

HOW

Alabama

TAXES

COMPARE

2018

How Alabama Taxes Compare

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Alabamians want similar things...

...good schools, safe neighbourhoods, 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.

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PARCA works to inform and improve the decision making of state and local leaders in Alabama through objective research and analysis.

PARCA's Values

- Alabama can do better.
- Alabama's state and local governments play a vital role.
- Sound public policy requires open, transparent and responsive government.
- Sound public policy is based on fact, pursues a clear goal, and is assessed honestly.

PARCA's Areas of Focus

Government Structure and Performance • Public Education • Public Finance • Workforce Development

PARCA's Services

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.

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

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Contents

Introduction.....1

Alabama’s taxes and revenues compared to other states.....3

Why are our taxes low on a per capita basis?.....5

 Taxes as a Percentage of Personal Income.....5

 Tax Burden as a Percent of GDP..... 6

What We Choose to Tax.....7

The Tax Mix: A Balancing Act 9

 Property Taxes 9

 Sales Tax..... 11

 Selective Sales Taxes 12

 Income Taxes.....10

Conclusion.....14

Introduction

Alabama’s state and local governments collect less per capita in taxes than state and local governments in any other state in the union, according to new data from the U.S. Census Bureau.

Annually, the U.S. Census Bureau surveys state and local governments across the country about their revenues and expenditures. This survey makes it possible to compare the finances of state and local government across the 50 states. In PARCA’s analysis of the data, state and local revenues are considered together, because states vary greatly in how they divide up the responsibilities between state and local governments for financing the operation of services like schools, roads, courts, health care, and public safety. In the end, the combined revenue from state and local taxes is used to provide government services. The data for 2016 is the most recent year available.¹

The most glaring difference between Alabama and other states is our low reliance on property taxes.

- Alabama ranks 50th in the U.S. in state and local property tax collections per capita.

If Alabama’s per capita property tax collections matched the average of other Southeastern states:

- State and local governments would have an additional \$2 billion to spend providing services.
- Alabama’s overall tax revenue per capita would rank in the middle of Southeastern states, roughly equaling Mississippi’s tax revenue per capita and putting Alabama above Florida, South Carolina and Tennessee in per capita collections. Alabama would still trail Arkansas, North Carolina, Louisiana, Kentucky, and Georgia.

Rank in Per Capita Tax Collections, 2016	
State and Local Tax Sources	Alabama’s Rank Among U.S. States
All Taxes	50
Property	50
Individual income	36
Corporate income	40
Sales and gross receipts	29
General sales	30
Selective sales	17
Alcoholic beverage	3
Public utilities	5
Motor fuel	34
Tobacco products	35
Other selective sales	32
Motor vehicle license	45
Other taxes	25

¹ U.S. Census Bureau State & Local Government Finance. (2016 data released on Sept. 7, 2017). Retrieved November 1, 2018 from <https://www.census.gov/programs-surveys/gov-finances.html>

As it stands, Alabama's traditional preference for low property taxes leaves state and local governments more reliant on other taxes for revenue. Alabama has among the highest sales tax rates in the U.S. Alabama also has some of the highest taxes per capita on alcohol and public utilities. Despite those higher rates, Alabama doesn't make up the difference created by its low property tax collections.

Other unusual features of Alabama's tax system include:

- ❖ Sales Taxes:
 - Alabama is one of three states that continue to apply sales tax fully to food purchased for home consumption without providing any offsetting relief for low- and moderate-income families.
 - Alabama's sales tax is not as broad as other states and doesn't apply to most services. Consequently, despite high rates, Alabama's sales tax isn't as productive as some other states.
- ❖ Income Taxes:
 - Alabama 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.
 - Alabama is one of three states that allows taxpayers to deduct from state income the full amount they pay in federal income taxes. Since federal income tax rates are higher the more you earn, the higher your earnings the larger the deduction for state tax purposes.

As a bottom line, Alabama governments operate with less revenue on a per capita basis than governments in all the other states.

This is not a new finding. This has been true since the early the 1990s. And it underlies the difficulties we face when trying to provide to our citizens the level of government services enjoyed by citizens in other states.

Alabama’s taxes and revenues compared to other states

In 2016, Alabama state and local governments collected a total of \$15.6 billion in taxes or \$3,203 per resident. Among U.S. states, the median value for state and local taxes per capita was \$4,484.

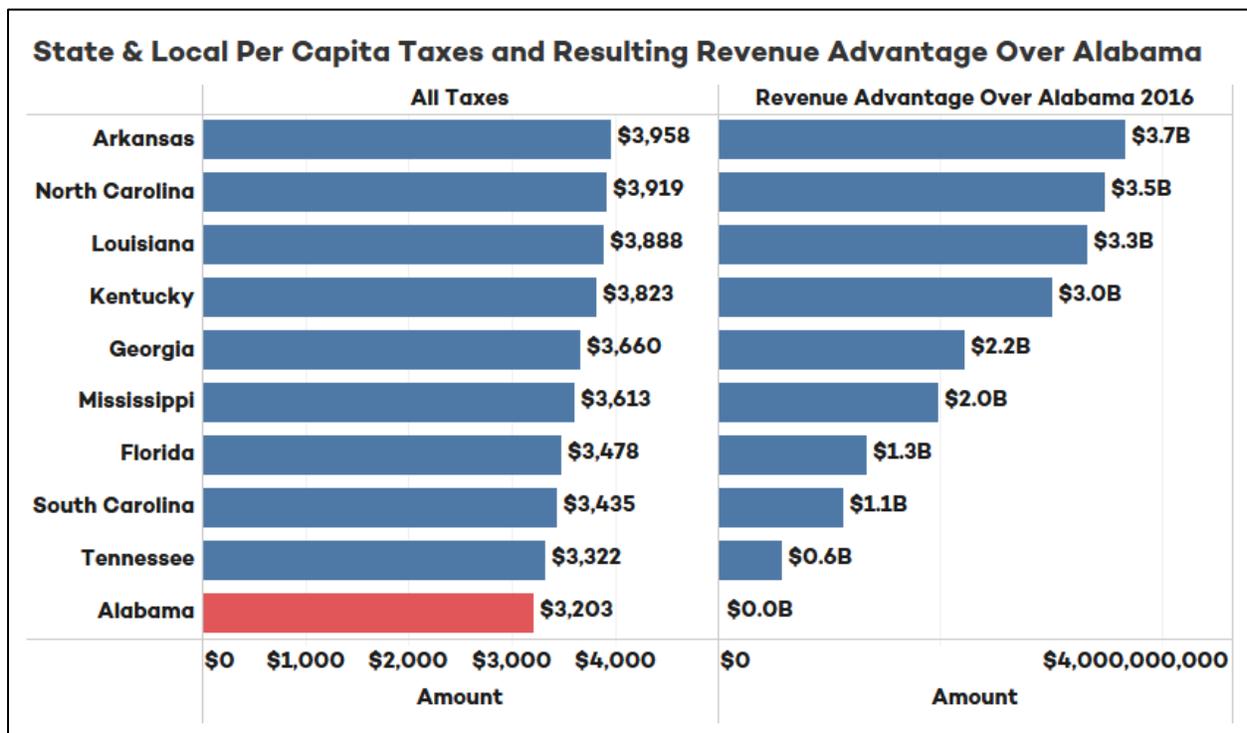
Thus, the median state had a per capita tax advantage of \$1,281 over Alabama. In other words, if Alabama collected taxes at the per capita rate of the median state, local and state governments here would have an additional \$6.2 billion to spend building and maintaining roads; providing police and fire protection; operating civil and criminal courts; supporting schools and colleges; libraries and parks; and the myriad of other functions government performs.

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 \$119 more per resident than Alabama. The top Southeastern state in terms of taxes per capita is Arkansas, which collects \$754 more per resident than Alabama.

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



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

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 billion more to spend. At Arkansas' per capita rate, Alabama state and local governments would have an additional \$3.7 billion to spend providing services.

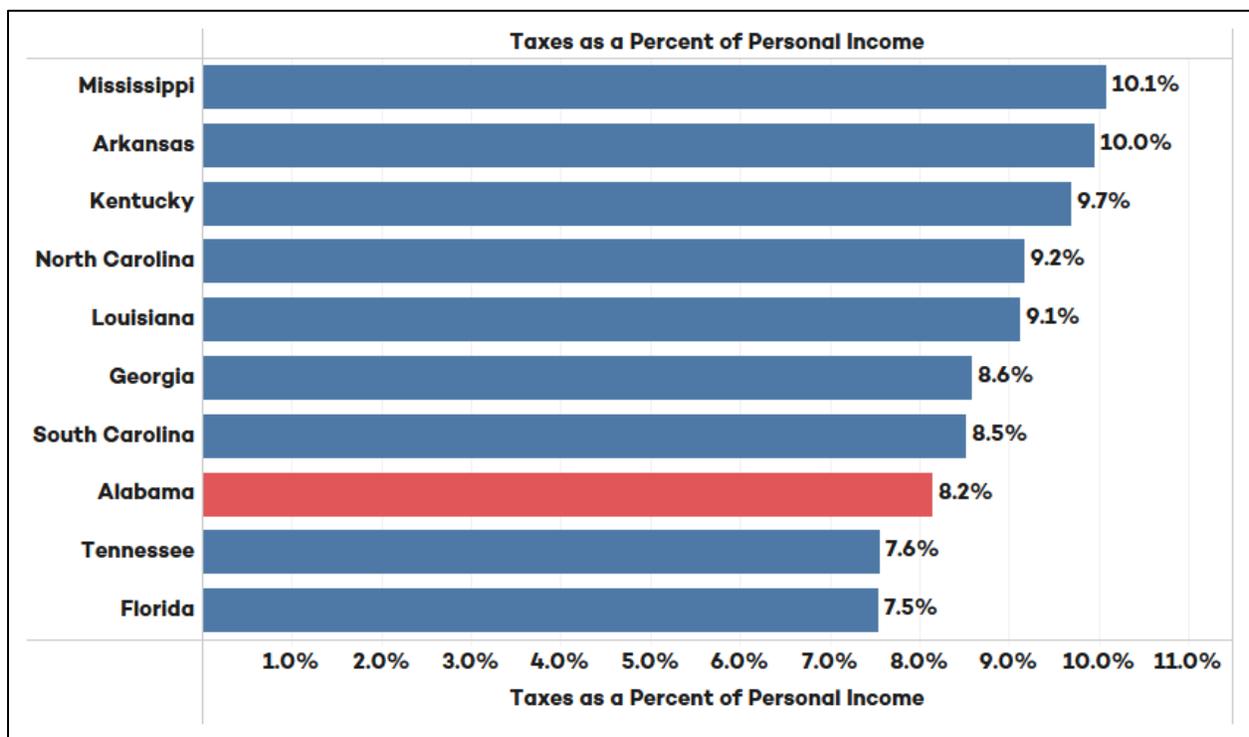
Why are our taxes low on a per capita basis?

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.

Taxes as a Percentage of Personal Income

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 as a Percent of Personal Income, 2016. Source: Census Bureau and U.S. Bureau of Economic Analysis²



On this measure, the only Southeastern states that rank behind Alabama are Florida (7.5 percent) and Tennessee (7.6 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 10.1 percent of Mississippi's total personal income for 2016. Because of that greater tax effort, Mississippi state and local governments have more to spend on a per capita basis than those in Alabama.

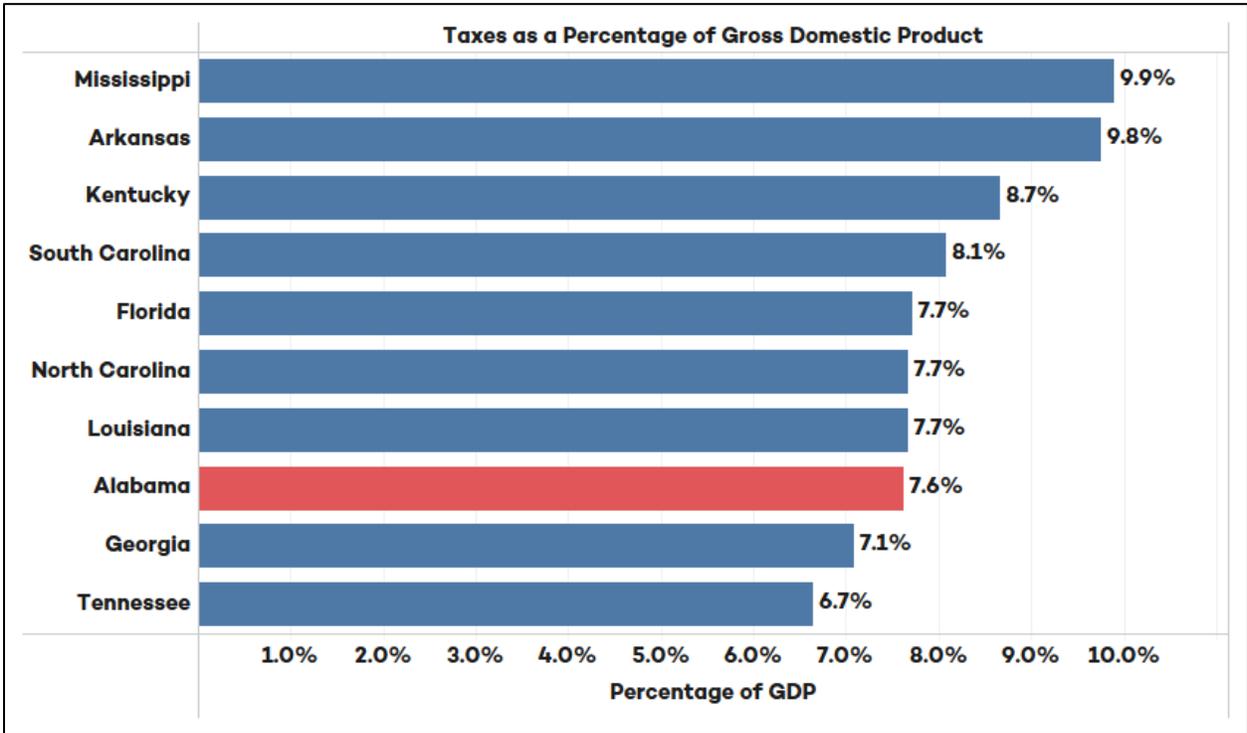
² U.S. Bureau of Economic Analysis, "SA1 Personal Income Summary: Personal Income," Retrieved November 1, 2018, from <https://www.bea.gov/iTable/iTableHtml.cfm?reqid=70&step=1&isuri=1>

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 7.6 percent of its GDP. The U.S. average for state and local taxes as a percent of GDP is 9.7 percent.

Figure 3. Taxes as a Percentage of GDP, 2016. Source: U.S. Census Bureau and U.S. Bureau of Economic Analysis³



As with the personal income measure, states like 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.

³ U.S. Bureau of Economic Analysis, "Gross domestic product (GDP) by state, 2015." Retrieved November 1, 2018, from <https://www.bea.gov/iTable/iTableHtml.cfm?reqid=70&step=1&isuri=1>

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.

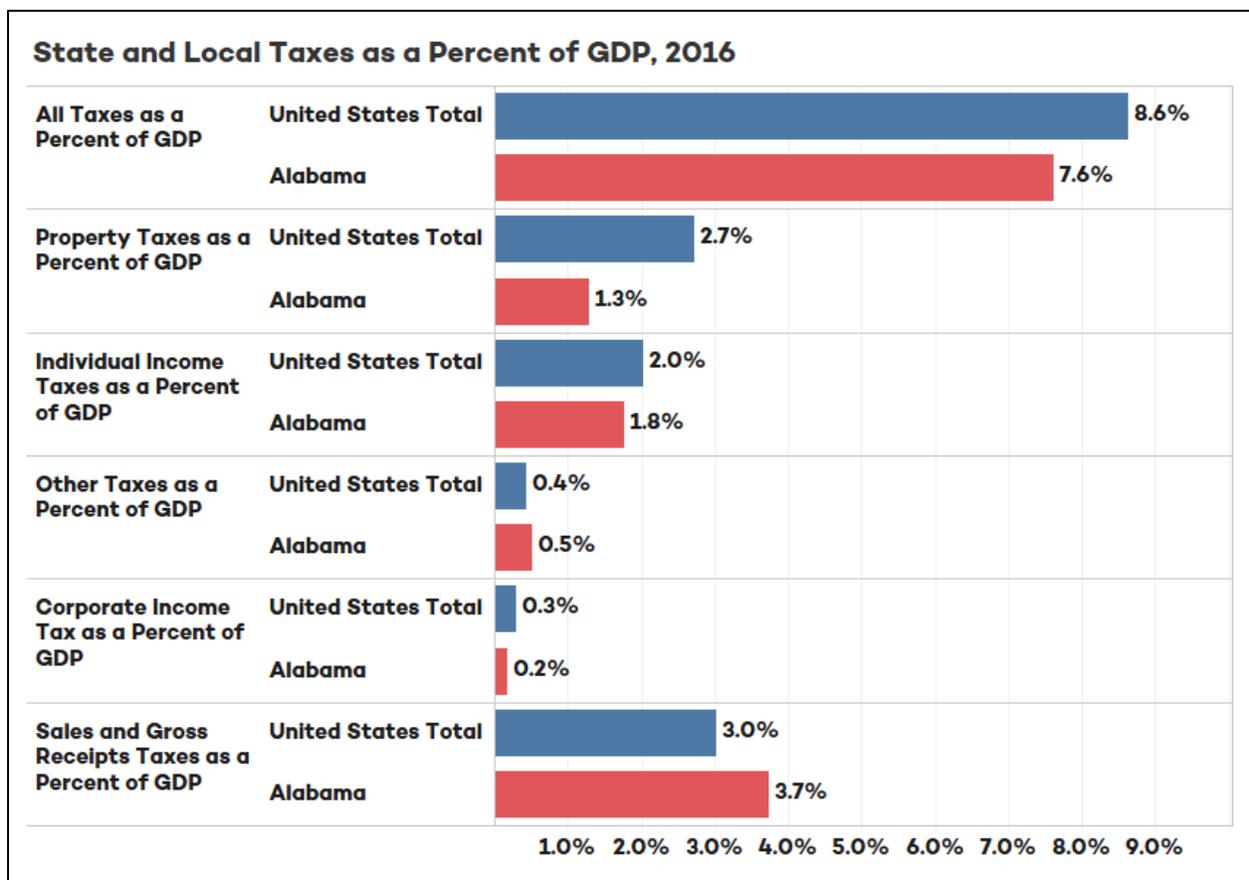
Every state has a unique blend of taxes. Most states depend on some combination of the three principal tax sources: income, property value, and sales transactions (what we earn, own, and buy).

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 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, 2016. 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.

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.

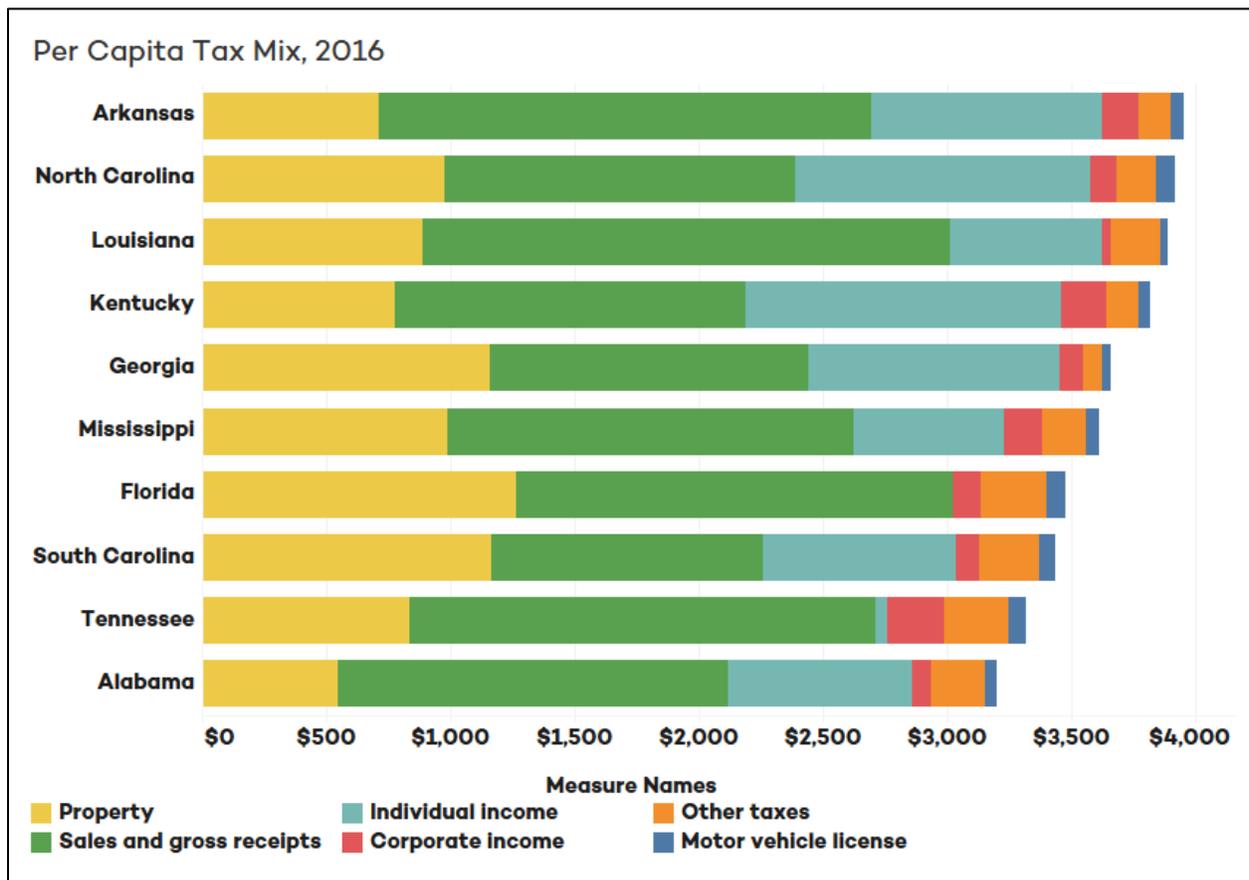
Alabama’s sales and gross receipts tax, on the other hand, is a higher share of GDP than in the average state, indicating that Alabama depends more heavily on the sales taxes to produce tax revenue than most states.

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 does not guarantee low taxes for all. Because of the imbalance in the tax structure, taxes fall more heavily on some groups than others.

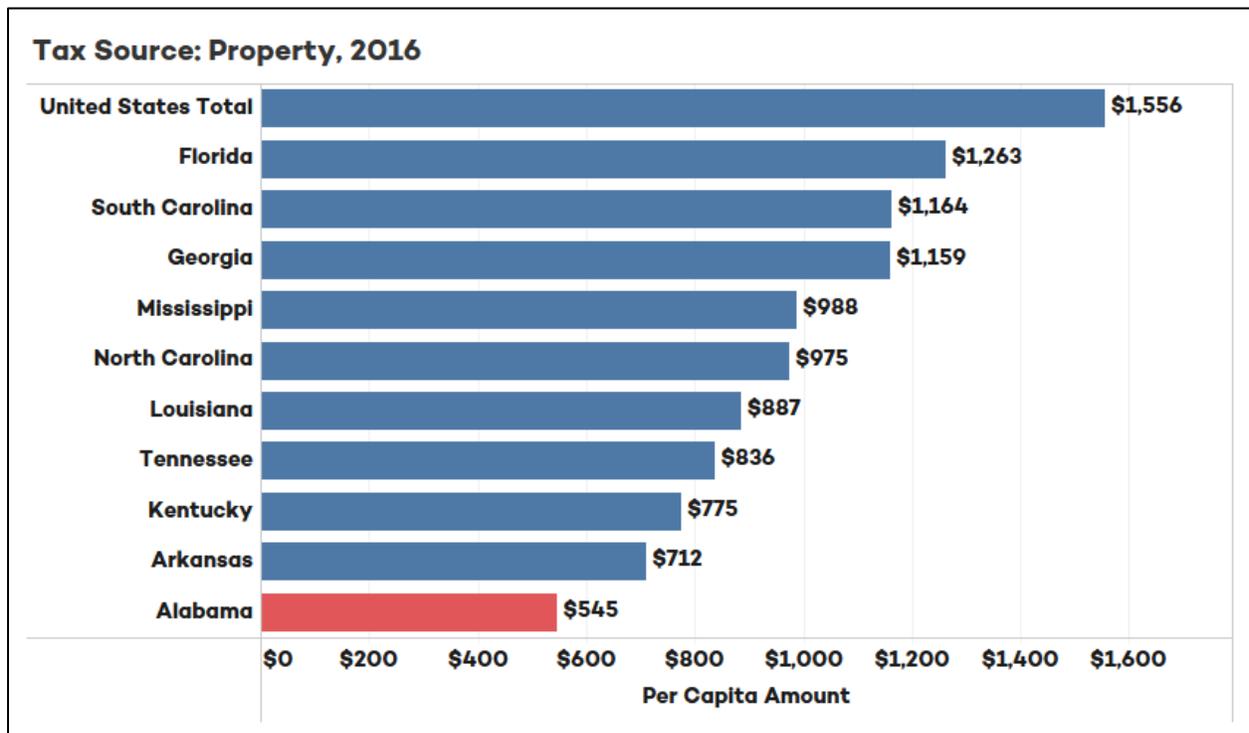
A sound tax structure avoids placing too heavy a burden on any particular group. Most states take measures to protect households with low incomes from taxation in hopes of encouraging economic advancement.

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, 2016. 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.

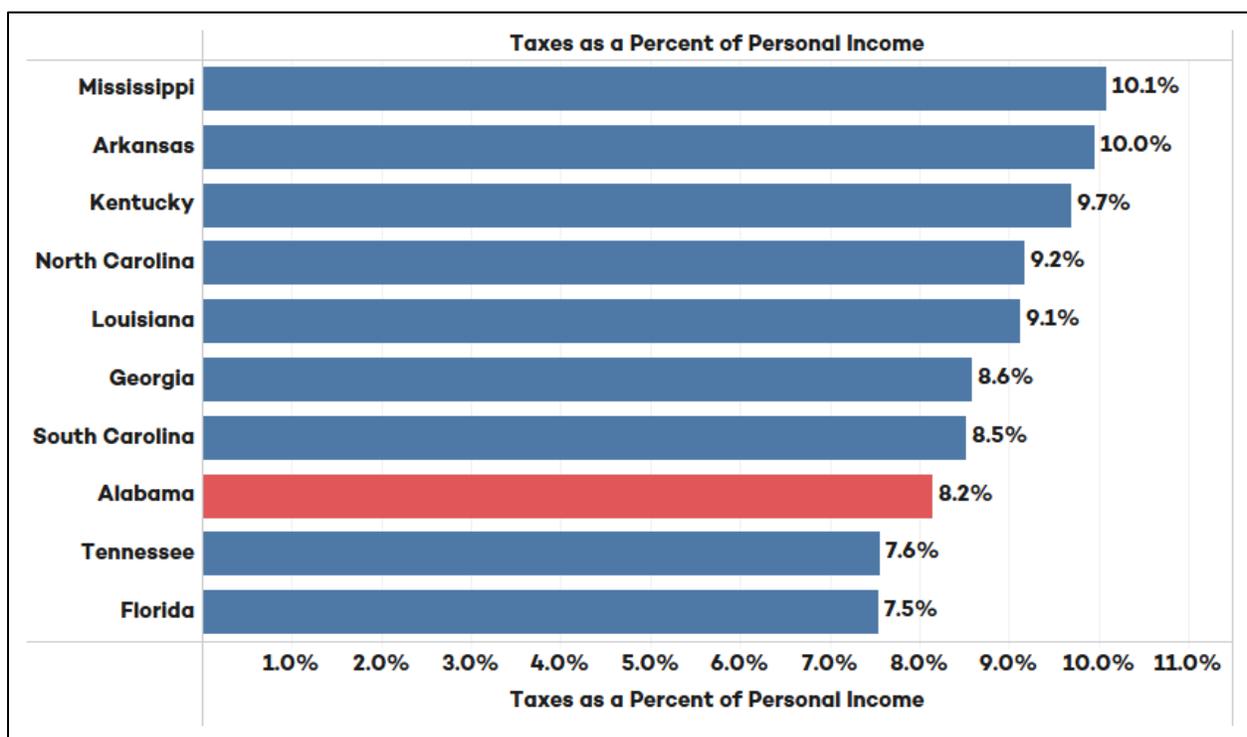
Under the current system of property classification, an increase in property taxes would be borne more heavily by businesses and utilities. Increases would also likely be passed along to consumers and to renters, since apartments are considered commercial property. And higher tax bills for utilities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

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.

Income Taxes

In 2016, Alabama’s income tax revenue per capita ranked 37th out of the 43 states that collect income taxes.

Figure 7. Per Capita Income Tax Collections, 2016. 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 interfere with the progressive nature of the tax. Alabama 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, kicks in after \$6,000 in earnings beyond exemptions and deductions, for a married couple filing jointly (earnings over \$18,600).

Meanwhile, Alabama allows taxpayers to deduct the full amount they pay in federal income taxes, one of only three states where federal income taxes are fully deductible. Since upper-income taxpayers 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.

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.

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 sales tax fully to food purchased for home consumption without providing any offsetting relief for low- and moderate-income families.⁴

Because low- and moderate-income families spend a greater share of their incomes on basic necessities, a greater share of those families' incomes goes 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 18th most regressive state and local tax system in the nation.⁵ 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 30th 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, and repair services. In recent decades a greater share of economic activity has shifted toward the consumption of such services. According to a survey conducted by the Federation of

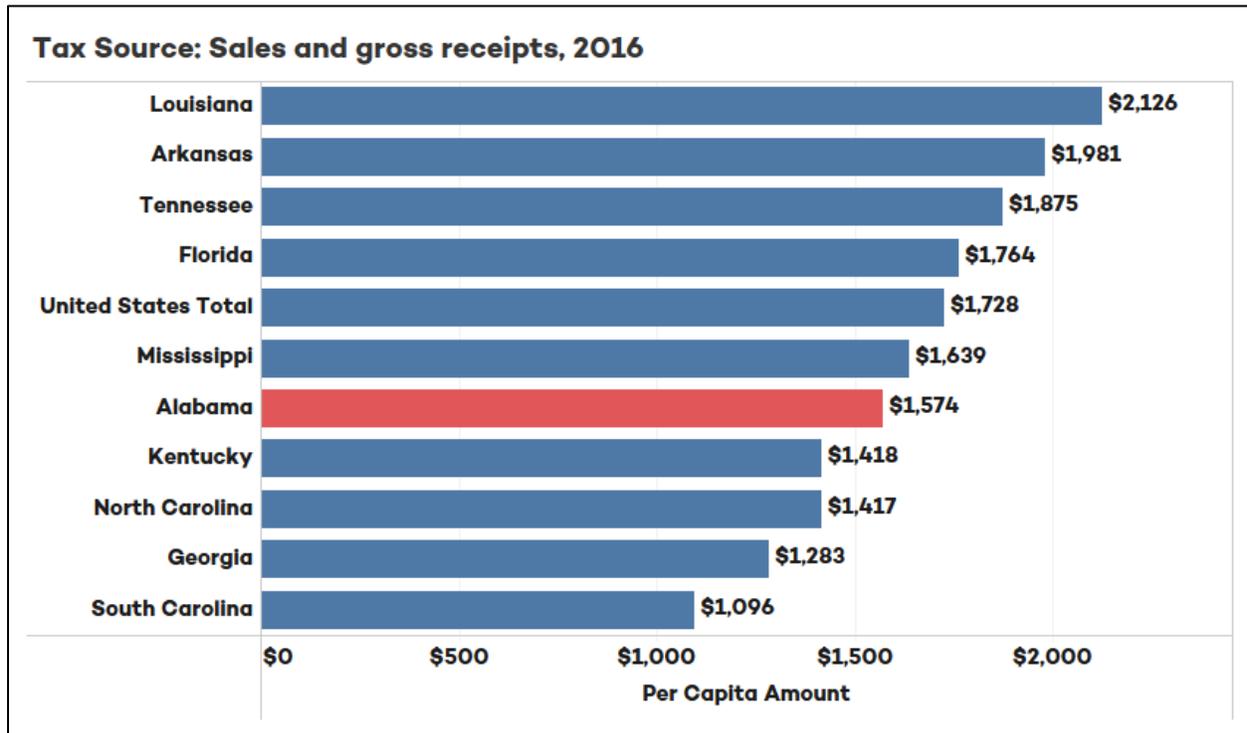
⁴ Figueroa, E., & Waxman, S. (2017, March 1). "Which States Tax the Sale of Food for Home Consumption in 2017?" Retrieved Nov. 30, 2017, from <https://www.cbpp.org/sites/default/files/atoms/files/3-16-06sfp3.pdf>

⁵ Wiehe, M, Davis, A., Davis, C., Gardner, M., Gee, L., Grundman, D., (2018, Oct). "Who Pays?" 6th Edition: Alabama. Retrieved November 27, 2018, from <https://itep.org/whopays/alabama/>

Tax Administrators, Alabama taxes 42 out of 176 categories of services.⁶ The median state applies the sales tax to 60 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.

Figure 8. Per Capita Sales and Gross Receipts, 2016. Source: U.S. Census Bureau, PARCA calculations.



States, including Alabama, are 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.

In 2015, Alabama created what's called the Simplified Sellers Use Tax, which captures some on the sales tax revenue from online sales. Further changes to that law were made in 2018, and in June 2018, the U.S. Supreme Court issued a ruling that bolsters states' abilities to tax online sales.

Selective Sales Taxes

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.).

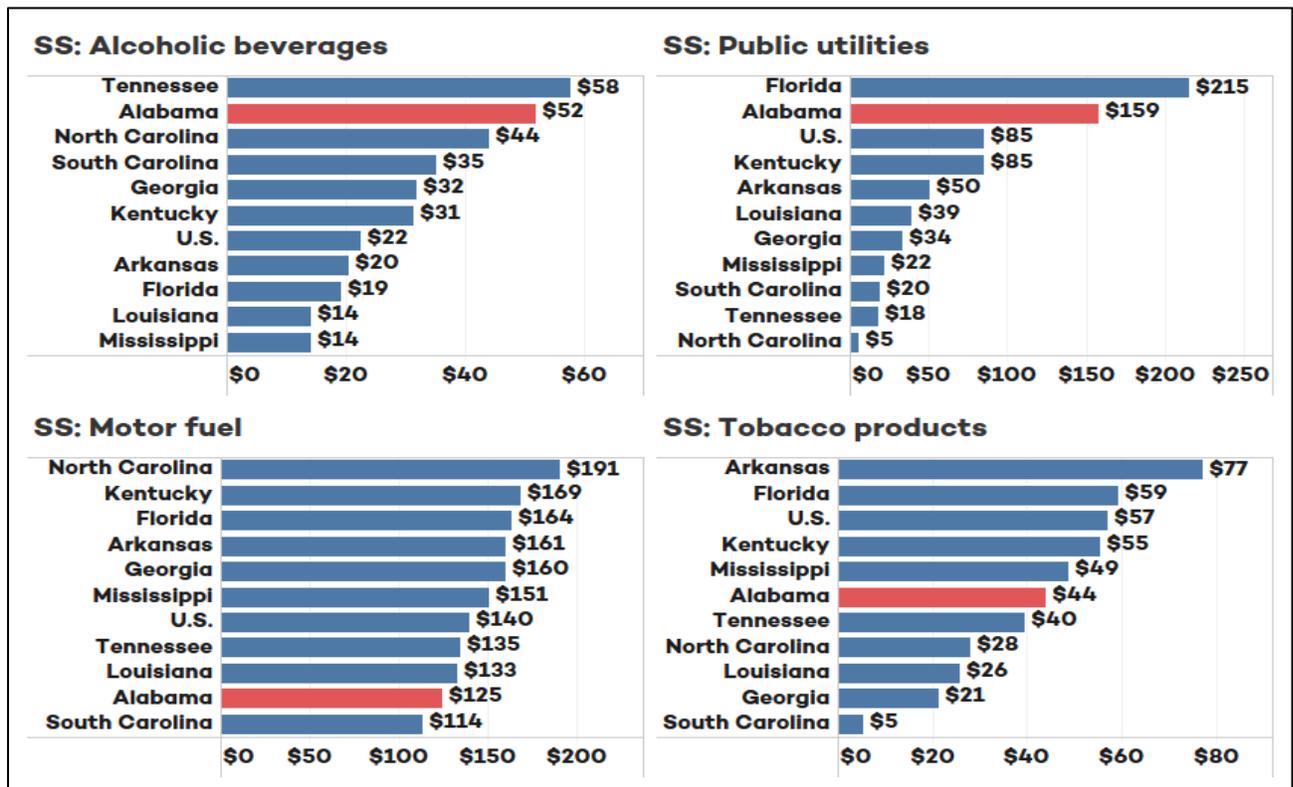
Alabama ranks No. 35 in per capita state and local tax collections on motor fuel. Considering only state per capita tax collections on motor fuel, Alabama ranks No. 42

⁶ Alt, R. (2017, August. Updated Jan. 2018). Sales Taxation of Services, Retrieved November 27, 2018, from <https://www.taxadmin.org/sales-taxation-of-services>

in the U.S. Several neighboring states have increased their motor fuels taxes in recent years, and Alabama's rank has declined relative to other Southeastern states. As of 2016, only South Carolina collected less in motor fuel taxes per capita among Southeastern states. South Carolina will likely surpass Alabama in coming years, as that state has adopted a plan to gradually raise its per gallon tax. South Carolina's gasoline tax rate now exceeds Alabama's. See more in PARCA's 2018 report [How Alabama Roads Compare](#).

Alabama's per capita tax collections on tobacco products edged up thanks to a 25-cent per pack increase in cigarette taxes enacted in 2015. In 2016, per capita revenue on tobacco products ranked No. 36 in the U.S. Alabama's state-level tax rate on cigarettes remains relatively low, at 67.5 cents a pack, ranking No. 39 among U.S. states.⁷ According to the Tax Foundation, the average tax rate among states is \$1.70 per pack.

Figure 9. Per Capita Selective Sales Collections, 2016. Source: U.S. Census Bureau, PARCA calculations.



⁷ Cook, C. (2018, January 25). "How High Are Cigarette Taxes in Your State?", Retrieved November 30, 2018, from <https://taxfoundation.org/state-cigarette-tax-rates-2018/>



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