

**HOW**

**Alabama**

**TAXES**

**COMPARE**

*How Alabama Taxes Compare*

December 2017

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Senior Research Associate

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## Our Mission

Alabamians want similar things: good schools, safe neighborhoods, a strong economy, freedom, equality, and opportunity, but we often disagree about the best way to achieve these goals. We resolve these disagreements through healthy debate and negotiation, which requires accurate and unbiased information. PARCA exists to provide this information.

### WHO WE ARE

The Public Affairs Research Council of Alabama is a 501(c)(3) nonprofit organization working to inform and improve state and local government, schools, and nonprofits through independent, objective, nonpartisan research and analysis.

### WHAT WE DO

**Data Analysis:** Data should be a flashlight, not a hammer. PARCA provides complex data analysis to illuminate opportunities and improve outcomes.

**Research and Recommendations:** Numbers may tell what, but they don't tell why. PARCA seeks to understand what is working, what is not working, and what changes might be feasible.

**Performance Evaluation:** Trying hard is not enough. PARCA works with nonprofits, schools, and government agencies to define goals, measure accomplishments, and identify areas for improvement.

**Implementation Services:** Policies and programs are only as good as their implementation. PARCA works with administrators to design and implement evidence-based solutions.

### WHERE WE WORK

PARCA focuses on issues impacting Alabama's state and local governments, education and workforce development, and quality of life.

#### State and Local Government

- Analysis of proposed amendments to Alabama's Constitution.
- Comparative studies of Alabama's budgets and taxes.
- Comparative studies of municipal finances.
- SMART budgeting analysis for cities and counties.

#### Education and Workforce Development

- Studies of Alabama's Pre-K program.
- Deep dives into school systems' performance.
- Audits of school systems' administrative practices and procedures.
- Long-form research in partnership with the Business Education Alliance.

#### Quality of Life

- Comparative studies of infrastructure and the built environment.
- Research in health, poverty, community wellbeing.
- Community Vitality Indexes.
- Program evaluations of local nonprofits and social services providers.



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## Introduction

Since late 1988, the Public Affairs Research Council of Alabama has produced an analysis of Alabama's tax revenues. Relying on the U.S. Census Bureau's annual survey of state and local governments across the country, we are able to determine how Alabama taxes and revenue compare to other states. In the analysis, state and local spending are considered together, because states vary greatly in how they divide up the responsibilities for funding government services. This report considers data from 2015, the most recent year available.

Alabama's state and local governments collect less in taxes than state and local governments in any other state in the union.

This has been a basic fact of life in this state since the early the 1990s. It lies at the root of our perpetual struggles to balance state budgets. It underlies the difficulties we face

when trying to provide to our citizens the level of government services enjoyed by citizens in other states.

As a bottom line, Alabama governments have less tax money available finance the operation of services like schools, roads, courts, health care, and public safety.

<b>Alabama's U.S. Rank on Per-Capita Tax Collections, 2015</b>	
<b>State and Local Tax Sources</b>	<b>Alabama's Rank Among U.S. States</b>
<b>Property</b>	<b>50</b>
<b>Sales and gross receipts (total)</b>	<b>30</b>
<b>General sales</b>	<b>31</b>
<b>Selective sales</b>	<b>20</b>
<b>Motor fuel</b>	<b>27</b>
<b>Alcoholic beverage</b>	<b>3</b>
<b>Tobacco products</b>	<b>42</b>
<b>Public utilities</b>	<b>5</b>
<b>Other selective sales</b>	<b>29</b>
<b>Individual income</b>	<b>36</b>
<b>Corporate income</b>	<b>35</b>
<b>Motor vehicle license</b>	<b>44</b>
<b>Other taxes</b>	<b>28</b>
<b>All Taxes (total)</b>	<b>50</b>

### Alabama’s Taxes and Revenues Compared

In 2015, Alabama state and local governments collected a total of \$15 billion in taxes, or \$3,144 per resident. Across the U.S., the median value for state and local taxes per capita was \$4,379.

Thus, the median state had a per capita tax advantage of \$1,235 over Alabama. In other words, if Alabama collected taxes at the per capita rate of the median state, local and state governments here would have an additional \$6 billion to spend building and maintaining roads; providing police and fire protection; operating civil and criminal courts; supporting schools and colleges; libraries and parks; and the myriad of other functions governments perform.

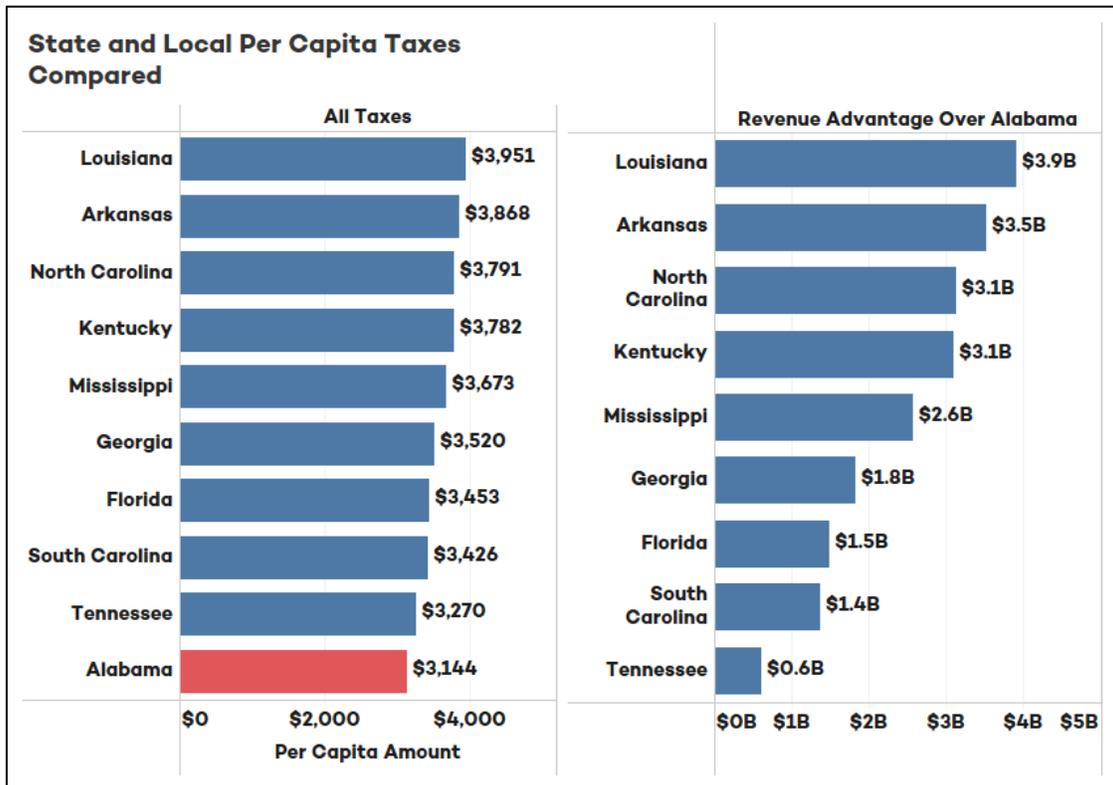
National comparisons aren’t always convincing because of regional economic differences. But Alabama stands out even in the Southeast.

Figure 1 presents two sets of calculations. On the left, the Southeastern states are compared and ranked on their total state and local tax collections divided by their populations, producing a total for tax collections per capita.

Alabama ranks at the bottom. The state closest to Alabama in terms of per capita tax collections is Tennessee, which collects \$126 dollars more per resident than Alabama. The top Southeastern state in terms of taxes per capita is Louisiana, which collects \$809 more per resident than Alabama.

The chart on the right illustrates the tax revenue advantage governments in the region enjoy over Alabama.

Figure 1. State and Local Taxes Per Capita, Source: U.S. Census Bureau, PARCA calculations.



## HOW ALABAMA TAXES COMPARE

This advantage results from the difference between Alabama's per capita tax collections and those of the other states. That per capita advantage over Alabama is then multiplied by Alabama's population.

If Alabama collected taxes at the same per capita rate as Tennessee, governments here would have an additional \$600 million to work with.

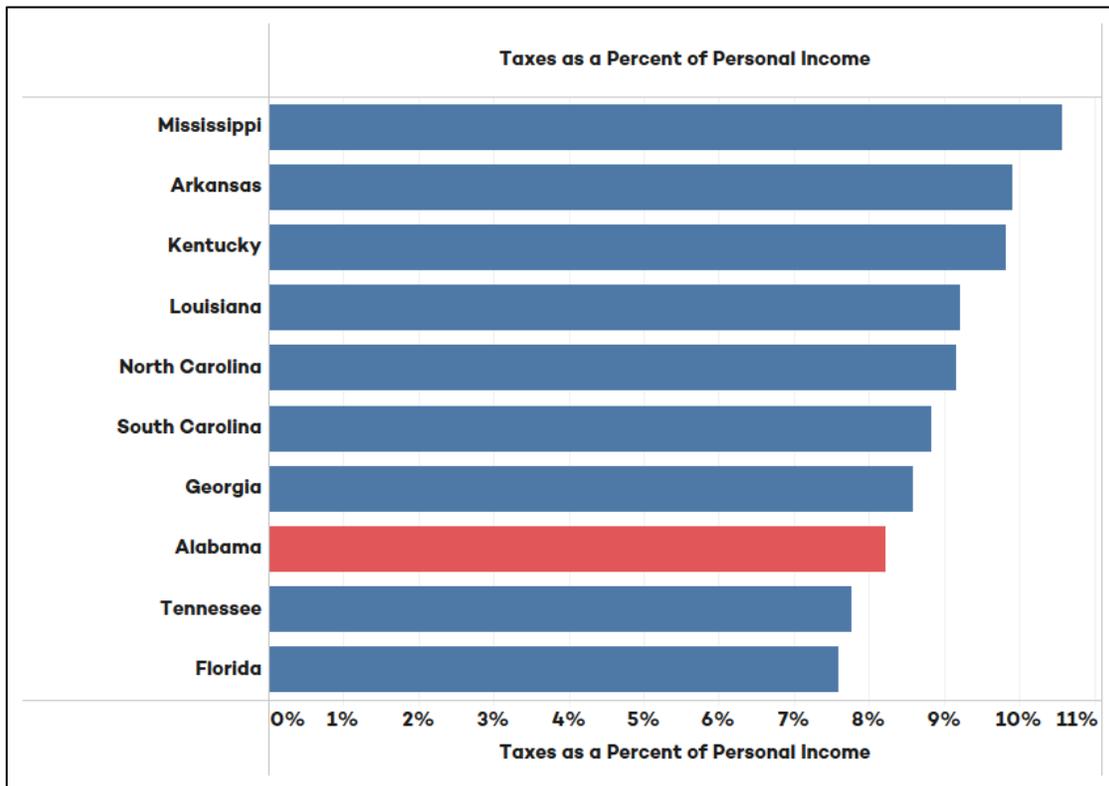
At Mississippi's per capita rate, Alabama would have \$2.6 billion more to spend. At North Carolina's per capita rate, Alabama state and local governments would have an additional \$3.1 billion to spend providing services.

### Tax Burden Per Capita

Our lowest-in-the-nation ranking in revenue results from two primary factors: tax rates that are lower than most other states and a base of wealth that is smaller than most other states.

Comparing total personal income to total state and local taxes collected, Alabama ranks No. 46 in the country, with state and local tax collections amounting to 8.2 percent of the total personal income earned by state residents.

Figure 2. Taxes vs. Income, 2015. Source: Census Bureau and U.S. Bureau of Economic Analysis<sup>1</sup>



<sup>1</sup> U.S. Bureau of Economic Analysis, "SA1 Personal Income Summary: Personal Income," Retrieved November 1, 2017, from <https://www.bea.gov/iTable/iTableHtml.cfm?reqid=70&step=1&isuri=1>

## HOW ALABAMA TAXES COMPARE

On this measure, the only Southeastern states that rank behind Alabama are Florida (7.6 percent) and Tennessee (7.8 percent).

Both have higher total personal income per capita than Alabama, allowing them to collect less as a percent of total personal income and still yield far more in taxes on a per capita basis.

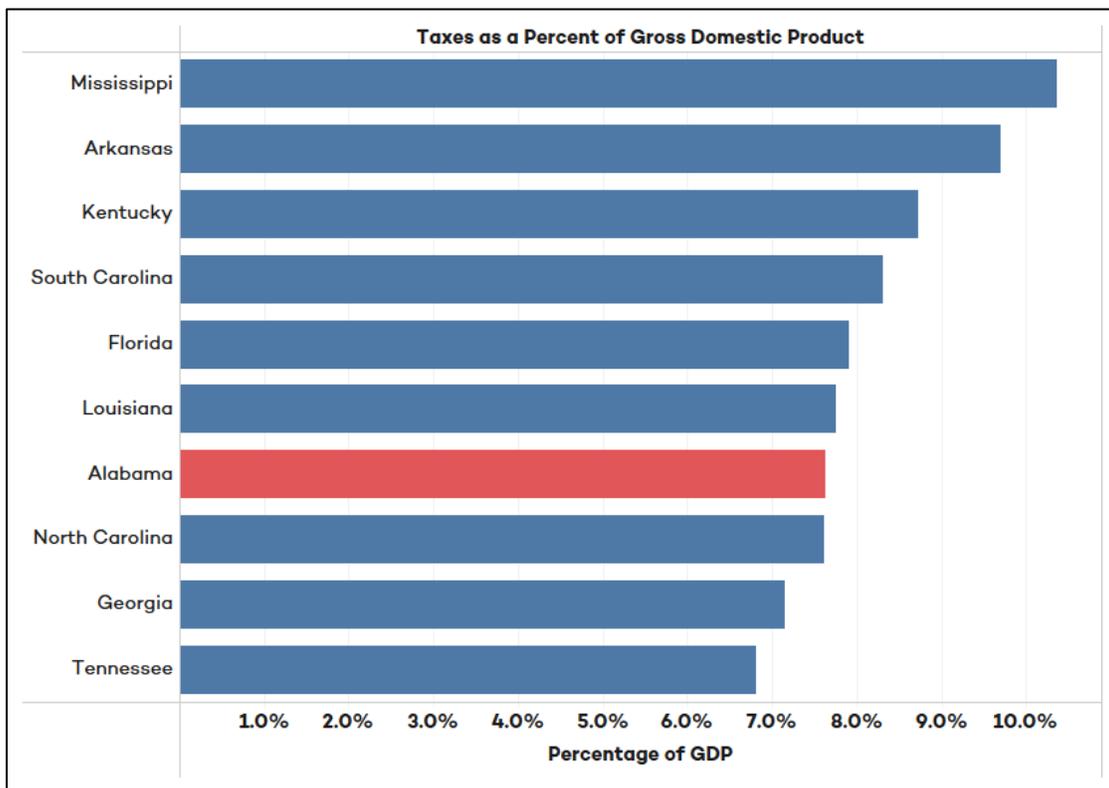
Mississippi's total personal income is lower than Alabama's, but its state and local government tax collections equaled 10.6 percent of Mississippi's total personal income for 2015. Because of that greater tax effort, Mississippi state and local governments have more to spend on a per capita basis than those in Alabama.

### Tax Burden as a Percent of GDP

Another way of measuring the tax burden is to calculate tax collections as a percent of each state's gross domestic product (GDP), a measure of economic output.

Alabama tax collections amount to 7.5 percent of its GDP. The U.S. average for state and local taxes as a percent of GDP is 8.7 percent.

**Figure 3. Taxes as a Percentage of GDP, 2015. Source: U.S. Census Bureau and U.S. Bureau of Economic Analysis<sup>2</sup>**



<sup>2</sup> U.S. Bureau of Economic Analysis, "Gross domestic product (GDP) by state, 2015." Retrieved November 1, 2017, from <https://www.bea.gov/iTable/iTableHtml.cfm?reqid=70&step=1&isuri=1>

## HOW ALABAMA TAXES COMPARE

As with the personal income measure, states like North Carolina, Georgia, and Tennessee have a higher level of economic output than Alabama on a per capita basis. Thus, those states can tax a lower percentage of economic activity and still yield a much higher amount in taxes per capita.

### What We Choose to Tax

While a state’s tax base and its tax rates are primary drivers of the total revenue collected, a state’s tax system is also affected by the mix of taxes it chooses to apply.

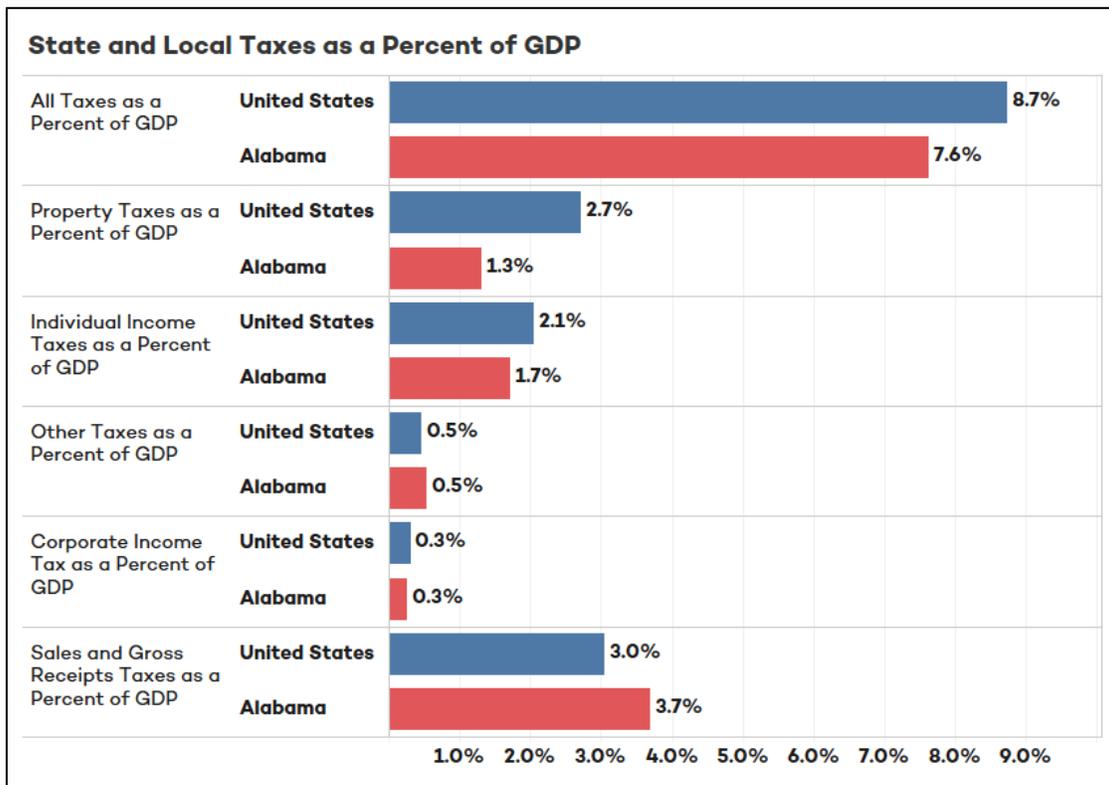
Every state has a unique blend of taxes. Most states depend on some combination of the three principal tax sources: income, property value, and sales transactions (what we earn, own, and buy).

A tax system that is balanced among these three sources promotes fairness and stability.

Alabama’s tax system is not balanced.

Figure 4 compares Alabama’s tax mix as to that of the average U.S. state. The relative share of each tax is expressed as a percentage of GDP. Alabama’s overall tax burden is lighter, a smaller share of GDP than the average U.S. state.

**Figure 4. Taxes and Gross Domestic Product, 2015.** Source: U.S. Census Bureau and U.S. Bureau of Economic Analysis.



Property taxes are particularly low. As a percentage of GDP, Alabama’s property taxes equal only 1.3 percent of GDP, compared to 2.7 percent in the average state. Alabama’s per capita property tax collections could be doubled and still be below the U.S. average.

## HOW ALABAMA TAXES COMPARE

Alabama personal income taxes are also lower than the national average, while corporate income and other taxes are roughly equivalent to those in other states, in terms of percentage of GDP.

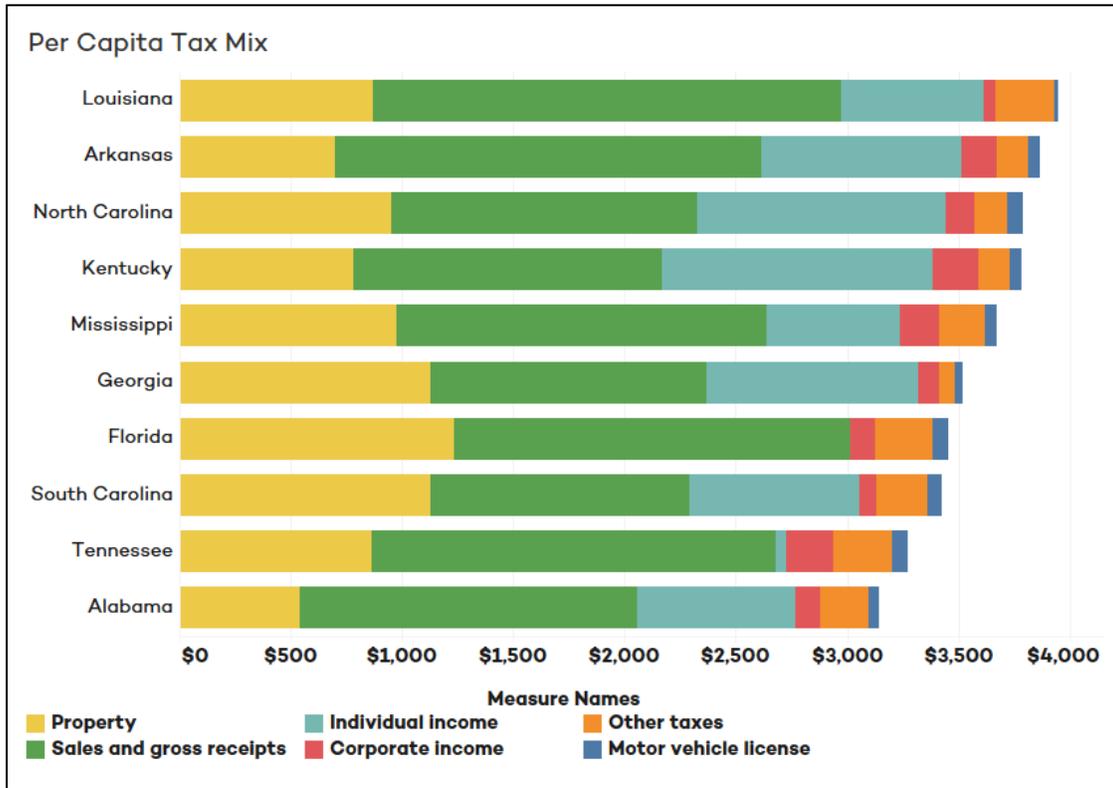
Alabama’s sales and gross receipts tax, on the other hand, is a higher share of GDP than in the average state, indicating that Alabama depends more heavily on the sales taxes to produce tax revenue than most states.

Figure 5 compares Alabama’s state and local tax mix with other Southeastern states, expressed on a per capita basis. The chart shows the different mix of taxes each state uses to produce total state and local tax revenues.

Alabama’s bar is shorter than those of any other state, reflecting lower per capita tax collections overall. Its lowest-in-the-nation per capita property tax collections are also apparent in the comparison.

Meanwhile, other states exhibit their own unique mixes. Florida does not have an income tax but makes up for it with high property and sales tax collections per capita. Tennessee also has only a minimal income tax but makes up for it with higher property, sales, and corporate income tax collections.

**Figure 5. Taxes Per Capita in the Southeast, by tax source. Source: US. Census Bureau, PARCA Calculations.**



### The Tax Mix: A Balancing Act

Although Alabama collects less in state and local taxes per resident than any other state, that doesn't guarantee low taxes for all. Because of the imbalance in the tax structure, taxes fall more heavily on some groups than others.

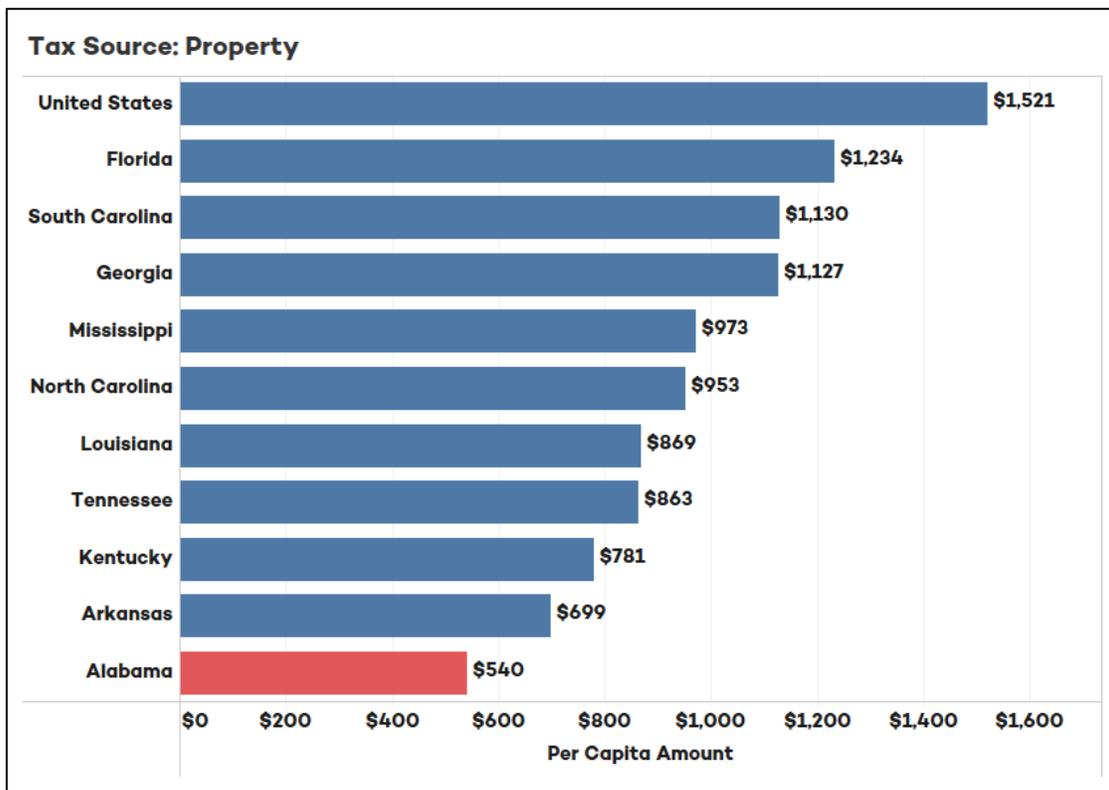
A sound tax structure avoids placing too heavy a burden on any particular group. Most states take measures to protect households with low incomes from taxation in hopes of encouraging economic advancement.

As lawmakers consider options for adding tax revenue, questions of balance and fairness should be considered.

### Property taxes

Alabama's low property taxes primarily benefit those who own homes, farms, and timberland.

Figure 6. Per Capita State and Local Property Tax Collections, 2015. Source: U.S. Census Bureau, PARCA calculations.



Those properties are taxed on just 10 percent of their value. That assessment is further reduced through homestead exemptions and valuations based on the current use of the property rather than current market rates.

Meanwhile, taxes on commercial and industrial property are double that of residences or farms because that property is taxed on 20 percent of its value. Property owned by utilities is taxed on 30 percent of its value, three times the rate of residential or agricultural property.

## HOW ALABAMA TAXES COMPARE

Under the current system of property classification, an increase in property taxes would be borne more heavily by businesses and utilities. Increases would also likely be passed along to consumers and to renters, since apartments are considered commercial property. And higher tax bills for utilities would likely be passed along to rate payers.

Property taxes are hard to change in Alabama. Caps on property taxes have been placed in the Alabama Constitution, and any change to property tax rates requires approval not just from the Legislature, but also by a vote of the people.

### Sales Tax

Partly because of the difficulty of raising property taxes, Alabama state and local governments have developed a heavy reliance on the sales tax.

Alabama's rates are among the highest in the country. And unlike many other states, Alabama's sales tax applies to groceries and medications. Alabama is one of three states that continue to apply their sales tax fully to food purchased for home consumption without providing any offsetting relief for low- and moderate-income families.<sup>3</sup>

Because low- and moderate-income families spend a greater share of their incomes on basic necessities, a greater share of those families' incomes go to paying state and local taxes.

Alabama's high sales taxes contribute to the regressive nature of our tax structure. According to an analysis by the Institute on Taxation and Economic Policy, Alabama's tax system is the 12<sup>th</sup> most regressive state and local tax system in the nation.<sup>4</sup> Under a regressive tax system, the poor pay a greater share of their income in taxes than the wealthy.

Despite high sales tax rates, Alabama's per capita state and local sales tax collections rank 30<sup>th</sup> among the 50 states. Alabama's sales taxes are not as productive, because of the smaller tax base of economic activity and because Alabama's sales tax is narrow in comparison to most states.

Alabama applies its tax to almost all sales of goods, but it does not apply the tax to most kinds of business, professional, computer, personal, or repair services. In recent decades a greater share of economic activity has shifted toward consumption of such services. According to a survey conducted by the Federation of Tax Administrators, Alabama taxes 37 out of 168 categories of services.<sup>5</sup> The median state applies the sales tax to 55 different services.

Other states also allow more forms of gambling than Alabama and apply a tax to that activity bolstering the sales and gross receipts taxes in those states.

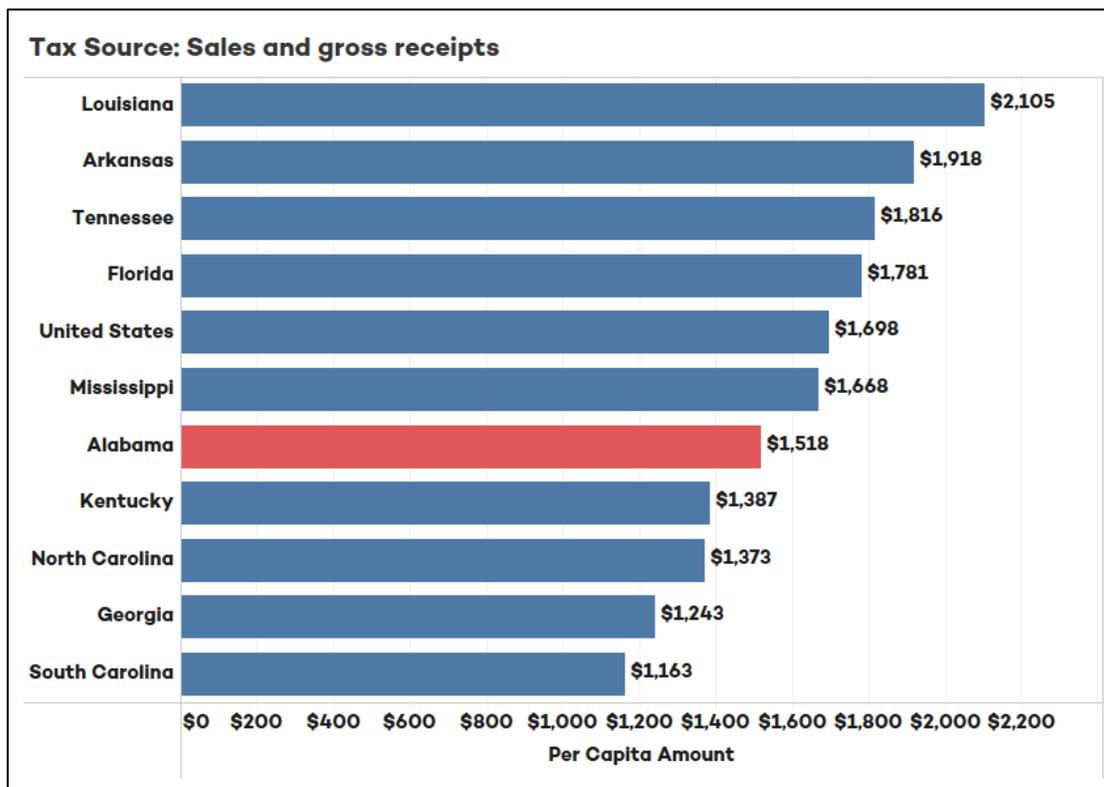
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<sup>3</sup> Figueroa, E., & Waxman, S. (2017, March 1). Which States Tax the Sale of Food for Home Consumption in 2017? Retrieved Nov. 30, 2017, from <https://www.cbpp.org/sites/default/files/atoms/files/3-16-06sfp3.pdf>

<sup>4</sup> Davis, C., Davis, K., Gardner, M., Heimovitz, H., Johnson, S., McIntyre, R. S., . . . Wiehe, M. (2015, January). Who Pays? 5th Edition: Alabama. Retrieved November 30, 2017, from <https://itep.org/whopays/alabama/>

<sup>5</sup> Minnick, R. (2008, July. Revised 2010). Sales Taxation of Services, Retrieved November 20, 2017, from <https://www.taxadmin.org/sales-taxation-of-services>

Figure 7. Per Capita Sales and Gross Receipts, 2015. Source: U.S. Census Bureau, PARCA calculations.



States, including Alabama, have been pursuing a variety of options for broadening the sales tax to capture the sales activity now being transacted on the Internet. Those transactions have, up to now, been generally off-limits to taxation. However, as internet sales constitute a greater share of economic activity and siphon business from traditional retailers, efforts to extend the reach of the sales tax to the Internet are continuing.

### Selective Sales Taxes

When searching for tax revenue, Alabama governments sometimes turn to selective sales taxes to avoid passing a general tax increase.

As an example, Alabama ranks high in per capita collections of taxes on alcoholic beverages (No. 3 in the U.S.) and on public utilities (No. 5 in the U.S.).

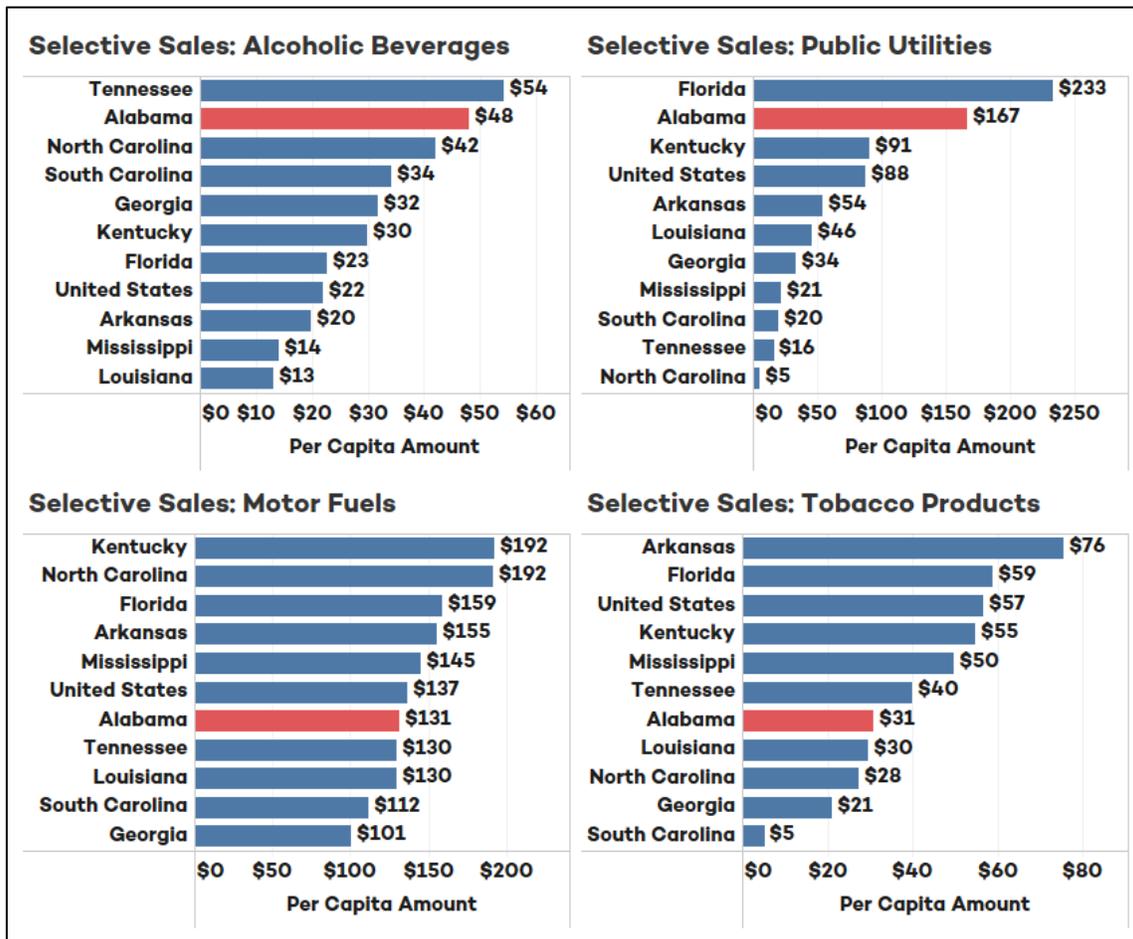
Alabama ranks in the middle of states when it comes to per capita tax collections on motor fuel. Alabama’s fuel tax rates are relatively low, but the state enjoys a high volume of pass-through traffic which boosts per capita collections.

In 2015, per capita revenue on tobacco products remained relatively low (No. 42 in the U.S.).<sup>6</sup> However, Alabama’s 25 cent per pack increase in cigarette taxes, which occurred in 2015,

<sup>6</sup> Scarboro, M. (2017, September 19). How High Are Cigarette Taxes in Your State?, Retrieved November 30, 2017, from <https://taxfoundation.org/state-cigarette-taxes/>

should raise the state’s ranking in future comparisons. Nonetheless, Alabama’s per pack tax rate is still ranked 39<sup>th</sup> in the nation, according to the Tax Foundation.

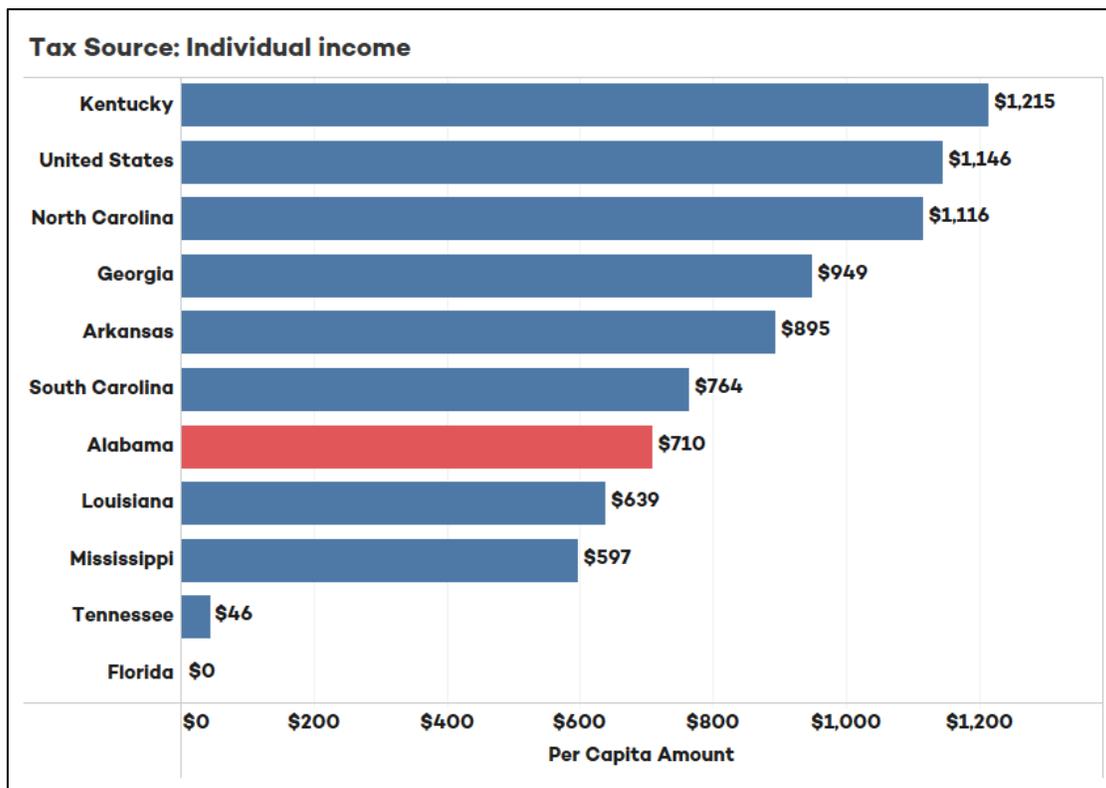
Figure 8. Per Capita Selective Sales Collections, 2015. Source: U.S. Census Bureau, PARCA calculations.



## Income Taxes

In 2015, Alabama’s income tax revenue per capita ranked 36th out of the 43 states that collect income taxes.

**Figure 9. Per Capita Income Tax Collections, 2015.** Source: U.S. Census Bureau, PARCA calculations.



In many states, the income tax is progressive, applying a higher rate to more affluent taxpayers and serving as a balance against the regressive nature of other taxes.

However, in Alabama several features of the tax work to prevent this. Alabama’s threshold for taxing income is the lowest in the nation. Most states set a higher income threshold than Alabama in order to allow poor households to keep more of the money they earn.

In Alabama, a family of four begins paying income taxes on anything earned over \$12,600. And the state’s top tax bracket, 5 percent, kick in at \$5,000 in earnings beyond exemptions and deductions.

Meanwhile, Alabama allows taxpayers to deduct the full amount they pay in federal income taxes. Since upper income tax payers pay a greater percentage of income in federal taxes, those higher earners get a larger break on Alabama income taxes.

The income tax rate and the deductibility of federal income taxes are both embedded in the Alabama Constitution, so any change to the rate would require an amendment to the constitution.

## HOW ALABAMA TAXES COMPARE

However, other state income tax deductions can be changed legislatively. Eliminating certain deductions or diminishing their value for those with high incomes would be one approach to increasing revenue generated by the state income tax.

### **Conclusion**

As the state's political leadership continues to grapple with how to pay for prisons, roads, health care and education, they need to keep three questions in mind:

1. Is the tax system adequate to provide the level of service and investment needed to make Alabama a competitive state?
2. Is the tax system equitable, fairly spreading the burden of paying for needed services and encouraging economic independence and advancement?
3. Is the tax system efficient in providing stable and sustainable revenue without imposing undue burden and complexity?





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