

A Tax on Survival: Grocery Tax Policies in America

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No matter how much or how little money we have, we all have to eat to live. But the share of earnings that people must devote to securing basic survival is not the same for everyone. Food takes a much bigger bite out of the household budget for low-income families than for richer ones, and **sales taxes** on groceries thus hit harder at lower incomes. In recognition of this fact, most states either have exempted groceries from state sales taxes entirely or have devised ways to help offset grocery taxes for low-income people.

Alabama is one of only two states that offer no tax break on groceries. That remains the case despite a growing national trend against applying the full sales tax to food for home consumption. This fact sheet will consider the effects of grocery taxes on low-income households and examine the ways that Alabama could reduce or eliminate its sales tax on groceries.

What taxes mean at different income levels

Taxes are the tools that Americans use to pay for education, public health, transportation and other public structures. States differ, though, in both the scale of services and how to pay for them. Some states lean on **property taxes** to fund public services, while others rely more on sales taxes or **income taxes**. Some states have only one or two of these basic taxes.

Taxes are considered regressive, flat or progressive according to their impacts at various income levels. **Regressive taxes** take a bigger share of income from people who make less than from people who make more. **Flat taxes** require all people to pay the same share of income, no matter how much or how little they make. **Progressive taxes** require high earners to pay a bigger percentage than people who make less.

Sales taxes are very regressive because low-income people must spend most of what they make just to maintain a minimal standard of living. Property taxes are mildly regressive because they do not respond to income changes and because homes account for a larger share of wealth for low- and middle-income households than for the rich. Income taxes often are designed to be progressive. Alabama's income tax looks progressive on paper but is effectively flat in practice because the top rate kicks in quickly.

Keywords

excise tax – a special sales tax on a particular type of product, such as alcohol, tobacco or gasoline.

flat tax – a tax levied at the same rate on all income levels, no matter how much or how little people make.

income tax – a tax on earned income (salaries or wages) and unearned income (dividends, interest, etc.).

progressive tax – a tax that requires people who make more money to pay a bigger share of their income than those who make less money.

property tax (also called *ad valorem tax*) – a tax levied by state or local governments on the assessed value of real estate and certain other property.

regressive tax – a tax that requires people who make less money to pay a bigger share of their income than those who make more money.

sales tax – a tax levied by a state or locality on the retail price of an item, collected by the retailer.

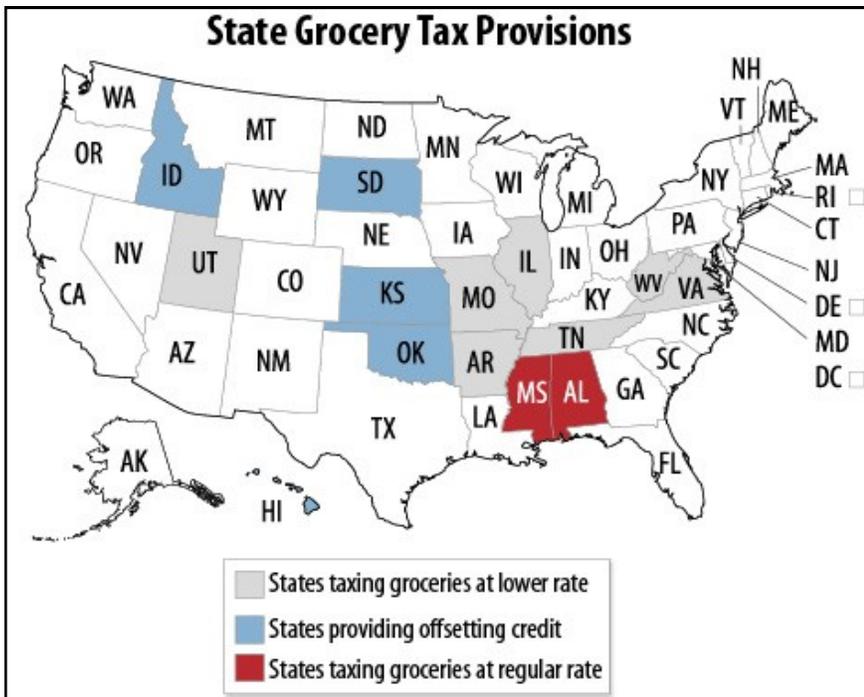
Alabama is widely known as a “low-tax state,” but taxes are not low for everyone. High sales taxes, low property taxes and an effectively flat income tax add up to a tax system in which low- and middle-income Alabamians pay more than twice the share of their income in overall state and local taxes that those with the highest incomes do, according to a 2009 study by the Institute on Taxation and Economic Policy (ITEP). The bottom fifth of Alabama's earners pay 10.2 percent of their income in state and local taxes, ITEP found, while the middle fifth pay 9.5 percent. By contrast, the top 1 percent of earners – those who made at least \$384,000 in 2007 – pay an effective 4 percent share after they deduct state taxes from their federal income taxes.

Grocery taxes hit hard at low incomes

High sales taxes, especially on groceries, are a key reason Alabama's state and local taxes are more regressive than the national average. The state constitution makes it hard for counties to increase property taxes, so local leaders seeking new revenue often have little choice but to raise sales taxes. Alabama's statewide rate is 4 percent, but local taxes have driven the total rate to 10 percent in Birmingham and Montgomery.

Sales taxes are especially regressive in Alabama because they apply to many kinds of spending that are not optional. All families must have necessities like food, clothing and furniture, all of which are subject to sales tax in Alabama. A gallon of milk plus sales tax costs the same for a family at the poverty line as for a millionaire. But that sales tax makes up a much larger share of income – and has a greater effect on the household’s standard of living – for a low-income family than for a richer one. Because low-income Alabamians must spend a much larger share of what

States offer numerous systems to reduce or end grocery taxes. Full exemption ensures an immediate tax break on groceries for all state residents, including low-income families. (Purchases with food stamps are not taxed, but many eligible families do not apply, and food stamps cover only a portion of costs for most of those who do.) Critics say full exemption is costly and poorly targeted, however, with out-of-state shoppers able to benefit and with most benefits going to middle-income and rich taxpayers. A reduced tax rate is less costly to states but also offers less relief to consumers.



SOURCE: Center on Budget and Policy Priorities, 2009

Grocery tax refunds or credits for low-income taxpayers ensure tax breaks go only to residents and limit the benefits to those who need them most. But credits in many states offset only part of the grocery taxes that a low-income family pays in a year, and they do not offer immediate relief. Credits also go only to eligible taxpayers who apply for them, meaning grocery tax relief may not reach everyone who needs it.

Some critics of exempting groceries from sales tax question how states can replace the revenue. Some tax experts say grocery taxes make sales tax revenue less volatile, because people still must buy food no matter how bad the economy gets. But other analysts say states could more than recoup the revenue lost to a grocery tax exemption by expanding sales taxes to services,

they make on groceries than people with higher incomes do, the state’s grocery tax disproportionately affects households struggling to stay afloat.

Options to reduce or end the grocery tax

Alabama and Mississippi are the last of a dying breed: states that fully tax groceries with no rebate or discount. Nationwide, 36 states and the District of Columbia completely exempt most food for home consumption from state sales tax. (Six states, including Georgia and Louisiana, have enacted full sales tax exemptions for groceries in the last decade and a half.) Seven states tax food at a lower rate, while five states apply the full sales tax to groceries but provide tax credits or partial refunds to help offset the taxes for low-income people. Local governments also do not tax groceries in most states with a full exemption, though Georgia and Louisiana are among the exceptions.

Internet sales and other fast-growing sectors. Those changes also could make state sales taxes mildly more progressive. Alabama lawmakers in past years have proposed another replacement revenue source: ending or limiting the state income tax deduction for federal income taxes, which only two other states offer in full. The top fifth of Alabama earners receive 81 percent of the deduction’s total value, a 2011 ITEP study found.

Whatever the model, Alabama could join the 48 other states that give a break on grocery taxes. A grocery tax cut would make our tax system more progressive and remove Alabama from the short list of states that tax one of the basics of survival.

For more information on state grocery tax policies, see Should States Tax Food? Examining the Policy Issues and Options, a report by Nicholas Johnson and Iris J. Lav of the Center on Budget and Policy Priorities, at www.cbpp.org/files/stfdtax98.pdf.

This fact sheet was prepared by policy analyst Chris Sanders. It may be reproduced with acknowledgment of Arise Citizens’ Policy Project, Box 1188, Montgomery, AL 36101; (800) 832-9060; arisecitizens.org.