



A FairTaxSM White Paper

The FairTax prebate explained

Under the FairTax, all Americans consume what they see as their necessities of life free of tax. While permitting no exemptions, the FairTax (HR 25) provides a monthly universal prebate to ensure that each family unit can consume tax free at or beyond the poverty level, with the overall effect of making the FairTax progressive in application.

Figure 1: Effective FairTax rate by annual spending level

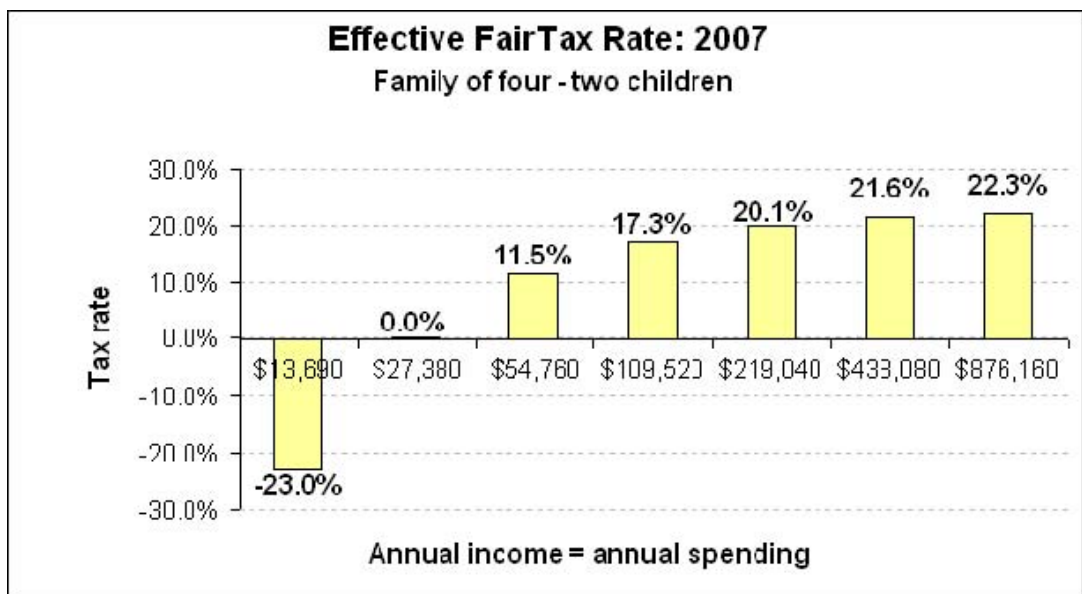


Figure 1 shows that while everyone pays the same tax rate at the cash register, the prebate results in effective tax rates (annual taxes paid divided by annual spending) that increase as the level of spending increases – a progressive tax rate structure. For example, a person spending at the poverty 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.

Qualification

All qualified families are entitled to receive the monthly prebate. The term “qualified family” means one or more family members sharing a common residence. A qualified family consists of all family members sharing the common residence. Family members include an individual and his or her spouse, children and grandchildren, parents, and grandparents. Children/students living away from home are considered family members if they are registered as a student for at least five months out of the year and receive at least 50 percent of their support from the family

unit. Children of divorced parents are considered to be family members of the custodial parent. Incarcerated individuals are not eligible to be members of a qualified family.

In order for a person to be counted as a member of the family for purposes of determining the size of the qualified family, a person must have a valid Social Security number and be a lawful resident of the United States. Unlike the Earned Income Tax Credit, the application/registration form that families who choose to receive the prebate must file is simple and straightforward. Those choosing not to register will not receive a prebate. The registration form requires only the following information:

1. The name of each family member who shares the residence;
2. the Social Security number of each family member;
3. the family member to whom the monthly prebate check should be paid;
4. a sworn statement that all listed family members are lawful residents, that all family members sharing the common residence are listed, and that no listed family members are incarcerated;
5. the address of the shared residence; and
6. the signature of all family members 21 years of age and older.

Calculation of the prebate

The monthly prebate check is calculated by multiplying the annual poverty level spending published each year by the Department of Health and Human Services times the FairTax rate and dividing by twelve. Poverty level spending represents what it costs families of varying household size and composition to buy their necessities. Figure 2 shows the monthly prebate amount for households of varying composition.

Figure 2: 2008 FairTax prebate schedule¹

One adult household				Two adult household			
Household Size	Family Consumption Allowance ¹	Annual Prebate	Monthly Prebate	Household Size	Family Consumption Allowance ¹	Annual Prebate	Monthly Prebate
1 person	\$10,400	\$2,392	\$199	couple	\$20,800	\$4,784	\$399
and 1 child	\$14,000	\$3,220	\$268	and 1 child	\$24,400	\$5,612	\$468
and 2 children	\$17,600	\$4,048	\$337	and 2 children	\$28,000	\$6,440	\$537
and 3 children	\$21,200	\$4,876	\$406	and 3 children	\$31,600	\$7,268	\$606
and 4 children	\$24,800	\$5,704	\$475	and 4 children	\$35,200	\$8,096	\$675
and 5 children	\$28,400	\$6,532	\$544	and 5 children	\$38,800	\$8,924	\$744
and 6 children	\$32,000	\$7,360	\$613	and 6 children	\$42,400	\$9,752	\$813
and 7 children	\$35,600	\$8,188	\$682	and 7 children	\$46,000	\$10,580	\$882

¹ Source: Based on the Department of Health and Human Services 2008 Poverty Guidelines published in the Federal Register, Vol. 73, No. 15, January 23, 2008, pp. 3971-3972.

Administration

The Social Security Administration (SSA) will send out the monthly prebate on or before the first day of every month. Prebate payments can only be made to persons 18 years or older. If a family wishes to designate more than one person to receive the prebate, then the prebate payment will be divided evenly among those persons designated. Example: Two single people sharing the same residence are able to each get a prebate check.

Registration renewal

After the initial registration, any qualified family that fails to renew its registration each year, within 30 days of the family determination date, will cease receiving the prebate 90 days following the failure to register. However, the family can file to get up to six months of missed prebate checks later (with no interest on missed payments). A possible method of assigning registration renewal dates would be on the birth date of the person filing the application. 30 or more days before the annual registration date, the sales tax authority is required to mail a proposed registration to each qualified family that simply needs to be signed and mailed back in if the family's circumstances have not changed.

Administrative cost

In accordance with instructions from each qualified family, SSA will provide the prebate in the form of a paper check via U.S. Mail, an electronic funds transfer to a bank account, or a "smart card" that can be used much like a bank debit card. (This method is already in use to provide other benefits from the federal government.) The National Taxpayers Union estimated that the cost of mailing monthly prebate checks via the U.S. Postal Service would be approximately \$225 million. To the extent SSA uses electronic funds transfer and "smart card" technology, this amount would be reduced accordingly.

Fraud prevention

When the state sales tax authorities process the prebate applications they will validate all names and Social Security numbers against the SSA database. States already do this in relation to the administration of other state/federal cooperative programs such as unemployment benefits and child support enforcement. They will also check for duplicate Social Security numbers being claimed by different households to prevent more than one household from listing the same person as a household member. Any duplicate Social Security numbers will have to be resolved before the prebate payment is made.

It is unlawful to willingly and knowingly file a false prebate claim. HR 25 provides for both civil and criminal penalties. The civil penalty is equal to the greater of \$500 or 50 percent of the claimed annual prebate amount not actually due, plus repayment of any falsely due prebate amounts. A criminal penalty of imprisonment for up to one year may also be imposed.

Fiscal impact

The number of households for 2007 is estimated to be 113 million. Assuming 100 percent participation, the cost of the prebate is estimated to be \$489 billion for 2007 (assuming that all legally resident households participate). This amount is about half of the amount of tax expenditures (standard deductions, personal exemptions, Earned Income Tax Credit, mortgage interest and charitable deductions, and various other tax preferences) doled out under the current federal income tax system that are repealed when the FairTax is enacted. For 2006, the total of all of these tax breaks exceeded \$945 billion (estimate by the congressional Joint Committee on Taxation, http://www.opencrs.com/rpts/RL33641_20060913.pdf).

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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.