



## **Tax Reform: Flat Tax or FairTax?**

**by Scott A. Hodge**

We are frequently asked if we support any particular tax reform plan such as the Flat Tax or the FairTax.

As an institution, the Tax Foundation believes that the current income tax system is fundamentally broken and should be replaced with a code adhering to the principles we have advocated for 70 years: neutrality, simplicity, stability, transparency, and growth promotion.<sup>1</sup>

We do not align ourselves with any particular tax reform camp. Indeed, we have Flat Tax advocates and sales tax advocates on our Board of Directors, and our research was cited in both Steve Forbes' book on the Flat Tax and Neil Boortz's book on the FairTax.

From an economic perspective, there are many similarities between the FairTax and a Flat Tax. For example:

- Both the FairTax and the Flat Tax are "consumption taxes." In other words, people are taxed for spending money, not earning it. The Flat Tax would require citizens to file tax returns as they do now, paying tax on all spent money (income minus savings). The FairTax would rely on merchants to collect tax at the point of sale, as they now collect state and local sales taxes.
- Both would eliminate the estate and capital gains taxes.
- Both plans are single tax rate systems that eliminate double taxation.
- Both plans would dramatically reduce compliance costs and the tax system's dead-weight loss to the economy.

Any tax reform plan will have transition issues and these will have to be thought through carefully. That said, the long-term benefits of fundamental tax reform should far outweigh the short-term transition costs.

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<sup>1</sup> See <http://www.taxfoundation.org/files/tfprinciples.pdf> for an explanation of the Tax Foundation's principles of sound tax policy.

It is disappointing that tax reform has moved to the back burner in America while it is at the top of the agenda in countries as diverse as Australia, Slovakia, India and China. According to a recent OECD report on global tax reform trends:

These tax reforms have been driven by the need to provide a more competitive fiscal environment: one which encourages investment, risk-taking, entrepreneurship and provides increased work incentives. At the same time, governments are aware of the need to maintain taxpayers' faith in the integrity of their tax systems. Fairness and simplicity have become the byword of reformers.<sup>2</sup>

These reforms are not happening in a vacuum; they directly impact U.S. competitiveness in the global economy and we will fall behind if Washington continues to drag its feet.

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<sup>2</sup> Jeffrey Owens, "Fundamental Tax Reform: An International Perspective," June 5, 2006, available at <http://www.taxfoundation.org/files/owensfundamentaltaxreform-20060605.pdf>.