A Discussion of “Unfair” Taxation in Alabama

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Introduction

My article here will make significantly more sense to you if you first read the one page fact sheet, *Alabama Taxes Are Not Fair* (http://www.alarise.org/taxes%20unfair%2003.pdf), which is on the Alabama Arise web site (http://www.alarise.org) and then read the brief press release (http://www.itepnet.org/wp2000/pr.pdf) of the report, *Who Pays, 2nd edition* (http://www.itepnet.org/whopays.htm which has the link to the 121 page PDF file and is the report I refer to numerous times in this article), which was put out by the Institute on Taxation and Economic Policy (ITEP) (http://www.itepnet.org). Read this report later as it is rather long and covers all 50 states. Keep my thoughts about deceptive language in mind as you read the report. According to the report, those in Alabama who earned $229,000 or more paid an average of 3.7 percent of their income in state, local sales, and property taxes while those who made less than $13,000 paid an average of 10.3 percent of their income in the same taxes. It appears that Alabama has a regressive tax system, or does it?

I have learned to be very suspicious of such claims because advocacy groups have a tendency to use carefully selected groupings of people for computing averages, to use various juxtaposition methods to paint a picture of facts that are individually true but collectively false, and to use craftily worded presentations that omits important information and bamboozles the reader into assuming certain "truths" that are never actually said. Unfortunately, the news media are very partial to a sob story concerning people with low income and readily broadcast or print propaganda provided to them by the various advocacy groups. The masses are too busy in their indulgences to take the time to check out such stories for reality and tend to accept them as fact and are thus lead like sheep.

In short, one kind of accounting is used to discredit actual taxes paid by the wealthy and another kind of accounting is used to enhance apparent taxes paid by the poor. If the problem is real, then why is it necessary to use deceptive methods to describe it instead of the truth? Economic comparisons must be made using the same accounting method. The premise that Alabama taxes are "highly regressive" is assumed to be true and then it becomes an exercise to try various accounting tricks to "prove" it. I dare to ask could the premise be wrong.

My point here is not to deny the existence of low income families or taxes they pay. Rather, I want to know the truth so I can make informed decisions about what could or should be done. One saying that I strongly believe in is ***if you have to lie about your cause then you do not have a cause***. Another very applicable saying is ***a half truth is a whole lie***. There is so much propaganda concerning low income and high income families that it is hard to extract the truth.

The following is an analysis of the taxes paid by two families of four, one with an income of $12,999 (less than $13,000 as in the report) and the other with an income of $229,000 ($229,000 or greater as in the report). It is not clear what the family size is for the tax calculations in the report although the inference is that it is for some kind of family. Many examples I have read are for a family of four so that is what I will use. I show the details of the calculations rather than just state a conclusion. These calculations are not hard. Anybody should be able to check my numbers. Federal and Alabama tax tables for income in 2001 are used (the effect of using 2002 tax tables would be that the low income family would pay a little less total tax and the high income family would pay less federal income tax and as a result a little more Alabama income tax). Note that in the report, 2002 tax law was applied to 2000 income where in my analysis, 2001 tax law is applied to 2001 income. It would have made better sense to use income and tax law for the same year as I have done. Only the most basic adjustments to income are used to keep things simple and easy for the reader to follow and verify without having to dig through many additional tax forms. In the interest of simplicity for this example I have chosen to leave out the Federal child credit which significantly reduces the taxes on the low income family if they can use it (In a future revision to this article I will include it and other credits to really illustrate the myth of the tax burden on low income and even middle income families). For more complex situations (and if certain qualifications are met), both families could end up paying lower net taxes than shown here. I state all the assumptions made and the reader should verify my calculations below as I am not immune to mistakes. I encourage the reader to try his or her own assumptions and check the resulting taxes. This is the only way to learn the truth. Never trust anyone, including me, who tells you what some truth is. Always check it out for yourself. Unfortunately, more information will come your way than you can possibly check. By spot checking some information you gain a perspective to know when to be suspicious.

A brief note about the federal Earned Income Tax Credit

Many people who read this have probably never used the Earned Income Tax Credit (EITC - also known as the Earned Income Credit or EIC) or even understand what it is. This lack of understanding plays right into the hands of those who would deceive you. The purpose of the EITC is to refund to low income people all or most of what are sometimes called employment taxes (Social Security and Medicaid), federal income taxes, as well as an allowance for taxes paid to the state and locality. It is a **credit for taxes paid** and not a deduction on income before taxes. For 2002 taxes it is possible for a family of four to earn $10,350 and receive a $4,140 refund from the federal government because of the EITC. The 7.65 percent employment tax they paid would be $791.78 so the net benefit is $3,348.22. The EITC phases out as income rises and a family of four could earn up to $25,050 and receive a full refund ($1,917) of the so-called employment tax. The threshold at which the EITC equals the employment and federal income tax (i.e. the income level at which the family pays no net employment or income tax to the federal government) for a family of four is $23,700. For 2002 the EITC ends at an income of $34,178 for a family of four.

Unfortunately, the amount is usually paid in a lump sum tax refund around February of the following year. Lump sum money is tempting to squander. This is why you see so many tax preparation offices put up Instant Refund banners in January to entice people to not only file early but to take out a loan and get their refund today or tomorrow instead of waiting for a check from the government. The fee for this "service" is typically quite high and is always a bad deal. But low income people are not known for making wise economic moves. Instead of spending the money on food, clothes, supplies, or utilities, the money is often spent on some luxury item such as wide screen television or a Florida or overseas vacation. It might be a down payment on a fancy new vehicle. Various stores and services compete for the EITC dollar in early winter. I have heard low income people describe the EITC as free money - it is meant to be blown on fun.

A much better way of distributing the money is possible. Simply arrange for the employer to add the appropriate amount to the paycheck so that over a year the entire amount has been paid. This method makes it more likely that the money will be used for better purposes. However, crafty stores and services can entice unneeded purchases by offering credit that can be paid for out of the increased paycheck. Again, this is a very bad deal. ***A fool and his money are soon parted.***

The low income family

I now consider a low income family of four who earned $12,999. I will assume that only one of the parents worked and that all of the income was from wages. It is improbable that they own any property other than a car so their total property tax is only for the car tag tax and is estimated at $50.00 maximum since the car is likely to be a number of years old.

Computing the federal income tax is simple. The Social Security tax (6.2%) would be $806.94 and the Medicaid tax (1.45%) would be $188.49 for a total of $995.43. The federal income tax would be negative $4008.00 using the EITC tables. Thus, the net tax paid to the federal government is $995.43 - $4008.00 = negative $3012.57.

It should be noted that the bulk of this refund comes from taxes paid by the wealthy (including the wealthy in Alabama) who presumably pay little tax. So the wealthy not only pay their own taxes, they pay taxes for the poor too. Even the middle class has its taxes partially subsidized by the wealthy. I realize that many will disagree with what I have just said. Instead of assuming populist thought, check the actual tax situation out for yourself.

For computing the Alabama income tax the first step is to reduce the gross income by the 20 percent standard deduction or $2600.00 since I assume that they do not have enough deductions to make itemized deductions worthwhile. Next subtract $3000.00 for married exemption and $600.00 for dependent exemption. The taxable Alabama income is $6799.00. The Alabama income tax is $258.00. Including the estimated property tax above the total income and property tax paid is $308.00.

The next question is how much this family paid in sales taxes. This number can vary considerably depending on what the sales tax is where they live and how much they spend on things not subject to a sales tax such as rent, debt payments, etc. It is likely that they live in public housing or have some other housing subsidy so that their rent payment could be zero - that is the figure I will use. Although they probably spend at least several hundred dollars a year on interest payments on debt, I will also take that figure to be zero. The goal here is to determine the absolute maximum possible sales tax they could pay. Rent and interest payments would reduce what they could purchase subject to sales tax. Note that this implies that the family is living rent free - they have an effective income that is not being counted here. There are two ways to calculate the sales tax. One way ignores the effect of the EITC and the other way includes it. I will show both methods.

Method 1: Ignoring the EITC, the total FICA, income and property tax they pay is $1303.43 leaving $11,695.57 available for purchases including sales tax. I will assume that the sales tax is 10 percent. Thus, they can purchase goods totaling $10,632.34 and pay $1,063.23 in sales taxes. The total tax this family pays is $2,366.66 which is 18.2 percent of their income. The total tax they pay to Alabama is $1,371.23 which is 10.5 percent of their income. This figure appears to agree very closely with the report although my figure is an extreme case rather than an average. Although this figure is true it ignores an important part of the whole picture.

Method 2: The calculation including EITC is interesting and opens the door to a variety of deceptions (I am not aware of anyone who carries the deception to the extreme I illustrate here). With the EITC their net income available for purchases is $15,703.57. With a 10 percent sales tax they can purchase goods totaling $14,275.97 and pay $1,427.60 in sales tax. Their income of $12,999.00 is used for computing the following tax rates. The net total tax this family pays is negative $1,276.97 which is negative 9.8 percent of their income. Ignoring the EITC after using it in a way to add to their tax burden, this family pays a total tax of $2,731.03 which is 21.0 percent of their income! The total tax they pay to Alabama is $1,735.60 which is 13.4 percent of their income. Although these figures are true, they are very misleading because it appears that the EITC makes their tax situation worse. I will tell you when the numbers are misleading. Others will not! The net tax of negative $1,276.97 is the correct result.

The reader should review the summary for Alabama on page 16 of the report and make general comparisons with my numbers. A direct comparison is not possible since the report is based on averages for all incomes below $13,000 whereas my calculations were based on a specific income of $12,999. However, the two excise taxes listed as well as the property tax seem rather high for averages for low income families.

Analysis: Viewed from the perspective selected facts (a.k.a. partial truths) this family pays a significant tax of 21.0 percent. Viewed from the perspective of including all the facts this family pays negative 9.8 percent tax. Some have made the argument that employment taxes are a high burden for the poor and should be reduced or eliminated. When the complete truth is examined, all of this tax and then some is refunded. This fact remains true until the income approaches the upper end of what is eligible for the EITC.

Some have argued that the income tax paid to Alabama is high but 2 percent hardly seems like a burden.

The example above was calculated for worst case. The sales tax is not 10 percent across the state. A more representative value statewide is around 7 percent. Some of their income would be spent on items or services where the sales tax is either zero or low. Thus, in any real case the actual tax paid to Alabama would be less. Using a 6 percent sales tax and assuming $1,500 spent on non tax items or services, the total tax paid to Alabama would be $1,111.98 or 8.6 percent. The actual tax paid is probably between the two extremes calculated. But do not omit the effect of the EITC which results in the family paying no net tax no matter what the sales tax is.

A corollary to this is if I gave $50,000 to charity every year would you think I was generous? Would you still think I was generous if you found out that I was reimbursed $60,000 every year? Is it correct to say a family is being burdened by taxes if all of the taxes and then some are reimbursed?

The high income family

Now consider a wealthy family of four who earned $229,000. I will assume that only one of the parents works and that all of the income is from wages. There is a wide variety of possibilities but I am going to illustrate two cases. One case minimizes the tax paid to Alabama and the other case is more typical of what tax might be paid. Again, the results of the two calculations are interesting. The common items between the cases will be that the family lives in a $500,000 home that is paid for and they have three nice cars. The family has no deductible health expenses. The family is stingy and gives nothing to charity. There are no deductible losses or expenses. All of the money they do not spend is invested in stocks which pay no dividends (this is just to account for where the money not spent goes). I will assume that the Alabama income tax with held is $7,700. Their personal/dependent exemption for Alabama taxes is $3,600.

The Social Security tax (6.2% on the first $80,400) would be $4984.80 and the Medicaid tax (1.45%) would be $3320.50 ($8,305.30 total). Because of the phase out of personal exemptions for high earners, the total personal exemption they can claim is $8854.00 (a less well to do family of four could claim $11,600.00). Thus, their adjusted income before itemized deductions is $220,146.00. Note that for the first case I am using the juxtaposition of geography method of deception.

Case 1: The family lives in a rural area where the property tax is 30 mils and the sales tax is 6 percent. The family is frugal and spends $18,000 for life's necessities and extras. Itemized deductions are: $7700.00 for Alabama income tax with held, $1500.00 property tax, and $750.00 for car tags (assumed for three reasonably nice cars in a rural area - maybe more or less) for a total of $9,950. Their federal taxable income is $210,196.00. The federal tax is $41,855.00 + 0.355 * ($210,196.00 - $166,500.00) = $57,367.08.

The Alabama income before deductions are applied is $229,000.00 - $57,367.00 - $3,600.00 = $168,000.00. The deductions are $8,305.00 for FICA, $1,500.00 property tax, and $750.00 for car tag tax for a total of $10,555.00. The taxable income is $157,445.00. The Alabama income tax is $4,918.00 + 0.05 * (157,445.00 - 100,000.00) = $7,790.00. The sales tax paid is $1,080.00. The total tax paid to Alabama is $11,120.00. This is 4.9 percent of their income and is in agreement with the 4.8 percent figure in the report prior to what the report refers to as the federal deduction offset of -1.1 percent which reduces the effective rate to 3.7 percent.

I will let the reader of the report determine how this "federal deduction offset" is an accounting trick to significantly reduce the reported taxes paid by the wealthy to the state of Alabama. Further, it is interesting that the federal EITC offset for low income families is excluded. The combination effect is to raise the apparent taxes paid by low income people while discrediting the actual taxes paid by high income people. How convenient!

The total tax paid for everything is $74,992.38 which is 32.7 percent of their income.

Case 2: The family lives in a wealthy city where the property tax is 99 mils and the sales tax is 9 percent. The family enjoys life and spends $35,000 for life's necessities and extras. Itemized deductions are: $7700.00 for Alabama income tax with held, $4950.00 property tax, and $1,500.00 for car tags (assumed as taxes are higher in the city - maybe more or less) for a total of $14,150.00. It is also likely that they paid various city fees but these are not counted as a tax or burden (For example, the fees I have to pay are almost equal to my property tax but these would typically be excluded as a burden for me. My "low" property tax is all that would count.). Their federal taxable income is $205,996.00. The federal tax is $41,855.00 + 0.355 * ($205,996.00 - $166,500.00) = $55,876.08.

The Alabama income before deductions are applied is $229,000.00 - $55,876.00 - $3,600.00 = $169,524.00. The deductions are $8,305 for FICA, $4,950.00 property tax, and $1,500.00 for car tag tax for a total of $14,755.00. The taxable income is $154,769.00. The Alabama income tax is $4,918.00 + 0.05 * (154,769.00 - 100,000.00) = $7,656.00. The sales tax paid is $3,150.00. The total tax paid to Alabama is $17,256.00. This is 7.5 percent of their income.

The total tax paid for everything is $78,287.38 which is 34.2 percent of their income.

The reader should review the summary for Alabama on page 16 of the report and make general comparisons with my numbers. A direct comparison is not possible since the report is based on averages for all incomes above $229,000 whereas my calculations were based on a specific income of $229,000. Note that all the tax figures listed are notably lower than my realistic case 2 above. The averages for both low and high income people used in the report do not seem to representative of typical. Typical is what the correct use of average is suppose to be. Faulty conclusions arise from faulty averages.

Analysis: The very large federal income tax paid hides differences in Alabama taxes. If I use the 3.7 percent figure from the study, the total tax paid to Alabama would be

$8,473.00 which is about half of the value I computed for the more likely Case 2. Note that the report concedes that the actual tax paid is higher (by about 30 percent!) but the artificially low number is emphasized and used by Alabama Arise in its fact sheet. So, I will take that figure as the "truth". How could either case be modified to come closer to this figure?

For starters, the value of the rural house they live in might only be $150,000 for a property tax of $450.00. They might drive older cars and pay only $150.00 in car tag tax. They might give $15,000 to charity. They might have had $10,000 in deductible medical expenses. They might have had $20,000 in deductible losses. In this case the deductions for federal income taxes would be $53,300 and the federal income tax would be $41,977.83. The Alabama income before deductions would be $183,422.00. Alabama deductions would be $53,905.00. Taxable income would be $129,517.00 and the income tax would be $6,394.00. The total tax paid to Alabama would be $8,074.00 which is 3.5 percent of their income. This figure is more in agreement with the report but the scenario is not believable as typical. The total of all taxes in this case is $58,357.13 which is 25.5 percent of their income.

Without assuming massive deductions (including perhaps large gifts to charity) it is not possible for this family to pay as little as 3.7 percent of their income in Alabama taxes. If they are actually giving a large amount to charity and/or have serious loses or expenses then it is not fair to refer to them as under-taxed or that they are the beneficiaries of a regressive tax system. Such pseudo-economic comparisons are bogus because apples are being compared to oranges to arrive at a lemon conclusion. But if details of the study are carefully omitted then the reader might not realize the actual truth. Rather than just report numerical conclusions I show how I arrived at the numbers. If you disagree with my result you then have a starting point to make changes acceptable to your way of thinking.

Tax relief? One point that has been harped on is that the "highly regressive Alabama tax structure" holds the poor back and prevents them from getting ahead. This has the "right" sound to it so it must be true. In order for this statement to be true then if a family of four received fully compensating additional income either in the form of higher wages or tax relief then the family should begin a move up the economic ladder. It is hard to speculate as to how high they might go but as long as they were in an income range that was subject to high tax relief they should keep climbing. The stable point would be somewhere after real taxes became a factor. At that point their income would not be considered low anymore. The family of four making $12,999 per year has had total tax relief and then some for many years. Even families with a much higher income have had total or near total tax relief for many years. The question is have these families moved ahead?

Beware of reaching conclusions that appear to be true with factual data based on the juxtaposition of time method of deception. There were low income families years ago and there are low income families today. If I assume that the families are the same then the conclusion is that no matter what is done, the poor stay poor. If I assume that the families are different then the conclusion is that families are moving up the economic ladder but are being replaced by new poor families at the bottom. In truth, there is some of both. In the absence of a debilitating situation that makes it impossible to move up, families that made wise use of their resources have moved up and families that squandered their resources are stuck near the bottom.

The argument for tax relief for low income families in Alabama is bogus. They have had tax relief for years. Calling for an end to taxation for these families is a back door way of asking for more welfare to be doled out. If you are for additional welfare benefits for these families then say so openly. I may not agree but at least I will respect your truthfulness. Do not masquerade under some false pretense. That is lying to me and causes me to discount your cause.

The real question is would these families move up the economic ladder faster if they received additional subsidies? If the subsidy were used wisely the answer is yes and some definitely would. Unfortunately, I believe most would just find a new comfort zone and not try - that is human nature. ***There is a huge difference between using a handout to work one's way up the economic ladder and using a handout to relax at one's current rung.*** If too large, a subsidy serves the purpose of discouraging the majority receiving it from moving ahead. This group can then be managed and controlled like cattle. That is the socialist's dream.

A digression to discuss the major types of taxes and fairness

The definition of a regressive tax has been distorted in recent years to be any tax that from some crafty perspective can be illustrated to be regressive. That definition is overly broad. In order for a tax to be regressive it must be specifically targeted so that an individual's income is used for accessing the tax ***and*** the tax rate accessed is higher for low income than for high income. The converse (i.e. a tax that is not based on income but is illustrated as a percent of income) does not make a tax regressive and is a contrived calculation.

If taxes were collected from only one source such as income many people would revolt at the realization of how much tax they were actually paying. By spreading out the collection over a wide variety of sources then each source does not by itself appear very large and does not attract too close attention by the tax payers. For this reason, the tax system is intentionally too complicated for most tax payers to figure out and so they do not bother. The tax calculation industry also benefits from a convoluted system. What follows is a brief description of the more common types of taxes.

Sales taxes: Sales taxes are an alternate form of income tax where the tax is applied as money is spent rather than when it is earned. Calculating a high effective tax rate based on the sales tax paid by low income people and comparing that with a low effective tax rate based on the sales tax paid by high income people is a contrived calculation rather than a regressive tax. To make the sales tax appear even more regressive, such calculations may include only specific types of purchases that low and high income people would have in common and ignore purchases made only by high income people.

Even if all purchases are included the sales tax would appear regressive since high income people usually put a large amount of money into savings (which will be sales taxed later rather than immediately). Furthermore, even if high income people spent everything they made on items subject to sales tax, the calculation would always show a lower effective rate for high incomes. Why? Because high income people pay so much in other taxes that they do not have proportionally as much to spend. But all of this does not make sales tax regressive.

Some have made a point that necessities of life such as food should not be subjected to sales tax. This has a nice sound to it but it opens the door to perpetual arguments over what is or is not a necessity. There was a recent comical argument in one state about whether a pumpkin was food and thus not subject to sales tax or a thing subject to sales tax. Such a tax supposedly "hits the poor the hardest" but this is a contrived calculation rather than a true burden. It is much simpler to sales tax everything purchased rather than argue over who is or is not being hurt by a selective tax. An alternative that seems to be gaining popularity is the concept of issuing an offsetting credit to low income people to roughly cover sales taxes on necessities. This has been done for years with the federal EITC which already provides an offset for state and local. Now advocates want a state EITC on top of that - i.e. double tax relief. Another alternative is to eliminate all sales tax and replace it with a (or expand an existing) gross receipts tax on business. The beauty of this is that sales tax is gone and businesses will be seen as paying considerably more tax (if businesses are paying more tax that has to be good, right?). Of course the tax would be passed on to the consumer as all costs of business operation are. This is definitely a way to reduce the tax burden on individuals while not reducing tax revenue. I make this point because I often hear that businesses do not pay their fair share of taxes. Do the people making that claim understand the consequences of businesses paying their so called fair share?

Sales taxes can definitely be regressive or even oppressive to the extent that they are too high. I am looking for a good definition not based on any opinion or biased thought that clearly indicates what too high is. In the meantime, all I have is personal opinion. Personally, I think 9 percent is too high as that is significantly noticed by all, rich or poor, and even me in the middle. Sales tax ought to not be a significant part of the total spent. I think 3 percent is hardly noticeable and that 5 percent is probably the threshold of pain. Thus, 4 or 5 percent seems to be a reasonable maximum. But, if income tax replaced sales taxes for all but specific government costs involving sales, the sales tax could be a fraction of a percent and just built into the price of the items rather than broken out. Regardless of one's economic status, sales taxes are a nuisance method of nickel and diming someone all year long to expropriate a significant total without the individual being that aware.

Income taxes: Alabama has been criticized for having the lowest income threshold for paying income taxes. That does not make Alabama income taxes either unfair or regressive. That another state has a different threshold is a moot point. What another state does or does not do has no bearing on whether Alabama income taxes are fair or regressive. There is a fundamental problem with having an income threshold higher than zero. When there is a tax rate cut for those who really do pay taxes then those below the threshold get nothing because they already pay no tax. Then there is a big whine about how tax cuts are only for the wealthy - who incidentally actually do pay taxes. If the threshold were zero then all would have the benefit of the same percentage cut in the tax rate. It is interesting that the ITEP report advocates a high threshold and steeply progressive rates but then later complains that that very situation causes taxes to rise faster at the lower income levels than at the higher income levels - duh! The report also complains that the high threshold and steeply progressive rates the writers advocate is unfair for the poor since allowable deductions are worth less at low income levels than at high income levels and also that low income people do not benefit from tax cuts - duh again. So are they against what they are for or for what they are against?

The effective Alabama income tax rate (income tax divided by income) begins at zero for low income and climbs towards 5 percent at high incomes. Because of high federal income taxes the maximum net income tax rate as a percentage of gross income levels off in the 3 percent range. Nothing is regressive about that. The steeply progressive federal rates can cause a small reduction in the effective Alabama rates at high incomes but this is a consequence of a complicated tax code rather than a regressive tax situation. There is no situation in which someone can have higher taxable income and pay less income tax to Alabama. Based on the arguments made in the report, if federal taxes on high income were 100 percent then the wealthy would pay no taxes at all in Alabama and would thus live tax free! It should not be surprising that bizarre results arise from distorted accounting.

There has been much ado about a hypothetical family of four in Alabama paying one dollar (0.022 percent) of income tax on an income of $4,600. One dollar just does not impress me as a burden especially when I am paying thousands of dollars on less than 20 times that income. Using the standard deduction, the Alabama income tax for a family of four with a gross income of $10,000 is $158 (1.6 percent); for an income of $20,000 it is $543 (2.7 percent); and for an income of $30,000 it is $1,043 (3.5 percent). I fail to see how this small tax holds anyone back especially when offsetting EITC refunds are considered. I will leave it as an interesting exercise for the reader to compare the net income after all employment and federal and state income based taxes and EITC refund for a family with $20,000 gross wage income and a family with $30,000 gross wage income (using 2001 tax calculations). Hint: this is the EITC phase out region where an interesting phenomena of very steep marginal tax rates occurs. The region I suggest is not the optimum for illustration and the region moves up each year. A crafty article could pick the optimum comparison points for a given tax year to extrapolate a high tax burden on all of low income.

Various advocates for the poor preach that income tax is too volatile with the economy to have stable government spending and that property tax is very stable so property should be taxed instead of income. What you are not told is that the wealthy advocates are really looking out for their own interests as discussed in the next section concerning property taxes. Another cry is that income taxes should be steeply progressive so that the wealthy are forced to pay their "fair share". This is actually a counter intuitive backdoor way of increasing revenue from the less wealthy without them realizing it. I will reserve the details to my forthcoming article concerning income taxes but let me leave you with one hint. Those at the top of the economic food chain do not care what the tax rate is as long as they can pass the expense on to those beneath them. If a steeply progressive income tax rate helps to keep "undesirables" out of an exclusive life style then the wealthy are for it. One problem here is the word, progressive. It sounds so nice. How could it possibly be problematic? Beware of things that sound nice - that is the classic way you are bamboozled. The second part of the first sentence of this paragraph is interesting. Stable spending literally means that spending is relatively constant year after year (i.e. teacher salaries remain constant for example). That is counter to the claims of the same advocates that government spending should increase faster than the economy each year (i.e. perpetual tax increases). I agree that double speak does not make sense.

I must point out that the high volatility of income tax is due to the fact that the wealthy, a small part of the population, pay the majority of all income tax. If that small group has a bad year then income tax collection is significantly down even though the total income for the population is much less volatile. In bad years the "solution" proposed by politicians is to make income taxes more progressive, i.e. make the problem worse. Progressive taxes magnify the volatility. The real message here is to question some of the populist speak that too many people take as gospel truths.

Property taxes: Like income taxes, sales taxes are based on the ability to pay. Property taxes are accessed whether the individual has the ability to pay or not. Most of the time people owning property have the income to pay. The money to pay property tax comes from income so property tax is really just another way of collecting income tax except that there might not be sufficient income. People have been kicked off of their own property if they had some hardship and could not make payments. The same is not true for income or sales tax. Are property taxes regressive? At first it might seem so. If a person had little or no income but was accessed a property tax then the effective tax rate could approach infinity. Again, this is a contrived calculation as property tax fails to pass the definition of a regressive tax given above. Property tax could be regressive if a low value property was accessed a higher tax rate than a high value property under the presumption that low income people would own low value property and high income people would own high value property. That this situation can exist (particularly with juxtaposition of geography - comparing a city parcel owned by a low income person with a rural parcel owned by a high income person) does not make the property tax in those situations regressive. It would be regressive if the properties were in the same area.

Another contrived perspective (illustrated on page 9 of the report) that can show property taxes to be regressive is to observe that property owned by lower income people is probably a larger percentage of their net worth than that of property owned by the wealthy. Thus, even with an absolutely flat property tax, low income families would pay a higher effective rate. It is interesting that higher property taxes are seen as the "solution" to Alabama's "regressive tax structure" but that solution can itself be shown to be regressive. Here we go again. I should point out that what the report is actually calling for is a tax on net worth. That is not a tax - it is confiscation.

The key to regressivity is if the rates are specifically targeted. If they are then the property tax in those cases is regressive. Use of asset or property tax to cover the expense of various asset or property related services provided by the government is legitimate. In some locations a fee (typically a fixed amount) is added to the property tax to cover direct expenses such as garbage pickup, snow removal, etc. These fees are prime candidates for contrived regressive property tax calculations. It is interesting in all of these cases that if the government got out of that business and a private company charged perhaps the identical fee for the service then the issue of regressive tax is moot. The use of asset or property tax as a revenue source is more a form of extortion than a tax particularly when the government has the power to declare what the value of the asset is. Although it may not be technically regressive, an asset based tax can have all of the ill effects as if it were. The proper description in those cases is extortion rather than regressive. I agree that regressive and extortion taxes are bad.

There has been a big case made for radically increasing the property tax in Alabama so that it is more like other states. Indeed, comparing the property taxes in rural Alabama with that in big cities in other states can really be dramatic. I am stretching the usual presentation just to see if you are paying attention. Averages are often used and rural property tax rates can cleverly average down the tax rates in wealthy cities. My statement could be modified to say that the average property tax paid by the wealthy in Alabama is much less than that paid by the wealthy in such-n-such city in some other state. Both statements are saying the same thing but my first one is a blatantly wrong comparison while the modified one sounds "right". Note that the wealthy do not pay average tax - they pay the high tax. But why use other states? Why not compare the property tax in rural Alabama with the property tax in wealthy Alabama cities? That is still a dramatic comparison. Yes, it is true that property taxes even in the wealthy cities are lower than corresponding cities in other states. That does not make Alabama a bad state. In selling the property tax increase concept, the wording is careful so that the reader assumes that it is the property taxes of only the wealthy that are going to rise. Those taxes may rise but it is the property taxes in all of rural Alabama that ought to rise to the level of wealthy Alabama cities. That would typically mean that rural property taxes should be double, triple, or more times higher than they are now while property taxes in the wealthy cities should remain about the same. That statement will never sell a property tax increase so it is necessary to trick the masses. Then Alabama will be well on its way to taxing itself to prosperity like other states do. Maybe I am blind but I just do not see this prosperity difference in other states.

Contrary the report, people who rent properties do not pay any property tax (see page 9 of the report). It is always the owner of the property who pays the tax. That the owner probably passes the tax on to the user in the form of rent payments is moot - like everything else, that is the cost of doing business and must be passed on. Note on that same page that actual property taxes paid by businesses were reduced by the amount of assumed property tax passed on. That is very flawed accounting but convenient for exaggerating the tax burden on the poor while discrediting the tax burden on the non-poor. Note the consistency in the report bias.

Property taxes actually serve a very different agenda than the liberal activists preach. It is well established that areas with high property tax tend to have the best school systems. The question that is rarely asked is do students achieve higher standards with the increased funding or do the high property valuations and taxes keep out the lower performing students who would pull the average down? I think the correct answer is a bit of both. An interesting experiment was conducted several years ago in one high school in a low income city near Birmingham. The standardized test *averages* for that school were noticeably higher than in previous years and to similar other poor schools. What happened? The principal of that school understood the real problem and had cleverly arraigned for a sizable number of crap students to be on suspension during the tests. Without the drag on the average that these students would have been the school looked much better. The moral: do not judge a school by averages. Hidden in the average were students who were doing fine. I am not trying to say that poor school should or should not receive more funding. The point is that the standard the school is measured by is flawed. No matter how much more funding the school received the crap students would still be crap and the school would have lower overall *average* test scores. What if the property tax in that area were to be significantly raised for the purpose of improving the schools. What if as a result the families with crap students moved somewhere else? Then the higher property tax would have had the intended effect - average scores would improve. This is a bit simplistic but it is interesting to consider effects that do not fit populist opinion.

It is interesting to note that wealthy people tend to congregate in high property tax areas. That seems counter to the argument that the wealthy avoid paying their "fair share". There is a simple explanation. High property taxes keep undesirables out of the area and forms the basis of an exclusive club. Price is a well known filter. I could live in a cheaper area but I choose to live in a more expensive area so that I have good neighbors and a very low crime rate. A tax structure based more on property than income benefits those with high incomes as overall their net taxes can be lower than if only income were taxed. Thus, the wealthy liberals get to live in exclusive areas while being credited with compassion for the poor. Wealthy conservatives enjoy the same living benefit but are cursed as being the cause of people being poor.

Excise taxes or fees: These are taxes on gasoline, etc. It is only by contrived calculation that these taxes can be viewed as regressive. It is proper for the amount paid to represent the real cost of delivering something associated with that item such as roads, etc. for the gasoline tax. That cost is the same regardless of whether the user has a high or low income. The amount of tax people pay should be in proportion to their use of the item. To the extent that such taxes or fees generate excess revenue, that excess may very well be regressive. A common phrase used is that *these taxes hit the poor the hardest*. This is an incorrect application of the definition of a regressive tax. That a phrase is in popular use does not make it correct. I agree that any excess in these taxes should be eliminated.

Sin taxes: Tobacco and alcohol fall into the so-called sin tax situation. These taxes should never be included as a burden on the poor. The revenue generated from sin taxes usually has little to do with any expense by the government other than various sins do cost the government in terms of law enforcement and social services to deal with the problems of sin. I do not have hard numbers at the moment but every report I have heard of in the past indicated that the government should probably raise sin taxes substantially to cover the real costs. If a tax were to be put on illicit drugs that would be seen as really hitting the poor. It ought not to. The poor have no business squandering their money on tobacco, alcohol, or illicit drugs. If excess sin taxes are collected the excess may very well be classified as regressive. If the tax succeeds in reducing demand for an unneeded as well as harmful substance or activity, particularly by the poor, then that tax is actually helping the poor and should not be viewed as a burden. That low income people might pay sin taxes does not make those taxes regressive. Low income people have the identical option as I do to not pay them. I do not pay any and I do not have any sympathy for those who do.

Which tax is the fairest? In another article I will make a compelling case that the primary revenue source of government should be the income tax. Property and sales taxes should only be used to pay for direct associated government expense and not be revenue sources. Here is a very brief summary of the concept.

There are problems with the current income tax system at the national and state levels and people rightfully argue that it does not work. **Governments run amok when there is an imbalance between representation and taxation**. Putting a low tax burden on too many people and a high tax burden on too few is the proven way to achieve unstable and wasteful government. This has been going on at the federal level for a number of years and now the states are moving more in that direction.

I take the position that income tax would work well if done correctly. Income based taxation is the right direction to move as the nationwide trend towards shorter term employment becomes more apparent. Technological advances mean that fewer people are needed for various jobs. This is a consequence of the apparent utopia that we have been striving towards. The population to jobs ratio is naturally rising. Everyone will experience periods of unemployment from time to time. That should not be a problem. With income based taxation, the tax burden automatically decreases for those unemployed. Contrast this with asset based taxation in which the effective tax rate skyrockets for the unemployed. Income is the most direct measure of the present economy. Assets are a measure of the past economy. Taking from the past to pay for the present only encourages squander.

My proposal is to convert existing property, sales, and other taxes to income taxes at the state and local level. There is a legitimate use of direct property, excise, and sales tax to cover direct associated government expenses but these (fees as they should be called) would be much lower than they are now since revenue is not the driver. The attraction of making income tax the overwhelming revenue source is that it is a very visible tax and **inspires people to vote accordingly**. Spreading taxes out and making tax calculations complicated confuses the masses (as intended) so that they do not realize how much tax they pay and thus will not vote to abate excess government growth. The income tax threshold must be zero rather than a high offset for this to work. All exemptions and deductions (even including the precious home mortgage interest and charity) and personal exemptions should be eliminated. These are just schemes to trick people into thinking they are getting a tax break. In the grand scheme they are not. Although a flat rate is better, the income tax could be mildly "progressive" but in no instance should someone who earns twice what someone else earns pay more than about two and a half times the tax. Although income taxes would be higher at all economic levels, there would be a significant offset from the virtual elimination of property and sales taxes. One example is that vehicle registration fees would only be for the cost rather than a revenue source. So, the blessed poor may pay a noticeable income tax (before credits are considered) but that would be it. No tax other than direct cost on everything else. The other tax structures that lead to regressive tax calculations (real or bogus) would be gone.

Those with special circumstances could fill out a form requesting relief and in special cases that should be granted. Subsidies (which have the effect of driving up prices) could be paid where appropriate but the emphasis must be on reducing the cost of living at the low economic end (i.e. actions that encourage/force market prices down). Unemployment benefits would extend without limit as long as the individual was making a qualified effort at employment. The goal is a stable society where every voter pays a noticeable tax and that no one who is doing their part in society falls into an economic trap. It is a legitimate function of government to assist those who are unable to do their part but taking care of those who refuse to do their part should be left to various charities as that is counter to the purpose of government.

Another important change that has to be coupled with this is to move elections to be about one week after taxes are due. This combination makes it difficult for the government to expand at the whim of politicians (who seek personal fortune in the loose money of expansion). Those on government salaries would have their pay linked to tax revenue - i.e. automatic proration in down years - like the rest of us. All elected officials would have automatic double or triple proration. I know proration is an evil word but the alternative is layoffs. It is far better to be prorated as I have been through than to be unemployed. **It makes no sense for government employees to be exempt from the economic reality of the rest of society** - that only encourages squander. Economic down years are always a good opportunity for governments, businesses, and individuals alike to question whether certain spending is really necessary. Good economic times always bring about waste which then needs to be eliminated in down times. Businesses and individuals have been doing this for years but governments first want to raise taxes to maintain squander when down times occur. My proposal would force government to join the rest of us in economic sanity.

Eliminating sales taxes keeps government out of private transactions. What people do with their private money is their own business regardless of the government's desire to meddle. It might seem mean spirited to remove tax exemption on various organizations but that is a very small price to pay to have the government off one's back. The organizations are then free to follow their own plan rather than meet qualifications and limitations set by the government. Tax fraud and schemes that are rampant in some organizations are eliminated.

There are a lot of populist myths about what should or should not be taxed and how much. The uphill battle I have to overcome is that the correct way of implementing income tax eliminates much of the power politicians have whether liberal or conservative. Both want a highly convoluted system to hide enrichments to their wealthy constituents including themselves. The convoluted system also benefits the huge tax preparing industry. That is what we are going to have as long as politicians are in control. The solution is for us to vote the right people into office. But as the well known economist, Milton Friedman, said some years ago (as best as I can recall the quote), "You can vote the right people into office but they become the wrong people once they enter office."

Unfortunately, the direction proposed to "solve" the problems in Alabama takes Alabama further in the direction of too few taxpayers with the power of the vote. The problems will just get worse like what has happened in other states.

Conclusion

Value received versus taxes paid: One very important fact that is usually omitted from tax burden on the poor presentations is the value received for the taxes paid. The primary function of taxes is to fund broad social interests such as security, schools, infrastructure, etc. Everybody receives these benefits whether or not they pay taxes although there are different benefits for different people. Low income people receive a high value in proportion to the taxes they seem to pay. Although the value of things such as housing subsidies, food subsidies, medical subsidies, schools, day care subsidies, and even direct cash subsidies are generally omitted in the accounting for low income people, these things have a real value that can substantially increase their real income. High income people receive a limited value no matter how high their taxes. ***It is always wrong to compare the pre-benefit income of the poor with the pre-tax income of the non-poor*** but that is the comparison most typically seen. Even if the poor received $1,000,000 in direct cash subsidies they would still be classified as poor because that subsidy is not part of their pre-benefit income. Bizarre results arise from faulty accounting. The main theme of this article is a call for correct accounting.

The value/taxes ratio: There is a very simple equation that measures true tax burden called the value/taxes ratio. Simply divide the value of all benefits and services received by the net taxes paid. If the ratio is greater than 1.0 then there is no tax burden period no matter how regressive or whatever various taxes can be packaged to appear. For low income people this ratio is significantly greater than 1.0 and can approach infinity or become negative. A real tax burden exists only if the ratio is less than 1.0 but not negative. For the very wealthy, the ratio approaches zero. For the middle class the ratio is in the neighborhood of 1.0, give or take.

The big picture: Comparing a subset of my numbers in Method 2 for a low income family (13.4 percent of income paid in tax to Alabama) and Case 2 for a high income family (7.5 percent of income paid in tax to Alabama) it might seem that even I have just proved that taxes are regressive in Alabama. These numbers are only part of the story and in of themselves do not indicate that Alabama taxes are regressive or not. The truth is in the details. The big picture is that my low income family paid a total of negative 9.8 percent of their income in all taxes while my high income family paid a total of 34.2 percent of their income in all taxes. This is a huge difference. **I reiterate that the majority of the funding that drove the net taxes of the low income family negative came from the wealthy - even the wealthy in Alabama. So it is not fair to say that the wealthy get tax breaks while the poor bear the burden.**

All the report shows is that it is possible to view taxation in such a way that not just Alabama, but every state in America has regressive taxes. Viewing the world upside down does not mean that fish fly and birds swim. It is a shame that all the effort that went into the report is wasted on bogus accounting thus rendering the report worthless except as an exercise for the reader to find all the different types of deception used.

Here is an interesting thought for discussion. Eliminate all taxes paid to Alabama by low income families and also reduce their EITC refund by the same amount and give that money to Alabama as additional aid from the federal government. This absolutely eliminates "regressive taxes in Alabama" and Alabama should then rank a strong number 1 in the next edition of the report. But this is only an accounting change and there has been no financial change in the low income family. A different method to accomplish the same thing is to reduce the federal EITC by the amount of all state taxes paid and give that to the state which would then hand it out to compensate for all taxes paid - i.e. a state EITC. In each case the "regressive taxes" that were holding low income people back are gone so now what? Some new reason would have to be found that holds low income families back.

The usual argument about regressive taxes fails the definition of regressive taxes and ignores the value/taxes ratio. Taxes are viewed only as an arbitrary burden on the poor that somehow end up benefiting the interests of the wealthy. This is a serious distortion of reality.

I am not aware of any regressive type of sales tax or income tax anywhere in the United States of America. Income tax is generally the inverse of regressive. It is interesting that some states that are given higher grades in the low income friendly category than Alabama also use higher asset taxes and fees (vehicle registration and various court costs are good places to look) to offset their "generosity" (the report also makes this point). The difficulty in comparing the tax structure in Alabama (or any state) with another state is that the taxes, fees, and general cost of living varies. I envy anyone who can truly do a complete comparison. Comparing isolated items as the various advocacy groups love to do is always wrong and misleading. The only fair and correct way is to use the total of all taxes, fees, or whatever by any other name. Even this will not be the whole story as there are differences in the basic cost of living that can offset a lower (or higher) total tax. That some states put a higher tax on business and property is not necessarily good for low income people as the cost to purchase goods and shelter can be higher as these taxes are passed on. It has been said that ***the best way to tax the poor is to tax the rich who will then pass the tax on to the poor.***

Never accept isolated comparisons for you are always being misled. Be very wary when population averages and medians are used to compute cost and tax burdens on the poor because by definition, both the poor and the wealthy live in a significantly different zone than either the average or median. Ignore the use of rankings (such as Alabama ranks 50th in the nation) as rankings are a way to exaggerate the difference between the state ranked number 1 and the state ranked number 50. By definition there will always be a state that is first and another state that is last no matter how narrow the difference. Look at the real difference between first and last as well as the cost of that difference. Rankings can be very contrived as it seems that every state is either first or last by some measure. Strive to look at the big picture rather than a crafty subset.