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Georgia Budget and Policy Institute

TAX REFORM FACTS

REDUCING EXEMPTIONS IS GOOD TAX REFORM – BUT TAXING GROCERIES IS HIGHLY REGRESSIVE

ELIMINATING EXEMPTION ON GROCERIES WOULD HARM TAX EQUITY

Media reports have mentioned the sales tax exemption on groceries as a potential target for elimination by the Special Council on Tax Reform and Fairness for Georgians. Most states exempt groceries from the sales tax to increase fairness among income groups in the state tax system.

Sales taxes are regressive -- meaning they impact middle and low income Georgians the most. Exempting groceries means that less income is spent on sales tax by families, especially low income families, and thus makes Georgia's tax system more equitable. Eliminating the exemption on groceries would disproportionately impact middle and low income families (see *distribution table on other side*).

ALTERNATIVES NEED TO BE EVALUATED

The grocery exemption costs \$600 million in state revenue, at a time when Georgia continues to face massive fiscal challenges. However, just ten tax breaks passed between 2005 and 2010 will total \$600 million in lost state revenues when fully implemented.

Before eliminating the grocery exemption, the Council and lawmakers should discuss whether other exemptions are of higher or lower value than the grocery exemption with attention to fairness, one of the Council's principles.

Eliminating the income tax deduction for state income taxes and the newly expanded exclusions for retirement income offer alternatives that would raise significant revenues, while increasing fairness and bringing Georgia's tax system more in line with the tax rules of other states.

R E C O M M E N D A T I O N

ALL EXEMPTIONS, CREDITS, AND DEDUCTIONS SHOULD BE EXAMINED AND WEIGHED AGAINST EACH OTHER AND AGAINST THE PRINCIPLES OF TAX REFORM. The grocery exemption, in particular, increases equity and should be weighed against other tax breaks with an equity lens. Eliminating the deduction for state income taxes offers an alternative worth considering.

OTHER ALTERNATIVES EXIST TO ELIMINATING THE GROCERY EXEMPTION, INCLUDING...

Eliminating the income tax deduction for state income taxes

\$450 MILLION

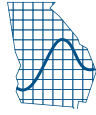
Keeping retirement income exclusions at current levels (\$35,000 for individuals; \$70,000 for couples) rather than phasing in expansions for the wealthiest seniors

\$150 MILLION

FOR MORE INFORMATION on the income tax deduction for state income taxes, download GBPI's *Advancing Georgia's Tax System to the Modern Day* at www.gbpi.org (August 25, 2010). **FOR MORE INFORMATION** on the retirement income exclusion, download GBPI's *Adding Up the Fiscal Notes 2010* at www.gbpi.org (July 26, 2010).

THOUGHTFUL ANALYSIS...RESPONSIBLE POLICY

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ELIMINATION OF DEDUCTION FOR STATE INCOME TAXES IS EQUITABLE ALTERNATIVE

Georgia is one of a handful of states that provide an income tax deduction for state income taxes. Most states sensibly disallow this deduction since it creates an unfair advantage for taxpayers who itemize over those who do not. Eliminating the exemption on groceries would fall much more heavily on middle and low income families than eliminating the deduction for state income taxes would, as shown below. An additional benefit to this alternative is that it lowers Georgians' federal income taxes, which will partially offset the increased state taxes.

STATES TYPICALLY EXEMPT GROCERIES BUT NOT STATE INCOME TAXES

STATES EXEMPTING GROCERIES, IN FULL OR IN PART

38

STATES OFFERING DEDUCTION FOR STATE INCOME TAXES

7

TAX COUNCIL SHOULD COMPARE EFFECTS OF PROPOSALS ON DIFFERENT INCOME GROUPS

Tax Reform Option	Estimated Revenue Impact (millions)	Average Tax Change as a Percent of Income (by income group)						
		Lowest 20%: Less than \$15,000	Second 20%: \$15,000 to \$28,000	Third 20%: \$28,000 to \$46,000	Fourth 20%: \$46,000 to \$77,000	Next 15%: \$77,000 to \$161,000	Next 4%: \$161,000 to \$400,000	Top 1%: \$400,000 or more
Eliminate grocery exemption	\$600	0.6%	0.4%	0.4%	0.3%	0.2%	0.1%	0.0%
Eliminate income tax deduction for state income taxes (INCLUDING FEDERAL OFFSET)	\$450 (state) -\$78 (fed) = net impact of \$372	0.0%	0.0%	0.1%	0.1%	0.2%	0.2%	0.2%

Source: Institute on Taxation and Economic Policy, 2010

Notes: (1) The distribution for the elimination of the grocery exemption accounts for food stamp participation. Individuals who purchase food with food stamps do not pay sales tax, regardless of state law. Thus if lawmakers eliminate the grocery exemption and food becomes taxable again, food stamp participants would continue to purchase food sales-tax free. It is important to note, however, that **37 percent of Georgians who are eligible for food stamps do not receive them**, according to the USDA. In addition, families with income over 130 percent of poverty are not eligible for food stamps (e.g. a family of three earning \$24,000 is not eligible for food stamps). Thus, many low and moderate income families do not receive food stamps and would pay sales tax on groceries if lawmakers eliminate the exemption.

(2) The federal offset takes into account the decrease in federal income taxes as state income taxes increase, since state income taxes are deductible at the federal level. Thus, the elimination of this deduction causes an increase of \$450 million in revenues at the state level and a decrease of \$78 million at the federal level, for a combined effect of about \$370 million for Georgians.