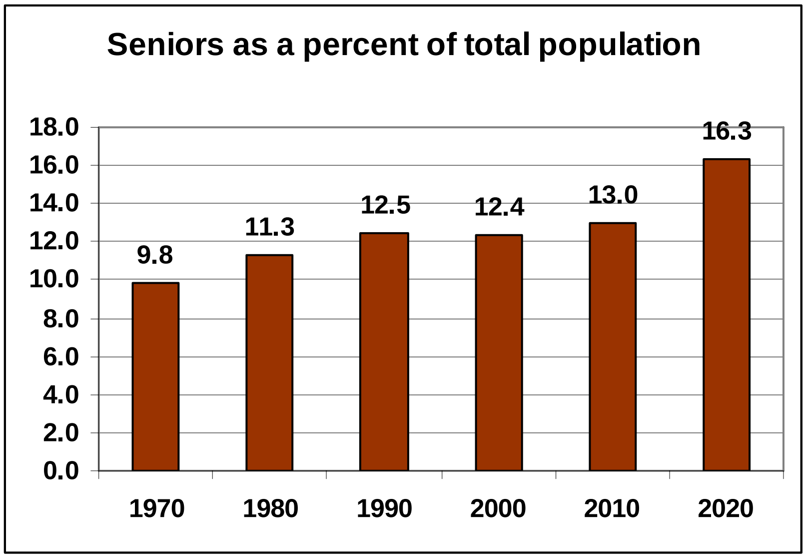
A FairTax[sm] White Paper

The FairTax benefits seniors

- The FairTax ensures Social Security's soundness by funding it with a progressive, broad-based national retail sales tax, rather than the current regressive, narrow payroll tax.
- The FairTax rebate zeros the retail taxation of necessities, up to poverty-level spending, for seniors.
- The FairTax repeals the taxation of Social Security benefits and adjusts Social Security indexing to protect seniors.
- The FairTax ends *all* record keeping and income tax filings of *any* kind for seniors, totally insulating them from the high costs and abusive tactics of tax preparers.
- The FairTax does not tax used goods, giving low-income seniors choices.
- The FairTax reduces manufacturers', services', and retailers' costs, allowing them to lower costs to seniors.
- The FairTax delivers a tax holiday on IRAs and other tax-deferred plans.
- The FairTax ends gift and estate taxes, along with all of the unfairness to heirs and complex planning for those who earned the money.
- The FairTax allows seniors to sell their homes and pay no capital gains taxes.
- The FairTax generates an economic boom, which eases future budget pressure on seniors' entitlements.
- The FairTax lowers average remaining lifetime tax rates.
- The FairTax ensures your grandchildren have the same opportunity you did.

Senior citizens are becoming a larger portion of the overall population and the overwhelming majority of them are much better off under the FairTax. In 1970, those over 65 years of age were 9.8 percent of the population. By 2000, seniors were 12.4 percent of the population. In 2010, seniors will account for 13.0 percent of the population and in 2020 they will account for 16.3 percent.[1]



Source: AFFT and Statistical Abstract of the United States, 2004-2005.

As would be expected, the average household income of persons over 65 – retirees no longer in the workplace, for the most part – is about 55 percent of the average of all households.[2] However, at any given time, a smaller proportion of seniors are poor than in the population in general.[3] Those persons 55-64 years old have the highest net worth,[4] with those 65-74 years old coming next.[5]

Complying with the current tax system is often more burdensome for persons after they retire than when they were working.

Retirees turning to their savings and Social Security for income face new tax calculations and complications. Most withdrawals from individual retirement accounts and 401(k) plans are taxable. People over 70½ must take required minimum distributions – and usually pay tax as a result – even if they would have

[1] U.S. Bureau of the Census, Statistical Abstract of the United States, 2004-2005, Table 11, p. 12.
[2] Ibid., Table 667, p. 444.
[3] Ibid., Table 686, p. 453.
[4] The total value of all assets, such as house, car, furniture, and investments, minus all debts, such as mortgages and credit card bills.
[5] U.S. Bureau of the Census, Statistical Abstract of the United States, 2004-2005, Table 694, p. 457.

preferred not to. Furthermore, any income received over the course of the year, including those 401(k) and IRA distributions, affects whether taxes will be owed on Social Security benefits. In fact, even tax-free income from municipal bonds gets counted in that calculation. All of this directly affects the amount of money a retiree gets to keep. Many retirees find they need to make quarterly estimated tax payments to the Internal Revenue Service, something they may not have done in their working years.[6] And if they work in retirement, they'll owe Social Security and Medicare taxes as well as income taxes on that income.

The FairTax ensures Social Security's soundness by funding it with a progressive, broad-based national retail sales tax, rather than the current regressive, narrow payroll tax.

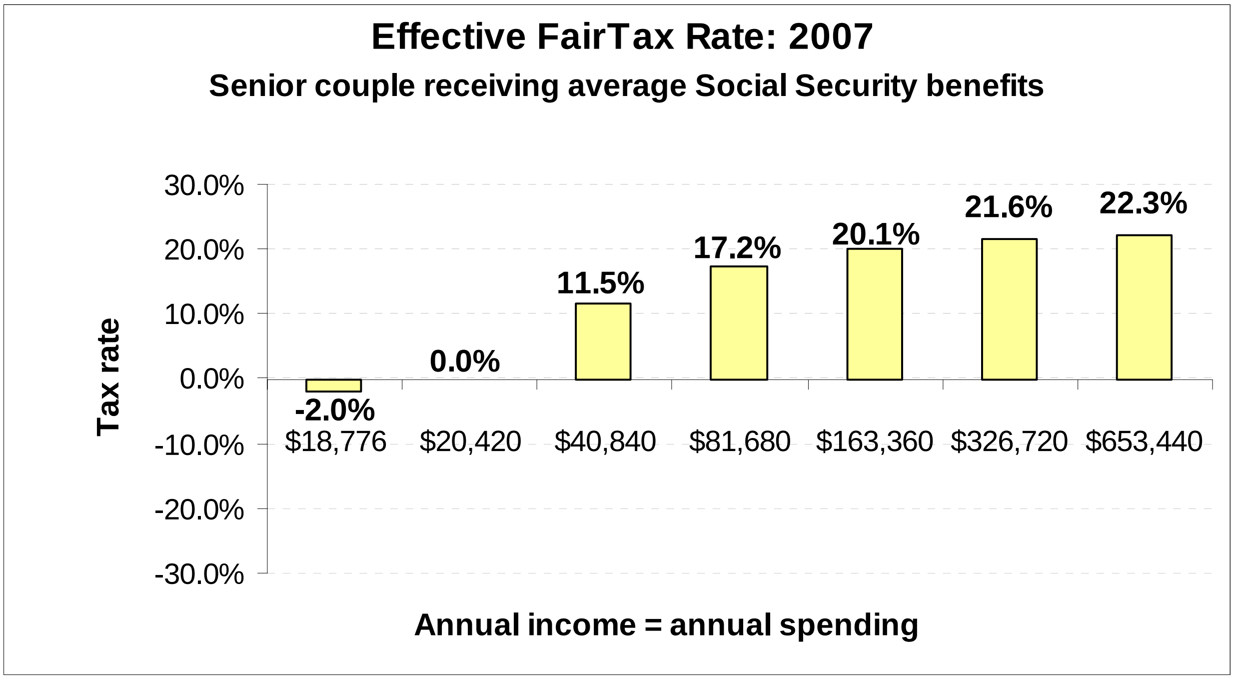
Currently, the Social Security system is funded by a payroll tax from workers, a very regressive tax that will only have to go up as more and more baby boomers retire and fewer and fewer workers fund seniors' retirement. The FairTax funds Social Security with a progressive, national retail sales tax, supported by the spending of every consumer in America, even teenagers, tourists, illegal immigrants, and the army of 18 million people who (illegally) do not file and pay today.

The FairTax prebate zeros the retail taxation of necessities, up to poverty-level spending, for seniors.

Under the FairTax, senior citizens, like others, receive a monthly cash prebate that exempts consumption of necessities (up to the poverty level as determined by the Department of Health and Human Services) from federal taxation. *Thus, seniors living at or below the poverty level pay no sales tax at all under the FairTax. The FairTax is the only tax plan, including the current income tax regime, that completely "untaxes" the poor.*

While everyone pays the same tax rate at the cash register, the prebate results in effective tax rates (annual taxes paid divided by annual spending) that increase as the level of spending increases – a progressive tax rate structure. For example, a person spending at the poverty level has a 0 percent effective tax rate, whereas someone spending at twice the poverty level has an effective tax rate of 11.5 percent, and so on.

[6] Lauricella, Tom, "When Work is Done, Tax Headaches Begin," *The Wall Street Journal*, August 27, 2006.



A retired couple living solely on Social Security and receiving the average annual benefits for a husband and spouse of approximately $18,776[7] receives a cash prebate of $4,697 per year. If they spent all of their Social Security benefits on taxable goods and services, the prebate would result in a negative tax rate of -2.0 percent. The prebate exceeds the national sales taxes on that amount of spending.

The FairTax repeals the taxation of Social Security benefits and adjusts Social Security indexing to protect seniors.

The FairTax legislation totally repeals the current income tax on Social Security benefits. The bill also adjusts the Social Security benefits indexing formula, commonly known as the cost of living adjustment or COLA, so that benefits increase to the extent, if any, that the federal sales tax results in higher costs to seniors.[8]

[7] The average monthly combined Social Security benefits check for retired workers and their spouses is $1,564.70 per month as of January 2007. Source: Social Security Administration, Master Beneficiary Record, 100 percent data.

[8] See Section 303. SALES TAX INCLUSIVE SOCIAL SECURITY BENEFITS INDEXATION of H.R. 25, The Fair Tax Act of 2007.

The FairTax ends *all* record keeping and income tax filings of *any* kind for seniors, totally insulating them from the high costs and abusive tactics of tax preparers.
Seniors (and their heirs) no longer need to keep tax records of any kind. Planning needs (and costs) are minimal and simple. There are no income tax filings of any kind. With this change, seniors no longer need assistance with complex forms, nor are subject to the devious and unethical tactics and expense of tax preparers. Nor are seniors the deliberate target of IRS audits – there is nothing to audit!

The FairTax does not tax used goods, giving low-income seniors choices.
The FairTax taxes only new goods and services. So seniors at all levels can make choices in their spending to reduce the taxes they pay. They can buy used cars, used appliances, used homes, even used clothing. They are very much in control of their tax burden.

The FairTax reduces manufacturers', services', and retailers' costs, allowing them to lower costs to seniors.
Because income tax, payroll tax, and compliance costs are so high, manufacturers, service companies, and retailers pass them on by raising retail prices. If competition does not allow this, these companies reduce payroll costs, putting working seniors out of jobs. And the last place these companies can pay for the high cost of the income tax system is by reducing profits to shareholders, which hurts pension plans.

The FairTax delivers a tax holiday on IRAs and other tax-deferred plans.
The income tax imposed on investment income and pension benefits or IRA withdrawals is repealed. No form of savings or investment is taxed. Pension funds, IRAs, and 401(k) plans had assets of over $11 trillion in 2003.[9] An income tax deduction was taken for contributions to most of these plans. All beneficiaries and owners of these plans expected to pay income tax on them upon withdrawal, but are not required to do so once the income tax is repealed. Roth IRA owners and post-tax retirement savers break even.

[9] U.S. Bureau of the Census, Statistical Abstract of the United States, 2004-2005, Tables 1212-1213, pp. 758-759. In 2003, private pensions had assets of $5,937 billion and state and local pension funds had assets of $2,284 billion. In 2003, Individual Retirement Accounts had assets of $3,007 billion.

The FairTax ends gift and estate taxes, along with all of the unfairness to heirs and complex planning for those who earned the money.

Under the FairTax, gift and estate taxes are repealed. The need for small businesses and farmers to engage in expensive estate planning involving attorneys, complex estate freeze transactions, and expensive life insurance plans in anticipation of future estate and gift tax liability disappears.[10] Heirs no longer need to sell the business or farm out of the family or borrow heavily, putting the business at risk, in order to pay the estate tax.

Repeal of the corporate and individual income tax, and the estate and gift tax has a substantial positive impact on the stock market.[11] Those seniors who own stocks either directly or through mutual funds, individual retirement accounts, 401(k) plans or otherwise, experience significant gains. In 2001, one-fifth of seniors owned stock and/or mutual funds.[12] In addition, unrealized capital gains that would have been subject to the income tax when realized are no longer taxed.

The FairTax allows seniors to sell their homes and pay no capital gains taxes.

The FairTax plan imposes a sales tax on newly constructed homes but exempts existing homes and other used property from any sales tax. Currently, equity payments on homes must be paid from after-income tax earnings (i.e., principal payments are not deductible). The purchase of existing housing is thus subject to the income tax. All owners of existing homes experience large capital gains due to the repeal of the income tax and implementation of the FairTax. Seniors have dramatically higher home ownership rates than other age groups (80.5 percent for seniors compared to 68.3 percent on average in 2003).[13] Homes are often a family's largest asset. Gains, which are not taxed, are likely to be in the 20 percent range.

The FairTax generates an economic boom, which eases future budget pressure on seniors' entitlements.

A federal retail sales tax makes the economy much more dynamic and prosperous. Consequently, federal tax revenues grow, spending is under less upwards pressure,

[10] Beach, William W., "The Case for Repealing the Estate Tax," The Heritage Foundation, August 21, 1996. Using both the Washington University Macro Model and the U.S. Macro Model of Wharton Econometric Forecasting, Beach estimates that repeal of the estate and gift tax would increase Gross Domestic Product by $11 billion per year, create 145,000 new jobs, increase personal income by $8 billion per year, and increase federal revenues marginally.

[11] See FairTax white paper, "Impact of the FairTax on the Stock and Bond Market."

[12] U.S. Bureau of the Census, Statistical Abstract of the United States, 2004-2005, Table 1162, p. 738.

[13] Ibid., Table 951, p. 612.

and the deficit declines. Budget pressure on Social Security and Medicare spending, already significant, will become much more pronounced once the post-World War II baby boomers enter their retirement years. There are 37 million people in the population age 65 and older today. By 2025, this number is estimated to rise to 62 million, a 68 percent increase. In contrast, by 2025 the number of workers is estimated to rise by only 13 percent. The economic growth caused by the sales tax replacement of the current tax system makes it substantially less likely that federal budget pressures will result in Medicare or Social Security benefits cuts.

The FairTax lowers average remaining lifetime tax rates.
Average remaining lifetime tax rates measure what percentage of remaining lifetime resources the taxpayer will pay to the government. The calculation of the average remaining lifetime tax rates takes into account all future federal tax payments net of Social Security benefits and the FairTax prebate.

According to a recent study of average and marginal tax rates under the FairTax by Laurence Kotlikoff, noted public finance economist and co-author of *The Coming Generational Storm: What You Need to Know about America's Economic Future*, "Since the FairTax would preserve the purchasing power of Social Security benefits and also provide a tax rebate, older low-income workers who will live primarily or exclusively on Social Security would be better off."[14] As an example, the average remaining lifetime tax rate for an age 60 married couple with $20,000 of earnings falls from its current value of 10.1 percent to -6.1 percent under the FairTax.

The table below presents average remaining lifetime tax rates[15] for seniors, both those now prevailing (current system) and those that would prevail under the FairTax. A striking feature of this table is the negative average tax rates under the FairTax of low-income seniors. These negative tax rates reflect the fact that, net of Social Security benefits and the FairTax prebate, seniors receive more under the FairTax than they pay in. In contrast, under the current system, low-income seniors would have positive average lifetime tax rates ranging from 6.5 percent to

[14] Kotlikoff, Laurence and David Rapson, "Comparing Average and Marginal Tax Rates under the FairTax and the Current System of Federal Taxation," revised October, 2006. This paper compares, for a set of stylized households, the total effective marginal and average tax rates under the current system with those that would arise under the FairTax.

[15] Average remaining lifetime tax rates are calculated by taking the sum of remaining lifetime Social Security benefits received plus the FairTax prebate and dividing it by remaining lifetime income.

14.2 percent of their annual income. Another key feature is how much lower average lifetime tax rates under the FairTax are for middle- and upper-income seniors compared to the current tax system. For example, high-income seniors experience significant positive average remaining lifetime tax rates of 18.2 percent for singles and 19.3 percent for couples. However, these rates are significantly lower than what they would experience under the current system – 40.8 percent for singles and 41.5 percent for couples.

Average remaining federal lifetime tax rates for seniors:
The current system vs. the FairTax

Single			Couple		
Household income	Tax rate: Current system	Tax rate: FairTax	Household income	Tax rate: Current system	Tax rate: FairTax
$10,000	6.5%	**-27.1%**	$20,000	7.2%	**-11.0%**
$15,000	9.8%	**-28.0%**	$30,000	10.1%	**-10.5%**
$25,000	14.1%	**-6.2%**	$50,000	14.2%	**1.4%**
$35,000	16.7%	**-5.9%**	$70,000	17.0%	**2.2%**
$50,000	21.5%	**3.9%**	$100,000	22.4%	**7.9%**
$100,000	32.1%	**9.2%**	$200,000	32.2%	**12.3%**
$250,000	40.8%	**18.2%**	$500,000	41.5%	**19.3%**

Note: The above table assumes that all heads of household and spouses are age 60, retire at age 65, and start collecting Social Security benefits at age 66. Earnings between the household's current (2005) age and retirement are assumed to remain fixed in real terms.

The FairTax ensures your grandchildren have the same opportunity you did. Seniors are able to take comfort in the fact that their children and grandchildren are no longer laboring under the yoke of the income tax, and are once again able to see their own standard of living improve, one generation to the next.

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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