Bureau" in the Treasury Department. The FairTax bill also wouldn't replace the federal tax code. It repeals four subtitles, redesignates seven others, and adds a new one that implements the FairTax.

Fourth, adopting the FairTax doesn't mean that the income tax couldn't be reimposed. Congress might simply decide to resurrect the income tax because it is not politically expedient to raise the rate of the FairTax. This could be sold to the American people by lowering the FairTax rate, reinstating the income tax, and then claiming that the combination of the two was revenue neutral. And even if the 16th Amendment were repealed, there is nothing preventing Congress from implementing some form of an income tax.

Fifth, the FairTax prebate will give some people more money "back" than they paid in (national sales) taxes, much like the earned income tax credit does today. Like any refundable tax credit, the prebate is just another income-redistribution scheme.

And sixth, FairTax proponents are very naïve to think that Congress wouldn't turn the FairTax into a monstrosity just as hideous as the current tax code. The rate of the FairTax could be raised at any time. The exemptions currently on certain services could be removed. The prebate could be subject to a means test, or simply eliminated for upper-income taxpayers and increased for seniors, the poor, minimum-wage earners, and anyone receiving public assistance.

Reducing Taxes

The fundamental problem is clearly taxation itself, not the tax code. The problem with the code is not that it is too complex, too intrusive, too long, too full of loopholes, too unfair, or too progressive. The problem is that it is used to feed the federal leviathan in the amount of almost \$3 trillion a year.

Since it is a *tax-reform* proposal instead of a *tax-reduction* proposal, the FairTax merely changes the way that taxes are collected. It is an incremental step toward neither lower tax rates nor lower taxes. And it is certainly not a plan to return the size, scope, and cost of the federal government to its proper constitutional authority. With President Bush's proposed new budget topping \$3 trillion and the national debt fast approaching \$10 trillion, the need of the hour is clearly to rein in government



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spending, not change the way the government raises its revenue. FairTax proponents have the proverbial cart before the horse. Their energy is misdirected. As Congressman Ron Paul has remarked on several occasions: “The real issue is total spending by government, not tax reform.”

The income tax should be repealed, not replaced. The IRS should be abolished, not given a new name. Tax reform should result in revenue reduction, not revenue neutrality. Because the FairTax falls far short of these goals, it should not be considered a “fair” tax. It should therefore be rejected by all Americans who favor a return to the limited government of the Founders.

Laurence M. Vance is a freelance writer who has reviewed both of Boortz and Linder’s FairTax books.

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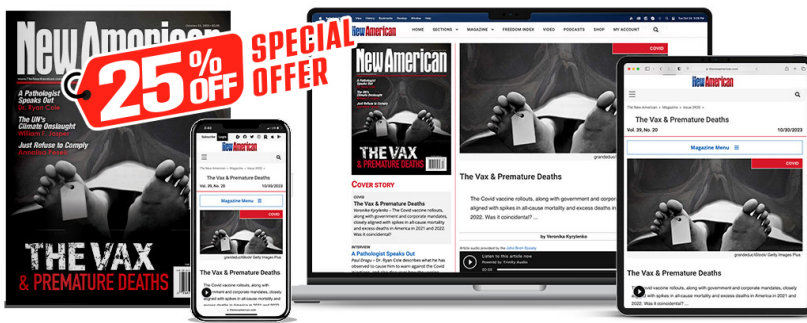


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