

### Permanent Tax Relief Should be the Alabama Legislature’s Top Fiscal Priority in 2023

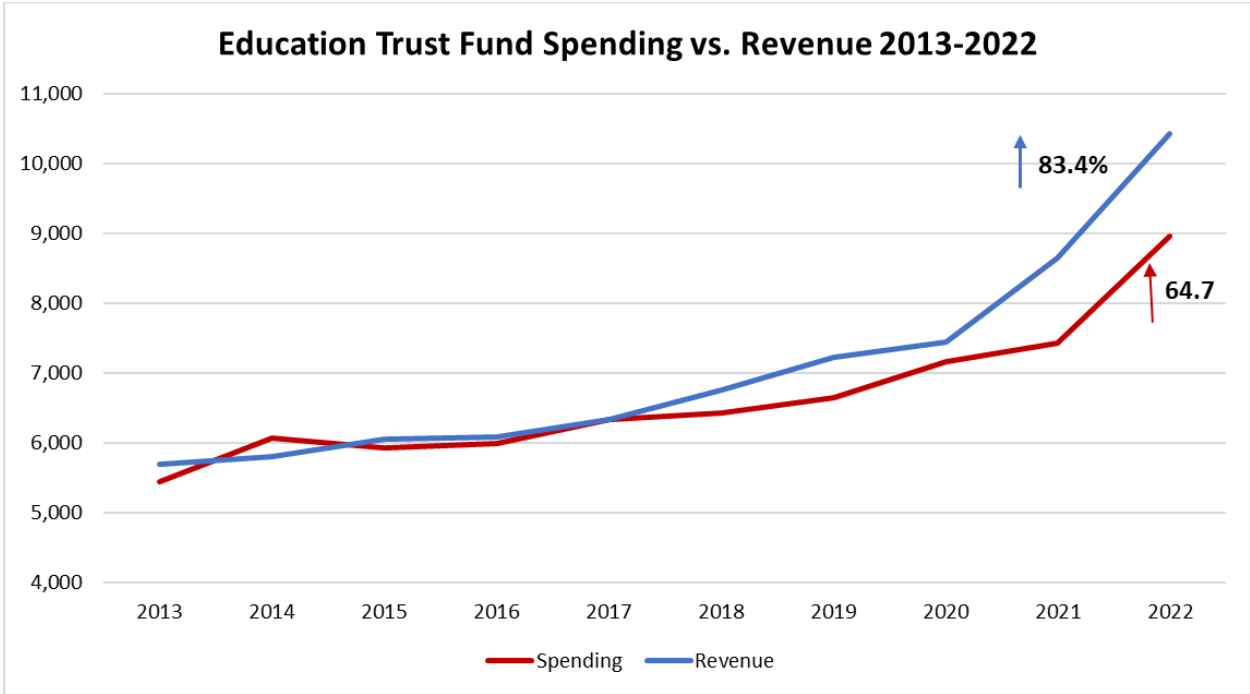
Alabama’s 2023 regular legislative session is officially underway, bringing with it bills to address important issues that could impact the lives of Alabamians for years to come.

Tax relief has been a topic of discussion within the state for months, and now that the session has begun, a number of proposals to reduce the tax burden of citizens have emerged. And while it is progress that lawmakers are openly discussing tax relief, lawmakers in neighboring states have already enacted or are continuing to push for bolder reforms.

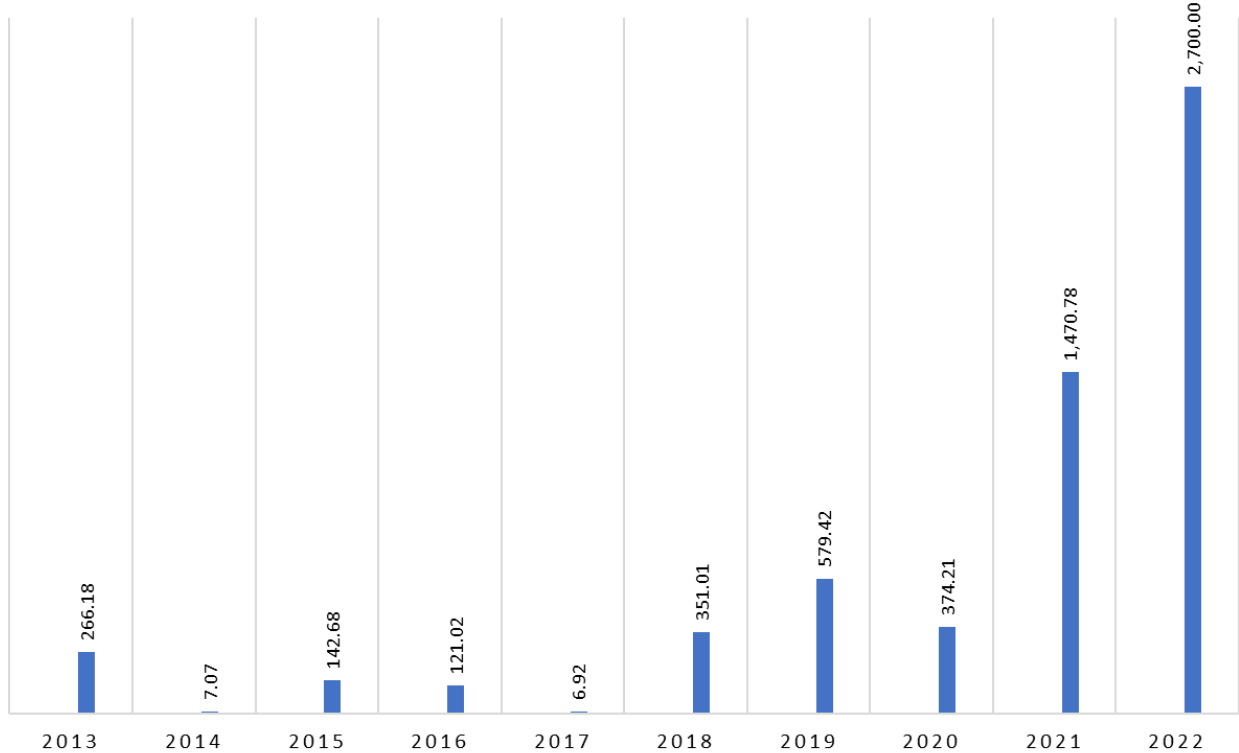
In the Alabama Policy Institute’s (API) 2023 [Conservative Platform for Alabama](#), API called on the Alabama Legislature to enact \$750 million in tax relief over the next three years. That goal remains the top fiscal priority for API in the 2023 regular session.

How did Alabama’s state government get to the point where it has the opportunity to provide historic tax relief to citizens? It comes down to a record period of growth in state revenue collections, primarily to the Education Trust Fund (ETF).

Over the past five years, revenue streams to ETF have grown by more than 54%. Ten year revenue growth is approaching 84%. This has resulted in average annual ETF surpluses of almost \$1.1 billion since 2018. In 2021 and 2022 revenue surpluses reached \$1.5 billion and \$2.7 billion respectively, record highs both years.



## ALABAMA ETF BUDGET SURPLUSES 2013-2022



The question now is what is the most effective way for the Alabama Legislature to provide relief to Alabamians? It is clear from recent remarks by Governor Kay Ivey (R) and by bills being introduced by state lawmakers on both sides of the aisle that some action will be taken this year.

In her recent [State of the State Address](#), Governor Ivey proposed giving one-time tax rebate checks of \$400 per person to Alabamians. This is [double](#) the tax rebate estimates that have been discussed since late last year.

There are several things to consider about the prospect of a tax rebate.

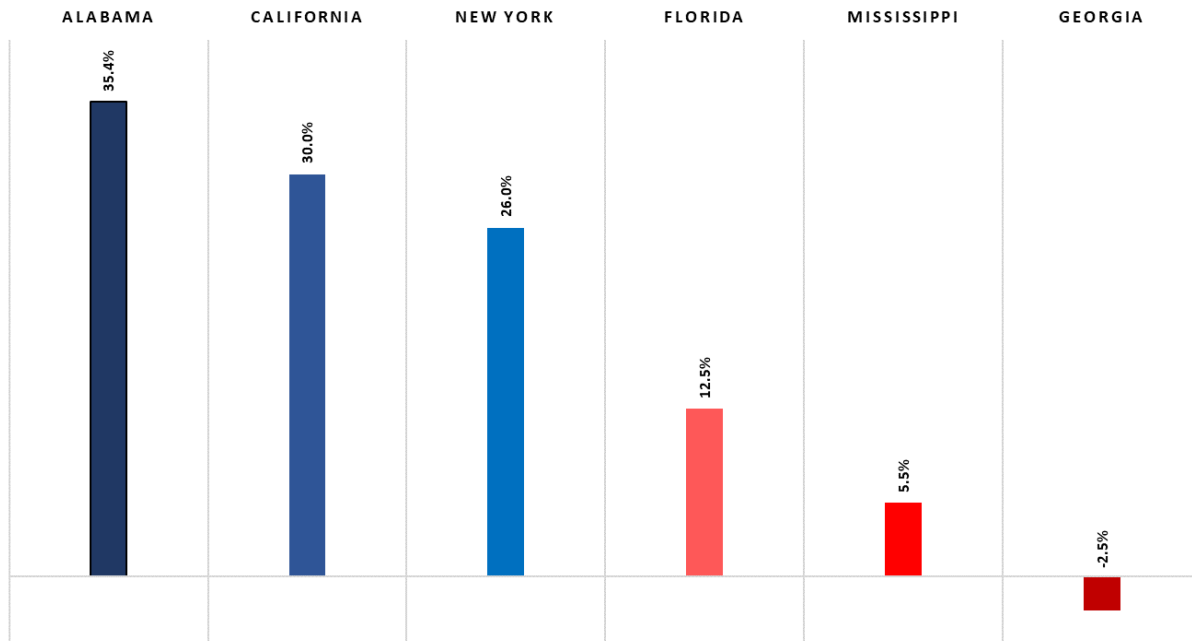
First, they are inherently temporary. The long-term benefits of permanent tax relief would greatly outweigh a one-time check that will be quickly spent. By giving citizens more of their income in perpetuity, the state's economy will be continually stimulated.

Lowering statutory tax rates has also proven to be effective in attracting new businesses and citizens to states. According to [2020 migration data](#) from the Internal Revenue Service, five of the top ten states for interstate migration gains levied no individual income tax, while four others have or are transitioning towards a flat income tax structure.

The magnitude must also be considered. Alabama's state government collected an excess \$2.7 billion from taxpayers in 2022. Governor Ivey's proposal would return about 37% of that to citizens, meaning that more than 60% would be reinvested into state government. Alabama's state government has already increased total spending by nearly 36% over the past four years. This is a

faster pace than Democratic controlled states such as California and New York and considerably higher than Alabama's neighbors in Florida, Mississippi, and Georgia.

### STATE SPENDING GROWTH 2019-2022



On the other hand, if permanent tax relief proves to be unattainable, doubling the rebate amount would return more money to Alabama taxpayers.

Beyond rebates, several of Governor Ivey's Republican colleagues are looking to build on targeted tax relief legislation enacted in 2022. Last year the Legislature approved approximately \$160 million in cuts, with more than \$85 million of that coming through the [efforts of](#) Senator Dan Roberts (R-Mountain Brook) to ensure that enhanced federal stimulus benefit payments made to Alabamians were not subject to state income taxes.

Senator Andrew Jones (R-Centre) recently introduced [Senate Bill 65](#) which would prohibit any Alabama municipality from levying an occupational tax of more than 1%. Occupational taxes are essentially a local tax on an employee's earnings which is assessed if they do not live within the city limits that they work in.

There are currently [seven cities](#) in the state that have occupational taxes above that rate. Under Senator Jones' proposal, they would be required to lower tax rates by 0.2% each year until they reach the maximum rate of 1%. This is a compromise version of a bill introduced by Senator Jones [last year](#), which would have completely repealed occupational taxes over 20 years.

A recent development to consider in relation to occupational taxes is the number of Alabamians who now work remotely full-time.

According to the U.S. Census Bureau's [American Community Survey](#), prior to the COVID-19

pandemic about 69,000 Alabama employees were fully remote. By the end of 2021 that total had increased to 208,767, a 203% increase. That upward trend of the number of remote workers is expected to continue to climb through 2025, meaning that based on the mailing address of their employer, Alabamians may face occupational tax levies despite working fully remotely.

Senator Arthur Orr (R-Decatur) has also filed several tax relief bills of note for the 2023 session.

[Senate Bill 47](#), bipartisan legislation with 25 cosponsors, would repeal the state's 2% tax bracket, which is the lowest in Alabama's graduated income tax rate structure. Changes would take effect during the 2023 tax filing year.

The 2% rate applies only to the first \$500 in taxable income that an Alabamian earns. Assuming that those with \$500 or less in taxable income account for 2% of Alabama's individual income tax collections, API estimates that repealing the tax would save citizens a total of approximately \$12 million per year. Mississippi, Georgia, and South Carolina are among several southeastern states that have recently raised the threshold at which citizens begin paying income tax.

In addition to eliminating Alabama's lowest individual income tax rate, Orr's [Senate Bill 48](#) proposes that Alabama's top rate (5%) be reduced to 4.95% over the next five years. API estimates that the maximum savings to taxpayers would be approximately \$55 million per year when fully implemented.

Reducing the top rate by 0.05% would not significantly improve Alabama's position amongst other states in the region. Neither Florida nor Tennessee assesses a state income tax. Georgia is on pace to move to a flat income tax structure and lower its top rate by 0.76 percent by 2030. Mississippi repealed its lowest tax bracket last year and will decrease its top rate by 1% by 2027. Governor Tate Reeves (R) has vowed to pursue a permanent elimination of Mississippi's state individual income tax in 2023.

Finally, Senator Orr has introduced [Senate Bill 49](#), which would exempt the first \$10,000 in taxable retirement income from state income tax. The exemption only applies to Alabamians who are over the age of 65. This builds on the efforts of [House Bill 162](#), which was passed during the 2022 regular session and provides a tax exemption for the first \$6,000 in retirement income. The Legislative Services Agency [estimated](#) that bill would reduce taxes by \$29 million per year.

Alabama Democrats are also looking at proposals to reduce taxes. One option being discussed by both parties is repealing the state's 4% sales tax on groceries, something that API has advocated in favor of for years. Currently, Alabama is one of just three states that still fully taxes the sale of food items.

In addition to his efforts to reduce individual income taxes, Sen. Arthur Orr is also targeting the state's sales tax on groceries. While his bill had not been introduced as of March 17, 2023, Sen. Orr indicated that it would [gradually reduce](#) the state portion of the tax from 4% to 0% over four years. However, if total Education Trust Fund revenues do not grow by at least 2% each year during that time, a pause provision would stop further reductions of the grocery tax until higher

growth resumes. Sen. Orr also plans to include a provision that would prevent local governments from increasing taxes to offset the state reduction.

Unlike previous grocery tax repeal attempts, which generally covered all food items, Sen. Orr's bill would only apply to "essential" foods as deemed by the U.S. Department of Agriculture's [Women, Infants, and Children \(WIC\)](#) program. Using the WIC definition of foods would limit the scope of a grocery tax repeal, meaning that many items that families typically purchase at a grocery store would still be taxed at the 4% rate. A complete list of Alabama's WIC eligible foods can be found [here](#).

Combined with the pause provision, Sen. Orr [feels that](#) a more limited definition of food is a measured approach that will not put future education budgets at risk. Sen. Orr projects that the partial repeal would save Alabamians about [\\$200 million](#) per year once fully implemented.

Local grocery tax reductions may also be on the agenda.

[House Bill 15](#) by Representative Chris England (D-Tuscaloosa) would allow county and municipal governments to repeal local grocery taxes. The implication is that if the Legislature does not repeal the state portion of the tax, local authorities should have the option to do so as a means to help their communities. Under statute, most cities need the approval of the Alabama Legislature to alter local taxes.

There is already evidence that reducing or repealing local grocery taxes would benefit both citizens and local governments.

Last year the City of Clay decided to reduce its local grocery tax by 50%. Its mayor saw the need and led the effort to do so without state legislative approval. The reduction took effect in November, and according to Mayor Charles Webster, there has not been a revenue loss to Clay. In fact, he estimates that revenues have increased, allowing the city to complete several city improvement projects, and provide relief from near record grocery prices to citizens.

Regardless of whether local governments have the authority to repeal grocery taxes, that does not mean that the state government should not continue to pursue a full repeal of the grocery tax.

Alabama House Minority Leader Anthony Daniels (D-Madison) has also vowed to fight for the elimination of the grocery tax this year. In a [recent appearance](#) on Alabama Public Television's Capitol Journal, Rep. Daniels suggested that the state have a month-long grocery tax holiday later this year. According to Daniels, a temporary elimination would allow state officials to study the economic effects compared to the same period last year and better determine what the impact of a full repeal would mean for the state budgets.

Rep. Daniels suspects that like what has occurred in Clay, any state revenue decrease incurred from eliminating the grocery tax would be replaced given that Alabamians will see their disposable income increase. This is a measured and reasonable approach towards assessing the impacts of a repeal, however, API continues to advocate for the full elimination of the grocery tax, without replacing revenues, this year.

Besides the grocery tax, Rep. Daniels has also proposed eliminating the state income tax on overtime pay this year. He sees it as a means to encourage Alabamians to work longer hours by allowing them to keep more of what they earn. Daniels feels that this incentive to work could also help mitigate the state's labor shortage. According to the [U.S. Chamber of Commerce](#), Alabama has a "most severe" shortage with only 50 available workers for every 100 open jobs. Encouraging Alabamians to work overtime hours is one way to potentially close that gap.

Legislators should be applauded for their current efforts to lessen the tax burdens placed on Alabama's citizens, however, lawmakers should use the proposals outlined above as a starting point for debate as they continue to pursue bolder tax reforms during the 2023 regular session.

In "[A Conservative Platform for Alabama 2023](#)" API calls for lawmakers to enact \$750 million in permanent tax cuts, with the goal of having that total fully phased in within the next three years. Given the state's current \$3 billion revenue surplus, API feels that \$750 million is a reasonable and minimum target that the Legislature should work towards.

There are a number of current taxes that the Legislature could target to achieve the \$750 million goal.

As already mentioned, API has been a longtime proponent of fully repealing the state's 4% sales tax on groceries, without replacing it with new or increased taxes in other areas. In 2020, the Legislative Services Agency estimated that repealing the grocery tax would save Alabamians [\\$514 million annually](#). With grocery prices remaining at near record highs, repealing the state tax would provide immediate and much needed relief to all citizens.

Beyond the grocery tax, the Legislature should consider lowering the state's corporate income Tax rate to 4.75% and eliminate the state deduction for federal taxes paid. Untying from the federal tax code would provide a more consistent tax rate and ensure that businesses can more accurately predict their liability each year.

For example, when the Tax Cuts and Jobs Act of 2017 went into effect, Alabama's effective tax rate rose from 4.3% to 5.2%. Because companies were paying less in federal taxes, they had less to deduct from their Alabama returns and saw a sharp increase in tax payments. Lowering the statutory rate to 4.75% would make Alabama more competitive with its neighbors in attracting new business to and keeping existing businesses in Alabama.

Another proposal that lawmakers should consider is reducing the state's 4% general sales tax to account for growth in the Simplified Sellers Use Tax (SSUT), which is more commonly known as the online sales tax. The state began collecting online sales taxes in 2017 and through 2021 collections increased by more than 900%. In fiscal year 2022, gross SSUT collections [totaled](#) more than \$633 million, a \$112.5 million increase from 2021.

The growth of the SSUT provided an unexpected windfall for state government. Lowering the 4% brick and mortar sales tax would save Alabamians money and encourage them to shop at Alabama based stores rather than turning to online shopping.

Finally, lawmakers should continue to pursue tax reduction that will benefit Alabama's small business community. Repealing the state's minimum Business Privilege Tax during the 2022 session, which is [projected to reduce](#) taxes by \$23 million beginning in 2024, was a start, but helps only a limited number of businesses. Total Business Privilege Tax collection were \$206.8 million in 2022. State government should not be taxing Alabama companies simply for the privilege of conducting business in the state. This and other reforms aimed at reducing the tax burden of small businesses should be considered during the 2023 regular session.

Alabama's state government currently has a \$3 billion combined revenue surplus. The surplus is a direct result of the government collecting too much in taxes from Alabamians. In the end, the surplus doesn't belong to the state government - it belongs to Alabama taxpayers. Lawmakers have a duty to pursue policies that will return a significant portion of that surplus back to its rightful owners.