

Bribing the States to Tax Food

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INTRODUCTION

In the design of consumption taxes, policymakers face a dilemma regarding the inclusion of food in the tax base. Because the percentage of household budgets devoted to food declines with income, taxing food exacerbates the regressivity of an already regressive tax, potentially jeopardizing the food security of the lowest income households. Largely because of these concerns, many consumption taxes—including value-added taxes (VATs) in use throughout the world and retail sales taxes (RST) in the U.S. states—feature exemptions for purchases of food for home consumption. However, exempting food from the tax base also entails potentially significant costs. Aside from the foregone revenue, not taxing food increases the volatility of government tax receipts because demand for food is relatively stable over the business cycle compared to other forms of consumption.¹ In addition, exempting food can distort consumption choices, a problem worsened by the fact that non-food consumption must be taxed at higher rates in order to generate revenue lost as a result of exempting food. Beyond these concerns, food exemptions also involve considerable administrative complexity, as lawmakers attempt to draw (sometimes comical) lines between taxable and non-taxable foodstuffs. A case in point is the epic controversy surrounding the proper tax treatment of large and small marshmallows in New York and other states.²

This paper considers the taxation of food within state retail sales taxes and evaluates a new proposal for a federal subsidy designed to compensate households for the estimated state sales tax cost of food purchased for home consumption.

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¹ Revenue volatility can be problematic to the extent that it contributes to budget instability. See, e.g., William F. Fox, *The Ongoing Evolution of State Revenue Systems*, 88 *Marquette L. Rev.* 19 (2005) (noting that “state funding challenges are exacerbated by the high degree of revenue volatility.”); Peter Orszag, *The State Fiscal Crisis: Why It Happened and What to do About It*, *The Milken Institute Review* (2003).

² Joel Stashenko, *Marshmallow Tax Gets Just Desserts*, *CBSNEWS* (1998); Melissa Hoffmann Lajara, *Exempt from Sense: Wacky Sales & Use Tax Rules in New York and Beyond*, *The Trusted Professional* (May 1, 2008); See also Richard Perez-Pena, *A Riddle at the Register: When is a Knish Tax Free? When It’s Frozen, Of Course*, *New York Times* (April 3, 1999).

Properly designed and implemented, such a subsidy could have the dual benefit of (1) mitigating the regressivity and food security concerns associated with taxing food, while (2) eliminating (or at least reducing) the volatility, efficiency and administrative costs of state laws that exempt food from the sales tax base. But most importantly from the perspective of the federal government, a food tax subsidy would help stabilize state and local revenue structures, enhancing counter-cyclical fiscal capacity and (hopefully) reducing instances of severe fiscal distress that give rise to demands for federal fiscal assistance.

An intergovernmental “bribe” of sorts, this new subsidy would be available only to full-time residents of states that include food for home consumption in the base of a general retail sales tax.³ At present, there are only 7 such states: Alabama, Hawaii, Idaho, Kansas, Mississippi, Oklahoma, and South Dakota.⁴ In the presence of a new food tax subsidy, these states would be expected to continue taxing food, but the cost of that burden would be offset by the federal subsidy. Those states that currently exempt food from the sales tax base (i.e., the large majority) would be expected to amend their revenue codes to tax food, with the result that their residents would be entitled to the new federal subsidy.

While this proposal would address the central tradeoff states face in deciding whether to tax or exempt food for home consumption, it has certain drawbacks that could potentially make it an unattractive policy reform. Aside from the cost to the federal government—a significant concern, given the nation’s dire fiscal condition over the long-term⁵—a subsidy that imperfectly compensates households for the cost of state food taxes (e.g., by mismatching the timing of the subsidy and the timing of the increased tax cost) could do more harm than good, at least in the case of low-income households that devote the highest percentage of their budgets to food. In addition, including food in the tax base is likely to slow the long-term growth rate of sales tax revenues, as food consumption has generally increased at a slower rate than other categories of household consumption.

Nevertheless, at a time when both state tax reform and increased federal assistance for the states are on the policymaking agenda,⁶ a food tax subsidy deserves attention as a possible means of delivering federal fiscal support for the

³ Such a subsidy would mark a significant departure from current federal law, which forbids states from imposing sales taxes on food purchased with federal food stamps. *See* discussion *infra* at notes XX-YY.

⁴ Five of these 7 states tax food but provide a tax credit designed to offset the cost of the food tax. The only two states that tax food without an offsetting credit are Alabama and Mississippi.

⁵ Alan J. Auerbach and William Gale, *Déjà Vu All Over Again: On the Dismal Prospects for the Federal Budget* (April 2010).

⁶ Robert J. Shiller, *The Case for Reviving Revenue Sharing*, *New York Times* (August 28, 2010).

states. With the abandonment of general revenue sharing over a quarter-century ago, federal assistance is now chiefly delivered either through conditional grants targeted at specific spending categories (e.g., Medicaid) or indirectly via federal tax preferences (e.g., deductibility of state/local taxes and the exclusion for interest on state/local bonds). Each of these approaches has its problems, suggesting that the time may be ripe for a more fundamental restructuring of the U.S. system of intergovernmental fiscal assistance. In separate work, I have examined how federal tax rules encourage the adoption of particularly volatile state revenue structures.⁷ A federal food tax subsidy would be one means of dampening the procyclical dynamics of state tax revenues and enhancing the counter-cyclical fiscal capacity of the states.

The remainder of the paper is divided into four parts. In Part I, I provide an empirical snapshot of food consumption in the United States based on data published by the Bureau of Labor Statistics in the Consumer Expenditure Survey (CEX) and the U.S. Department of Agriculture's Economic Research Service (ERS). The CEX/ERS data, published annually, contain estimates of amounts spent on food purchased away from home (typically taxable) and food purchased for home consumption (typically exempt). Of particular interest to the question of how or whether states should tax food are data relating to (i) how food consumption as a percentage of disposable income varies by income level, and (ii) how food consumption varies for all households over the business cycle for all households.

In Part II, I provide an overview of the state sales tax treatment of food. The approach followed by the majority of states (31 out of 45)—i.e., exempting from the sales tax base food purchased for home consumption—is then critiqued in Part III on several grounds, including its effect on revenue volatility, efficiency, and administrative complexity. These considerations support a strong *prima facie* case for taxing food, which must then be weighed against the costs of that approach, which are outlined in Part IV of the paper.

Finally, Part V considers the possibility of a federal tax subsidy, most likely delivered via a refundable tax credit, that would be made available only to residents of states that tax food purchased for home consumption. Such a subsidy might be modeled after the refundable food tax credits currently available in a handful of states, such as Hawaii and Kansas, that currently tax food. The proposal considered in this paper can be viewed as an expansion and federalization of the food tax credits currently in place in these states. In addition to enabling the states to remedy the flaws associated with exempting food, this policy is consistent with standard principles of normative fiscal federalism, which hold that redistributive programs

⁷ Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 *Virginia Tax Review* 407-444 (2010).

like food tax credits should generally be assigned to the central government rather than residing with subnational jurisdictions.⁸

I. FOOD CONSUMPTION IN THE UNITED STATES

According to the most recent data published by the Bureau of Labor Statistics, the average American household spent approximately \$6,372 per year on food in 2009. This amount represents approximately 10 percent of average income (before taxes) and 13 percent of annual consumption.⁹ These percentages have been steadily declining over time. In 1997, for example, the average American household spent 12 percent of its annual income on food (14 percent of consumption); in 1984, food expenditures accounted for 14% of income and 15% of consumption; in 1973, these same figures were 14% and 19%, respectively. Thus, the general trend is that Americans are devoting a smaller and smaller share of their total income and spending to food. To some extent these changes reflect the fact that food prices have increased at a slower rate than other categories of consumption, such as housing and healthcare. Yet the declining share of family budgets devoted to food also reflects the fact that, as real income rises, the percentage of income spent on food declines. As statistician Ernst Engel noted in an early study of Belgian working class households, “the poorer the family, the greater the proportion of its total expenditures that must be devoted to the provision of food.” This observed empirical regularity has since come to be known as “Engel’s Law.”¹⁰ In the data just summarized, we see Engel’s Law in operation over time—as a country’s average household income increases, the aggregate percentage of national income devoted to food expenditures declines.

Significantly, the *composition* of household food expenditures—i.e., food purchased for home consumption vs. food purchased away from home—has also changed over this period. Over the past four decades, Americans have increased their purchases of food away from home relative to food purchased for home consumption. Whereas in 1970 the average household spent 26 percent of its total food budget away from home, that figure rose to 35 percent in 1984 and 39 percent in 1997. As of 2009, the average U.S. household devoted 41 percent of its food

⁸ Richard Musgrave, *Who Should Tax, Where, and What?*, Tax Assignment in Federal Countries, edited by Charles E. McLure, Jr. (1983); Richard Musgrave, *Essays in Fiscal Federalism* (1965); Wallace Oates, *Fiscal Federalism* (1972); Richard M. Bird, *Fiscal Federalism*, *Encyclopedia of Taxation and Tax Policy* (1999).

⁹ U.S. Department of Labor, U.S. Bureau of Labor Statistics, Report 1023, *Consumer Expenditures in 2008*, Table 1 (March 2010).

¹⁰ Ernst Engel, *Die Productions und Consumptionsverhaeltmisse des Koenigreichs Sachsen*, *ZEITSCHRIFT DES STATISTISCHEN BUREAUS DES KONIGLICH SACHSISCHEN MINISTERIUMS DES INNERN*, Nos. 8 and 9 (Nov. 22, 1857).

expenditures to food consumed away from home. Again, the chief dynamic at work here seems to be the general increase in household income over the past half century.¹¹ At higher income levels, households are more likely to favor eating out over eating at home; thus, as real income has increased, the share of food budgets devoted to home consumption has declined.

Two major features of the empirical findings on U.S. food consumption are particularly relevant to the question of extending the retail sales tax to food: (1) how food consumption varies by income level, and (2) how food consumption fluctuates over the business cycle. The first question goes directly to the argument about the regressivity of taxing food, while the second relates to the effects on state and local revenue volatility of exempting food from the tax base. In neither case do the data reveal any striking surprises, though having a more precise understanding of the facts on the ground will help frame the analysis that follows.

Food Consumption and Income Level

As shown in Table 1 below (see appendix), the total food consumption of the average U.S. household rises with income. Whereas households in the bottom quintile spend \$3,501 on food (at home and away from home combined), the average figure for the middle quintile is \$5,483 and the amount for the top quintile is \$10,780. These data merely demonstrate that food is a “normal good”—that is, as income increases, the demand for food increases. By the same token, these data also clearly illustrate Engel’s Law regarding the relationship between income level and food share. Whereas households in the bottom quintile devoted 36 percent of their income to food expenditures, the middle quintile spent 12 percent on food and the top quintile just under 7 percent. These figures confirm the widely held intuition that flat rate sales taxes on food are likely to be highly regressive. The composition of households’ food budget also varies systematically by income level, with the percentage of food consumed at home the highest for low-income households. From the bottom quintile to the top, households spend 70 percent, 66 percent, 61 percent, 57 percent, and 52 percent of their total food expenditures on food purchased for home consumption.

Variation in Food Consumption over the Business Cycle

A second concern regarding the taxation of food is the variability in food expenditures relative to underlying changes in the economy. A central question in the literature on state and local public finance in recent years has been the volatility

¹¹ Rodney b. Holcomb, John L. Park, Oral Capps, Jr., Revisiting Engel’s Law: Examining Expenditure Patterns for Food at Home and Away from Home, *Journal of Food Distribution Research* 1-8 (September 1995); Patrick J. Byrne and Oral Capps, Jr., Does Engel’s Law Extend to Food Away from Home?, *Journal of Food Distribution Research* 22-32 (July 1996).

of tax receipts. Numerous commentators have expressed concern that excessive revenue volatility over the business cycle has contributed to subnational budget instability, as state governments have increased public expenditures during boom years to levels that prove to be unsustainable when the economy slows.¹² While the smoothing of public expenditures over the business cycle is theoretically possible through the judicious reliance on budget stabilization funds (aka “rainy day” funds), in practice states have found it difficult to maintain rainy day fund balances at a level sufficient to insure against large macroeconomic shocks. To the extent that changes in the revenue structure come to be seen as an alternative to unattainable rainy day fund balances, it will be useful to have data regarding the relative volatility of different tax instruments.

Not surprisingly, food consumption is relatively stable over the business cycle as compared to other components of household consumption. In a 2008 study of relative volatility of alternative taxes, Felix reports the variance in the annual percentage change for nine different categories of consumer expenditures for the period 1967-2007.¹³ As shown in Table 2 below (see appendix), durable goods purchases such as automobiles, furniture or household appliances exhibit the greatest volatility over time. For most families, these are items that are likely to be purchased during periods of strong income growth. When money is tight, purchases of cars or refrigerators are infrequent and households make do with the older model. As Bernanke explains in a 1984 paper, “the durables component of expenditure is large, the most volatile, and the most cyclically sensitive.”¹⁴

The opposite is true for nondurables, especially food. As shown in Table 2, only gasoline (with a variance of 1.35) exhibits less volatility than food (with variance of 1.94). These simple variance figures are consistent with the intuition that food is a core household expenditure that is unlikely to fluctuate significantly from year to year. While everyone has stories of cutting back during hard times—perhaps opting for Spam over Jamón Ibérico, Velveeta over Époisses—these cyclical variations pale in significance to the variability in durable goods purchases over the business cycle. It follows that the exclusion of food from the tax base will predictably increase the volatility of sales tax revenues, contributing to the budget instability that many states have experienced over the business cycle.

¹² See William Fox (2005); Peter Orszag (2003)—supra note 1; see also David Gamage (2010); Gamage and Bearer-Friend (2010); Stark (2010).

¹³ R. Alison Felix, *The Growth and Volatility of State Tax Revenue Sources in the Tenth District*, Federal Reserve Bank of Kansas City 63-88 (2008).

¹⁴ Ben Bernanke, *Permanent Income, Liquidity, and Expenditure on Automobiles: Evidence from Panel Data*, 99 *Quarterly Journal of Economics* 587, 588 (1984).

II. STATE SALES TAX TREATMENT OF FOOD

There are 45 states with general retail sales taxes.¹⁵ Only Alaska, Delaware, Oregon, Montana, and New Hampshire do not have sales taxes. Based on aggregate data from the U.S. Census of Governments, state and local governments raised approximately \$304.4 billion in general retail sales taxes in 2008, accounting for 23 percent of total state and local taxes nationwide.¹⁶ The sales tax is a far more important source of revenue for state governments than for local governments. State governments raised just over \$241 billion in general retail sales taxes in 2008, an amount representing 31 percent of total state taxes. The remaining \$63.4 billion collected by local governments accounted for 11.6 percent of total local government tax receipts for 2008.¹⁷

The retail sales tax employed in most U.S. states is far from ideal. The tax originated in the 1930's and has many lingering Depression-era characteristics.¹⁸ Most significantly, the tax was designed chiefly as a tax on the sale of tangible personal property at retail. This means that, for the most part, the tax does not reach the sale of intangible property or the consumption of services. In addition, as a result of a pair of U.S. Supreme Court decisions issued in 1967 and 1992, states are prohibited from imposing a sales tax collection obligation on out-of-state vendors who lack a physical presence in the taxing state.¹⁹ In many respects, therefore, the retail sales tax base is under-inclusive, failing to reach large swaths of household consumption. At the same time, most state sales taxes are also over-inclusive in that they include transactions that should be exempt in a tax designed to reach household consumption. Although states typically exempt from the tax goods purchased for resale, as well as items that are incorporated into goods to be resold, as a general rule states do not systematically exempt business inputs from their sales taxes.²⁰

¹⁵ 2009 State Tax Handbook, CCH (Wolters Kluwer) 529-530 (2008).

¹⁶ For 2008, total taxes (R05) were \$1,330,441,772,000 and total general sales taxes (R09/T09) were \$304,434,833,000. The entire set of State and Local Government Finance data can be accessed at <http://www.census.gov/govs/estimate/index.html>.

¹⁷ Id.

¹⁸ Kirk J. Stark, *The Uneasy Case for Extending the Sales Tax to Services*, 30 Florida State University Law Review 435, 439-446 (2003) (general overview of history of state sales/use tax).

¹⁹ *National Bellas Hess v. Dept of Revenue*, 386 U.S. 753 (1967) (striking down Illinois use tax collection obligation on out-of-state vendor without a physical presence in the taxing state as violating both the due process clause and the commerce clause); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (rejecting due process clause challenge, but still striking down North Dakota imposition of use tax collection obligation on out-of-state vendor without a physical presence in the taxing state as violating the commerce clause).

²⁰ John L. Mikesell, Thomas S. Neubig, Robert J. Cline, Andrew Phillips, *Sales Taxation of Business Inputs: Existing Distortions and the Consequences of Extending the Sales Tax to Business Services*, 35 State Tax Notes, No. 7 (February 14, 2005).

One well-known study estimates the producers' share of state sales taxes at 41 percent.²¹ The taxation of business inputs results in a "pyramiding" of sales tax liability, at least in those cases where items subject to tax at the producer level are taxed again when sold to consumers. Effective tax rates on such goods are substantially higher than nominal statutory rates.

The standard state sales tax treatment of food purchased for home consumption moves the tax further still from the ideal of personal household consumption tax. The consensus approach followed in a significant majority of states is to fully exempt from the sales tax all purchases of food for home consumption.²² For the 45 states with general retail sales taxes, there are four basic approaches followed: (1) full exemption, (2) reduced rate, (3) full taxation offset by a credit, and (4) full taxation with no credit. The treatment of food for all states is set forth below in Table 3 (see appendix).

Full Exemption States (31). Thirty-one of the 45 states with sales taxes fully exempt food purchase for home consumption from the sales tax base, including two of the most populous states—California and New York. For example, section 6359 of the California Revenue and Taxation Code exempts "food products for human consumption." It then goes on to define "food products" in considerable detail and specifies numerous items that will not be regarded as "food products"—including, most significantly, "when the food products are furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others."

Reduced Rate States (7). Seven states tax food at a lower rate than is generally applicable to other taxable goods. These states include Arkansas, Illinois, Missouri, Tennessee, Utah, Virginia, and West Virginia. The difference between the ordinary sales tax rate and the food sales tax rate varies significantly across these states, ranging from a very small difference in Tennessee (7% versus 5.5%) to a large difference in Illinois (6.25% versus 1%). As with the states that fully exempt home food from the sales tax, these states must make certain legal and administrative determinations regarding which types of food will be subject to the tax and which will be exempt.

²¹ Raymond Ring, Consumers' Share and Producers' Share of the General Sales Tax, 52 National Tax Journal 79-90 (March 1999).

²² For an overview of alternative approaches to the sales tax treatment of food, see Nicholas Johnson and Iris J. Lav, Center on Budget and Policy Priorities, Should States Tax Food? Examining the Policy Issues and Options (1998) (at <http://www.cbpp.org/files/stfdtax98.pdf>). For a recent discussion of the policy considerations, see Alan D. Viard, Should Groceries Be Exempt from Sales Tax?, State Tax Notes (July 25, 2011).

Full Taxation States—with Credit (5). Five states, including Hawaii, Idaho, Kansas, Oklahoma, and South Dakota, provide no exemption from the sales tax for food; however, each of these states provides some sort of credit to offset the cost associated with the state sales tax on food. These credits vary in both generosity and design. Certain states provide relief to a subgroup of the population, such as the impoverished elderly, while others provide relief to a broader population but often at smaller amounts. A report published in 1998 by the Center on Budget and Policy Priorities (CBPP) highlights two particular credit programs as “exemplary”—the credit in place in Hawaii until 1995 and the credit available in New Mexico until 1986. The Hawaii credit was pegged at \$55 per family, an amount that, as of 1991, was estimated to offset 80 percent of the tax on groceries for a family of four incurring food expenses at a level equal to the bare minimum required for adequate diet under federal guidelines. New Mexico’s food tax rebate offered \$45 per exemption for residents with income up to \$30,000, with the rebate phased out over the \$30,000-\$45,000 income range. This rebate was repealed in 1986 and replaced with a “Low-Income Comprehensive Tax Rebate” that the CBPP characterizes as “limited in scope.”²³

Full Taxation States—No Credit (2). Only two states fully tax food purchased for home consumption without providing any sort of relief for the associated tax cost: Alabama and Mississippi. In part because of the inclusion of groceries in the tax base, Alabama is consistently ranked as having one of the most regressive tax systems in the country.²⁴ Mississippi’s tax system is somewhat less regressive because the state has a (slightly) more steeply graduated individual income tax.

III. THE PROBLEM WITH FOOD TAX EXEMPTIONS

Food tax exemptions are problematic on several levels. In the analysis below, I examine the problems associated food tax exemptions along the following dimensions: (1) lost revenue, (2) increased revenue volatility, (3) distortions in consumer behavior, (4) administrative complexity.

Lost Revenue and/or Higher Tax Rates

The most obvious effect of exempting food from the sales tax base is the reduction in state tax revenues. States that estimate the cost of tax expenditures

²³ Center on Budget and Policy Priorities, *Should States Tax Food? Examining the Policy Issues and Options*, 34-35 (1998).

²⁴ Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax systems in All 50 States* (November 18, 2009); Arise Citizens Policy Project Fact Sheet, *Off Balance: Alabama’s Regressive Tax System* (June 11, 2008).

often do so not only for their income taxes, as is done at the federal level in periodic reports published by the Joint Committee on Taxation, but also with regard to sales tax expenditures. For example, in its most recent annual report on tax expenditures, the California Department of Finance estimated the revenue loss from exempting food from the sales tax at just over \$7 billion for fiscal year 2010-2011.²⁵ The exemption for candy, snack foods and bottled water (constitutionally required by virtue of Proposition 163, adopted in 1992) costs the state an additional \$671 million per year. Based on total state sales tax revenue of approximately \$27 billion per year, it would appear that including food in the tax base would increase sales tax receipts by about 28 percent. Of course increased revenue is not the only option. If California expanded the tax base to include food, it could instead reduce the state sales tax rate from its current level of 6 percent to 4.6 percent. [At least one study shows that food exemptions lead to higher sales tax rates. In a 1998 paper, Bahl reports that “state tax rate data indicate that states with a food exemption have a higher rate today and this relationship can be observed over the past 25 years.”²⁶] In terms of the aggregate effect on Golden state revenues, adding \$7.7 billion to the general fund via taxing food would increase total general fund receipts by approximately 8 percent. These calculations reveal that the cost of exempting food from the sales tax is very large.

Increased Revenue Volatility

As noted above, food is one of the least volatile components of consumer expenditures. As a result, exempting food from the sales tax base predictably increases revenue volatility, which in turn contributes to state budget instability over the business cycle. This point has been made repeatedly in the public finance literature on the sources of revenue volatility. For example, Dye and McGuire note in their 1991 study that states that tax food “have relatively slow-growing but stable tax bases.”²⁷ In a separate but related paper, Dye and McGuire estimate the effect on tax base growth and variability of several specific tax reforms, including the possibility of extending the tax to cover food for home consumption.²⁸ The authors begin by examining the growth and variability features of a “core” sales tax base (defined to include most goods taxed by most states), and then estimate the effect of

²⁵ California Department of Finance, page 9, Table 3

²⁶ Roy Bahl, Does a Food Exemption Lead to a Higher State Sales Tax Rate?, State Tax Notes (January 5, 1998).

²⁷ Richard F. Dye and Therese J. McGuire, Growth and Variability of State Individual Income and General Sales Taxes, 44 National Tax Journal 55-66 (1991).

²⁸ Richard F. Dye and Therese J. McGuire, Expanding the Sales Tax Base: Implications for Growth and Stability, in Sales Taxation: Critical Issues in Policy and Administration 169-176 (Edited by William F. Fox) (1992).

adding to the core base certain goods and services, including food.²⁹ They conclude that “[a]lthough adding food to the core decreases the growth rate slightly, it expands the base considerably (by 38 percent), allowing for either higher revenues or a lower revenue-neutral sales tax rate.”³⁰ As for the impact of taxing food on the variability of sales tax revenues, Dye and McGuire conclude that doing so “would diversity the risk and lower the combined rate of variability” and thus have a “substantial impact on stabilizing revenues.”³¹ In a 2008 study of states within the Tenth District of the Federal Reserve System, Felix also examined the influence of exempting food on revenue variability. Among the seven states within the Tenth District (which include CO, KS, MO, NE, NM, OK, and WY), Kansas—a state that taxes food at the ordinary sales tax rate (but provides a credit to low-income households to offset that cost)—had the least volatile tax revenues over the preceding 40 years.

Consistent with these findings, Holcombe and Sobel examined the short-run cyclical variability of the retail sales tax in all 50 states (including those without sales taxes) and report that “the estimate for the retail sales tax base was 0.968 with food included and 1.104 with food exempt.”³² These state-by-state estimates are set forth in Table 4 below (see appendix). The authors conclude that “of the fifty states, forty receive higher short-run elasticity estimates when food is not included. This is strong evidence that exempting food increases the cyclical variability of a state’s retail sales tax.”³³ Thus, as Sobel explained in a later paper with a different co-author, based on “the average estimate across all states, it still appears that exempting food from the retail sales tax base significantly increases the variability of state retail sales tax revenue.”³⁴

Distorted Consumption Choice

Another cost of food tax exemptions concerns the welfare losses resulting from the distortion in consumption choices induced by the differential sales tax treatment. As a first cut, one might assume that efficiency principles might favor uniform tax rates on the theory that the tax system shouldn’t necessarily favor the consumption of one commodity over another. As Hendrix and Zodrow note in a paper on the

²⁹ Id. at Table 12.1 (notes) (defining “core” sales tax base).

³⁰ Id. at 172-173.

³¹ Id.

³² Randall G. Holcombe and Russell S. Sobel, *Growth and Variability in State Tax Revenue: An Anatomy of a State Fiscal Crises* 138 (1997).

³³ Id. at 32.

³⁴ Russell S. Sobel and Gary A. Wagner, *Cyclical Variability in State Government Revenue: Can Tax Reform Reduce It?*, *State Tax Notes*, 441-447, November 3, 2003.

sales tax treatment of services, “commodity tax differentials, which distort consumer decisions among various consumer products (such as the choice between goods and services), should be avoided by imposing a tax system that is neutral across consumer choices.”³⁵ Following this principle, it would seem that exempting food for home consumption but not food purchased away from home (or other forms of consumption) would generate inefficiencies to the extent that consumers substitute tax-free food consumption for otherwise preferred taxable consumption. Significantly, however, optimal commodity taxation sometimes favors differential tax rates. When the elasticity of demand varies across commodities, it may be optimal to impose higher tax rates on those commodities that are inelastically demanded and lower tax rates on those that are subject to more elastic demand. The intuition is that higher rates are less likely to influence consumer demand when such demand is inelastic. Thus, the theory of optimal commodity taxation envisions the possibility of differential commodity taxation in certain instances.

In the case of food, however, if anything it would seem that the theory of optimal commodity taxation might actually favor a *higher* tax rate for food than for other commodities. This might be the case, for example, because the demand for food is relatively inelastic as compared to other types of commodities. Another factor is that food for home consumption is a complement to “leisure” (meaning, in this context, untaxed labor). As Slemrod notes in his survey discussion of optimal commodity taxation, “the optimal tax pattern should take advantage of commodities’ relative substitutability or complementarity with leisure. A complement to leisure, such as skis, should be taxed relatively heavily and a substitute for leisure (complement to labor), such as work uniforms, should be taxed relatively lightly.”³⁶ In this framework, the problem with food purchased for home consumption, as distinct from food purchased away from home, is that the household production of food is not subject to the labor income tax. Thus, in combination with the relatively inelastic demand for food consumed at home, the principles of optimal commodity taxation would seem to favor a higher tax rate on such food. At a minimum, it appears that the efficiency case for exempting food for home consumption is very weak (perhaps non-existent), while the case for (at least) uniform taxation is quite strong.

³⁵ Michele E. Hendrix and George R. Zodrow, Sales Taxation of Services: An Economic Perspective, 30 Florida State University Law Review 411, 417 (2003).

³⁶ Joel Slemrod, *Optimal Taxation and Optimal Tax Systems*, 4 Journal of Economic Perspectives 157, 159 (Winter 1990).

Administrative Complexity

Finally, a moment's reflection reveals that the differential sales tax treatment of food purchased for home consumption and food purchased away from home gives rise to numerous administrative complications that most Americans (or at least those who reside in the 31 states that exempt food purchased for home consumption) contend with on a daily basis. One need only pay a short visit to the website of the revenue department for one of these 31 states to gauge the magnitude of the burden involved in distinguishing between taxable and exempt foodstuffs. For example, Publication 880 of the New York State Department of Taxation and Finance explains, among other things, that (1) fruit juices are exempt while fruit drinks are taxed, (2) Clamato juice cocktail is exempt but Cranberry juice cocktail is taxed,³⁷ (3) Tang is exempt but Kool Aid is taxable, and (4) Ovaltine is exempt but Gatorade is taxable. In some instances, the exemption for a specific item or product is limited to those containing ingredients below a certain threshold, such as with "nuts and nut products," which are only exempt "provided they are not candy- or sugar-coated or sold heated." Likewise, sugar-coated raisins, malted milk balls and similar products are taxable. Notably, however, sugar itself (along with sugar substitutes) is exempt from tax, as are cookies, marshmallows, potato chips, and ice cream. Thankfully, Slim Fast is also exempt from tax.

Every state that exempts food purchased for home consumption while taxing all other food is faced with a heroic line-drawing undertaking of the sort just described. The variety of foodstuffs available for human consumption is simply too extraordinary for tax administrators to keep pace. Just when it seems that the latest revenue department ruling has settled on a stable line between what's taxable and what's exempt, some new marvel of culinary innovation (including favorites such as chicken-fried bacon or the deep-fried cheese steak on a stick) emerges to occupy the zone of ambiguity.

IV. THE PROBLEM WITH TAXING FOOD

Of course, if taxing food brought only benefits without any costs, it would be the first complex social policy in human experience with such a one-sided ledger of pros and cons. Along with the various benefits of taxing food enumerated above, policymakers must also consider the possible drawbacks.

³⁷ Clamato in its present form was first invented at the Duffy-Mott factory in Hamlin, New York. Paradoxically, the "Clamato Mary"—a popular cocktail with the "Italian Avant-Garde" in TriBeCa—contains no Clamato juice. See Robert Simonson, Cocktails of the Italian Avant-Garde in TriBeCa, *New York Times* (June 1, 2010).

Principal among these drawbacks is the financial burden imposed on households—particularly low-income households—as a result of taxing food.

The Regressivity of Taxing Food

Based on the food expenditure data summarized earlier, it is possible to estimate the additional sales tax burden resulting from such a reform. Recall that the average U.S. “consumer unit” (i.e., household) spends \$6,372 on food for 2009 according to the Consumer Expenditure Survey. Of this amount, \$3,752, or 59 percent, consists of food purchased for home consumption, which is currently exempt from sales tax in most states. Hassett and Moore calculate the average state sales tax rate for 2004 (weighted by state population) at about 5 percent.³⁸ Thus, taking into account only state sales taxes, the average U.S. household would experience a tax increase of \$187, based on an assumed state sales tax rate of 5 percent. Of course, as a percentage of income, a new food tax of 5 percent would bear most heavily on low-income households as shown in Table 5 below (see appendix). These figures, which are not surprising but nonetheless troubling, are the principal reason why most states exempt food from the tax base.

Perhaps even more troubling is the possibility that including food in the sales tax base would imperil the food security of the lowest-income households. In a 2006 study examining interstate variation in household food security, Bartfeld and Dunifon found that the greater the state tax regressivity, as measured by the mean percentage of income owed in state and local taxes by households in the bottom quintile, the greater the risk in food security. More specifically, the authors reported that a one percentage point increase in the tax burden of the bottom quintile was associated with a 1.7 percent increase in the odds of food insecurity.³⁹ Bartfeld and Dunifon were not focused on specific tax policies, though as noted above taxing food would result in an unmistakable increase in the tax burden on the bottom quintile. Consistent with these findings, the two states that currently tax food at the ordinary sales tax rate without offer any rebate or credit—i.e., Alabama and Mississippi—rank consistently at or near the top of states with the highest rates of food hardship.⁴⁰ Arkansas, which applies reduced tax rate for food but also permits

³⁸ Kevin A. Hassett and Anne Moore, How Do Tax Policies Affect Low-Income Workers?, in *Working and Poor: How Economic and Policy Changes Are Affecting Low-Wage Workers* (edited by Rebecca M. Blank, Sheldon H. Danziger, and Robert F. Schoeni) (2006).

³⁹ Judi Bartfeld and Rachel Dunifon, State-Level Predictors of Food Insecurity among Households with Children, 25 *Journal of Policy Analysis and Management* 921-942 (2006). I am grateful to Howard Chernick for referring me to this study.

⁴⁰ Food Research and Action Center, *Food Hardship: A Closer Look at Hunger Data for the Nation, States, 100 MSAs, and Every Congressional District* (January 2010) (Mississippi is first; Alabama is third).

local governments to impose sales taxes on top of that reduced rate, has likewise ranked high in the degree of food hardship.⁴¹

Long-Term Growth Rate

A second problem with taxing food is the effect that doing so would have on the long-term growth rate of the retail sales tax. Alongside concerns over the short-run variability of tax revenues over the business cycle is a concern about the ability of the tax base to keep pace with long-term changes in the economy. The question is ultimately one of fiscal sustainability—or “the fulfillment of the government’s present value budget constraint, requiring that the present value of liabilities is not greater than the present value of assets.”⁴² If expenditures are projected to increase at a particular pace over time, revenues must be capable of growing at a comparable pace to ensure budget stability over the long-term. Including food in the sales tax base is likely to slow the long-term growth rate of the retail sales tax, given that food occupies a diminishing share of aggregate household consumption. The CBPP argues against taxing food on this ground, asserting that “the taxation of food is a drag on the growth rate of state tax revenue relative to economic growth.”⁴³

On the other hand, expanding the sales tax to cover food would entail a very significant broadening of the base, enabling either increased revenues or decreased tax rates. Unless the revenues from taxing food are used to provide new exemptions for purchases of goods or services that are likely to experience strong long-term growth, it seems unlikely that taxing food would imperil the fiscal sustainability of state and local governments.

V. A FEDERAL SUBSIDY FOR STATE FOOD TAXES?

The object of a federal food tax subsidy would be to encourage states to make an efficiency-enhancing, complexity-reducing, revenue-stabilizing change in their state tax structures while at the same time mitigating the regressive effects of taxing food. The subsidy would be made available only to residents of states that tax the purchase of food for home consumption at generally applicable state sales tax rates.

Under the revenue laws currently in place in the states, only residents of the seven states that tax food purchases in full (i.e., Alabama, Hawaii, Idaho, Kansas,

⁴¹ Id (Arkansas is second).

⁴² Nicola Giammarioli, Christiane Nickel, Philipp Rother, and Jean-Pierre Vidal, *Assessing Fiscal Soundness: Theory and Practice*, 637-672 at 638, European Central Bank, Occasional Paper Series, No. 56 (March 2007) (at <http://www.ecb.int/pub/pdf/scpops/ecbocp56.pdf>).

⁴³ Center on Budget and Policy Priorities, *Should the States Tax Food? Examining the Policy Issues and Options* 13 (1998).

Mississippi, Oklahoma, and South Dakota) would be entitled to the credit. These states would presumably continue taxing food at generally applicable rates, since amending state law to exempt food would result in a suspension of the subsidy for their residents. States that offer partial credits or rebates for food taxes (i.e., Hawaii, Idaho, Kansas, Oklahoma, and South Dakota) would be free to continue those programs, though it seems likely that the legislative impulse motivating the adoption of such credits would diminish in the presence of a federal subsidy. In effect, the federal government would be taking over the financing of food tax credits/rebates, reducing the need for states to fund their own programs.

Residents of states that currently tax food but at a reduced rate (i.e., Arkansas, Illinois, Missouri, Tennessee, Utah, Virginia, and West Virginia) would not be entitled to the federal credit unless the states increased the tax rate on food purchases to the level of generally applicable sales tax rates. Taxing food at a lower rate is equivalent to a partial exemption regime. For example, in the presence of a generally applicable sales tax rate of 6 percent, Arkansas's food tax rate of 2 percent is equivalent to exempting two-thirds of food purchases from taxation. The same arguments against full exemptions for home food purchases apply with respect to the difference between these states' food tax rates and their generally applicable tax rates.

Finally, residents of the remaining 31 states with sales taxes—i.e., those that fully exempt from the sales tax purchases of food for home consumption—would not be entitled to the subsidy unless they amended their revenue codes to tax all food purchases at generally applicable state sales tax rates. In some states, such as California, this would require a constitutional amendment. In most states, the change could be effectuated via simple statutory amendment, accompanied by a dismantling of the administrative apparatus currently in place to police the line between taxable and exempt food items. In all of these states, applying generally applicable state sales tax rates to food purchased for home consumption would result in a significant expansion of the sales tax base. Recall that the cost of the current exemption for food in California results in a revenue loss to the state general fund of approximately \$7.67 billion per year.⁴⁴

Why Should the Federal Government Care?

A first order question raised by the suggestion of a federal subsidy for residents of states that tax food is why the *federal* government should be involved in this issue at all. Sales taxes are state taxes and the costs associated with food tax exemptions, including revenue loss, consumption distortions, and administrative complexity, are chiefly borne by residents of the states that make the policy choice to exempt food

⁴⁴ California Department of Finance, page 9, Table 3.

from the tax base. Given these factors, one might justifiably wonder why the federal government should concern itself with the design features of state sales taxes.

While there is something to this point, it is also true that the federal government has an interest in promoting the long-term fiscal sustainability of state and local governments. Recent experience in various federations around the world has focused attention on the importance of subnational fiscal discipline and the value of self-sufficient, fiscally responsible state and local governments.⁴⁵ While the U.S. is “generally regarded as an example of a well-managed federal fiscal system,” the emergence of an increasingly procyclical state/local revenue structure, coupled with substantial federal assistance during periods of fiscal distress, could jeopardize the long-standing U.S. commitment to enforcing hard budget constraints.

These developments have their origin in the sharp decline in reliance on real property taxes dating back to the mid-1970s. Over the past thirty-plus years, state and local governments in the United States have experienced a long-term structural transformation in their tax bases, shifting out of a relatively stable fiscal structure with significant support from property taxes to a new tax mix characterized by increased reliance on income taxes and substantial revenue volatility. Whereas in 1977 personal income taxes accounted for only 16.6% of total state and local tax revenues, by 2007 they accounted for 22.5% of the total. This same period saw an increased concentration of income in the top decile of the income distribution, as well as a doubling of real tax receipts of state and local governments.⁴⁶

The effect of these changes is a subnational fiscal structure characterized by dramatic revenue swings over the business cycle. For complicated political reasons, states have not always been able to manage revenue volatility through the judicious use of budget stabilization funds or other such mechanisms. As a result, they have needed—and received—substantial federal fiscal assistance during periods of severe fiscal distress.⁴⁷

This new pattern of “boom, bust, bailout” has the potential of jeopardizing the fiscal discipline of U.S. subnational governments. A key objective of a federal subsidy for taxing food—perhaps *the* objective for such a policy—would be to

⁴⁵ Robert P. Inman, *Transfers and Bailouts: Enforcing Local Fiscal Discipline with Lessons from U.S. Federalism*, Fiscal Decentralization and the Challenge of Hard Budget Constraints (MIT Press, Rodden ed., 2003).

⁴⁶ For a more complete discussion of these trends, see Brian Galle & Kirk Stark, *Beyond Bailouts: Federal Tools for Preventing State Budget Crises*, 87 *Indiana Law Journal* 599, 604-606 (2012).

⁴⁷ Robert P. Inman, *States in Fiscal Distress*, Federal Reserve Bank of St. Louis, 6 *Regional Economic Development* 65 (2010) (discussing ARRA’s fiscal assistance to the states).

encourage states to adopt a revenue structure that is designed to minimize the likelihood of bailout demands during cyclical downturns in the economy. Put differently, the object of this policy is to enhance the counter-cyclical fiscal capacity of U.S. state and local governments so as to strengthen their fiscal position over the business cycle as compared to the status quo.

Note that the increased revenues to the state (or the opportunity to lower tax rates or make other revenue-reducing reforms) are in the nature of an unrestricted federal grant. While the federal funds would technically be remitted to taxpayers via a (refundable) federal credit, conditioning eligibility of the credit on residence in a state that extends its sales tax to food ensures delivery of the funds to the state treasury. In effect, to the extent that the credit compensates taxpayers for the food tax cost, the federal government is simply using consumers as a vehicle for delivering fiscal assistance to state governments. This may sound like an unduly complicated roundabout approach, but it has the benefit of embedding the grant in a statutory vehicle (i.e., the Internal Revenue Code) that is both free from the annual appropriations process and more unhitched from the usual distributional conflicts associated with determining conventional federal grants to the states.

The proposed policy has some parallels to the so-called “soak-up” credit previously available for state death taxes. For decedents dying prior to January 1, 2005, Section 2011 of the Internal Revenue Code allowed a credit for “the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia, in respect of any property included in the gross estate.”⁴⁸ The amount of the credit was limited by section 2011(b) to taxes paid according to statutorily specified state death tax rates, ranging from 0.8 percent for the smallest estates to a maximum of 16 percent for estates in excess of \$10 million.

The principal effect of this federal provision, before it was repealed in 2005, was that numerous states adopted so-called “pick-up” or “soak-up” death taxes. Indeed, states had little reason *not* to adopt soak-up death taxes—either way the federal estate tax applied; the credit merely shifted a portion of the revenue from the tax to the states, subject to the adoption of a suitable state death tax. Thus, the now-repealed state death tax credit can be viewed as a type of revenue-sharing via federal tax law. Likewise, a federal subsidy for state food taxes operates like an unrestricted federal grant. State sales tax burdens nominally increase, augmenting state general fund revenues, but are offset by the federal subsidy. The result is a transfer of the regressivity-mitigating function, currently effectuated via the flawed state sales tax exemptions for food, to the federal government.

⁴⁸ I.R.C. §2011.

Design Considerations for a Food Tax Subsidy

A federal food tax subsidy could be designed in any number of ways. Unfortunately, none of the approaches is fully satisfactory. Options might include some augmentation of an existing federal tax benefit—such as the personal exemption, child tax credit, or EITC. Another option would be to enact a separate, free-standing refundable tax credit. In each case, for the reasons indicated above, the benefit would be limited to individuals living in states that tax food. One problem with delivering the subsidy via the federal tax code is that the subsidy would fail to reach individuals that do not file federal income tax returns. [[kjs: check on the significance of this issue, minimized b/c of the EITC.]] Another problem with delivering the subsidy through the tax code is that most likely it would take the form of a lump-sum payment at the time of the filing of the tax return. Despite the availability of the EITC wage subsidy via periodic payments throughout the year, nearly all EITC beneficiaries receive the refundable credit in a single lump payment upon filing a tax return. If the food tax subsidy were structured as a refundable tax credit, it seems likely that this same dynamic would apply. As a result, households would bear an increased sales tax cost throughout the year that would be felt as an increase in food prices. The year-end lump sum payment designed to compensate for that cost may do so only imperfectly because of its differential timing. This suggests that some alternative delivery mechanism, such as reduced FICA withholding or augmented food stamp benefits, might be appropriate in certain cases. Rules would be needed to ensure that individuals could not claim the subsidy more than once.

There are numerous additional design considerations to be addressed for any food tax subsidy, two of which deserve particular emphasis here: (1) should the amount of the subsidy be adjusted for family size?, and (2) should the subsidy be phased out by income? In many ways, these considerations mirror those found in numerous federal tax expenditures.

On the first question, it seems clear that the subsidy should be adjusted for family size, since food tax burdens plainly vary according to the number of persons in a household, though an important subsidiary question is whether there should be some limit on the extent to which the subsidy increases for larger families.⁴⁹ The current earned income tax credit provides different amounts for taxpayers with one, two or “three or more” children, an approach that obviously treats families with four or more children less favorably than one where the subsidy continues to increase.

⁴⁹ The difficulties posed by this question are discussed at some length in Lawrence Zelenak, *Children and the Income Tax*, 49 *Tax Law Review* 349 (1994) and Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage*, 57 *Tax Law Review* 301 (2004).

By contrast, there is no limit on the number of personal exemptions that a taxpayer can claim, although taxpayers subject to the alternative minimum tax are allowed a flat exemption amount that does not vary according to family size. To the extent that the purpose of the subsidy is to serve as a federal substitute for state food tax exemptions, it would seem that an unlimited family size adjustment would be the preferred approach. Those states that provide a blanket exemption for food purchased for home consumption, the value of the subsidy clearly increases with the amount of food purchased, which presumably is a function of household size.

As for phasing out the subsidy by income, this raises familiar questions about the overall “cost” of the federal subsidy, as well as the incentive effects of withdrawing the subsidy over the phase-out range. A subsidy that is not phased out is in the nature of a “demogrant”—i.e., a lump-sum transfer made available to everyone regardless of income. Structuring the subsidy without a phaseout makes the overall cost to the federal government seem larger to the extent that one conceptualizes “cost” as the amount of the subsidy multiplied by the number of persons to whom the subsidy is made available. But of course funds to pay for any subsidy must come from the same population (i.e., U.S. taxpayers), so the cost is not really avoided by limiting the subsidy to low-income households; rather, the two approaches simply involve different methods of financing the same amount of cost.⁵⁰ A subsidy that is phased out according to income can be thought of as a demogrant that is financed in part by a lump sum tax that is phased in over the same income range.⁵¹ This conceptualization focuses attention on the marginal tax rates implicit in withdrawing the subsidy. There is nothing unique about a food tax subsidy in this regard. As with any government subsidy, delivered through the tax system or otherwise, policymakers must confront a trade-off between a universal approach, where all funding is external to the subsidy, and a “targeted” or phased-

⁵⁰ To illustrate, assume legislation is enacted providing all residents of Country X an annual cash grant of \$2,000. For a population of 200 million, this legislation would nominally “cost” the federal government \$400 billion per year. The reason for putting “cost” in quotation marks is that the \$400 billion must be paid for by (some or perhaps all of) the same 200 million residents. We might just as well identify the cost of this system as the sum of net positive outlays by the country’s residents. For example, let’s assume that half the population receives the \$2,000 grant and contributes nothing to the funding (i.e., total net receipts of \$200 billion), while the other half receives the \$2,000 but also pays \$4,000 each (i.e., total net payments of \$200 billion). Focusing exclusively on net positive outlays, one might say the program “costs” \$200 billion rather than \$400 billion. From yet another perspective, one might even say that the program doesn’t “cost” anything at all since the net outlays exactly equal the net receipts.

⁵¹ For example, a \$200 subsidy phased out ratably over the \$50,000-\$50,400 income range is equivalent to a \$200 demogrant that is financed in part by a \$200 head tax that is phased in over the \$50,000-\$50,400 income range. The difference may seem silly, but recognizing the equivalence focuses attention on the fact that phasing out the subsidy is merely one method of paying for subsidy (and not necessarily the best method).

out subsidy, where nominal cost is contained through higher marginal tax rates on those in the phase-out range.⁵²

Estimating the Cost of a Federal Food Tax Subsidy

In the discussion that follows, I will assume a food tax subsidy that is not phased out by income. To calculate the total cost to the federal government of adopting such a subsidy, it is necessary to have a ballpark estimate of the total sales tax burden arising from extending state sales taxes to food for home consumption, assuming (as seems likely) that states would amend their sales taxes to tax food for home consumption in order to qualify their residents for the subsidy.

Each year the U.S. Department of Agriculture, Economic Research Service, calculates an estimate of total food purchased for home consumption. For 2009, the latest data available, the USDA puts the total sales of food for home production at just over \$600 billion. This is somewhat higher than the amount one derives from the Consumer Expenditure Survey data. Based on a total number of 120,847,000 consumer units, the CEX average home food expenditure of \$3,753 would result in approximately \$453 billion of total food expenditures. Working from these data, it would seem that total purchases of food for home consumption range from \$450-\$600 billion per year. If a federal subsidy were designed to compensate households for a presumed 5 percent sales tax on those purchases, this would result in a total cost to the federal government in the range of \$22.5 billion to \$30 billion.

It is worth noting that this total cost is roughly the range of the current (2010) tax expenditure cost attributable to the itemized deduction for state/local property taxes (\$21.25 billion) and state/local income, sales, and personal property taxes (\$30.7 billion).⁵³ In direct contrast to these tax expenditures, which are regressive subsidies that encourage the adoption of progressive subnational taxes, a food tax subsidy would (depending on precise design characteristics) be a progressive subsidy meant to encourage the adoption of regressive subnational taxes. Such a change in policy is in line with standard principles of normative fiscal federalism concerning the assignment of redistributive functions to the central level of government.

Coordination with Federal Food Stamps Program

One significant point of interaction between federal law and the state sales tax treatment of food is in the area of food stamp benefits. With regard to the Supplemental Nutrition Assistance Program authorized by Chapter 51 of Title 7

⁵² For a general discussion of these issues, see Daniel N. Shaviro, *Welfare, Cash Grants, and Marginal Rates*, 59 SMU L. Rev. 835 (2006).

⁵³ Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for 2010-2014*, pages 51, 55 (December 15, 2010).

(i.e., food stamps), federal law provides that “a State may not participate in the food stamp program if the Secretary determines that State or local sales taxes are collected within that State on purchases of food made with coupons issued under this chapter.”⁵⁴ Similarly, in the Supplemental Nutrition Program for Women, Infants, and Children (WIC), federal law provides that “a State shall be ineligible to participate in programs authorized under this section if the Secretary determines that State or local sales taxes are collected within the State on purchases of food made to carry out this section.”⁵⁵

These provisions appear to be motivated by a policy concern that federal resources devoted to ensuring food security for low-income households should not be diverted for the purpose of general state fiscal assistance. The analysis above suggests that this policy may be worth reconsidering. [KJS: *need to elaborate on the use of food stamps program not only to ensure food security for low-income earners but also as a means of delivering general fiscal assistance to the states*].

CONCLUSION

[to be continued...]

⁵⁴ 7 U.S.C. §2013(a).

⁵⁵ 42 U.S.C. §1786(c)(4). In 1987, the Department of Agriculture promulgated regulations under §1786(c)(4). These rules are published in the Federal Register at Vol. 52, No. 107, p. 21236 (June 4, 1987).

Table 1: Income, Expenditures, and Food Consumption by Quintile, 2009 Bureau of Labor Statistics, Consumer Expenditure Survey (October 2010)						
	Lowest 20 Percent	Second 20 Percent	Middle 20 Percent	Fourth 20 Percent	Top 20 Percent	All Consumer Units
Average Income before Taxes	\$9,846	\$27,227	\$46,012	\$73,417	\$157,631	\$62,857
Average Annual Expenditures	\$21,611	\$31,382	\$41,150	\$56,879	\$94,244	\$49,067
Average Total Food Consumption	\$3,501	\$4,569	\$5,483	\$7,522	\$10,780	\$6,372
Food at Home	\$2,463	\$2,999	\$3,355	\$4,316	\$5,629	\$3,752
Food Away from Home	\$1,038	\$1,569	\$2,127	\$3,206	\$5,151	\$2,619

TABLE 2: Volatility of Consumer Expenditures, 1967-2007 Compiled by Felix (2008) from U.S. Department of Agriculture and Bureau of Economic Analysis	
Spending Categories	Variance of the Annual Percent Change
<i>Durable Goods</i>	30.28
Motor vehicles and parts	74.07
Furniture and household equipment	22.47
<i>Nondurable Goods</i>	2.04
Food	1.94
Clothing and shoes	6.58
<i>Transportation</i>	11.81
<i>Medical Care</i>	2.61
<i>Recreation</i>	3.69
<i>Gasoline</i>	1.35
<i>Cigarettes</i>	3.10

Table 3: STATE SALES TAX RATES AND TREATMENT OF FOOD FOR HOME CONSUMPTION					
<small>(as of January 1, 2010)</small>					
STATE	STATE SALES TAX RATE	TREATMENT OF FOOD	STATE	STATE SALES TAX RATE	TREATMENT OF FOOD
Alabama	4%	taxed	Montana	none	no tax
Alaska	none	no tax	Nebraska	5.5%	exempt
Arizona	5.6%	exempt	Nevada	6.85%	exempt
Arkansas	6%	2% (local taxes apply)	New Hampshire	none	no tax
California	8.25%	exempt	New Jersey	7%	exempt
Colorado	2.9%	exempt	New Mexico	5%	exempt
Connecticut	6%	exempt	New York	4%	exempt
Delaware	none	no tax	North Carolina	5.75%	exempt (local taxes apply)
Florida	6%	exempt	North Dakota	5%	exempt
Georgia	4%	exempt (local taxes apply)	Ohio	5.5%	exempt
Hawaii	4%	taxed	Oklahoma	4.5%	taxed
Idaho	6%	taxed	Oregon	none	taxed
Illinois	6.25%	1%	Pennsylvania	6%	exempt
Indiana	7%	exempt	Rhode Island	7%	exempt
Iowa	6%	exempt	South Carolina	6%	exempt
Kansas	5.3%	taxed	South Dakota	4%	taxed
Kentucky	6%	exempt	Tennessee	7%	5.5%
Louisiana	4%	exempt (local taxes apply)	Texas	6.25%	exempt
Maine	5%	exempt	Utah	4.7%	1.75% (local taxes apply)
Maryland	6%	exempt	Vermont	6%	exempt
Massachusetts	6.25%	exempt	Virginia	5%	2.5%
Michigan	6%	exempt	Washington	6.5%	exempt
Minnesota	6.875%	exempt	West Virginia	6%	3%
Mississippi	7%	taxed	Wisconsin	5%	exempt
Missouri	4.225%	1.225%	Wyoming	4%	exempt

**Table 4: Short-Run Elasticity Estimates
for State Sales Tax Bases with and without Food**
Source: Holcombe & Sobel (1997)

	Retail Sales Tax (including food)	Retail Sales Tax (excluding food)
Alabama	1.301	1.606
Alaska	0.695	0.744
Arizona	0.669	0.734
Arkansas	0.776	0.750
California	0.583	0.727
Colorado	1.254	1.104
Connecticut	0.784	0.904
Delaware	1.526	1.720
Florida	1.568	1.616
Georgia	1.720	1.923
Hawaii	2.037	2.149
Idaho	0.703	0.738
Illinois	1.231	1.471
Indiana	1.144	1.306
Iowa	-0.100	-0.176
Kansas	0.202	0.092
Kentucky	1.332	1.318
Louisiana	0.231	0.256
Maine	0.724	0.945
Maryland	0.728	0.993
Massachusetts	1.271	1.479
Michigan	1.156	1.378
Minnesota	0.701	0.762
Mississippi	1.537	1.572
Missouri	1.233	1.367
Montana	1.173	1.256
Nebraska	-0.257	-0.263
Nevada	1.134	1.327
New Hampshire	1.143	1.341
New Jersey	0.855	1.061
New Mexico	1.579	1.562
New York	0.844	1.016
North Carolina	1.109	1.197
North Dakota	-0.043	-0.034
Ohio	1.864	2.220
Oklahoma	0.487	0.303
Oregon	1.328	1.644
Pennsylvania	0.630	0.652
Rhode Island	1.455	1.726
South Carolina	1.718	1.812
South Dakota	-0.068	-0.080
Tennessee	1.555	1.966
Texas	0.856	0.885
Utah	0.443	0.502
Vermont	0.397	0.588
Virginia	1.064	1.090
Washington	0.565	0.864
West Virginia	0.951	0.870
Wisconsin	1.621	1.917
Wyoming	0.950	0.888
Nationwide Average	0.967	1.076

Table 5: Estimated Food Tax Burden by Quintile based on data from Bureau of Labor Statistics, Consumer Expenditure Survey (October 2010)						
	Lowest 20 Percent	Second 20 Percent	Middle 20 Percent	Fourth 20 Percent	Top 20 Percent	All Consumer Units
(A) Food at Home	\$2,463	\$2,999	\$3,355	\$4,316	\$5,629	\$3,752
(B) Cost of 5% Sales Tax on Food at Home (i.e., (A) x .05)	\$123	\$150	\$168	\$216	\$281	\$187
(C) Cost as a Percentage of Pre-Tax Income (i.e., (B)/Income)	1.25%	0.55%	0.365%	0.294%	0.178%	0.298%