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Does Alabama’s Tax System “Redistribute Wealth?” *Yes: From the Poor to the Rich. And Tax Reforms Currently Under Consideration Won’t Change this “Robin Hood in Reverse” Effect*

Last week, an Alabama legislative committee approved a bill, House Bill 1, that would take an important step towards making one of the most unfair tax systems in the nation somewhat less unfair. Some opponents of the bill have characterized it as a “redistribution of wealth” from the best-off families to low-income taxpayers. However, these opponents have got it exactly wrong: the Alabama tax system actively redistributes income away from those living below the poverty line and towards the state’s millionaires. HB 1 would reduce this “Robin Hood in reverse” effect somewhat, but would not eliminate it.

Alabama’s Unfair Tax System Redistributes from the Poor to the Rich

Alabama’s tax system is currently among the most unfair in the nation. A November 2009 ITEP analysis showed that the poorest families pay an average of 10.2 percent of their income in Alabama state and local taxes, more than twice as high as the 4.0 percent of income that the very best-off 1 percent of Alabamians must pay.¹ This upside-down pattern, in which effective tax rates decline as income increases, is known as a *regressive* tax system. ITEP’s 2009 analysis ranked Alabama as the tenth most regressive tax system in the nation. The analysis identified two principal reasons for this: the state relies more heavily on regressive sales taxes than do most other states, and its state income tax is among the least progressive in the nation.

When a tax system imposes higher effective tax rates on low-income families—while allowing the best-off taxpayers to pay much lower tax rates—it is effectively redistributing income away from poor families, and toward the best-off families. Alabama is no exception to this rule:

- The best-off 1 percent of non-elderly Alabamians enjoyed 19.6 percent of statewide income in 2007—but paid 11.5 percent of the Alabama taxes on Alabama residents.
- The middle 20 percent of Alabamians earned 11.4 percent of statewide income, but paid 15.9 percent of the Alabama taxes.
- The poorest 20 percent of Alabamians realized just 3.4 percent of statewide income—but paid 5 percent of the taxes falling on Alabamians!
- As a group, the poorest 80 percent of Alabamians enjoyed 41 percent of statewide income—and paid 54 percent of the taxes falling on Alabamians.

As a result, the impact of the Alabama tax system is to actually reduce low-income families’ share of statewide income:

¹ Institute on Taxation and Economic Policy. “Who Pays: A Distributional Analysis of the Tax Systems in All 50 States.” November 18, 2009.

- Before taxes, the poorest 20 percent have 3.4 percent of statewide personal income—but their share of after-tax income is just 3.3 percent.
- Middle-income families have 11.4 percent of statewide pre-tax income, and 11.1 percent of after-tax income.
- The best-off 1 percent of Alabamians enjoy 19.6 percent of pretax Alabama income, and 20.2 percent of after-tax income!

House Bill 1 Would Reduce, But Not Eliminate this Redistribution of Income

Last week, the Alabama House Education Appropriation Committee approved a bill, House Bill 1, that would make the state sales tax less unfair by exempting groceries, and would make the income tax somewhat fairer by scaling back an unusual deduction for the federal income taxes Alabamians pay. The benefits from this tax break are remarkably concentrated among a small number of upper-income families: the best-off 1 percent of Alabamians enjoy 35 percent of the benefits from this tax break, and the best off 20 percent get 84 percent of the benefits. HB1 would not repeal this tax break—it would simply phase it out for upper-income taxpayers (starting for singles earning over \$100,000 and married couples earning over \$200,000).

These two changes would reduce state sales taxes by about \$400 million a year and increase the income tax by about the same amount, leaving the overall level of Alabama taxes basically unchanged—but would result in substantial tax cuts for the low- and middle-income families hit hardest by the current tax system. For families in the middle twenty percent of the income distribution, this plan would unambiguously result in a tax cut, since these families earn too little to be subject to the income tax increase and would see a tax cut averaging \$173 per middle-income family if this plan were implemented in 2011.

The plan would make the Alabama tax system somewhat less unfair: if the plan had been in effect for tax year 2007, ITEP's November 2009 report would have shown that the effective tax rate on low-income Alabamians was 9.4 percent, and would be 4.6 percent for the very best-off Alabama taxpayers. Put another way, even after this reform, the best-off Alabama taxpayers would still pay less than half as much of their income in Alabama state and local taxes as those living below the poverty line must pay.

As ITEP Executive Director Matthew Gardner noted, "if HB1 were implemented tomorrow, the Alabama tax system would still actively redistribute income from the poor to the rich. This impact would simply be less pronounced than it is right now."

Conclusion

Those members of Alabama's legislature who have recently expressed their concern over the "redistribution of wealth" through Alabama's tax system are right to be concerned—but their understanding of the current state of affairs is exactly wrong. Under current law, the Alabama tax system actively redistributes income away from the poorest Alabama families and towards the best-off families. Put another way, income inequality in Alabama is made even worse by the state's tax system. House Bill 1 would reduce the scope of this indefensible income shift—but would not, in itself, even approach eliminating it.