



*"For Truth in Taxation
And Job Creation"*

Competitive Border Issues

This paper discusses how the MI FairTax will impact businesses and residents in regard to competition from other states?

- A. How will the MI FairTax affect retail businesses, especially near the border with neighboring states, in their ability to compete with businesses in states with lower sales tax rates?
- 1) The total amount of tax on businesses varies from state to state. Just like all other costs of doing business, these taxes are passed on in the prices that we consumers pay for all goods and services we purchase. These "passed on" taxes are actually a hidden sales tax on all Michigan produced goods and services. Under Michigan's current tax code businesses (actually people) are paying both sales tax on all their purchases for non resale items and the Michigan Business Tax (MBT) which includes tax on:
 - a. gross receipts
 - b. business real estate
 - c. personal property (on furniture, fixtures and equipment)
 - d. income

In addition, businesses pass on to consumers their cost of complying with the tax code. A large business typically has an entire department devoted to tax compliance, employing dozens to hundreds of individuals. Many small businesses pay more to their accountant to calculate their MBT than the business's tax obligation.

All these taxes and compliance costs are imbedded (hidden) in the cost of all purchases by consumers. These costs are included in the price we pay for food, medicine, cars, etc.

- 2) Under the MI FairTax these "business" taxes will be eliminated and residents will pay the taxes directly, without the illusion that businesses are paying the taxes. The ruse that businesses pay taxes will be eliminated. Michigan residents will be able to see their true tax burden for the first time in generations. Economists generally consider the dishonest practice of hiding taxes in the prices of products most damaging to the economy; and they share a general consensus that consumption taxes (like a sales tax) are the least harmful to the economy.
- 3) Because Michigan businesses will no longer have the cost of Michigan taxes and tax compliance imbedded in their products, they can lower their price to compete with businesses from other states and countries. Today, Michigan consumers with after tax dollars (remember our income is taxed first, then we make our purchases with the remaining dollars) pay the:
 - a. cost to produce the product
 - b. business taxes imbedded in the product's price
 - c. current 6% sales tax

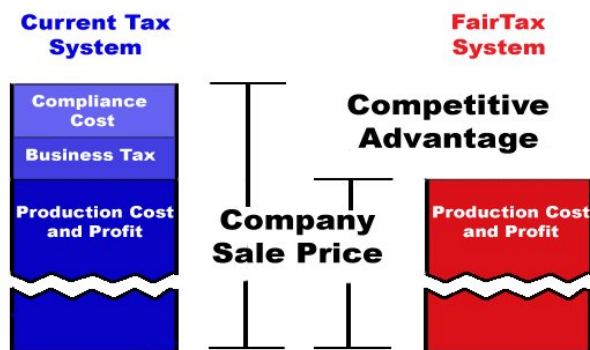
Under the MI FairTax consumers will pay with pre tax dollars (remember we will receive our full pay without reduction for an income tax) the:

- a. cost to produce the product
- b. 9.75% MI FairTax

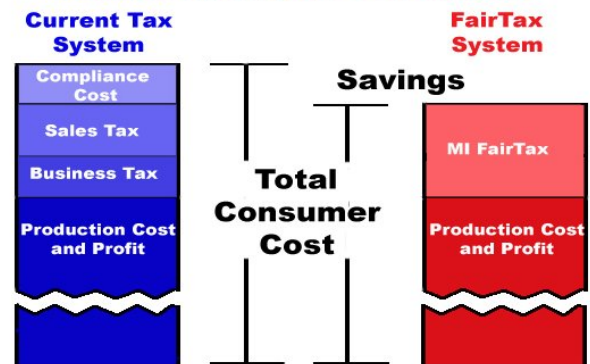
Part or all of the 9.75% is offset by the prebate resulting in a net tax rate of 0 – 9.75%. When the prebate is combined with other untaxed expenditures the typical effective tax rate is 2.5%. [See “[Prebate](#)” at www.mifairtax.org to view the effective tax rate at different spending levels for households of different sizes.]

The result is that the final price to consumers, when all taxes are included, will be about the same as they are today. See charts below.

Competitiveness of Michigan Products



Cost to Michigan Consumers



The cost to comply with the MI FairTax is about the same as complying with today’s sales tax. Because the current sales tax is being replaced by the MI FairTax there is no added compliance cost for the MI FairTax in the above charts.

The MI FairTax will make Michigan labor and business more competitive by removing hidden taxes from the price of Michigan produced goods and services; and we consumers will be able to see our true tax burden for the first time in generations.

- 4) There is a cost incurred by consumers in traveling to other states to attempt to save the difference in sales tax. The sales tax rates of surrounding states vary from 0 to 4 cents below the proposed MI FairTax rate. In the unlikely event (due to cross border competition) that the lower costs to businesses described above are not passed on to consumers in lower retail prices, there is still only very limited incentive to travel to another state to save 0-4 cents, especially when the cost of fuel and wear and tear on the family car is considered. This situation is unlike that for tobacco or alcoholic products, where the difference in taxes can be very substantial.
- 5) And if someone discounts the above points, which is most important, where people buy things from or where those items are made? We believe ‘Made in Michigan’ is the key!

B. How will the MI FairTax impact businesses that sell “large ticket” items:

- 1) The same things described above also apply to bigger purchases and generally would negate any perceived savings by purchasing from an out of state source. Put simply,

Michigan businesses would have a lower cost of doing business and this would give them an ability to compete with businesses located elsewhere.

- 2) The purchases of many of the biggest things consumers buy (cars, boats, and big toys) require that they be licensed in Michigan. So unless someone wants to buy these things and leave them in another state, Michigan will collect the tax when the items are licensed in Michigan.

C. How will the MI FairTax be collected when things are purchased out of state when Michigan residents travel or purchases are made by catalog or via the Internet:

- 1) The same measures that are in effect to collect the current sales and use taxes will still be in effect after the MI FairTax is adopted.
- 2) Michigan belongs to an association of a large and growing number of states that exchange information on purchases to enhance compliance with the law. Today, if you go to North Carolina and buy a trailer full of furniture and fail to pay the tax when you file your tax return, you will receive a notice from the Michigan Department of Treasury that you owe the tax and a penalty.

The challenge that the state has collecting sales and use taxes today will still be present after the MI FairTax is adopted. To put this in perspective, however, the most recent IRS study (2007) determined that 32.1% of the income and business taxes from legal enterprises that are owed are not collected,* whereas, only about 4% of a FairTax type sales tax owed is not collected.** It is much easier to determine and audit sales than it is to determine and audit income. In addition, the number of points of collection will have been reduced by about 90% under the MI FairTax, because only retailers will collect and remit the MI FairTax, whereas, today retailers collect sales taxes plus they pay many business taxes, residents pay income taxes, non retail companies pay numerous taxes and most everyone files tax returns.

Under the current income tax system it only takes one person to cheat. The laws are complex and punctuated with loopholes. Because of this complexity and the great number of returns there is less than a 2% likelihood that the cheater will be audited.

Under a sales tax it takes two to cheat, one to lie and the other to swear to it. In addition, over 80% of all purchases are made at large stores, and it may be difficult to convince the Wal-Mart cashier to “forget” the sales tax to help you out. There are few folks that could be counted on to go to jail for us. With a 90% reduction in the number of remitters of the tax to the government and because it is much simpler to audit sales, the likelihood that cheaters would get caught is too high to risk for most sane folks.

Concerns that a higher sales tax may increase black markets, under the table deals, cash transactions and the like have not been experienced where sales taxes are higher today. In fact, these things are much more prevalent under our current tax code as is evidenced by the fact that only 68% of today’s income and business taxes are collected (this does not include taxes not collected on under the table labor and on illegal income from such things as gambling, illegal drug dealing, prostitution, etc.)*, compared with 96% of state sales taxes** being collected. We must remember that the MI FairTax is not collected on the sale of most used items, and this is where most such tax avoidance would otherwise take place.

The ease of collection makes avoidance of the MI FairTax most difficult. Under the current tax code illegal aliens, drug dealers, gamblers, prostitutes, cash laborers, etc. easily avoid paying income taxes; however, under the MI FairTax they will pay taxes on their earnings when they buy the things they want, just like law abiding residents of Michigan.

As Chairman of the Presidents Council of Economic Advisors, Dr. Alan Greenspan, lectured Congress, "Businesses do not pay taxes. Only people pay taxes". Since we understand that Michigan residents pay all Michigan business taxes (in the prices of the things we buy) we can't be fooled by someone telling us that the MI FairTax is a tax shift from business to individuals. We understand that business taxes are just a deceptive means of taxing individuals.

On occasion someone will express the concern that business should pay for the services they receive. This is true for direct services like water and sewer which businesses pay for based on their usage. Since consumers pay the business taxes it is impossible to tax business for indirect services they receive (police, fire, roads etc). What is a business anyway, but consumers organized as a legal entity laboring to produce goods and services... businesses are people. The attempt to hide our taxes in the price of goods and services produced in Michigan has resulted in our diminished ability to compete in the world marketplace. This is largely the cause of the exportation of our companies and jobs rather than our products in recent years.

The MI FairTax is the best solution to Michigan's economic decline. By eliminating the punishment of productive behavior (the taxation of income) we will unleash the productive capacity of Michigan residents.

***IRS Updates Tax Gap Estimates**

IR-2006-28, Feb. 14, 2006. Washington — Internal Revenue Service officials announced their estimates of the Tax Year 2001 tax gap based on the National Research Program (NRP). The updated estimate of the overall gross tax gap for Tax Year 2001 – the difference between what taxpayers should have paid and what they actually paid on a timely basis – comes to \$345 billion. IRS enforcement activities, coupled with other late payments, recover about \$55 billion of the tax gap, leaving a net tax gap of \$290 billion for Tax Year 2001. <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>

****Minnesota Sales Tax Gap study**

http://www.taxes.state.mn.us/legal_policy/research_reports/content/taxgap_exec_1102.pdf

The Minnesota sales tax gap was 9.9%, however, a substantial portion of the Minnesota tax gap was due to nonpayment of taxes on transactions that are not taxable under the FairTax. When the Minnesota results are applied to the FairTax base, the tax gap is reduced to 3.9%. Items taxed by Minnesota state sales tax but not by the FairTax are business purchases and used items.