

ECONOMY DOLLAR LOCAL  
HOW RATE BUDGET PERCENT  
SERVICES INCOME GOVERNMENT DEBT RECEIPTS  
Alabama  
FINANCE DEBT RECEIPTS  
RATE CORPORATE ANALYSIS PERCENT  
LOCAL % STATE  
TAXES LOWEST  
REVENUE MONEY  
REGRESSIVE  
BUDGET  
COMPARE  
2023  
ANALYSIS RETAIL SPENDING  
COMMERCIAL INDIVIDUAL  
CAPITAL % BRACKET COMMERCIAL  
BUDGET

*How Alabama Taxes Compare, 2023*

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**Public Affairs  
Research Council  
of Alabama**

## **How Alabama Taxes Compare, 2023 Edition**

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## Executive Summary

Despite the wild gyrations in the economy since the outbreak of COVID-19 in the spring of 2020, the latest comparative data from the U.S. Census Bureau finds Alabama in a familiar position: at or near the bottom in state and local government tax collections.

### Key Findings

- Alabama is a low-tax state: In FY 2021, adjusted for population, Alabama collected less in state and local taxes than all but one other state. Alaska, thanks to disruptions in the oil market over the period, had the lowest per capita revenues.
- Alabama's per capita property tax collections are the lowest in the nation. That helps owners of homes, farms, and timberland but creates a revenue deficit, leaving state and local governments with less to spend to provide government services such as education, health, and public safety.
- Alabama's state and local sales tax rates are among the highest in the U.S., which compensate for low property taxes.
- Alabama's income tax does not provide the balancing effect that income taxes in other states do. Low-income workers begin paying taxes at a lower threshold than any other state. At the other end of the spectrum, Alabama is the only state that allows a full deduction for federal income taxes paid, a tax break that benefits high-income earners.

Despite unusual circumstances, Alabama's rankings in per capita state and local tax collections were generally consistent with rankings in prior years.

Motor fuel collections per capita jumped in rank because half of Alabama's fiscal year was pre-pandemic at a time when the economy was booming and gas prices high. In contrast, most states' fiscal years began in the months after the pandemic began. Gas prices plummeted, and the total miles traveled on American roads didn't recover until the calendar year 2022.

Alabama's sales and gross receipts were also elevated thanks to the state's high sales tax rate, the elevated volume of pandemic-related buying, and the economic stimulus payments that accelerated spending beginning in April 2020.

Despite all that, Alabama continues to lag behind almost all other states in total per capita collections.

*Table 1. Alabama Rank in Per Capita Tax Collections, 2019, 2020, 2021.*

	2019	2020	2021
<b>All Taxes</b>	<b>49</b>	<b>49</b>	<b>49</b>
<b>Property</b>	<b>50</b>	<b>50</b>	<b>50</b>
<b>Individual income</b>	<b>36</b>	<b>35</b>	<b>35</b>
<b>Corporate income</b>	<b>30</b>	<b>25</b>	<b>22</b>
<b>Sales and gross receipts</b>	<b>30</b>	<b>25</b>	<b>20</b>
<b>General sales</b>	<b>32</b>	<b>31</b>	<b>27</b>
<b>Selective sales</b>	<b>18</b>	<b>16</b>	<b>16</b>
<b>Alcoholic beverage</b>	<b>3</b>	<b>3</b>	<b>2</b>
<b>Public utilities</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>Motor fuel</b>	<b>32</b>	<b>20</b>	<b>14</b>
<b>Tobacco products</b>	<b>37</b>	<b>37</b>	<b>37</b>
<b>Other selective sales</b>	<b>31</b>	<b>32</b>	<b>30</b>
<b>Other taxes</b>	<b>30</b>	<b>29</b>	<b>30</b>
<b>Motor vehicle license</b>	<b>43</b>	<b>43</b>	<b>43</b>

In the years since FY 2021, tax revenues have surged based on the infusion of federal stimulus, low unemployment, and high inflation. Legislators have responded by making needed investments, particularly in education, in the form of teacher pay raises and a surge of additional support for literacy and math instruction.

At the same time, the Legislature has also passed tax cuts. In 2022, it increased the standard deduction for low-income Alabamians, allowing more households to shield more of their earned income from the income tax. In 2023, the state sales tax on food items was reduced from 4% to 3%, with a further 1% reduction scheduled for 2024 if revenue targets are met. These targeted tax cuts are a fitting response at a time when inflation is elevated,

with state tax collections surging to historic highs and federal COVID-19 relief funds swelling government accounts.

Flush times could allow Alabama to address years of chronic underinvestment compared to other states. Unacceptable conditions, such as understaffed and crumbling prisons, persist. Investments in education that show positive results must be sustained. However, as growth slows and federal aid is exhausted, Alabama governments will likely return to a familiar position of having less money to spend and yet a greater need for government services.

## Introduction

PARCA's *How Alabama Taxes Compare, 2023 Edition*, uses data published by the U.S. Census Bureau's Annual Survey of State and Local Finances. The report makes it possible to compare the revenue and expenditures of state and local governments across the 50 states.<sup>1</sup>

This most recent set of revenue and expenditure data covers state and local fiscal years ending between July 1, 2020, and June 30, 2021, identified as the fiscal year 2021. That means the state of Alabama's data is from the fiscal year that ended September 30, 2020.

The timing differences in fiscal years typically do not pose a problem for state-to-state comparisons. However, the unusual economic conditions created by the COVID-19 pandemic and the government response to it may cause some fluctuations in some comparisons.

In FY 2020, more than half the states saw a decline in per capita collections, which is highly unusual. In FY 2021, almost all states saw increases in collections. Only three states saw declines: Alaska, North Dakota, and Wyoming, three states heavily dependent on energy extraction. The rest of the states saw increases.

PARCA's analysis considers the tax revenues of both local and state governments because states differ on which level of government provides which services. The two levels of government together provide services to citizens.

Since the early 1990s, when PARCA began this analysis of Alabama's taxes compared to other states, Alabama has had the lowest or second lowest tax collections per capita among U.S. states. For FY 2021, Tennessee's tax collections moved back ahead of Alabama's, but Alaska's dropped to the bottom of the rankings.

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<sup>1</sup> US Census Bureau, "2021 State & Local Government Finance Historical Datasets and Tables," The United States Census Bureau, accessed October, 2023, <https://www.census.gov/data/datasets/2021/econ/local/public-use-datasets.html>

Most state and local tax revenue derives from three categories of taxation: property taxes, sales taxes, and income taxes. A fair and stable tax system is built on a balance between the three sources and adjustments made to each to promote fairness. Alabama's tax system is not balanced and is regressive, falling more heavily on the poor than the wealthy.

## **Property Taxes**

Alabama has the lowest per capita property tax collections in the nation.

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*Alabama has the lowest per capita property tax collections in the nation.*

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Low property taxes benefit homeowners and owners of agricultural and timberland but present a challenge to local governments and schools needing to pay for adequate services.

Across the country, property taxes provide a greater share of revenue and a more stable source of revenue. In Alabama, state and local governments rely on more volatile alternatives. Our aversion to property taxes, protected by the Alabama Constitution, leads to imbalance and inadequacy.

## **Sales Taxes**

At a weighted average of 9.24%, Alabama has among the highest sales tax rates in the U.S.<sup>2</sup> These high rates are partly the result of the constitutional roadblocks and limits on property taxes.

Sales taxes place a disproportionate burden on low-income households because those with lower incomes spend a greater share of income on necessities covered by the sales tax. In 2023, the Legislature took the long-sought step of reducing the state sales tax rate on food items, joining 47 other states that provide an exemption, reduction, or offset to sales taxes on

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<sup>2</sup> Janelle Fritts, "State and Local Sales Tax Rates, 2023," *Tax Foundation* (blog), Feb 7, 2023, <https://taxfoundation.org/2023-sales-taxes/>.

groceries.<sup>3</sup> However, the state tax, though reduced, remains, and local sales taxes are high and unchanged.

## **Income Taxes**

Alabama's income tax kicks in early – \$4,500 in earnings for a single individual and reaches the top rate of 5% for an individual's income over \$10,500. And that threshold is an improvement. The Legislature raised it in 2022 and increased the range of taxpayers who qualify for that enhanced deduction level.

Still, no other state starts taxing income at the low level set by Alabama. In fact, 29 states provide an Earned Income Tax Credit, which reduces taxes on earned income and, in some cases, provides a refundable credit to working low-income households.<sup>4</sup>

Beyond this low threshold, Alabama's income tax is flat: the same percentage no matter how much more you earn.

In most states, the income tax provides some balance for the regressive effects of other taxes, providing credits to low-income households to offset sales taxes, for instance.

Alabama, on the other hand, provides a unique tax break that increases in value the more you earn. Alabama is the only state that allows taxpayers to deduct federal income taxes when calculating state taxes completely, a tax break that disproportionately benefits upper-income earners.<sup>5</sup> Other states that had this provision, such as Iowa and Louisiana, have recently repealed it.

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<sup>3</sup> "Alabama and Utah Join Growing Number of States Moving to Reduce or Eliminate Sales Taxes on Groceries | Center on Budget and Policy Priorities," September 28, 2023, <https://www.cbpp.org/blog/alabama-and-utah-join-growing-number-of-states-moving-to-reduce-or-eliminate-sales-taxes-on>.

<sup>4</sup> "States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy | Center on Budget and Policy Priorities," January 19, 2016, <https://www.cbpp.org/research/working-family-tax-credits/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a>.

<sup>5</sup> Jared Walczak, "Federal Deductibility Is Distorting Tax Liability in Six States," *Tax Foundation* (blog), November 1, 2021, <https://taxfoundation.org/federal-deductibility/>.

## The Bottom Line

Alabama has taken steps to improve tax fairness. In 2022, the Legislature increased the income tax threshold for low-income Alabamians, shielding more income from taxation and expanding eligibility for that enhanced tax deduction.<sup>6</sup>

And in 2023, the Legislature reduced the state sales tax on store-bought food items from 4% to 3%, joining the 43 other states that have either reduced or eliminated sales taxes on groceries. That legislation calls for an additional reduction of the tax to 2% in 2024 if the state hits revenue increase targets.<sup>7</sup>

Lawmakers have adjusted the Alabama tax system to make it fairer and allow low-income households to keep more of what they earn and hopefully build wealth. Alabama has not gone nearly as far as other states, but it's a start.

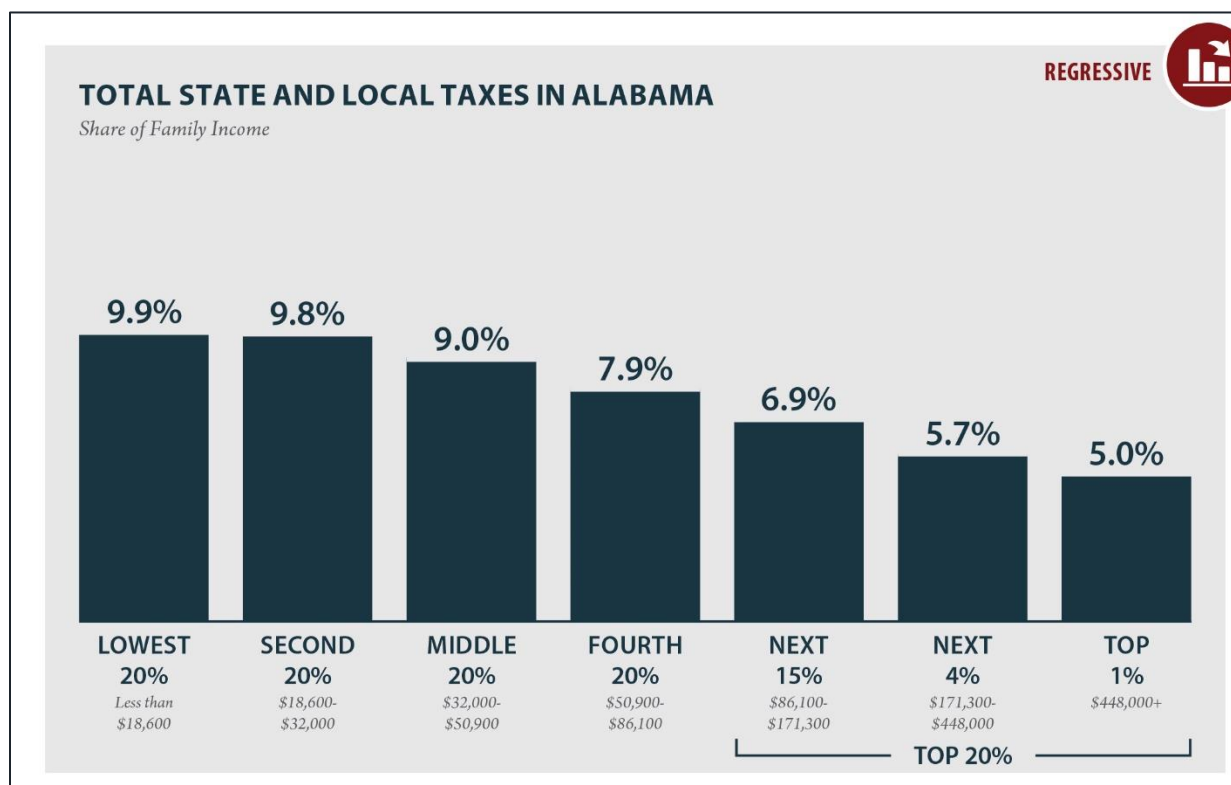
According to 2018 estimates by the Institute on Taxation and Economic Policy, the lowest-income Alabamians pay almost 10% of their earnings in state and local taxes, while upper-income Alabamians pay a substantially lower percentage.

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<sup>6</sup> Act 2022-297, <https://arc-sos.state.al.us/ucp/L0928706.A11.pdf>

<sup>7</sup> Act 2023-554, <https://arc-sos.state.al.us/ucp/L1286222.A11.pdf>

Figure 1. State and local taxes as a percentage of income, by income quintile. Source: Institute on Taxation and Economic Policy



The steps to counter the regressive nature of the tax structure will have consequences to state revenue, as no accompanying measures to increase revenue were included. The Legislative Fiscal Office estimated that the 2022 adjustment to income taxes would decrease receipts by \$17 million annually.<sup>8</sup> The 2023 adjustment to the sales tax on food is estimated to reduce receipts by \$152 million in 2024 and by \$318 million going forward.<sup>9</sup>

Revenue growth appears to be tapering. After a 21% leap in FY 2022, the Education Trust Fund saw little to no growth in FY 2023. From the beginning of the fiscal year through December 1, income to the Education Trust Fund is down slightly compared to the same time last year.

<sup>8</sup> Fiscal Note for ACT 2022-297, <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2022RS/FiscalNotes/FN-44632.pdf>

<sup>9</sup> Fiscal Note for House Bill 479, [www.legislature.state.al.us/pdf/SearchableInstruments/2023RS/FiscalNotes/FN-SO6Q85-3.pdf](http://www.legislature.state.al.us/pdf/SearchableInstruments/2023RS/FiscalNotes/FN-SO6Q85-3.pdf)

The Legislature has exercised discipline, keeping budgets at a reasonable rate of growth, spending some of the surplus but also padding reserves and investment accounts. Eventually, though, revenues and expenses will converge, and Alabama will face choices.

Alabama schools face a shortage of teachers at a time when sustained investment in improving instruction is critical. Signs of improved performance<sup>10</sup> have coincided with major increases in professional development and coaching in reading and math, investments that will need to be sustained.

Alabama has failed to take advantage of Medicaid expansion on affordability grounds. That's despite multiple studies, including one by PARCA and the Center for Economic Development and Business Research at Jacksonville State University,<sup>11</sup> that predict Alabama could save money and generate a positive economic impact by extending coverage to more Alabamians.

Alabama lawmakers have glimpsed the positive effects of a citizenry with more money to spend: they spend it, and as a side effect, the government has more money to address needs. Alabama lawmakers are showing signs they see the virtue of helping lower-income Alabamians keep more of the money they earn and spend it to advance themselves economically.

Federal stimuli are ending, and the massive surpluses that were a by-product will subside. Can we sustain investments in improving health, education, job training, and infrastructure that, in turn, increase wealth and prosperity?

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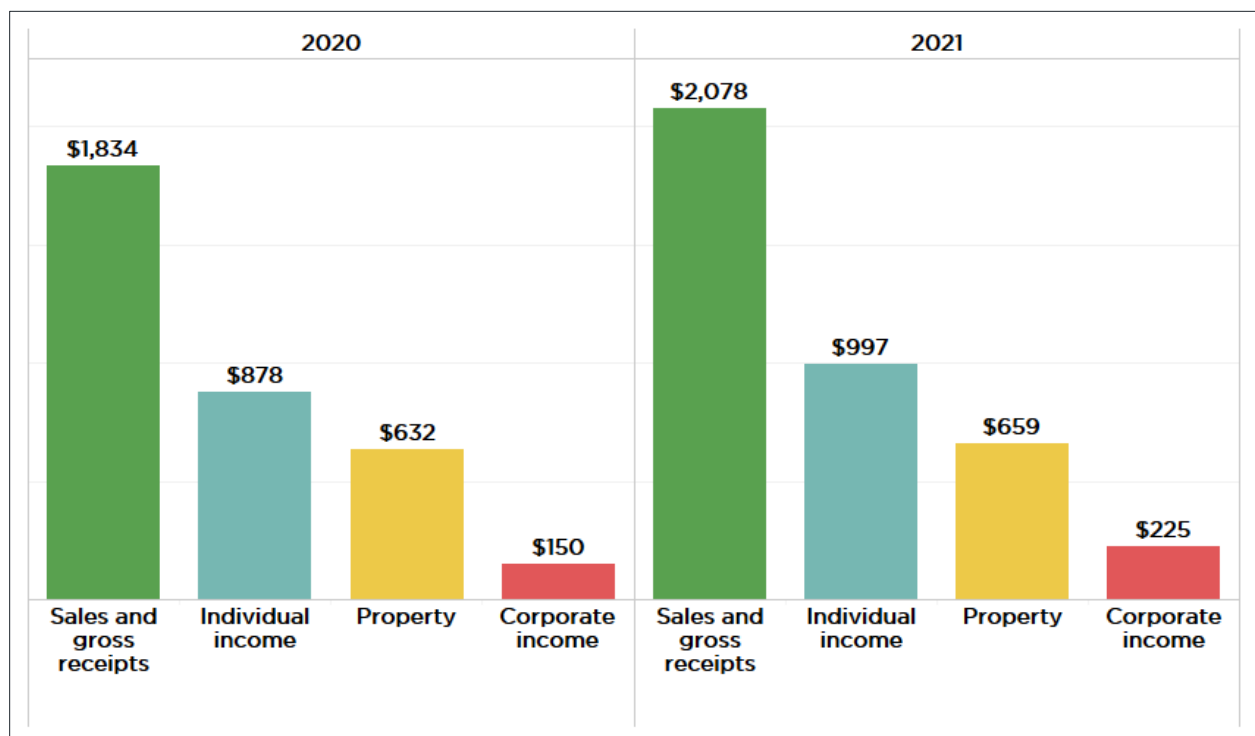
<sup>10</sup> Thomas Spencer, "Despite Headwinds, Alabama Gains in 4th Grade Reading and Math," *Public Affairs Research Council of Alabama* (blog), October 28, 2022, <https://parcalabama.org/despite-headwinds-alabama-gains-in-4th-grade-reading-and-math/>.

<sup>11</sup> Khadijah Edwards and Ryan Hankins, "THE ECONOMIC IMPACT OF EXPANDING MEDICAID IN ALABAMA," 2022, Public Affairs Research Council of Alabama.

## Alabama Taxes Compared

In 2021, Alabama state and local governments collected \$4,237 per resident through sales, property, income, and an array of other taxes. That's up from \$3,756 in 2020, a gain of \$481. Alabama's per capita tax collections increased in all major categories, reflecting a growing economy despite the economic disruptions of the pandemic.

Figure 2. Change in Alabama Per Capita Tax Collections, FY 2020–FY 2021, Source: U.S. Census Bureau.

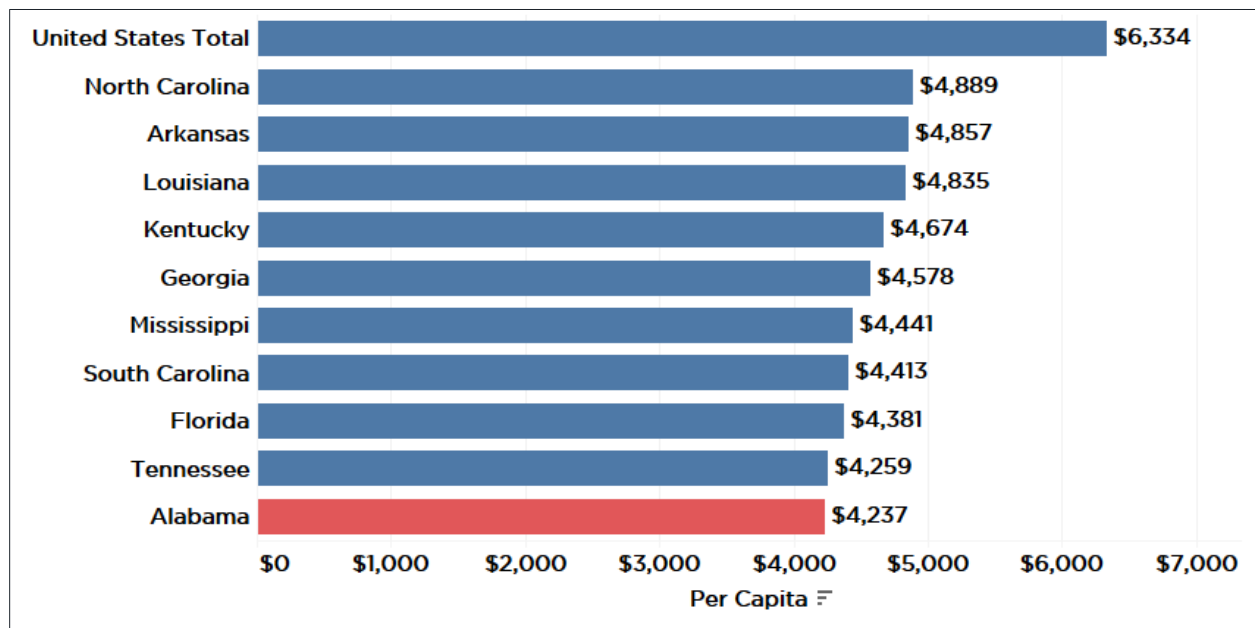


In the discussion that follows, Alabama's per capita collections are compared with other Southeastern states. In general, Alabama's approach to government and taxation is more similar to other Southeastern states than to the governments in other regions.

Over the course of the past 30 years, Alabama has consistently ranked at the bottom of the Southeast and last in the U.S. when it came to per capita collections of taxes.

After temporarily being displaced by Tennessee, Alabama returned to the bottom spot in the Southeast in 2021. Only Alaska collected less in taxes per capita in 2021, and that was due to extremely unusual conditions in the oil market related to the pandemic. Alaska normally collects about \$1,000 more per capita than Alabama.

Figure 3. Total State and Local Taxes Collected Per Capita, 2021, Southeastern States and U.S. Average<sup>12</sup>



The average per capita total for Southeastern states was \$4,556, \$319 per resident higher than Alabama. The median value for U.S. states was \$5,385 per capita, \$1,196 more per resident than Alabama.

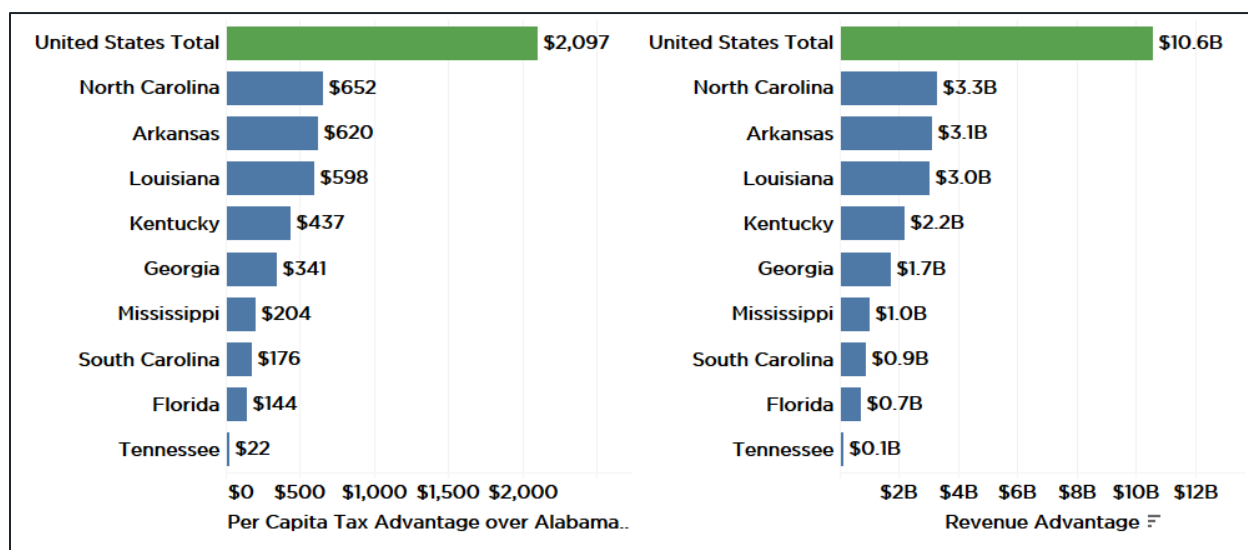
Alabama's \$481 gain in per capita tax collections between 2020 and 2021 ranked third out of the 10 Southeastern states, trailing Tennessee and North Carolina.

Figure 4 presents two sets of comparisons: 1) the per capita advantage enjoyed by other Southeastern states over Alabama and 2) the revenue advantage that the level of taxation provides those other states.

<sup>12</sup> This comparison considers tax revenues but does not consider lottery proceeds or other revenue generated through charges or fees.

The revenue advantage is each state's per capita tax advantage multiplied by Alabama's population. In other words, if Alabama's tax system produced the same level of revenue per capita as the comparison state, Alabama would have that much more to spend on providing services to its residents.

Figure 4. Southeastern States' Per Capita Tax Collection and Revenue Advantage Over Alabama, 2021



For instance, with the same tax base and tax rates as North Carolina, Alabama would bring in an additional \$3.3 billion in taxes. If Alabama collected taxes at the same per capita rate as South Carolina, it would have an additional almost \$900 million to spend.

Mississippi, a state with less wealth and economic activity, nevertheless collects \$204 more per capita than Alabama.

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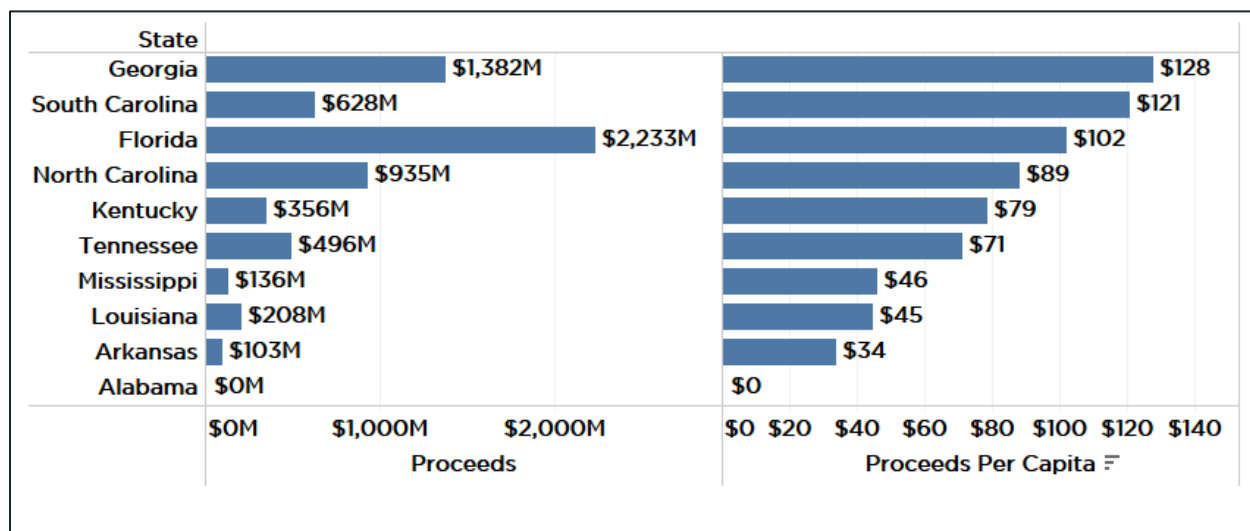
*If Alabama collected taxes at Mississippi's rate, state and local governments would have an additional \$1 billion in state dollars to fund education, health care, highways, public safety...*

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If Alabama collected taxes at Mississippi's rate, state and local governments would have an additional \$1 billion in state dollars to fund education, health care, highways, public safety, and the broad spectrum of state and local services governments provide.

The tally of tax collections does not include lottery proceeds. Five states—Alabama, Utah, Nevada, Hawaii, and Alaska—do not have lotteries. On average, states that have lotteries generate \$84 per capita of proceeds available to spend on public purposes.

Figure 5. State Lottery Proceeds Per Capita, 2021<sup>13</sup>



## Low Rates and Low Wealth = Low Tax Revenues

Alabama has tax rates that are lower than most other states and a base of wealth that is smaller than most.

*Alabama has tax rates that are lower than most other states and a base of wealth that is smaller than most.*

Our low tax revenue per capita results from two primary factors: lower tax rates than most other states and a smaller wealth base than most other states.

<sup>13</sup> Income and Apportionment of State-Administered Lottery Funds, U.S. Census Bureau, 2021. Proceeds are the amount available to spend after paying commissions, administration, and awarding of prizes. <https://www.census.gov/data/tables/2021/econ/state/historical-tables.html>

In 2022, Alabama had the 7<sup>th</sup>-highest poverty level among U.S. states, with 16% of residents living below the federal poverty level.<sup>14</sup>

Adjusted for population, the state's gross domestic product (GDP), the total value of all goods and services produced, ranks in the bottom five of states.

Compared to other states, Alabama has lower levels of educational attainment, a lower percentage of its population in the workforce, and a higher percentage of its population receiving disability.

All those factors drive down the resources available and simultaneously increase the need to invest in improving individuals' health, education, and skills.

### **Taxes as a Percentage of Personal Income**

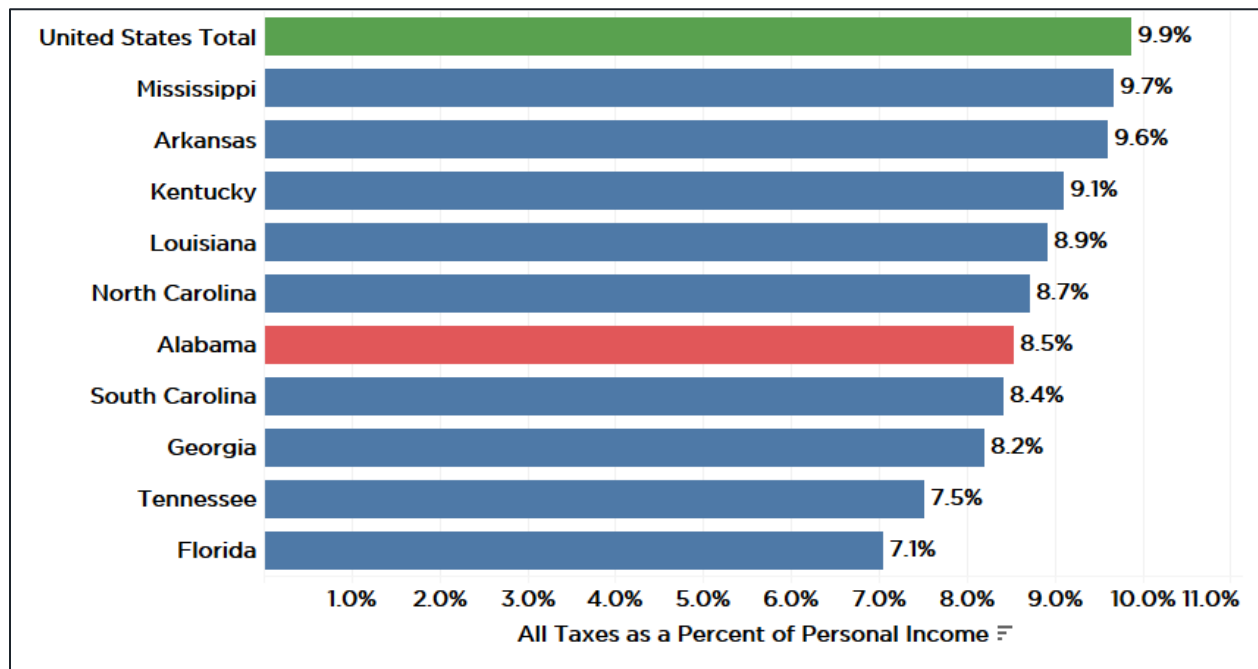
Alabama may collect less in taxes per capita, but it does not necessarily have the lowest tax burden. There are a couple of ways to measure tax burden. One is to compare all taxes to the state's total personal income.

Comparing total personal income to the total of state and local taxes collected, Alabama ranks No. 45 in the country, with state and local tax collections amounting to 8.5% of state residents' total personal income.

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<sup>14</sup> U.S. Census Bureau, "Poverty Status in the Past 12 Months," 2022. American Community Survey, ACS 1-Year Estimates Subject Tables, Table S1701, 2022, accessed on November 28, 2023, [https://data.census.gov/table/ACSST1Y2022.S1701?t=Income and Poverty&g=010XX00US\\$0400000](https://data.census.gov/table/ACSST1Y2022.S1701?t=Income and Poverty&g=010XX00US$0400000).

Figure 6. Taxes as a Percent of Personal Income, 2021. Source: Census Bureau and U.S. Bureau of Economic Analysis.<sup>15</sup>



The states ranked below Alabama have higher personal income per capita than Alabama, so despite collecting less as a percentage of total personal income, all those states raise more revenue per capita than Alabama. They can produce high tax revenues with less tax effort.

Mississippi's total personal income is lower than Alabama's, but its state and local government tax collections equaled 9.7% of Mississippi's total personal income for 2021. Because of that greater tax effort, Mississippi state and local governments have more to spend on a per capita basis than those in Alabama.

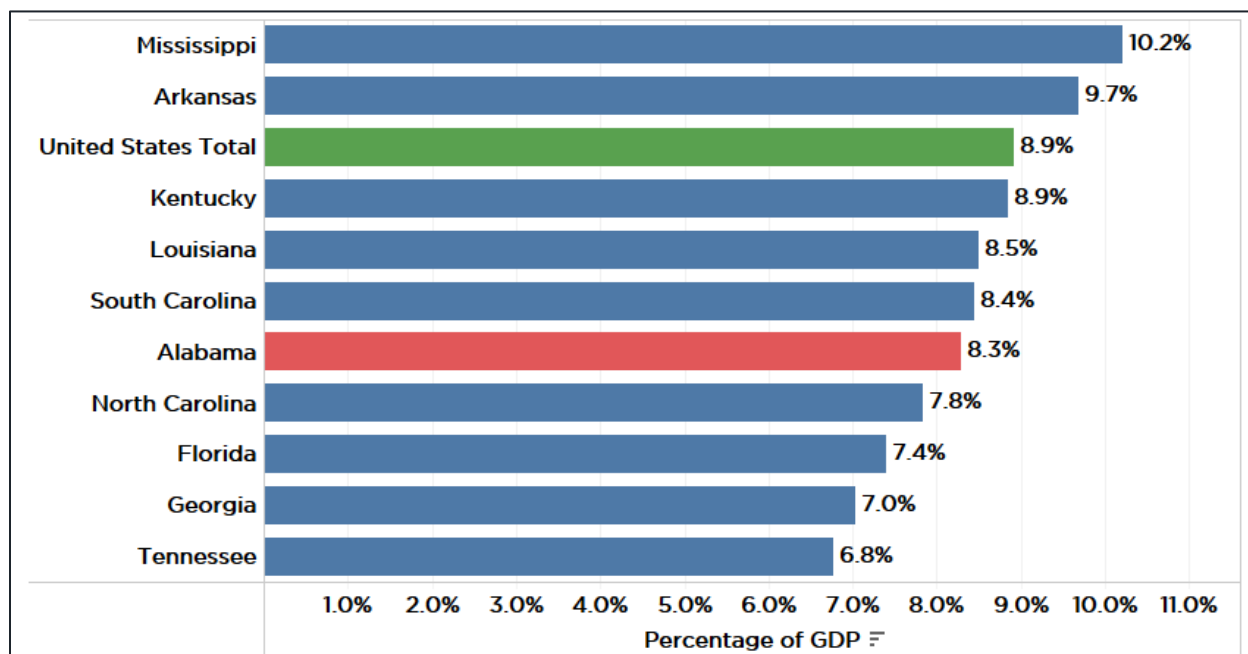
### Tax Burden as a Percent of GDP

Another way of measuring the tax burden is to calculate tax collections as a percentage of each state's GDP.

<sup>15</sup> U.S. Bureau of Economic Analysis, "[SAINC1 State annual personal income summary: personal income, population, per capita personal income](#)" (accessed Monday, December 4, 2023).

Alabama's tax collections amount to 8.3% of its GDP. The U.S. average for state and local taxes as a percentage of GDP for 2021 was 8.9%. Alabama ranks No. 33 in taxes as a percentage of GDP.

Figure 7. Taxes as a Percentage of GDP, 2021. Source: U.S. Census Bureau and U.S. Bureau of Economic Analysis.<sup>16</sup>



As with the personal income measure, states such as Tennessee, Georgia, North Carolina, and Florida have a higher economic output level than Alabama on a per capita basis. Thus, those states can tax at a lower percentage of economic activity and still yield higher tax revenues.

## What We Choose to Tax

While a state's tax base and tax rates are primary drivers of the total revenue collected, a state's tax system is also affected by the mix of taxes it applies.

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

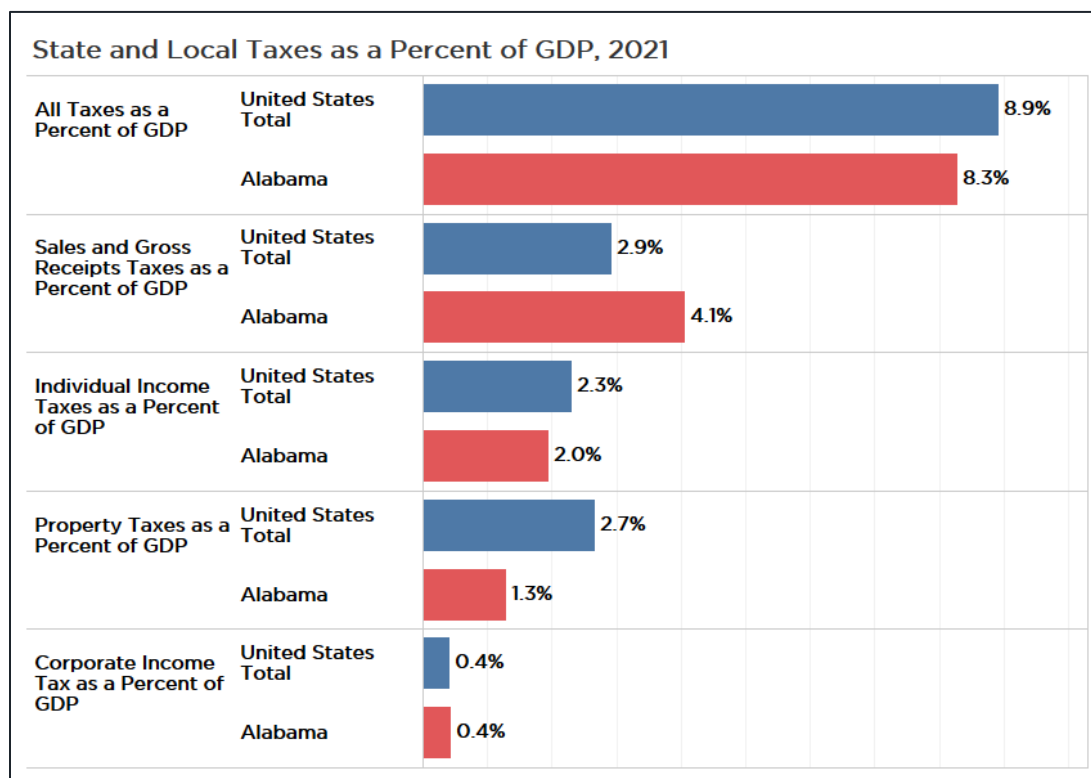
<sup>16</sup> "U.S. Bureau of Economic Analysis, ["SAGDP1 State annual gross domestic product \(GDP\) summary"](#) (accessed Monday, December 4, 2023).

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

## Alabama's Tax System Is Not Balanced

Figure 8 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 8. Types of Taxes and Gross Domestic Product, Alabama and U.S. Compared, 2021. Source: U.S. Census Bureau and U.S. Bureau of Economic Analysis.



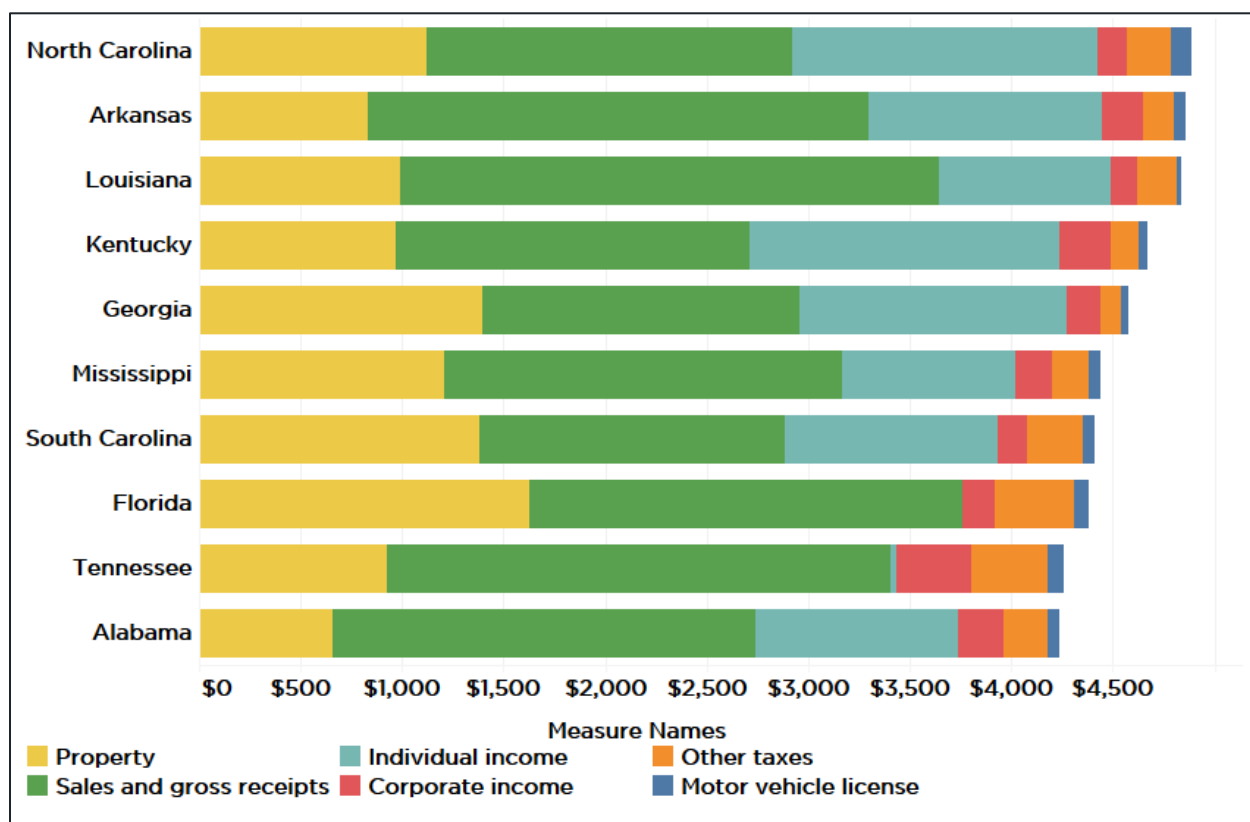
State and local property taxes are particularly low. As a percentage of GDP, Alabama's property taxes equal only 1.3% of GDP, compared to 2.7% in the average state. Alabama's per capita property tax collections could be doubled and still be below the U.S. average.

On the other hand, Alabama's sales and gross receipts tax is a higher share of

GDP than the average state, indicating that Alabama depends more heavily on sales taxes to produce tax revenue than most states.

Figure 9 compares Alabama's state and local tax mix with other Southeastern states, expressed on a per capita basis. The chart shows the different blend of taxes each state uses to produce total state and local tax revenues.

Figure 9. Mix of Taxes Per Capita in the Southeast, 2021, by tax source. Source: U.S. Census Bureau, PARCA Calculations.



The portion of the bar representing Alabama's property taxes, colored yellow, is shorter than the yellow section in any other state, reflecting lower per capita tax collections overall.

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*Florida compensates for no income tax with higher per capita property and sales tax collections.*

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Meanwhile, other states exhibit their own unique mixes. Florida has no income tax but makes up for it with high property and sales tax collections per capita.

For the most part, Tennessee has eliminated its income tax, but higher per capita property, sales, corporate income, and other taxes outpace Alabama's.

## The Tax Mix: A Balancing Act

Although Alabama collects less in state and local taxes per resident than almost every 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.

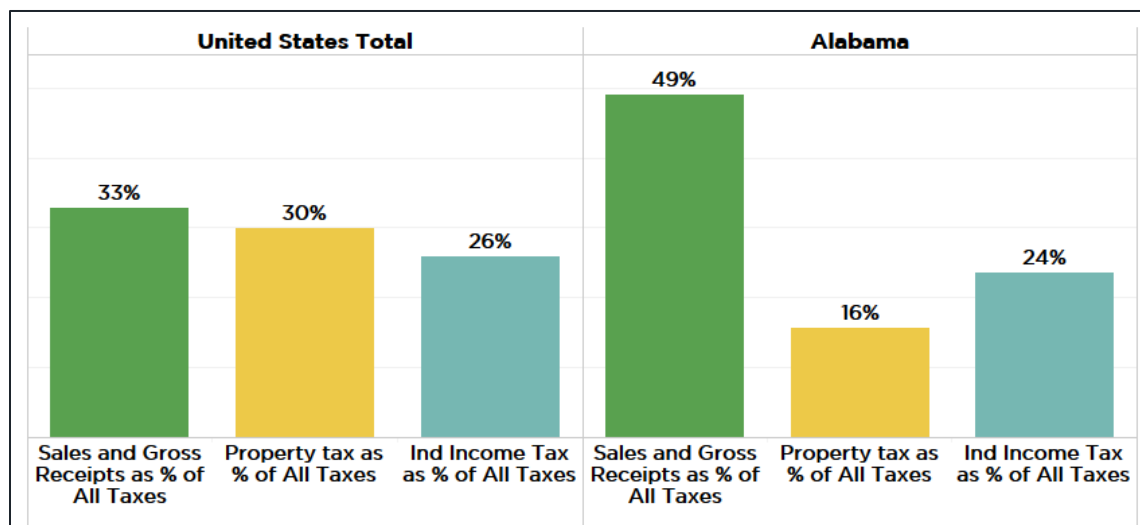
A sound tax structure avoids burdening any particular group too heavily. Most states take measures to protect households with low incomes from taxation to encourage economic advancement.

## Property Taxes

Alabama's state and local property tax collections are lower than any other state, creating an imbalance in the state's tax system.

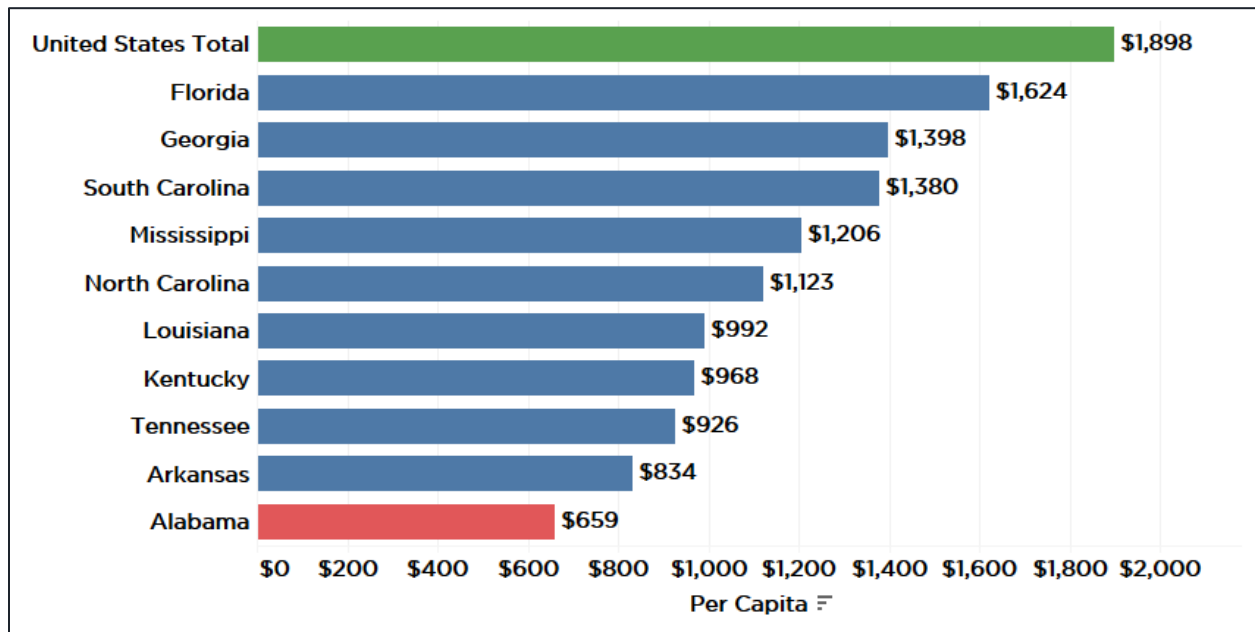
When all state and local revenue across the U.S. is considered, property taxes generate 32% of revenue, second to sales and gross receipts and ahead of income taxes. Property taxes account for only 17% of state and local revenue in Alabama and rank third behind income and sales taxes.

*Figure 10. Principal tax sources as a percentage of state and local tax revenues, all states vs. Alabama, 2021. Source: U.S. Census Bureau, PARCA Calculations.*



Alabama's property taxes are low not only in comparison to all states but also in comparison to peer states in the Southeast.

Figure 11. Per Capita State and Local Property Tax Collections, 2021. Source: U.S. Census Bureau, PARCA Calculations.



The mechanisms for raising property taxes embedded in the Alabama Constitution make raising rates or adequate revenue through the property tax difficult. Local property tax increases must be recommended by a local government body, approved for the ballot by the state legislative delegation, and voted on by the affected voters.

Even if voters approve a rate change, Alabama's constitutional property tax classifications and caps hold down the amount of revenue generated. That is particularly true in communities with limited commercial property, where the land is mostly in homes or in agriculture.

Alabama's low property taxes primarily benefit those who own homes, farms, and timberland. Those properties are taxed on just 10% of their value. Their property tax bills are further reduced through homestead exemptions and valuations based on the current use of the property rather than current market prices for the land and buildings.

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

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

## Income Taxes

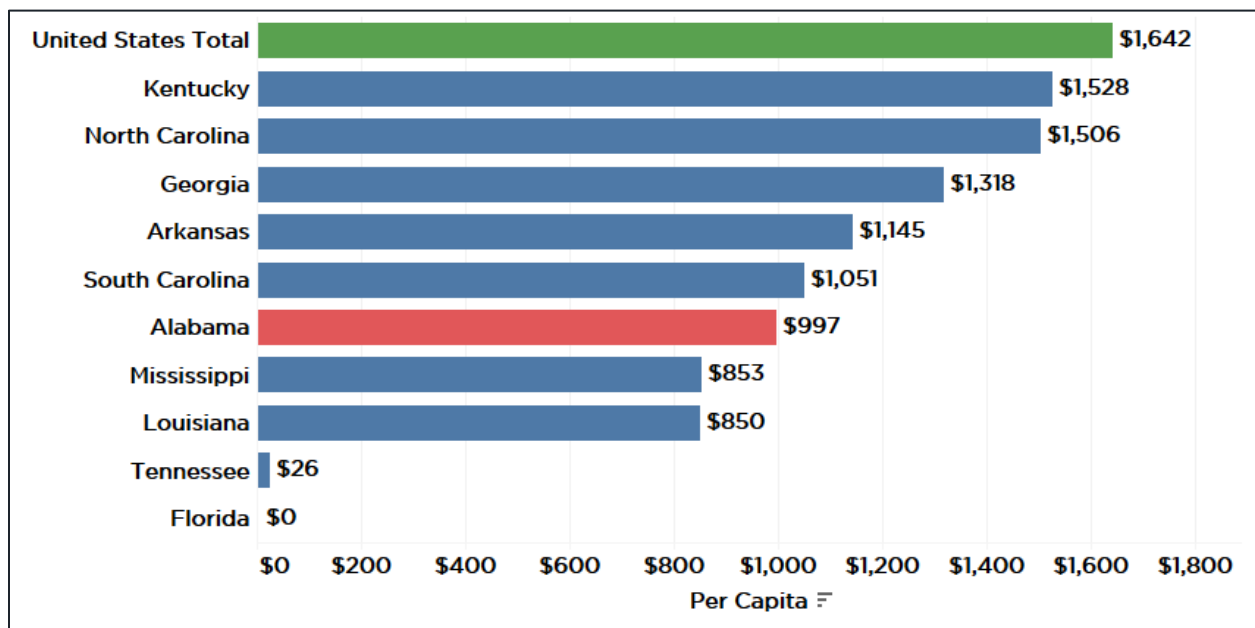
In 2021, Alabama's income tax revenue per capita ranked 35<sup>th</sup> out of the 43 states that collect income taxes.

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*In 2021, Alabama's income tax revenue per capita ranked 35<sup>th</sup> out of the 43 states that collect income taxes.*

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Figure 12. Per Capita State and Local Individual Income Tax Collections, 2021. Source: U.S. Census Bureau, PARCA Calculations.



In many states, the income tax is progressive, applying a higher rate to individuals with higher income levels. The income tax can serve as a balance against the regressive nature of other taxes.

However, in Alabama, several features of the tax interfere with the potentially progressive nature of the tax. Alabama sets the lowest threshold for taxing income in the U.S., requiring poverty-level families to pay income taxes.

The income of a single individual earning just \$4,500 annually is subject to the income tax. After earning \$12,500, a family of three starts paying income taxes. For that family, all income above \$18,600 in earnings is subject to the top state tax rate of 5%.

On the other hand, Alabama gives an unusual break to high-income earners: It allows a full deduction for federal income tax paid. That break does nothing for low-income Alabamians but is generous to high earners. Allowing the deduction for federal income taxes results in \$689 million less in state income tax collections.<sup>17</sup> Alabama is the only state to allow both individuals and corporations to fully deduct federal income taxes paid when calculating state income taxes.

### *Income tax history*

The current-day implications of Alabama's income tax are very different from when it was created. Alabama's income tax was created in the depths of the Great Depression and only applied to the wealthy at the time. Authorized by a 1933 Constitutional amendment, Alabama income tax has just three tax brackets that closely resemble the brackets set up in the 1935 enabling legislation.

- The first \$500 of income is taxed at 2%
- Income between \$500 and \$2,999: 4%
- Income above \$3,000: 5%

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<sup>17</sup> REPORT ON ALABAMA TAX EXPENDITURES, Legislative Services Agency, Fiscal Division. February 2022. [https://alison.legislature.state.al.us/2022\\_Tax\\_Expenditure\\_Report](https://alison.legislature.state.al.us/2022_Tax_Expenditure_Report)

Those tax brackets were supposed to create a progressive income tax that rises in percentage terms as the taxpayer's ability to pay rises. But, because the brackets have undergone only minor adjustments, they are almost meaningless today.

Also unchanged are the personal exemptions of \$1,500 for single adults and \$3,000 for married couples, created by the 1935 law that implemented the tax.

That meant married couples with \$3,000 of taxable income didn't pay income taxes. In 1935, personal per capita income was only \$216.<sup>18</sup> Thus, very few married couples or individuals made enough to be subject to the tax. In 1935, only 7,000 Alabamians earned enough to owe income tax, one-quarter of 1% of the population.<sup>19</sup>

A standard deduction was added later. In 2022, Legislation raised the standard and dependent deductions, shielding the first \$12,500 in income for a family of three from income taxes.

Since then, other states have continued to adjust their exemptions and standard deductions. Alabama continues to tax income at the lowest level threshold in the United States.

In 2023, a single Alabamian with a poverty-level income of \$14,580 would owe \$463. A family of three with income at the federal poverty threshold (\$24,860 in 2023) would owe \$538.

The federal income tax allows standard deductions of \$13,850 for individuals in 2023 and \$27,700 for married couples filing jointly. Thirty-two states use this federal adjusted gross income level as the starting point for figuring state taxes.

Others set their own thresholds, all of which, in the end, compute to a higher income tax threshold than Alabama's. In addition, the federal government

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<sup>18</sup> U.S. Bureau of Economic Analysis and Federal Reserve Bank of St. Louis, Per Capita Personal Income in Alabama [ALPCPI], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/ALPCPI>, December 6, 2021.

<sup>19</sup> Alabama Arise, "The Alabama Tax & Budget Handbook," Alabama Arise (blog), May 2, 2015, <https://www.alarise.org/resources/the-alabama-tax-budget-handbook/>.

provides child tax credits worth up to \$2,000 per child and an earned income tax credit, reducing or eliminating working families' tax liability. The tax credit payment is designed to offset the burden of other taxes and to help support the family. Alabama provides a tax deduction.

According to the Center for Budget and Policy Priorities, 11 states have enacted a state-level child tax credit, and 31 states have enacted their own versions of the federal Earned Income Tax Credit (EITC). Alabama has neither.

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*Taking into account exemptions and standard deductions, an Alabama family of three begins paying income taxes on anything earned over \$12,500.*

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While Alabama does little to spare low-income households from the income tax burden, it provides a break that primarily benefits high-earning households. Alabama allows taxpayers to deduct the full amount they pay in federal income taxes. Alabama is the only state where federal income taxes are fully deductible. Iowa and Louisiana recently eliminated that deduction, leaving Alabama alone in offering that benefit.

Since upper-income taxpayers pay a greater percentage of income in federal taxes, those higher earners get a larger break on Alabama income taxes. Meanwhile, the federal government has much larger deductions and exemptions, so the lowest-income workers pay little to no federal taxes.

The deductibility of the federal income tax also creates unintended consequences. When federal taxes go down for individuals, their state taxes go up.

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.

If desired, Alabama can change the standard deduction legislatively and create a system of credits.

## Sales Tax

Because of the difficulty of raising property taxes, Alabama state and local governments have heavily relied on the sales tax.

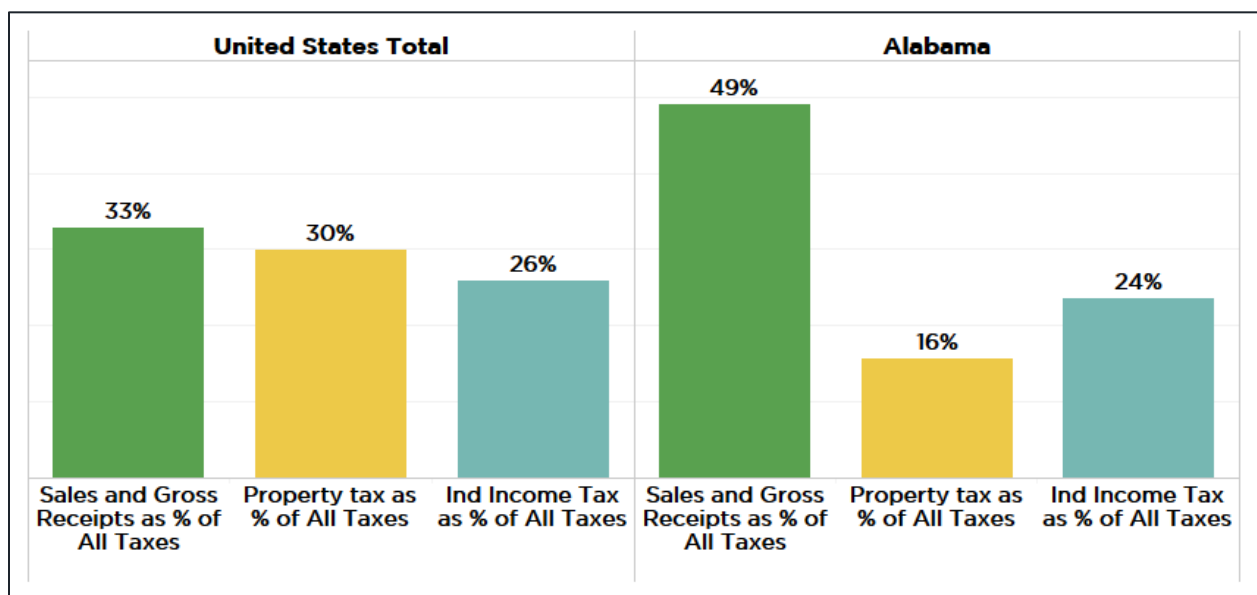
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*Alabama state and local governments have developed a heavy reliance on the sales tax.*

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As noted, almost half of the revenue collected by Alabama state and local governments comes from sales taxes. Across the U.S., sales taxes account for just a third of state and local taxes.

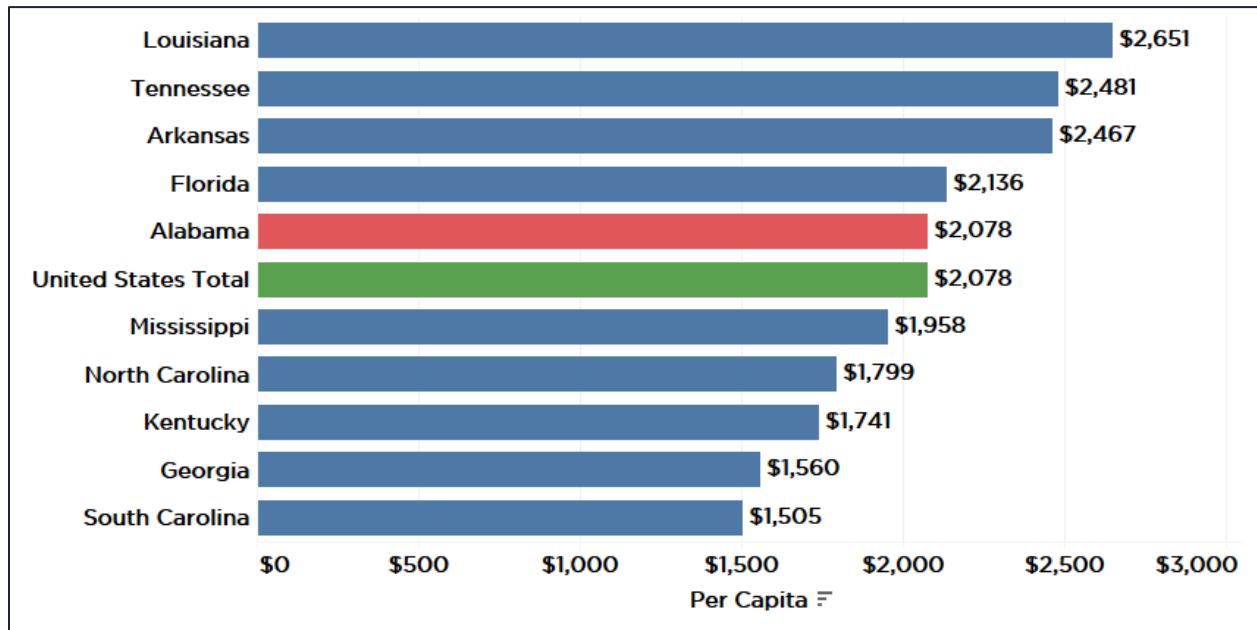
Figure 13. Share of state and local taxes from three principal sources, U.S. vs. Alabama



Alabama's per capita state and local sales tax collections are equal to the national average. Alabama's per capita collections trailed Louisiana, Tennessee, and Arkansas, which have slighter higher average sales tax rates. Alabama's per capita collections also trail Florida's, which benefits from a heavy infusion of out-of-state tourism dollars and has a higher level of economic activity and wealth.

According to calculations by the Tax Foundation, Alabama has the fifth highest combined state and local tax rates in the country at a weighted average of 9.24%.<sup>20</sup>

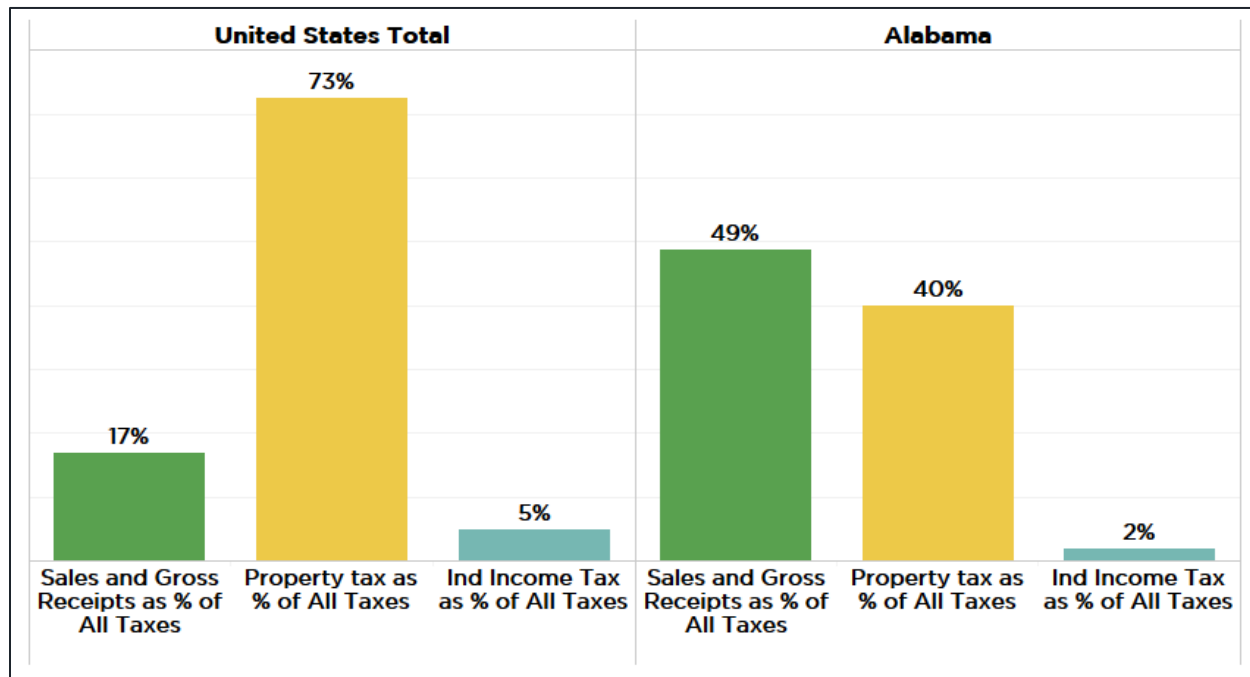
Figure 14. Per Capita Sales and Gross Receipts, 2021. Source: U.S. Census Bureau, PARCA Calculations.



Alabama's high reliance on sales taxes is most obvious at the local level. Across the country, 73% of local tax revenue comes from property taxes. In Alabama, only 40% of local revenue comes from property taxes. Nationally, only 17% of local revenue comes from sales tax. In some states, local governments do not levy sales taxes. In Alabama, half of local revenue comes from sales and gross receipts.

<sup>20</sup> Tax Foundation. "State and Local Sales Tax Rates, Midyear 2023," July 17, 2023. <https://taxfoundation.org/data/all/state/2023-sales-tax-rates-midyear/>.

Figure 15. Percentage of local government tax revenue comes from the three principal sources, U.S. total vs. Alabama.



Sales taxes tend to be regressive because those with lower incomes tend to spend a higher percentage of their income on goods and services subject to the sales tax.

Attempting to counter the regressive nature of the tax, many states exempt items such as groceries and medicine from the sales tax. Until 2023, Alabama was one of three states that fully applied sales tax to food purchased for home consumption without providing any offsetting relief for low- and moderate-income families.<sup>21</sup>

However, in its 2023 session, the Alabama Legislature voted to reduce the state sales tax on store-bought food items from 4% to 3%.<sup>22</sup> The change went into effect in September 2023. The legislation calls for a further reduction in 2024 to 2% if revenue targets are met.

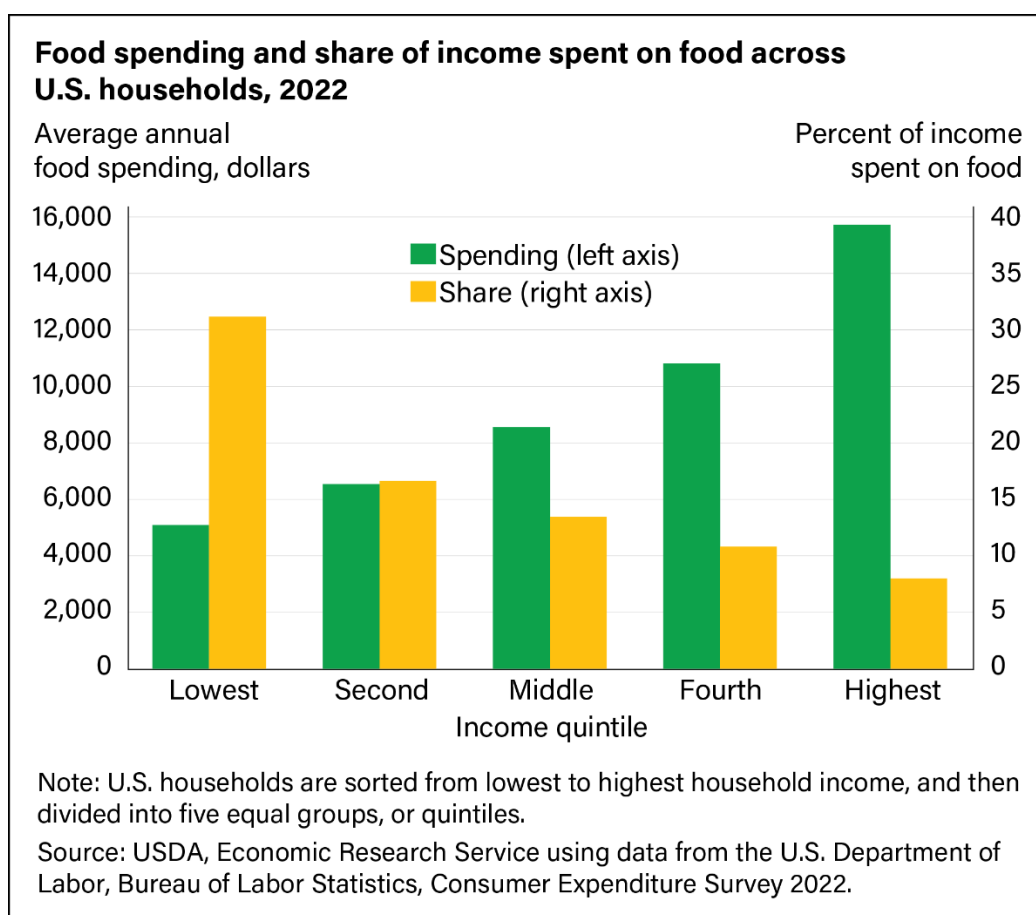
<sup>21</sup> “Alabama and Utah Join Growing Number of States Moving to Reduce or Eliminate Sales Taxes on Groceries | Center on Budget and Policy Priorities,” September 28, 2023. [www.cbpp.org/blog/alabama-and-utah-join-growing-number-of-states-moving-to-reduce-or-eliminate-sales-taxes-on-groceries](https://www.cbpp.org/blog/alabama-and-utah-join-growing-number-of-states-moving-to-reduce-or-eliminate-sales-taxes-on-groceries)

<sup>22</sup> Act 2023-554, <https://arc-sos.state.al.us/ucp/L1286222.A11.pdf>

Reduction or elimination of the sales tax on groceries has long been sought because the sales tax, especially the taxes on groceries, falls disproportionately on low- and moderate-income families. Those families spend a greater share of their incomes on basic necessities; therefore, a greater share of those families' incomes goes to paying state and local taxes.

According to U.S. Department of Agriculture 2022 estimates, the 20% of households with the lowest income spent \$5,090, or 31.2% of their annual income, on food. Meanwhile, the 20% of households with the highest income spent an estimated average of \$15,713, or 8% of their annual income, on food.

Figure 16. Percentage of income spent on food, by income level, USDA estimate<sup>23</sup>



The Legislature's decision to reduce the sales tax on food provides some relief for consumers struggling with inflation and will disproportionately benefit those

<sup>23</sup>"Food Spending as a Share of Income Declines as Income Rises." Accessed December 5, 2023. <http://199.135.94.241/data-products/chart-gallery/gallery/chart-detail/?chartId=58372>

with the lowest incomes. However, the reduction in the state sales tax on groceries does not affect local sales taxes on groceries. In large metro areas, over half the sales taxes are local. So, the combined rate of state and local sales taxes is 10% (now reduced to 9% on groceries). Because property taxes are procedurally difficult to raise and their productivity is capped, it would be difficult for municipalities to follow suit and reduce or eliminate the sales tax on food.

Some states counter the regressive effects of their sales taxes using a progressive income tax system. Some states effectively pay back the taxes low-income households pay on groceries and medications through targeted tax credits or deductions. This is a method of compensating for the regressive nature of the sales tax. It is a more targeted way to create balance than eliminating the sales tax on groceries for everyone.

Despite high sales tax rates, Alabama's per capita state and local sales tax collections rank 31st among the 50 states. Alabama's sales taxes are not as productive as other states because of the smaller base of economic activity and because Alabama's sales tax is narrow compared 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 consuming such services. According to a survey by the Federation of Tax Administrators, Alabama taxes 42 out of 176 categories of services.<sup>24</sup> 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.

### *Taxing Sales Online*

States, including Alabama, are pursuing various options for broadening the sales tax to capture the sales activity transacted on the Internet. Those

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<sup>9 24</sup> Alt, R. (2017, August. Updated Jan. 2018). Sales Taxation of Services, Retrieved Oct. 30, 2020, from <https://www.taxadmin.org/sales-taxation-of-services>.

transactions have, up until recently, been generally off-limits to taxation. In 2015, Alabama created the Simplified Sellers Use Tax (SSUT), which captures some of the sales tax revenue from online sales. Further changes to that law were made in 2018. In June 2018, the U.S. Supreme Court issued a ruling that bolstered states' abilities to tax online sales.

Since then, taxes on online sales have continued to climb, with \$185 million collected in FY 2020, \$257 million in FY 2021, \$311 million in FY 2022, and 369 in FY 2023. This tax source was particularly important during the pandemic, as consumers increasingly turned to online shopping and delivery.

The SSUT's rate of 8% on online purchases is lower than the weighted average sales tax of 9.24% levied on in-store purchases across the state. The tax collections are submitted to the Alabama Department of Revenue. Half of the tax flows to the state; the other half is distributed to cities and counties based on a population-based formula.

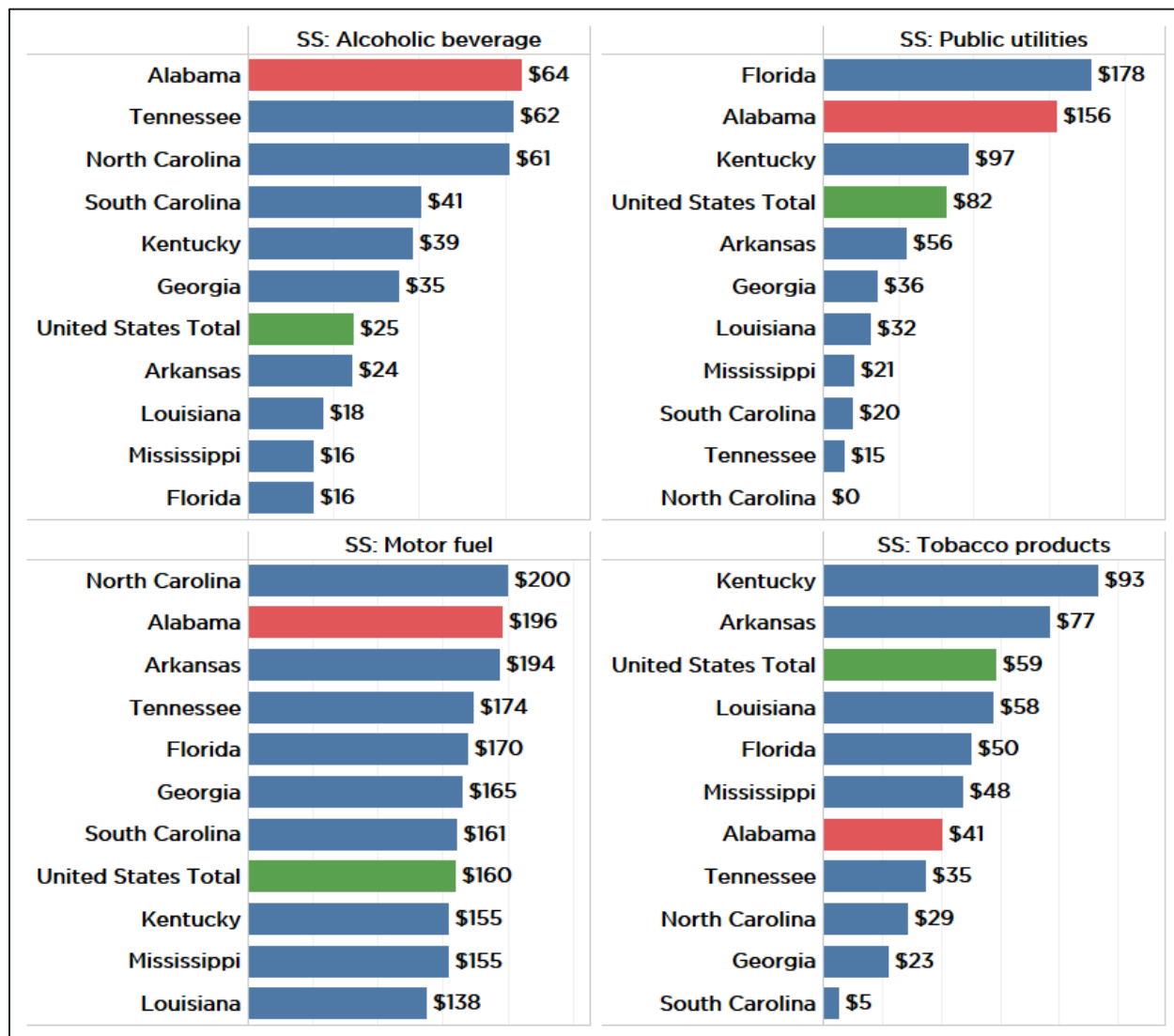
Larger cities, which tend to be centers of commerce and depend on the sales tax for revenue, point out that the current scheme creates an advantage for online retailers because those retailers collect an 8% tax. In comparison, Alabama-based retailers often collect a 10% tax.

Smaller cities and counties with less of a sales tax base tend to support the current population-based system because SSUT revenue is a new and added source of revenue for them. Read more about SSUT revenue in PARCA's report released earlier this year: [\*E-Commerce and Taxation: Questions of Efficiency and Equal Treatment\*](#).

## Selective Sales Taxes

Alabama governments sometimes turn to selective sales taxes to avoid passing a general tax increase. For example, Alabama ranks high in per capita collections of taxes on alcoholic beverages (No. 2 in the U.S.) and public utilities (No. 5 among U.S. states).

Figure 17. Per Capita Selective Sales Collections in the Southeast, 2021. Source: U.S. Census Bureau, PARCA Calculations.



Alabama's ranking and calculated per capita rank in motor fuels collections appears to be inflated, perhaps based on the timing of reporting. Alabama's rank of No. 14 in 2021 is much higher than it has ever been previously, and it does not correspond with Alabama's motor fuel tax rates. According to the

American Petroleum Institute's most recent survey, Alabama's gasoline tax ranks No. 26, far below the national average. Gasoline tax rates in North Carolina, Georgia, and Florida are higher.<sup>25</sup> According to the latest AAA survey, Alabama's gas prices rank 43<sup>rd</sup> in the U.S.<sup>26</sup>

Alabama's fiscal year is different than most states, and Alabama's fiscal year used in this survey began in October of 2019. During the months preceding the pandemic, gas prices and travel volume were high. After the outbreak of COVID-19, travel plummeted, and gasoline prices plummeted.

In 2021, per capita revenue on tobacco products ranked No. 37 in the U.S. Alabama's state-level cigarette tax rate remains relatively low, at 67.5 cents a pack, ranking No. 41 among U.S. states. According to the Campaign for Tobacco-Free Kids, the average tax rate among states is \$1.93 per pack.<sup>27</sup> That does not factor in local tobacco taxes.

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<sup>25</sup> "Gasoline Tax," accessed December 2, 2023, <https://www.api.org/oil-and-natural-gas/consumer-information/motor-fuel-taxes/gasoline-tax>.

<sup>26</sup> "AAA Gas Prices," accessed December 2, 2023, <https://gasprices.aaa.com/>.

<sup>27</sup> "STATE CIGARETTE EXCISE TAX RATES," Campaign for Tobacco Free Kids, accessed December 9, 2023, <https://www.tobaccofreekids.org/fact-sheets/tobacco-control-policies>

## Conclusion

Since 2017, Alabama's state tax collections have grown at a healthy pace, and in 2021 and 2022, collections grew at extraordinary rates that are not likely to be seen again.

Providing tax relief in light of high inflation was a fitting response by lawmakers. Targeting that relief in ways that provided benefits for low-income households was also a positive step. The Legislature also budgeted responsibly and saved surplus funds for long-term investment.

But as conditions trend toward normal, it will be important to remember the state has underinvested for a long time compared to other states. And our tax system continues to be engineered to produce lower tax revenues per capita than other states.

The ideal way to grow tax revenues is to build the health, wealth, and prosperity of the state and its residents. The best predictor of prosperity, health, wealth, and prosperity is educational attainment. On the other hand, low rates of educational attainment are correlated with poor health, higher rates of poverty, unemployment, and involvement with the criminal justice system.

In the long run, Alabama must be able to make sustainable, competitive investments in programs proven to improve health, education, and economic growth. Otherwise, we will end up paying the bills for neglect.



# Public Affairs Research Council of Alabama

## WHO WE ARE

The Public Affairs Research Council of Alabama is a nonpartisan research organization focused on helping state and community leaders make better-informed public policy decisions.

## WHAT WE BELIEVE

State and community leaders make better-informed decisions when provided with unbiased, nonpartisan data and resources about the topics they care about the most.

## HOW WE WORK

We conduct *nonpartisan research* on issues affecting the people of Alabama so state and community leaders, and others, can make better-informed decisions based on facts, not rhetoric.

We *independently evaluate* the efficacy of public programs and services.

We offer technical and research assistance for public and nonprofit partners to help them integrate the use of *accurate data* into their work.

We engage in *meaningful dialogue* with state and community leaders and others on the topics Alabamians care about the most.



## WHY WE MATTER

There are many groups and organizations vying for the attention of state and community leaders. It's often hard to identify what's real from alternative facts and partisan-leaning talking points. Our founders started the Public Affairs Research Council of Alabama more than three decades ago to counter the rising tide of misinformation. They recognized then, and it remains true today, that emotional appeals and fiery rhetoric often lead to indecision and false choices.

### Major Projects

PARCA's research informs major policy debates of the day and is relied upon by policymakers and policy organizations across the spectrum.



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