

Sunday, April 15, 2007

Taxes, Taxes, I Hate Taxes!

Don't we all?

Is there a solution to the incredible tax mess? Sure. And it's right under your nose.

Its called [The Fair Tax](#), and it is the **only** competing proposal that:

- Totally "untaxes" the working poor at the federal level. No income tax, no FICA, no Medicare, no nothing. No federal taxes. Period.
- Is *entirely voluntary*. You spend money voluntarily. *YOU* decide at what standard you wish to live, and by doing so, you decide what level of tax you wish to pay.
- Eliminates filing requirements and thus overhead for all taxpayers.
- Imposes no real additional costs on existing tax collectors (businesses); they already collect sales taxes. In fact, the act allows a 1/2% "rebate" to them for collection to cover their administrative costs.

What is [The Fair Tax](#)? In short, it is a national sales tax with a twist.

Now detractors have been out on this one over the last year or two, but they continually misrepresent the truth. Let's go through a bit of [The Fair Tax](#) for you, although if you want the full story, the links will get it for you.

You can and should read those links, but you're going to have to do a lot more reading than you will here in order to understand the basis of the proposal.

[The Fair Tax](#) is advertised as, and is in fact, a national sales tax which *replaces* the taxes authorized by the 16th Amendment. It includes effective repeal of the 16th Amendment to prevent the Federal Government from playing games and imposing **both** this tax AND an income tax, which would be ruinously bad. So let's scratch one "opposing point" right up front - the bill (yes, it really is a bill in the House) prohibits this up front. How? It abolishes the IRS (can't enforce any attempt to re-impose an income tax), it repeals the Internal Revenue Code (the law imposing these taxes) and it eliminates the filing requirements for individual taxpayers. The authors and co-sponsors of [The Fair Tax](#) recognize that the 16th Amendment needs to go away - and that will take a Constitutional Amendment - but in the short term breaking the "egg" that is the Internal Revenue Service into a few million pieces will prevent any attempt to re-impose an income tax until the 16th can be formally repealed as well.

The second argument is that "your prices will go way up" if this is passed. I want to perform a bit of math for you here, and illustrate why this *simply is not so*.

First, The Fair Tax includes a provision called **The Prebate**. The Prebate is quite simple - each month the US Federal Government will mail (or direct deposit) to *each household* a check. Yes, really, the government is going to give you money back *on the first of every month!* How much money? That's simple - we take the US Federal Poverty level for your area and household size (there are tables for each "market" area, reflecting the local costs of living - for example, the poverty level is higher in Hawaii than in rural Alabama; in addition, the poverty level for a single person is lower than for a family of four), multiply that by the Fair Tax rate (the proposal is initially for 23%), divide by 12 (since the poverty level is an *annual* income) and that check is then sent to you.

You qualify for the Prebate *if you are a legal US resident or citizen*. That's it. Nothing more or less.

So each month you receive *in advance* the money that The Fair Tax will cost you at the store for *all your expenditures* if you live at the poverty level income.

That is, *if you make less than the poverty level income for your household, you pay a **negative** amount of tax, because you got the prebate in advance.*

If you make *exactly* the poverty level income, you pay zero federal tax; you pay the tax at the cash register, but you got it back in advance from the government. Therefore, your **net tax expense** is **ZERO**.

If you make **twice** the federal poverty level income, *your federal tax rate is **one half** of the Fair Tax Rate*, because you pay twice that much in tax at the register, but you got the poverty level tax back each month. Net - one half of the tax rate.

As you earn more, you pay more (as a percentage) of the total Fair Tax Rate, until, as you make a lot of money, you effectively pay all of it (you still get the prebate, but it is lost in the noise)

Now naysayers say "but but but I am only taxed at 15% because I only make \$60,000 as a married couple - you want to tax me at 26%!"

Guys, you *have to think this one through*. First, you don't pay 15%. You also pay *another 15% of your income in payroll taxes!* **EVERYONE PAYS THAT 15%!** You only **SEE** the 7.65%, but you **PAY** the entire 15.3%, because your employer bases your **salary** on the **TOTAL** cost of your tax bill.

So if you are in the 15% tax bracket, **in fact you pay 30% right now!**

Second, the prebate applies. That family of four has a poverty level income of \$20,650 (unless you live in Alaska or Hawaii, in which case it is quite a bit higher.) That is 1/3rd of your income at \$60,000, roughly. Therefore, your *effective* tax under the **Fair Tax**, with its Prebate Feature, is $(\$60,000 \times 23\%) - (20,650 \times 23\%)$ or \$9,050, which is 15%.

Fifteen percent kids! Guess what - your federal tax bill **drops by half if you make \$60,000 a year!**

Now there are, of course, exceptions. Many people in the \$60,000 income range pay far less than a 15% federal rate due to allowable deductions - deductions that *all go away* under The Fair Tax, because there is no tax on which to allow deductions!

But for the person who makes \$60,000, their PAYROLL TAX is more than their Fair Tax burden, and there is NEVER a deduction allowed against your PAYROLL TAXES!

And... it gets better!

There is *no tax imposed at all on the earnings you get from passive income!* That is, if you save or invest, you *pay no tax at all on the gains until and unless you spend them.*

The next part of the argument is that "prices will actually rise". Oh really?

Guess who pays the taxes that corporations have levied against them? You do. Every time you walk into a store and buy something, you pay *their tax* imputed into the price of that product. You buy a box of cereal, part of the price on the shelf is the tax that cereal maker paid.

All taxes are paid by people - you cannot tax a corporation as it simply adds the tax onto the price of the

product! Always!

How much of the price is tax? There is some dispute over that. But what is difficult to dispute is that it is a very significant part of the price of the products you buy. It is not just the tax itself - its also all the lawyers and accountants, the lobbyists and other "related expenses" that corporations have in preparing and filing tax returns, trying to gin the game so they pay less tax, and associated other compliance costs.

I can tell you this, as a former CEO of a "small C Corporation" (about \$5m in annual sales) - it is not a small number. The larger the company, the more expense is incurred. Further, this expense is incurred all the way up the line! That is, when I as "Joe Business" buy a "widget" to use in my business (or as a raw material to make into a "super widget") *every company up the line to the point of that sale has paid these compliance costs!* That is, that "widget" is probably 30% more expensive simply due to those costs - costs which disappear under The Fair Tax.

In addition, the capital markets (read: stock market) and business impact of The Fair Tax is not to be understated. By passing this law we will create a tax haven of unprecedented proportion. There *are* other tax havens out there - Bermuda, the Cayman Islands, and others. But **none** have the stability, the workforce and the natural resources of The United States of America. None. Passing this reform would **instantly** cause The United States to become **the** place for businesses to locate their headquarters and facilities. The resulting impact on employment, incomes and wages would be extraordinary - a positive impact *never before experienced in American history*.

You will probably not hear much about **The Fair Tax** today. But you should.

Get educated, get involved, become part of the groundswell that gets this done.

For you.

For your children.

For America.

Posted by Karl Denninger at 14:16

For at least part of this discussion, you appear to be conflating spending with income. Someone earning \$60K would only be taxed on the dollars they actually spent, not the money they earn. This could be less than \$60k, if they live within their means, or more if they are adding to their credit card debt or spending money from a HELOC. A few questions: How would housing be accounted for? Rent could have the tax added in directly (although this would be a new expense for landlords). But how about payments for mortgages? What about Roth IRAs (and now Roth 401ks)? Or any money already taxed as income and saved, for that matter? This could be a potentially huge penalty for those Americans who actually have savings. What is the confidence interval on the 26% tax rate (more of a tax asymptote, I guess)? And how will changes in this rate affect retailers? Currently, sales tax rates are relatively static but the effective federal income tax rate tends to bounce around from year to year. Anonymous on Aug 12 2007, 04:14