



A FairTaxSM White Paper

Your federal tax burden under current law and the FairTax

by Ross Korves

As farmers and ranchers prepare 2006 federal income tax returns or provide income and expense information to accountants and other tax professionals, a logical question is how would the tax burden change under the FairTax? The FairTax would eliminate all individual and corporate income taxes, all payroll taxes and self-employment taxes for Social Security and Medicare, and the estate tax and replace them with a national retail sales tax on final consumption of goods and services.

Payroll and self-employment taxes

The starting point in calculating the current tax burden is payroll taxes and self-employment taxes. Most people pay more money in payroll and self-employment taxes than they do in income taxes because there are no standard deductions or personal exemptions that apply to payroll and self-employment taxes. You pay tax on the first dollar earned. While employees see only 7.65 percent taken out of their paychecks, the reality is that the entire 15.3 percent payroll tax is part of the cost of having an employee and is a factor in determining how much an employer can afford to pay in wages. Self-employed taxpayers pay both the employer and employee portions of the payroll tax on their earnings, and the entire 15.3 percent on 92.35 percent of their self-employed income (they do not pay on the 7.65 percent of wages that employees do not receive as income); however, they are allowed to deduct the employer share of payroll taxes against the income tax.

To determine the real payroll tax burden in 2006, add up the Social Security and Medicare taxes withheld on all W-2 forms for the family and then double that amount. Your self-employment tax form (Form 1040 Schedule SE) will show the amount of self-employment taxes paid in 2006. That amount also appears on line 58 of the second page of the Form 1040 in the "Other Taxes" category.

Adding together the payroll taxes paid and the self-employment taxes paid gives the total taxes paid for Social Security and Medicare.

Income taxes

Total income tax owed after exemptions, deductions, and tax credits appears on line 57 of the second page of your Form 1040. That number is the result of calculations that reduce the total income on line 22 of the first page of the Form 1040 by the payments on the bottom part of page one to give adjusted gross income on line 37 (that is also on line 38 at the top of the second page). Also at the top of page two are the personal exemptions and the standard or itemized deduction that reduces taxable income. The personal exemption is \$3,300 per person and the



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standard deduction is \$5,150 for an individual and \$10,300 for a couple. For a family of four, the personal exemptions and the standard deduction total \$23,500.

All of the deductions are subtracted from the total income to determine taxable income. For 2006, for a couple filing jointly the first \$15,100 of taxable income is taxed at 10 percent, the \$15,100 to \$61,300 bracket is taxed at 15 percent, the \$61,300 to \$123,700 bracket is taxed at 25 percent, and the \$123,700 to \$188,450 bracket is taxed at 28 percent. Taxpayers with children under the age of 17 qualify for a \$1,000 per child tax credit.

Total taxes under the current system

Payroll/self-employment taxes plus income taxes give the total taxes owed.

Taxes under the FairTax

The FairTax would tax the final retail consumption of goods and services, not income. Taxes would be paid as consumption occurs throughout the year. Individuals would not file a tax return under the FairTax.

To calculate your FairTax burden, begin by estimating how much you spend on retail purchases of goods and services throughout the year. All consumption except education tuition would be taxed. To estimate taxable consumption, subtract all forms of saving, including reinvestment in the farming operation and other businesses, education tuition, charitable contributions, and state and local taxes from income. Then multiply the resulting spending estimate by 23 percent. This gives you your "gross" FairTax estimate. To arrive at the "net" FairTax paid, you must subtract the FairTax "prebate" from your gross FairTax estimate.

The FairTax prebate ensures that no taxpayers are required to pay taxes on essential goods and services. The prebate is a monthly check (or more likely a direct deposit to your checking account) equal to the FairTax rate of 23 percent times the federal government's estimate of spending at the poverty level for your size family with an adjustment to avoid a marriage penalty. For a single taxpayer the 2006 annual prebate is \$2,254 and twice that amount or \$4,508 for a couple. The prebate amount is increased by \$782 for each additional child in a family. For example, the prebate for a husband and wife with two children would be \$6,072 per year based on poverty level spending of \$26,400 per year. The estimated sales taxes paid minus the prebate would be the estimated tax burden for your family under the FairTax for 2006.

Note that the level of spending exempted from taxation for a family of four of \$26,400 under the prebate program is \$2,900 more or 12 percent higher than the \$23,500 under the current income tax system. The most important difference is that the exemption under the current system only applies to the income tax and not to payroll and self-employment taxes.

If consumption patterns remain the same, and there is no reason to expect them to differ substantially for most families, the amount of money spent on consumption under the FairTax on an after-tax basis would be roughly the same as is spent under the current tax system.



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About Ross Korves

Ross Korves is an independent economic policy analyst.

He is a Trade Policy Analyst with Truth About Trade and Technology, a group begun and run by farmers and ranchers who believe in increased international trade and the use of biotechnology, and an Economic Policy Analyst with the ProExporter Network, a transportation and grain processing analysis firm. He also provides analysis and advice on federal tax policy for farmers and ranchers and health care policy.

Ross spent 25 years as an economist for the American Farm Bureau Federation. He is a native of southern Illinois and a graduate of Southern Illinois University.

What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans For Fair Taxation (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

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(AFFT Documents\Papers on a specific subject\Your federal tax burden under current law and the FairTax)