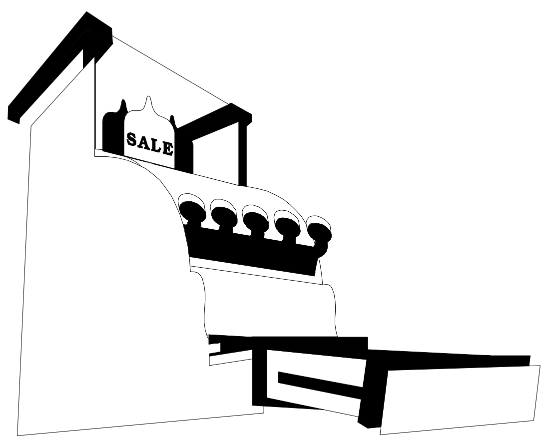
Staff Working Paper

Sales Tax on Food: Targeting Relief to the Working Poor and Elderly Poor



Tennessee Advisory Commission on Intergovernmental Relations

May 1999

Sales Tax on Food: Targeting Relief to the Working Poor and Elderly Poor

Introduction

Twenty-seven[1] of the forty-five states that levy a general sales tax exempt food purchased for home consumption. Another three states tax food at reduced rates. Unfortunately for Tennessee, three of the states that fully exempt food are on Tennessee's border (Kentucky, North Carolina, and Georgia).[2]

There are numerous arguments in support of the removal of food from the sales tax. They include the following:

1. Reduces the regressivity of the sales tax, especially benefiting low and moderate income households who spend relatively more on food than upper income households.
2. Food expenditures, while a large share of consumer expenditures, have been falling as a per cent of total expenditures, and therefore represent part of the reason that sales tax collections are somewhat inelastic-their removal from the base in conjunction with the addition of more income elastic types of expenditures, would improve the overall elasticity of the sales tax.
3. The food stamp program covers only a portion of eligible families' food spending, therefore a full exemption still provides them with benefits.
4. A food exemption will remove or reduce the sales tax border problem Tennessee is currently experiencing at several border locations.

Several states that do not exempt food sales from their sales tax provide alternative methods to reduce the burden of the tax on food (and in some cases other items) on certain targeted groups of citizens. Most such programs are directly tied to state personal income taxes and provide refundable credits. New Mexico, and more recently, Kansas are the only states with programs that provide substantial benefits low-income households.

A credit or rebate program offers several advantages over a full sales tax exemption of food for home consumption: (1) relief can be targeted to the specific groups in need of relief while avoiding the revenue loss that results from a full exemption; (2) food exemptions involve substantial administration problems for both vendors and state tax

[1] North Carolina is included in this number although the exemption from the state sales tax will not be complete until 5/1/99. Virginia will soon begin phasing out half of its state tax on food.
[2] Georgia and North Carolina still allow local governments to tax food.

departments; and (3) visitors and businesses continue to pay sales taxes on food purchases.

Food Tax Rebate Program for Tennessee

A food tax rebate program has three major advantages for Tennessee:

- Targets assistance where it is most needed.
- Maintains the stability of the food tax in the sales tax base.
- Improves sales tax equity.

The major features of this program are:

- Target assistance to the working poor and the elderly poor.
- Utilize a delivery system already in place.
- Rebates an estimated 100% of actual state and local food tax paid by most eligible households with a phase-out for higher income eligibles.
- Cost is between $51.4 million and $86.7 million depending on option chosen.

The proposed rebate program is designed to benefit low-income Tennessee households only. The program identifies low income households as those falling at and below the official Poverty Guidelines of the Department of Health and Human Services.[3] Modified Gross Income (MGI) used as criteria for the rebate includes all income of all members of a household. The definition used is the same used in the New Mexico rebate program with the exception of the inclusion of the value of food stamps received.[4] A proposed rebate program application (see Exhibit 1, pages 19 and 21) includes a full description of the calculation of household modified gross income

Rebate amounts, as shown in the Rebate Tables (two different program levels are provided, see Rebate Table 1 and 2), are based on estimated expenditures by eligible households on food for consumption at home. This data was developed using the most recently available information on household expenditures for food at home.[5] The rebates in the table reflect the estimated state and local sales tax (8.25%) on food purchases by low-income households of different size (number of persons) and income. The rebate amounts rise to a maximum level for each household size and are then

---

[3] The Federal Department of Health and Human Services issues the guidelines each year in the Federal Register. The guidelines for 1999 can be found in the **Federal Register**, Vol. 64, No. 52, March 18, 1999, PP. 13428-13430.

[4] The existing Tennessee property tax relief program also uses a very broad definition of income in its program guidelines, but requires the combined income of property owners only. While certain low-income elderly citizens are also exempt from the Tennessee Hall income tax, no specific form or material is available that spells out all the forms of income that must be included for eligibility to the program.

[5] Bureau of Labor Statistics, **Consumer Expenditure Survey, 1996-97.**

phased out beginning when MGI reaches the poverty guideline level for each household size.[6]

Table 1 provides rebates that closely approximate the full state and local sales tax that such households would pay on food expenditures, based on average expenditures by such households in the United States. It is not designed or intended to represent the actual tax paid by any specific household. As presented, it represents a more reasonable sales tax rebate program than any existing state sales tax rebate/refund program. Most existing programs poorly reflect the variations in expenditures on food by households of different size or fail to include all low-income households in the targeted relief program. The rebate program presented in Table 1 would provide rebates to 595,000 households and cover an estimated 1,353,000 people. The rebate portion of the program is estimated to cost $86.7 million.

[6] The rebates in the table are not adjusted to reflect purchases using food stamps. However, Modified Gross Income includes the value of food stamps which limits the amount of the rebate by increasing incomes and potentially reaching rebate phase-out levels.

Table 1
Full Rebate Program

Modified Gross Income (See Exhibit 1, Page 21)		Number Of Household Members								
More than	Less Than	1	2	3	4	5	6	7	8	9
$0	$1,000	$41	$41	$41	$41	$41	$41	$41	$41	$41
$1,000	$2,000	$83	$83	$83	$83	$83	$83	$83	$83	$83
$2,000	$3,000	$122	$124	$124	$124	$124	$124	$124	$124	$124
$3,000	$4,000	$122	$165	$165	$165	$165	$165	$165	$165	$165
$4,000	$5,000	$122	$206	$206	$206	$206	$206	$206	$206	$206
$5,000	$6,000	$122	$206	$248	$248	$248	$248	$248	$248	$248
$6,000	$7,000	$122	$206	$248	$285	$289	$289	$289	$289	$289
$7,000	$8,000	$122	$206	$248	$285	$306	$330	$330	$330	$330
$8,000	$9,000	$103	$206	$248	$285	$306	$367	$371	$371	$371
$9,000	$10,000	$79	$206	$248	$285	$306	$367	$413	$413	$413
$10,000	$11,000	$54	$178	$248	$285	$306	$367	$429	$454	$454
$11,000	$12,000	$30	$137	$248	$285	$306	$367	$429	$490	$495
$12,000	$13,000	$6	$96	$248	$285	$306	$367	$429	$490	$536
$13,000	$14,000	$0	$54	$242	$285	$306	$367	$429	$490	$551
$14,000	$15,000	$0	$13	$192	$285	$306	$367	$429	$490	$551
$15,000	$16,000	$0	$0	$143	$285	$306	$367	$429	$490	$551
$16,000	$17,000	$0	$0	$93	$268	$306	$367	$429	$490	$551
$17,000	$18,000	$0	$0	$44	$211	$306	$367	$429	$490	$551
$18,000	$19,000	$0	$0	$0	$154	$306	$367	$429	$490	$551
$19,000	$20,000	$0	$0	$0	$97	$277	$367	$429	$490	$551
$20,000	$21,000	$0	$0	$0	$40	$216	$367	$429	$490	$551
$21,000	$22,000	$0	$0	$0	$0	$154	$367	$429	$490	$551
$22,000	$23,000	$0	$0	$0	$0	$93	$319	$429	$490	$551
$23,000	$24,000	$0	$0	$0	$0	$32	$246	$429	$490	$551
$24,000	$25,000	$0	$0	$0	$0	$0	$172	$429	$490	$551
$25,000	$26,000	$0	$0	$0	$0	$0	$99	$357	$490	$551
$26,000	$27,000	$0	$0	$0	$0	$0	$25	$271	$490	$551
$27,000	$28,000	$0	$0	$0	$0	$0	$0	$185	$488	$551
$28,000	$29,000	$0	$0	$0	$0	$0	$0	$100	$390	$551
$29,000	$30,000	$0	$0	$0	$0	$0	$0	$14	$292	$551
$30,000	$31,000	$0	$0	$0	$0	$0	$0	$0	$194	$530
$31,000	$32,000	$0	$0	$0	$0	$0	$0	$0	$96	$419
$32,000	$33,000	$0	$0	$0	$0	$0	$0	$0	$0	$309
$33,000	$34,000	$0	$0	$0	$0	$0	$0	$0	$0	$199
$34,000	$35,000	$0	$0	$0	$0	$0	$0	$0	$0	$88
$35,000	$36,000	$0	$0	$0	$0	$0	$0	$0	$0	$0

A modified rebate program is presented in Table 2. Rebates are calculated using the same process as in Table 1, with the following major change. Rebate amounts are phased-out beginning at a level of income that is $4,000 lower than a household's poverty guideline level. The result of the earlier phase-out is that some households receive less than with the full rebate and some at the higher end of the income scale (relative to household size) receive nothing. The modified rebate program would provide rebates to 409,000 households and cover an estimated 979,000 people, more than 18 percent of the state population. The rebate portion of this program is estimated to cost $51.4 million.

Table 2
Modified Rebate Program

Modified Gross Income (See Exhibit 1, Page 21)		Number Of Household Members								
More than	Less Than	1	2	3	4	5	6	7	8	9
$0	$1,000	$41	$41	$41	$41	$41	$41	$41	$41	$41
$1,000	$2,000	$83	$83	$83	$83	$83	$83	$83	$83	$83
$2,000	$3,000	$122	$124	$124	$124	$124	$124	$124	$124	$124
$3,000	$4,000	$122	$165	$165	$165	$165	$165	$165	$165	$165
$4,000	$5,000	$103	$206	$206	$206	$206	$206	$206	$206	$206
$5,000	$6,000	$79	$206	$248	$248	$248	$248	$248	$248	$248
$6,000	$7,000	$54	$178	$248	$285	$289	$289	$289	$289	$289
$7,000	$8,000	$30	$137	$248	$285	$306	$330	$330	$330	$330
$8,000	$9,000	$6	$96	$248	$285	$306	$367	$371	$371	$371
$9,000	$10,000	$0	$54	$242	$285	$306	$367	$413	$413	$413
$10,000	$11,000	$0	$13	$192	$285	$306	$367	$429	$454	$454
$11,000	$12,000	$0	$0	$143	$285	$306	$367	$429	$490	$495
$12,000	$13,000	$0	$0	$93	$268	$306	$367	$429	$490	$536
$13,000	$14,000	$0	$0	$44	$211	$306	$367	$429	$490	$551
$14,000	$15,000	$0	$0	$0	$154	$306	$367	$429	$490	$551
$15,000	$16,000	$0	$0	$0	$97	$277	$367	$429	$490	$551
$16,000	$17,000	$0	$0	$0	$40	$216	$367	$429	$490	$551
$17,000	$18,000	$0	$0	$0	$0	$154	$367	$429	$490	$551
$18,000	$19,000	$0	$0	$0	$0	$93	$319	$429	$490	$551
$19,000	$20,000	$0	$0	$0	$0	$32	$246	$429	$490	$551
$20,000	$21,000	$0	$0	$0	$0	$0	$172	$429	$490	$551
$21,000	$22,000	$0	$0	$0	$0	$0	$99	$357	$490	$551
$22,000	$23,000	$0	$0	$0	$0	$0	$25	$271	$490	$551
$23,000	$24,000	$0	$0	$0	$0	$0	$0	$185	$488	$551
$24,000	$25,000	$0	$0	$0	$0	$0	$0	$100	$390	$551
$25,000	$26,000	$0	$0	$0	$0	$0	$0	$14	$292	$551
$26,000	$27,000	$0	$0	$0	$0	$0	$0	$0	$194	$530
$27,000	$28,000	$0	$0	$0	$0	$0	$0	$0	$96	$419
$28,000	$29,000	$0	$0	$0	$0	$0	$0	$0	$0	$309
$29,000	$30,000	$0	$0	$0	$0	$0	$0	$0	$0	$199
$30,000	$31,000	$0	$0	$0	$0	$0	$0	$0	$0	$88
$31,000	$32,000	$0	$0	$0	$0	$0	$0	$0	$0	$0

Basis of Estimates

1. ***Poverty guidelines are as provided by the Department of Health and Human Services. See Table 3.***

Table 3
1999 Poverty Guideline

Size of Family Unit	Poverty Guideline
1	$8,240
2	$11,060
3	$13,880
4	$16,700
5	$19,520
6	$22,340
7	$25,160
8	$27,980
For each additional person, add	$2,820

Source: Website at http://aspe.os.dhhs.gov/poverty/99poverty.htm

2. ***Expenditures on Food for Home Consumption***

All data derived from Consumer Expenditure Survey data are available at website http://stats.bls.gov/csxross.htm. Estimated food expenditures for the rebate are calculated based on average per person expenditures on food at home for income levels below $20,000 only. (see Table 5).

Table 4
Expenditures on Food At Home

Spending on Food at Home	Size of Consumer Unit				
	1	2	3	4	5 or more[2]
$5,000-$9,999[1]	$1,348	$2,370	$2,595	$3,741	$4,192
$10,000-$14,999	$1,433	$2,469	$3,208	$3,280	$4,146
$15,000-$19,999	$1,640	$2,658	$3,203	$3,364	$4,134
Average	$1,474	$2,499	$3,002	$3,462	$4,157
Average Per Person	$1,474	$1,250	$1,001	$865	$742

[1]*Data for consumer units of 4 and 5 or more were only available for income range <$10,000*
[2]*Date for consumer units of 5 or more computed using an average number of persons of 5.6.*

3. Estimated State and Local Sales Tax

Table 5 presents the estimated state and local sales tax paid by various households. The estimates are based on the figures developed in Table 4 multiplied by 8.25%. The average for consumer units of 5 or more ($742) was used as the estimate for all households greater than 5.

Table 5
Estimated State and Local Sales Tax on Food at Home

Size Of Household	Estimated Spending Per Person	Total Spending	State & Local Sales Tax
1	$1,474	$1,474	$122
2	$1,250	$2,500	$206
3	$1,001	$3,003	$248
4	$865	$3,460	$285
5	$742	$3,710	$306
6	$742	$4,452	$367
7	$742	$5,194	$429
8	$742	$5,936	$490
9 or more	$742	$6,678	$551

4. The rebates in Table 1 (Full Rebate Program) are based on Table 5 subject to the following two adjustments.

1. Rebates are not allowed to exceed 8.25% of half (50%) the upper income level for a household's income range. For example, the rebate for a household of 3 whose income falls in the interval range of $3000-$4000 is limited to no more than 8.25% times half of $4,000 or $165. This insures that no household, regardless of its estimated food expenditure, receives more than 8.25% times half its modified gross income.
2. Once a household reaches the poverty guideline level for its household size, the rebate is phased out within a $4,000-$5,000 range above its poverty guideline. The phase-out procedure avoids an abrupt cutoff from the program. The phase-out process reduces a household's full rebate by 10% for every $500 by which its modified gross income exceeds its poverty guideline.

5. The distribution of Tennessee households by modified gross income is estimated using the information in Tables 6 and 7.

Table 6
Distribution of US Household for Complete Income Reporters.

CES 1996-97 Complete reporting of income Numbers in (1000s)						
Income	**Size of Consumer Unit**					
	1	2	3	4	5 or more	**Total**
<$5,000	2625	849	452			**3926**
$5,000-$9,999	5689	1713	754	833	595	**9584**
$10,000-$14,999	4035	2485	1026	789	699	**9034**
$15,000-$19,999	2294	2925	918	739	666	**7542**
$20,000-$29,999	3537	4547	1766	1365	1269	**12484**
$30,000-$39,999	2631	3168	1589	1488	1234	**10110**
$40,000-$49,999	1455	2416	1483	1412	972	**7738**
$50,000-$69,999	1223	3600	2361	2601	1566	**11351**
$70,000 & over	656	4301	2533	2931	1619	**12040**
Total	**24145**	**26004**	**12882**	**12158**	**8620**	**83809**

Source: Tables 36-40 of 1997 CES Crosstab of Consumer Units By Income-Complete reporting of income only)

Table 7
Distribution of Consumer Units Based on Table 7

Modified Gross Income(In $1000s)						
Income	**Size of Consumer Unit**					
	1	2	3	4	5 or more	**Total**
<$5,000	3.1%	1.0%	0.5%	0.0%	0.0%	**4.7%**
$5,000-$9,999	6.8%	2.0%	0.9%	1.0%	0.7%	**11.4%**
$10,000-$14,999	4.8%	3.0%	1.2%	0.9%	0.8%	**10.8%**
$15,000-$19,999	2.7%	3.5%	1.1%	0.9%	0.8%	**9.0%**
$20,000-$29,999	4.2%	5.4%	2.1%	1.6%	1.5%	**14.9%**
$30,000-$39,999	3.1%	3.8%	1.9%	1.8%	1.5%	**12.1%**
$40,000-$49,999	1.7%	2.9%	1.8%	1.7%	1.2%	**9.2%**
$50,000-$69,999	1.5%	4.3%	2.8%	3.1%	1.9%	**13.5%**
$70,000 & over	0.8%	5.1%	3.0%	3.5%	1.9%	**14.4%**
Total	**28.8%**	**31.0%**	**15.4%**	**14.5%**	**10.3%**	**100.0%**

The distribution of Tennessee households by modified gross income was then estimated[7] based on (1) Table 7 data, (2) an estimated 2,102,230 Tennessee households in 1999[8] and (3) an estimate of the distribution of large households (five or more) by modified gross income not available from the CES data. The assumed distribution of large households is given in Table 8. For example, 67% of households of 5 or more were assumed to be households of five persons.

Table 8
Estimated Distribution of Large Households by Size

Assumed distribution of households of 5 and more				
5	6	7	8	9
67.0%	21.0%	8.5%	3.0%	0.5%

The full cost of the program was then calculated using Table 1 and the estimated distribution of Tennessee households.

6. Table 2 was calculated the same as Table 1 with the following major difference:

The rebate was phased out beginning at $4,000 before a household's poverty guideline. The phase-out procedure still avoids an abrupt cutoff from the program as was true for the full rebate in Table 1 but provides less benefits as a household's income approaches and exceeds its poverty guideline level.

Implementing the Sales Tax Rebate Program

The Tennessee Property Tax Relief Program

Tennessee already has in place a program to provide property tax relief to low-income elderly and disabled Tennesseans. The Property Tax Relief Program which is administered by the Tennessee Division of Property Assessments provides reimbursements for property taxes for low-income homeowners who are elderly, disabled, or disabled veterans or their surviving spouses. There were 84,423 claims for property tax relief paid for the 1997 tax year. The total value of the claims was $7,931,338 with an average per claim payment of $93.95. For fiscal year 2000, the amount budgeted for the Property Tax Relief Program (PTRP) is $10,546,000.

The (PTRP) is administered with the help of county trustees across the state. The trustees provide and process applications for first-time claimants. Applications are sent from the trustees to the Division of Property Assessments (DPA) to be verified for eligibility. If full property taxes were paid, DPA sends rebate checks to eligible

[7] There is no direct information on the distribution of Tennessee households by income, except dated Census (1990) information.
[8] Estimated based on a Census estimate of 2,041,000 households in Tennessee in 1996, increase by 3%.

applicants. For claimants that have qualified in past years and continue to own homes in the jurisdiction, vouchers for each claimant are sent to the Division of Property Assessments, verified for eligibility, and funds are disbursed to the trustees to provide credits against property taxes owed by the claimants.

Delivering Sales Tax Rebates Through County Trustee Offices

The current cost of administering the PTRP is within the Division of Property Assessments. The DPA provides PTRP applications and vouchers to trustee offices, as well as some training for trustee office staff.

Implementing a sales tax rebate program through the trustees will assuredly expand their responsibilities. However, the DPA has received funding for implementing a new system for administering the PTRP. During fiscal year 2000, the PTRP system will become more automated. Several programmers will be hired to set up the new PTRP system. According to officials within the DPA, costs of expanding the PTRP to include a sales tax rebate would be minimized because programming has not yet begun for the PTRP and could include the required elements of implementing the sales tax rebate program. The new system will allow trustee staff to send applications and vouchers using the Internet.

DPA officials related that trustees are general very positive about the Tennessee PTRP and were of the opinion that further expansion of offering tax credits would be well received. However, DPA officials said that some computer equipment would probably be needed to supplement the increased workload. Presumably additional staff would be needed as well.

Since the DPA now processes the rebate checks for the PTRP, it is more feasible for them to process checks for the sales tax rebate program. DPA officials were also very positive about the expansion of the PTRP to include another program. They did, however, stress the need to maintain simplicity in an expanded system.

Based on the experience that DPA officials have with this type of program, and the willingness of county trustees to assist, using the PTRP seems a viable mechanism for providing sales tax relief. Having the program administered through the trustees' offices has greater appeal than using traditional eligibility mechanisms, such as local food stamp offices, because of the anonymity it provides to taxpayers. Taxpayers visit trustee offices for a variety of reasons. Applying for a sales tax rebate within this context could insure greater participation in the program.

Tax Relief Programs and Current Practices in Other States

A Rationale for Targeted Relief

Many states concluded the 1998 fiscal year with significant budget surpluses. Although most states are using the surpluses to invest in rainy day funds some 13 states are using surpluses to cut taxes.[i] Some states have considered ways to provide tax relief for low-income people by exempting food from the sales tax base. Georgia and North Carolina have recently fully exempted food from the state sales tax base. Virginia recently passed legislation to phase in a reduction in the state sales tax rate on food by nearly half.

Tennessee is one of eighteen states that fully tax food (that is, the full state sales tax is applied to food for home consumption). Furthermore, of these states, Tennessee has the second-highest combined state and local sales tax rate on food, second only to Oklahoma. Tennessee is considered to have one of the most regressive tax structures in the country, largely due to its reliance on the sales tax, a highly regressive tax, but also due to the full application of the sales tax to food.[ii]

Currently, 25 states plus the District of Columbia, fully exempt food from the sales tax. Of these states, 4 do not have a personal income tax. The remaining states either have no state sales tax (of which there are 5) or levy lower rates on food (of which there are 3). The 4 states that fully exempt food but have no personal income tax include Texas, Florida, Nevada, and Washington. These states, relative to Tennessee, have been in a better position to exempt food because of the nature of their economies and tax systems and the corresponding ability to compensate through other revenue sources. Although the severance tax in Texas has declined since the 1970s, it continues to be an important source of revenue. Additionally, Texas broadly taxes services, including information and data processing services and real property services, growing sectors in many state economies. Florida has significant sales tax collections due to tourism. Nevada has significant revenues from gambling activities and tourism.

There are additional equity issues associated with the pattern of consumer expenditures toward services and away from goods. Services expenditures nationally were slightly less than 48 percent of total personal consumption expenditures in 1978.[iii] By 1998, services were nearly 58 percent of expenditures. Although no state-level data are available, there is evidence that Tennessee parallels the U.S. pattern because of growing activity in services as a percentage of gross state product (GSP). In 1977, services were nearly 64 percent of GSP in Tennessee. By 1996, services had grown to over 72 percent of GSP.[iv] Since it is generally accepted that consumption of services increases with income, the regressivity in Tennessee's tax system is compounded by the full taxation of food.[v]

The regressivity in the tax system necessitates some form of relief for low-income taxpayers. However, it appears that states with similar tax systems as Tennessee's that have fully exempted food may have the means to maintain the exemption. In absence of major tax reform, such as the restructuring of business taxes or a personal income tax, removing the sales tax from all food sales, regardless of income level, to provide relief to low-income taxpayers, is extremely expensive. Without a well-balanced tax system, the tax incidence of full exemption of the food tax results in a shift away from consumers to other taxpayers. Providing significant targeted relief to qualifying low-income families, however, would alleviate some of the regressivity in the tax system while maintaining revenue stability, and could cost no more than up to 25 percent of what full exemption would cost.

The current discussion centered on recapturing business tax revenues lost through re-organization and restructuring is focused on the weaknesses in the business tax structure. Implementing a tax structure that would better capture business activity in the state and hence, increase declining revenues should be determined apart from expenditure considerations, such as the tax expenditure of exempting food from the sales tax base. However, the state also has the responsibility of establishing a tax system that provides relief for some taxpayers who are bearing a relatively greater tax burden than other taxpayers. There is rationality in reducing the burden of low-income working taxpayers while broadening the business tax base to capture activity that is currently being untaxed. The implementation of a fairer business tax structure should be accompanied by a fairer tax burden on low-income working taxpayers.

There is precedence in other states for establishing tax relief without a personal income tax mechanism. Also, there are states with income taxes that use other means to deliver tax relief. Tennessee already has a tax relief program in place for low-income elderly and disabled property tax payers designed to provide property tax relief. South Dakota administers a state rebate program to offset both property and sales taxes for elderly and disabled residents. The South Dakota program provides relief to renters as well. Wyoming has a similar program as South Dakota with but also includes utility cost relief in addition to property and sales tax relief. Nevada has a low-income homeowner and renter program to offset property taxes in the form of a rebate check.[vi]

Kansas and Maryland are states with income taxes that provide relief outside the income tax framework. Kansas offers property tax relief to low-income homeowners and sales tax relief to households with dependent children, elderly, or disabled people.

Maryland has a property tax credit and renters' rebate. The renters' rebate is tied to the federal poverty level.

This paper reviews a targeted, refundable food tax relief program, either a credit or a rebate, as an alternative to a full exemption of the sales tax on food in Tennessee. Included is a discussion of the desirable traits of a workable program, the structure of existing credits and rebates in other states, and alternative delivery methods and associated costs for a relief program in Tennessee.

Public finance experts generally agree that an exemption of the sales tax on food is an expensive way to improve tax equity. The alternative to an exemption most often suggested is a targeted, refundable food tax credit or rebate for low-income consumers. A targeted credit or rebate can provide substantial benefits to low and moderate income residents at a relatively low cost.[vii]

The Center on Budget and Policy Priorities (CBPP), in a recent report, noted that states have encountered significant problems in implementing sales tax credits for food. Existing credits in other states fall prey to one or more of the following shortcomings:

- Credits are not available to all low- and moderate-income households
- Credits tend to be inadequate to offset the sales tax on food paid by a typical family
- Credits diminish or erode over time
- Credits do not adequately reach the intended recipients
- Credits are vulnerable during fiscal crises

The CBPP identified seven desirable features for a model credit to offset the sales tax on groceries:

1. The credit would be either:
    (a) available to all households, or
    (b) available in the full amount to households with incomes below 150 percent or 200 percent of the poverty line, and would be phased out gradually as household income increased above 200 percent of the poverty line.
2. The credit would vary with the number of individuals in a household to reflect the greater amount of food purchased by large families.
3. If possible, the credit would be administered through a state income tax and would be fully refundable to offset the sales tax on groceries for all eligible families. (A credit that is not refundable would offset only income tax liability, not sales tax payments). A rebate program outside of an income tax is also a viable option.
4. Intensive outreach efforts would accompany the credit.

5. The credit would be large enough to offset the full amount of state and local food taxes paid by a family at the poverty line and would be adjusted automatically each year to reflect food cost inflation. These goals would be accomplished by linking the credit to the federal government's Thrifty Food Plan, which computes the lowest possible cost of a nutritious diet for a family of a given size and composition. (In 1997, the Thrifty Food Plan for a two-parent family of four in the lower 48 states cost $4,950 per year; for a single person it cost $1,400). Since the Thrifty Food Plan is adjusted annually for changing food prices, such links would prevent inflation from eroding the credit's value.
6. The credit would be built on a strong base of political support to ensure it survives in the long run.
7. Since the credit would not alleviate the drag on revenue growth created by the food tax, other steps to improve revenue growth – such as broadening the sales tax base to include services – should be considered as well.

These features are used as general guidelines in the remainder of this paper. Obviously, it would be a matter for Tennessee's policy makers to decide which of the recommended features to apply to any future credit program in Tennessee.

Existing Credit Programs in Other States

As of April 1998, six states – Hawaii, Idaho, Oklahoma, South Dakota, Wyoming, and Kansas – offered residents credits to offset some part of their grocery sales tax. The first four of these states offer a credit on their state income tax, while the last three offer a rebate that is administered outside of an income tax. Table 1 compares the major features of these seven programs and identifies their costs to their respective states for Tax Year 1995.

Table 1
States with Refundable Credits or Rebates to Offset Food or Other Sales Taxes, Tax Year 1995

State (General Sales Tax Rate)	Rebate or Income Tax Credit	Amount of Credit	Major Eligibility Requirements	Annual Cost to State
Hawaii (4%)	Credit	$27 per exemption	Available to all residents	$24 million (calendar year 1995)
Oklahoma (4.5%)	Credit	$40 per exemption	Gross household income <$12,000; for welfare recipients, credit is folded into monthly payment	$13.4 million [a] (calendar year 1995)

Table 1 continued

State (General Sales Tax Rate)	Rebate or Income Tax Credit	Amount of Credit	Major Eligibility Requirements	Annual Cost to State
Idaho (5%)	Credit	$15 per individual ($30 per elderly)	Available to all residents *except* non-elderly households with income lower than state income tax filing requirement ($5,400 for married filing jointly)	$18.2 million (calendar year 1996 estimate)
South Dakota (4%)	Rebate (state has no income tax)	$46 TO $258 for individual, $74 to $581 for household [b]	Elderly or disabled persons with household income < $12,000	$1.4 million (fiscal year 1995-96)
Wyoming (4%)	Rebate (state has no income tax)	Up to $500 for individual, $600 for married couple [b]	Elderly or disabled persons with limited assets and with household income < $11,000 for joint filers, $7,500 for single.	$1.7 million (fiscal year 1995-96)
Kansas (4.9%)	Rebate (separate from state income tax)	Up to $40 per head of household, $30 per dependent. [b]	Families with children and elderly or disabled persons; income < $13,000	$2.2 million (fiscal year 1994-95)

Note. Tax rates shown do not include local sales taxes.
[a] Includes $5.6 million paid directly to families through the tax system and $7.8 million distributed to low-income households by Department of Human Services.
[b] Credits are awarded on a sliding scale – credits decline in value as recipient income rises.
Source: Center on Budget and Policy Priorities

Since Tennessee does not have a broad-based income tax, it would be most productive to examine in greater detail the state programs – South Dakota, Wyoming, and Kansas – that provide rebates outside of an income tax structure.

South Dakota

South Dakota does not have a comprehensive personal income tax. In South Dakota, the tax refund program is a method of returning to senior and disabled citizens some of the dollars they pay each year in sales and property taxes. The program has been in effect since 1974 and from 1974 through 1996, the program has refunded $23 million to eligible South Dakotans.

The requirements for the refund are:

- Must have lived in the state for one-year;

- Must be 65 years or older on or before January 1 or disabled at any time during the previous year;
- A single eligible recipient must have a yearly income under $9,000 or live in a household whose members' combined income is under $12,000.

All applicants must submit an application to the Tax Refund Office. Applications are due by July 1 of the year. The refund distribution is based on how much the legislature appropriates and how many people who apply qualify for the refund. Last year, the average refund was $160.

Wyoming

Wyoming does not have a personal income tax, so individuals who believe they are qualified for the sales tax rebate must file an application with the Department of Health. Applicants must go to one of the 37 senior centers around the state. All applications must be submitted to the Department of Health by August 31.

The requirements for eligibility are:

- Must be a state resident for at least one-year;
- Must be 65 or older; or
- Must be 18 years or older and totally disabled during the year prior to the date of filing the application.

Applicants who reside in state institutions are not eligible for the rebate program. A qualified single person whose actual income is less than $7,500 will receive $500. That benefit will decrease by one percentage point if the recipient's income exceeds $6,000. A married person whose income is less than $11,000 will receive a benefit of $600. That benefit will decrease by one percentage point if the recipient's income exceeds $8,000.

Additionally, no applicant is entitled to a refund who owns resources that exceed an equity value of $4,500. However, a combined property of $100,000 is exempt if that combined property includes:

- An applicant's primary residence;
- Household furnishings and personal belongings;
- One automobile.

Kansas

Kansas distributes the food sales tax rebate through information obtained from the state's personal income tax form (K-40). Each eligible recipient must submit a return even if an individual is not required to file an income tax return.

The requirements for the food sales tax rebate are:

- State resident for all last year;
- Must be 55 years of or older on January 1; or,
- Must be permanently disabled or blind during the entire year, regardless of age; or,
- Must have one or more dependent children claimed as a personal exemption and who was under the age of 18 all of last year. The child must have been born before January 1 and lived with applicant for the entire year.

The refunds are calculated based on the amount of one's Kansas adjusted gross income and the number of dependents in one's household. If a recipient's income is $12,500 or less, the food sales tax rebate is $60 for each dependent. If a recipient's income is between $12,501 and $25,000, the food sales tax rebate is $30 for each dependent. If a person's Kansas adjusted gross income is over $25,000, that person is not eligible to receive the food sales tax refund.

New Mexico

New Mexico's Low Income Comprehensive Tax Rebate program requires applicants to:

- Have a modified gross income of $22,000 or less;
- Have been physically present in New Mexico on the last day of the tax year;
- Have been physically present in New Mexico for at least 6 months during the current calendar year;
- Not be eligible to be claimed, or claimed as a dependent of other tax payer for the current year and;
- Not been an inmate of a public institution for more than 6 months during the current year.

The program is administered by the Department of Revenue. In order to apply for the refund, every applicant must provide a personal income tax form. The amount of the money that a qualified recipient would receive is based on the individual's income and the number of dependents that the recipient is claiming. For example, if an applicant reports an income over $14,000 and not greater than $15,000 and claims four dependents, the total refund will be $90. Additionally, extra exemptions are available if the applicant, is married, files jointly, and is 65 years of age or over.

---

[i] National Governors Association and National Association of State Budget Officers. *The Fiscal Survey of the States*, December 1998, Table 11.
[ii] Michael P. Ettlinger, et al. *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, Citizens for Tax Justice and the Institute for Economic Policy, June 1996.
[iii] U.S. Bureau of Economic Analysis.
[iv] U.S. Bureau of Economic Analysis.
[v] See William Fox and Matthew Murray, "Taxing Services," *National Tax Journal*, Vol. XLI, No 1, March, 1988. The authors reported the "average propensity to consume taxable goods declines as income increases, it is possible that the average propensity to consume potentially taxable services increases. As such, the taxation of services would add a progressive element to sales taxation." However, they concluded that taxation of services is regressive for those earning less than $30,000.
[vi] Much of the material included on targeted state programs is from "Low-Income Tax Relief in the Absence of an Income Tax" by Iris Lav, Center of Budget and Policy Priorities.
[vii] Much of the material included on targeted state programs is from *Should States Tax Food? Examining the Policy Issues and Options*, Nicholas Johnson and Iris J. Lav, Center on Budget and Policy Priorities, Washington, D.C., 1998.