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Funding Leviathan, Part 2

by Laurence M. Vance

When the Federal Reserve chairman, Alan Greenspan, broached the idea of a consumption tax to replace all or part of the income tax in his testimony before the President's Advisory Panel on Federal Tax Reform, he was not alone. There are three other voices that have of late been promoting a consumption tax in the form of a national retail sales tax (NRST) called the FairTax: Congressman John Linder (R-Ga.), syndicated radio talk-show host Neal Boortz, and an organization called Americans for Fair Taxation.

Representative Linder is the sponsor of H.R. 25, "The Fair Tax Act of 2007," which now has 57 co-sponsors. Boortz, who claims to be a "card-carrying libertarian," is the author, along with Linder, of *The FairTax Book* (Regan Books, 2005). Americans for Fair Taxation claims to have hundreds of thousands of members and volunteers nationwide. The group maintains an elaborate website dedicated to promoting the FairTax.

The FairTax is an NRST on all new goods and services. It is designed to replace not only personal income taxes, but "estate, gift, capital gains, alternative minimum, Social Security, Medicare, self-employment, and corporate taxes." The FairTax would apply to all new goods: homes, cars, food, prescription drugs, and gasoline; and all services: haircuts, taxis, airline travel, medical procedures, and electricity. Internet purchases of new goods would not be exempt.

The initial rate of the FairTax is usually given as 23 percent. This would normally mean that the prices of all new goods and services would rise. However, FairTax advocates claim that the prices of most new goods and services would still be about the same. This is because the removal of the cost of taxes that is embedded in the price of everything would offset any price increase due to the imposition of a sales tax. As Boortz explains, When you buy that loaf of bread, you're paying a portion of all of the bills, including tax bills, of every person or business entity that had anything to do with that bread, from before the wheat was planted up until the loaf of bread ends up in that plastic bag in the back seat of your minivan.

We are even told that a new home, even with the FairTax added to the price, "may cost less than that home would have cost under our current tax structure."

So we will we pay no income taxes and the lower prices we will pay for goods will effectively cancel out the NRST. Moreover, every family in America will receive a monthly check from the federal government (a “pre-bate”) that reimburses each household for the taxes paid on “the basic necessities of life.”

FairTax proponents make some grandiose claims for their tax reform proposal. The FairTax will not just increase economic growth, it will

- Send the American economy into warp drive.
- Create millions of new jobs.
- Double the size of the economy in the first 15 years.
- Reduce interest rates by almost 30 percent.
- Increase capital investment by a staggering 76 percent.
- Create a financial bonanza for the poor and the middle class.
- All but eliminate the tax burden on the middle class.

Maintaining the status quo

One of the main selling points of the FairTax is that it will eliminate the dreaded IRS. FairTax supporters rightly point out the intrusive nature and complexity of the tax code, the millions of dollars and hours wasted on compliance and enforcement costs, the abuses of IRS agents, and the hidden evils of the withholding tax.

But the FairTax does not abolish the IRS. It merely changes its name and function. The FairTax simply exchanges one federal agency for another. If there were no enforcement agency to ensure the collection of a national sales tax, why would anyone bother paying or collecting the tax? According to Title III, Sec. 302 of the Fair Tax Act of 2007,

There shall be in the Department of the Treasury a Sales Tax Bureau to administer the national sales tax in those States where it is required pursuant to section 404, and to discharge other Federal duties and powers relating to the national sales tax (including those required by sections 402, 403, and 405). The Office of Revenue Allocation shall be within the Sales Tax Bureau.

The Fair Tax Act also maintains tax courts and sets up a Problem Resolution Office with “problem resolution officers.” The IRS bureaucracy is not eliminated merely because the name “Internal Revenue Service” is changed to “Department of the Treasury” and “Commissioner of Internal Revenue” is changed to “Secretary.”

But not only does the FairTax not eliminate the IRS, it is fraught with other problems as well.

Although the FairTax would replace individual income taxes, social insurance taxes, corporate income taxes, excise taxes, and estate and gift taxes, nothing would prevent those taxes from being reinstated at a later date. One argument for the income tax in the late 1800s was that it would permit large tariff reductions, but once the income tax was enacted Americans ended up with both a tax on income and high tariffs on imports.

The rate of the FairTax is actually 30 percent, not 23 percent. The new math used by FairTax advocates figures the rate inclusively (the tax is included in the price of the product) rather than exclusively (the tax is added to the price of the product). Other economists believe that the rate of any national sales tax would have to be much higher if it is to be revenue-neutral, especially if the losses from tax evasion and legislative erosion of the tax base are factored in.

FairTax supporters maintain that an NRST will be offset by a fall in prices once the cost of embedded taxes is removed from goods. But the problem is that there is no way to know by what amount prices would fall. We know for sure that prices will immediately increase by 23 percent (actually 30 percent), but we don't know with any certainty how much prices may decrease. It is a grave economic fallacy to say that because costs will fall by a certain amount prices will fall by the same amount.

The FairTax plan makes welfare universal, since it includes a monthly "prebate" check from the federal government sent to all households. In other words, it is an income redistribution scheme under the guise of tax reform. This also means that the FairTax is a progressive system that will result in millions of Americans' effectively paying no federal taxes of any kind. It is even more of a progressive system than our current one. But what is so "fair" about requiring the "rich" to pay more just because they can afford to do so?

In addition, the FairTax creates new taxes, it creates new taxpayers, it creates new tax collectors, it makes it easier for the federal government to raise taxes, it makes it easier for state governments to raise taxes, and it has unknown and potentially huge transition costs. The FairTax cannot be considered an incremental step toward more liberty and less government.

The FairTax's fatal flaw

The FairTax is doomed from the beginning as a solution because it ignores the real problem. It is predicated on the belief that taxation should be done in a "fair" manner instead of eliminated altogether. Although the FairTax plan would drastically change the structure of our current tax system, it still suffers from the same underlying problem as the other plans mentioned in part one: It is revenue-neutral.

In "An Open Letter to the President, the Congress, and the American People Concerning Reform of the Federal Tax Code," which is posted on the FairTax website, along with the endorsement of 75 "professional and university economists," we can see the problem immediately:

We are not calling for elimination of federal taxation, which would be irresponsible and undesirable. Nor does our endorsement call for reduced federal spending. The tax reform plan we endorse is revenue neutral, collecting as much federal tax revenue as the current income tax code, including payroll withholding taxes.

Boortz admits that the FairTax is a “tax reform measure, not a government reform measure.” It merely “changes the way revenues are raised for the legitimate operations of the federal government.” The problem, however, is not the way revenues are raised; the problem concerns the “legitimate” operations of the federal government. The FairTax does nothing to tame the federal leviathan. The solution is nothing less than a drastic reduction or wholesale elimination of its revenue source. What is fair about allowing the government to confiscate 23 percent or 30 percent of the value of every new good and service?

Since it is a consumption tax, the FairTax can be included in Rothbard’s conclusion about consumption taxes:

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.

Other tax-reform proposals

Although the Flat Tax and the FairTax usually take center stage, there are some other, albeit lesser known, tax-reform proposals.

Although Boortz quotes Dale Jorgenson to give weight to his FairTax proposal, Jorgenson is not a devotee of the FairTax — he supports an income-tax plan called the Efficient Taxation of Income:

Efficient Taxation of Income is a new approach to tax reform based on taxation of income rather than consumption. This would avoid a drastic shift in tax burdens by introducing different tax rates for property-type income and earned income from work. Earned income would be taxed at a flat rate of 10 percent, while property-type income would be taxed at 30 percent.

Income would be defined under Jorgenson’s plan “in exactly the same way as in the existing tax code.”

Another proposal is the Business Transfer Tax (BTT): “a value-added tax based on the difference between revenues and purchased goods and services for all enterprises and employers.” The BTT is a subtraction-method value-added tax that exempts fixed investment and exports, credits an employer for social-insurance taxes paid, and substitutes rebates for exemptions, deductions, and credits. Proponents envision the BTT first replacing the corporate income tax, then the personal income tax, and then the entire tax code (but not FICA taxes).

Like the previous tax-reform plans, these other tax-reform proposals suffer from the same underlying fallacy: they are designed to be revenue-neutral. Additionally, without some major tweaking, it will be very difficult for any tax-reform plan to be truly revenue-neutral. If the plan didn't raise enough money for the federal government, is there any doubt that the tax rate would be raised? And if it turned out that the new tax plan increased government revenue, is there any doubt that Congress would spend the extra money?

The only real solution

The winner in all of the aforementioned tax-reform proposals is the federal government, a government that now spends almost \$3 trillion a year redistributing the wealth of its citizens, enriching federal contractors and other special interests, and maintaining an empire of troops and bases around the globe. A tax plan that perpetuates the welfare state and pays for the warfare state is not the solution. The real problem is the very existence of the federal leviathan that feeds off tax dollars. All current tax-reform proposals allow the members of Congress to maintain their obscene spending orgy and appear to cut taxes at the same time. They merely shift the debate to how the federal leviathan is fed rather than how much it consumes. As the “Taxpayers' Friend,” Congressman Ron Paul (R-Tex.), so succinctly says, “The real issue is total spending by government, not tax reform.”

The “best” tax system from the standpoint of liberty, and not from the standpoint of what the government says it needs, would be one that interferes the least with the free market. The ideal amount of tax collected would then, of course, be zero. Therefore, the best type of tax reform is one that has for its goal the lowering of the amount of tax collected. As much as libertarians want the federal government to simply go away, that is not likely to happen any time soon. For the time being, then, it is certainly reasonable to support any tax-reform proposal that aims to substantially reduce the federal leviathan's food supply.

To begin with, individual income taxes can and should be abolished. This, of course, depends on Congress. Although it is true that the president, according to the Budget and Accounting Act of 1921, must annually submit a budget to Congress for the next fiscal year by the first Monday in February, it is Congress that ultimately decides on the amount of federal spending.

We “need” an income tax because of the federal government’s insatiable desire for money. Such was not always the case, however, for we have had a permanent income tax only since 1913 — long before the present welfare/warfare state. Before that time the federal government operated successfully with the revenue it received from tariffs, fees, and excise taxes. If the federal government were truly a limited one, as envisioned by the Founders, and not a monstrous welfare/warfare state, as it has become, it could probably be funded by donations. If the idea of donations sounds ludicrous, it should be noted that, in addition to paying taxes, Americans regularly give money to the Bureau of the Public Debt to reduce the public debt. About \$2 million was given in FY 2006.

It’s time to put the federal leviathan on a diet. Then we can abolish individual income taxes, social-insurance taxes, corporate income taxes, excise taxes, and estate and gift taxes — not replace them with something else that will continue funding leviathan.

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