

Arise Policy Choices 2012

Ending the State Grocery Tax and Protecting Schools

BACKGROUND:

Alabama's tax system is upside down, and the state sales tax on groceries is one reason why. Alabama remains one of only two states – the other is Mississippi – with no tax break on groceries. Food costs consume a larger portion of the household budget for low-income families than for those who are better off, so the grocery tax hits low-income people especially hard. The grocery tax is part of why Alabama's overall tax system requires low- and middle-income people to pay twice as big a share of their incomes in state and local taxes as the richest households pay.

HB 45, sponsored by Rep. John Knight, would give state voters a chance to amend the Alabama Constitution to make two changes. The bill would:

- **Remove the state portion of the sales tax on groceries and over-the-counter (OTC) medicines.** The overall sales tax on groceries and OTC medicines would be 4 percentage points lower than on other items. Local sales taxes still would apply, but the bill would bar localities from changing taxes on groceries and OTC medicines alone. The overall sales tax on those items would stay 4 percentage points lower than on other items.
- **End the state deduction for federal income taxes.** Only two other states (Iowa and Louisiana) allow a full state income tax deduction for federal income taxes. More than half of the deduction's total benefits went to the top 3 percent of taxpayers last year, the state Revenue Department estimated. Ending the deduction would offset the revenue loss from ending the state grocery tax and bring in new money for Alabama's Education Trust Fund (ETF) budget, where next year's spending is set to be 24.2 percent lower than fiscal year (FY) 2008, adjusted for inflation. HB 45 would add a net \$113 million to the ETF next year and about \$150 million annually in later years, based on Legislative Fiscal Office projections.

HB 45 would end the state grocery tax without raising taxes on low-income Alabamians in other ways. SB 387, sponsored by Sen. Gerald Dial, also would end the state sales tax on groceries, but that plan would replace lost revenue by increasing the state sales tax on all other items by 1 percentage point. Such a move likely would negate low-income Alabamians' grocery tax savings by increasing the cost of everything else. SB 387 would phase out the state sales tax on groceries over four years, while HB 45 would end it all at once, if approved by voters this fall.

BOTTOM LINE:

- **Alabama can remove the state sales tax on groceries and OTC medicines without cutting funds for K-12 and higher education.**
- **HB 45 would end the state grocery tax and protect school funding without increasing low-income Alabamians' taxes.**