



Thumbnail sketch of the FairTaxSM a comprehensive plan to replace income and payroll taxes

The FairTax proposal is a comprehensive plan to replace federal income and payroll taxes, including personal, gift, estate, capital gains, alternative minimum, Social Security/Medicare, self-employment, and corporate taxes. The FairTax proposal integrates such features as a progressive national retail sales tax, dollar-for-dollar revenue replacement, and a rebate to ensure that no American pays such federal taxes up to the poverty level. Included in the FairTax plan is the repeal of the 16th Amendment to the Constitution. The FairTax allows Americans to keep 100 percent of their paychecks (minus any state income taxes), ends corporate taxes and compliance costs hidden in the retail cost of goods and services, and fully funds the federal government while fulfilling the promise of Social Security and Medicare.

Americans take home their *whole* paychecks.

Not only do more Americans have jobs, but they also take home 100 percent of their paychecks (except where state income taxes apply). No federal income taxes or payroll taxes are withheld from paychecks, pensions, or Social Security checks.

No federal sales tax up to the poverty level means progressivity like today's tax system.

To ensure no American pays tax on necessities, the FairTax plan provides a prepaid, monthly rebate (prebate) for every registered household to cover the consumption tax spent on necessities up to the federal poverty level. This, along with several other features, is how the FairTax completely untaxes the poor, lowers the tax burden on most, while making the overall rate progressive. However, the FairTax is progressive based on lifestyle/spending choices, rather than simply punishing those taxpayers who are successful. Do you see how much freer life is with the FairTax instead of the income tax?

No tax on used goods. The amount you pay to fund the government is totally visible.

With the FairTax you are only taxed once on any good or service; the sales tax is charged just as state sales taxes are today. If you choose to buy *used* goods – used car, used home, used appliances – you do not pay the FairTax. If, as a business owner or farmer, you buy something for strictly business purposes (not for personal consumption), you pay no consumption tax. When you decide what to buy and how much to spend, you see exactly how much you are contributing to the government with each purchase.

Retail prices no longer hide corporate taxes or their compliance costs, which drive up costs for those who can least afford to pay.

Did you know that income taxes and the cost of complying with them currently make up 20 percent or more of *all* retail prices? It's true. According to Dr. Dale Jorgenson of Harvard University, hidden income taxes are passed on to the consumer in the form of higher prices for everything you buy. If competition does not allow prices to rise, corporations lower labor costs, again hurting those who can least afford to lose their jobs. Finally, if prices are as high as competition allows and labor costs are as low as practical, profits/dividends to shareholders are driven down, thereby hurting retirement savings for moms-and-pops and pension funds invested in Corporate America. With the FairTax, the sham of corporate taxation ends, competition drives prices down, more people in America have jobs, and retirement/pension funds see improved performance.

The income tax exports our jobs, rather than our products. The FairTax brings jobs home.

Most importantly, the FairTax does not burden U.S. exports the way the current income tax does. The FairTax removes the cost of corporate taxes and compliance costs from the cost of U.S. exports, putting U.S. exports on a level playing field with foreign competitors. Lower prices sharply increase demand for U.S. exports, thereby increasing job creation in U.S. manufacturing sectors. At home, imports are subject to the same FairTax rate as domestically produced goods. Not only does the FairTax put U.S. products sold here on the same tax footing as foreign imports, but the dramatic lowering of compliance costs in comparison to other countries' value-added taxes also gives U.S. products a definitive pricing advantage which foreign tax systems cannot match.

The FairTax strategy is revenue neutrality: Neither raise nor lower taxes so consumer costs remain stable.

The FairTax pays for all current government operations, including Social Security and Medicare. Government revenues are more stable and predictable than with the federal income tax because consumption is a more constant revenue base than is income.

If you were in a 23-percent income tax bracket, the federal government would take \$23 out of your paycheck for every \$100 you made. With the FairTax, if the federal government gets \$23 out of every \$100 spent in America, the same total revenue is delivered to the federal government. This is revenue neutrality. So, instead of paycheck-earning Americans paying 7.65 percent of their paychecks in Social Security/Medicare payroll taxes, plus an average of 18 percent of their paychecks in federal income tax, for a total of about 25.65 percent, consumers in America pay only \$23 out of every \$100. Or about 30 percent at the cash register when they elect to spend on *new* goods or services for their own personal consumption. And this tax is collected only on spending above the federal poverty level, providing important progressivity.

Tax criminals – don't make criminals out of honest taxpayers.

Today, the IRS will admit to 25 percent noncompliance with the code. FairTax.org will be generous and simply take the position that this is likely a conservative estimate of the underground economy. However, this does not take into account the criminal/drug/porn economy, which equally conservative estimates put at one trillion dollars of untaxed activity. The FairTax *does* tax this – criminals love to flash that cash at retail – while continuing to provide the federal penalties so effective in bringing such miscreants to justice. The substantial decrease in points of compliance – from every wage earner, investor, and retiree, down to only retailers – also allows enforcement to concentrate on following the money to criminal activity, rather than making potential criminals out of every taxpayer struggling to decipher the current code.

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

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

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**FairTax
Frequently Asked Questions**

1. **What is taxed?** The FairTax is a single-rate, federal retail sales tax collected only once, at the final point of purchase of new goods and services for personal consumption. Used items are not taxed. Business-to-business purchases for the production of goods and services are not taxed. A rebate makes the effective rate progressive.
2. **Exactly what taxes are abolished?** The FairTax is replacement, *not* reform. It replaces federal income taxes including personal, estate, gift, capital gains, alternative minimum, Social Security, Medicare, self-employment, and corporate taxes.
3. **How does the rebate work?** All valid Social Security cardholders who are U.S. residents receive a monthly rebate equivalent to the FairTax paid on essential goods and services, also known as the poverty level expenditures. The rebate is paid in advance, in equal installments each month. The size of the rebate is determined by the Department of Health & Human Services' poverty level guideline multiplied by the tax rate. This is a well-accepted, long-used poverty-level

calculation that includes food, clothing, shelter, transportation, medical care, etc. See chart in Figure 1 below.

4. **Why not just exempt food and medicine from the tax? Wouldn't that be fair and simple?** Exempting items by category is neither fair nor simple. Respected economists have shown that the wealthy spend much more on unprepared food, clothing, housing, and medical care than do the poor. Exempting these goods, as many state sales taxes do, actually gives the wealthy a disproportionate benefit. Also, today these purchases are *not* exempted from federal taxation. The purchase of food, clothing, and medical services is made from *after*-income-tax and *after*-payroll-tax dollars, while their purchase price hides the cost of corporate taxes and private sector compliance costs.

Finally, exempting one product or service, but not another, opens the door to the army of lobbyists and special interest groups that plague and distort our taxation system today. Those who have the money will send lobbyists to Washington to obtain special tax breaks in their own self-interest. This process causes unfair and inefficient distortions in our economy and must be stopped.

Figure 1: 2006 Rebate calculation for the 48 contiguous states¹

One-adult household				Two-adult household			
Family size	Annual consumption allowance ²	Annual rebate	Monthly rebate	Family size	Annual consumption allowance	Annual rebate	Monthly rebate
1 person	\$ 9,800	\$2,254	\$188	N/A	N/A	N/A	N/A
and 1 child	\$13,200	\$3,036	\$253	couple	\$19,600	\$4,508	\$376
and 2 children	\$16,600	\$3,818	\$318	and 1 child	\$23,000	\$5,290	\$441
and 3 children	\$20,000	\$4,600	\$383	and 2 children	\$26,400	\$6,072	\$506
and 4 children	\$23,400	\$5,382	\$449	and 3 children	\$29,800	\$6,854	\$571
and 5 children	\$26,800	\$6,164	\$514	and 4 children	\$33,200	\$7,636	\$636
and 6 children	\$30,200	\$6,946	\$579	and 5 children	\$36,600	\$8,418	\$702
and 7 children	\$33,600	\$7,728	\$644	and 6 children	\$40,000	\$9,200	\$767

¹ Alaska and Hawaii have different poverty levels and different FairTax rebates. See last page of FAQs.

² Federal Register: Jan. 24, 2006 (Vol. 71, No. 15, pp. 3848-3849).

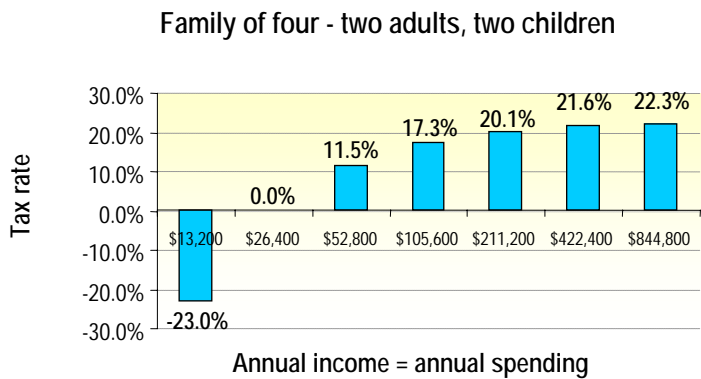
5. Is the 23% FairTax revenue-neutral rate³ higher or lower when compared to income and Social Security taxes people pay today?

Most people are paying that much or more today – much of it is just hidden from view. The income tax bracket most people fall into is 15 percent, and all wage earners pay 7.65 percent in payroll taxes. That’s 23 percent right there, without taking into account the 7.65 percent employer matching! On top of that, you have to add in the business taxes and associated compliance costs passed on to consumers in higher prices.

Effective tax rates vs. stated tax rates

Because the 23-percent FairTax rate of \$0.23 on every dollar spent is not imposed on necessities, an individual spending \$30,000 pays an effective tax rate of *only* 15.5 percent, *not* 23 percent. That same individual will pay 17.3 percent of his or her income to federal taxes under current law. See effective tax rates for a family of four at various spending levels in Figure 2.

Figure 2: 2006 effective tax rates



6. Does the FairTax rate need to be much higher to be revenue neutral?

The proper tax rate has been carefully worked out; 23 percent³ does the job of: (1) raising the same amount of federal funds as are raised by the current system, (2) paying the universal

³ The 23-percent rate is tax inclusive, as income taxes are quoted. See question 47 for a discussion of tax-inclusive and tax-exclusive rates.

rebate, and (3) paying the collection fees to retailers and state governments. Unlike some other proposals, several different, nonpartisan institutions have independently confirmed this rate across the country. Detailed calculations are available from FairTax.org.

7. How is the Social Security system affected?

Like all federal spending programs, Social Security operates exactly as it does today, except that its funds come from a broad, progressive sales tax, rather than a narrow, regressive payroll tax. Employers continue to report wages for each employee, though, to the Social Security Administration for the determination of benefits. The transition to a reformed Social Security system is eased while ensuring there is sufficient funding to continue promised benefits. Meanwhile, Social Security/Medicare funds are no longer triple-taxed as under the current system: 1) when payroll taxes are initially withheld; 2) when those withheld payroll taxes are counted as part of the taxable base for income tax purposes; and 3) when the promised benefits are finally received.

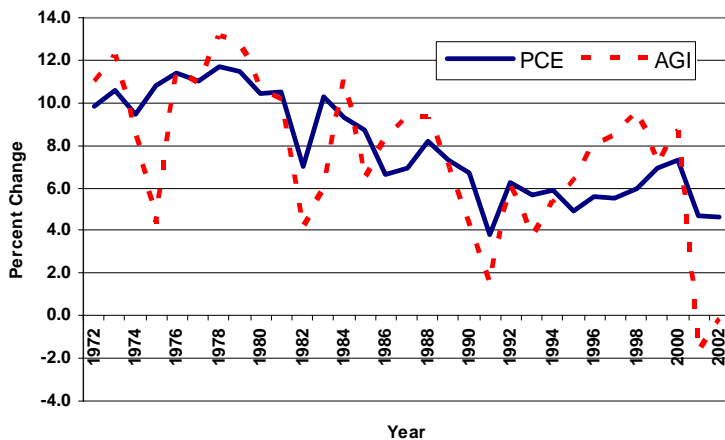
8. How does the FairTax affect Social Security reform?

FairTax.org is a one-issue organization: Tax replacement. However, its proposal does benefit *any* Social Security reform proposal. The FairTax.org plan does not change Social Security benefits or the structure of the Social Security system. All it does is replace the current revenue source (narrow, regressive payroll taxes) with a new revenue source (broad, progressive sales taxes paid by all consumers).

Additionally, research shows that consumption is a more stable revenue source than income. If Social Security is reformed or privatized in a way that reduces the government’s need for revenue, then the FairTax rate can be reduced. For example, if a mandatory private savings program is implemented where people must save ten percent of their income and Social Security benefits are curtailed, then the FairTax rate can be reduced just as payroll taxes would be reduced.

9. **Is consumption a reliable source of revenue?** Yes, in fact, consumption is a more stable source of revenue than income. A recent study by former American Farm Bureau economist Ross Korves shows the FairTax base is less variable than the income tax base. Why? Because during difficult times due to loss of a job or an inability to work, people may not have as much income, or may have no income at all. They borrow funds or use savings. They may not have earnings, but they still continue to consume. Figure 3 below shows the yearly changes in the tax base, adjusted gross income (AGI) under the current tax system for 1972-2002, and changes in personal consumption expenditures (PCE) of the same time period.

**Figure 3: Stability of the tax base⁴
1972 to 2002**



10. **How is the tax collected?** Retail businesses collect the tax from the consumer, just as state sales tax systems already do in 45 states; the FairTax is simply an additional line on the current sales tax reporting form. Retailers simply collect the tax and send it to the state taxing authority. All businesses serving as collection agents receive a fee for collection, and the states also receive a collection fee. The tax revenues from the states are then sent to the U.S. Treasury.

⁴ AGI data comes from IRS individual tax return data; PCE data comes from the National Income and Product Accounts (NIPA) for years 1972 to 2002.

11. **Why is the FairTax better than our current system?** Our present tax system is one of the reasons that people are finding it so difficult to get ahead these days. It is one of the reasons the next generation may not have a standard of living as high as this generation. Cars replaced the horse and buggy, the telephone replaced the telegraph, and the FairTax replaces the income tax. The income tax is holding us back and making it more difficult than it needs to be to improve our families' standard of living. It makes it needlessly difficult for our businesses to compete in international markets. It wastes vast resources on complying with needless paperwork. We can do better and we must.
12. **Is the FairTax fair?** Yes, the FairTax is fair, and in fact, much fairer than the income tax. Wealthy people spend more money than other individuals. They buy expensive cars, big houses, and yachts. They buy filet mignon instead of hamburger, fine wine instead of beer, designer dresses, and expensive jewelry. The FairTax taxes them on these purchases. If, however, they use their money to build job-creating factories, finance research and development to create new products, or fund charitable activities (all of which help improve the standard of living of others), then those activities are not taxed.

13. **How does the FairTax protect low-income and lower-middle-income families and individuals?** Under the FairTax plan, poor people pay no net FairTax at all up to the poverty level! Every household receives a rebate that is equal to the FairTax paid on essential goods and services, and wage earners are no longer subject to the most regressive and burdensome tax of all, the payroll tax. Those spending at twice the poverty level pay a tax of only 11.5 percent – a rate much lower than the income and payroll tax burden they bear today.

Under the federal income tax, slow economic growth and recessions have a disproportionately adverse impact on lower-income families. Breadwinners in these families are more likely to lose their jobs, are

less likely to have the resources to weather bad economic times, and are more in need of the initial employment opportunities that a dynamic, growing economy provides. Retaining the present tax system makes economic progress needlessly slow, thus harming low-income people the most.

In contrast, the FairTax dramatically improves economic growth and wage rates for all, but especially for lower-income families and individuals. In addition to receiving the monthly FairTax rebate, these taxpayers are freed from regressive payroll taxes, the federal income tax, and the compliance burdens associated with each. They pay no more business taxes hidden in the price of goods and services, and used goods are tax free.

14. **Is it fair for rich people to get the exact same FairTax rebate from the federal government as the poorest person in America?** Let's look at a billionaire under the FairTax – if he spends \$10,000,000 he pays a tax of \$2,300,000 and gets a rebate of \$4,508 (assuming he is married and has no children). His effective tax rate as a percent of spending is 22.95 percent.

Now, let's look at a middle-income married couple with no children under the FairTax – if they *spend* \$40,000 they pay \$4,692 net of their rebate for an effective tax rate of 11.7 percent. The effective tax rate increases as spending increases, but *never* exceeds 23 percent!

Figure 4: Comparison of effective tax rates

	FairTax	Current tax
Expenditures = income	\$40,000	\$40,000
Net tax	\$4,692	\$5,870
Effective tax rate	11.7%	14.7%

In contrast, if this same couple *earns* \$40,000 in wages today under the current tax system, they pay \$2,810 in income taxes and \$3,060 in payroll taxes for a total of \$5,870 in taxes (14.7 percent).

In addition, their employer pays another \$3,060 in payroll taxes. Most economists agree that the employer payroll tax is actually borne by employees in the form of lower wages. Looked at this way, this couple is paying \$8,930 (22.3 percent) in taxes today, which doesn't even include the hidden taxes they pay every time they make a purchase.

Finally, let's look at a low-income couple under the FairTax – *they pay no net FairTax at all*. Today, under the income tax system, they not only pay 15 percent in payroll taxes, but they also pay hidden taxes – arising from corporate taxes, private sector compliance costs, and payroll taxes passed on to consumers and embedded in the price of everything they buy.

15. **What about senior citizens, retired people, and anyone on a fixed income?** As a group, seniors do very well under the FairTax. Low-income seniors are much better off under the FairTax than under the current income tax system.

Some erroneously believe that people who live exclusively on Social Security pay no taxes. They may not know it, but they are paying hidden corporate income taxes and employer payroll taxes whenever they buy anything. Under the FairTax, seniors pay \$0.23 out of every dollar they *choose to spend* on new goods and services.

Plus, seniors, like everyone else, receive a monthly rebate, in advance of purchases, for taxes paid on the cost of necessities which more than pays for all of the taxes they would pay if they received the average Social Security benefit amount and spent it all. If seniors choose to work, they are freed from regressive payroll taxes, the federal income tax on wages, and the compliance burdens associated with each. They pay no more hidden taxes on goods or services, and used goods are tax free. There is no income tax on their Social Security benefits.

The income tax imposed on investment income and pension benefits or IRA withdrawals is repealed. Pension funds, IRAs, and 401(k) plans had assets of \$12 trillion in 2004. An income tax deduction

was taken for contributions to most of these plans. All beneficiaries and owners of these plans expected to pay income tax on them upon withdrawal, but are not required to do so under the FairTax.

All owners of existing homes experience large capital gains due to the repeal of the income tax and implementation of the FairTax plan. Seniors have dramatically higher home ownership rates than other age groups (81 percent for seniors compared to 65 percent on average). Homes are often a family's largest asset. Gains are likely to be in the range of 20 percent.

The FairTax makes the economy much more dynamic and prosperous. Consequently, federal tax revenues grow. This makes it less likely that federal budget pressures require Medicare or Social Security benefit cuts.

16. **How does the FairTax help seniors who have paid taxes on their retirement savings or invested in Roth IRAs?** Simply put, the FairTax is a revenue-neutral proposal, raising no more money than does the current system. The FairTax only changes where the money is raised, not the amount.

Additionally, some erroneously believe that people who have invested in Roth IRAs will never pay taxes on this money again. They may not know it, but they are paying corporate income taxes, employer payroll taxes, plus the associated compliance costs that are hidden in the price of every retail purchase they make. Under the FairTax, these hidden taxes are driven out of retail prices. And note, they elect to pay these taxes through their lifestyle choices.

Furthermore, used goods are not taxed because they have already been taxed once – when they were new. Therefore senior citizens, like all Americans, do not lose purchasing power, but gain it instead. Moreover, the FairTax preserves the purchasing power of Social Security benefits and seniors receive a monthly rebate so they don't pay taxes on the purchase of necessities. Tax-deferred investments get a one-time windfall. Savings invested in any long-term, income-generating asset such as a stock, real

estate, or a long-term bond that can't be called, increase substantially in value. Finally, complex estate planning is an artifact of an earlier age.

17. **How does the FairTax affect wages and prices?** Americans who produce goods and earn wages must pay significant tax and compliance costs under the current federal income tax. These taxes and costs both reduce after-tax wages and profits and are then passed on to the consumers of those goods and services in the form of price increases. When the FairTax removes income, capital gains, payroll and death taxes, the pre-FairTax prices of these goods and services will fall. The removal of these hidden taxes may also allow wages to rise. Exactly how much prices will fall and wages will rise depends on market forces. For example, in a profession with many jobs and too few to fill them, wages will likely increase more than in fields where there are too many employees and not enough jobs.
18. **Why not just exempt necessities from the FairTax instead of providing for a rebate?** The rebate is the most equitable and most efficient way to make the FairTax progressive. If the FairTax were to exempt necessities, the tax rate would have to be 20 percent higher than the FairTax rate with a rebate.
19. **Should the government tax services?** Service providers are not exempt from the income tax today, and should not be exempt from the FairTax. Services now account for well over one-half of the gross domestic product (GDP). Neither consumption of services nor consumption of goods should be tax preferred. And it is economically foolish not to tax the fastest growing segment of our economy. Competition, not politics, should determine what goods and services cost.
20. **How does the FairTax affect income tax preparers, accountants, and many government employees?** There are, of course, still some people who are involved in sales tax return preparation and sales tax

administration under the FairTax, but many fewer than those involved with the income tax today. Those tax preparers, tax lawyers, and Internal Revenue Service employees, who are typically well educated and well equipped with transferable skills, have to find other, more productive work. The projected 10.5 percent growth in the economy during the first year of the FairTax will provide plenty of new jobs. But the heavy compliance costs of the income tax are like an anchor holding back economic growth. *We have nothing to show for the \$265 billion (three years' worth of spending on the Iraq war) that we spend each year measuring, tracking, sheltering, documenting, and filing our annual income.* Surely these valuable labor and capital resources can be employed more productively – for example, in following the money trails left by terrorist, drug, and other criminal enterprises, rather than in tracking every American wage earner.

21. What about the home mortgage deduction?

The FairTax has positive effects on residential real estate far beyond this narrow question.

Today's homeowners, if they itemize (and 70 percent do not), pay their interest with post-Social Security/pre-income-tax dollars. They then pay their principal with post-SS/post-income-tax dollars. Those who do not itemize get no advantages at all. Under the FairTax, *all* homeowners make their *entire house payment* with pre-tax dollars.

With the FairTax, mortgage interest rates fall by about 25 percent (about 1.75 points) as bank overhead falls; this is a huge savings for consumers. For example, on a \$150,000, thirty-year home mortgage at an interest rate of 7.00 percent, the monthly mortgage payment is \$999.12 for principal and interest. On that same mortgage at a 5.25 percent interest rate, the monthly payment is \$830.01. Over 30 years, the 1.75-percent decrease in interest rates in this instance results in a \$60,879 cost savings to the consumer.

Finally, first-time buyers save for that down payment much faster, as savings are not taxed.

Under the FairTax, home ownership is a

possibility for many who have never had that option under the income tax system. Lower interest rates, the repeal of the income tax, the repeal of *all* payroll taxes, and the rebate mean that people have more money to spend, and have an increased opportunity to become homeowners.

22. What happens to charitable giving?

Charitable contributions depend on one factor more than any other: The health of the economy (*not* tax benefits). As a wide range of economists agrees on the economic expansion the FairTax delivers, charitable contributions benefit also.

For all of the money that pours into churches every Sunday and into a broad range of charities every day, only the 30 percent who itemize get any tax benefit. The other 70 percent have given and keep giving with no *tax* benefit whatsoever.

The FairTax allows people to make charitable contributions out of *pre-tax dollars*. Thus, those generally less affluent taxpayers who do not itemize see their cost of charitable giving go down under the FairTax.

Finally, the wealthy make decisions on charitable giving based on the cause. Once they have determined the cause is worthy, their contribution is structured to maximize the gift and minimize the tax. But the intention to give comes first; taxes simply determine the structure – rarely the amount – of the gift.

23. Do corporations get a windfall with the abolition of the corporate tax?

Corporations are legal fictions that have not, do not, and never will bear the burden of taxation. Only people pay taxes.

Corporations pass on their tax burden in the form of higher prices to consumers, lower wages to workers, and/or lower returns to investors. The idea that taxing a corporation reduces taxes on, say the working poor, is a cruel hoax. A corporate tax only makes what the working poor buy more expensive, costs them jobs, lowers their lifestyle, or delays their retirement. Under the FairTax plan, money retained in the business and reinvested to create jobs, build factories, or develop new

technologies, pays no tax. This is the most honest, fair, *productive* tax system possible. Free market competition will do the rest.

24. **Does the FairTax burden the retail industry?** All businesses are tax collectors today. They withhold income and payroll taxes from their employees. Moreover, the vast majority of retail businesses operating in states with a sales tax (45 states currently use a sales tax) are already sales tax collectors. Under the FairTax, retailers are paid a fee equal to one-quarter of one percent of federal sales tax they collect and remit. In addition, of course, retailers no longer bear the cost of complying with the income tax, including the uniform capitalization requirements, the various depreciation schemes, and the various employee benefit and pension rules. Finally, the economic growth resulting from the aggregate, beneficial effects of dramatically lower income tax compliance costs and no payroll or income taxes, customers having substantially more money – the greatest influence on retail sales – and a reasonable fee for collecting the FairTax, all ensure that retailers do quite well.
25. **How are state tax systems affected, and can states adequately collect a federal sales tax?** No state is required to repeal its income tax or piggyback its sales tax on the federal tax. All states have the opportunity to collect the FairTax; states will find it beneficial to conform their sales tax to the federal tax. Most states will probably choose to conform. It makes the administrative costs of businesses in that state much lower. The state is paid a one-quarter of one percent fee by the federal government to collect the tax. For states that already collect a sales tax, this fee proves generous. A state can choose not to collect the federal sales tax, and either outsource the collection to another state, or opt to have the federal government collect it directly. If a state chooses to conform to the federal tax base, they will raise the same amount of state sales tax with a lower tax rate – in some cases more than 50 percent lower – since the FairTax base is broader than their

current tax base. States may also consider the reduction or elimination of property taxes by keeping their sales tax rate at or near where it is currently. Finally, conforming states that are part of the FairTax system will find collection of sales tax on Internet and mail-order retail sales greatly simplified.

26. **How does the plan affect economic growth?** With the penalty for working harder and producing more removed, Americans are free to keep every dollar they earn, and a new era of economic growth and job creation is unleashed. Hidden taxes are history, Americans are able to save more, and businesses invest more. Capital formation, the real source of job creation and innovation, is facilitated. Gross domestic product (GDP) increases by an estimated 10.5 percent in the first year alone. The FairTax as proposed raises the economy's capital stock by 42 percent, its labor supply by four percent, its output by 12 percent, and its real wage rate by eight percent.
- As U.S. companies and individuals repatriate, on a tax-free basis, income generated overseas, huge amounts of new capital flood into the United States. With such a huge capital supply, real interest rates remain low. Additionally, other international investors will seek to invest here to avoid taxes on income in their own countries, thereby further spurring the growth of our own economy.
27. **What economic changes come at the retail level with the FairTax?** Our baby boom generation has been trained to spend money before inflation eats it up or savings is taxed away. This group, for good or evil, will likely spend their initial pay raise. Others will recognize the advantages of savings and investment. There will be a whole new round of home refinancings. There will likely be a lot of interest in the actual cost of the federal government when consumers see their most recent contribution at the bottom of each retail receipt.
- Since the FairTax plan is *revenue neutral*, the same amount of resources is

extracted from the economy as is extracted under current law. These funds are, however, extracted in a less economically damaging way. Every known economic projection shows the economy doing better, often much better, under the FairTax.

Because the economy grows, is more efficient and more productive, that means investment, wages, and consumption are higher than they are under the income tax.

28. **What happens to interest rates?** First, interest rates drop quickly by approximately one-quarter. Interest rates include compensation to the lender for the tax that they must pay on the interest you pay them. That is why taxable bonds bear a higher interest rate than tax-exempt bonds. When the tax on interest is removed, interest rates will drop toward today's tax-exempt rate.
- Second, under the current system, savings and investments are taxed. Under the FairTax, savings and investments are not taxed at all. As Americans save more money, the pool of funds in lending institutions grows. When you add to this the flood of capital currently trapped offshore, we realize a huge increase in the pool of capital, thereby causing the cost of borrowing funds to drop.
29. **What happens to the stock market, mutual funds, and retirement funds?** Investors prosper greatly under this plan, since corporations face lower operating costs and individuals have more money to save and invest. The reform significantly enhances the retirement savings and/or retirement spending power of most Americans.
30. **What happens to tax-free bonds?** Tax-free bonds are still tax free, though they are now directly competitive with corporate bonds. Under the FairTax, equities, treasuries, bonds, and other investments are all tax free. There is a one-time windfall in non-callable instruments, such as corporate bonds; this windfall also has a positive effect on callable instruments with some time remaining to the call date, including treasuries.

31. **How does this affect U.S. competitiveness in foreign trade?** Because the FairTax is automatically border adjustable, the 17 percent competitive advantage, on average, of foreign producers is eliminated, immediately boosting U.S. competitiveness overseas. American companies doing business internationally are able to sell their goods at lower prices but at similar margins, and this brings jobs to America.

In addition, U.S. companies with investments or plants abroad bring home overseas profits without the penalty of paying income taxes, thus resulting in more U.S. capital investment.

And at last, imports and domestic production are on a level playing field. Exported goods *are not* subject to the FairTax, since they are not consumed in the U.S.; but imported goods sold in the U.S. *are* subject to the FairTax because these products are consumed domestically.

32. **What about border issues?** It is unlikely that "shopping across the border" in Canada or Mexico will result in any cost savings to the consumer. Remember, the FairTax is revenue neutral and therefore price neutral. This means the relative cost of retail goods and services after the FairTax remains very close to the same levels found in the marketplace today. With regard to interstate competition, since all states have the same federal sales tax rate, the federal sales tax is not an incentive to cross state lines to avoid the tax.
33. **Does the FairTax improve compliance and reduce evasion when compared to the current income tax?** The old aphorism that nothing is certain except death and taxes should be modified to *include* tax evasion. Tax evasion is chronic under any system so complex as to be incomprehensible. As a percentage of gross domestic product (GDP), tax evasion in 2001 is beyond 2.6 percent, compared to 1.6 percent in 1991. This represents over 16 percent of taxes due. Almost 40 percent of the public, according to the IRS, is out of compliance with the present

tax system, mostly unintentionally due to the enormous complexity of the present system. These IRS figures *do not* include taxes lost on illegal sources of income with a criminal economy estimated at a *trillion dollars*. All this, despite a major enforcement effort and assessment of tens of millions of civil penalties on American taxpayers in an effort to force compliance with the tax system. Disrespect for the tax system and the law has reached dangerous levels and makes a system based on taxpayer self-assessment less and less viable.

The FairTax reduces rather than increases the problem of tax evasion. The increased fairness, transparency, and legitimacy of the system induces more compliance. The roughly 90-percent reduction in filers enables tax administrators more narrowly and effectively to address noncompliance and increases the likelihood of tax evasion discovery. The relative simplicity of the FairTax promotes compliance. Businesses need answer only one question to determine the tax due: *How much was sold to consumers?* Finally, because tax rates decrease, tax evasion is less profitable; and because of the dramatic reduction in the number of tax filers, tax evaders are more easily monitored and caught under the FairTax system.

34. Can the FairTax really be passed into law?

Do women have the right to vote in this country? Did we pass Prohibition? Did we repeal it? Do Civil Rights guarantee freedoms far beyond the lunch counter and mass transit? Do free-market economies dominate Eastern Europe, peoples once under the boot of communism? All these were grassroots efforts that effected significant changes in our nation and the world. Is the current income tax system any less a yoke around the necks of otherwise free peoples? We think not.

Passing the original 16th Amendment and the income tax wasn't easy and repealing the income tax and the 16th Amendment won't be easy either. That is why the FairTax has undertaken to build a grassroots movement and grassroots alliances to support the effort.

When the FairTax generates unprecedented economic growth in the first few months of its effective date, citizens nationwide will make it clear to Washington that they want to make the change permanent. But this will only happen when the American people rally behind the effort, throw off the yoke, and demand rectification of 90 years of wrongs done by the income tax.

- 35. What other significant economies use such a tax plan?** Two of the largest economies in the world rely almost solely on sales taxes: Florida and Texas. Many civilizations in history have relied solely on transaction-based consumption taxes: A percentage of a grain shipment in exchange for a safe harbor. Even a cursory study of history shows that nation/states that relied on consumption taxes flourished and prospered, supported democracies/republics, had expanding economies, and high levels of civil rights for their citizens. The exact opposite is true for empires that relied on income/poll/head taxes. These taxes were used to support despots, eventually collapsed the economies in which they were applied, and sundered civil rights.

The sales tax is a familiar tax, being a major source of revenue in 45 states and the District of Columbia. It is true, however, that no post-industrial nation, until now, has ever *repealed* its income tax and *replaced* it with a federal retail sales tax. However, England did repeal its detested income tax upon the defeat of Napoleon and enjoyed the fastest, longest expansion of its economy in its long history. An expansion that ended only with the – you guessed it – re-imposition of an income tax.

No other country has a system of government like ours, and no other country has led the world in so many fields as ours. It was France and Germany that forced the imposition of a VAT *in addition to* income taxes across the European Community. Shall we follow France's lead? In contrast, we can observe the Irish Miracle that stems from their refusal to join the EU members in imposing high tax rates and their choice to follow their own path on taxation. Thus, we should

simply strive to have the best tax system, period.

36. **What about the flat tax? Would it be better and easier to pass?** The flat tax and the FairTax share some important similarities. They are both flat-rate taxes that are neutral with respect to savings and investment. The flat tax, however, retains the invasive income tax administration apparatus and can easily revert to a graduated, convoluted mess, as it has many times over many years.

Very few people really understand the flat tax. Its authors will tell you it is a consumption tax that uses the income tax system for implementation. Only an academic or government bureaucrat would dream up a consumption tax that needs the invasive income tax apparatus for its application, when one can simply have a retail sales tax and reduce the bureaucracy by 90 percent or more! In addition, a large part of the burden of the flat tax – the business tax – will remain hidden from people in the retail price of goods and services.

In contrast, the FairTax is simple, easy to understand, and visible. It cannot be converted into an income tax.

Under a flat tax, individuals would still file an income tax return each year similar to today's 1040 EZ. While this is a simple postcard, the record keeping required to fill in the blanks is still long and burdensome. Under the FairTax, individuals never file a tax return again, ever! Under the flat tax, the payroll tax would be retained and income tax withholding would still be with us. Under the FairTax, the payroll tax, which is a larger and more regressive tax burden for most Americans than is the income tax, is repealed. Under the FairTax, what you earn is what you keep. No more withholding taxes; no more income tax.

Notwithstanding flat tax proponents' honorable intentions, income tax reform has been less than a success in the past. Congress has tried to reform the income tax again and again, with the result being greater complexity and, generally, higher rates. The problem is the income tax, and it is time to stop tinkering

with it.

Flat tax supporters have made major political attempts to pass their reform, including the efforts of former Majority Leader Dick Armey and presidential candidate Steve Forbes, and yet their efforts have not progressed politically for several years. With every debate, the flat tax loses grassroots and congressional support to the FairTax. It is time to junk the entire income tax system and start over with a tax system that is more appropriate for a free society and better able to meet the needs of the information age.

37. **Can Congress just simply raise the rate once the FairTax is passed into law?** Yes, of course Congress can raise the FairTax rate just as it could raise the flat tax rate or can and does raise the income tax rate. And if we in the grass roots allow them to do it, shame on us!

However, the FairTax is highly visible. And because there is only one tax rate, it will be very hard for Congress to adopt the typical divide-and-conquer, hide-and-disguise strategy employed today to ratchet up the burden gradually, by manipulating the income tax code. Ultimately, the tax rate will be dictated by the size of government. If government gets larger, higher tax rates will be required. If government shrinks relative to the economy, then the tax rate will fall. *Federalist 21*, by Alexander Hamilton, is a great read on the futility of government raising a consumption tax too high, and thus reducing revenues.

38. **Could we end up with both the FairTax and an income tax?** No current supporter of the FairTax would support the FairTax unless the entire income tax is repealed. Moreover, concurrent with the repeal of the income tax, a constitutional amendment repealing the 16th Amendment and prohibiting an income tax will be pushed through Congress for ratification by the states (filed as HJR 16 in the 109th Congress).

39. **Is the FairTax just another conservative tax scheme? Or just another liberal tax**

scheme? The FairTax has nonpartisan support from people in all walks of life. From both major parties and several third parties. Its supporters need only have one common belief: That it is a fairer, simpler, more efficient way to raise federal revenue. The FairTax delivers these benefits to all American people and more. More government accountability for taxpayer dollars, a tax system that is less susceptible to being manipulated by special interests, a tax system that will make it easier – not harder – for the average person to get ahead, and perhaps most importantly, a tax system that provides real, honest, and transparent tax relief for those who need it most.

40. **What assumptions have been made about government spending?** The FairTax plan is devised to be revenue neutral for the first year of operation. It raises the same amount of revenue as is raised by current law. After the first year, revenue is expected to rise because of the growth generated by this plan. At that time the American people, the Congress, and the president will have to decide whether to lower the tax rate or to spend the additional revenue.
41. **How does the FairTax affect government spending?** The public must remain vigilant to ensure that the economic gains caused by the FairTax benefit the people and the causes they deem worthy. However, it is easier to determine if your elected representatives are acting in your best interest. Legislators can more easily be held accountable for their decisions. For the first time in decades, it is simple to see whether a politician is advocating an increase in taxes or a restraint on government spending as the economic pie gets bigger. This is not the case today.
42. **What about the 16th Amendment?** It is not the intention of this plan, or the desire of the American people, to end up with both a federal income tax and a federal sales tax. The objective is to ensure that one is replaced by the other, not added on top of the other. By repealing the 16th Amendment, we close

the door on an income tax for generations to come.

43. **How does the income tax affect our economy?** How does dragging an anchor affect the speed of a ship? Our entire economy is *not* dependent on the income tax. Instead our economy is held back by the income tax. There was no income tax for the first 124 years of our history – that’s more than half the time we have existed as a nation. A study by the Government Accountability Office estimated that the federal tax system imposed efficiency costs on the U.S. economy of two to five percent of GDP. Under the FairTax, within ten years average Americans will be at least 10 percent and probably 15 percent better off than they would be under the current system. That translates to an increase of \$3,000 to \$4,500 per household, per year.
44. **How does this plan affect compliance costs?** It is estimated that Americans spend at least \$265 billion a year to comply with the tax code – nearly \$900 for every man, woman, and child in America. That is three years’ worth of spending on the Iraq war. Billions of dollars in compliance costs are wasted each year and we have nothing of value to show for this expenditure – not one single productive service or product is added to our nation’s wealth. It is estimated that the FairTax dramatically cuts such compliance costs, perhaps as much as 95 percent.
45. **What about value-added taxes (VATs), like they have in Europe and Canada? Are they not consumption taxes?** While VATs are also consumption taxes, and better than income taxes, the FairTax is not a VAT. A VAT works very differently. It taxes every stage of production. It is much more complex, and is typically hidden from the retail consumer. Second, in industrialized countries that have a VAT, it coexists with high-rate income tax, payroll, and many other taxes that, in some instances, have led to marginal tax rates as high as 70 percent. Third, all other industrialized countries, except Australia and Japan, have a much

larger tax burden than the U.S., which requires higher rates and makes tax administration much more difficult. Lastly, a VAT is a lobbyist’s dream, allowing them to install their loopholes unbeknownst to the purchaser. A retail sales tax, in contrast, is a lobbyist’s nightmare, applied as it is under the bright lights of the retail counter.

46. What do we experience in the transition from the income tax to the FairTax?

Everyone will have to think about taxes in a different way. Income – what we earn – no longer has to be documented, measured, and kept-track-of for tax purposes. The only relevant measure of our tax liability is the amount we choose to spend on final, discretionary consumption. Tax-related issues are suddenly a lot simpler and more straightforward than they used to be. The aggravation and anxiety associated with “April 15th” disappears forever after passage of the FairTax. The FairTax is not new – most Americans come into contact with such taxes daily, since 45 states currently use them to collect state revenues. It is easier to switch from an income tax to the FairTax system than it is to switch from gallons to liters, or from feet to meters! Of course, those who depend on the structure and complexity of our current system (e.g., tax lobbyists, tax preparers, and tax shelter promoters) have to find more productive economic pursuits. However, everyone will have enough advance notice to adjust to the new system.

Job creation booms. Residential real estate booms. Financial services boom. Exports boom. Retail prospers. Farming and ranching prosper. Churches and charities prosper. Civil liberties are enhanced. In short, it is difficult to imagine the far-reaching, positive effects of this change.

Though this tax policy is exactly what our Founding Fathers counseled us to do with the *Federalist Papers* and the Constitution.

47. I know the FairTax rate is 23 percent when compared to current income and Social Security rate quotes. What is the rate of the sales tax at the retail counter? 30 percent. This issue is often confusing, so we explain more here.

When income tax rates are quoted, economists call that a *tax-inclusive* quote: “I paid 23 percent last year.” For every \$100 earned, \$23 went to Uncle Sam. Or, “I had to make \$130 to have \$100 to spend.” That’s a 23-percent *tax-inclusive* rate.

We choose to compare the FairTax to income taxes, quoting the rate the same way, because the FairTax replaces such taxes. That rate is 23 percent.

Figure 5: 23-percent tax-inclusive vs. 30-percent tax-exclusive rate

Quoting a tax-inclusive rate vs. quoting a tax-exclusive rate
 The rates are *stated* differently, but the taxes you *pay* are identical.

Income taxes are quoted *tax-inclusive*.

<u>You earn</u>	<u>You keep</u>	<u>Your income tax rate</u>	<u>Gov’t keeps</u>
\$100	\$77	23%	\$23

Sales taxes are quoted *tax-exclusive*.

<u>You earn</u>	<u>You keep</u>	<u>Choose to spend</u>	<u>FairTax rate</u>	<u>Gov’t gets</u>
\$100	\$100	\$77	30%	\$23

Sales taxes, on the other hand, are generally quoted *tax exclusive*: “I bought a \$77 shirt and had to pay that same \$23 in sales tax.” This is a 30-percent sales tax. Or, “I spent a dollar, 77¢ for the product and 23¢ in tax.” This rate, when programmed into a point-of-purchase terminal, is 30 percent.

Note that no matter which way it is quoted, the amount of tax is the same. Under an income tax rate of 23 percent, you have to earn \$130 to spend \$100.

Spend that same \$100 under a sales tax,

you pay that same tax of \$30, and the rate is quoted as 30 percent.

Perhaps the biggest difference between the two is that under the income tax, controlling the amount of tax you pay is a complex nightmare. Under the FairTax, you may simply choose not to spend, or to spend less.

48. Since business purchases are not taxable, how does the FairTax keep individuals from pretending to have a business so they can buy things tax free?

The FairTax has several features that make it difficult and very risky for persons to have a scam business in order to purchase items tax free. First, in order for any person to purchase items tax free for business purposes, the business has to be a registered seller and possess a registered seller certificate issued by the state sales tax authority. Registered sellers are expected to file monthly or quarterly sales tax returns with the state (depending on sales volume). The certificate enables the business to purchase tax free from wholesale vendors, but the vendor must retain a copy of the registration certificate to justify not having collected tax on the sale. When a business purchases items for business use from a retail vendor, they have to pay the tax on the purchase and take a credit against the tax due on their monthly sales tax return. They must keep invoices/receipts to document what they purchased and the amount of the purchase. They might also make note of the purpose of the purchase on the invoice.

Also, as registered sellers, they are subject to the possibility of being audited by the state. During such an audit they will have to produce the invoices for all the “business purchases” that they did not pay sales tax on, and will have to be able to show that they were bona fide business expenses. If they cannot prove this, then they will have to pay the taxes that should have been paid when the items were purchased, plus interest and penalties. The probability of being audited will be much greater than it is under the current system with its over 140 million tax filers. Under the FairTax, there will be less

than 20 million businesses that will be filing sales tax returns and thus subject to the possibility of being audited. Thus the probability of tax cheats getting caught will be much greater than it is today, making tax evasion riskier than it is today. Additionally, while the FairTax has much stronger taxpayer rights than does the current tax system, the FairTax legislation provides for a number of fines and penalties for noncompliance. It also authorizes a mechanism for reporting tax cheats and obtaining a reward. An example would be 1-800-TAX-CHET.

Another potential scam would be to have a “fake” family business in order to buy things for family members tax free. The FairTax has a specific provision to prevent this. Although it does not prohibit businesses from providing taxable property or services as gifts, prizes, rewards or as remuneration for employment, the gift, reward, etc. is considered to be the conversion of property or services from business use to personal use and is therefore taxable. Likewise, there is a similar provision to prevent abuse of employee discounts. Under the FairTax, employer-provided employee discounts over 20 percent are taxable. The term “employee discount” means an employer’s offer of taxable property or services for sale to its employees or their families for less than the offer of such taxable property or services to the general public. If the employee discount amount exceeds 20 percent of the price to the general public, then the sale of such taxable property or services by the employer to the employee is considered the conversion of property or services to personal use and is subject to tax. The taxable amount is the amount by which the discount exceeds 20 percent of the price to the general public.

49. Is the FairTax progressive? Do the rich pay more and the poor pay less as a percentage of their spending?

Absolutely, as you can see in Figure 6 below – where the graph shows annual expenditures for a family of four and the corresponding FairTax effective tax rates. The poor actually

pay less than zero-percent retail sales tax on their spending. Much like with the earned income tax credit of today, the rebate may give them more money than they actually spend on retail taxes. Especially if they are

frugal and buy mostly used products. On the other hand, the wealthy approach a maximum of 23-percent retail sales tax on their spending.

Figure 6: Annual expenditures vs. FairTax effective tax rates, for a family of four

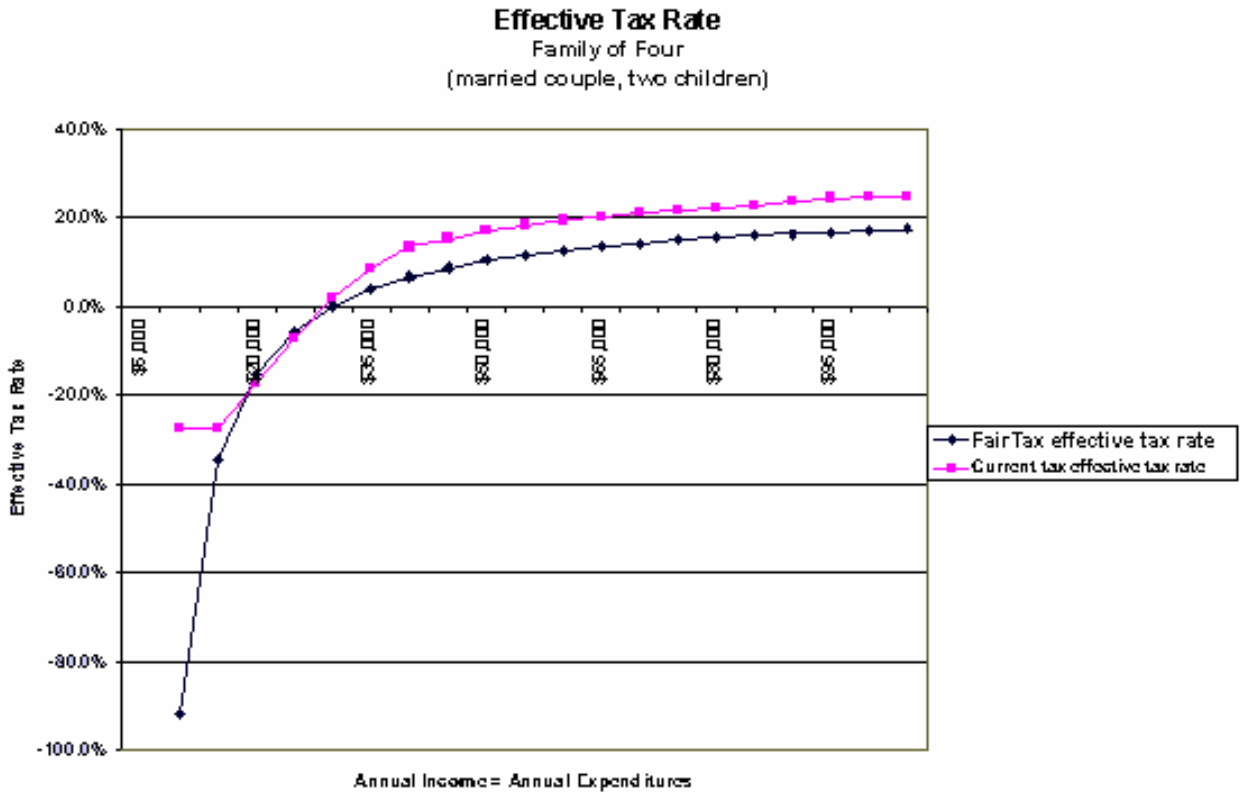


Figure 7: 2006 rebate calculations for Alaska

One-adult household				Two-adult household			
Family size	Annual consumption allowance ⁵	Annual rebate	Monthly rebate	Family size	Annual consumption allowance	Annual rebate	Monthly rebate
1 person	\$12,250	\$2,818	\$235	N/A	N/A	N/A	N/A
and 1 child	\$16,500	\$3,795	\$316	couple	\$24,500	\$ 5,635	\$470
and 2 children	\$20,750	\$4,773	\$398	and 1 child	\$28,750	\$ 6,613	\$551
and 3 children	\$25,000	\$5,750	\$479	and 2 children	\$33,000	\$ 7,590	\$633
and 4 children	\$29,250	\$6,728	\$561	and 3 children	\$37,250	\$ 8,568	\$714
and 5 children	\$33,500	\$7,705	\$642	and 4 children	\$41,500	\$ 9,545	\$795
and 6 children	\$37,750	\$8,683	\$724	and 5 children	\$45,750	\$10,523	\$877
and 7 children	\$42,000	\$9,660	\$805	and 6 children	\$50,000	\$11,500	\$958

Figure 8: 2006 rebate calculations for Hawaii

One-adult household				Two-adult household			
Family size	Annual consumption allowance ⁶	Annual rebate	Monthly rebate	Family size	Annual consumption allowance	Annual rebate	Monthly rebate
1 person	\$11,270	\$2,592	\$216	N/A	N/A	N/A	N/A
and 1 child	\$15,180	\$3,491	\$291	couple	\$22,540	\$5,184	\$432
and 2 children	\$19,090	\$4,391	\$366	and 1 child	\$26,450	\$6,084	\$507
and 3 children	\$23,000	\$5,290	\$441	and 2 children	\$30,360	\$6,983	\$582
and 4 children	\$26,910	\$6,189	\$516	and 3 children	\$34,270	\$7,882	\$657
and 5 children	\$30,820	\$7,089	\$591	and 4 children	\$38,180	\$8,781	\$732
and 6 children	\$34,730	\$7,988	\$666	and 5 children	\$42,090	\$9,681	\$807
and 7 children	\$38,640	\$8,887	\$741	and 6 children	\$46,000	\$10,580	\$882

What is the FairTax?

The FairTax is a nonpartisan proposal (HR 25/S 25) that abolishes all federal income taxes, including personal, gift, estate, capital gains, alternative minimum, Social Security/Medicare, self-employment, and corporate taxes, and replaces them all with one simple, visible, federal retail sales tax. The FairTax dramatically changes the basis for taxation by eliminating the root of the problem: Taxing income. The FairTax taxes us only on what we choose to spend, not on what we earn. It does not raise any more or less revenue; it is designed to be revenue neutral. The FairTax is a fair, efficient, 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 dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the web page: www.FairTax.org or call 1-800-FAIRTAX.

KEW/km 7-21-06
(AFFT Documents\FairTax FAQs)

⁵ Federal Register: Jan. 24, 2006 (Vol. 71, No. 15, pp. 3848-3849).

⁶ Ibid.

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