Rethinking the Sales Tax Food Exclusion With SNAP Benefits

by Anna L. Johnson and Steven M. Sheffrin

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In this special report, the authors discuss the consequences of the nontaxability of benefits under the Supplemental Nutritional Assistance Program, formerly known as food stamps, using data from a typical city in Alabama, which is a full taxing state, and New Orleans, which taxes food at a slightly reduced rate at the local level.

Earlier versions of this paper were presented at the 2015 Tulane Tax Roundtable and the 2015 National Tax Association meetings. We thank Andrew Hayashi, Susan Morse, Alex Raskolnikov, Kirk Stark, and John Brooks for their valuable comments. More details on our methods and additional discussion can be found in our working paper, "The Success of SNAP (Food Stamps) and the Desirability of Taxing Food."

I. Introduction

Food is taxed differently by states and local municipalities depending on where the food is intended to be prepared and consumed. Food purchased to be prepared at home is considered food at home, or non-prepared foods that would typically be purchased at a grocery store. Most states either totally or partially exclude food at home from the general sales tax. That exclusion generates a debate between tax policy analysts with their emphasis on broad-based, low-rate tax systems, and advocates for the poor who argue that the exemption for food is necessary on distributional grounds. States that do tax food at home are often singled out as having particularly regressive and punitive tax systems.

What is missing from that debate is a serious discussion of the consequences of the nontaxability of benefits under the Supplemental Nutritional Assistance Program (SNAP), formerly known as food stamps.

In 2012, 46.6 million individuals were enrolled in SNAP, which virtually equaled the nation's number of individuals in poverty, 47 million.[1] The surge in the number of SNAP recipients — up from 26.3 million in 2007 before the Great Recession — and sustained high levels far past the recovery have generated considerable policy discussion on the implications of food stamp persistence.[2] From a different perspective, there are concerns that improvements in the unemployment picture will eliminate the ability of states to request temporary waivers from work requirements and thereby reduce the number of recipients in 2016.[3]

Meanwhile, another policy debate continues in the states. As states review their fiscal systems, they revisit the exemptions in their sales taxes. The largest state sales tax exemption is typically the exclusion for food at home. Tax analysts have long pointed out that this exemption is costly and ill-targeted. Yet states rarely want to tinker with that exemption, believing it would have adverse distributional consequences.

While those two policy areas may seem distinct, they do have something important in common. Since 1987 the federal government has prohibited states and local governments from taxing SNAP benefits under their general sales taxes. That means that virtually all the 46.6 million recipients in 2012 did not pay sales tax on their purchases through SNAP. Since in its intent and through its structure SNAP is designed to reach those in poverty, an extremely large segment of the poor was largely free of any sales taxes on their basic food needs. A strong but largely invisible thread thus ties SNAP to the "food at home" sales tax exemption.

[1] U.S. Department of Agriculture, "Characteristics of Supplemental Nutrition Assistance Program Households: Fiscal Year 2012" (Feb. 2014), Table 2.1.

[2] Damian Paletta and Caroline Porter, "Use of Food Stamps Swells Even as Economy Improves," *The Wall Street Journal*, Mar. 27, 2013.

[3] Ed Bolen, "Approximately 1 Million Unemployed Childless Adults Will Lose SNAP Benefits in 2016 as State Waivers Expire," Center on Budget Policy and Priorities (Jan. 5, 2015).

While experts have recognized SNAP's connection to the food at home exemption, they rarely analyze its consequences.[4] For example, a New York state tax reform commission recently engaged in a major tax revision and recognized the costly exclusion for food, but did not recommend any changes for that provision.[5] Although its report does mention the nontaxability of SNAP benefits in an appendix, the commission does not discuss it in the actual report, nor did it justify why it recommended changing the clothing exemption but not the food exemption. Some scholars have deliberately downplayed the taxability link.[6]

Few policy analysts have recognized the implications of the nontaxability of SNAP benefits. In 2004 then-Gov. Bill Richardson of New Mexico proposed removing the state and local gross receipts tax from food at home (and some other items) while raising the overall gross receipts tax rate in municipalities. One policy analyst opposed that change:

> "The really big losers are food stamp recipients," said Kelly O'Donnell, an economist with New Mexico's Voices for Children, to the Associated Press. The gross receipts tax isn't imposed on food stamp transactions; about 80,000 households in New Mexico receive food stamps. . . . O'Donnell contends that those who can most afford to pay for the tax — middle to upper-middle income New Mexicans — would receive the biggest benefits from elimination of the tax on food.[7]

In this article, we examine the implications of the nontaxability of SNAP benefits for state sales tax systems using data from the Consumer Expenditure Survey (CEX). We analyze the effects of nontaxability of SNAP benefits in a typical city in Alabama, which is a full taxing state, and also in New Orleans, which taxes food at a slightly reduced rate at the local level. Using SNAP participation rates from studies commissioned by the U.S. Department of Agriculture, we recalculate the effective incidence of the sales tax (using both income and consumption as bases) to highlight the effect of the nontaxability of benefits. Because SNAP effectively reaches a high percentage of the poor, we find that the sales tax is substantially less regressive once that feature of SNAP is considered. While there will always be some of the poor who would pay more if the food at home exemption is repealed, our work suggests that taxing food but compensating with a revenue-neutral reduction in the overall sales tax rate would provide considerable benefits to the poor and, at the same time, lead to a more rational sales tax system.

II. The Food at Home Exemption From the General Sales Tax

Exempting food at home from the sales tax is the rule rather than the exception; nonetheless, there is considerable variation across states. Here are the basic facts based on the latest data from the Federation of Tax Administrators[8]:

- No sales taxes: Alaska, Delaware, Montana, New Hampshire, and Oregon;
- Food taxed at lower rate: Arkansas, Illinois, Missouri, Tennessee, Utah, and Virginia;
- Food subject to local taxes: Arkansas, Georgia, Louisiana, North Carolina, and Utah;
- Food taxed, but credits allowed: Hawaii, Idaho, Kansas, Oklahoma, and South Dakota;
- Food fully taxed (no credits allowed): Alabama and Mississippi; and
- Food fully exempted from tax: The remaining 27 states and the District of Columbia.

A few notes regarding that categorization. Three of the states that give credits have relatively low rates: Hawaii (4 percent), Oklahoma (4.5 percent), and South Dakota (4 percent). In some states that only tax food at home on the local level, the tax rates can still be significant — for example, Louisiana (4.5 percent in New Orleans), Georgia (2.97 percent average), and Arkansas (2.69 percent average).[9] Also, the credits that are available in numerous states can be restrictive.[10]

Policy analysts generally criticize the food at home exemption on three grounds: It is expensive and thus necessitates higher rates to achieve revenue targets; it is poorly targeted; and exempting food at home while taxing prepared food, snacks, and other items, as typical, leads to complexity.

Although published estimates vary across states, a typical estimate of the reduction of the taxable base through the food at home exemption is about 20 percent. Based on published data, the reduction in the base in Louisiana is 15 percent, John Mikesell estimates 15 to 20 percent for Indiana, and Kirk Stark uses California figures to arrive at 28

[4]For example, it is only mentioned in passing three times in the excellent treatise *Sales Taxation: State and Local Structure and Administration*, second edition, John F. Due and John L. Mikesell (1994). In their first edition, in 1983, the federal law exempting food stamps from tax was not in effect.

[5]Report of the New York State Tax Reform and Fairness Commission (Nov. 11, 2013). *Available at* http://www.governor.ny.gov/sites/governor.ny.gov/files/archive/asset s/documents/greenislandandreport andappendicies.pdf.

[6]*See, e.g.*, Katherine S. Newman and Rourke L. O'Brien, *Taxing the Poor* (2011). The preface begins with the story of the attempt of a progressive group in Alabama to repeal the tax on food for home consumption in 2007 and then details the story of an impoverished citizen. Yet they fail to mention until 10 pages into the preface that SNAP benefits are not subject to tax.

[7]"Governor's Proposal to End Food Tax Meets Opposition," *State Tax Notes*, Feb. 16, 2004, p. 530. New Mexico did eventually exempt food at home from its gross receipts tax.

[8]Federation of Tax Administrators, "State Sales Tax Rates and Food and Drug Exemptions" as of Jan. 1, 2015. *Available at* http://www.taxadmin.org/assets/docs/Research/Rates/sales.pdf

[9]Tax Foundation, "State and Local Sales Tax Rates in 2014," a*vailable at* http://taxfoundation.org/article/state-and-local-sales-tax-rates-2014.

[10]*See* Alan Viard, "Should Groceries Be Exempt From Sales Tax?" *State Tax Notes*, July 25, 2011, p. 241.

percent.[11] Earlier estimates by John Due and Mikesell placed the revenue loss at 20 to 25 percent.[12] A 20 percent reduction in the base is substantial. If a state's rate were 5 percent, the same revenue level would be maintained if it were reduced to 4.16 percent with the inclusion of food at home in the base.

Unlike many other business-related exemptions such as the sale for resale exemption, the food at home exemption is justified not on efficiency grounds but on purely distributional grounds. As we will show later, the nontaxability of SNAP benefits sharply reduces the distributional case. If the poor are generally protected, the direct benefits of the tax exemption accrue to middle- and upper-income households. Purchases of filet mignon, expensive fresh fish, or exotic organic mushrooms at Whole Foods or gourmet stores escape taxation. Of course, politicians are well aware of that. When Richardson pushed for removing food from the gross receipts tax, he was quoted as saying, "This is a tax cut for middle-class families."[13]

Finally, there are the administrative issues that arise when tax authorities need to draw lines between taxable and nontaxable items. The literature on that topic is immense, and by now there are well-known anecdotes that tax professionals love to share. Large versus mini marshmallows (the former taxable as candy, the latter nontaxable as food at home), the "hot nuts" rule (taxable, while unheated nuts are not), and related stories are legendary.[14] Stark describes several decisions made in New York in which fruit juices, Tang, and Ovaltine are exempt, while, respectively, fruit drinks, Kool-Aid, and Gatorade are taxable.[15]

Simplifying those provisions is difficult. California introduced a snack tax in the 1990s that would have reduced complexity. But it was eventually overturned by a voter-approved constitutional amendment that defined candy, snack foods, and bottled water as food at home and therefore exempt from tax.[16] Thus, candy in California now has the same constitutional status as the property tax limitations under Proposition 13!

The eligible food items that can be purchased under SNAP closely match the provisions in state tax systems for food at home. Hot foods and foods consumed on the premises cannot be purchased under SNAP. Soft drinks, candy, cookies, snack crackers, and ice cream are counted as food items and thus are eligible. There are detailed rules for energy drinks, live animals, fish, gift baskets, pumpkins, and other items that may or may not be consistent with the provisions in different states. But as a general rule, the SNAP eligibility provisions can be considered quite close to the rules for food at home in state sales tax statutes.[17]

III. SNAP

In this section, we briefly discuss the history and some legal aspects of the program, the requirements for eligibility for the program, and finally the participation rates in the program. By most accounts, SNAP is a very successful government program, with a high level of participation and coverage for the targeted groups.

A. Institutional and Legal Background

The Food Stamp Act of 1964, passed by President Lyndon B. Johnson, eventually transformed into SNAP as known today. The food stamp program required households to purchase stamps that could be used to purchase food, and a bonus amount was awarded based on the participant's income level. The federal government funded the program, and the state governments were in charge of authorizing applications for the stamps and distributing the benefits.

The Food Security Act of 1985 prohibited participation in the Food Stamp Program in states that assessed taxes on food stamp transactions. States were required to comply by October 1, 1987, or they would no longer be allowed to participate. All the states chose to remain in the program and not assess taxes on food stamp transactions.

What was the constitutional basis for the federal government to require states to not tax purchases made by individuals under SNAP? That issue is especially pertinent after the U.S. Supreme Court's ruling in *National Federation of Independent Business v. Sebelius* that prohibited the federal government from requiring states to expand their Medicaid programs on the grounds that it unconstitutionally coerced the states.[18]

In 1985 Thomas B. Ripy, a lawyer with the Congressional Research Service, examined the constitutionality of proposals of either requiring rebates to the federal government of revenue raised by states through the taxation of food stamps or outright prohibiting the taxation of food stamp purchases.[19] Ripy himself considered a proposal in which the states, if they taxed food stamps, would be required to

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[11]For Louisiana, I used figures from pages 6 and 8 of the "Louisiana Tax Exemption Budget" (2013-2014), Louisiana Department of Revenue. For Indiana, see Mikesell, "Reforming Indiana's Retail Sales Tax," *State Tax Notes*, Aug. 11, 2014, p. 407. For California, see Kirk Stark, "Bribing the States to Tax Food," unpublished (Aug. 2014) (available from author).

[12]Due and Mikesell, *supra* note 4, at 75.

[13]"Governor's Proposal to End Food Tax Meets Opposition" (op. cit.) at 530.

[14]*See* Richard D. Pomp and Oliver S. Oldman, *State & Local Taxation* 6-15 (2001).

[15]Stark, *supra* note 11 at 13.

[16]Constitutional Amendment 163.

[17]For additional detail and other links, see the U.S. Department of Agriculture website at http://www.fns.usda.gov/snap/eligible-food-items.

[18]*Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

[19]Thomas B. Ripy, "Constitutional Questions: Amending Federal Law to Prohibit Applications of States Sales Taxes to Food Purchases by Beneficiaries Under the Food Stamp and WIC Program," Congressional Research Service, 85-551A.

rebate a presumptive amount back to the federal government or face the loss of an equivalent amount of funds from the federal government.[20] He said that this method was less likely to infringe on state sovereignty than an outright prohibition on taxation.[21] Whether the federal government could enact a similar law today is an open question.

Beginning in 2000, the traditional stamps that were used to purchase food were replaced by Electronic Benefit Transfer (EBT) cards. Those cards transferred the government benefits from a federal account to the food stamp retailers. The EBT cards were implemented in order to reduce instances of fraud and the stigma associated with the use of food stamps. The 2008 Farm Bill renamed the Food Stamps Program the Supplemental Nutrition Assistance Program and also began a pilot program to study the use of incentives to encourage healthy food purchases with SNAP benefits.

B. Eligibility

SNAP is carefully designed to reach poor households, which must meet specific requirements to qualify. To target its benefits, SNAP categorically includes some households and has specific income limits, asset limits, and selected work requirements.

Households in which all members receive Supplemental Security Income (SSI) benefits, cash Temporary Assistance to Needy Families (TANF), or General Assistance (GA) automatically qualify for SNAP. Those households, which comprise 91 percent of the participating population, are exempt from asset tests.[22] As with all other SNAP recipients, their benefits are tied to their income.

The income requirements are based on both gross income and a net income measure. The starting point is gross income, which includes most cash income but excludes noncash or in-kind benefits. Gross income must be less than 130 percent of the poverty line based on household size and composition. Households with elderly or disabled members are not subject to that test.

The asset tests consist of limits on fungible resources and vehicles. Households may have $2,250 in countable resources, such as a bank account, or $3,250 in countable resources if at least one person is age 60 or older or is disabled. A home and a lot and assets in pension plans are not included. There are specific rules for vehicles, but they typically are overridden by state policies. Overall, an analysis conducted for the U.S. Department of Agriculture estimates that only 2 million individual adults are deemed ineligible through the asset tests.[23]

Presuming the household meets the gross income test and asset tests, the next step is to allow for a deduction to determine members' net income. A household's net monthly income — the gross income minus allowed deductions — must be less than 100 percent of the federal poverty level. The allowed deductions include a standard deduction based on household size, a 20 percent deduction for earned income, a dependent care deduction, a deduction for medical expenses for the elderly or disabled, and a deduction for excess shelter costs that are more than half of the household's income after the other deductions.[24]

There are various nonfinancial eligibility standards. The two most important are restrictions on noncitizens and work requirements. Legal resident noncitizens under the age of 18 or who have lived in the United States for five years or more are eligible, but unauthorized immigrants are not. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 limits the receipt of SNAP benefits to three months in a three-year period for able-bodied adults without dependents who are not working, participating in, and complying with the requirements of a work program for 20 hours or more each week, or a workfare program. Individuals are exempt from that provision if they are under 18 or over 50, responsible for the care of a child, pregnant or medically certified unfit for employment, or otherwise exempt from the SNAP work requirements. In 2012 there were fewer than 4 million individuals potentially subject to work requirements.[25] There are numerous ways in which states can override the work requirements if unemployment exceeds 10 percent or there are insufficient available jobs.[26] Since the last recession, the work requirements have been effectively suspended. However, in the next several years as the job market is expected to improve, those requirements will likely once again become binding in some areas.[27]

Once the deductions are made and eligibility has been confirmed for each household, the amount of SNAP benefits is determined by multiplying net monthly income by 30 percent and subtracting that result from the maximum allotment set by the USDA. The 30 percent reduction exists because SNAP households are expected to spend about 30 percent of their resources on food. Those benefits are adjusted for household size and composition.

C. Participation Rates

The USDA employs Mathematica Policy Research to analyze the participation rates for SNAP. The company's most recent report is from July 2014 and explores the trends

[20]*Id.* at 12.

[21]*Id.* at 12-13.

[22]Characteristics, *supra* note 1, at Table A.4.

[23]USDA, "Trends in Supplemental Nutritional Assistance Program Participation Rates: Fiscal Year 2010 to Fiscal Year 2012" (July 2014) at 64.

[24]For additional detail, see the eligibility section of the USDA's website for SNAP, *available at* http://www.fns.usda.gov/snap/eligibility.

[25]This is the number of non-disabled adults age 18-49 living in childless households who are not otherwise exempt. *See* USDA "Characteristics," *supra* note 1, Table A.16.

[26]*See* the USDA website for details and links, *available at* http://www.fns.usda.gov/snap/able-bodied-adults-without-dependents-abawds.

[27]*See* CBPP, *supra* note 3.

from fiscal 2010 to fiscal 2012.[28] Its sophisticated method uses data from the Current Population Survey and supplements the Survey of Income and Program Participation to estimate eligibility. It takes into account state-specific rules, legislative changes to the program, and state-by-state estimates of undocumented immigrants.[29] They separately estimate the number of participants in a given year and divide the result by their estimates for eligible households.

For fiscal 2012 the overall participation rate was 83.1 percent for individuals in households, 87.2 percent for households, and 95.6 percent for the benefit receipt rate (the percentage of benefits that would be paid out if every eligible household participated).[30] The latter rate is much higher because households eligible for higher benefits are most likely to participate.

Participation rates vary by demographic groups.[31] One-hundred percent of eligible children participated in the program. Of those people below the poverty line, the participation rate was 98 percent; and for those between 100 and 130 percent of the poverty line, the rate was 50 percent. Since fiscal 2010, there has been a large increase in the participation rates of those subject to work requirements, from 62.4 percent in fiscal 2010, to 76.5 percent in fiscal 2011, and 93.6 percent in fiscal 2012. As we noted above, in addition to the standard provisions in the program that allow states to suspend work requirements in times of high unemployment and insufficient jobs, various provisions enacted beginning in fiscal 2010 gave states the option to suspend work requirements through fiscal 2012.[32]

Historically, the elderly have had lower participation rates. In fiscal 2012 the overall elderly participation rate was 41.6 percent, with rates of 55.1 percent for those living alone and 23.8 percent for those living with others. Finally, those eligible for the maximum benefit rate had 95.8 percent participation, while those with the minimum benefit or less had 30.1 percent participation.

Overall, both the design of the program and the participation rates indicate that this program is carefully targeted to reach the poor and is remarkably effective in meeting that goal. Both the categorical inclusions and income provisions effectively limit the provision to those most in need. And given the eligibility rules, the extremely high participation rates for those in poverty indicate SNAP reaches the neediest in practice as well.

Because error rates for the program are low, SNAP does not provide benefits to those deliberately excluded by law. In particular, unauthorized noncitizens are not eligible for the program (although their citizen children may be). Similarly, for policy reasons and consistent with values the public holds, work requirements have also limited eligibility (except in the most recent years). However, those are deliberate policy choices based on public sentiment.[33] For those reasons, we will take the SNAP eligibility criteria as conterminous with our definition of the poor.

IV. The Proper Metric: Income or Consumption?

Typically, sales taxes are said to be regressive because taxable expenditures for low-income households represent a larger fraction of their income than taxable expenditures do for middle- or higher-income households. However, numerous economists have challenged that account because current income may be a poor metric to measure burden. They have suggested that consumption is a much better measure to gauge the incidence of taxes.

There are three reasons why consumption is a better metric. First, income fluctuates substantially from year to year for many households. Using the Panel Survey of Income Dynamics, James Poterba shows that low-income households in one year have a significant probability of being higher-income households in other years.[34] Second, according to traditional economic models, households will attempt to set their consumption levels according to their long-term resources. Consumption, therefore, is a better (although not perfect) proxy for long-run income.[35]

Finally, as a practical matter, a significant number of low-income households report zero income. For example, 20 percent of SNAP participating households reported zero gross income.[36] Based on our analysis with the CEX, we know that households reporting zero gross income had significant amounts of consumption, indicating that they had resources available to them.

V. Calculating the Burden

In this section, we first discuss the sales tax systems in place in Alabama and in New Orleans, which are representative for the states that tax food. We then explain how we use the CEX to calculate tax burdens and present the results from our analysis.

A. Sales Tax Structures

Alabama has a sales tax rate of 4 percent.[37] The local sales tax varies greatly by local municipality. In Montgomery the local sales tax is 2 percent; Birmingham adds a 4 percent rate. The total local and state sales tax, at its highest, reaches

[28]*Supra* note 23.
[29]*Id. at 51-67.*
[30]*Id.* at 3.
[31]This data is from "Trends," *supra* note 23, Table 3, at 9.
[32]*See* the discussion in "Trends," *supra* note 23, at 4-5 and 55.

[33]For a discussion of the economic psychology of work requirements, see Steven Sheffrin, *Tax Fairness and Folk Justice*, 133-142 (2013).
[34]*See* Poterba, "Lifetime Incidence and the Distribution Burden of Excise Taxes," 79 *Am. Econ. Rev.* 325-330 (1989). The probability of leaving the lowest quintile after seven years is 46 percent.
[35]*See id.* for a fuller discussion.
[36]USDA, "Characteristics," *supra* note 1, at xvii.
[37]Tax rates for Alabama were taken from Avalara, a*vailable at* http://www.avalara.com/.

12 percent in Alabama. All food purchases are taxed at both the state and local levels. That is a rare occurrence, even among Southern states. However, prescription drugs are not taxed at any level in Alabama.

When calculating the average sales tax burden using the Alabama sales tax structure, we used the state sales tax rate, 4 percent, plus the average local sales tax rate of the state, 4.5 percent. That total sales tax of 8.5 percent will be applied to purchases of food for home consumption, food for away from home consumption, and other taxable goods.

Louisiana's state sales tax is also set at 4 percent. The local sales tax rate again varies, with the highest total state and local sales tax reaching 11 percent.[38] In New Orleans the local sales tax is 5 percent. However, food purchased for home consumption is taxed at a reduced local rate of 4.5 percent. The sales tax burden calculations for New Orleans will differ from those of Alabama because of the exemptions in place. In Louisiana, food purchased for home use is only taxed at the reduced local level. Prescription drugs are also exempt from the state sales tax.

In calculating the average tax burdens for income groups using the tax structure in New Orleans, food purchased for consumption away from home will be taxed at the joint state and local rate of 9 percent. Food purchased for home consumption and prescription drugs will be taxed only at the reduced local level, 4.5 percent.

B. Data

We derive consumption and income data from the public use microdata from the 2012 CEX Quarterly Interview Survey.[39] That dataset provides information on the buying habits of American consumers and is collected for the Bureau of Labor Statistics by the U.S. Census. It is the only federal-level survey that provides information on a complete range of consumers' expenditures, income, and other characteristics. Recently, there have been numerous studies of the accuracy of the CEX. In general, the survey does an excellent job of capturing consumption along most dimensions, and its measures are close to other commonly used datasets.[40] However, it is less accurate regarding self-reports of government transfer programs.[41] For those reasons, we rely on the CEX survey for our consumption data, but as we describe below, we use data from USDA studies to estimate benefit levels.

[38]Data for Louisiana are available on the parish map from the Louisiana Association of Tax Administrators, a*vailable at* http://bit.ly/1Osj1kS.

[39]Bureau of Labor Statistics, "Consumer Expenditure Survey, U.S. Department of Labor" (2012), a*vailable at* http://www.bls.gov/cex/.

[40]For an assessment of the accuracy of the CEX for consumption data, see Adam Bee et al., "The Validity of Consumption Data: Are the Consumer Expenditure Interviews and Diary Surveys Informative?" (Aug. 1, 2012).

[41]*See* Thesia Garner et al., "Strengths and Weaknesses of the Consumer Expenditure Survey From a BLS Perspective" (July 2009), at 12.

Because we are examining income and expenditure levels, it is important to be able to differentiate between households of different sizes. We are able to determine the number of people making joint financial decisions in each consumer unit through the family size variable. The CEX is most recently available for the year 2013; however, we chose to use the 2012 survey because the most extensive and recent SNAP data was from fiscal 2012.

To study the tax burden on people of different income levels, a definition of poor is needed. The obvious and most convenient way to differentiate the poor from the non-poor is to use the poverty guidelines issued each year by the U.S. Department of Health and Human Services. Those guidelines are sometimes loosely referred to as the "federal poverty level." As we discussed, these guidelines are used to determine SNAP eligibility and benefit amounts.

We use the federal poverty guidelines for 2012. Any consumer unit reporting income at or below that guideline is considered to make 100 percent or less of the federal poverty level and will be categorized as the poor group. We will also consider what we term the upper-poor, those making gross incomes between 100 and 130 percent of the poverty line. For comparison, we also analyze the sales tax burden on middle-income consumer units. There will be two categories for those consumer units as well: 150 to 250 percent of the federal poverty level and 350 to 450 percent of the federal poverty level. Those categories will be called the lower-middle class and middle class, respectively. All variables are reported at annual levels.

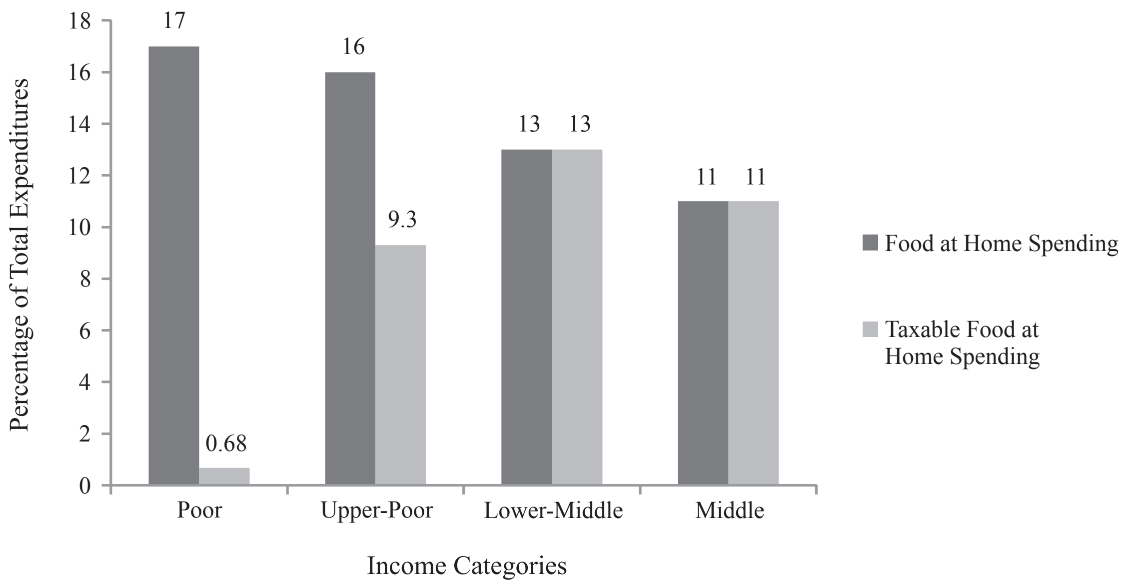
To calculate the sales tax burden properly for each of those income categories, we must break out expenditures into specific categories to apply the sales tax structure correctly. Total expenditure levels for the year were calculated by adding the current quarter's total expenditures to the previous quarter's expenditure level and multiplying by two. All expenditure categories are thus transformed into yearly values.

Typically, services are not taxed at the state or local level, so as many service categories as possible should be separated from the total expenditure level before estimating the sales tax burden. In the data, the nontaxable services available to exclude included transportation expenditures, housing expenditures (including rent and mortgage payments), medical services, health insurance payments, and expenditures on prescription drugs. Prescription drugs are taxed differently in different states, so it is important that they be a separate expenditure category.

SNAP benefits apply to food purchased to be prepared at home. There is also the food category "food away from home," which is food purchased at restaurants. That category of food expenditure is typically taxed to the full extent at the state and local levels.

We then subtract all the service categories, prescription drugs, food at home, and food away from home from the total yearly expenditures to create an "all other spending" variable. Throughout the analysis, we consider that category

Figure 1.
Percentage of Expenditures Spent on Food at Home



to be taxable at both the state and local levels. That is obviously not completely accurate, but we believe we have excluded as many nontaxable services as possible.

Figure 1 depicts the percentage spent on food at home for the different income categories. For a household size of two that is below the federal poverty cutoff, only 17 percent of all total expenditures are used to purchase food for home consumption.[42] The pattern shows that as the income categories increase, higher-income households spend a smaller portion of their expenditures on food. That figure also presents an estimate of the taxable household food consumption taking into account the nontaxability of SNAP (we discuss the derivation of those numbers below). When the expected value of nontaxable SNAP benefits is taken out of the poor and upper-poor households' food expenditures, the percentage of total taxable expenditures on food at home dramatically drops.

C. SNAP Benefit Calculations

Any food bought with SNAP benefits is not subject to any state or local sales tax, in accordance with federal law. Therefore, when calculating the tax burden, food purchased with those benefits must not be taxed. Although the CEX contained self-reports of SNAP benefits, they were implausible or inconsistent with the SNAP data. Instead of using the self-reports, we calculated an expected value of SNAP benefits using the average amounts given to each household type and the percentage of each income category that receives the benefits.

We estimated expected SNAP benefits for both the poor and upper-poor for five household types. To estimate the expected values of benefits, we need estimates of both the participation rates and average benefits for each category. The average benefits for each household type are taken from Table 3.3 and Table A.2 in the USDA report on the characteristics of SNAP households.[43] We use those measures of benefits for the poor households. For the upper-poor households, we reduce the benefits by multiplying by 48 percent, which is the ratio of the benefits received by the upper-poor to the benefits received by the poor. We assume in our analysis that the higher-income categories receive no benefits.[44]

To estimate participation rates, we start with Table 3 in the USDA report on trends in SNAP participation by household type for fiscal 2012.[45] For single-person households, we use participation rates from fiscal 2010 to offset

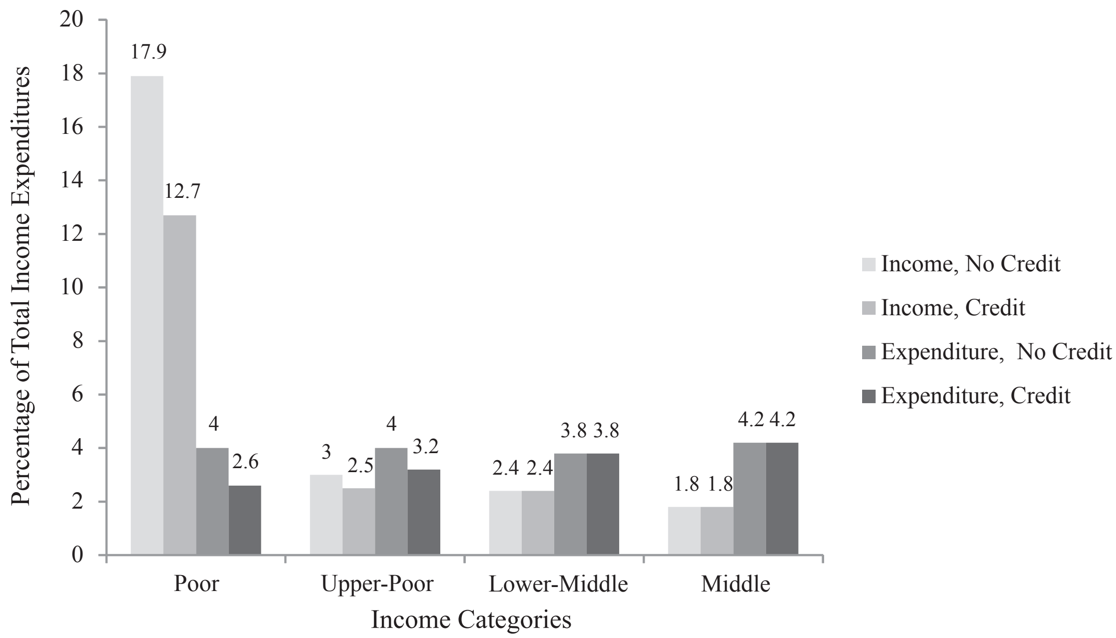
[42]This is the average of the ratio for each household.

[43]*Supra* note 1, Tables 3.3 and A.2.

[44]Households with income higher than 130 percent of the poverty line can receive benefits if they are categorically eligible. However, they comprise only 4.8 percent of the recipients and receive only 1.5 percent of the benefits. *Supra* note 1, Table A1.

[45]*Supra* note 23, Table 3. For the elderly, we make adjustments to reflect that our data contains households with only elderly members. After this adjustment, our elderly participation rate becomes 53.8 percent.

Figure 2.
Average Tax Burden Percentage: Alabama



the increased participation rates in 2012 because of a relaxation of the eligibility requirements during the most recent recession.[46] We make a few additional adjustments to those rates. In fiscal 2012 approximately 98 percent of all eligible households earning less than 100 percent of the federal poverty level received SNAP benefits; however, of those eligible earning between 101 and 130 percent of the federal poverty level, 50 percent participated in the program. For the upper-poor, we thus assumed a 50 percent participation rate for all categories. To preserve the average participation rate in each category by household type, we also adjusted upward the average participation rates of the poor (over the average in each category).[47]

D. Tax Burden Calculations

In this section, we illustrate our findings, using graphs to depict the burden of the sales tax in Alabama and New Orleans. For each jurisdiction, we present the sales tax burden for two-person households for all four income groups, measured by both income and consumption and with and without the benefits of SNAP. Results for other household sizes were similar.

Figure 2 presents the results for Alabama. SNAP benefits clearly make a difference. Expressed as a percent of income, the sales tax burden is 17.9 percent without SNAP benefits but falls to 12.7 with SNAP. As expected, even with SNAP benefits, the poor pay a higher percentage of income in taxes — but that is largely because so many households in that category report zero income. Comparing the upper-poor with our two other income classes, lower-middle and middle, the burden is roughly proportional even using income as a measuring rod.

However, the average tax burden based on total expenditures (our preferred measure) changes the picture and makes the sales tax slightly progressive. Taking into account the SNAP benefit, the effective tax rates as measured by consumption for our four income categories are 2.6 percent, 3.2 percent, 3.8 percent, and 4.2 percent. That is mildly progressive, and there clearly is an increase in effective tax rates. The SNAP benefits do make a difference — without them the poor would pay a higher effective rate than the upper-poor and comparable rates to the other categories.

In summary, once the SNAP benefits are taken into account, the sales tax appears to be slightly progressive as measured by consumption. Even using income, there is a substantial drop in measured burden. As Figure 1 revealed, the SNAP benefits do make a substantial difference in the overall tax base for the poor.

[46]Participation and eligibility rates both increased from fiscal 2010 to fiscal 2012 for this category. If participation rates do not fall materially in the future as eligibility decreases, then the number of households that we assume would be enrolled in SNAP in our analysis would be the same as in fiscal 2010.

[47]Specifically, for each household type, we set the poor participation rate 10 percentage points higher than the average participation rates for all eligible households. This adjustment preserved the average as we reduced the participation rate for the near-poor.

Figure 3.
Average Tax Burden Percentage: New Orleans

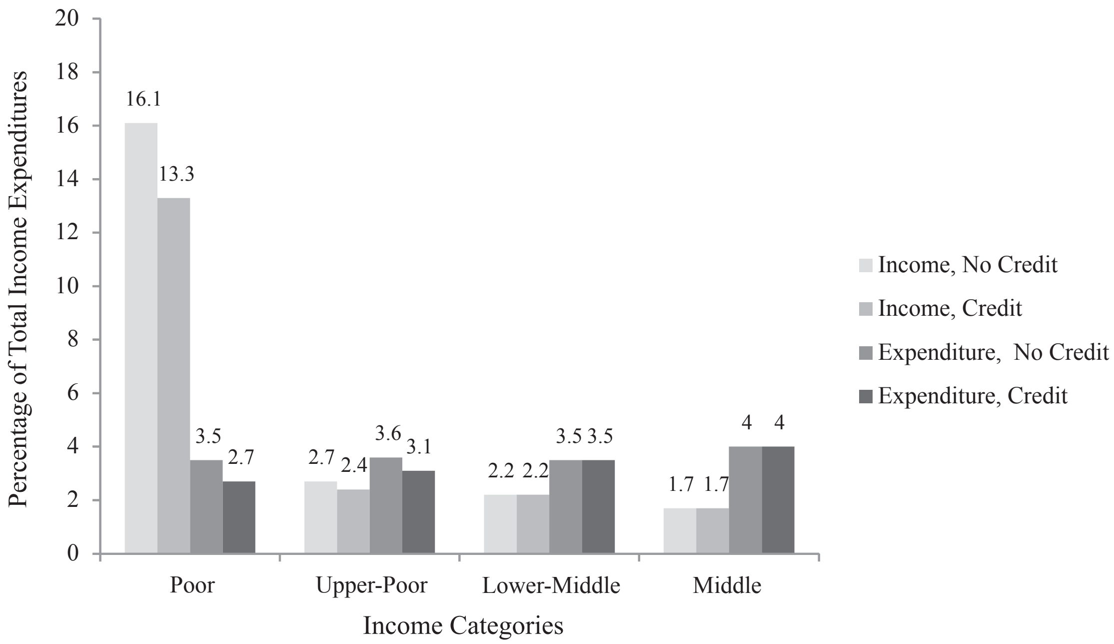


Figure 3 presents the key data for two-person households in New Orleans. That graph presents the calculations for average sales tax burden based on total income, total expenditure, and total income and expenditures with the SNAP purchases removed from the total sales tax calculations. Again, the income-based tax burden is regressive, with those in the poor category paying about 13.3 percent of their income in sales tax after SNAP benefits are taken into account.

However, when looking at the tax burden based on total expenditures, that inequality appears to disappear. The average sales tax burden based on expenditures *without* the SNAP exclusion is 3.5 and 3.6 percent of total expenditures for the poor and upper-poor, respectively, while it is around 3.5 for the lower-middle and 4 percent for the middle category. Once we account for SNAP purchases, that incidence falls to around 2.7 percent and 3.1 percent for the poor and upper-poor categories, respectively, while the lower-middle and middle burdens remain the same. With and without taking into account SNAP purchases, the sales tax seems to be proportional, if not progressive.

The effective tax rate for the poor is higher in New Orleans (2.7 percent) compared with Alabama (2.6 percent) even though New Orleans taxes food only at the local level and at a slightly reduced rate. On the other hand, for the middle-income group, the effective rate is higher in Alabama than in New Orleans (4.2 percent versus 4 percent). The middle class pays a higher effective rate in Alabama because food at home is taxable, but the SNAP benefits offset that effect for the poor. The poor benefit from the slightly lower sales tax rate in Alabama and from the effects of SNAP benefits. In general, broadening the sales tax base to include food at home and lowering the rate will make the sales tax more progressive and help the poor with their SNAP benefits. Conversely, exempting food at home from the tax base will hurt the poor.

VI. Conclusion

In this article, we have shown that because SNAP effectively targets poor households and because SNAP benefits are nontaxable, the poor do not really benefit from the sales tax exemption for food at home. Indeed, almost surely they would be better off if food at home were in the tax base and revenue-neutral adjustments were made to the sales tax rate.

Why then have advocates for the poor (and a governor) supported removing food at home from the sales tax base? There are probably numerous explanations. First, the success of SNAP in reaching the poor may not be fully appreciated because the program has evolved over time. SNAP is complex, and only potential recipients of SNAP benefits have a direct incentive to learn about the program.

Second, some advocates for the poor do not want to see *any* poor individual pay any tax. SNAP, although remarkably successful, will clearly not eliminate all taxable at-home purchases for every single poor household. In that view, no poor person should be left behind. Moreover, the near-poor would potentially be subject to taxation on their food at home consumption.

A third potential reason is that since the sales tax is generally viewed as a regressive tax, any means to eviscerate it may be welcome, particularly if a progressive tax — say, the income tax — becomes its substitute. That rationale requires a set of optimistic political economy calculations that may not be met in practice. On a related point, many voters and politicians do not believe there are "revenue-neutral adjustments." If a government is indeed a leviathan, it will take any opportunity to increase its revenue. Base broadening without an associated rate decrease would just be another way to increase government revenue.

Finally, advocates for the poor might believe that the institution of SNAP benefits could prove to be less durable than an exemption from the sales tax for food at home. Although SNAP historically has been supported by a stable coalition of urban Democrats and rural Republicans, anti-welfare-state sentiment could potentially make the program vulnerable to legislative changes in the future. Advocates for the sales tax exemption would contend that the exemptions would be harder to reverse. One example of that political economy calculation occurred during the passage of the Australian VAT.[48] Politicians in Australia debated whether to include food in the VAT but with a subsidy program, or to simply exclude food. They eventually chose to exclude food, pointing to the experience in New Zealand in which subsidies designed to offset the regressivity of the VAT were eliminated.

Regardless of those political economy rationales, excluding food at home from the sales tax is a costly exclusion. And, on balance, with the SNAP benefits that have been successfully in place for near half a century, it also hurts the very poor. ✫

[48] *See* Susan C. Morse, "How Australia Got a VAT," *The VAT Reader* 15-17 (Robert Goulder ed., 2011).