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Michigan State FairTax Estimates

FairTax Rate Calculation component	2005-2006 Amount	FairTax Replacement Rate
Gross State Product*	\$399,469,931,496	
FairTax Base (excluding government consumption)	286,659,622,842	
FairTax Base Reduction for Prebate	<u>64,287,047,876</u>	
MI FairTax Base Reduced by Prebate	\$222,372,574,966	
Revenues for Potential Replacement By Michigan FairTax:**		
Convert state sales tax to state FairTax	\$8,360,500,000	3.76%
State individual income taxes	6,150,400,000	2.77%
Single Business Tax (SBT) & Insurance Proceeds Tax	2,115,800,000	0.95%
Personal Property Tax (local government tax)	1,800,000,000	0.81%
State 6 mill Education Tax (SET) on Business ONLY	<u>653,000,000</u>	<u>0.29%</u>
Replace all above taxes	\$19,079,700,000	8.58%
*2004 Gross State Product grown by estimated increase in Michigan personal income from House Fiscal Agency (4.4% in 2005 and 5.3% in 2006). CY2005 and CY2006 averaged to yield estimate for FY2005-2006.		
**These rates are for individual taxes. The MI FairTax rate necessary to replace existing state sales tax revenues and to replace state individual income taxes is obtained by adding the two rates together.		

Data sources: MI Gross State Product, US Dept. of Commerce, BEA, Dec. 2004; Revenue source and distribution report, House Fiscal Agency, 2005.

Methodology Note: The above analysis does not factor in an increased level of economic growth that has been predicted by a number of economists to accompany the replacement of income taxes at the state level or income/payroll taxes at the federal level with the FairTax. Therefore, the MI FairTax rates to replace the various revenue sources are conservative estimates. A description of the methodology follows. Detailed results can be obtained from karen.walby@fairtax.org

Calculations by Karen Walby, Ph.D., Director of Research, FairTax.org, August 25, 2005.

About the MI FairTax Rate Estimates



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Dr. Karen Walby, Director of Research at FairTax.org, prepared these calculations. These are valid estimates using standard estimation techniques and information available from the US Bureau of Economic Analysis, and the Michigan House Fiscal Agency. However, they are static rather than dynamic estimates in that they do not take into account any feedback effects from economic growth that would be induced by the replacement of income taxes and business taxes with a sales tax. Economic growth effects would lower the rates presented in the above estimates.

The calculations assume that the state would exclude expenditures up to the poverty level from the FairTax. This is accomplished by a monthly universal "prebate" to each household in the amount of what the tax would be on expenditures up to the poverty level for a household of that size. This untaxes the truly poor and causes the tax to be progressive. The MI FairTax is levied on the sales of all NEW goods and services. No tax is charged on used items because the tax is to be applied only once and it has already been taxed when sold new. Expenditures for education are not taxed because education is considered an investment rather than consumption. Because the prebate untaxes all necessities, no exemptions from the tax are necessary. If this no exemption policy is maintained, it will drastically reduce the temptation for lobbying induced corruption and maintain the desired simplicity and fairness of the FairTax. If any exclusion is granted it would open the door to arguments that various other goods and/or services be exempt from the tax. This would soon result in a complicated and loophole riddled sales tax that would have to increase in rate to compensate for the loopholes.

Prior to adoption of a federal FairTax, a MI FairTax will result in savings to MI government units due to the elimination of the MI taxes that are today embedded in the price of goods and services consumed by the governmental units, and from a reduction of tax administration cost. Because a federal FairTax will decrease MI government expense by the elimination of Social Security and Medicare costs and additional business to business taxes, it is advisable that MI government consumption be subject to the MI FairTax in the event a federal FairTax is adopted to maintain a competitive level playing field between private and government enterprises. Until such time, the proposed MI FairTax excludes government from the tax and government consumption from the tax base (no tax on government consumption).

The above "Michigan State FairTax Estimates" exclude government from the MI FairTax. It is intended that this MI FairTax be replaced with a MI FairTax that includes government in the event a federal FairTax is adopted. The proposed MI FairTax rate of 8.58% would be about 1% lower if a federal FairTax is enacted due to the larger tax base caused by the inclusion of government.

To achieve the maximum economic benefit of enacting a MI FairTax it is imperative that Michigan be the first state to adopt such a business friendly tax. Time is of the essence, as some other states are already looking at adopting a state FairTax. In order to compete with Michigan, other states will soon follow our lead. A MI FairTax will cause us to be the most attractive state in the Union in which to do business.

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Calculation Methodology

While every effort has been made to provide useful and representative data in this analysis, this is not an exhaustive, dynamic work. We have used the most recently available data from third-party sources for this static analysis. We encourage its use as a starting point for more comprehensive modeling and analysis. Significant work by respected institutions has been done to model the effects of replacing existing income and Social Security systems with the FairTax, many concluding that significant economic growth would be the result. This foregoing analysis does not factor in these economic growth effects at either the state level or national level. Therefore, the MI FairTax rates to replace the various revenue sources are conservative estimates. While we can logically conclude that states using a FairTax system would benefit comparatively, the academic work for a state FairTax has not been undertaken.

In order to estimate the state FairTax rates for Michigan, the following steps were undertaken:

1. Estimate the state FairTax base.
2. Adjusting the gross FairTax base downward to account for the rebate of taxes on spending up to the poverty level.
3. Determine the revenues to be replaced.
4. Calculate the state FairTax rate by dividing the revenue to be replaced by the net state FairTax base.

Step One: Estimating the gross FairTax base for each state

The national FairTax rate is calculated according to the methodology explained in David R. Burton and Dan R. Mastromarco, "Emancipating America From the Income Tax: How a National Sales Tax Would Work," Cato Institute, Policy Analysis No. 272, April 15, 1997. A spreadsheet showing this computation for 2003 appears on the last page. Lacking such detailed data at the state level, the national FairTax base was apportioned to Michigan by removing government consumption, and applying the ratio of the US FairTax base to GDP to Michigan's Gross State Product. The reason it is referred to as the gross base is because it does not take into account the FairTax prebate.

Step Two: Lowering the FairTax base to account for the prebate

This analysis assumes that states will provide for a prebate of spending up to the poverty level, the same as the national FairTax. To adjust the FairTax base for the prebate at the national level, we calculate total poverty level spending for all households. This is accomplished by multiplying the poverty level consumption allowance (as determined by the Dept. of Health and Human Services poverty guidelines) for each household size times the number of households in that size group, and summing across all household size groups. This amount is then subtracted from the FairTax base. To derive the comparable prebate base reduction at the state level, the national poverty level consumption total is apportioned to Michigan based on the ratio of its population to total U.S. population. This amount is subtracted from the "gross" base resulting in the net Michigan FairTax base (after prebate).

Step Three: Determining revenue to be replaced in each state

State tax revenues are from the State of Michigan House Fiscal Agency Revenue source and distribution report, 2005.

Step Four: Calculating the revenue-neutral state FairTax rate

The revenue neutral state FairTax rate is the rate that would generate the same amount of state sales tax revenues as the existing state sales tax when applied to the same base as defined in the FairTax legislation, HR25 at the federal level. The MI FairTax base taxes all new goods and services, excluding all government consumption, charitable contributions, non public education tuition, and intermediate sales to businesses. Since the base is much broader, a much lower rate will raise the same amount of revenue. This rate is calculated by dividing current state sales taxes (2005-2006) by the state FairTax base after the rebate. The revenue-neutral rate being much lower than the current sales tax rate provides an opportunity for states to increase the state FairTax rate and use the "surplus" revenue generated to repeal/replace other taxes, such as state income, business and property taxes.

National FairTax Rate Calculation: 2003

Line	Description	FairTax base	Source
	Taxable item	Billions	
1	Personal consumption expenditures	\$ 7,760.9	NIPA Table 1.1.5, line 2
2	Purchases of new single-family homes	\$ 310.6	NIPA Table 5.3.5, line 20
3	Purchases of new mobile homes	\$ 7.1	NIPA Table 5.4.5B, line 40
4	Improvements to single-family homes	\$ 132.0	NIPA Table 5.4.5B, line 42
5	Less: imputed rent on owner-occupied housing	\$ 859.6	NIPA Table 7.4.5, line 3
6	Less: imputed rent on farm housing	\$ 11.9	NIPA Table 7.4.5, line 5
7	Additional financial intermediation services	\$ 83.1	Financial & risk Intermediation greater than NIPA definition
8	Foreign travel by U.S. residents	\$ 39.6	One half of NIPA Table 2.5.5, line 110
9	Less: expenditures abroad by U.S. residents	\$ 6.6	NIPA Table 2.5.5, line 111
10	Less: food produced and consumed on farms	\$ 0.5	NIPA Table 2.5.5, line 6
11	State and local government consumption	\$ 1,058.5	NIPA Table 3.10.5, line 47
12	Gross purchases of new structures	\$ 213.4	NIPA Table 3.9.5, line 24
13	Gross purchases of equipment	\$ 51.5	NIPA Table 3.9.5, line 25
14	Federal government consumption	\$ 658.6	NIPA Table 3.10.5, line 12
15	Gross purchases of new structures	\$ 15.5	NIPA Table 3.9.5, line 9
16	Gross purchases of equipment and software	\$ 78.1	NIPA Table 3.9.5, line 10
17	Less: state and local government sales taxes	\$ 343.9	NIPA Table 3.3, line 7
18	Less: government education expenditures	\$ 414.7	Table 255, SAOUS 2003
19	Less: private education expenditures	\$ 151.7	NIPA Table 2.5.5, lines 105 & 106
20	Expenditures in U.S. by non-residents	\$ 86.7	NIPA Table 2.5.5, lines 112
21	Travel to U.S. by non-residents	\$ 33.3	One half, SAOUS 2003 Table 1280
22	National retail sales tax base	\$ 8,740.0	
	Revenues to be replaced		
23	Income tax	\$ 927.7	Dept. of Treasury; derived from Table B-81 ERP 2004
24	Estate and gift tax	\$ 22.4	Dept. of Treasury; derived from Table B-81 ERP 2004
25	Payroll taxes	\$ 717.8	Dept. of Treasury; derived from Table B-81 ERP 2004
26	Excise taxes	\$ -	
27	Total	\$ 1,667.9	
	Revenue-neutral rate calculation		
28	Tax exclusive rate (no rebate)	19.1%	
29	Tax inclusive rate (no rebate)	15.9%	
30	Base reduction equivalent for rebate	\$ 1,746.1	Total consumption allowance for 109 million rebate units
31	Net tax base	\$ 6,993.8	
32	Tax exclusive rate (with rebate)	23.8%	
33	Tax inclusive rate (with rebate)	19.3%	

Source abbreviations: NIPA – National Income Product Accounts, Bureau of Economic Analysis, US Dept. of Commerce, SAOUS – Statistical Abstract of the United States, ERP – Economic Report of the President.