Tax reform and small business: the potential impact of flat tax legislation

Martin S. Bressler
Southeastern Oklahoma State University

Linda Bressler
University of Houston-Downtown

Darlene Serrato
Houston Baptist University

ABSTRACT

Calls for tax reform are nothing new. However, since the current recession began and now with the impending budget crisis and growing national debt, an increasing number of Americans believe that the time for tax reform (both personal and corporate income tax) has come. Kristina Peterson of the *The Wall Street Journal* cites a report from Citizens for Tax Justice on large corporations including General Electric, DuPont Chemical, Verizon communications, FedEX, IBM, and Exxon Mobil, that pay little or no taxes (The Wall Street Journal, 2011), while at the same time, other reports suggest that U.S. corporate tax rates to be among the highest in the industrialized world.

Many economists consider small business the engine that drives the economy. In fact, the U.S. Small Business Administration (SBA) reports more than 27.3 million small businesses (SBA Office of Advocacy, 2009) in operation. In addition, small businesses account for more than half of the nation's employment.

Increasingly, calls for tax reform center on various flat tax proposals. In this paper, the authors provide background information on the concept of the flat tax, existing flat taxes in the United States and elsewhere, and examine the potential impact a flat tax might have on small businesses.

Keywords: The Fair Tax, flat tax, small business, implications

INTRODUCTION

Despite their significant number, individual small businesses tend to be less significant in terms of revenue. In 2004, the Internal Revenue Service (IRS) reported businesses with gross receipts greater than one million dollars annually as only four percent of all small businesses (IRS, cited in Effective Federal Tax Rates, 2009). That same report indicated slightly more than three percent of all small businesses earned an annual profit of greater than one million dollars. Further, the report goes on to state that in 2004, nearly 88 percent of small businesses reported gross receipts of $250,000 or less.

While arguments exist both in favor and in opposition to the Fair Tax, some members of the Democratic Party, the Republican Party, the Tea Party and others support the idea (http://en.wikipedia.org/wiki/The_Fair_Tax_Act). In 1999, Georgia Congressman John Linder introduced a bill that would implement the Fair Tax plan. Several years later, the Congressman co-authored a book with talk radio personality Neal Boortz outlining the plan to the public (The Fair Tax Book, 2006). Despite being submitted to several sessions of Congress for consideration and becoming an issue in the 2008 presidential campaign, Fair Tax legislation does not appear to have sufficient broad-based support from Congress or the general public. Nevertheless, many agree that changes need to be made in the tax code and that some aspects of the FairTax proposal could be considered in any such change.

Currently, small businesses in the United States pay an estimated average effective tax rate of approximately 19.8 percent (www.FairTax.org). The actual rate varies depending on the form of small business—sole proprietorship, limited liability company (LLC), or corporation. This paper examines the potential impact of the FairTax proposal and possible outcomes on small business growth and the economy in general.

One aspect of the Fair Tax proposal that makes debate more complicated can be found with the number of varying proposals. First, flat tax proposals range from 17 to 23 percent which would obviously result in a wide range of revenue collections. Second, some Fair Tax proposals include a national sales tax, or would be based exclusively on a national sales tax. An advantage of a national sales tax could be the ability to collect "consumption taxes" from those who have evaded income tax, whether through illegal activity or by not reporting income. The fairness rationale focuses on higher-income individuals purchasing more goods, thereby paying higher national sales taxes. However, sales taxes can often be considered regressive, impacting lower-income persons to a greater extent. In addition, during an economic downturn, consumers reduce purchases which results in lower tax revenues.

Another major issue centers on the state-level impact of the Fair Tax on the various states. Tuerck, Bachman, and Jacob (2007) examined the potential effect of the Fair Tax across five states including Massachusetts, Illinois, Virginia, New Jersey, and Texas and projected increases in employment, investment, wage rates, and real disposable income. The broader base of taxpayers allows for lower tax rates, which then sets off a chain reaction of more spending, which leads to increased demand.

During the current economic climate, legislators such as Congressman Mike Pence continue the call for tax reform (Vital Speeches of the Day, 2011). Although much of the discussion centers on individual taxpayers, some argue that businesses must also pay their "fair share" of the tax burden. Although what the fair share might be varies from one person to the next, some might argue that the issue could be more about loopholes and exemptions, rather than the actual effective tax rates.

The Fair Tax can be considered a national sales tax which would be applied to all goods and services sold at retail. Proponents call for a rate of 23 percent that would shift tax focus to consumption, rather than income. Under this scenario, everyone pays the same tax rate, but those who spend more would pay more actual taxes. The Fair Tax does not allow exemptions and as the tax focuses on consumption, would likely acquire tax revenue from underground businesses that previously evaded the federal tax system. The national sales tax aspect of a flat tax proposal would assume that tax evaders, who do not pay taxes on income earned through the underground economy, would now pay taxes on purchases made from that income when purchasing products and services. In addition, higher income earners would pay more sales taxes as they generally purchase more goods and services.

Different plans with different tax rates and different lists of exemptions complicate the debate whether we should scrap the current tax code in favor of a flat tax. For example, flat tax proposals put forth in the 1990's ranged from 17 to 20 percent. The Fair Tax, as proposed by Governor Mike Huckabee in the 2008 presidential campaign and referred to here, proposes a rate of 23%, and current presidential candidate Herman Cain suggests a "9-9-9" plan, which for individual taxpayers would be 9 percent income tax and 9 percent national sales tax on purchases while corporations would also pay a flat 9 percent tax rate. Simply stated, neither proponents nor opponents can agree upon a tax rate that would be revenue neutral.

Background and historical context

In 1999, Georgia Congressman John Linder introduced a bill that would implement the Fair Tax plan. Despite being submitted to several sessions of Congress for consideration and becoming an issue in the 2008 presidential campaign, Fair Tax legislation does not appear to have sufficient broad support from Congress or the general public. Nevertheless, many agree that changes need to be made in the tax code and that some aspects of the Fair Tax proposal could be considered in any such change.

Rationale for a flat tax

Golob, (1996) offers several good reasons to support a flat tax. First, the flat tax would result in a simplified tax code saving business and individual taxpayers billions of dollars. Larerriere (cited in Golob, 1996) estimates that compliance costs for businesses could be reduced by as much as 90 percent. Second, Golob argues that taxes discourage taxed activities, therefore, taxes discourage work. In addition, taxing businesses discourages business investment. An employee with a lower tax burden would spend more money on purchases, thereby increasing demand for goods and spurring on more employment (this is the basis for the supply-side argument). As an alternative, rather than spending the additional income from the reduced flat tax, an employee might save more money. This would in turn, provide banks with more money to loan out for investment.

Under any tax system, compliance becomes a challenge and 2001 estimates of (nonbusiness) non-filers approximated 18 million (Walby, 2011). According to Wallby (2011), "non-filers alone accounted for $30 billion in the tax gap in 2001". Further, Wallby indicates this represented an increase of almost 300 percent over the previous ten-year period.

Golob (1996) further points to investment incentives for businesses as they would be able to take immediate deductions for investment in plants and equipment, rather than over the course of several years. The flat tax would also eliminate double-taxation currently paid on dividends and capital gains. Finally, Golob argues that most economists agree that a flat tax would stimulate economic activity although economists do not agree on how much economic activity would increase.

Many find the simplicity of the flat tax appealing as evidenced by a 2005 study conducted by the National Federation of Independent Businesses where 36 percent of small business owners responded that tax regulation compliance to be more burdensome than environmental, health and safety, or other business requirements (FairTax.org, 2011). Simplification and the (near) zero compliance cost could be features extremely attractive to small business owners.

Jones, Thomas, and Lang (2011) report that the Internal Revenue Service currently only audits about 1,000 tax returns per year. In addition, Jones, Thomas, and Lang (2011) also find that tax preparer's expend 6.6 billable hours to complete a tax return. This could be particularly costly to lower income taxpayers as tax rules can be lengthy and difficult for the average person to understand. For example, the instructions pamphlet to claim the Earned Income Credit requires more than 50 pages of reading.

Exemptions

The Fair Tax proposal provides tax payers with a rebate, paid in advance, or prebate. Under the proposal, a family of four would be allowed to spend $27,380 per year, tax free. The proposal allows a married couple with two children a rebate of $525 per month. That aspect of the plan results in no family paying the federal sales tax on essential goods and services. In addition, proponents argue that middle class families would be exempted from much of their annual spending.

Used goods would not be subject to tax under this proposal. Neither would intermediary goods—those used by businesses in the production of other goods. Savings, investments, and college tuition payments also would be exempted.

Flat tax proposals generally include exemptions based on family size (Mitchell, 2005). For example, a "Family-Friendly" bill introduced by Congressman Michael Burgess did not tax a family of four unless their income exceeded $30,000 (Mitchell, 2005).

The current economic and political climate

The current economic climate perhaps provides the greatest impetus for reconsideration of some form of flat tax. In a speech to the Detroit Economic Club, Congressman Mike Pence called for a new economic growth agenda called S.T.A.R.T. (Vital Speeches of the Day, 2011). START refers to the Republican Congress plan for: **S**ound monetary policy; **T**ax relief and reform; **A**ccess to American energy; **R**egulatory reform; and **T**rade. The call for tax code reform does not simply provide tax cuts for individuals or corporations, but also includes energy and regulatory issues.

According to Congressman Pence, the current tax code contains more than 3.8 million words (Vital Speeches of the Day, 2011). Further, Pence refers to a study by Dr. Art Laffer and others who find that the cost of compliance with the current tax code to be in excess of $540 billion per year and requires more than 7.6 billion hours preparing and filing tax returns (Vital Speeches of the Day, 2011). Congressman Pence further points to bi-partisan support of a flat tax and even favorable commentary by *The New York Times* (Vital Speeches of the Day, 2011). In addition, Pence argues that we already use a flat tax system for sales and property taxes, as well as Medicare and Social Security (Vital Speeches of the Day, 2011).

Despite earlier bi-partisan support for a flat tax, since the 2010 election, support comes from Republicans while Democratic challengers focus on their Republican opponents' support for the flat tax. For example, in a 2010 special election for a Pennsylvania Congressional seat, the Democratic challenger beat his Republican opponent in a district John McCain carried in the 2008 Presidential election in part, by pointing to his opponent support for a flat tax (The Wall Street Journal, 2010).

A 2009 Rasmussen Reports poll reported 43% of Americans would support replacing federal income tax with a national sales tax (FairTax History, 2011). Thirty-eight percent of those polled opposed the idea of a national sales tax. More Republicans (52%) than Democrats (44%) supported the idea of the national sales tax, while 49% of Independents favored the idea. President Barack Obama does not support the bill, and prefers a more progressive income tax system (FairTax History, 2011).

Earlier this year, lawmakers in the state of Missouri considered a flat tax to replace the current state income tax. McClatchy (2011) reports that under the Missouri plan (based upon a sales tax) churches and nonprofits would be required to pay taxes on goods and service purchases. In his editorial, McClatchy further suggests that middle class families would suffer as doctor visits and apartment rents would also be subject to the proposed tax.

Other states, such as Colorado, Illinois, Indiana, Massachusetts, Michigan, Pennsylvania, Rhode Island and Utah state residents already pay a flat state income tax rate. Rhode Island and Utah allow taxpayers the option of filing at the flat tax rate without certain deductions or the progressive rates with deductions such as charitable giving and home mortgage interest (Rabushka, 2007).

TERMS

AMT-Alternative Minimum Tax required by the Internal Revenue Service since 1969 of higher income citizens. The AMT is a higher, flat rate than what tax filers would normally pay under the typical, graduated income tax with allowed exemptions.
http://www.irs.gov/businesses/small/article/0,,id=150703,00.html
Earned Income Credit-The earned income credit (EIC) is a tax credit for certain people who work and have earned income under $48,362.
http://www.irs.gov/individuals/article/0,,id=96406,00.html
Exemption-reductions in taxable income often based upon mortgage interest, charitable contributions, child care, or business expenses. http://www.irs.gov/pub/irs-pdf/p501.pdf
FairTax-flat tax proposal, such as proposed by 2008 Presidential candidate Governor Mike Huckabee. http://www.fairtax.org/site/PageServer
Flat tax-tax system whereby every taxpayer pays the same rate, regardless of income. Various flat tax proposals differ on what current exemptions might remain.
en.wikipedia.org/wiki/Flat_tax
Gross Domestic Product (GDP)-the market value of all final goods and services produced within a country in a given period.
http://www.investopedia.com/terms/g/gdp.asp#axzz1d2QebOYo

Intermediate goods-raw materials, component parts, accessories used in the production of completed goods for sale. http://www.fairtax.org/PDF/TheEconomicEffectsoftheFairTax-ResultsfromBHI.pdf
Prebate-tax rebate paid in advance, based upon taxpayer income as part of the FairTax proposal. http://www.fairtax.org/PDF/2009FairTaxPrebateSchedule.pdf
Tax gap-the difference between the amount of tax actually due and the amount actually collected. www.irs.gov/newsroom/article/0,,id=158619,00.html
Used goods-items previously owned and used, such as a used car or used appliances. http://www.fairtax.org/site/PageServer?pagename=about_basics_thumbnail

LITERATURE REVIEW

Tax reform and the entrepreneur

A detailed study conducted by Cullen and Gordon (2006), projected the potential impact of entrepreneurial activity based upon implementation of the Hall-Rabushka Flat Tax. Their findings resulted in a projected 50% decline in entrepreneurial activity. The authors report the problem lies with current Internal Revenue Service tax code (sections 172 and 1244) if eliminated as part of an overall tax reform. According to Cullen and Gordon (2006), "Section 172 currently allows business losses to be carried back or carried forward into other tax years, while Section 1244 allows realized capital losses on shares in a small business to be deducted as ordinary rather than capital losses" (p.67).

Europe embraces the flat tax, well, sort of

Estonia set off a chain reaction when enacting a flat tax of 26 percent in 1994 (Rabushka, 2007). Since that time, Estonia lowered their nation's tax rate to 20 percent. In addition, Estonia eliminated corporate income taxes, replacing them with the flat tax on dividends. The new flat rate plan continues to produce a budget surplus for that country.

Latvia and Lithuania followed, then the Ukraine, Slovakia, Georgia and Romania. Each country determined a different rate, ranging from 12 percent to 24 percent, depending on each country's financial and economic circumstances (Rabushka, 2007). Other countries such as Kyrgyzstan and Macedonia also replaced progressive income tax rates with a flat tax (Rabushka, 2007).

Countries throughout Europe appear to be breaking away from progressive tax systems and moving toward various forms of a flat tax. Perhaps one of the most interesting examples can be found with the case of Russia, which adopted a flat tax in 2001. In the case of Russia, the government set the flat tax rate at 13%. In the next year, revenue from personal income taxes rose by 26%. Experts do not suggest jumping to any particular conclusion as socio-economic circumstances in Russia at that time could likely account for at least some of the increased tax revenue. However, several studies, notably Ivanova, Keen, and Klemm (2005) concluded that increased tax enforcement probably accounts for some of the increased tax revenue. Another study by the International Monetary Fund (2006) confirms increased compliance and in addition, does not find Laffer-type effects generating revenue increases.

A study by Aaberge, Colombino, and Strom (2000) examined the impact of the flat tax in Italy, Norway, and Sweden. Their findings suggest that in all three countries, "rich" households tend to benefit more than “poorer” households. In those countries, the flat tax ranges from 23 percent in Italy, to 25 percent in Norway, and 29 percent in Sweden. Additional differences may also affect the actual impact in each country. However, their findings also indicate that in Italy and Sweden only a minority benefit from a shift to the flat tax, although in Norway, a majority of households would benefit.

Financial justice

Both those in favor of and against a flat tax often base their arguments on financial justice. The problem lays in how one defines financial justice. Goodman (2011), points to the example of the Alternative Minimum Tax (AMT) established in 1969. The AMT would close the loophole on a small number of very high-income individuals who, through provisions in the tax code could avoid paying the regular income tax. Failure to increase the AMT exemption resulted in millions of taxpayers, hardly considered wealthy, subject to paying the Alternative Minimum Tax.

Arguments opposing a flat tax

Despite the need for tax reform, little common ground can be found between Democrat and Republican lawmakers. Research studies providing different possible tax revenue outcomes fuel differing opinions among members of Congress. Citizens for Tax Justice points to their three-year study of major corporations which found companies such as General Electric, Dow Chemical, Verizon Communications, Exxon Mobil, and IBM with at least one of the three years with no tax paid (Citizens for Tax Justice, cited in the Wall Street Journal, 2011). Twelve companies in the study, including those mentioned above, reported $171 billion in pre-tax income during that three-year period (Citizens for Tax Justice, cited in the The Wall Street Journal, 2011).

Others take issue with plans that combine a flat tax with a national sales tax, such as Herman Cain’s “9-9-9 Plan” (http://www.democratichub.com/herman-cain.aspx?gclid=CI3JgcnCk6wCFacAQAodCRxaFg). Most experts, including Gale (2004) report that sales taxes generally could be characterized as regressive in nature, meaning lower-income taxpayers bear a greater tax burden than higher-income taxpayers.

Despite a more simplified tax system, the government could not assume complete compliance. In 2001, the Internal Revenue Service estimated a “tax gap” of $345 billion (http://en.wikipedia.org/wiki/Tax_evasion). Cebula & Feige (2008), report the income gap to be $450 to $500 billion with an additional $2 trillion in unreported income. In another study, OurFiscalSecurity.org estimates the cost of tax evasion to be $3.09 trillion from 2001-2010 (http://www.ourfiscalsecurity.org/taxes-matter/2011/4/15/tax-evasion-the-real-costs.html). Given this, approximately 18-19 percent of total income goes unreported, and therefore no tax revenue can be collected (http://en.wikipedia.org/wiki/Tax_evasion). Flat tax proponents should not presume that all this unreported income would generate tax revenues, as tax avoiders would likely find new ways to avoid paying taxes. Finally, financial justice could be argued if you believe that those who earn more money should pay a higher tax rate than those who earn less money.

The bottom line

If the United States were to scrap the current tax code in favor of a flat tax, would there be a positive effect on economic growth? Economists Cassou and Lansing (2004) conducted an extensive study of the potential impact of shifting from a graduated income tax system to a flat tax system. They concluded that a revenue-neutral flat tax would provide slightly greater economic growth than the graduated tax system.

Others support this claim. According to Americans For Fair Taxation, many economists agree that The Fair Tax would boost the economy, and eighty economists, including Nobel Laureate Vernon Smith, signed a letter of support to that effect (Wikipedia.org, 2005). The economists further stated that numerous economic measures including gross domestic product (GDP), business investment, consumption, employment, and real wages would post sharp improvement (Wikipedia.org, 2005) if Congress would enact Fair Tax legislation.

DISCUSSION

Discussion and debate concerning the Fair Tax proposal seems to center around the following issues: how the Fair Tax would affect the individual taxpayer, what would be the impact on the business, what would be the impact on the federal government, and what would be the impact on state governments? In addition, a great deal of debate focuses on the concept of what people consider fair with regard to taxation.

Although the authors discuss the impact on other stakeholders, the study will begin by considering the impact of a Fair Tax proposal on small business owners. Considering that many small business owners file as sole proprietors or under S-Corporation (S-Corp) rules, or as Limited Liability Corporation (LLC), most small business owners should benefit. Despite what might appear as a higher rate (23 percent versus the reported effective rate of 19.8 percent), keep in mind that each taxpayer would receive the rebate and would not pay any tax on intermediate goods and services.

Consider a small business owner currently earning $100,000 per year. Under the current tax system, that small business owner pays $19,800 in federal taxes ($100,000 x 19.8 percent). Under the Fair Tax proposal, the small business owner would pay $16,702 ($100,000 - $27,380 = $72,620 x 23 percent). In this case, the small business owner would save over $3,000 per year in federal taxes, *assuming they spent everything they earned.* Remember, any money spent on used goods would not be taxed, nor would any money that would go into savings or investments so the actual savings could be much greater. Retail businesses would also receive an administrative fee of one quarter of one percent to collect the tax for the federal government. Based upon annual gross sales of $500,000 per year, this would amount to $1,250. Using this example, the effect on the individual taxpayer would seem to be favorable.

The authors provide three examples demonstrated by income statements in the appendix of this paper. Each of which could be considered a typical small business. In fact, the basic financial information mirrors examples from BizPlan business plan software. In the first example (Table 1), the authors examined a bakery/delicatessen with first year sales of $422,500 and net profit under current tax rules of $13,903. However, when applying the 23% flat tax rate, net profit climbs to $19,861. In the second year, sales increase to $469,000 with a net profit of $29,196 under current tax rules. When we apply the flat tax rate, net profit climbs to $41,709.

In the second example (Table 2), a small manufacturer with first year sales of $1,000,000 earns a net profit of $47,250 under current tax rules. Applying the Fair Tax, first year profits climb to $67,500. In the second year, sales increase to $1,050,000 with a net profit of $45,902. Under the Fair Tax plan, net profit increases to $65,574.

The third example (Table 3), profiles a small home accessories store where first year sales total $829,000 with a net profit of $32,861 under current tax rules. Under the Fair Tax, net profit increases to $46,687. During the second year, store profits would be $27,171 under current tax rules but would increase to $38,816 under the Fair Tax.

CONCLUSION

While some evidence can be found suggesting the flat tax could expand economic activity, conflicting evidence suggests that other factors (societal, infrastructure, political) could determine actual results. Given the current climate for tax reform, perhaps the best argument might be presented based upon increased revenue as consumption taxes would now capture underground economic activity expenditures.

The study by Flesischman and Hutchison (2011) offers an interesting view of tax reform. In their study, Fleischman and Hutchison surveyed 645 tax professors to find what views tax professors held on a number of tax reform issues. The survey (based upon the Armey plan, proposed by then House Leader, Congressman Dick Armey) questioned tax professors whether the current tax code should be eliminated, resulting in 60 percent opposed to eliminating current tax code. Keep in mind, however, should a tax plan be adopted and the tax code simplified, few tax specialists and preparers would be necessary as your tax form could be as small as a postcard and simple enough for anyone to prepare.

Since many variations of a flat tax exist, we should not expect that each and every proposal would provide similar results. Not only will differing tax rates result in differing tax revenues, details such as what exemptions might be kept would also impact tax revenues. Perhaps most important, would a flat tax that combines a consumption tax with a flat income tax (such as the tax proposed by presidential candidate Herman Cain) be acceptable to voters and effective at stimulating the economy (http://www.hermancain.com/999plan)?

Implications for further research

Many citizens appear dissatisfied with the current tax system. Some deem the current tax structure unfair while others actively fight the tax code in court, as in the case of Warren Buffett (http://taxprof.typepad.com/taxprof_blog/2011/08/warren-buffetts.html). As tax reform has become highly politicized with each political party taking side, a more detailed study could examine the potential impact of differing flat tax rates. Although the Cain “9-9-9” rate might not be ideal, perhaps serious discussion and debate could begin to explore various options (http://www.hermancain.com/999plan). For example, current corporate tax rates of 35% (deemed the highest corporate tax rates in the world) could be lowered considerably if exemptions which allow some corporations to avoid paying any tax were reduced or eliminated.

Both sides of the Fair Tax debate claim research data support their point of view. However, most studies would seem to support the premise that a flat tax of some type would indeed be revenue neutral, yet provide incentives for investment to stimulate the economy. What the tax rate should be and what exemptions might remain continue to be areas of concern, however.

Serious tax reform requires analysis, debate and discussion to determine outcome consensus, as well as processes to achieve desired outcomes. Thorough, objective analysis examining typical personal and corporate returns at various income levels might reveal new data. As original Fair Tax proposals garnered bi-partisan support, a new look at the Fair Tax, or some other flat tax proposal will require renewed bi-partisan approach.

REFERENCES

Aaberge, R., Colombino, U., & Strom, S. (2000). Labor supply responses and welfare effects from replacing current tax rules by a flat tax: Empirical evidence from Italy, Norway, and Sweden. *Journal of Population Economics*, *13*: 595-621.

Boortz, N. & Linder, J. (2006). The Fair Tax Book. NY: Harper Paperbacks.

Cassou, S., Lansing, K. (2004). Growth effects of shifting from a graduated-rate tax system to a flat tax. *Economic Inquiry Publisher*, *42*(2).

Cebula, R. & Feige. E. "America's Underground Economy: Measuring the Size, Growth and Determinants of Income Tax Evasion in the U.S" http://ideas.repec.org/p/pra/mprapa/29672.htm

Cullen, J. & Gordon, R. (2006). Tax Reform and entrepreneurial Activity. Tax Policy and the Economy, *20*, 41-71. *National Bureau of Economic Research*.

Editorial, *The Daily Star-Journal*. McClatchy-Tribune Business News, March 25, 2011.

Effective Federal Tax Rates Faced by Small Businesses in the United States, SBA Office of Advocacy, release date April, 2009. U.S. Government Printing Office: Washington.

FairTax History. http://www.fairtaxforum.com/forum/content.php?45-documentation

Fleischman, G., Hutchison, P. (2011). A tax reform conundrum: Insights From a survey of tax professors. *The Journal of Applied Business Research*, *17*(4), 17-29.

Gale, W. (2004, September) National retail Sales Tax working paper prepared for the Brookings Institution.

Golob, J. (1996). How would a flat tax affect small businesses? Economic Review (01612387), *81*(3), 5. Retrieved from Ebscohost, 10/19/2011.

http://www.democratichub.com/herman-cain.aspx?gclid=CI3JgcnCk6wCFacAQAodCRxaFg

http://en.wikipedia.org/wiki/Tax_evasion

http://hermancain.com/999plan

http://www.irs.gov/businesses/small/article/0,,id=150703,00.html

http://www.irs.gov/individuals/article/0,,id=96406,00.html

http://www.irs.gov/pub/irs-pdf/p501.pdf

http://www.ourfiscalsecurity.org/taxes-matter/2011/4/15/tax-evasion-the-real-costs.html

http://www.sba.gov/advo/research/rs343tot.pdf

http://taxprof.typepad.com/taxprof_blog/2011/08/warren-buffetts.html

http://en.wikipedia.org/wiki/FairTax#Legislative_overview_and_history

http://en.wikipedia.org/wiki/The_Fair_Tax_Act

http://en.wikipedia.org/wiki/Tax_avoidance_and_tax_evasion

Keen, M., Kim, Y, and Varsano, R. (2006). The "Flat Taxes)": Principles and Evidence. IMF Working Paper, WP/06/218 Washington, D.C.: International Monetary Fund, Fiscal Affairs Department, 2006.

Ivanova, A., Keen, M. & Klemm, A. (2005). The Russian ‘flat tax’ reform. *Economic Policy*, *20*(43), 397-444. Doi:10.1111/j. 1468-0327.2005.00143.x
Mitchell, D. (2005). A Brief Guide to the Flat Tax. Working paper number 1866, The Heritage Foundation.
Pence, M. (2011). To Restore American Economic Exceptionalism. *Vital Speeches of the Day*, *77*(2), 61-66. Retrieved from EBSCO*host*, 10/19/2011.
Rabushka, A. (2007). The Flat Tax’s *Silver Anniversary*. Hoover Classics : Flat Tax hcflat fm Mp_7 rev1 page vii   Retrieved 10/24/2011.
The impact of the FairTax on small business (2007). FairTax.org
The Small Business Economy: A report to the President. SBA Office of Advocacy, 2009. U.S. Government Printing Office: Washington. http://archive.sba.gov/advo/research/sb_econ2009.pdf
The Wall Street Journal (Online). New York, NY: June 1, 2011.
The Wall Street Journal (Eastern edition). New York, NY: October 29, 2010, pg. A.16.
Tuerck, D., Bachman, P., & Jacob, S. (2007). Fiscal Federalism: The National FairTax and the States. The Beacon Hill Institute at Suffolk University, Boston, MA.
Wallby, K. (2011). Testimony before the House Committee on Ways and Means Hearing on Fundamental Tax reform, January 20.

APPENDIX

Table 1

Profit and Loss	Delicatessen and Bakery Income Statement			
	Year 1	Flat Tax	Year 2	Flax Tax
Sales	**$422,500**	**$422,500**	**$469,000**	**$469,000**
Direct Cost of Sales	$121,360	$121,360	$130,400	$130,400
Flat Tax on Purchases		$27,913		$29,992
Other Production Expenses	$0	$0	$0	$0
Total Cost of Sales	**$121,360**	**$149,273**	**$130,400**	**$160, 392**
Gross Margin	$301,140	$273, 227	$338,600	$308,608
Gross Margin %	71.28%	64.67%	72.20%	65.80%
Expenses				
Payroll	$205,200	$205,200	$217,000	$217,000
Sales and Marketing and Other Expenses	$7,000	$7,000	$10,000	$10,000
Depreciation	$1,440	$1,440	$1,440	$1,440
Leased Equipment	$0	$0	$0	$0
Utilities	$4,800	$4,800	$4,800	$4,800
Insurance	$6,000	$6,000	$6,000	$6,000
Rent	$21,600	$21,600	$21,600	$21,600
Payroll Taxes	$30,780	$0	$32,550	$0
Other	$0	$0	$0	$0
Total Operating Expenses	**$276,820**	**$246,040**	**$293,390**	**$260,840**
Profit Before Interest and Taxes	$24,320	$27,187	$45,210	$47,768
EBITDA	$25,760	$28,627	$46,650	$49,208
Interest Expense	$4,459	$4,459	$3,501	$3,501
Taxes Incurred	$5,958	$0	$12,513	$0
Net Profit	**$13,903**	**$22,728**	**$29,196**	**$44,267**
Net Profit/Sales	**3.29%**	**5.38%**	**6.23%**	**9.44%**

Table 2

Profit and Loss	**Retail Furniture Manufacturer Income Statement**			
	Year 1	Flat Tax	Year 2	Flat Tax
Sales	**$1,000,000**	**$1,000,000**	**$1,050,000**	**$1,050,000**
Direct Cost of Sales	$430,000	$430,000	$450,000	$450,000
Flat Tax on Purchases		$98,900		$103,500
Other Production Expenses	$0	$0	$0	$0
Total Cost of Sales	**$430,000**	**$528,900**	**$450,000**	**$553,500**
Gross Margin	$570,000	$471,100	$600,000	$496,500
Gross Margin %	57.00%	47.11%	57.14%	47.29%
Expenses				
Payroll	$326,500	$326,500	$356,000	$356,000
Sales and Marketing and Other Expenses	$60,000	$60,000	$60,000	$60,000
Depreciation	$11,424	$11,424	$11,424	$11,424
Leased Equipment	$0	$0	$0	$0
Utilities	$9,600	$9,600	$9,600	$9,600
Insurance	$12,000	$12,000	$12,000	$12,000
Rent	$24,000	$24,000	$24,000	$24,000
Payroll Taxes	$48,975	$0	$53,400	$0
Other	$0	$0	$0	$0
Total Operating Expenses	**$492,499**	**$443,524**	**$526,424**	**$473,024**
Profit Before Interest and Taxes	$77,501	$27,576	$73,576	$23,476
EBITDA	$88,925	$39,000	$85,000	$34,900
Interest Expense	$10,001	$10,001	$8,002	$8,002
Taxes Incurred	$20,250	$0	$19,672	$0
Net Profit	**$47,250**	**$17,575**	**$45,902**	**$15,474**
Net Profit/Sales	**4.73%**	**1.76%**	**4.37%**	**1.47%**

Table 3

Profit and Loss	**Home Accessories and Gifts Income Statement**			
	Year 1	Flat Tax	Year 2	Flat Tax
Sales	**$829,000**	**$829,000**	**$995,000**	**$995,000**
Direct Cost of Sales	$373,050	$373,050	$447,750	$447,750
Flat Tax on Purchases		$85,802		$102,903
Other Production Expenses	$0	$0	$0	$0
Total Cost of Sales	**$373,050**	**$458,852**	**$447,750**	**$550,733**
Gross Margin	$455,950	$370,149	$547,250	$444,268
Gross Margin %	55.00%	44.65%	55.00%	44.65%
Expenses				
Payroll	$152,591	$152,591	$214,707	$214,707
Sales and Marketing and Other Expenses	$57,182	$57,182	$66,167	$66,167
Depreciation	$19,726	$19,726	$19,726	$19,726
Leased Equipment	$0	$0	$0	$0
Utilities and Telephone	$10,419	$10,419	$10,732	$10,732
Insurance	$2,617	$2,617	$9,885	$9,885
Rent	$102,892	$102,892	$108,036	$108,036
Payroll Taxes	$22,889	$0	$32,206	$0
Merchant Fees and Outbound Freight	$17,780	$17,780	$24,103	$24,103
Repairs and Maintenance	$618	$618	$637	$637
Supplies -- Office, POS, Giftwrap, Packaging	$3,247	$3,247	$3,897	$3,897
Taxes -- Other and Licenses	$1,700	$1,700	$1,850	$1,850
Other	$7,330	$7,330	$8,063	$8,063
Total Operating Expenses	**$398,991**	**$376,102**	**$500,009**	**$467,803**
Profit Before Interest and Taxes	$56,959	-$5,954	$47,240	-$23,536
EBITDA	$76,685	$13,773	$66,967	-$3,810
Interest Expense	$10,272	$10,272	$8,424	$8,424
Taxes Incurred	$14,006	$0	$11,645	$0
Net Profit	**$32,681**	**-$16,226**	**$27,171**	**-$31,960**
Net Profit/Sales	**3.94%**	**-1.96%**	**2.73%**	**-3.21%**

Table 4
History of support for Flat Tax legislation

Armey-Shelby proposal	1996 House/Senate proposal
Senator Gramm proposal	1996 Presidential campaign
Senator Spector proposal	1996 Presidential campaign
Steve Forbes proposal	1996 Presidential campaign
Linder-Chambliss proposal	1999 House/Senate proposal
Hall & Rabushka	(Hoover Institution Fellows) 1981
Governor Mike Huckabee	2008 Presidential campaign
Herman Cain	2012 Presidential campaign
Governor Rick Perry	2012 Presidential campaign
National Commission on Economic Growth and Tax Reform (1995)	