Impact of the FairTax℠ on Seniors

Senior citizens are becoming a larger portion of the overall population, and the overwhelming majority of them will be much better off under the FairTax. In 1970, those over 65 years of age were 9.8 percent of the population. By 1995, seniors were 12.7 percent of the population. In 2010 seniors will account for 13.3 percent of the population, and in 2020 they will account for 16.5 percent.[1]

The average household income for those over 65 is about 56 percent of the average of all households.[2] At any given time, a lower proportion of seniors are poor than in the population in general.[3] Those 55-64 years old are the wealthiest age group, with those 65-74 years old coming next.[4]

Under the FairTax, senior citizens, like others, will receive a monthly cash rebate that will exempt consumption of necessities (up to the poverty level) from federal taxation. *Thus, poor seniors will pay no consumption tax at all under the FairTax. In fact, the FairTax is the only tax plan, including the current income tax regime, that completely "untaxes" the poor*. As a benchmark, in the year 2000, a family of four spending twice the federal poverty level would have paid an effective tax rate of about 11½ percent under the FairTax.[5]

Because income and payroll taxes are embedded in the price of everything we purchase, it is unlikely that prices, <u>even when they are calculated with the consumption tax</u>, will increase. This is because pre-consumption-tax prices will fall once the income and payroll taxes are repealed. Nevertheless, the FairTax plan makes sure that the Social Security benefits indexing formula will be adjusted so that benefits will increase to the extent, if any, that the consumption tax results in higher tax-inclusive prices. The income tax imposed on Social Security benefits will be repealed under the FairTax.

The income tax imposed on investment income and pension benefits or IRA withdrawals will be repealed. Pension funds, IRA's, and 401(k) plans had assets of over $9 trillion in 1998.[6] An income tax deduction was taken for contributions to most of these plans, and all beneficiaries and owners of these plans expected to pay income tax on them upon withdrawal – but they will not be required to do so once the income tax is repealed.

Repeal of the corporate and individual income tax, and the estate and gift tax will have a substantial positive impact on the stock market.[7] Those seniors who own stocks either directly or through mutual funds, Individual Retirement Accounts, 401(k) plans, or otherwise, will experience

[1] Middle Series, U.S. Bureau of the Census, Statistical Abstract of the United States, 1999, Table 17, p. 17.

[2] U.S. Bureau of the Census, Statistical Abstract of the United States, 1999, Table 744, p. 475.

[3] U.S. Bureau of the Census, Statistical Abstract of the United States, 1999, Table 763, p. 484.

[4] U.S. Bureau Labor Statistics, Statistical Abstract of the United States, 1999, Table 771, p. 488.

[5] For a more detailed discussion of the rebate and fairness issues generally, see Position Papers, "The FairTax: Good For Taxpayers, Businesses, the Economy" and "Effective Tax Rates under Present Tax Law, the NRST, and the Armey Flat Tax."

[6] Statistical Abstract of the United States, 1999, Tables 850-853, pp. 538-539. In 1998, private pensions had assets of $5,732 billion, and state and local pension funds had assets of $2,344 billion. In 1996, Individual Retirement Accounts had assets of $1,347 billion. In 1997 section 401(k) plans had assets of $985 billion.

[7] See Position Paper "Impact of the FairTax on the Stock and Bond Markets."

significant gains. More seniors own stocks than any other age group.[8] In addition, unrealized capital gains that would have been subject to the income tax when realized will no longer be taxed.

The FairTax plan imposes a consumption tax on newly constructed homes, but exempts existing homes and other used property from any consumption 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 will experience large capital gains due to the repeal of the income tax and implementation of the FairTax. Seniors have dramatically higher homeownership rates than other age groups (79.3 percent for seniors compared to 66.3 percent on average in 1998).[9] Homes are often a family's largest asset. Gains, which will not be taxed, are likely to be in the 20 percent range.

Under the FairTax, the estate and gift tax will be 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 will disappear.[10] Heirs will 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.

A consumption tax will make the economy much more dynamic and prosperous. Consequently, federal tax revenues will grow, spending will be under less upwards pressure, and the deficit will decline. Budget pressure on entitlement spending, already significant, will become much more pronounced once the baby boom starts retiring in 2010, in just 10 years. The economic growth caused by a consumption tax will make it substantially less likely that federal budget pressures will result in Medicare or Social Security benefits cuts.

According to recent work by Stanford University economist Joseph Kahn, those seniors with a net worth over $400 thousand (nearly four times the median) may see a reduction in their purchasing power. The largest decline in purchasing power, about 3.5 percent, is for those with net worth above about $700 thousand. The primary reason for this effect is that wealth spent for consumption purposes that is held in non-tax-deferred accounts like IRA's will be taxed when spent under a consumption tax and would not be taxed any further under current law.[11]

Seniors will be able to take comfort in the fact that their children and grandchildren will no longer be laboring under the yoke of the income tax, and will once again be able to see their own standard of living improve, one generation to the next.

[8] Board of Governors of the Federal Reserve System, Statistical Abstract of the United States, 1999, Table 801, p. 518.

[9] Statistical Abstract of the United States, 1999, Table 1215, p. 731.

[10] William W. Beach, "The Case for Repealing the Estate Tax," The Heritage Foundation, August 21, 1996. Beach estimates, using both the Washington University Macro Model and the U.S. Macro Model of Wharton Econometric Forecasting, that repeal of the estate and gift tax will 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] "Examining a Change to a National Retail Sales Tax Regime: Impact on Households by Stanford University," November 1996.