TAX FACTS

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IS TAXING FOOD ALL THAT REGRESSIVE?

By Ryan Aprill

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This article examines the policy behind Illinois's largest tax expenditure – a reduced tax rate on food - to determine whether the policy objective of reducing the regressivity of the sales tax has been accomplished. Contrary to intended policy, we find that a reduced tax rate on food likely increased the regressivity of the sales tax.

The amount of the Illinois tax expenditure associated with a food exemption has increased dramatically, growing by approximately 110% between 1993 and 2008 to approximately $900 million, far in excess of the 49% increase in the consumer price index over the same period, a measure of inflation.[1] However, we find that the beneficiaries of such growth are not the low income households the exemption is meant to benefit, but rather the benefits of the exemption accrue disproportionally to the highest income households. **Figure 1** on page 2 shows the distribution of tax savings accruing to each income quintile as a result of the reduced tax rate on food.[2]

[1] 2008 Illinois Comptroller Tax Expenditure Report (The tax expenditure resulting from exempting food for home consumption is not specifically reported by the state. Rather, the Illinois Comptroller reports the figure together with the exemption for prescription drugs and medical appliances, which are similarly taxed at 1%. Similarly, the portion of food consumption procured through food stamps is not separately presented. The total amount reported is $1.4bn. To arrive at the $900 million estimate, it was assumed that Illinois households had similar average consumption profiles as those provided in the 2008 Consumer Expenditure Survey); Inflation data gathered from the Bureau of Labor Statistics.

[2] Calculation made after accounting for the effects of the receipt of federal food stamps, which provide for the tax free purchase of food for home consumption. For more detailed discussion see infra page 2.

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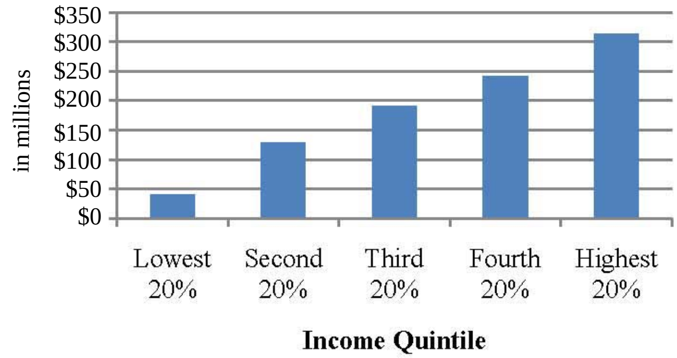
NOTES FROM THE INSIDE. . .

By J. Thomas Johnson

This issue of the Tax Facts explores two issues. Ryan Aprill addresses in his article one near and dear to my heart. Did the sales tax exemption of food purchased for home consumption in fact reduce the regressivity of the sales tax? **It did not.** In fact the lowest income households incurred a higher tax burden than before the exemption. Ryan suggests that a tax credit mechanism would have done a much better job of accomplishing the intended result. The question is can we fix the unintended result of the exemption? How do we explain the actual versus the perceived result of the "shitake mushroom and caviar" exemption?

The other article deals with the issue we have heard a lot about in this election cycle, loss of jobs and its impact on Illinois' overall ranking of economic impact. Illinois' ranks at the bottom of most of the economic indicators associated with employment including personal income growth and gross state domestic product. How does Illinois recover from the impact that job loss has had on our state's economy and which has contributed to the fiscal challenges facing not only our citizens but our state and local government health? One thing for certain is that Illinois is not the only state that will be vying for the jobs that a recovering economy will produce. The question is what are the public policy decisions that we must make that will secure Illinois' share of the recovery? A big "the biggest" challenge for our future governmental leaders to say the least.

FIGURE 1. Tax Savings by Exempting Food for Home Consumption (by income quintile)



Source: Bureau of Labor Statistics, Consumer Expenditure Survey; calculations by the Illinois Tax Foundation

As shown above, over 80% of the tax savings resulting from a reduced tax rate on food are accruing to the three highest income quintiles. Specifically, the highest income households receive in aggregate a tax break of over $300 million, while the lowest income households save less than $50 million.

EFFECTIVENESS OF THE REDUCED SALES TAX RATE

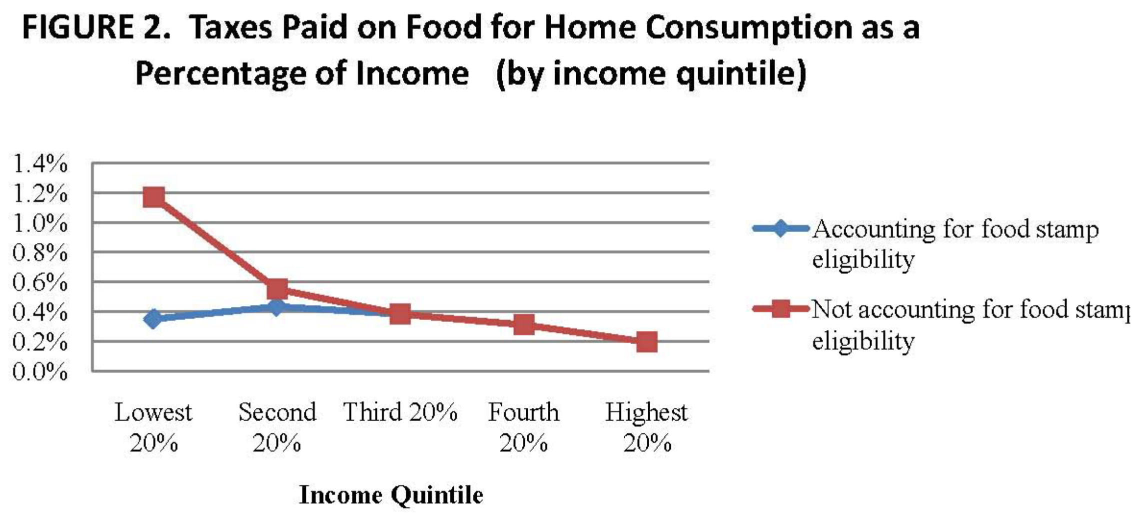
In Illinois, food for home consumption is taxed at a rate of 1 percent, rather than the basic state sales tax rate of 6.25 percent. This results in approximately $900 million in lost revenue to the state.[3]

The policy rational for taxing food purchased for home consumption at a lower rate is that it would make the sales tax less regressive. A tax is considered regressive if low income persons pay a larger percentage of their income in taxes than do higher income persons.

At first glance, taxing food for home consumption appears to be a highly regressive tax. Before accounting for those who are eligible to receive food stamps, which provide for the tax free purchase of food for home consumption, the lowest income quintile pays a much

[3]See footnote 1 for calculation methodology.

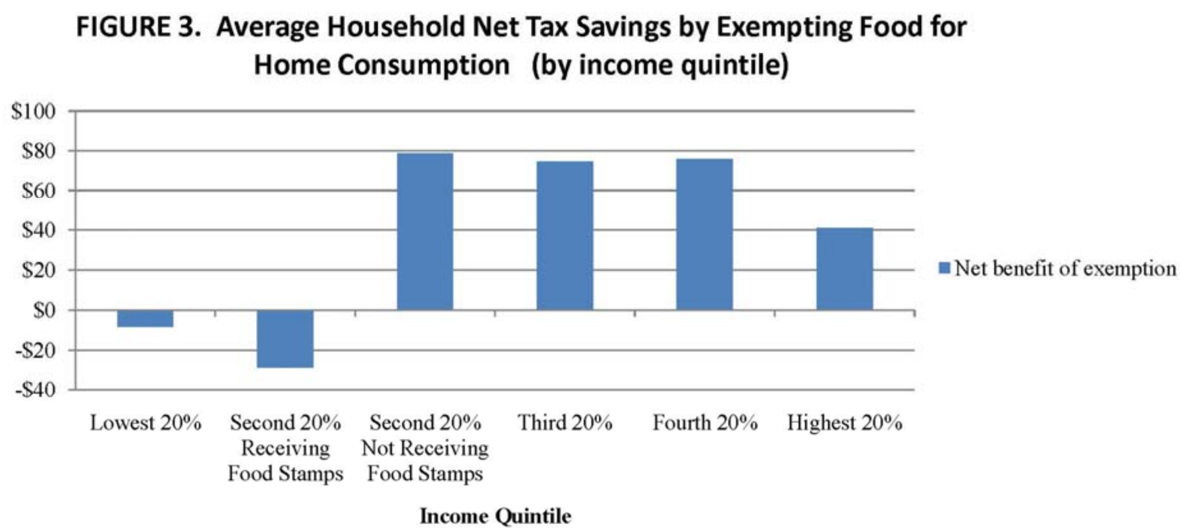
larger percentage of their income on taxes assessed on food purchased for home consumption.[4]



Source: Bureau of Labor Statistics, Consumer Expenditure Survey; calculations by the Illinois Tax Foundation

However, taxing food may not be as regressive as previously thought. A preliminary qualification to receive food stamps is that households have gross income less than 130% of the federal poverty level for their household size.[5] If it is assumed that the first income quintile and a portion of the second of Illinois households are eligible to receive food stamps (because they fall below 130% of federal poverty line), and Illinois households have the same consumption characteristics as those presented in the Consumer Expenditure Survey, the lowest quintile of income pays only an additional .4% of their income in sales taxes, compared with the highest who pay .2% of their income in such taxes.[6]

Finally, when Illinois implemented the food and drug sales tax exemption in the 1980s, the sales tax rate was increased by 1%. This increase had the ancillary effect of increasing the tax burden on all other taxable goods consumed. The increased taxes on other goods had the effect of increasing the regressivity of the sales tax, as low income households spend larger percentages of their income on taxable items than do higher income households.



Source: Bureau of Labor Statistics, Consumer Expenditure Survey; calculations by the Illinois Tax Foundation

[4]Households eligible to receive food stamps typically receive an amount that still requires them to spend 30% of their adjusted household income on food for home consumption (see SNAP – Supplemental Nutrition Assistance Program FAQs, http://www.fns.usda.gov/snap/faqs.htm#8).
[5]Supplemental Nutrition Assistance Program (SNAP).

[6]It is assumed that the distribution of households eligible for food stamps are the entire lowest income quintile of 1,058,401, and the remaining eligible recipients are in the second lowest income quintile. Consumption profiles are based on the 2008 Consumer Expenditure Survey.

With such a small portion of the tax savings resulting from a reduced tax rate on food for home consumption (see above), coupled with the increased tax burden resulting from a higher sales tax rate on all other taxable goods, the lowest income quintile is actually worse off.

CONCLUSION

The existence of a food tax exemption causes the state to forgo $900 million in sales tax revenue with the intention that such forbearance will result in a fairer, or stated otherwise a more progressive tax system. However, after accounting for the effect of households who are eligible to receive food stamps, it appears that the existence of a food exemption actually increases the regressivity of the sales tax, making it more unfair. At the very least, recognizing that not all of those in poverty actually receive food stamps and that others may qualify for food stamps, it is highly unlikely that any benefits that do accrue to the lowest income quintiles are material enough to warrant a $900 million tax expenditure.

Arguably, it would be better public policy to fully tax food for home consumption while cutting the overall sales tax rate. In fact, five states currently tax food for home consumption at the full sales tax rate, but offer some form of a credit or rebate to offset taxes paid on food for home consumption, they include: Hawaii, Idaho, Kansas, Oklahoma, and South Dakota. Additionally, Alabama and Mississippi both fully tax food for home consumption, without providing any rebate or credit.[7]

A reduction in the overall sales tax rate would better reduce the regressivity of the sales tax as low income households spend a much larger percentage of their income on taxable goods other than food consumed at home. At the very least, if not fully taxing food in exchange for a lower overall sales tax rate, a credit or rebate could be implemented for a fraction of the cost and would also do a better job of offsetting the tax incurred on purchases of food for home consumption than a general sales tax exemption.

[7]Center on Budget and Policy Priorities - http:www.cbpp.org/cms/index.cfm?Fa=view&id=1230

APPENDIX

Income Quintiles –
Source: 2008 Consumer Expenditure Survey

Lowest 20 percent	$0 to $19,064
Second 20 percent	$19,065 to $36,280
Third 20 percent	$36,271 to $59,086
Fourth 20 percent	$58,087 to $93,257
Highest 20 percent	$93,358 and Up

Food Stamp Qualification[8] –
Source: United States Department of Agriculture – Food and Nutrition Service

Household Size	Gross Annual Income (130 percent of poverty)
1	$14,088
2	$18,948
3	$23,808
4	$28,668
5	$33,528
6	$38,400
7	$43,260
8	$48,120

[8]To qualify households must meet other tests in addition to an income test (eg. resource test). Furthermore, several additional elements are considered such as deductions against income. For further information see http://www.fns.usda.gov/snap/applicant_recipients/eligibility.htm#income (Federal Supplemental Nutrition Assistance Program Eligibility Criteria).

Illinois Household Food Stamp Participation –
Source: United States Department of Agriculture – Food and Nutrition Service

Fiscal Year	Illinois
2007	569,073
2008	595,832
2009	677,147

Illinois Average Annual Household Food Stamp Benefit –
Source: United States Department of Agriculture – Food and Nutrition Service

Fiscal Year	Illinois
2007	$2,748
2008	$2,884
2009	$3,430

Average Annual Food and Taxable Expenditures by Income Quintile –
Source: 2008 Consumer Expenditure Survey

Average Annual Food and Taxable Expenditures by Income Quintile	Lowest 20%	Second 20%	Third 20%	Fourth 20%	Highest 20%
Food Consumed at home	$2,369	$2,929	$3,436	$4,340	$5,645
Food consumed away from home	$1,103	$1,631	$2,167	$3,249	$5,336
Other Taxable Consumption	$4,558	$7,496	$10,592	$15,196	$25,549
Food at home as % of Income	22.3%	10.5%	7.3%	6.0%	3.7%

ILLINOIS LAGS NATION IN JOB AND INCOME GROWTH FOR DECADE by Jim Nowlan and Ryan Aprill

A former president of the Taxpayers' Federation of Illinois, Jim Nowlan is a senior fellow with the University of Illinois Institute of Government and Public Affairs. He is lead author of a new book, Illinois Politics, published by the University of Illinois Press.

Illinois and nearby states of Indiana, Michigan and Ohio ranked near the bottom among the states in employment, personal income and GDP growth over the past decade, according to figures from the U.S. Bureau of Labor Statistics as calculated by the Illinois Tax Foundation.

As can be seen at **Figure 1** on page 6, Illinois ranked 48th among the states in job growth from 1999-2009, with negative growth in non-farm payroll for the decade of -6 percent. Only Ohio and Michigan ranked behind Illinois.

FIGURE 1. Percentage of Growth (Decline) in Employees on Nonfarm Payroll 1999 - 2009

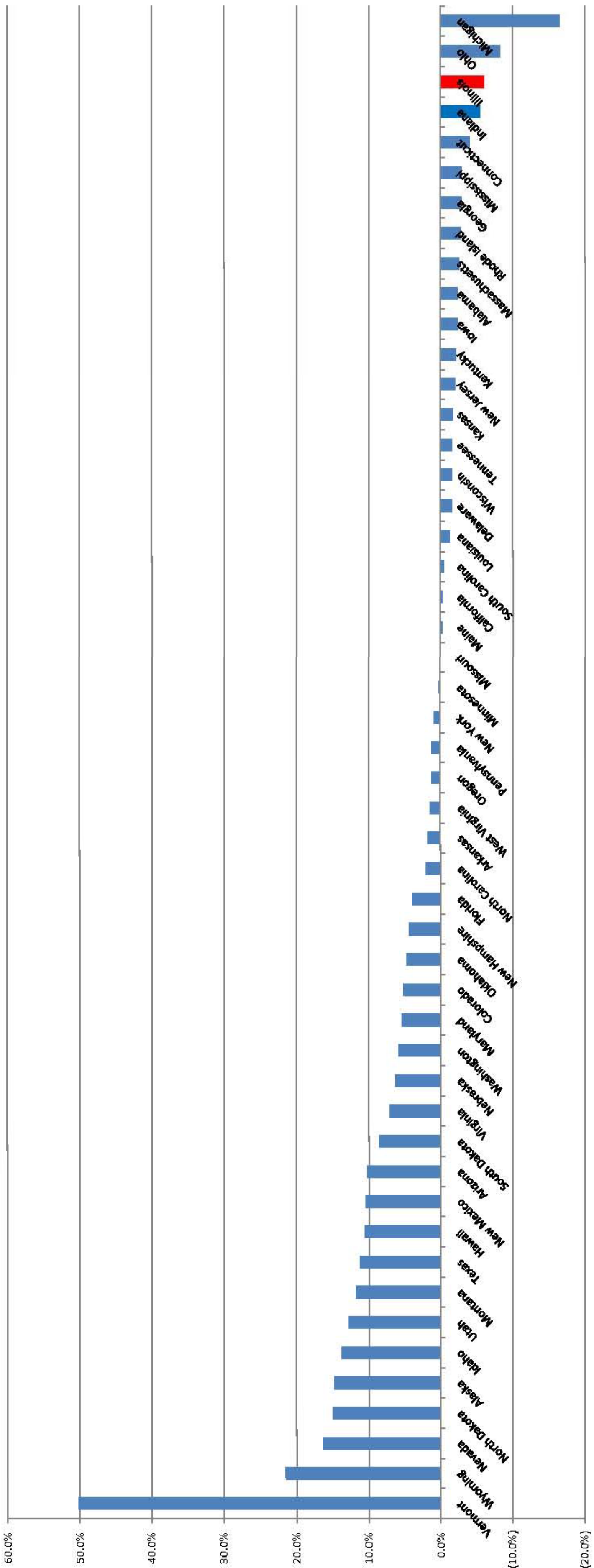


FIGURE 2. Percentage of Decline of Employees in Manufacturing 1999-2009

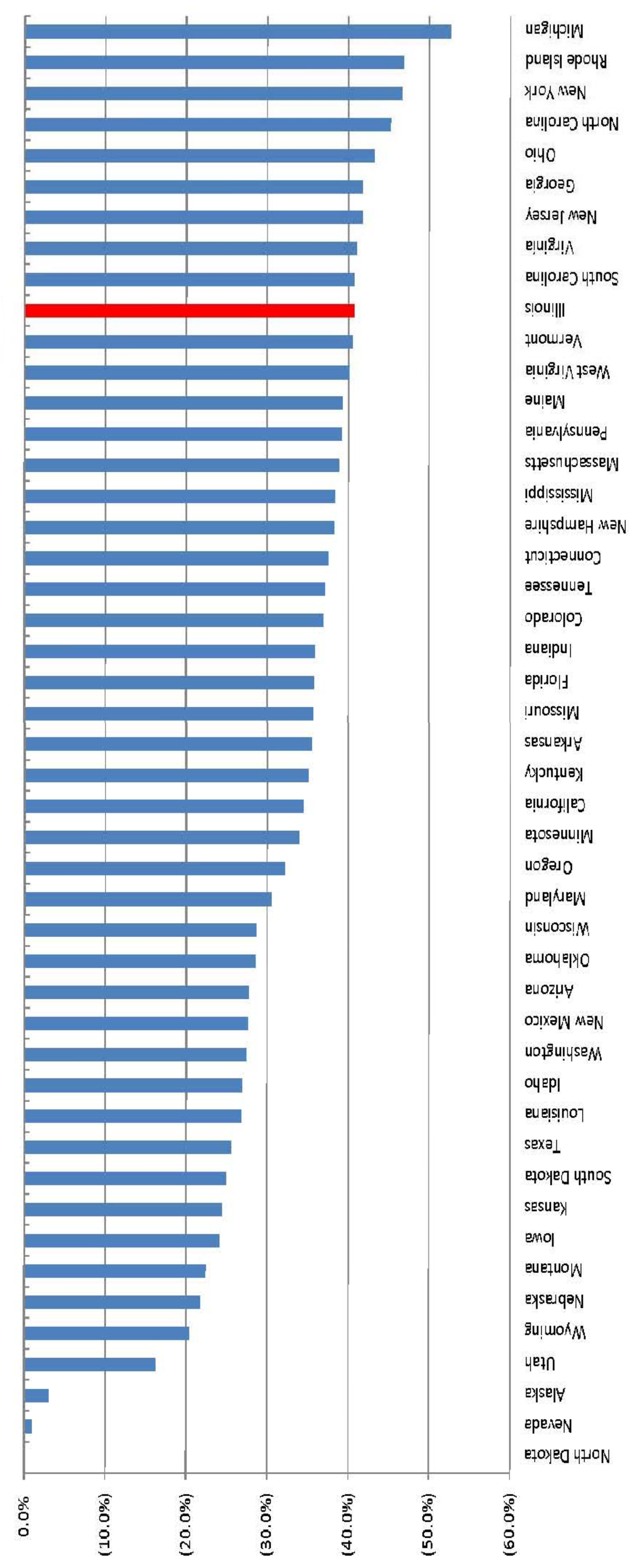


FIGURE 3. Percentage of Growth in Personal Income 1998-2008

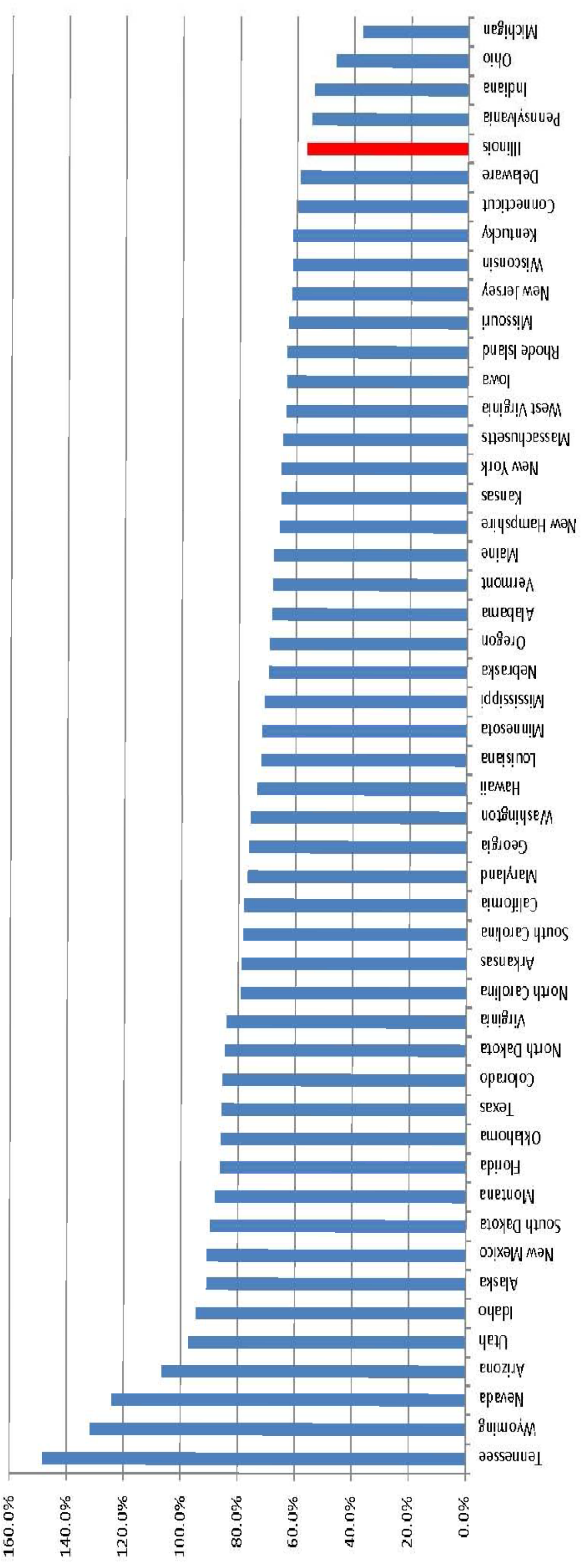
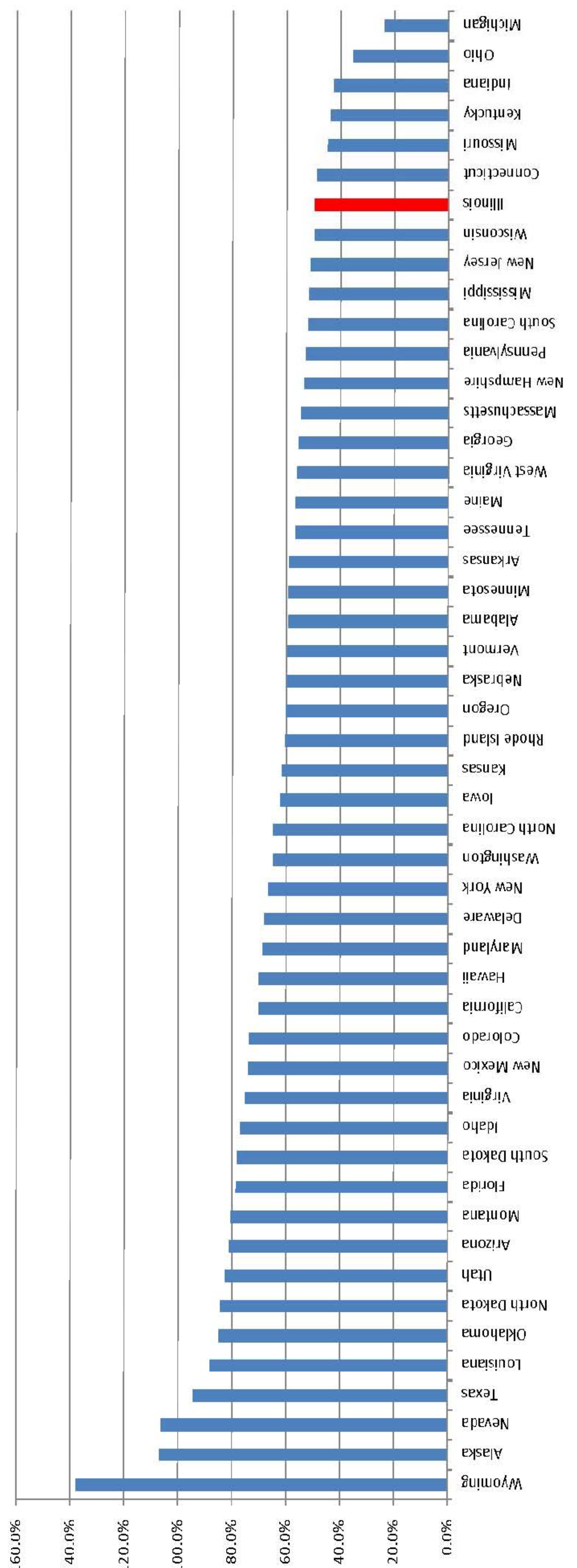


FIGURE 4. Percentage of Growth in State GDP 1999-2009



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In job growth by sectors, Illinois suffered a decline of -40.7 percent in manufacturing jobs during the past decade, ranking the state 41st in that sector. (**See Figure 2**.) Illinois also suffered job declines in the finance, insurance and real estate sector (-9.8 percent decline; ranking, 46th) as well as construction (-14.6 decline; ranking, 35th). Illinois did see a 5.8 percent growth in government jobs in the decade, ranking the state 40th on that indicator.

Illinois also was at the back of the states in growth in personal income from 1998-2008, at 56.5 percent for the decade, followed only by Pennsylvania, Indiana, Ohio and Michigan. (**See Figure 3**.) Our state ranked 44th in growth in GDP for the 1999-2009 decade, at 49.5 percent. (**See Figure 4**.)

Unemployment for 2009 in Illinois was 10.5 percent, which ranked Illinois 43rd in the nation.

On these various economic indicators, Illinois has clearly been a laggard overall.