



*A FairTax for Alabama:
The Tax Base and Tax Rate*

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Overview

The federal FairTax proposal would replace most existing federal taxes with a comprehensive consumption tax in the form of a national retail sales tax levied at a tax-inclusive rate of 23 percent. The act would repeal the federal income tax (including the capital gains tax and the alternative minimum tax), the corporate income tax, federal payroll taxes, the self-employment tax, and the estate and gift tax. The FairTax Act is intended to be revenue neutral in the sense that it would raise the same amount of tax revenue as the taxes it would replace.

Most of the analysis of a “FairTax” has examined its prospects at the national level.¹ However, there is some interest in enacting “Fair Taxes” or consumption tax-based reform at the state level. One such state is Alabama.

In this study, The Beacon Hill Institute for Public Policy Research (BHI) calculates the revenue-neutral Alabama FairTax rate that would replace existing taxes under two scenarios. Scenario 1 replaces state tax revenues listed in Table 1. Scenario 2 adds local sales tax to the state taxes to be replaced by the Alabama FairTax assuming the local sales taxes would be levied on the Alabama FairTax base.

Tax Revenues to be Replaced.

The Alabama Department of Revenue’s “Monthly Abstract” for September 2019 reports that net state tax collections totaled \$10.759 billion in Fiscal Year (FY) 2019.² We assume the Alabama FairTax would only replace state tax revenues raised by the individual income tax, the corporate income tax, the state sales tax and several industry-specific excise taxes. This assumption lowers the tax revenue to be replaced by the Alabama FairTax to \$9.481 billion in FY 2020 and \$9.639 billion in FY 2021.

We include an additional calculation that incorporates the local sales taxes in the revenues replaced by the FairTax. These taxes would be repealed along with the state

¹ For a comprehensive review of the federal FairTax proposal see the series of research papers at <http://www.beaconhill.org/FairTaxPapers.htm>.

² State of Alabama Revenue Abstract, September 2019, Department of Revenue, <https://revenue.alabama.gov/wp-content/uploads/2019/10/abssep19web.pdf>

sales taxes under a switch to the Alabama FairTax. Table 1 lists details of the taxes and estimated revenues that would be replaced by the Alabama FairTax.

Table 1: State Tax Revenues to be Replaced (\$)

State Net Receipts	2020	2021
Individual Income Tax	4,332,042,000	4,404,455,548
Corporate Income Tax	464,094,900	471,852,618
Financial Institutions Excise Tax	83,980,680	85,384,484
Business Privilege Tax	132,090,000	134,297,990
Sales Tax	2,054,189,220	2,088,526,636
Plus, items paid from gross sales:		
Revenue Admin	66,196,129	67,302,650
Counties	385,560	393,271
Human Resources	54,421,747	55,331,450
PSCA Debt Service	200,771,886	204,127,948
Auto Sales	112,136,636	114,011,089
Department of Conservation	5,083,579	5,168,555
Parks Bonds	22,941,175	23,324,655
Simplified Sellers Use	190,068,840	193,245,993
Use Tax	362,987,400	369,055,025
Use Tax Discount	5,730,360	5,826,148
Use Tax Remote	103,293,360	105,019,991
Contractor's Gross Receipts	49,809,055	50,641,653
Vapor Products	2,100,000	2,135,103
Total	8,242,321,285	8,380,098,279
Other Taxes not repealed, but subject to double taxation		
Deed Record Tax	16,918,740	17,201,550
Mortgage Record Tax	48,204,180	49,009,951
Leasing and Rental Tax	84,112,260	85,518,264
Utility Gross Receipts Tax	425,923,440	433,043,091
Public Utility License Tax	167,919,540	170,726,449
Lodgings Tax	83,142,240	84,532,029
Insurance Company Taxes	412,870,500	419,771,961
Total	1,239,090,900	1,259,803,296
Total State Taxes	9,481,412,185	9,639,901,575
Sales	2,567,736,780	2,619,091,516
Use	453,696,000	462,769,920
Total Local Taxes	3,021,432,780	3,081,861,436
Grand Total	12,502,844,965	12,721,763,010

Under the second scenario, we assume the Alabama FairTax would replace all local sales and use tax revenues, which would raise \$3.021 billion in FY 2020 and \$3.081

billion in FY 2021. We assume that local governments would adopt the Alabama FairTax base for their local sales and use taxes.

These tax revenue figures are the numerator in the calculation of the Alabama FairTax rate under the two scenarios. In other words, the Alabama FairTax must raise this amount of revenue to be considered a revenue-neutral tax change (neither lowers nor raises tax revenue).

Tax-inclusive versus Tax-exclusive Rates

It is worth noting the difference between a tax-inclusive and a tax-exclusive rate. Individual income and payroll tax rates (Social Security; Medicare; Medicaid) include the taxes to be paid in the tax base on which the tax rate is imposed (tax-inclusive). If an individual's gross income is \$100 and the sum of their income plus employment tax rate is 23%, taxes owed equals \$23. Traditional state sales taxes are imposed on a tax base equal to the pre-tax portion of a good's price (tax-exclusive). A good priced at \$77 with a 30% sales tax rate yields a \$23 tax bill.

These differences make the comparison between income and sales tax rates complicated, especially when a sales tax replaces an income tax. Each tax can just as easily be quoted as a tax-inclusive or tax-exclusive rate for easier comparison.

The federal FairTax rate first proposed in 2005 uses a tax-inclusive rate, as does the current Alabama personal income tax, whereas most state-level sales taxes are quoted on a tax-exclusive basis. Since our data includes taxes in the tax base variables, we calculate the tax-inclusive rate.

The Prebate

To make the tax more progressive across all income groups, the FairTax calls for a Prebate that would be paid to all households. The Prebate is based on the federal poverty guidelines adjusted to remove any marriage penalty. The Prebate may be thought of like a rebate, except that it is paid at the beginning of each month in advance of that month's consumption expenditures. The size of the monthly Prebate is set at the amount of FairTax that a given household would pay over the course of the month, were its

members to consume goods and services at the federal poverty line. Table 2 displays the details of the Prebate calculation.

Table 2: Computing the FairTax Base Reduction Due to the Prebate for FY 2020

I. Single Households			
Household Size	Poverty Line	Number of households	Prebate Base Reduction (thousands)
1	\$12,760	543,128	\$6,930,313
2	\$17,240	66,032	\$1,138,392
3	\$21,720	9,437	\$204,972
4	\$26,200	3,391	\$88,844
5	\$30,680	555	\$17,027
6	\$35,160	210	\$7,384
7 or more	\$39,640	79	\$3,132
Subtotal, Single		622,832	\$8,390,063
II. Married Households			
2	\$25,520	587,882	\$15,002,749
3	\$30,000	289,944	\$8,698,320
4	\$34,480	219,279	\$7,560,740
5	\$38,960	91,365	\$3,559,580
6	\$43,440	30,032	\$1,304,590
7 or more	\$47,920	15,361	\$736,099
Subtotal, Married		1,233,863	\$36,862,078
Total		1,856,695	\$45,252,142

*Totals may not add up due to rounding.

The U.S. Department of Health and Human Services publishes the poverty guidelines by household size for the 48 lower states.³ The U.S. Census Bureau provides estimates of the number of Alabama households by family size.⁴ Using these figures, we

³ U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, 2020 Poverty Guidelines, <https://aspe.hhs.gov/poverty-guidelines>.

⁴ U.S. Department of Commerce, U.S. Census Bureau, Table B11016: Household Type by Household Size, Alabama, http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_13_5YR_B11016&prodType=table.

estimate the Prebate will reduce the tax base by \$45.252 billion in FY 2020 and \$44.348 billion in FY 2021.

The Alabama FairTax Base

The next step is to determine the tax base to which the rate applies. The FairTax attempts to create an extensive tax base that would allow for a low rate. The broadest FairTax base for Alabama would be the total State Gross Domestic Product (GDP). If we were to levy the Alabama FairTax on our estimate of \$233.10 billion of state GDP for FY 2020, the rate would be 4.06 percent ($\$9.481 / \233.10) on a tax-inclusive basis, since GDP includes tax revenues.⁵

Although broad, a state FairTax excludes some components of GDP, such as investment and federal government spending. Also, the FairTax calls for the “Prebate” (see above) that excludes from the tax base all consumption spending up to the national poverty line. We account for these changes in calculating the Alabama FairTax base.

We calculate the tax base using data from The Bureau of Economic Analysis (BEA) which provides detailed datasets for state and local economies. The BEA data includes Alabama specific data for household consumption, government consumption and national data for spending on new structures.⁶ We use data from the U.S. Census Bureau and National Multi-Family Housing Council to estimate the portion of the national data attributable to Alabama. Table 3 on page 8 displays the results of the calculation.

BEA provides comprehensive household consumption data.⁷ However, we exclude spending on education and imputed rent from private consumption and add back in the sale of new homes and dwellings as called for in the federal FairTax Act. We also exclude spending on motor fuels from private consumption.

We estimate the household consumption base of \$152.460 billion in Alabama for Calendar Year (CY) 2018, the most recent data available. We grow the 2018 data to 2020

⁵ The Bureau of Economic Analysis, Regional Data, GDP and Personal Income, SAGDP2 Gross domestic product (GDP) by state, Alabama Gross Domestic Product (Accessed January 2020)
<https://apps.bea.gov/itable/iTable.cfm?ReqID=70&step=1#reqid=70&step=1&isuri=1>.

⁶ The Bureau of Economic Analysis, Regional Data, Alabama, SAEXP1 Total personal consumption expenditures (PCE) by state, SAINC7N Wages and Salaries by NAICS Industry, Table 5.4.5. Private Fixed Investment in Structures by Type
http://www.implan.com/index.php?option=com_virtuemart&view=category&virtuemart_category_id=2501&Itemid=1808.

⁷ IMPLAN Group LLC, State Data Package: Alabama,
http://www.implan.com/index.php?option=com_virtuemart&view=category&virtuemart_category_id=2501&Itemid=1808.

and 2021 using the Compound Annual Growth Rate (CAGR) within the BEA data for each sector. Then we take one-quarter from CY 2019 and three-quarters from CY 2020 to produce our estimate for FY 2020 of \$163.550 billion and \$169.342 billion for FY 2021.

The FairTax base includes the sale of new homes, home improvements, and related commissions. BEA estimates national data for spending on new single-family and multi-family housing, manufactured homes, home improvements and real estate brokers and commissions. We estimate the portion of the national data attributed to Alabama. We estimate Alabama's share of these items summed to \$9.992 billion in 2018. We use the CAGR to grow these figures to \$10.176 billion in FY 2020 and \$10.269 billion FY 2021. Adding the new home sales data to the household consumption data to obtain our estimate for private consumption of \$173.726 billion in FY 2020 and \$179.612 billion in FY 2021. See the first row of Table 3.

The U.S. Census Bureau provides data for state and local government consumption spending.⁸ Alabama state and local government spending on goods and services was \$8.093 billion in 2017, the most recent data available. We grow the 2017 data to FY 2021 using the same method as with private consumption spending, yielding \$11.011 billion in FY 2021, seen in the second row of Table 4.

Another component of the consumption tax base is state and local government spending on non-education salaries and wages. According to the United States Census Bureau, Alabama state and local governments spent \$14.063 billion in 2018 on salary and wages. IMPLAN provides data for state and local government consumption spending.⁹ We take the proportion of Alabama state and local spending on non-education salaries and wages to total state and local spending on salaries and wages and apply it to the Census Bureau estimate to yield \$7.453 billion in 2018. Using the same growth method as above, we estimate state and local spending on non-education salaries and wages at \$8.092 billion in FY 2021, listed in the third row of Table 4.

Adding the three lines together yields a gross FairTax tax base of \$191.796 billion in FY 2020 and \$198.715 billion in FY 2021. See line 4 in Table 3.

⁸ 2017 State & Local Government Finance Historical Datasets and Tables, Alaska

<https://www.census.gov/programs-surveys/gov-finances/newsroom/updates/2017released-data.html>

⁹ IMPLAN Group LLC, State Data Package: Alabama,

http://www.implan.com/index.php?option=com_virtuemart&view=category&virtuemart_category_id=2501&Itemid=1808.

A Beacon Hill Institute study showed the national FairTax gross tax base to be 80 percent of the national economy in 2007.¹⁰ We estimate that Alabama State GDP is \$233.10 billion in 2020, which means our gross FairTax base of \$191.796 billion in 2020 is 82.28 percent of state GDP. Although slightly higher than the national calculation, it gives us confidence that our gross FairTax is reasonable.

The FairTax Act includes an administrative fee of 0.25 percent of the tax base to be paid to vendors and states for collecting the FairTax. We calculate the administrative fee as a percentage of the net tax base.

The FairTax Rate

As stated above, we calculate the FairTax rate under two scenarios. Scenario 1 replaces the state tax revenues displayed in the row labeled “Total State Taxes” listed in Table 1. Scenario 2 adds local options sales and use tax to the state taxes to be replaced using the Alabama FairTax base. We report the Alabama FairTax and local options sales tax rates for FY 2020 and FY 2021.

Scenario 1

To calculate the FairTax rate, we first add the components of the household and government consumption bases, which yields a gross tax base of \$191.796 billion in FY 2020. Next, we subtract the Prebate from the gross base, yielding \$146.543 billion. We calculate the administrative fee by multiplying \$146.543 billion by 0.25 percent, generating \$366 million. We subtract the \$366 million from the base to produce the net FairTax base of \$146.177 billion.

¹⁰ See David G. Tuerck, Jonathan Haughton, Paul Bachman, Alfonso Sanchez-Penalver, *A Comparison of the FairTax Base and Rate with Other National Tax Reform Proposals*, (February 2007).

<http://www.beaconhill.org/FairTax2007/FairTaxBaseandRate3-15-07FINAL.pdf>.

Table 3: The Calculation of the Alabama FairTax Rate (millions \$)

Tax Base*	2020	2021
Private consumption	173,726	179,612
State and local government consumption	10,196	11,011
State and local government salaries and wages	7,874	8,092
Gross tax base	191,796	198,715
Prebate	-45,252	-45,349
Tax base	146,543	153,366
Adjustment for administrative fee (0.25%)	-366	-383
Net tax base	146,177	152,983
Tax revenue (to be replaced)	9,481	9,640
Tax-inclusive rate (%)	6.49%	6.30%

*Totals may not add due to rounding.

We calculate the tax revenues to be replaced as \$9.481 billion in FY 2020. To calculate the FairTax rate, we divide the \$9.481 in revenue to be replaced by the FairTax by the net tax base of \$146.177 billion which yields a rate of 6.49 percent for FY 2020. The same calculation would produce a FairTax rate of 6.30 percent in FY 2021.

Scenario 2

The tax bases under scenario 2 are precisely the same as scenario 1, but the revenues to be replaced change. Table 4 displays the calculations under scenario 2.

Under scenario 2, we add all local sales and use taxes, or \$3.021 billion in FY 2020 and \$3.081 billion in FY 2021 to the taxes to be replaced by the Alabama FairTax. This addition increases total revenues to be replaced to \$12.502 billion in FY 2020 and \$12.721 billion in FY 2021. Using the same calculation as in scenario 1, we estimate the FairTax rate of 8.55 percent in FY 2020 and 8.32 percent in FY 2021.

Table 3: The Alabama FairTax Rate Including all Local Sales Taxes* (millions \$)

Tax Base	2020	2021
Net tax base	146,177	152,983
Tax revenue (to be replaced)	12,503	12,722
Tax-inclusive rate (%)	8.55%	8.32%

*Totals may not add due to rounding.

Conclusion

An Alabama FairTax would replace several state taxes with a comprehensive consumption tax levied on a broad tax base. The tax base would include the majority of private and state and local government consumption. The larger tax base would allow for the repeal of the state individual and corporate income taxes, the existing state sales and use tax, and over a dozen other excise taxes and items at a reasonable tax rate.

When we include local options sales and use taxes in the tax revenues to be replaced, we calculate an Alabama FairTax rate of 8.55 percent in FY 2020. This rate, while slightly higher than the combined sales tax rate of several states, the rate would be realistic and affordable to Alabamans.

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