

House Committee on Ways and Means

Statement of The Honorable Michael K. Conaway, a Representative in Congress from the State of Texas

Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means

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Mr. Chairman and distinguished Members of the Committee, it is an honor and a privilege to testify before you today about an issue that I've spent my career working on: Taxes.

As a CPA and small business owner, I have worked with our inefficient tax code and the many challenges that arise as a result of its complex nature. I believe that as federal tax regulations have grown, economic efficiencies have decreased drastically. The best and most effective tax system for the federal government, would be one where individuals and businesses do not need to hire professionals to prepare their taxes. The complexities inherent to our tax code create a number of fundamental problems that must be addressed.

I believe in the natural efficiencies of the free market and the need to let the market forces operate without unnecessary government regulation. As a nation, we waste over 6.5 billion hours every year filling out tax forms, keeping records, and learning new tax rules. The cost of complying with federal income taxes is roughly \$200 billion annually. Unfortunately, the 6.5 billion man hours and \$200 billion spent, only demonstrate half of the economic losses caused by our tax code.

In addition, every year the IRS fails to collect over fifteen percent of the tax revenues owed to the federal government. This 'tax gap' is estimated to be approximately \$345 billion per tax year. To put this amount into perspective, this year we will spend \$420 billion on all non-defense domestic discretionary spending and our estimated budget deficit for fiscal year 2006 year is \$260 billion. As you know, \$345 billion is a large sum, even by federal government standards. Yet, through our broken tax system, we allow this money to go uncollected each year. This loss in tax revenue is apparently unavoidable with our current tax code.

The IRS has increased its enforcement revenues from nearly \$39 billion in 2001 to \$47 billion in 2005 by increasing the number of audits of taxpayers. While I applaud their efforts, more audits are not going to fix this problem. Even if every single taxpayer received an unwelcome audit from the IRS, we would still have a tax gap. We need to radically change the tax system in a way that completely eliminates that gap.

When looking at proposals for fundamental tax reform, we should keep a few guiding principles in mind. The following principals were among ten outlined in a recent report by the AICPA on good tax policy: Equity and fairness, economy in collection, simplicity, economic efficiency,

transparency, and minimizing the tax gap. It would behoove all of us, to keep these ideals in mind as we debate the future tax system.

Taxpayers in the same or similar financial situations should be taxed in the same manner. By treating like taxpayers equally the system becomes more economically efficient and transparent, with diminished incentives to evade taxes. Likewise, a tax scheme that is simple and provides for easy compliance greatly increases economic efficiency, while reducing costs associated with collections.

There is a proposal that will adhere to the aforementioned principles without requiring taxpayers to file tax returns, eliminate all federal income, estate, and payroll taxes and reduce the 'tax gap' to zero -- the Fair Tax.

The Fair Tax plan, H.R. 25 introduced by Congressman John Linder, is a federal tax plan that would eliminate all federal income, payroll, personal, gift, estate, capital gains, alternative minimum, Social Security, Medicare, self-employment, and corporate taxes. All of these taxes would be replaced with a simple progressive national retail sales tax. The plan includes tax rebates to ensure that no American pays federal taxes while living at or below the poverty level. By taxing only what we choose to spend and not what we earn, the Fair Tax creates a system that is totally transparent and simple to comply with.

Opponents of this plan claim it is regressive, hitting the poorest Americans the hardest. However, this problem is avoided by providing a prepaid monthly rebate for every household to pay for the taxes on all necessities up to the poverty level. This important feature ensures that low income Americans are not taxed and keeps the system progressive.

Additionally, it is important to note that the prices for goods and services would not rise significantly under the Fair Tax. Under our current tax scheme hidden taxes make up to twenty percent of the cost of all retail prices. Income and corporate taxes are passed on to the consumer in everything we buy. By repealing the hidden taxes that are built into the retail price of an item and replacing them with a transparent national sales tax, all Americans will know exactly how much money they are contributing to the federal government every time they make a purchase.

The IRS readily admits that there is a systemic problem of noncompliance inherent in the tax code. There is a vast underground economy in this country, consisting of illegal immigrants and criminals operating outside the confines of our tax system. Illegal immigrants, paid "off the books" don't file tax returns. With the Fair Tax, those who live in the trillion dollar world of the underground economy would be forced to pay their fare share.

However, I must caution the committee about adopting a 'hybrid' type scheme that would include components of a national sales tax along with either payroll or income taxes. Such a proposal would fail to eliminate the complexities of the current system and would allow some of the inefficiencies to remain.

Bearing in mind such a massive tax overhaul could not happen overnight, I would also like to take the opportunity to champion provisions that allow the deductibility of sales taxes in lieu of

state income taxes. Not renewing this deduction before 2006, would amount to a tax increase for taxpayers in states that do not have income taxes, such as Texas. The American Jobs Creation Act of 2004, reinstated the deduction of sales tax in lieu of income taxes. If we allow the sales tax deduction to expire at the end of this year, we will have to defend what is in effect a \$1.5 to \$3 billion dollar a year tax increase on selected citizens.

In closing, I would like to reiterate my support for a comprehensive overhaul of our current tax collection scheme to bring clarity, transparency and fairness to the system. I thank the Committee for its time and hard work and I look forward to working with you to find a working solution to reforming our tax system.