The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Commerce and Tourism

BILL: SM 118

INTRODUCER: Senator Hays

SUBJECT: National Retail Sales Tax

DATE: December 6, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Siples	Hrdlicka	CM	**Pre-meeting**
2.			GO	
3.			RC	

I. Summary:

SM 118 urges the United States Congress to enact H.R. 25, the Fair Tax Act of 2013, which imposes a national retail sales tax and eliminates the personal income tax, the alternative minimum tax, the estate tax, the gift tax, the capital gains tax, the corporate income tax, the self-employment tax, and the employee and employer payroll tax.

II. Present Situation:

Background

Sixteenth Amendment[1]

In 1913, the 16th Amendment to the United States Constitution was ratified, establishing the framework for our modern federal tax system. Specifically, the 16th Amendment grants Congress the power to lay and collect taxes on "income, from whatever source derived," and eliminates the previous requirement that all direct federal taxes be apportioned by population.

In 1939, the Internal Revenue Code (IRC) was created to simplify the process for making changes to existing tax statutes. Previously, any statutory revisions to existing law required the passage of an entirely new set of tax provisions. With the creation of the IRC, revisions to existing law would only demand changes to be made to the affected section. Since 1939, the IRC has been recodified on two occasions: 1954 and 1986. Presently, the federal government is operating under the Internal Revenue Code of 1986.

[1] Information in this section was adapted from Shirley Dennis Escoffier & Karen A. Fortin, Taxation for Decision Makers, 3-4 (Thompson South Western 2008).

Federal Taxes[2]

Federal Income Tax

Federal income tax includes income taxed at both the individual and corporate level. Notable variations in the governing rules apply to each category. An individual taxpayer's liability is determined by the greater of "(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."[3] Depending on the applicable tax standard, a different rate schedule will apply.

Determining regular tax liability requires calculating taxable income, defined as "the taxpayer's total gross income less certain exclusions, exemptions, and deductions."[4] An individual's adjusted gross income (AGI) is calculated by subtracting "above-the-line-deductions," such as trade or business expenses, moving expenses, and capital losses, from the individual's gross income.[5] The AGI is then reduced by the personal exemption deduction and by either the appropriate standard deduction or itemized deduction amount to arrive to the taxable income figure.[6] Marginal tax rates based on corresponding ordinary income brackets are then applied to the taxable income, with the maximum rate set at 39.6 percent. Note that most gain acquired from a capital asset is taxed under a separate rate structure, with the maximum rate set at 20 percent.[7]

Additionally, federal law requires that the alternative minimum tax also be calculated to determine if an individual's regular tax liability falls below the alternative minimum tax liability amount. If so, then an alternative minimum tax will be imposed to account for the difference between the taxable income and alternative minimum taxable income (AMTI) amount.[8] When calculating the AMTI, the taxpayer is precluded from taking a personal exemption, standard deduction, and certain itemized deductions, such as state and local taxes paid, to reduce his or her overall income.[9] The AMTI is then reduced by the appropriate exemption amount. The difference, if any,[10] is the taxable excess, which serves as the basis for determining the taxpayer's tentative minimum tax liability.

At the corporate level, regular income tax liability is calculated in a similar way. Numerous rules exist that are unique to corporations, such as the dividends received deduction (DRD) provision

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[2] Staff of J. Comm. on Taxation, 113th Cong., Overview of the Federal Tax System as in Effect for 2013 (JCX-2-13R), (Jan. 8, 2013), *available at* https://www.jct.gov/publications.html?func=startdown&id=4498 (select download link to access pdf file) (last visited December 2, 2013).

[3] *Id.* at 4.

[4] *Id.* at 2.

[5] *Id.*

[6] *Id.* at 3.

[7] *Id.* at 7. Although historically classified as ordinary income, the Jobs and Growth Tax Relief Reconciliation Act of 2003 allows for dividends to be taxed at favorable capital gains rate subject to certain conditions.

[8] *Id* at 6.

[9] *Id* at 6. ("AMTI is the taxpayer's taxable income increased by the taxpayer's tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.")

[10] *Id.* Note that if there is no difference then the individual taxpayer is subject to federal tax rules governing regular tax liability.

that allows a corporate shareholder to deduct, at a minimum, 70 percent of the dividend it receives.[11] The effect of this provision is to mitigate the effects of a triple taxation.[12] However, a distributing corporation is restricted from deducting the dividend amount paid to shareholders.[13] Furthermore, unlike individuals, a separate tax rate structure does not apply for corporate capital gains. Thus, corporate capital gains will be taxed at the same schedule as ordinary corporate income tax rates.[14]

Corporations are also required to calculate an alternative minimum tax. Like the individual taxpayer, a corporation is subject to the alternative minimum tax to the extent that it exceeds its regular income tax liability.[15] A corporation's alternative minimum taxable income is calculated by increasing the corporation's regular taxable income by disallowing favorable tax treatment on certain items. Again, the effect is to negate the deferral of income that would normally take place under the regular tax treatment of those items. The alternative minimum taxable income is then increased by 75 percent of the difference between a corporation's adjusted current earnings and its alternative minimum taxable income.[16] That amount is then reduced by the applicable exemption amount, if one is applicable.[17] The leftover amount is then taxed at a flat rate of 20 percent.[18]

Estate and Gift Tax

In the United States, a gift tax is imposed on the transfer of any property by gift that is made by a U.S. citizen or resident.[19] The gift tax is imposed at the donor level and is based on the fair market value of the property transferred. Deductions are allowed for certain gifts that are made to spouses and charities. As of 2013, annual gifts of $14,000 or less per donor and per donee generally will not be subject to any tax.

An estate tax is imposed on the taxable estate of any person who was a citizen or resident of the United States at the time of death. A nonresident's estate may also be subject to the estate tax if certain property belonging to the decedent is located in the United States at the time of death. Similar to the gift tax, the tax is imposed based on the fair market value of the property at the time of death. In its simplest form, the taxable estate generally will equal the value of the worldwide gross estate reduced by allowable deductions, such as marital deductions and charitable bequests.

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[11] *Id.* at 10 and United States Department of the Treasury, Internal Revenue Service, Corporations (Publication 542, Rev. March 2012), *available at* http://www.irs.gov/pub/irs-pdf/p542.pdf (last visited December 2, 2013).
[12] Note that without this deduction, corporate profits would be taxed first to the corporation that earned them, again to the corporate shareholder receiving the distribution, and again to the individual shareholder upon receipt of a distribution from the second corporation.
[13] Staff on J. Comm. on Taxation. at 10.
[14] *Id.* at 11.
[15] *Id.* at 12.
[16] *Id.*
[17] Note that the exemption amount is phased out for corporations with income above certain thresholds, and is completely phased out for corporations with alternative minimum taxable income of $310,000 or more. *Id.* at n. 19.
[18] *Id*. at 12.
[19] *Id*. at 14.

The gift and estate taxes are based on the same graduated rate schedule, with a maximum tax rate of 40 percent. In addition to the gift and estate taxes, a transfer tax may also be imposed on generation-skipping transfers. As a general rule, this tax is imposed on transfers in excess of $5.25 million to a beneficiary in more than one generation below that of the transferor at a flat rate of 40 percent.

Employment Tax

The Federal Insurance Contributions Act (FICA) imposes taxes on both employers and employees.[20] Under the act, employers are required to pay the following: "(1) the old, age survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($113,700 in 2013); and (2) the Medical hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages."[21] In addition, employers are required to pay a federal unemployment insurance payroll tax of generally 0.6 percent of the total wages of each employee, up to $7,000, on covered employment.[22]

Employees are also subject to a federal withholding tax equal to the amount of FICA tax imposed on the employer. Note that the withholding tax does not include the employer's obligation to pay unemployment insurance tax. Lastly, the Self-Employment Contributions Act (SECA) requires that taxes be imposed on the net income derived from self-employment. The general rule is that the OASDI and HI tax rate portions will be paid by the self-employed individual at the combined employer and employee rates as required under FICA.[23]

Fair Tax Act of 2013

Below is a summary describing H.R. 25, The Fair Tax Act of 2013, 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-

[20] *Id.* at 16.
[21] *Id.*
[22] The unemployment insurance payroll tax is 6 percent; however, most states receive a credit of 5.4 percent, making the effective tax rate 0.6 percent.
[23] *Id* at 16.

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.'[24]

III. Effect of Proposed Changes:

Resolution: SM 118 urges Congress to enact H.R. 25, the Fair Tax Act of 2013, which imposes a national retail sales tax and eliminates the personal income tax, the alternative minimum tax, the estate tax, the gift tax, the capital gains tax, the corporate income tax, the self-employment tax, and the employee and employer payroll tax.

Rationale for Resolution: SM 118 stipulates that the current federal taxation regime retards economic growth and the country's international competiveness. It further states that the current system is inequitable and imposes unnecessary administrative and compliance costs on both individual and business taxpayers. As such, SM 118 recommends the repeal of the 16th Amendment to the federal constitution.

In the alternative, SM 118 calls for the imposition of a national sales tax. It provides that the imposition of such tax would promote fairness and reduce administrative burdens faced by American taxpayers. SM 118 recommends that Congress consider administering and collecting the national sales tax at the state level in return for a reasonable administration fee to the states.

Circulation: Copies of this memorial are to be dispatched to the President of the United States, to the President of the United States Senate, to the Speaker of the United States House of Representatives, and to each member of the Florida delegation to the United States Congress.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

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[24] Sherlock, Molly F., Cong. Research Serv., R43060, Tax Reform in the 113th Congress: An Overview of Proposals (May 6, 2013), *available at* http://www.fas.org/sgp/crs/misc/R43060.pdf (last visited December 2, 2013).

B. Private Sector Impact:

None.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

None.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.