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The Alabama Constitution's Impact on Taxes and Spending

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The Alabama Constitution's Impact on Taxes and Spending

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This report is an installment of PARCA's yearlong series on the unfinished work of reforming Alabama's Constitution. This project is supported, in part, by the Alabama Citizens for Constitutional Reform (ACCR) Foundation.

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Alabama Taxes and the Alabama Constitution

PARCA is re-examining Alabama's Constitution in light of the 2022 passage of a revised and reorganized version of the state's fundamental law.

The approval of the Constitution of 2022 was the culmination of decades of advocacy. Some important changes were achieved, including a substantial reorganization and the removal of racist and unconstitutional provisions central to the spirit of the state's 1901 Constitution.

And yet, the Alabama Constitution of 2022 maintains the fundamental shackles on government from the 1901 Constitution. Embedded in the Constitution is a tax system that is inadequate, inefficient, and inequitable.

Since the early 1990s, PARCA's *How Alabama Taxes Compare* analysis has found that Alabama state and local governments consistently collect less per capita in taxes than almost all other states. After occupying the bottom spot for most of the past 30 years, Alabama has traded back and forth with Tennessee for last place since 2018. This year, Tennessee's per capita collections came in \$4 lower than Alabama's, resulting in a rank for Alabama of No. 49. Alabama continues to collect less per capita in state and local property taxes than any other state. Property taxes are strictly limited by provisions in the state constitution.

Low taxes create some advantages. Low property taxes on land and homes are attractive in some regards, decreasing the cost of homeownership and shielding rural land and farms from development pressure. Lower taxes also can be attractive to businesses and individuals moving to the state.

However, low property taxes come at a cost, creating a greater reliance on other taxes, mainly sales taxes. Those sales taxes put a particular burden on low-income Alabamians. Low tax collections also mean that Alabama state and local governments have less to invest in services such as education, health, public safety, and the justice system. That is in a state with high poverty rates, low educational attainment, poorer health outcomes, and higher rates of violent crime than most other states. In turn, high poverty and less economic activity mean less wealth to tax and, thus, lower tax collections.

Inadequate

In contrast to other states, where the state legislature and local governments generally have the power to adjust tax rates, Alabama's constitution sets limits, rates, and procedural restraints on state and local taxes. That makes taxes hard to raise, adjust, or rebalance. In the end, Alabama's lower base of

wealth and structural and cultural resistance to taxes mean that governments here have less to spend on providing vital public services, placing Alabama in the bottom ten states in most spending categories.

Figure 1. Alabama’s rank in state and local spending per capita. Source: Census Bureau, Annual Survey of State and Local Finances, FY 2022

	Alabama
Corrections	41
Elementary & secondary education	40
Financial administration	41
Fire protection	40
Health	42
Highways	43
Housing and community development	38
Judicial and legal	46
Libraries	46
Parks and recreation	42
Police protection	38
Protective inspection and regulation	40
Public welfare	48
Sewerage	48
Solid waste management	34
Transit	46

One sector in which Alabama spends more than most states is higher education, ranking No. 10. However, over half of that revenue, 52.5%, is provided by students through tuition, not through tax dollars. The student share of higher education revenue is the second highest in the Southeast.¹ Alabama’s in-state tuition ranks second highest in the Southeast. Because the cost of attendance is higher in Alabama than in other Southeastern states and because the state provides less in aid, families with the lowest incomes pay more to attend a four-year college on average than students in all other Southeastern states.²

It’s a vicious cycle. Alabama has more acute needs than most other states in areas such as education, health, and welfare but generates less to invest in these areas. That’s because of low tax revenue. And low tax revenue is due

¹ “Data Downloads: State Higher Education Finance (SHEF) Report,” SHEF, accessed December 23, 2024, <https://shef.sheeo.org/data-downloads/>.

² “Fact Book Tables,” Southern Regional Education Board, December 10, 2024, <https://www.sreb.org/fact-book-tables>.

both to how we tax and to high poverty and less wealth, which, in turn, is based on generations of underinvestment in human capital.

Inefficient

Alabama's constitution lays the groundwork for an inefficient tax system, one that makes predetermined decisions about how tax revenues are spent and creates an imbalance among tax sources. That limits the ability of legislators and local governments to address pressing needs or to adjust taxes toward greater fairness or competitiveness.

Earmarks

Alabama earmarks more of its revenue than any other state. That means revenues are collected and must be spent for purposes specified in the constitution or by law. These earmarks prevent policymakers from shifting resources to meet the most pressing priorities.

For example, the Constitution specifies that taxes on gasoline may only be spent on road construction. That protects the interests of road builders but hobbles the state when it comes to supporting other transportation needs, such as public transit. Alabama is one of only five states that provides no state funding for public transportation.³

Since many of Alabama's tax rates and earmarks are set in the constitution rather than by the Legislature, they are difficult to change.

Unbalanced

Most state and local tax revenue is derived 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; it is regressive, falling more heavily on the poor than the wealthy.

Strict limits on property taxes produce the lowest per capita property taxes in the U.S., leaving state and local governments more reliant on sales and income taxes, which experience greater ups and downs than the more stable property tax.

Alabama's constitution-based property tax system keeps taxes low for homeowners, farmers, and especially for owners of timberland. That property

³ Alabama Arise, "Investing in the Public Transportation Trust Fund," *Alabama Arise* (blog), April 2, 2024, <https://www.alarise.org/?p=9400>.

enjoys protections from being taxed based on its appraised value, taxing it instead on a complicated method that values the property on its “current use.” Most states have current use protections for agricultural and timberland, but Alabama’s are particularly generous.

A 2021 study by authors including Auburn University Rural Sociology Professor Conner Bailey, examined timberland ownership in Alabama and documented the implications for tax revenue and the rural economy.⁴

The study found that 70% of Alabama land is timberland, and 94% of that land is privately owned. That ownership is highly concentrated:

- Six corporate owners control 10% of the total 1.9 million acres.
- 1,208 owners control 1,000 acres or more. Those large owners control 7 million acres or 36% of privately owned timberland in Alabama.
- 59% of private forest acreage is absentee owned, with property tax billed to owners outside the county where the property is located.
- 36.5% of all timberland is owned by absentee owners, often corporate entities, headquartered outside Alabama or overseas.

These absentee owners thus enjoy the benefits of Alabama’s low taxes. Timberland in other states produces more revenue for governments and communities. Comparing millage rates and current use values to neighboring states, the study found that timber owners in Alabama paid half of what timberland owners in Florida pay and one-third of what owners in Georgia, Tennessee, and Mississippi pay. The owners pay annual property taxes ranging from \$1.33 to \$3.89 per acre in Alabama.

The study found that in Alabama counties where absentee ownership rates are higher, quality of life measures are lower: higher poverty and unemployment rates, for example. Low property taxes limit the ability of governments to pay for quality public schools, to provide infrastructure, and offer basic services.

Even in suburban districts, Alabama’s constitutional system makes raising revenue from property taxes difficult. Rate increases need approval by the local governmental body, then the area’s legislative delegation, and finally by affected voters through a ballot referendum.

Having citizens vote directly on property tax rates is certainly democratic. However, it differs from the process employed by neighboring states, where

⁴ “Taking Goldschmidt to the Woods: Timberland Ownership and Quality of Life in Alabama*,” accessed December 16, 2024, <https://doi.org/10.1111/ruso.12344>.

elected officials who are ultimately accountable to voters adjust property tax rates based on the revenue needed to meet budgets.

Due to the difficulty in raising property taxes, local governments rely more heavily on sales taxes, which can be controlled by local governments. Sales taxes are regressive, extracting a greater share of income from low-income residents. This dependence on sales taxes creates an advantage for some cities that have a strong commercial base but leaves small towns and rural areas at a disadvantage. Their residents help subsidize the services in other cities where they travel to shop.

Inequitable

Alabama's taxes are low but not low for everyone. As grounded in the state Constitution, the tax system falls most heavily on those who can least afford to pay. Because of property tax limits and the complicated procedure for adjusting them, local governments rely most heavily on the sales tax, which extracts a greater share of income from the poor.

High Sales Tax

At a weighted average of 9.29%, Alabama has among the highest combined state and local sales tax rates in the U.S.⁵ According to the Tax Foundation, Alabama has the highest average local sales tax rate in the United States at 5.29%.

In 2023, the Alabama Legislature took the long-sought step of reducing the state sales tax rate on food items, joining 48 other states that provide an exemption, reduction, or offset to sales taxes on groceries.⁶ Alabama's law called for another 1-cent reduction in the rate in 2024 if revenue grew at a target rate. However, the target was not reached, and the food tax remained at 3%.

Flat Income Tax

When it was established by constitutional amendment in 1935, Alabama's income tax was progressive, applying higher tax rates to those with higher income. It provided generous exemptions, shielding most households from

⁵ Janelle Fritts, "State and Local Sales Tax Rates, 2024," *Tax Foundation* (blog), July 24, 2023, <https://taxfoundation.org/data/all/state/2024-sales-tax-rates-midyear/>

⁶ Katelyn Washington last updated Contributions from Gabriella Cruz-Martinez in Features, "The 'Food Tax': Grocery Tax by State," Kiplinger.com, July 5, 2023, .

having to pay it. In 1935, only 7,000 Alabamians earned enough to owe income tax, one-quarter of 1% of the population.⁷

Locked in the constitution, those 1935 tax brackets, rates, and exemptions have never been adjusted, meaning almost everyone has to pay it, and everyone's taxable income over \$3,000 is taxed at 5%, essentially a flat tax. Deductions and exemptions shield only a tiny fraction of income from taxation. Alabama's income tax kicks in early, at \$4,500 in earnings for a single individual.

No other state starts taxing income at the low level set by Alabama. In contrast, 31 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. Eleven states have enacted a child tax credit that refunds money to help support children.⁸

Meanwhile, the Alabama Constitution also locks in a tax break that benefits higher earners. Individuals and corporations can fully deduct federal income taxes when computing their state income taxes, and since federal income taxes apply higher rates to higher earners, the Alabama tax break increases in value as income increases. Alabama is the only state that allows taxpayers a full deduction for federal income taxes paid when calculating state taxes.⁹ Other states that had this provision, such as Iowa and Louisiana, have recently repealed it.

According to 2024 estimates by the Institute on Taxation and Economic Policy, the lowest-income Alabamians pay more than 11% of their earnings in state and local taxes, while upper-income Alabamians pay a substantially lower percentage.¹⁰ According to the study, Alabama has the 12th most regressive tax structure in the U.S., meaning that when all taxes are considered, lower-income Alabamians pay a greater share of their income in taxes than those with higher incomes. The 20% of families whose income is less than \$19,500 a year pay almost 12% of their income in taxes, while the wealthiest 1% of families whose income is more than \$484,300 a year pay only 5.4% of their income in state and local taxes (Figure 2).

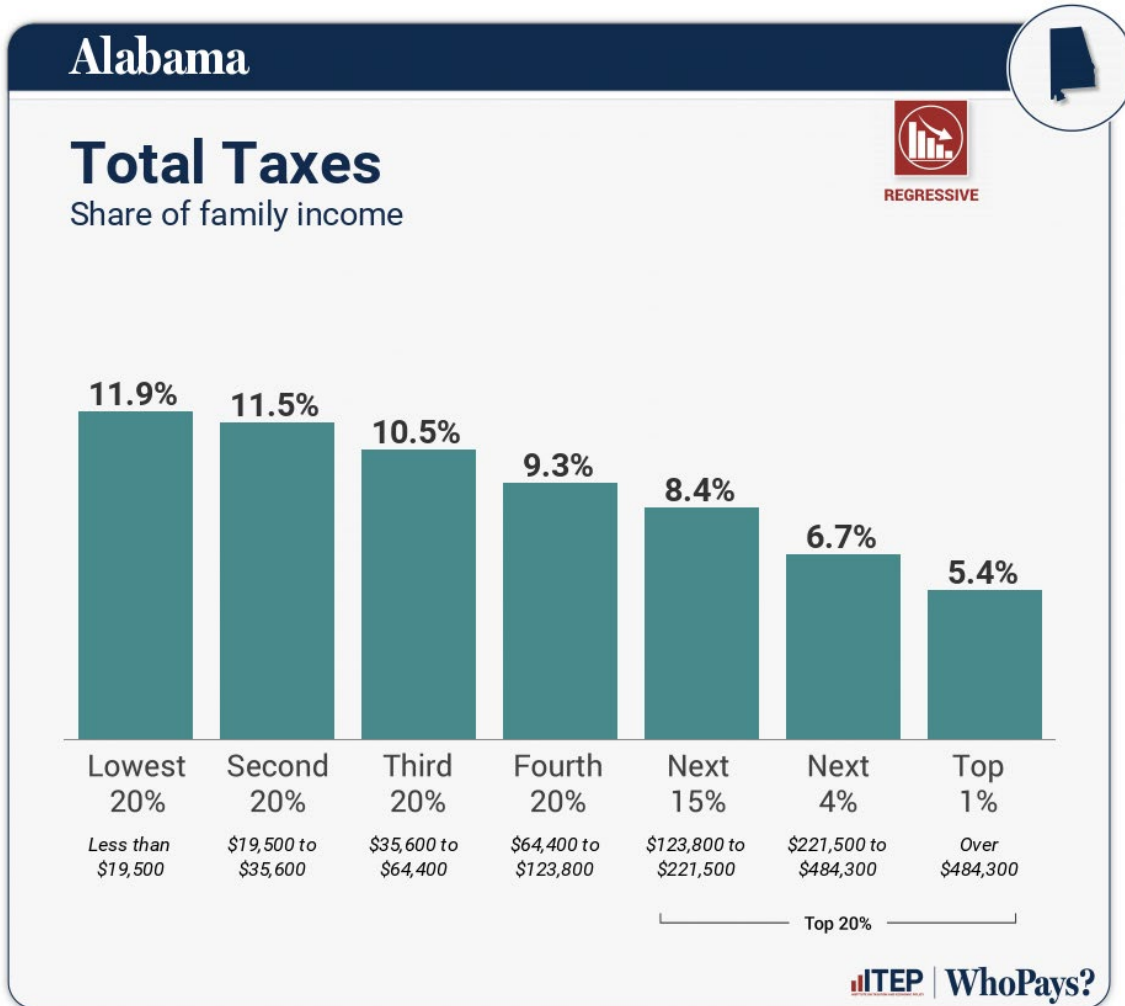
⁷ Alabama Arise, "The Alabama Tax & Budget Handbook," *Alabama Arise* (blog), May 2, 2015, <https://www.alarise.org/resources/the-alabama-tax-budget-handbook/>.

⁸ "States Can Enact or Expand Child Tax Credits and Earned Income Tax Credits to Build Equitable, Inclusive Communities and Economies | Center on Budget and Policy Priorities," March 3, 2021,

⁹ Jared Walczak, "Federal Deductibility Is Distorting Tax Liability in Six States," *Tax Foundation* (blog), November 1, 2021, <https://taxfoundation.org/federal-deductibility/>.

¹⁰ "ITEP-Who-Pays-7th-Edition.Pdf," accessed December 11, 2024, <https://sfo2.digitaloceanspaces.com/itep/ITEP-Who-Pays-7th-edition.pdf>.

Figure 2. State and local taxes as a percentage of income, by income quintile. Source: Institute on Taxation and Economic Policy



How We Got Here—A Constitution Based in Inequity

In some ways, we still live with a backward-looking, agrarian-oriented system, which protected large landowners and envisioned a very limited government. Since its adoption, that constitution-based system has been stretched and resown by 1,000 amendments in an attempt to stitch together a government that can address modern needs.

The roots of the system reach back to before the Civil War. Prior to the Civil War, Alabama’s government was largely funded by taxes paid by slaveholders on the value of the individuals they enslaved. Two-thirds of state revenue for the early antebellum period came from such taxes. The government provided minimal public education and no education for Black Alabamians.

After the Civil War, with the government under the control of Republicans, a new Constitution in 1868 sought to establish a government capable of modernizing and developing the state. Central to that endeavor was the education of both Whites and formerly enslaved Blacks.¹¹

However, revenue was needed to fund schools. With the slave tax gone, higher land taxes were imposed. Those taxes on land fell particularly hard on poor White yeoman farmers, increasing resentment of government. Those farmers, locked in the mindset of White supremacy, regarded the increased spending on the education of Blacks as a waste.

In addition, Reconstruction-era governments sought to modernize the state through public-private partnerships in which the state helped finance the construction of railroads. Many of those endeavors ended in failure and bankruptcy and were tainted with corruption, leaving the state with a burden of debt.

When White Democrats regained control, a new constitution in 1875 imposed strict limits on taxation and debt and banned government participation in internal improvements. Concerned that Republicans could regain control of local governments in counties where the Black population was the majority, the Constitution centered power in Montgomery, where the elite could maintain control of taxing and spending.

The 1875 Constitution abolished the state board of education and mandated segregated schools. Since it slashed taxes, new revenue was needed. Part of the answer was developing the convict lease system, under which convicts were rented out to plantations, coal mines, and steel mills. Almost all the convicts were Black, descendants of people who had been enslaved.

According to historians, the convict lease system was not devised to deal with penal issues; it was a way to replace revenue lost when land taxes were slashed. It was, in effect, a reinventing of slavery and the antebellum slave tax.

Another “new” Constitution was adopted in 1901, which added additional provisions that stripped voting rights from Blacks and poor Whites, with the stated aim of preserving White supremacy. That Constitution also preserved the attitudes of bare-bones government and low taxes from the 1875 version.

¹¹ The historical discussion is drawn from two principal sources: *The History of A Deep South State* and from the federal court order issued in the case, *Lynch v. Alabama*. William Warren Rogers, ed., *Alabama: The History of a Deep South State* (Tuscaloosa: University of Alabama Press, 2010). “*Lynch, et al. v. State of Alabama, et al., No. 11-15464 (11th Cir. 2014)*,” Justia Law, December 19, 2024, <https://law.justia.com/cases/federal/appellate-courts/ca11/11-15464/11-15464-2014-01-10.html>.

For the following century, the 1901 Constitution helped preserve a poorly funded and discriminatory governmental and education system, the legacy of which the state still struggles to overcome.

Hope for the Future?

In recent years, Alabama leaders have shown increased interest in adjusting taxes to decrease the burden on the poor. In 2022, reductions to the standard deduction shielded more earnings for low-income taxpayers. In 2023, the Legislature decreased the state sales tax on food from four cents to three. In 2023, a measure was passed to allow wage earners to avoid paying income taxes on overtime pay.

However, no offsetting changes were made to compensate for the revenue decreases. Because of earmarks that dedicate the income and sales taxes to schools, the tax cuts mean less money for education than would have been collected otherwise.

The Legislative Fiscal Office estimated that the 2022 adjustment to income taxes would decrease receipts by \$17 million annually.¹² The 2023 adjustment to the sales tax on food is estimated to have reduced receipts by \$125 to 130 million.¹³ The State Department of Revenue estimated that the bill exempting overtime pay from the income tax decreased collections by \$230 million during the first nine months of 2024, far more than expected.¹⁴

At the same time, lawmakers have added costs through new initiatives. The CHOOSE Act, passed in 2024, will allow parents to use up to \$7,000 in tax dollars per child to pay private school tuition or up to \$2,000 for home school. The Legislature plans to inject \$100 million into the program in the first year. Right now, the program will be limited to eligible low-income families, but in its third year, the income caps are scheduled to be removed, which would provide a subsidy to all private school students who apply. That would greatly increase the cost of the program.

Revenue growth has slowed. After a 21% leap in FY 2022, the Education Trust Fund saw little to no growth in FY 2023 and only a 2% increase in FY 2024.

¹² Fiscal Note for ACT 2022-297, <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2022RS/FiscalNotes/FN-44632.pdf>

¹³ Ralph Chapoco, "Alabama State Grocery Tax Likely to Stay at 3% • Alabama Reflector," *Alabama Reflector* (blog), February 13, 2024, <https://alabamareflector.com/2024/02/13/alabama-state-grocery-tax-likely-to-stay-at-3/>.

¹⁴ Mike Cason | mcason@al.com, "Alabama's Popular Overtime Tax Exemption Costs Schools \$230 Million in 9 Months: What Will Lawmakers Do?," *al*, December 16, 2024, <https://www.al.com/news/2024/12/alabamas-popular-overtime-tax-exemption-costs-schools-230-million-in-9-months-what-will-lawmakers-do.html>.

The General Fund saw abnormally high growth in FY 2023 and 2024, largely thanks to high interest returns on surplus money the state held in its accounts. But, as the surplus is spent and interest rates fall, that source will diminish.¹⁵

During these flush years, Alabama has increased spending on education. Signs of improved performance have coincided with major increases in professional development and coaching in reading and math, investments that will need to be sustained.¹⁶

The Legislature has exercised discipline, keeping budgets at a reasonable rate of growth, spending some of the surplus, and padding reserves and investment accounts. However, inflation also helped produce a surge in the cost of providing government services. Eventually, revenues and expenses will converge, and Alabama will face choices.

There are important investments that should be made. The Legislature is currently studying a new approach to funding schools, what is known as a student-weighted model.¹⁷ The approach, adopted in 45 other states, recognizes that more resources are needed to educate students with academic disadvantages. Students who grow up in economically disadvantaged households, students who are learning English, and students with disabilities need extra attention in school. Schools with high concentrations of disadvantaged students struggle to provide equal educational opportunities. A student-weighted model provides additional money for each student identified as disadvantaged, an effort to level the playing field and give all children the support they need.

Proponents of the student-weighted model believe that surpluses generated and saved in recent high-revenue years can allow a transition to the model while still increasing state funding for all districts without tax increases. Still, to maintain the increased investment required, Alabama will need to sustain revenue growth, which leaves less room for measures to address inequities in the current tax system.

Fears of inadequate revenue so far have prevented the Legislature from taking advantage of Medicaid expansion. Multiple studies, including one by

¹⁵ Thomas Spencer, "A Final Upside Surprise, Signs of Slower Growth Ahead, Alabama Tax Collections, 2024," *Public Affairs Research Council of Alabama* (blog), November 20, 2024, <https://parcalabama.org/a-final-upside-surprise-signs-of-slower-growth-ahead-alabama-tax-collections-2024/>.

¹⁶ Thomas Spencer, "English Scores Jump with Full Implementation of Literacy Act; Math and Science Mixed Results," *Public Affairs Research Council of Alabama* (blog), August 30, 2024, <https://parcalabama.org/english-scores-jump-with-full-implementation-of-literacy-act-math-and-science-mixed-results/>.

¹⁷ "School Funding Reform," Every Child Alabama Coalition, accessed December 18, 2024, <https://everychildalabama.org/school-funding-reform/>.

PARCA and the Center for Economic Development and Business Research at Jacksonville State University,¹⁸ predict that expansion could save money and generate a positive economic impact by drawing in additional federal funding and extending health insurance coverage to Alabamians who lack it.

The state faces other critical and expensive needs. The state prison system is among the most overcrowded in the nation, leading to dangerous conditions that federal courts have found to violate the U.S. Constitution's ban on cruel and unusual punishment. The state is building a new prison at a cost of \$1 billion and anticipates building another. But even if the state can finance the construction of the second prison, the new prisons will not increase capacity. They are designed to replace dilapidated old facilities.

Thanks to historically low levels of unemployment and extraordinary federal stimulus spending, 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.

Can we sustain investments in improving health, education, job training, and infrastructure that, in turn, increase wealth and prosperity? Can we rebalance our tax structure to make it fairer? Can we address the inefficient and convoluted process through which we tax and spend?

The answer to all those questions leads back to the Alabama Constitution, which, despite its 1,000 amendments, is remarkably resistant to change.

¹⁸ Khadijah Edwards and Ryan Hankins, "The Economic Impact of Expanding Medicaid in Alabama," 2022, Public Affairs Research Council of Alabama. <https://parcalabama.org/wp-content/uploads/2022/01/Economic-Analysis-of-Alabama-Medicaid-Expansion.pdf>



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