

## Giving Credit Where Credit is Due: Boosting the Grocery Tax Credit Would Provide Targeted Help for Struggling Families

The family budgets of low- and moderate-income Oklahomans are under increasing strain from the rapidly rising costs of such essentials as food, fuel and utilities. Food costs rose 5.9 percent over the past year, according to the government's August inflation data. Price increases have been particularly steep for such dietary staples as dairy (6.4 percent increase over the past year), bread and cereals (11.7 percent), and fruits and vegetables (12.0 percent). With Oklahoma already suffering one of the highest rates of food insecurity and hunger in the nation, rising food costs pose a direct threat to family health and well-being.

This situation has brought renewed attention in Oklahoma to the state's continued levying of the sales tax on groceries. Of the 45 states that have a general sales tax, Oklahoma is one of just 16 that taxes groceries (see map below). Counties and municipalities also assess sales taxes on groceries.

This brief considers the arguments for and against eliminating the sales tax on groceries. Given the budgetary constraints on state and local government, it recommends an increase in the state grocery tax credit as the most targeted and cost-effective way to assist those with the greatest needs.

### Should Oklahoma Eliminate the Sales Tax on Groceries?

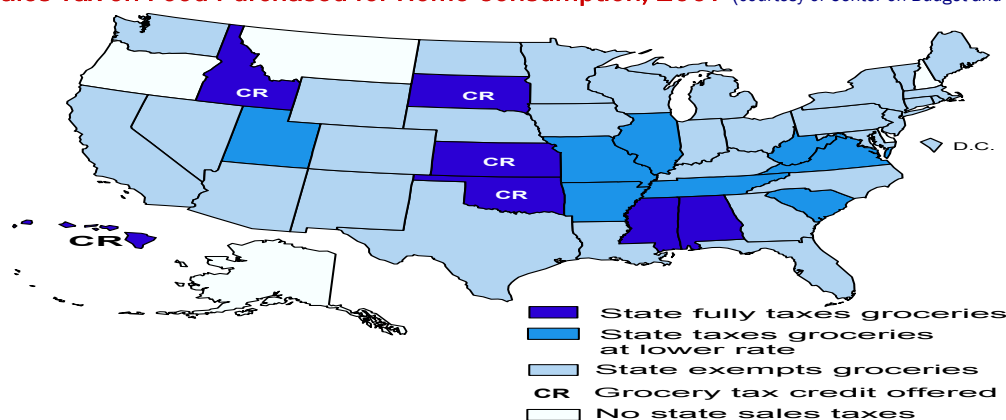
The main argument against taxing groceries is that it represents an especially *regressive form of taxation*, taking a larger slice of the income of the poor and middle-class than of the wealthy. Overall, Oklahomans pay an average of 0.4% of total income in state sales taxes on groceries, according to analysis conducted by the Institute on Taxation and Economic Policy (ITEP). However, the average house-

holds in the bottom fifth of income pays 1.0% of their total household income in state grocery sales taxes, compared to just 0.1% of income for households in the top 1% of income.

Exempting groceries from the sales tax would be the simplest way to assist Oklahomans with their grocery bills and make the state tax system more equitable. However, there are also several drawbacks to this proposal:

- *Cost* – The sales tax on groceries contributed an estimated \$308 million to state revenues in 2007, which represented approximately 17% of total states sales tax revenues. The loss of this revenue would have a significant impact on funding of core public services. For example, grocery tax revenues provide over \$100 million each year for the operation of public schools, \$37 million for the Medicaid program and \$17 million for the teachers retirement system;
- *Targeting* – The benefits from eliminating the sales tax on groceries would be poorly targeted. According to ITEP's analysis, the poorest 40% of taxpayers would get just one-fifth of the savings (an average of \$120 per household), while those in the top fifth of income would get roughly one-third of the benefits (an average of \$364 per household);
- *Impact on local government* – Under current Oklahoma law, counties and municipalities can only tax items that

**Sales Tax on Food Purchased for Home Consumption, 2007** (courtesy of Center on Budget and Policy)



are taxed by the state. The Oklahoma Tax Commission estimates that local governments collect roughly \$250 million in taxes from grocery sales, which represents about 7% of total local tax collections. Eliminating the sales tax on groceries would either impose an enormous budgetary loss on local governments, or, by decoupling state and local sales tax bases, create new complications and costs for retailers and tax administrators.

### Expanding the Grocery Tax Credit

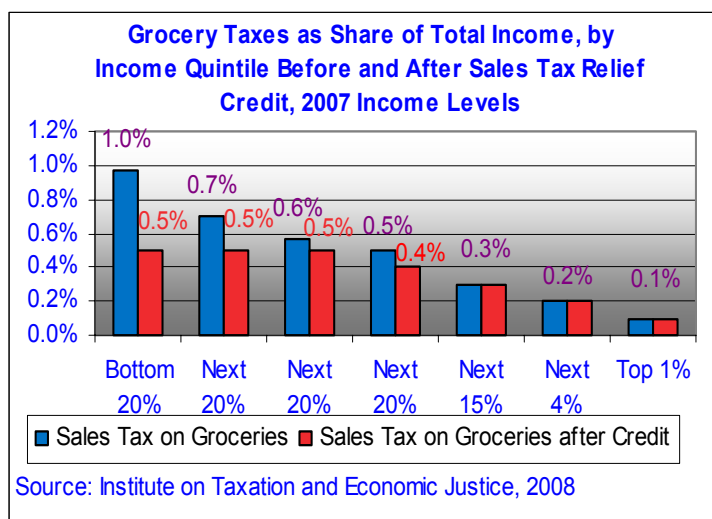
A more modest and cost-efficient alternative to eliminating the sales tax on groceries is to increase the state’s grocery tax credit, officially known as the Sales Tax Relief Credit.

Enacted in 1990 as a means to offset the state sales tax on groceries, the Sales Tax Relief Credit currently provides a rebate of \$40 per household member to households with incomes at or below the following levels:

- \$50,000 per year for filers who are elderly, have a physical disability or claim a dependent; or
- \$20,000 per year for everyone else.

The credit was claimed by 486,000 households in 2007, representing about one-third of Oklahoma households. These taxpayers received credits totaling \$41.2 million. In addition to those who claimed the credit by filing a tax return, an additional \$3.8 million was distributed as cash payments by the Department of Human Services to Medicaid-eligible nursing home residents and TANF (Temporary Assistance to Need Families) recipients.

The sales tax relief provides targeted assistance to low- and moderate-income households and limits the regressivity of the sales tax on groceries. As can be seen from the chart below, the Sales Tax Relief Credit has the effect of decreasing grocery taxes as a share of household income from 1% to 0.5% for the bottom fifth of households, from 0.7% to 0.5% for those in the second



fifth, and from 0.6% to 0.5% for the middle fifth. Those in the top 40% of household income do not qualify for the credit.

While the credit is an important instrument in offsetting grocery sales taxes, it has failed to keep pace with rising food costs. The amount of the credit has been left at \$40 since it was initially enacted in 1990, while eligibility for the credit was last raised in 1998. Increasing the amount of the credit and expanding eligibility would provide immediate and ongoing benefits to low and moderate-income Oklahomans.

The estimated fiscal impact of possible scenarios, according to analysis conducted by ITEP, would be as follows:

- Increasing the credit to \$60 per household member and expanding eligibility to \$60,000 for filers who are elderly, have a physical disability or claim a dependent and \$30,000 for childless adults = \$36 million;
- Just increasing the value of the credit from \$40 to \$60 per exemption = \$19 million;
- Keeping the credit amount unchanged at \$40 but expanding eligibility to \$60,000/\$30,000 = \$11 million.

The main drawback to expanding the Sales Tax Relief Credit as a form of targeted assistance is that not all eligible recipients claim the credit. In some cases, taxpayers eligible for the credit do not file income tax returns at all, while others file returns but neglect to claim the credit. ITEP estimates the take-up rate at 70% for the Sales Tax Relief credit. Expanded publicity and outreach about the credit could lead to more eligible taxpayers claiming the credit

The final report of the Oklahoma Task Force on Hunger, issued in December 2007, called for an increase in the amount of the Sales Tax Relief Credit, along with outreach efforts to promote greater awareness of the credit among eligible taxpayers, as part of its strategy for addressing food insecurity in Oklahoma.

As part of an increase in the Sales Tax Relief Credit, policymakers should consider indexing to inflation the eligibility limit and amount of the credit to protect its value in future years. In addition, it would be worth redesigning the credit so that the amount phases out at higher income levels, in lieu of the current all-or-nothing approach that creates a steep drop-off for those whose income rise above the eligibility cut-off.

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