on consumer purchases of automobiles is clear. The automobile industry currently is struggling with stagnant demand, using rebates and other incentives to encourage consumer purchases. Those sales incentives would be totally offset by a new 30% tax on automobiles, a tax that would be in addition to any State or local sales tax. The Republican proposal would entail 'negative rebates' that would be at least $9,000 on a $30,000 automobile.

The new retail sales tax applies to both domestic and foreign produced cars. In that respect, it does not discriminate against U.S. producers. It would make all consumer purchases more expensive. However, the Republican retail sales tax has other features that would further weaken the competitiveness of U.S. manufacturers.

Unlike any State retail sales tax now in existence, the Republican proposal would impose a 30% tax on all purchases of health care, including employer-provided health care. Already, the cost of producing a car in the United States includes $1,200 of healthcare costs, costs not incurred when producing in other countries. The Republican sales tax bill would increase that competitive disadvantage by at least 30%.

Also, the Republican retail sales tax proposal would impose a 30% retail sales tax on gasoline. At current gasoline prices, it would be an additional 60-cent per gallon tax, none of which would be earmarked for transportation or highway projects. This increase in the price of gasoline would also work to disadvantage U.S. manufacturers because it would favor consumer purchases of smaller, typically imported cars.

B. Farms and Ranches

Farmers, ranchers, and other small businesses already pay significant amounts of State and local retail sales taxes. Unlike large businesses, they purchase many items at retail where the tax is collected. There are attempts to exempt business purchases, but there are administrative problems that make those attempts not totally effective. As a result, 20-40% of State and local retail sales taxes currently are attributable to business purchases.

H.R. 25 attempts to exempt business purchases, but there is no reason to believe that its exemption would be more effective than the current efforts to exempt business purchases from State and local retail sales taxes. As a result, farmers, ranchers, and other small businesses could face increased costs in the form of the new national retail sales tax.

As discussed above, the Republican national retail sales tax proposal could result in dramatic increases in State and local property taxes. Farmers and ranchers would be among those most apt to face those increased taxes.

C. Insurance Industry

There are two types of insurance: property and casualty insurance, and life insurance and annuity products.

The property and casualty insurance industry includes the sale of health insurance, homeowner's insurance, automobile liability insurance, and other liability or casualty coverage. It does not rely on income tax benefits for its sales. Individuals and businesses purchase the coverage because they choose to reduce their risk.

No State or local retail sales tax applies to purchases of property or casualty insurance. The imposition of a new Federal retail sales tax on those products would increase their cost, resulting in less insurance coverage. Many individuals may choose to go without insurance coverage because of the increased cost. There would be costs to the general society. For example, less health insurance coverage would mean more uncompensated care. Less hurricane coverage could increase the cost of disaster relief borne by the Federal Government.

The other types of insurance products, life insurance and annuity contracts, largely depend on current income tax benefits for their sale. The inside buildup on traditional life insurance contracts (i.e., the investment income earned on the cash surrender value) is not taxed to the policyholder or the company. Death benefits are exempt from tax. The income on deferred annuity contracts is tax-free during the accumulation period.

Simply repealing the current law tax benefits probably would eliminate much of the market for traditional life insurance or deferred annuity contracts. The Republican sales tax bill goes further than simply repealing current tax benefits. It also imposes a 30% retail sales tax on all fees, loads, or charges on those contracts. It is doubtful that those products could be sold with those taxes.

The insurance industry is both an important financial intermediary and a substantial source of employment. The industry sells various contracts that protect their policyholders by efficiently spreading the risks of economic loss. They also make the credit markets more liquid and efficient. As a result, harming the insurance industry could harm the economy by reducing the amount of efficient risk spreading and interrupting the normal flow of funds in the market.

Harming the insurance industry also would have large regional effects. Hartford, Connecticut advertises itself as the insurance capital of the world. If the Republican retail sales tax proposal became law, Hartford would need to find a new industry to employ its citizens.

D. Financial Services

H.R. 25 would impose a 30% retail sales tax on all implicit and explicit charges for financial services.

The explicit charges that would be subject to the tax include brokerage fees, transaction fees, and mutual fund management and sales fees. The impact on areas like New York, Connecticut, and others that have large financial service businesses could be dramatic. The cost of trading on the New York Stock Exchange would be subject to the new tax, trading offshore through foreign entities would not. The expenses of domestic mutual funds would be subject to the tax. There would be extraordinary incentives for individuals to invest through offshore entities.

E. Mail Order and Internet Sales

U.S. businesses engaged in sales of goods by mail order or internet would be required to collect the new retail sales tax on their sales. Mail order or internet sales operations overseas would not face that requirement. However, the U.S. purchaser theoretically would be required to pay the new retail sales tax on purchases overseas.

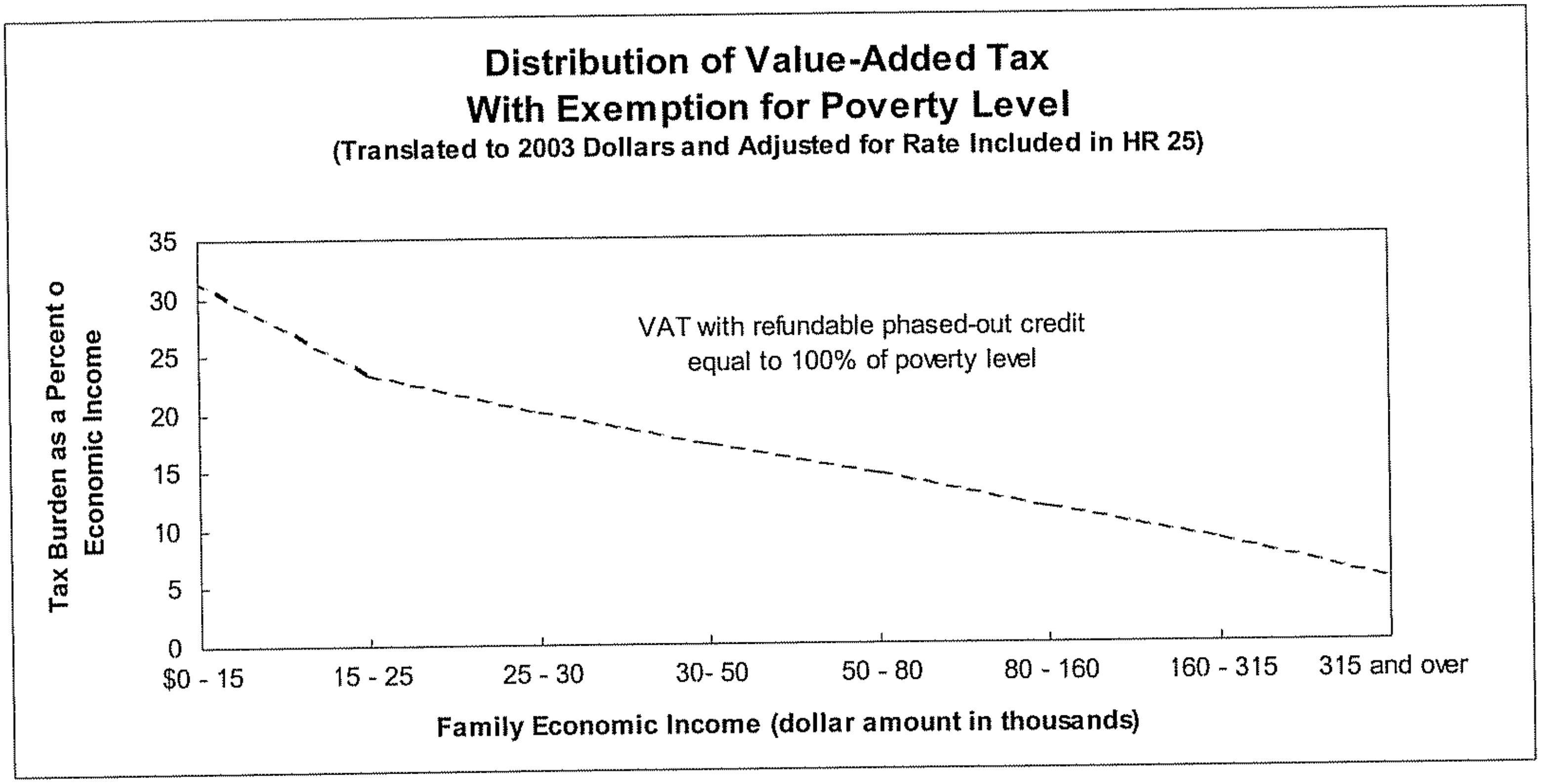
This is similar to what happens under State retail sales taxes. Operations with a physical presence in the State are required to collect the tax, otherwise, the tax is supposed to be paid by the consumer. States have had little success in collecting the tax from consumers. There is no reason to believe that the Federal government will be more successful in collecting tax on mail orders or internet orders shipped from overseas. Therefore, one could expect a quick shift of mail order and internet sales operations offshore.

F. Tourism

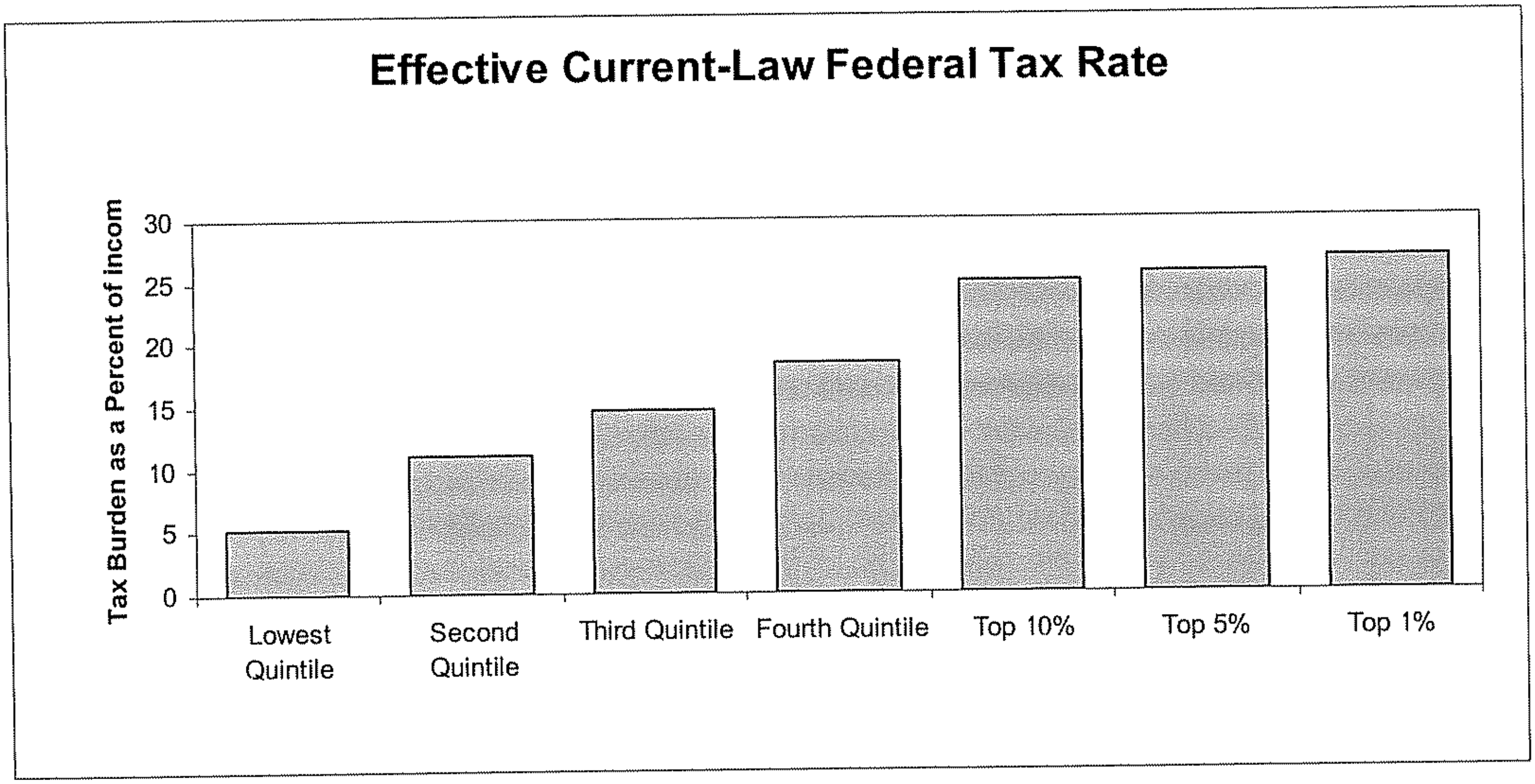
H.R. 25 would impose taxes on amounts paid for transportation within the United States, hotel accommodations, and other tourist-related expenses. It would also place significant taxes on gambling conducted in the United States. All of those taxes would be in addition to any State or local hotel taxes or other State or local taxes on the tourism industry.

The additional tax liabilities under H.R. 25 could create competitive problems for the U.S. tourism industry. For example, the entire cost of air travel in the United States would be subject to the new tax. The tax would apply to one-half of the cost of transportation that begins in the United States and ends overseas. For example, it may be cheaper to fly to the Bahamas from New York than to fly to Miami. Also, hotel taxes could be dramatically higher in the United States with the new sales tax than in foreign countries.

Appendix A



Source: Ways and Means Democratic Staff calculations based on analysis from "Tax Reform for Fairness, Simplicity, and Economic Growth," The Treasury Department Report to the President, November 1984.



Source: Congressional Budget Office, "Effective Federal Tax Rates Under Current Law, 2001 to 2014," August 2004. The figure uses rates applicable to 2004.

Appendix B

Size of Unfunded Mandate By State

(Dollar Amounts in Millions)

STATE	State's Direct Tax Liability Under Natl. Sales Tax	Potential Loss of State Income Taxes under Natl. Sales Tax	Total Potential Additional Budget Costs for State	Additional Budget Costs as % of Current Property Taxes
Alabama	4,980	2,449	7,430	504.2%
Alaska	1,802	269	2,071	249.6%
Arizona	5,607	2,437	8,044	189.1%
Arkansas	2,460	1,743	4,202	419.2%
California	50,497	38,380	88,877	294.0%
Colorado	5,652	3,681	9,333	224.2%
Connecticut	4,582	3,835	8,417	140.4%
Delaware	969	1,015	1,984	496.1%
DC	1,838	1,160	2,999	373.3%
Florida	18,707	1,219	19,926	126.5%
Georgia	8,792	7,056	15,847	238.7%
Hawaii	1,695	1,164	2,859	464.9%
Idaho	1,277	919	2,196	229.1%
Illinois	14,171	8,855	23,026	145.1%
Indiana	6,233	4,831	11,063	185.1%
Iowa	3,262	1,903	5,165	179.5%
Kansas	2,782	1,977	4,759	188.5%
Kentucky	4,184	3,798	7,982	403.8%
Louisiana	4,697	2,053	6,751	347.9%
Maine	1,522	1,150	2,672	139.7%
Maryland	5,601	8,004	13,604	251.4%
Massachusetts	8,456	8,725	17,181	197.0%
Michigan	10,961	8,663	19,624	200.4%
Minnesota	6,974	5,977	12,951	248.4%
Mississippi	3,102	1,181	4,283	260.1%
Missouri	5,491	4,229	9,720	250.5%
Montana	927	586	1,512	177.4%
Nebraska	2,323	1,261	3,584	204.9%
Nevada	2,532	0	2,532	148.8%
New Hampshire	1,120	449	1,569	72.3%
New Jersey	10,120	7,969	18,089	112.7%
New Mexico	2,086	1,107	3,194	422.5%
New York	35,267	35,283	70,551	263.0%
North Carolina	9,077	7,933	17,010	313.7%
North Dakota	742	250	992	186.3%
Ohio	12,537	12,555	25,092	235.7%
Oklahoma	3,448	2,460	5,907	398.6%
Oregon	4,789	3,871	8,660	275.9%
Pennsylvania	14,395	10,708	25,104	230.1%
Rhode Island	1,280	852	2,132	145.8%

South Carolina	4,756	2,509	7,265	234.6%
South Dakota	738	41	779	116.6%
Tennessee	7,112	649	7,761	224.8%
Texas	20,250	0	20,250	82.6%
Utah	2,564	1,716	4,280	301.5%
Vermont	684	445	1,129	137.1%
Virginia	7,070	7,020	14,090	210.0%
Washington	8,807	0	8,807	152.1%
West Virginia	1,787	1,255	3,042	337.6%
Wisconsin	6,159	5,419	11,578	179.1%
Wyoming	776	0	776	112.1%
TOTAL	347,643	231,010	578,653	

Source: Ways & Means staff computations (D. Rogers), from Census data for 2001-02 (http://www.census.gov/govs/www/estimate02.html)

Appendix C

Following are two examples showing the difference between the current law income and payroll tax liability and the amount of the sales tax liability that would be imposed under H.R. 25. The examples use a families with 2 young children, and owning a home with mortgage debt of $200,000 ($250,000 in the second example) with an interest rate of 6%. The example assumes that the sales tax will be passed on in the form of higher prices to consumers.

The examples also assume that the family has significant annual savings that are done through a 401(K) plan. They also assume that the family has approximately $10,000 in pre-tax health benefits, including the employee and employer share of health insurance, and out-of-pocket expenses utilizing flexible spending arrangements.

The examples are based on what would happen in a State like Texas of Florida that does not have an income tax. The results would not be much different in States with income taxes.

The examples are extremely conservative in that they use the tax rate contained in H.R. 25, even though that rate would not get anywhere close to replacing current law revenues. They assume that the home was purchased without the new sales tax and that the family does not incur any debt for consumer purchases.

Example 1

	Current Law	**H.R. 25**
1. Overall Income	$65,000	$65,000
2. Tax-exempt Fringe Benefits		
a. Health Care ($10,000)	– $10,000	(included, since health care is subject to tax)
b. 401(K) plan ($10,000)	– $5,000	– $5,000 (saved income is exempt)
3. Adjusted Gross Income	$50,000	N/A
4. Allowable Deductions		
a. Personal Exemptions	– $12,500	N/A
b. Home Mortgage Interest	– $12,000	– $8,000 (approximately 1/3 of mortgage interest expense is subject to the retail sales tax)
c. Real Property Taxes	– $5,000	(included because taxed at State level)
d. Charitable Contributions	– $1,000	– $1,000
5. Taxable Income	$19,500	N/A
6. Pre-Credit Income Tax	$2,210	N/A

7. Per Child Credit	– $2,000	N/A
8. Final Income Tax Liability	$210	N/A
9. Payroll Tax Liability	$4,207 (6.2% of $55,000 + 1.45% of $55,000)	
10. Taxable Consumption Expenditures before Low-Income Exemption	N/A	$51,000
11. Exemption for Poverty Level	N/A	$19,000
12. Total Consumption Expenditures Subject to Retail Sales Tax	N/A	$32,000
TOTAL LIABILITY	$4,417 (which is the sum of the net income tax liability and the payroll tax liability)	$9,600 (computed at the 23% tax-inclusive rate included in H.R. 25)

Example 2

	Current Law	H.R. 25
1. Overall Income	$130,000	$130,000
2. Tax-exempt Fringe Benefits		
a. Health Care ($10,000)	– $10,000	(included, since health care is subject to tax)
b. 401(K) plan ($10,000)	– $10,000	– $10,000 (saved income is exempt)
3. Adjusted Gross Income	$110,000	N/A
4. Allowable Deductions		
a. Personal Exemptions	– $12,500	N/A
b. Home Mortgage Interest	– $15,000	– $10,000 (approximately 1/3 of mortgage interest expense is subject to the retail sales tax)
c. Real Property Taxes	– $6,000	(included because taxed at State level)
d. Charitable Contributions	– $1,000	– $1,000
5. Taxable Income	$75,500	N/A
6. Pre-Credit Income Tax	$12,350	N/A

7. Per Child Credit	– $2,000	N/A
8. Final Income Tax Liability	$10,350	N/A
9. Payroll Tax Liability	$7,045 (6.2% of $87,900 + 1.45% of $110,000)	
10. Taxable Consumption Expenditures before Low-Income Exemption	N/A	$109,000
11. Exemption for Poverty Level	N/A	$19,000
12. Total Consumption Expenditures Subject to Retail Sales Tax	N/A	$90,000
TOTAL LIABILITY	$17,395 (which is the sum of the net income tax liability and the payroll tax liability)	$27,000 (computed at the 23% tax-inclusive rate included in H.R. 25)