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MAKE IT JUST ANOTHER DAY

Americans For Fair Taxation

The impact of the FairTax on the services sector

In short, the retail services sector will cease to deal with the income and Social Security tax systems entirely, but will begin to charge and forward sales taxes to their state sales tax authority.

The FairTax proposal is a revenue neutral proposal – replacing the revenues from income and Social Security taxes on a dollar-for-dollar basis. There is no intention to raise taxes here or to lower them or to redistribute the burden. The senior intention is to replace a broken, expensive, intrusive system of taxation with a workable, efficient, unobtrusive system. Therefore, in contemplating the taxation of services, FairTax economic research took a careful look at how services are taxed today.

The results of that research, completed by Harvard Economist Dale Jorgensen, Ph.D., conclusively show that the average hidden burden of taxation in the retail cost of services is 25 percent. Said another way, our income and Social Security tax systems add an average 25 percent to the cost of services delivered in the United States today. For that matter, such services "insourced" by corporations outside our borders and delivered by US companies are burdened by the same 25 percent. (In an era of chronic "outsourcing" – with our tax system a clear unindicted co-conspirator – the US is a net insourcer of services.) This hidden 25 percent is the cost of the income tax paid by all suppliers delivering and supporting the delivery of that service, their cost of compliance with the tax systems, and Social Security taxes.

Revenue neutrality leads to cost neutrality.

Since the intention of the FairTax is revenue neutrality, there will be no net additional tax revenues raised. Yes, to the shock of many, hidden taxes will show up at the bottom of a retail sales tax receipt, *but the net cost of services will not change substantially in either direction*. Here is the calculation:

Figure 1: How a 23-percent income tax rate is revenue neutral with a 30-percent sales tax rate

You earn	You keep		Your income tax rate	Gov't keeps
$100	$77		23%	$23

You earn	You keep	Choose to spend	FairTax rate	Gov't keeps
$100	$100	$77	30%	$23

Figure 2: How retail service costs will remain stable under the FairTax

Current income tax system

Retail price	Hidden taxes & compliance costs	Gross profit		Retail cost	Tax system costs
$100	$25	$75		$100	$25.00

FairTax system

Retail price	Hidden taxes & compliance costs	Gross profit	FairTax rate	Retail cost	Gov't receives
$75	$0	$75	30%	$97.50	$22.50

The FairTax taxes the delivery of retail services to the final, end-user recipient of such services. If you go to your lawyer to get a new will, these services will be taxed; incorporate a new business, pay no tax. If you get your car repaired, you will be taxed; get your farm vehicle fixed, pay no tax. Go in for a Botox injection, you will be taxed; have an operation covered by insurance, pay no tax (though you did pay taxes on your health insurance premium). Yes, get your hair permed or cut, you will pay the FairTax.

Why tax services?

There are several factors that make taxing services an important part of a tax system that does not distort our economy:

- Services account for about 50 percent of total consumption.
- Tax neutrality requires that there be no discrimination between the seller of goods and the seller of services.
- The consumption of services is growing at a faster rate than the consumption of goods.

Today, pure service businesses, i.e., those that do not sell a product with their services, are usually not registered as sales tax collectors in their respective states since most services are not taxed by state sales tax laws. For example, automotive repair services are often taxed when they sell parts as part of the service. On the other hand, the services of a consultant do not usually involve a tangible product so they are not taxed.

The FairTax taxes all goods and services so these “pure” services, when delivered at retail, would be taxed. Therefore, providers of “pure” services will have to register as sales tax collectors. This will be a new requirement for them, though in comparison to the current federal income tax code that is eliminated from their business, a minor new requirement. They will bill their client in the amount of their service fee and add the FairTax to it. They will file monthly sales tax returns to remit the sales tax collected to the state sales tax authority that is administering the FairTax. The FairTax legislation (HR 25/S 1493) provides for a collection allowance for their services. They will get to keep ¼ of one percent of the total sales tax they collect (or $200) each month to defray their costs.

A common concern of service businesses is that they will earn less income because the FairTax will increase the price of their services and thereby lower the demand for their services. The main thing that needs to be pointed out to them is that the cost of providing their services should drop by an average 25 percent once the effect of embedded income/payroll taxes and the accompanying costs of tax compliance are removed. So the cost of their services to their clients, including the FairTax, should be the same as it is today.

The majority of service businesses have effective tax rates of well over the 23 percent of the FairTax. They pay 15.3 percent of their income in payroll taxes alone. Under the income tax system they have to pay estimated tax payments and suffer high penalties if they underpay. With the FairTax, there will be nothing to estimate, no income tax surveillance, no income tax records, no income tax planning, no income tax filings, no income tax audits, and no income tax compliance/enforcement actions. The cost of compliance should be drastically reduced. They will have to keep records of the total amount of services sold and the amount of the tax and remit monthly or quarterly depending on the volume. This is far simpler than what they have to do now to comply with the income/payroll tax system. As an employer, they will be required to report earnings to the Social Security Administration for the determination of benefits.