If there’s an issue “most likely to be debated” in the 2011 session of the Missouri General Assembly, it’s a proposal to replace state income taxes – both individual and corporate – with a greatly expanded sales tax. Proponents of the legislation refer to it as the “fair tax.” But Missourians should think twice because the “fair tax” is anything but.

Missourians know that if it sounds too good to be true, it probably is. And that’s exactly the case with the proposal to change how the state collects revenue. No income tax might sound great at first blush. But reality dictates that the revenue that would be lost has to be made up. Someone has to pay, and that “someone” is the average Missouri family. In fact, 95 percent of Missourians would pay considerably more in taxes under the “fair tax.”

How does that happen? Missouri would become completely reliant on a greatly expanded sales tax. This would be a sales tax like none ever seen before in any state. Far more things would become taxable – in fact, almost all goods and services would be taxed.

The devil is in the details, but the details of the so-called “fair tax” are hard to pin down. Not only have proponents of this idea submitted SJR 1 in the legislature, but they have filed nine initiative petitions with the Secretary of State’s office. Each initiative is different, but while some exempt a specific service, all would apply the greatly expanded sales tax to the vast majority of spending on products and services by Missourians.

The intent of the proponents is clear. The various versions of the proposal are meant to confuse Missourians and pick off one or more of the opponents to the measure. However, as described further below, the basic tenets of both the initiative and legislative proposals remain fundamentally flawed, and Missourians should not be fooled by this gamesmanship.

The way the legislative proposal is written, the new sales tax would apply to nearly everything anyone buys. That means food, prescription medicine, utilities and even new homes. It would also apply to services, including child care, nursing homes and assisted living for seniors, doctor’s office visits, legal counseling, financial services and more — even funerals. No other state taxes services to that extent.

Moreover, even with all those new items added to what’s taxable, the sales tax rate itself would need to be considerably higher to make up for revenue lost from the income tax. Proponents of the plan indicate that a 5 to 7 percent state tax rate would be required (in addition to local sales taxes). SJR 1 specifically cites a rate of 5.11 percent, and the initiative petitions cap the state rate at 7 percent.

However, we at the Missouri Budget Project, in partnership with the Institute on Taxation and Economic Policy, estimate that an 11 percent state sales tax rate would be necessary to make up for lost revenue.

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The “Fair Tax” is Fundamentally Flawed
A Proposed Sales Tax Would Tax Just About Everything You Buy

By Amy Blouin

“We estimate that an 11 percent state sales tax rate would be necessary to make up for lost revenue.”

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Tennessee: No Panacea With “Fair Tax”

By Rita Linhardt

A November 2009 report by the Institute on Taxation and Economic Policy found that the poorest 20 percent of Tennesseans paid on average 11.7 percent of their income in taxes, while the wealthiest one percent of taxpayers paid an average of only 3.1 percent.

Proponents of the “fair tax” often point to Tennessee as a model state because its tax structure embodies some principles of their proposal. Since Tennessee is similar to Missouri in geographic region and demographic characteristics, it can provide a good case study for the “fair tax.” Unfortunately, Tennessee is not the success story that advocates in Missouri claim it to be.

Despite the state’s beautiful mountain vistas and country music fame, there is much to be desired about Tennessee’s quality of life. According to Morgan Quitno ratings, Tennessee ranks near the bottom of the 50 states in key areas of public school spending, graduation rates and higher education enrollment. The state ranks near the top in crime rate and was considered the 47th most livable state. Census Data from 2008 shows the state ranked 11th highest in the nation in the number of persons living below the poverty level. Tennessee’s household income is well below the national average and unemployment is currently hovering at 9.4 percent. Missouri generally ranks ahead of Tennessee in statewide rankings measuring quality of life issues.

Many in Tennessee would say that the state’s problems are due in part to its tax structure. Tennessee does have a very limited income tax on investments, which falls particularly hard on retirees. Also the state has a corporate tax similar to Missouri’s. Tennessee’s corporate tax is levied at a rate of 7 percent and has an estimated $1.5 billion shortfall in the state’s revenue finally started to increase in the spring of 2010, but the state is still facing an estimated $1.5 billion shortfall in the upcoming fiscal year.

Part of the problem with the heavy reliance on sales tax has to do with the state’s geography. Tennessee is a long narrow state that borders eight other states. With half of the state’s population living in counties that do not border other states, it’s very enticing for residents to shop across the border of the Internet. This has a negative effect on local businesses and job stability. (In Missouri, shopping outside of state would experience similar problems; the “fair tax” is especially unpopular in the Kansas City area.)

One of the messages being used in the campaign for “fair tax” in Missouri is that Tennessee is a “low tax” state. That is true but only when you consider certain taxes.

According to the Institute on Taxation and Economic Policy in Washington, D.C., Tennessee is third lowest in the nation as a share of personal income primarily because of its limited personal income tax. Tennessee property taxes are also quite low, in fact 36 percent below the national average. Where Tennessee makes up its difference in sales taxes and excises taxes, which are 38 percent above the national average. The state ranks eighth highest in terms of sales and excises taxes as a share of income.

Taxes are to government what engines are to cars: government can’t run without them. Since ancient times, governments have taxed their subjects (or later citizens) in order to raise funds to operate the government. If a state enacted the “fair tax,” it would follow a different model of taxation. In the spring of 2010, the Tennessee State Senate approved a bill that would gradually replace the existing tax structure with a national sales tax. This bill had been reintroduced for the third time since the spring of 2009.

The “fair tax” is fundamentally flawed...
A proposed amendment to the Missouri Constitution (SJR 1) would enact a new kind of state sales tax that would tax not just goods purchased but services rendered. The proposal raises several concerns of interest to Missouri Catholics.

**Taxing Catholic Churches**

SJR I eliminates almost all of the current sales tax exemptions. At present churches don’t pay sales tax on goods purchased. Church renovations, supplies for the church picnic, etc. are all exempt from the current state sales tax. If SJR 1 is enacted, churches will pay sales taxes, adding to their current fiscal challenges. The rationale for exempting churches from taxation has always been that they further the common good by raising the moral fiber of society and providing charitable services not effectively provided by government. SJR 1 rejects this approach and taxes churches.

**Taxing Catholic School Parents**

As initially introduced, SJR I requires K-12 Catholic school parents to pay a sales tax on top of their school tuition payment. Meanwhile, higher education tuition is one of the few items exempted from the so-called “fair tax,” on the basis that higher education is an “investment” that should not be taxed. To fully replace existing state revenue, as SJR 1 claims to do, it may take a tax rate of as much as 10 to 11 percent. At a 10 percent tax rate, a parent would pay $400 in sales tax on $4,000 of school tuition.

SJR I taxes parents for choosing Catholic schools. This is a tax a parent can avoid by not choosing Catholic schools. This tax is troubling when one considers Catholic teaching, as enunciated in the Catechism of the Catholic Church:

“As those first responsible for the education of their children, parents have the right to choose a school for them which corresponds to their own convictions. This right is fundamental ... Public authorities have the duty of guaranteeing this parental right and of ensuring the concrete conditions for its exercise.” (par. 2229)

Government therefore has a duty to ensure that parents can, in fact, exercise their right to choose a school for their children. The MCC has long sought tax relief for Catholic school parents, such as a state income tax credit for school tuition. Instead of pursuing this kind of tax relief, SJR I moves in exactly the opposite direction. For the first time, a tax is specifically imposed on Catholic school parents.

**Taxing Catholic Charities**

SJR I would impose a sales tax on many of the services provided by Catholic charities. If a service is offered entirely for free, then no tax would be imposed; but in many instances fees are charged on a sliding scale based on the person’s income. Some of the services provided by the Catholic Church that could be taxed include: nursing home and assisted living services; child care; family counseling; and, pro-life counseling and emergency assistance.

In addition, because SJR I eliminates the state income tax, a number of tax credits that benefit the Church’s charitable ministries would be eliminated. At present, for example, donors can obtain tax credits for contributions made to maternity homes, pregnancy resource centers, domestic violence shelters and other agencies that help people in crisis situations. For example, a donor who may have been considering a donation of $300 may decide to give $600 if he knows he can claim a $300 tax credit. If the credit is eliminated, this same donor may go back to giving just the $300. This kind of drop in charitable giving would hinder the extent of assistance Catholic charities could provide.

**Taxing Knights of Columbus**

Under current state law fraternal organizations like the Knights of Columbus do not have to pay sales tax for their sales or purchases. SJR 1, however, removes the sales tax exemption for fraternal organizations. The Knights, for example, would have to collect sales tax on their tootsie roll sales.

**Why Are All These Things Taxed?**

SJR I, the so-called “fair tax,” repeals all of Missouri’s current taxes, including the personal and corporate income tax, the corporate and bank franchise tax and the current sales tax. All of the current taxes are replaced by one tax: a new state sales tax. But to replace all the revenue lost from abolishing the current taxes, the “fair tax” must have a very large tax base; hence, the taxes on Catholic churches, schools and fraternal organizations.

Proponents could exempt some things from their tax. But every time an exemption is granted, it will be necessary to hike the tax rate. And if the tax rate is too high voters will likely reject the new tax. That is why in many of the versions of the “fair tax” filed with the Secretary of State for circulation to voters the tax rate is capped at 7 percent. But the 7 percent tax rate will not replace current state revenue and will result in severe cuts in vital state services.