HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HM 15 Fair Tax Act of 2013
SPONSOR(S): Van Zant and others
TIED BILLS: **IDEN./SIM. BILLS:** SM 118

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Local & Federal Affairs Committee	13 Y, 5 N	Kelly	Rojas
2) Finance & Tax Subcommittee	12 Y, 6 N	Flieger	Langston

SUMMARY ANALYSIS

HM 15 urges the United States Congress to adopt H.R. 25, also known as the Fair Tax Act of 2013 (Act). The Act would eliminate the federal income tax, payroll tax, estate tax, gift tax, capital gains tax, alternative minimum tax, self-employment tax, the corporate tax, and all other current federal taxes. In place of these removed taxes, the Act would implement a 23 percent inclusive national retail sales tax on all new goods and services bought at the point of final purchase for consumption.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Present Situation

H.R. 25 is federal legislation known as the Fair Tax Act of 2013 (Act). The Act would eliminate the federal income tax, payroll tax, estate tax, gift tax, capital gains tax, alternative minimum tax, self-employment tax, the corporate tax, and all other current federal taxes. In place of these removed taxes, the Act would implement a 23 percent inclusive national retail sales tax on all new goods and services bought at the point of final purchase for consumption.

Congressman Woodall of Georgia introduced the Act in January 2013. Currently, the bill has been assigned to the Ways and Means Committee.[1]

Background on Taxation

The basis for income taxes in the United States comes from the ratification of the 16th Amendment to the U.S. Constitution in 1913. Accordingly, the 16th Amendment grants Congress the power to lay and collect taxes from individuals and corporations on "income, from whatever source derived," and eliminates the previous requirement that all direct federal taxes be apportioned by population.[2]

Federal Tax System

Federal Income Taxes

Federal income taxes are a tool used to raise revenue for the federal government. This tax is calculated by applying taxable income calculated as gross income minus any tax deductions that is defined by the Internal Revenue Code (IRC) to a tax rate (which can increase as income increases) also set in the IRC. Individuals and corporations can be directly taxed, while estates and trusts may be taxable on undistributed income.[3]

On an individual basis, tax liability is determined by: "(1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) [alternative] minimum tax reduced by credits allowed against the minimum tax."[4] Income that is taxable is determined by the individual's total gross income less the individual's deductions (using the standard deduction or itemized deductions) and personal exemptions.[5] An individual's adjusted gross income (AGI) is determined by the individual's total income less certain adjustments for items like moving expenses, student loan interest, IRA contributions, and alimony. After the AGI is reduced, marginal tax rates based on corresponding income brackets are then applied to the taxable income with the maximum rate set at 39.6 percent.[6]

Some individual's may also elect to pay Alternative Minimum Tax (AMT). Taxpayers must pay the higher rate of the regular income tax or the AMT. AMT is usually applied at a flat rate on taxable income. The main difference between the AMT and the regular income tax is that the various exemptions usually available for regular income tax is replaced by a single deduction that is phased out at higher income levels. Taxes for corporations are paid in a similar manner.[7]

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[1] H.R. 25, GOVTRACK.US, *available at* https://www.govtrack.us/congress/bills/113/hr25.
[2] U.S. CONST. amend. XVI; 46 A.L.R. Fed. 2d 301 (Originally published in 2010).
[3] JOSEPH M. DODGE ET AL., FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY (4th ed, 2012).
[4] SHIRLEY DENNIS ESCOFFIER & KAREN A. FORTIN, TAXATION FOR DECISION MAKERS, 3-4 (Thompson South Western 2008).
[5] Kelly Phillips, *Making Sense of Income and Tax Terms*, FORBES.COM (November 13, 2012), http://www.forbes.com/sites/kellyphillipserb/2012/11/13/making-sense-of-income-and-tax-terms/.
[6] JOSEPH M. DODGE ET AL., FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY (4th ed, 2012).
[7] *Id.*

Federal Payroll Taxes

Payroll and estate taxes also interact with the federal income tax scheme. Federal "payroll" taxes largely refer to the federal Social Security tax (enacted in 1935) and the Medicare tax. (enacted in 1966). The revenue for these taxes comes from labor income including wages and self-employment income. Originally, for the Social Security tax, the first $3,000 of wages were subject to the tax at a rate of 1 percent to the employer and 1 percent to the employee. Wages above that line were exempt. Today, the rate and the "wage ceiling" have increased, making the wage ceiling approximately $106,800 at a tax rate of 6.2 percent for both the employer and the employee. Despite this change, wages above this ceiling still remain to be exempt.[8]

The Medicare tax is imposed today on all wages and self-employment income at a rate of 1.45 percent on both the employer and the employee. There is no wage ceiling for this particular tax. Collectively, most households pay more payroll taxes than income taxes. Likewise. Federal revenue generated from payroll taxes contributes almost as much as individual income taxes.[9]

Federal Estate and Gift Taxes

A gift tax is imposed on any transfer of ownership of property made in the United States. The tax is imposed on the donor of the gift. However, certain exemptions apply including deductions for gifts made to spouses, charities, tuition, or medical expenses paid for someone made directly to a medical or educational entity. Estate taxes are imposed when a person inherits money or property from a deceased person. The gift and estate taxes are based on the same graduated rate schedule, with a maximum tax rate of 40 percent.[10]

<u>The Fair Tax Act</u>

In 2011, similar legislation to the current Act was introduced in the 112th Congress (known as the Fair Tax Act of 2011).[11] Presently, Act have been re-introduced in the 113th Congress.[12] Below is a summary describing current Act, prepared by the Congressional Research Service:

> This legislation proposes to repeal the individual income tax, the corporate income tax, all payroll taxes, the self-employment tax, and the estate and gift taxes. These taxes would effectively be replaced with a 23% (tax-inclusive, meaning that the rate is a proportion of the after-tax rather than the pre-tax value) national retail sales tax. The tax-inclusive retail sales tax would equal 23% of the sum of the sales price of an item and the amount of the retail sales tax. Every family would receive a rebate of the sales tax on spending amounts up to the federal poverty level (plus an extra amount to prevent any marriage penalty). The Social Security Administration would provide a monthly sales tax rebate to registered qualified families. The 23% national retail sales [tax] would not be levied on exports. The sales tax would be separately stated and charged. Social Security and Medicare benefits would remain the same with payroll tax revenue replaced by some of the revenue from the retail sales tax. States could elect to collect the national retail sales tax on behalf of the federal government in exchange for a fee. Taxpayer rights provisions are incorporated into the act. The sales tax would sunset at the end of a seven-year period beginning on the enactment of this act if the Sixteenth Amendment is not repealed. This amendment provided Congress the 'power to lay and collect taxes on income.[13]

Effect of Proposed Changes

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[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] H.R. 25 / S. 13.
[12] H.R. 25 / S. 13.
[13] Congressional Research Service, *Tax Reform in the 113th Congress: An Overview of Proposals, available at* http://www.fas.org/sgp/crs/misc/R43060.pdf.

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B. SECTION DIRECTORY:
Not applicable.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:
   None.

2. Other:
   None.

B. RULE-MAKING AUTHORITY:

Not applicable.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

N/A.