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Rick Perry's "Flat Tax" and "Fair Tax" Both Mean Higher Taxes for Most Americans, Lower Taxes for the Rich

Texas Governor and presidential candidate Rick Perry has endorsed both the concept of a flat income tax and the so-called "Fair Tax," which is a national sales tax. Estimates from the Institute on Taxation and Economic Policy (ITEP) show that both of these proposals would result in substantial tax increases for the poor and middle-class and significant tax cuts for the rich.

Flat Income Tax

The idea of a "Flat Tax," a single-rate tax to replace the existing progressive personal income tax, corporate income tax and estate tax, was first proposed in a 1983 book by Robert Hall and Alvin Rabushka.

The Flat Tax authors wrote that it "will be a tremendous boon to the economic elite"¹ and also admitted that "it is an obvious mathematical law that lower taxes on the successful will have to be made up by higher taxes on average people."²

In February of 2010, ITEP estimated the impacts of the Flat Tax legislation introduced by then-Senator Arlen Specter of Pennsylvania. The estimates, which were cited by Citizens for Tax Justice,³ confirmed what Hall and Rabushka said about the plan, which would result in:

- **Enormous tax cuts for the richest five percent of taxpayers** of \$209,562 for the richest one percent in 2010.
- **Tax hikes for all other income groups.** The bottom 95 percent of taxpayers would pay an average of \$2,887 more in federal taxes in 2010.

Income Group	Average Income	Average Tax Change
Lowest 20%	\$ 12,400	\$ +1,485
Second 20%	24,900	+2,299
Middle 20%	40,100	+2,678
Fourth 20%	65,500	+3,576
Next 10%	99,600	+5,182
Next 5%	140,100	+4,323
Next 4%	243,900	-5,834
Top 1%	1,327,700	-209,562
Bottom 95%	\$ 48,000	+2,887

Source: ITEP Microsimulation Model, February 2010

¹ Robert Hall and Alvin Rabushka, *Low Tax, Simple Tax, Flat Tax*, 1983, p. 67.

² Hall and Rabushka, p. 58.

³ Citizens for Tax Justice, "Senator Specter's "Flat Tax" Cuts Taxes for the Richest 5% and Raises Taxes for Everyone Else," February 19, 2010. <http://ctj.org/pdf/specterflattax.pdf>

- **Low-income Americans would lose the refundable credits** that they receive under the current income tax.
- **The form of income that mostly flows to the wealthy — investment income — would be exempt** from the personal income component of the flat tax, while all compensation for work, including wages and even employer-provided health care benefits, would be taxed.
- **There would be little simplification in taxes for the majority of Americans.** Most middle-class taxpayers take the standard deduction and have fewer complications to deal with than wealthy taxpayers, who pay others to do their taxes for them. (Some complications that middle-income people do face, like income from multiple jobs, would not be eased at all by the Flat Tax.)

The So-Called “Fair Tax” (aka National Sales Tax)

The so-called “Fair Tax” would replace the federal personal income tax, corporate income tax and estate and gift taxes with a 30 percent sales tax. A frequently-cited 2004 report from the Institute on Taxation and Economic Policy (ITEP) analyzed this proposal.⁴ Here are a few key points to remember:

Proponents use a convoluted calculation to claim that their proposed 30 percent sales tax actually has a 23 percent rate.

The tax allegedly would apply to all types of consumption, including those that would be difficult or impossible to tax in the real world (like rent, health care services, and, oddly, government spending.)

ITEP estimated that the sales tax rate would actually have to be between 45 and 53 percent in order to truly raise as much revenue as the current federal tax system (which proponents claim the Fair Tax would do). ITEP then modeled the impacts of a Fair Tax with a 45 percent rate.⁵

ITEP found that poor and middle-class families would pay thousands of dollars more in federal taxes each year despite the rebate that proponents claim would mitigate the gross unfairness of the tax.

ITEP found that:

- In virtually every state in the union, the bottom 80 percent of taxpayers would face much higher taxes under a sales tax. Nationwide, these tax increases would average about \$3,200 a year.

⁴ Institute on Taxation and Economic Policy, “The Effects of Replacing Most Federal Taxes with a National Sales Tax: A State-by-State Distributional Analysis,” September 2004. <http://www.itepnet.org/pdf/sale0904.pdf>

⁵ The 45 percent rate was found to be the closest possible rate to Fair Tax proponents’ 30 percent rate while still meeting their goal of raising as much revenue as the taxes it would replace. The rate would probably need to be higher given the tax cheating likely to take place.

- Put another way, on average the 80 percent of Americans in the middle- and lower-income ranges would pay 51 percent more in sales taxes than they now pay in the federal taxes that the proposed national sales tax would replace.
- In contrast, the best-off one percent of all taxpayers nationwide would get average tax reductions of about \$225,000 each per year.

Citizens for Tax Justice has long warned lawmakers about the “Fair Tax” and CTJ’s director, Robert McIntyre, wrote an op-ed in the *New York Times* about it in 1998.⁶

But the history of the proposal goes back a little further than that. The original idea was conceived by the Church of Scientology as a way to abolish the IRS.⁷

Both Plans Consolidate Loopholes for the Rich

Both plans are presented as tax simplification plans, but federal income taxes are already fairly straightforward for most middle-income families. What actually make the tax system complicated are the various loopholes and special breaks that mostly benefit businesses and higher-income individuals.

For example, capital gains and stock dividends (which wealthy investors tend to have) are currently taxed at a lower rate than the wage and salary income that constitutes almost all income for most Americans. Many wealthy people have an incentive to use various schemes to disguise what is really compensation for work as capital gains income.

Both of these plans are designed to expand these loopholes into a blanket tax exemption for investments. And since most investing is done by the rich, both plans shift taxes away from the rich and towards middle- and lower-income Americans.

For example, proponents of the “Flat Tax” concept are quite clear that it would entirely exempt capital gains and dividend income. The flat, single-rate structure seems almost incidental.

The national sales tax (the so-called “Fair Tax”) would tax all income that is spent on consumption, but none of the income that is saved or invested. Poor families have little or nothing left to save after they buy the basic necessities, whereas very high-income families are likely to put the majority of their incomes towards investment and savings.

As a result, a national sales tax would inevitably take a larger share of income from a poor family than it would from a rich family. As ITEP’s figures illustrate, this is true despite the rebate that each family would receive under the plan.

⁶ Robert S. McIntyre, “A 23 Percent Solution?” *New York Times* Op-Ed, January 23, 1998.
<http://ctj.org/pdf/NatlSalesTaxNYTJan1998.pdf>

⁷ Bruce Bartlett, “Dianetics, The Tax Plan: Fred Thompson channels L. Ron Hubbard,” *The New Republic*, December 13, 2007. <http://www.tnr.com/article/politics/dianetics-the-tax-plan>