

## **The Alabama Tax System: Origins and Current Issues**

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### **Abstract**

*Alabama is similar to many U.S. states in that it has faced various revenue shortages and increasing demand for services during the period from 2000 – 2009. This period is indicative of the noticeable rollercoaster effect of irregular but recurrent periods of financial prosperity and financial hardship experienced by Alabama's tax system. This research seeks to provide a thorough understanding of the current tax law and current fiscal conditions facing the state that can serve as a basis for tax reform discussions. Alabama's tax system is heavily constrained by constitutional mandates that cap tax rates as well as earmark revenue which is generated by the tax system. Such earmarks contribute to fiscal problems by preventing state officials from reallocating revenue to cover essential services. Given these constraints and the sensitivity of the tax base to economic fluctuations, Alabama may expect future periods of budgetary shortfalls and prosperity.*

**Key Words:** State Government Finance, Taxation, Tax Revenue, Tax Law

### **Introduction**

Alabama is fairly typical of most U.S. states in that it is constrained by a constitutionally mandated balanced budget. In addition, Alabama has been and will continue to be forced to confront rising expectations for state services and periodic but serious budget shortfalls of the type experienced between 2000 and 2004 and again from 2007 to the present. Alabama is of interest because it is not a typical U.S. state in some important respects. A 2006 report, released by the Center on Budget and Policy Priorities<sup>1</sup>, notes that in fiscal year 2002, Alabama had a lower threshold for paying income taxes than any other state in the nation. In fact, the threshold of \$4,600, which prevailed through 2005, required that two-parent families of four begin paying income taxes at an income level which is seventy-five percent below the current poverty line. Additionally, state policymakers are not only required to balance the budget, but they are required to do so with constitutionally earmarked tax receipts flowing into the Alabama Education Trust Fund, the General Fund, and various other subsections of the budget.

The state currently earmarks more of each tax dollar than any other state, a fact which complicates the budget balancing process. Due to the high percentage of earmarking, elected officials have a limited ability to transfer funds between budgets in order to achieve the necessary balance. Alabama is also responsible for virtually all primary and secondary educational expenditures with little support from other levels of government. Local governments account for only a relatively small fraction of total expenditures with a minimum contribution specified by the state. U.S. Department of Education statistics report that Alabama K-12 school districts are more dependent on state level funding than school districts in other states on average.

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<sup>1</sup> Levitis, J.A. and N. Johnson, 2006, "The Impact of State Income Taxes On Low-Income Families in 2005", Center on Budget and Policy Priorities. From <http://www.cbpp.org>

Finally, Alabama is one of only a few states that allow for complete federal deductibility for income taxes and has relatively low state and local taxes compared with the U.S. average. Such characteristics and numerous fiscal shortfalls between 2000 and 2009 have led to persistent calls for tax reform in Alabama. Prior to tax reform, a thorough understanding of the existing tax system and current fiscal condition is necessary. This paper provides such an understanding by examining the constitutional beginnings of the current tax structure and a thorough review of fiscal conditions and trends from 2000-2009. Section One provides background information on Alabama's tax system and recent fiscal concerns. Section Two outlines and discusses the relative importance of each of the major components of Alabama's tax system as well as how each component fits into total state revenue. The final section provides brief concluding remarks.

### ***1. Origins of Alabama's Tax System and Current Fiscal Situation***

Alabama's tax system provides the bulk of the revenue available to the state, with block grants and earmarked highway funds from accounting for most of the remainder. Oil and gas royalties and other minor sources also contribute to state revenues. The state collects many different types of taxes and the structure of the tax system has several unique qualities. Five distinguishing characteristics are:

- The distribution of Alabama's state and local tax burden is among the most regressive in the United States.
- Alabama has relatively low state and local taxes compared with regional states and the U.S. average. This is true even after adjusting for the fact that Alabama is among the poorest states.
- Income taxes in Alabama are lower than in most states.
- Property taxes in Alabama are lower than any other state.
- Sales taxes in Alabama are above the national average.

Additionally, as noted above, Alabama's tax system is subject to numerous constitutional provisions and constraints, which control maximum rates for some taxes, force the earmarking of tax revenues, and divide the budget into numerous independent funds.

#### **1.1 Origins**

*A Legislator's Guide to Alabama's Taxes* (2011) explains the historical development of the current tax system by noting that it was adopted in two stages. Following the adoption of the Constitution of Alabama of 1901, the first stage involved the enactment of the property tax, which did not occur until 1935. As detailed by Harvey (1989), local school systems in Alabama and across the country experienced a prolonged financial crisis during the Great Depression. With local school systems facing bankruptcy, Alabama essentially took over public school funding responsibilities. The collapse of local school district finances and other fiscal problems led the state to impose a property tax rate of 6.5 mills. The legislature earmarked 3 mills for the education trust fund, designated 2.5 mills for the general fund and used the remaining mill to support needy confederate veterans and their widows. Since 1935, the property tax has seen numerous revisions in assessment ratios, property classifications, and exemptions, but the maximum tax rate has been maintained at the constitutionally mandated level of 6.5 mills.

Individual and corporate income taxes were also enacted during this first stage of adopting the current tax structure of Alabama. In addition to taxing property, the Constitution of Alabama of 1901 also provided levying provisions for individual and corporate income taxes, and the Alabama Legislature began to collect income taxes in 1933. Maximum rates for individuals and corporations were established in 1935 at five percent (5%) on individual income and at a three percent (3%) tax on corporate income. The maximum corporate rate was later raised to five percent (5%) in 1963 and six and one-half percent (6.5%) in 2001. As with the property tax above, income tax collections are earmarked for specific purposes. In fact, one hundred percent of income tax collections are earmarked for educational purposes.

The second stage of the current Alabama tax system involves the adoption of the sales tax. Alabama began to tax general sales and automobile purchases in 1939. At that time, Alabama imposed a two percent (2%) tax on general sales and a tax on automobiles of one half of one percent (0.5%). In an effort to increase public school funding, a portion of the proceeds from sales taxes was distributed to the Special Education Trust Fund. Since 1939, the maximum tax rate on general sales, at the state level, has been raised to four percent (4%), and automobiles are currently taxed at two percent (2%). In addition to the rate changes, earmarking of sales taxes has increased with only a little over four percent (4%) of net collections flowing into the General Fund in 2009, while approximately eighty-two percent (82%) of tax revenue flowed into the Education Trust Fund.

Since the initial implementation of income and property taxes in 1935, each tax has been subjected to numerous alterations to further define or redefine exemptions, exclusions, and deductions. However, maximum tax rates for property and income are included in the original constitutional levying provisions. Thus, once the legislature has exercised the maximum rate, a constitutional amendment is necessary to increase these rates. As a result, the maximum personal income tax and property tax rates remain at five percent (5%) and 6.5 mills respectively. As noted earlier, the corporate income tax law has been amended on two occasions and any additional increases in tax rates would require subsequent constitutional amendments. Sales taxes have also experienced numerous modifications to further define exemptions and exclusions since first being introduced into the tax structure in 1939. Sales taxes, however, are levied by statutory authority and are not subject to constitutional provisions. Absent constitutional provisions, sales tax rates may be changed through action of the legislature and therefore are much easier to modify than income and property taxes.

Up to this point we have only discussed three of the approximately forty-five taxes that are currently part of the Alabama tax structure. Many additional taxes were instituted at each of the two stages but account for only a relatively small amount of tax revenue collected compared with the three major taxes previously described. The Use tax is one example of a relatively minor tax that was installed during the second stage of the process in 1939. Since the initial implementation of the state's tax structure, the Constitution of Alabama of 1901 has been amended numerous times to allow Alabama to levy new taxes. Gasoline and Motor Fuel taxes and the Utility Gross Receipts tax, which were first levied in 1952 and 1969 respectively, are two examples of such amendments. As in the case of taxes previously discussed, at least some portion of these lesser taxes is earmarked for designated purposes. For example, 100% of the Utility Gross Receipts tax is earmarked, a majority of which is deposited into the Education Trust Fund with the remainder deposited into the Special Mental Health Fund.

Table 4.1 provides specific 2009 records relating to the earmarking of key taxes. Inspection of the table reveals that approximately ninety-two percent (92%) of each tax dollar collected from these sources is earmarked for education or other purposes. Alabama, like most states, earmarks gasoline and motor fuel taxes for highway programs, but in addition, Alabama earmarks all revenue collected from income taxes for the education trust fund and teachers' salaries. The majority of sales tax revenue is also earmarked for general education purposes. Unlike the income tax, revenues from other taxes are not earmarked at the one-hundred percent (100%) rate, but many are earmarked at quite high rates. There are also some exceptions, namely the Insurance Premium tax and Production Privilege tax, which are earmarked at lower rates. Thus, the majority of revenue generated by these taxes is deposited into the general fund.

Given the small number of exceptions and the large number of taxes which are earmarked at a high rate, it is expected that total tax collections in Alabama will be earmarked at a rate slightly less than ninety-two percent (92%). In fact, as noted in "How Alabama's Taxes Compare," a publication by the Public Affairs Research Council of Alabama (PARCA) (2006), constitutional provisions and other statutes earmark, or allocate to specific accounts, 87.5 cents of every tax dollar collected in Alabama. Compared with other states, Alabama earmarks far more tax dollars with no other state being even remotely close. The PARCA Report also notes that, "most other states earmark less than thirty percent tax revenues."

With over eighty-seven percent (87%) of state funds earmarked and maximum tax rates imposed by constitutional provisions, the Governor and legislature have only limited authority regarding state financial decisions. They are limited to appropriating funds and authorizing annual expenditures for each budget. This process is further complicated by the fact that Alabama's budget is divided into seven separate funds. Tax revenue flows into five of the seven funds. The Education Trust Fund and the General Fund are the largest recipients of tax revenues and therefore comprise two of the largest budgets for the state. Tables 4.2 and 4.3 contain detailed information pertaining to sources of funds for the Education Trust Fund and General Fund respectively. Services supported by the Education Trust Fund include salaries for teachers, youth services, and the educational television commission. Colleges and universities also receive some funding from this budget. Social services, physical and mental health, corrections, and various other programs are supported by the General Fund. Tables 4.4 and 4.5 provide a summary of key budgeted expenditures for the Education Budget and General Fund Budget in 2009.

## **1.2 Current Fiscal Situation**

As we fit tax collections into the overall picture of state finances, they represent 44.46% of total state revenue for 2009.

Federal funds constitute 42.22% of total revenue with the remaining 13.32% derived from licenses, permits, investment income and other sources. Examining the sources of total state revenue from 2000 through 2009, as shown in Table 4.6, provides an interesting picture. Beginning with 2000 revenue statistics, the tax system generated 50.44% of total revenue for that year with only 36.02% derived from federal sources. Since 2000, both total taxes collected and federal funds have increased. Examining each category as it relates to total state funding indicates that the percentage contributed by state taxes declined each year through 2002 while the federal funds share increased during the same period. Oppositely, state taxes as a percent of total revenue increased from 2003 through 2008 while the share of federal funds declined. While this represents a positive move, in terms of own source financing, Alabama nevertheless has not returned to pre-2001 levels. As noted above, tax collections declined during 2009 which again lead to increased dependency on federal funds. This increased dependency for Alabama has become a trend as by 2009, the difference between the shares of taxes and federal funds declined from 14.42%, in 2000, to only 2.24%.

Given the limited authority of the Governor and Legislature and the extreme degree of earmarking, any need for supplementary funding or an economic contraction could result in a fiscal crisis. Under Alabama's balanced budget mandate, the state is required to prorate subsections of the budget when budgeted expenditures exceed revenue collected for that budget element. Under the proration process, any budget experiencing a shortfall in revenue will be reduced by a percentage necessary to obtain the required balance. This process is further complicated by the fact that some areas within the subsection to be prorated are exempt from proration. Teacher's salaries, for example, are a part of the Education Trust Fund and cannot be reduced even if the fund as a whole is subject to proration. Since 2000, Alabama has been on the threshold of prorating the General Fund and Education Trust fund on numerous occasions. In fact, it was estimated that during 2001 the General Fund would need to be prorated by up to twenty percent (20%). Due to various cost saving and budget refinement processes, proration of the General Fund was not necessary through the end of 2009. However, the Education Trust Fund has not been as fortunate, experiencing proration of 6.2% in 2001 and 4.41% during 2003, 6.5% in 2008, and 18% in 2009.

Furthermore, it is important to note that the absence of proration during some of the years between 2000 and 2009 does not necessarily imply that Alabama's budget is fiscally sound. Throughout the budgeting process in these "non-proration" years, Alabama has faced increasing demand for services but was forced to reduce authorized appropriations to both the General Fund and the Education Trust Fund in order to maintain a balanced budget. Beginning in 2004, Alabama's fiscal condition improved slightly since the budget shortfalls and proration of 2001 and 2003. As reported in Table 4.6, the Alabama tax system produced net revenue of \$6.43 billion in 2004 which is an increase of \$0.164 billion over 2003 collections. This is the second consecutive year that tax collections have increased since collections declined in 2001 and 2002. Unlike previous years, Alabama experienced an increase in collections in more individual areas than it saw decreases in 2004. Specifically, twenty-five areas encountered an increase while only fourteen areas saw a decrease in revenue collections.

Improvements in 2004 revenue collections suggested the beginning of a period of fiscal prosperity for Alabama. Tax collections continued to increase during 2005, and Alabama was projected to be financially sound throughout 2006 and 2007. This period of fiscal stability enabled lawmakers to enact HB 292, a revenue reducing tax reform mitigating tax burdens for low income individuals - a problem identified by Levitis and Johnson (2006). The conditions of proration and relative financial soundness from 2000 through 2006 illustrate the unstable nature of Alabama's tax revenue stream. In fact, this period is indicative of the noticeable rollercoaster effect of irregular but recurrent periods of financial prosperity and financial hardship experienced by Alabama's tax system. In fact, the rollercoaster began again in 2007 as the growth in collections slowed down as the national economy moved into a recession. Collections slowed quickly, growing by only \$19,104 in 2008 and then declining by over \$635,000 in 2009. The future outlook for tax collections in Alabama is bleak, with additional proration likely, as long as the national economy continues to be stagnant.

To better understand Alabama's tax structure, the next section, provides a comprehensive overview of the tax system by dividing it into four basic components and analyzes recent historical trends. Three of the four - the income tax, sales tax, and property tax -- were briefly discussed earlier in connection with the initial implementation of the Alabama tax system. The fourth classification refers to a catchall, "other taxes," which accounts for all other tax revenue. For purposes of this discussion, the overview of these other taxes will be limited to those that generated a minimum of \$100 million in revenue in 2009.

## 2. Alabama Tax System Components

Relevant 2009 and historical tax data by major source are highlighted in Tables 4.7.a and 4.7.b. The overview begins by discussing recent trends in revenue collection and concludes by examining individual areas of taxation. Unless otherwise noted, all of the data contained in this section has been gathered from 2001 – 2009 editions of the State of Alabama Department of Revenue *Annual Report, A Legislator's Guide to Alabama's Taxes (2005 and 2011)*, and the *State of Alabama Comprehensive Annual Financial Report (2001 – 2009)*.

### 2.1 Income Tax

The income tax provides more revenue than any other single tax in Alabama, so it is discussed first. The combined individual and corporate income tax revenue in 2009 contributed 40.5% of the total tax receipts and 18% of all state revenue. The revenue provided by the personal income tax is far larger than the corporate income tax. In 2009 more than 90 percent of income tax receipts came from individual taxpayers and this is fairly typical of most years. The rate for corporations is set at six and one-half percent (6.5%) of net income collected from operations in Alabama, while the highest marginal rate on personal incomes is five percent (5%). Residents are required to pay tax based on their entire taxable income, while non-residents are required to pay taxes on any income earned in Alabama. During fiscal year 2009, combined income tax collections totaled \$3.251 billion. Both the personal and corporate income taxes are somewhat cyclical. Since fiscal year 2000, personal (individual) income tax revenue has experienced periods of growth and decline. Seven out of ten years saw growth in personal income tax revenue with revenue increasing by 27.66% in the 2005 fiscal year. Oppositely, revenue declined by more than twelve percent (12%) during 2009. This decrease in revenue collections totaled \$424 million.

Corporate income tax collections are much less significant as part of total state revenue than personal income tax collections. There exist several contributing factors that help account for the relatively low level of corporate income tax revenue. The chief factor is simply the low tax rate. Relative to other states, Alabama has one of the lowest corporate income tax rates in the nation. Other factors that exist in Alabama and but not necessarily in many other states include – federal deductibility and separate reporting. Separate reporting allows companies operating in Alabama to file a tax return for each subsidiary rather than filing one return containing information for the entire company. In addition, corporations operating in Alabama may use separate reporting to minimize their tax liability by taking advantage of innumerable loopholes including transfer pricing and holding companies.<sup>2</sup> Certain tax incentive plans utilized to attract business firms to the state also work to lower corporate income tax collections.<sup>3</sup>

The largest amount of corporate income tax revenue reported in our historical overview is \$255 million, which was collected in 2004. During the period from 2000 through 2009, collections for corporate income taxes showed much of the same up and down movement as discussed above. For the ten year period collections were at their lowest level in 2006 after two consecutive years of decreasing collections. Specifically, corporate income tax collections experienced significant declines of 65.52% and 39.60% during 2005 and 2006 respectively. Considerable gains were also experienced at a rate of 54.7% during 2002 and 123.45% during 2009. Even with the large growth from 2009, with collections totaling over \$164 million, revenue has not returned to the 2004 level.

### 2.2 Sales Tax

The general sales tax is the second principal source of tax revenue for the State of Alabama. In 2009, sales tax revenue totaled almost \$1.83 billion, which accounts for 22.83% of total tax revenue collected and almost 10.15 percent of total state revenue. It is important to note that both the state and local levels of government have separate sales taxes, and the rates vary across products and geographical areas. The State of Alabama has set a maximum state sales tax rate of four percent (4%), which applies to receipts from sales of tangible personal property and receipts from amusement or entertainment business.

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<sup>2</sup> Brunori (1998) observes that separate reporting allows businesses operating in multiple states to shift profits from high tax to low tax states. In fact, if properly utilized, this method of tax planning can completely eliminate a corporation's tax liability in a given state.

<sup>3</sup> Fisher (2002) and Brunori (1998) conclude that tax incentive plans hurt the states more than they help because they work to reduce corporate income tax collections and they are potentially ineffective as a means of significantly increasing economic growth in the region.

Other sales taxes range from a one and one-half percent (1.5%) tax on farm and mining machinery to a two percent (2%) tax on automobile sales. Any sales tax, in addition to the tax amounts listed above, is levied by local counties and municipalities pursuant to the Code of Alabama (1975). On average, the general sales tax rate (excluding vehicles, and farm machinery) across all Alabama jurisdictions is 8.36%, with four percent (4%) going to the state, and an average of 4.36% going to local governments. The sales tax is imposed on all taxable goods as they are sold to the public or corporations and on the proceeds from operating places for amusement or entertainment. Until 2009, sales tax collections had increased considerably since collecting \$1.53 billion in 2000. In fact, for fiscal year 2008, Alabama collected \$2.024 billion in sales taxes. This represents an increase of 32.3% from 2000 collection levels. Collections in 2009 experienced a nearly ten percent (10%) decrease to approximately \$1.83 billion. The 2009 reduction in collections lowers the average growth rate per year down to just under two percent (2%). During the ten year period, changes in sales tax collections are similar to the changes in income taxes as most years have experienced growth at varying rates. However, in addition to the decline in 2009, collections also decreased by 1.11% during 2001.

### 2.3 Property Tax

State property taxes are taxes imposed on real estate and improvements to real property. In addition, the tax is imposed on personal property. Similar to sales taxes, property taxes are levied by both state and local governments. There is a state levy of 6.5 mills per dollar of “assessed” value. A mill is defined as 1/1000 of a dollar or 1/10 of one cent. This definition makes a levy of 6.5 mills equal to \$0.0065 or 0.65% of \$1. The tax in Alabama applies to four general classes of property, with different effective tax rates applying to each class. The classes of property are a result of a series of constitutional amendments that define a series of assessment ratios for calculating property tax liabilities. The classes and assessment ratios are:

- Class I – 30% for tangible property of electricity, gas and other utilities
- Class II – 20% for tangible property not otherwise classified
- Class III – 10% for tangible agricultural, residential, and forest property
- Class IV – 15% for private passenger automobiles and trucks devoted to personal use.

Thus, each property class has its own assessment ratio, which can be changed only by a constitutional amendment. The 6.5 mill rate applies to all classes of property, but the varying assessment ratios described above result in different effective tax rates. In addition to the constitutionally defined assessment ratios, numerous exemptions decrease the effective assessed value of property taxes and reduce revenue. The *homestead exemption* and the *current use rule* are important explanations of why property tax collections in Alabama are less than what market values, assessment ratios, and the 6.5 mil rate might otherwise suggest. The homestead exemption excludes property owned by people over age 65, the blind, and people who retired due to total and permanent disability from the state property tax. In addition, it provides a \$4,000 exclusion in assessed property values for owners less than age 65 on up to 160 acres.

The treatment of agricultural and forest lands provides an additional example of the effect of special provisions in Alabama property tax law. Property tax collections would be quite different under a highest and best use valuation instead of the current use valuation that now exists under Alabama property tax law. Instituting a highest and best use assessment through a constitutional amendment, without any other changes to property tax law, would undoubtedly change the assessment ratio to 20% for some land located in close to urban areas. For example, Hamill (2002) points out that the U.S. Forest Service has estimated that approximately seventy-one percent (71%) of Alabama is covered by forest property. This suggests that a highest and best use assessment would certainly increase state property tax revenue, but the exact amount is uncertain because considerable portions of agriculture and forest property would not be reclassified and taxed at the higher assessment ratio.

It is widely known that Alabama has one of the lowest effective property tax rates in the country. As shown in the 2006 PARCA report, Alabama has the lowest property tax burden of any state, more than sixty percent (60%) lower than the national average. Property tax data from 2002 collected by the Bureau of the Census and compiled by the Tax Foundation<sup>4</sup> reveals that state and local governments in Alabama collect \$329 in property tax revenue per capita while the U.S. average per capita is \$971. This tells us that the tax could be tripled and per capita property tax revenue would rank only slightly above the national average. Such a move, however, would change Alabama’s placement in per capita property tax revenue collected from 50<sup>th</sup> to 17<sup>th</sup>.

<sup>4</sup> *State Tax Collections and Rates*, Special Report Number 128, 2004

Revenue generated from income, sales, gasoline and motor fuel, and utility gross receipts taxes all exceed revenue collected from property taxes, which makes the property tax relatively inconsequential at the state level. For fiscal 2009, state property tax collections totaled \$0.313 billion, which represents only 3.9% of total state tax revenue and 1.73% of total state revenue. Much like the taxes discussed above, property tax collections have increased at varying rates since 2000, increasing between 5% and 10% during most years – with a single decrease of approximately 10.5% during 2005. Only the insurance premium tax, discussed below, also experienced only one year of decreased collections during the 2000-2009 period.

#### **2.4 Other Taxes**

The final set of taxes we discuss is a catchall category referred to as “other taxes.” While many of these taxes have a small individual impact; together, they provide a sizeable portion of revenue, accounting for \$2.6 billion or 32.68% of Alabama’s total 2009 tax revenue. Some items included in the “other taxes” category are cellular telecommunications tax receipts, corporate shares tax receipts, financial institutions’ excise tax receipts, motor vehicle title fees, rental or leasing tax receipts, and numerous license fees. Five taxes – gasoline and motor fuels, use, utility gross receipts, production privilege, and insurance premiums – account for \$1.45 billion or more than half of the revenue generated by “other taxes”. The gasoline and motor fuel tax produced revenue of \$0.403 billion while the utility gross receipts tax collected \$0.426 billion, the insurance premium tax supplied \$0.269 billion, and the use tax generated \$0.245 billion in revenue during the course of 2009. In contrast, the production privilege tax provided only \$0.111 billion during 2009. With the exception of gasoline and motor fuel taxes, 2009 collections were higher than 2000 collections. However, as with major taxes, collections have both increased and decreased within this time period. Gasoline and motor fuel taxes, on the other hand, have experienced a decrease of approximately \$0.100 billion since 2000. The remaining taxes included in the category “other taxes” each normally generate less than \$100 million in revenue per year.

Gasoline and motor fuels taxes are excise taxes on the sale, consumption, distribution, storage, or withdrawal from storage of gasoline and/or motor fuel. Alabama places a total tax of \$0.16 per gallon on gasoline and \$0.17 per gallon on motor fuel.<sup>5</sup> The utility gross receipts tax is a privilege tax imposed on every utility furnishing services in Alabama. Electricity, domestic water, and natural gas are taxed at four percent (4%) of the monthly gross if the gross does not exceed \$40,000, and further, these services are taxed on a graduated scale for a monthly gross between \$40,000 and \$60,000. Any amount larger than \$60,000 is taxed at the maximum rate on the scale. Telegraph and telephone services are taxed at 6.7% of gross sales if under \$60,000 or \$4,020 plus 3.7% of the excess over \$60,000. Insurance company licenses and premium tax is known simply as the insurance premium tax. Under this tax, levies are imposed on the amount of premiums written by an insurer, and a license tax is also imposed on the privilege of providing insurance within the state. Companies who are subject to the premium tax are exempt from paying corporate income taxes in Alabama but are subject to a business privilege tax. Tax rates and license fees vary according to the type of insurance provided and the organizational structure of the insurer.

Use taxes behave essentially like the sales taxes previously discussed. A use tax is levied, in the form of an excise tax, on the use, storage, or other consumption of tangible personal property and/or machinery in Alabama when such property is used in the performance of a contract. Alabama charges a four percent (4%) tax on tangible personal property, a one and one-half percent (1.5%) tax on machinery, and a two percent (2%) tax on automobiles. Production privilege taxes, as reported by the State of Alabama Annual Comprehensive Financial Report, are a combination of oil and gas production and privilege taxes. These taxes are levied on the production of oil and gas from wells in Alabama and also on all persons engaged in producing oil or gas in Alabama. The tax rate for production is defined as 2% of the gross production value of oil and gas and the privilege tax rate varies depending on firm specific factors.

### **3. Conclusion**

This overview of Alabama’s tax system focused on nine of the more than forty state taxes levied, which produced over eighty-five percent (85%) of Alabama’s total tax receipts in 2009. Education funding and other state programs in Alabama depend on the revenue stream generated by these taxes.

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<sup>5</sup> The gasoline tax is a subset of the overall motor fuels tax which is reported separately from other motor fuels. Other fuels included in the more general motor fuel classification include diesel fuel, tractor fuel, gas oil, kerosene, and jet fuel. The motor fuels tax also includes a tax on motor carriers operating on Alabama highways.

Additionally, given that some of the major tax categories are sensitive to economic conditions, recessions produce reductions in revenue that could lead to severe budgetary shortfalls. Coupling budgetary shortfalls with a balanced budget mandate has historically yielded periodic budget proration. These proration last until economic conditions improve and tax collections return to previous levels. Fiscal year 2001 provides an example of this process; total tax collections fell precipitously. Despite an increase in some tax rates during the year, twenty-four individual areas experienced a decrease in collections for a total decline in collections of \$0.150 billion. Fiscal year 2009 shows similar problems with total tax revenues declining by more than \$0.500 billion and proration for both the general fund and education trust fund. Adding additional problems to the mix is the ever increasing demand for state services which has proration constantly on the horizon even as the economy begins to recover. Such fluctuations in state finances, increasing dependency on federal funds and proration will continue to result in calls for tax reform in Alabama.

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**Table 4.1: Earmarking of Major Tax Revenues - Fiscal Year 2009**

(Amounts in Thousands)

Taxes	Net Revenue*	General Fund	Public Fund	School Education Trust Fund	Other
<b>Income Tax**</b>	\$3,037,529.00	\$0.00	\$0.00	\$3,037,529.00	\$0.00
<b>Sales Tax</b>	1,791,185	74,559	--	1,466,901	249,745
<b>Property Tax</b>	307,360	118,223	142,409	--	46,728
<b>Gasoline Taxes</b>	392,277	--	--	--	392,277
<b>Motor Fuel Tax</b>	138,110	--	--	--	138,110
<b>Use Tax</b>	241,289	2,273	--	237,459	1,557
<b>Utility Gross Receipts Tax</b>	425,462	--	--	410,862	14,600
<b>Insurance Premium Tax</b>	268,586	231,866	--	30,946	5,774
<b>Production Privilege Tax</b>	110,651	94,442	--	--	10,209
<b>Total</b>	<b>\$6,712,449.00</b>	<b>\$521,363.00</b>	<b>\$142,409.00</b>	<b>\$5,183,697.00</b>	<b>\$859,000.00</b>

\* Net Revenue is Total Revenue - Administrative Expense

\*\* Income tax represents both individual and corporate income taxes

Source: State of Alabama Comprehensive Annual Financial Report for FY 2009



**Table 4.2: Education Revenue Sources - Fiscal Year 2009**

(Amounts in Thousands)

Revenue Sources	Public School Funds	Education Trust Fund	Education Department
<b>Taxes</b>			
Income Tax	0	3,037,529	0
Sales Tax	--	1,466,901	--
Property Tax	142,409	--	--
Use Tax	--	237,459	--
Utility Gross Receipts Tax	--	410,862	--
Property Tax Relief	20,199	--	--
Insurance Premium Tax	--	30,946	--
State Beer Tax	--	22,771	--
Hydroelectric Companies	--	481	--
Court Cost Taxes	--	--	3,560
Cellular Telephone Tax	--	37,354	--
Miscellaneous Taxes	91	--	--
<b>Total Taxes</b>	<b>\$162,608</b>	<b>\$5,244,303</b>	<b>\$3,560</b>
<b>Licenses, Permits, and Fees</b>			
Privilege License	0	47	1,611
<b>Total Licenses, Permits, Fees</b>	<b>0</b>	<b>47</b>	<b>1,611</b>
<b>Fines and Forfeits</b>			
Miscellaneous Fines and Forfeits	0	0	1
<b>Total Fines and Forfeits</b>	<b>0</b>	<b>0</b>	<b>1</b>
<b>Investment Income</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Federal Revenues</b>	<b>0</b>	<b>0</b>	<b>846,591</b>
<b>Miscellaneous Revenues</b>	<b>1,989</b>	<b>772</b>	<b>9,742</b>
<b>Total Revenues</b>	<b>\$164,597</b>	<b>\$5,245,122</b>	<b>\$861,505</b>

Source: State of Alabama Comprehensive Annual Financial Report for FY 2009

**Table 4.3: General Fund Revenue Sources - Fiscal Year 2009**

(Amounts in Thousands)

Revenue Sources	General Fund	Revenue Sources	General Fund
<b>Taxes</b>		<b>Licenses, Permits, and Fees</b>	
Sales Tax	74,559	Drivers Licenses and Fees	33,355
Use Tax	2,273	Wholesale Oil Company License	6,552
Property Tax Relief	18,656	Motor Vehicle License	42,174
Property Tax	118,223	Privilege License	11,070
Insurance Premium Tax	231,866	Court Fees	58,189
Liquor & Wine Tax	50,124	Alcoholic Beverage Licenses	2,477
Tobacco & Cigarette Taxes	122,419	Insurance Corp. Licenses and Fees	602
Corporation Taxes	127,395	Miscellaneous License and Fees	3,691
State Beer Tax	17,078	<b>Total Licenses, Permits, Fees</b>	<b>158,110</b>
Public Utilities	21,764	<b>Fines and Forfeits</b>	
Leasing/Renting Personal Property	66,037	Court Fines and Forfeits	23,233
Production Privilege Tax	94,442	Tobacco Settlement	0
Financial Institutions Excise Tax	21,297	Miscellaneous Fines and Forfeits	53,559
Documentary Filing Taxes	61,163	<b>Total Fines and Forfeits</b>	<b>76,792</b>
Coal Severance Tax	0	<b>Investment Income</b>	
Inheritance Tax	-24		<b>33,900</b>
Lodgings Tax	31,347	<b>Federal Revenues</b>	
Lubricating Oil Tax	532		<b>0</b>
Pari-mutuel Betting	2,427	<b>Miscellaneous Revenues</b>	
Court Cost Taxes	10,474		<b>833</b>
Cellular Telephone Taxes	70,209	<b>Total Revenues</b>	<b>1,415,520</b>
Miscellaneous Taxes	3,624		
<b>Total Taxes</b>	<b>1,145,885</b>		

Source: State of Alabama Comprehensive Annual Financial Report for FY 2009

**Table 4.4: Education Budget - Fiscal Year 2009**

(Amounts in Thousands)

<b>Expenditures</b>	<b>Budget</b>
Commission on Higher Education	19,791
Education	3,827,507
Post Secondary Education	414,929
Public Health	17,048
Rehabilitation Services	37,285
Youth Services	59,143
Colleges and Universities	1,134,457
Educational Television Commission	7,515
ETF Direct Disbursements	12,754
High School of Math and Science	6,231
Knight vs. Alabama Financial Obligation	9,332
Education Trust Fund Transfers	59,232
Other Education Expenditures	123,580
<b>Total Education Budget</b>	<b>5,728,804</b>

Source: State of Alabama Comprehensive Annual Financial Report for FY 2009

**Table 4.5: General Fund Budget - Fiscal Year 2009**

(Amounts in Thousands)

<b>Expenditures</b>	<b>Budget</b>
Administrative Office of Courts	\$159,222.00
Corrections	372446
Economic and Community Affairs	18092
Finance	14336
Medicaid Agency	452045
Public Health	43827
Public Safety	78752
Youth Services	15512
Court of Civil Appeals	3753
Court of Criminal Appeals	4353
Development Office	3887
Finance Special Appropriations	26492
Direct Disbursements	1979
Military	7622
Pardons and Paroles	41808
Veterans Affairs	3486
Transfers Out	316390
Other General Fund Expenditures	231959
<b>Total General Fund Budget</b>	<b>\$1,795,961.00</b>

Source: State of Alabama Comprehensive Annual Financial Report for FY 2009

**Table 4.6: Total State Revenue**

Historical Data 2000 - 2009

(Amounts in Thousands)

Year	Total Taxes Collected <sup>a</sup>	Federal Funds	Total Revenue	Taxes as a % of Total	Fed Funds as a % of Total
2000	\$5,940,174	\$4,242,012	\$11,777,322	50.44	36.02
2001	5,790,458	4,672,417	12,084,706	47.92	38.66
2002	5,699,382	5,321,974	12,988,450	43.88	40.97
2003	6,267,772	5,515,520	14,065,658	44.56	39.21
2004	6,431,299	5,675,945	14,211,435	45.25	39.94
2005	7,566,234	6,216,771	16,031,829	47.2	38.8
2006	8,126,310	6,643,162	17,195,618	47.26	38.63
2007	8,627,293	6,380,166	17,871,927	48.27	35.7
2008	8,646,397	6,697,069	17,626,743	49.05	38
2009	8,010,768	7,606,333	18,016,546	44.46	42.22

a = Excludes Expendable Trust Funds

Source: State of Alabama Comprehensive Annual Financial Report (Multiple Years)

**Table 4.7.a: Historical Tax Collections by Major Source**

Historical Data 2000 – 2009

(Amounts in Thousands)

Year	Individual Income Tax*	Corporate Income Tax*	Sales Tax	Property Tax	Gasoline and Motor Fuel Tax	Use Tax	Utility Gross Receipts Tax	Insurance Premium Tax	Production Privilege Tax
1999-2000	\$2,071,433	\$221,575	\$1,530,050	\$197,464	\$505,849	\$187,079	\$294,468	\$191,830	\$68,341
2000-2001	2,099,161	124,515	1,513,061	209,566	501,947	199,577	321,319	197,382	107,024
2001-2002	2,030,693	192,666	1,550,266	222,341	511,193	197,696	316,762	216,110	43,235
2002-2003	2,040,152	218,109	1,576,670	233,802	515,753	187,887	341,850	228,561	92,695
2003-2004	2,243,537	255,351	1,703,151	255,293	531,808	208,759	347,884	240,334	101,140
2004-2005	2,864,100	88,056	1,807,811	228,561	447,844	229,170	352,490	271,515	131,878
2005-2006	3,206,533	53,185	1,969,656	249,533	408,046	256,106	398,318	272,229	177,269
2006-2007	3,428,864	68,364	2,019,169	270,641	412,717	264,667	408,925	275,693	138,912
2007-2008	3,510,202	73,644	2,024,540	297,938	404,593	266,757	434,346	292,820	192,171
2008-2009	3,086,469	164,559	1,828,808	312,659	403,366	245,189	425,834	268,586	110,651

\*Collections net of refunds

Source: Alabama Department of Revenue Annual Report, A Legislator's Guide to Alabama's Taxes and State of Alabama Comprehensive Annual Financial Report (Multiple Years)

**Table 4.7.b: Historical Tax Collections by Major Source - Percent Change**

Historical Data 2000 – 2009

(Amounts in Thousands)

Year	Individual Tax*	Corporate Income Tax*	Sales Tax	Property Tax	Gasoline and Motor Fuel Tax	Use Tax	Utility Gross Receipts Tax	Insurance Premium Tax	Production Privilege Tax
1999-2000	--	--	--	--	--	--	--	--	--
2000-2001	1.34	-43.80	-1.11	6.13	-0.77	6.68	9.12	2.89	56.60
2001-2002	-3.26	54.73	2.46	6.10	1.84	-0.94	-1.42	9.49	-59.60
2002-2003	0.47	13.21	1.70	5.15	0.89	-4.96	7.92	5.76	114.40
2003-2004	9.97	17.07	8.02	9.19	3.11	11.11	1.77	5.15	9.11
2004-2005	27.66	-65.52	6.15	-10.47	-15.79	9.78	1.32	12.97	30.39
2005-2006	11.96	-39.60	8.95	9.18	-8.89	11.75	13.00	0.26	34.42
2006-2007	6.93	28.54	2.51	8.46	1.14	3.34	2.66	1.27	-21.64
2007-2008	2.37	7.72	0.27	10.09	-1.97	0.79	6.22	6.21	38.34
2008-2009	-12.07	123.45	-9.67	4.94	-0.30	-8.09	-1.96	-8.28	-42.42

\*Collections net of refunds