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PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM

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The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW
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From: Edward Lawrence
To: President's Advisory Panel on Federal Tax Reform
Date: June 6, 2005
Subject: Proposal for a National Sales Tax, aka "FairTax"

I have reviewed the submission of Americans for Fair Taxation (A.F.T.) to the President's Advisory Panel on Federal Tax Reform, and find some very serious flaws in their assumptions. A careful analysis of their proposal for a so-called "Fair Tax" suggests that:

1. The A.F.T. quoted tax rate of "23%" is really a tax rate of 30%.
2. The assumed tax base of \$8.7 trillion is not explained.
3. The proposed "prebate" would offer little help to middle & lower income people.
4. At the rate they are proposing (i.e. 30%, or as A.F.T. would say 23% tax inclusive), the revenue from the proposed tax would not come close to providing the revenue required to fund the federal government.
5. To adequately fund government, the tax rate on goods and services sold to American households would have to be at least 60 percent.
6. A national sales tax, as they are proposing, would be extremely regressive, even with the proposed prebate of 23 percent of poverty level income.

I will discuss each of these points in more detail. After looking at the A.F.T. proposal carefully and objectively, I hope you will reject their proposal for a very regressive and unfair national sales tax.

1. The Purported 23% Tax Rate is Really a 30% Tax Rate

The first problem with the 23 percent tax rate figure is the "tax inclusive" figure. The actual tax rate they are talking about is a 30 percent rate.

When you pay a \$30 tax on purchasing \$100 worth of groceries, most people would call this a 30% tax rate: i.e. \$30 divided by \$100. Only the folks at A.F.T. would call it a 23% tax rate: i.e. \$30 divided by \$130.

2. There is No Explanation for the Assumed \$8.7 Tax Base

The Americans for Fair Taxation statement estimates that the total base to be taxed was \$8.7 trillion in 2003. They do not identify exactly what this figure covers or how it was derived. We can evaluate the credibility of this figure by looking at data from the U.S. Census Bureau and the Bureau of Economic Analysis.

The 2002 Economic Census Advance Report indicates that total retail sales amounted to \$3.2 trillion. Adding receipts by educational services, health care & social assistance services, arts, entertainment & recreation services, accommodation & food services, repair & maintenance services, and personal & laundry services would bring the total sales volume up to \$5.2 trillion. Assuming a 6.5 percent annual increase this suggests a 2003 sales volume of about \$5.5 trillion.

These figures, however, include sales of used items and sales to business, both of which would not be subject to the national sales tax.

Thus, A.F.T. assumes about \$3.2 trillion more in the tax base than would be suggested by a reasonable analysis. What do they include in their tax base estimate that is not included in the Census figures on retail sales and the non-business service receipts?

In order to bridge this \$3.2 trillion gap such things as utility services (already subject to an excise tax which A.F.T. does not call for repeal), insurance, and housing rent & mortgage payments would have to be included. Can you imagine someone barely able to pay \$1,000 for rent having to start paying \$1,300 (or perhaps \$1,600) rent if the national sales tax were to be implemented? Even after adding utilities and housing to the retail sales and non-business services, the total tax base would still be \$2.9 trillion short.

Obviously the assumed tax base of \$8.7 trillion is invalid.

3. The Prebate Would Offer Little Help to the Poor

In an effort to ameliorate the regressive nature of the sales tax, A.F.T. proposes what they call a "prebate", i.e. a rebate (paid in advance) to all family units, equal to 23 percent times the HHS poverty level by family size, plus an additional amount in the case of married couples to avoid a marriage penalty.

There are many problems with this. The Health & Human Services Poverty Guidelines for the 48 contiguous states and the District of Columbia for 2005 are as follows:

1 person	\$ 9,570
2 people	\$ 12,830
4 people	\$ 19,350

Can anyone prepare a budget for food, clothing, shelter, transportation, medical care, child care, and state & local taxes that falls within these guidelines and still provides a decent standard of living for the family unit?

Furthermore, the A.F.T. proposal calls for only a 23% rebate, even though the tax that these family units are paying is a 30% tax. There is no way that a \$2,950 rebate to a couple, or \$4,450 for a family of four, would make all the necessities of life "tax free", as claimed by A.F.T. on page 4 of their submission.

4. The Proposed Tax Would Not Cover the Costs of Government

The national sales tax being proposed by A.F.I. assumes that their tax only has to replace the \$1.67 trillion of federal tax revenues collected by the internal revenue service in 2003. The fact is, however, that the federal government spent \$2.16 trillion. It's bad enough to drift into a situation of deficit spending, but to plan a new tax system with built-in perpetual deficit spending is incredibly irresponsible.

Not only should our tax system, during good economic times, raise the funds necessary to fund government, but it should also take into account the need to begin to reduce our \$7.8 trillion national debt. To repay this debt over 30 years (assuming 6% interest) would require an annual payment of about \$560 billion per year. Unless we want to condemn our children and all generations to come to pay interest forever on the debt we have built up, we are obligated to begin to pay off this debt.

Consequently, the revenues that would have to be raised are \$2.9 trillion: \$1.9 trillion for federal expenditures excluding interest on the national debt, \$6 trillion for amortization of the national debt, and about \$4 trillion for the prebate. But as we have seen, the prebate is much too small, so this amount should be doubled to permit the necessities of life to be purchased "tax free". Thus the total revenue needs would be \$3.3 trillion, not the \$1.67 trillion admitted to by A.F.I.

5. The National Sales Tax Rate Would Have to be 60 Percent

Given a tax base of \$5.5 trillion (which is a generous assumption, since it includes sales of used items and sales to business), the required tax rate for a national sales tax would be closer to 60 percent (i.e. \$3.3 trillion revenue requirements divided by \$5.5 trillion tax base). And this assumes one hundred percent compliance, no switching from new items to used goods, no buying of goods in foreign countries to avoid the 60 percent sales tax, and no bartering of goods or services to avoid the tax. And this 60 percent national sales tax is in addition to the existing state and local sales taxes.

6. The National Sales Tax Would be Very Regressive

To call a national sales tax the "Fair Tax" is the epitome of Orwellian newspeak. The sales tax is among the most regressive taxes, and the proposed prebate would do little to reduce the regressivity. Under a national sales tax middle and lower income people would pay a much higher share of their income in taxes than would the wealthy.

The national sales tax is an unfair regressive tax incapable of raising the revenues required to fund the obligations of our government required by the Constitution. The proposal should be rejected. The alternative should be to have a simple progressive income tax that taxes all income: wages, dividends, interest, and capital gains.

