

untax groceries 2010

House Bill 1: Answers to Some Common Questions

Updated Feb. 12, 2010

What would House Bill 1 do?

- It would remove the 4 percent state sales tax on groceries and over-the-counter medicines.
- It would cap the state income tax deduction for federal income taxes paid.
- It would continue to allow the full deduction for all married taxpayers with adjusted gross income (AGI) of \$200,000 or less per year and all single taxpayers with AGI of \$100,000 or less per year. Above those income levels, the deduction would shrink on a sliding scale before it disappeared entirely at \$300,000 for couples and \$150,000 for singles.
- It would take effect on Jan. 1, 2011, if approved by legislators and voters.

Would untaxing groceries result in a tax increase for many people?

- No. More than 96 percent of state taxpayers — all couples making \$200,000 or less and all singles making \$100,000 or less — would be *guaranteed a tax cut* under House Bill 1. Fewer than 4 percent of Alabamians would pay more.
- For those who would pay more, the net tax increase would be about 1 percent of their income on average. For example, a family of four making \$300,000 a year would pay about \$3,000 more in state income taxes under the bill, according to the Legislative Fiscal Office (LFO).
- Some people whose state income taxes would increase slightly would get a net tax cut because of lower grocery taxes and a larger federal tax deduction for state income taxes.

Would the bill increase or decrease the amount of overall state tax revenues?

- Neither. The bill would change the source of about \$405 million in Education Trust Fund (ETF) revenue. It would not remove a cent from the education budget.
- The change would be close to an even swap, with a difference of about \$2 million out of the total \$405 million. The LFO considers this difference to be within the range of “revenue-neutral” for a measure of this size. That means the amendment would neither increase nor decrease revenue coming into the ETF.

Don't the richest people pay most of the state and local taxes?

- No. The top 20 percent of Alabama income earners pay 46 percent of the state and local taxes – but they *make* 59 percent of the state's income, according to the Institute on Taxation and Economic Policy (ITEP).
- The bottom fifth of Alabama's earners, who make less than \$16,000 a year, pay 10.2 percent of their income in state and local taxes, according to ITEP.
- The middle fifth pay 9.5 percent of their income in state and local taxes, according to ITEP.
- The top 1 percent, who make \$384,000 or more a year, pay an effective state and local tax rate of 4 percent after the federal offset for state income taxes paid, according to ITEP.

Is untaxing groceries a "Robin Hood" plan to redistribute wealth?

- No. Alabama's current tax system requires middle-income families to pay more than twice the share of their income in state and local taxes that those at the top pay.
- Even after the bill went into effect, high-income Alabamians still would pay a smaller share of their income in state and local taxes than middle-income and low-income people.

Food stamps aren't taxed, so how could untaxing groceries help low-income Alabamians?

- Untaxing groceries would help middle-income Alabamians the most, but it also would help hundreds of thousands of low-income people.
- About one out of every three Alabamians who qualify for food stamps do not receive them, according to the U.S. Department of Agriculture (USDA). They pay the full grocery tax.
- Food stamp benefits are not designed to cover the total cost of feeding a family. Recipients pay the full grocery tax on any food they buy after their benefits run out.

Could Alabama untax groceries without increasing taxes on anyone?

- Yes, but it would hurt education funding. Alabama's education budget gets about \$405 million in revenue annually from the state sales tax on groceries. Eliminating the state grocery tax or offering a low-income grocery tax credit without replacing the revenue would leave a hole in an ETF budget that already is in proration for the second year in a row.
- The state grocery tax could be phased out over time without replacing the revenue and without increasing anyone's taxes, but such a phase-out would deprive the education budget, over time, of \$405 million that it otherwise would have had. A phase-out also would take several years to eliminate the state grocery tax completely.

If the state were to eliminate its 4 percent sales tax on groceries, could cities or counties cancel out the cut by raising their local sales taxes by 4 percentage points just on groceries?

- No. House Bill 1 would prevent local governments from changing their sales taxes on groceries or over-the-counter medicines alone. Any increase or decrease in the local sales tax would have to apply across the board to all taxable items, not just groceries.

How much could Alabamians save by untaxing groceries?

- Untaxing groceries would save Alabama families about \$100 per person every year. An Alabama family of four would save \$452 a year, according to an Arise estimate based on the USDA's moderate-cost food plan for December 2009.
- The USDA's moderate-cost food plan assumes a family of four spends about \$8 per person per day on groceries. If a family spends more, its grocery tax savings would be even greater.

Would undocumented immigrants still pay taxes if the state were to untax groceries?

- Yes. Undocumented immigrants still would pay taxes when they buy the same things that everyone else does, like clothes and gasoline. Most employers are required to withhold taxes from undocumented immigrants' paychecks as well.
- Alabama's undocumented immigrant population in 2008 was about 100,000, the Pew Hispanic Center estimated. That number is a small fraction — about 2 percent — of the state's total population of more than 4.6 million.

Would House Bill 1 increase taxes on small businesses?

- Most small business owners in Alabama would get a tax cut.
- Small business owners whose businesses file income taxes as limited liability companies (LLCs) or S corporations report their incomes on their personal income tax returns. Married small business owners who report incomes of \$200,000 or less would see no change on their state income taxes and would be *guaranteed a tax cut* under House Bill 1.
- Nationwide, about 90 percent of tax filers with small business income report incomes of \$200,000 or less, according to the Tax Policy Center. The percentage for Alabama likely is not drastically different.

Could untaxing groceries reduce federal income taxes for some people?

- Yes. House Bill 1 would reduce federal taxes for filers whose state taxes would increase.
- Under the bill, a married couple making \$300,000 a year would pay about \$3,000 more in state income taxes, according to the LFO. But they then could reduce their federal taxes by about \$1,000 by deducting that \$3,000 on their federal income tax return.
- The couple's grocery tax savings would further reduce their overall tax increase.

What are other states' policies on taxing groceries and deducting federal income taxes paid?

- Alabama and Mississippi are the only two states that impose the full state sales tax on groceries without any credits or reduced rates. Most states exempt groceries entirely.
- Of the 42 states with a broad-based income tax, Alabama, Iowa and Louisiana are the only three that allow all taxpayers to take a full state deduction for federal income taxes paid.
- Three other states allow partial deductions for federal income taxes paid, but most states do not allow any state deduction at all for federal income taxes paid.