Why Retailers Should Support the FairTax

Retailers Will Be More Profitable

- Like other firms, retailers will enjoy a zero corporate tax rate and their shareholders will not be taxed on dividends or capital gains on their investments.
- Retailers will receive a collection fee of 25 basis points on federal funds collected.
- Compliance costs (discussed below) will be lower by a conservative estimate of $225 billion[1].

The Economy Will Grow, More People Will Have Jobs, Incomes Will Increase More Rapidly

- Those taxpayers who receive a payroll check will benefit from more disposable income from the first day under the FairTax, due to the repeal of the payroll tax in its entirety.
- All known economic projections predict a much healthier economy[2]. People are willing and able to purchase more goods and services in a healthy economy. Typical estimates are that the economy will be 10 to 14 percent larger within 10 years and consumption will grow very substantially. Some studies show the potential gains to be much higher[3]. Real wages will increase. Retailers will make more money in a prosperous, growing economy.
- Consumer interest rates will fall dramatically, between 25 to 30 percent[4]. Therefore, consumer's ability to finance consumption will increase. In the case of interest that is presently deductible (home mortgage interest deductions, etc.), this projected drop in interest rates should more than off-set any benefits lost due to the lack of deductibility. With regard to consumer loans, since consumer interest is not deductible under present law, the effect of

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[1] Compliance Costs of Alternative Tax Systems II, Arthur P. Hall, Ph.D., Senior Economist, The Tax Foundation, Special Brief, House Ways & Means Committee Testimony, March 1996; Testimony of Arthur Hall, before the Ways and Means Committee, March 20, 1996 on "Replacing the Federal Income Tax" wherein he estimates that under a national retail sales tax plan compliance costs would decline by 95 percent to $8.2 billion.

[2] See, e.g., "The National Sales Tax: Moving Beyond the Idea," *Tax Notes* March 21, 1996, David R. Burton and Dan R. Mastromarco. "The Economic Impact of Replacing Federal Income Taxes with a Sales Tax"; Laurence J. Kotlifkoff, April, 15, 1993, Cato Institute Policy Analysis; The Economic Impact of Taxing Consumption; Dale W. Jorgenson, Ph.D., Harvard University, Testimony before the Ways and Means Committee, March 27, 1996; "The Economic Impact of Fundamental Tax Reform, Dale W. Jorgenson; Testimony before the House Ways and Means Committee, June 6, 1995.

[3] "The Economic Impact of Fundamental Tax Reform, Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995. "Looking Back to Move Forward: What Tax Policy Cost Americans and the Economy; Gary Robbins, Aldona Robbins, September 1995, Policy Report Number 127, Institute for Policy Innovation.

[4] John E. Gobb, *Economic Review*, Federal Reserve Bank of Kansas City, "How Would Tax Reform Affect Financial Markets?", Fourth Quarter, 1995. He estimates a 25-35 percent drop (p. 27). See also *The Flat Tax*, 2nd Edition 1995, Robert E. Hall and Alvin Rabushka, The Hoover Institution Press.

[5] "The Economic Impact of Fundamental Tax Reform, Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995. "Looking Back to Move Forward: What Tax Policy Cost Americans and the Economy.

lower interest rates will strongly and positively impact credit card or consumer loan financed purchases.

Consumption Is Taxed Once Under Both an Income Tax and a Sales Tax

- Under the current federal income tax system, as well as under the FairTax, consumption purchases must be made from after-tax dollars. Therefore, the primary difference between a sales tax and an income tax is not the way they impact consumption, but rather how they impact savings. The income tax double or triple taxes savings, while the sales tax does not tax savings until consumed.
- The criticism by some that consumers will not have available funds to pay the sales is incorrect. Consumers will see their paychecks immediately increase by over $1.6 trillion because income and payroll taxes are eliminated (estimated for 2001). In addition, Dale Jorgensen, head of the Economics Department at Harvard University, has shown that producer prices will drop between 15 and 25 percent after the switch to consumption-based tax[5]. A substantial part of producer price reductions can be passed on to the consumer in the form of lower retail prices, which will increase consumer demand. But, while offering lower prices, retailers will be able to maintain their current profit margins.

Retailers Suffering From Direct Mail Competition and Cross State Sales Should Benefit

- Direct mail sales from out of state sources, and in practice, made tax-free because state use taxes are not enforced. Under the new system, retailers must collect the federal sales tax on all sales occurring within the United States. States that choose to conform to the federal base will have the added advantage of information sharing and clear interstate revenue allocation rules. The ability for the state to collect these heretofore-uncollected taxes would be a major incentive for states to conform their sales tax to the federal sales tax base. Retailers suffering from tax-free direct mail competition or from tax-free sales from out of state retailers would see a major competitive disadvantage removed.

Retailers' Compliance Costs Will Be Lower

- Instead of having to comply with the complexities of the income tax and payroll tax, there will be one sales tax on all goods and services. The firm will simply need to calculate its total retail sales on a monthly basis.
- No more uniform inventory capitalization requirements.
- No more complex rules governing employee benefits and retirement plans.
- No more tax depreciation schedules.
- No more tax rules governing mergers and acquisitions.
- No more international tax provisions.

- Over time, most states will conform their sales taxes to the federal sales tax, reducing the costs of complying with multiple rules in each state and its political subdivisions.
- The firm's accounting, tax and personnel (human resources) departments will shrink dramatically.

The Mad Dash to Consume Prior to Enactment of the FairTax

Some retailers have speculated that in the period prior to the enactment of a consumption tax, there will be a "mad dash" by consumers to purchase durable goods without tax. This positive spike in consumption prior to enactment would then be followed by a compensatory drop in consumption of equal magnitude. This drop in consumption would translate into a lack of sales tax revenue for the government during a period following enactment.

The government would not, however, lack funding during this period. It would benefit from the income tax imposed on corporate profits as a result of any increase in earnings during the period preceding the enactment of the FairTax. In other words, a drop in revenues from retail sales, should it occur temporarily, would be offset by revenues derived under the old income tax system---from corporate income taxes on earnings, payroll taxes, and income taxes received from individual workers earnings as a result of increased demand for goods. It should be noted that consumption of durable goods represents only 14% of total consumption.

The National Retail Association and the Nathan Associates Study

- A study prepared by Nathan Associates[6] for the National Retail Institute, which by its own admission made every conceivable adverse assumption, represents the worst case scenario for a consumption tax. It predicts that the economy will grow **only** three percent more in ten years than it would have under the income tax and that the increase in consumption will be 1.15 percent less in the first year relative to what it would have been under the income tax. The Nathan study concludes that **consumption will be higher in the fourth year and every year thereafter than it would have been under the income tax**. *In other words, even in the Nathan Associates worst-case scenario, consumption will continue to grow at a healthy pace.* (The Nathan study did not assume the repeal of the payroll tax in its entirety, as called for by the FairTax plan.) Even if the growth in consumption is reduced in the first year by the amount predicted by Nathan Associates, **retailers will be more profitable after-tax because of the repeal of the income tax and lower compliance costs**. This study assumes 1) very low labor responsiveness to lower tax rates on labor, 2) that every dollar in new U.S. investment must come from the U.S. rather than foreign investors and, 3) there will be very small effects of increased investment on productivity. Additionally, the study assumes no gain in productivity from lower compliance costs.

[6] Replacing the Federal Income Tax with a Consumption-Based Tax System, Nathan Associates, Inc., for the National Retail Institute, March 1996.