Exemptions of Consumption Purchases Under State Retail Sales Taxes

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State Retail Sales Taxes

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Abstract

Just as the case for excluding all purchases of business inputs from a sales tax is strong, equally the case for taxing all consumption purchases has merit, in terms of compliance and administrative ease, avoidance of discrimination on the basis of consumer preferences, distortions of production patterns, and revenue at a given tax rate. But almost all of the sales taxes (the states closest to universality are Hawaii and New Mexico) exclude a number of consumer purchases, either by outright exemption or by limited inclusion of services as distinguished from commodities. A major reason for exemption is to improve equity by lessening regressivity and burden on the poor, but other reasons play some role, especially with services. Food exemption is the principal example, found in 25 states.
EXEMPTIONS OF CONSUMPTION PURCHASES UNDER STATE RETAIL SALES TAXES

John F. Due

State sales taxes provide a number of exemptions of purchases of commodities for consumption use, although the practice varies widely among the states. These are designed primarily to bring the tax more in line with accepted standards of equity, but some seek to avoid collection problems, and others reflect the political strength of particular groups.

FOOD EXEMPTION

In terms of revenue, the most costly exemption is that of food, which costs a state from 20 to 25 percent of sales and use tax revenue, judging from calculations made in various states. There has been no significant change in the extent of food exemption in recent years. In the early years of the tax, food was taxable in all states except Ohio and California and temporarily in North Carolina; by 1971 15 of the 45 sales tax states exempted food; by 1983 the figure had risen to 25 (plus the District of Columbia). In January 1994 the figure remained at 25, and two states, Illinois and Louisiana, taxed food at a lower than basic rate. Of the states that tax food, most fall into two geographical groups (the pattern thus supporting the domino theory of taxation), the south, Alabama, Arkansas, Georgia, Louisiana (lower rate), Mississippi, North Carolina, South Carolina, Tennessee, Virginia and West Virginia, plus Illinois (lower rate), Missouri, and Oklahoma, and neighboring Kansas. The second group is in the mountain area: Idaho, New Mexico,
Utah, and Wyoming. The two others are ones with extremely broad overall coverage of the tax (along with New Mexico), South Dakota and Hawaii. In most states which still tax food, strong political pressure to exempt it continues, but in the last decade these efforts have not been successful.

The Case for Food Exemption.

The primary argument for food exemption is that it will make the tax less regressive, since the lower income groups spend relatively higher percentages of their income on food than do those in the upper income groups. This is demonstrated by Table 1 for Nebraska and Table 2 for Minnesota. Similar results are obtained in other states. The exemption also lessens the discrimination against large families compared to small at the same income level and against persons in urban areas compared to those in rural areas. The argument is also advanced that in some sense it is "immoral" to tax food.

The Case Against Food Exemption

There are several serious objections to food exemption. First is the very substantial revenue loss, from 20 to 25 percent. If a given sum of revenue is to be raised, the tax rate must be one percentage point or more higher--with consequent adverse affects on location and other decisions. The exemption also lessens stability of sales tax revenue, important to state budgeting though desirable for national fiscal policy.

Secondly, exemption favors those persons with relatively high preferences for expensive foods.
Table 1

Nebraska

Effective Tax Rate for Food Sales
By Income and Family Size:
4 Percent Tax Rate on Food
(in percentages)

<table>
<thead>
<tr>
<th>Decile</th>
<th>Income</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>14</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Less than $2,618</td>
<td>1.58</td>
<td>7.07</td>
<td>5.24</td>
<td>4.30</td>
<td>14.0</td>
<td>9.34</td>
<td>9.34</td>
<td>30.17</td>
<td>2.51</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>2,618 - 5,187</td>
<td>.70</td>
<td>1.11</td>
<td>1.90</td>
<td>2.51</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>5,188 - 8,411</td>
<td>.50</td>
<td>.83</td>
<td>1.01</td>
<td>1.34</td>
<td>1.00</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>4</td>
<td>8,412 - 11,684</td>
<td>.48</td>
<td>.83</td>
<td>.65</td>
<td>.73</td>
<td>1.13</td>
<td>1.79</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.83</td>
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<tr>
<td>5</td>
<td>11,685 - 15,820</td>
<td>.27</td>
<td>.55</td>
<td>.61</td>
<td>.66</td>
<td>1.18</td>
<td>1.15</td>
<td></td>
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<tr>
<td>6</td>
<td>15,821 - 20,009</td>
<td>.21</td>
<td>.39</td>
<td>.53</td>
<td>.68</td>
<td>.72</td>
<td>.77</td>
<td>1.06</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>7</td>
<td>20,010 - 25,014</td>
<td>.13</td>
<td>.28</td>
<td>.37</td>
<td>.31</td>
<td>.57</td>
<td>.55</td>
<td>.42</td>
<td>.12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>25,015 - 31,206</td>
<td>.13</td>
<td>.25</td>
<td>.37</td>
<td>.39</td>
<td>.39</td>
<td>.54</td>
<td>.80</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>9</td>
<td>31,207 - 41,348</td>
<td>.10</td>
<td>.23</td>
<td>.22</td>
<td>.32</td>
<td>.40</td>
<td>.42</td>
<td>.61</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Greater than $41,348</td>
<td>.05</td>
<td>.15</td>
<td>.18</td>
<td>.29</td>
<td>.26</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

*The tax burden for decile 1 and decile 3 (family size 7) may be biased due to sampling procedures, or income and consumption variation.

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$4,151 &amp; Under</td>
<td>0.3%</td>
<td>6.0%</td>
<td>3.4%</td>
<td>9.6%</td>
<td>9.3%</td>
<td>7.1%</td>
<td>16.7%</td>
</tr>
<tr>
<td>2</td>
<td>$4,152 - 6,957</td>
<td>0.2%</td>
<td>3.6%</td>
<td>2.0%</td>
<td>5.8%</td>
<td>5.0%</td>
<td>3.3%</td>
<td>9.1%</td>
</tr>
<tr>
<td>3</td>
<td>$6,958 - 10,959</td>
<td>1.1%</td>
<td>3.2%</td>
<td>1.7%</td>
<td>6.0%</td>
<td>4.7%</td>
<td>3.2%</td>
<td>9.2%</td>
</tr>
<tr>
<td>4</td>
<td>$10,690 - 15,294</td>
<td>2.1%</td>
<td>2.9%</td>
<td>1.5%</td>
<td>6.5%</td>
<td>3.6%</td>
<td>2.7%</td>
<td>9.2%</td>
</tr>
<tr>
<td>5</td>
<td>$15,295 - 20,326</td>
<td>2.5%</td>
<td>2.5%</td>
<td>1.3%</td>
<td>6.3%</td>
<td>3.1%</td>
<td>2.6%</td>
<td>8.8%</td>
</tr>
<tr>
<td>6</td>
<td>$20,327 - 25,883</td>
<td>3.2%</td>
<td>2.3%</td>
<td>1.1%</td>
<td>6.5%</td>
<td>2.7%</td>
<td>2.5%</td>
<td>9.0%</td>
</tr>
<tr>
<td>7</td>
<td>$25,884 - 32,630</td>
<td>3.5%</td>
<td>2.2%</td>
<td>1.1%</td>
<td>6.8%</td>
<td>2.2%</td>
<td>2.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>8</td>
<td>$32,631 - 41;916</td>
<td>4.0%</td>
<td>2.1%</td>
<td>0.9%</td>
<td>7.0%</td>
<td>1.8%</td>
<td>1.8%</td>
<td>8.9%</td>
</tr>
<tr>
<td>9</td>
<td>$41,917 - 56,705</td>
<td>4.6%</td>
<td>2.0%</td>
<td>0.7%</td>
<td>7.2%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>8.9%</td>
</tr>
<tr>
<td>10</td>
<td>$56,706 &amp; Over</td>
<td>5.6%</td>
<td>1.6%</td>
<td>0.5%</td>
<td>7.7%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>9.1%</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>4.2%</td>
<td>2.1%</td>
<td>0.9%</td>
<td>7.2%</td>
<td>2.1%</td>
<td>1.9%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Top 5%</td>
<td>$72,942 &amp; Over</td>
<td>5.9%</td>
<td>1.5%</td>
<td>0.5%</td>
<td>7.8%</td>
<td>1.3%</td>
<td>1.3%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>$147,214 &amp; Over</td>
<td>6.3%</td>
<td>1.4%</td>
<td>0.4%</td>
<td>8.0%</td>
<td>0.9%</td>
<td>0.9%</td>
<td>8.9%</td>
</tr>
</tbody>
</table>

Note: Food is exempt.

Thirdly, the notion that all foods are necessities and taxation is therefore immoral is little short of absurd.

Fourthly, exemption is a very crude technique for lessening regressivity, because it quite unnecessarily exempts the food purchases of the middle and upper income groups, in order to free the lower income families from tax.

Fifthly, exemption creates major problems of delimiting food from nonfood sales, with consequent errors in application of tax. There are several major areas of concern:

Meals. The universal practice is to tax meals even when food is exempt, under the theory that purchase of meals is not a "necessary" expenditure. This argument ignores the fact that many meals eaten out are in no sense luxury purchases, reflecting the needs of workers, the elderly, families in which both adults are working, and the like.

Apart from the principle is the problem of distinguishing meals from purchase of food. While the exact definitions vary, there are problems with deli counters in supermarkets and fast food restaurants, where the customers may eat on the premises or take the food out. The general rule now is to tax all sales for on premise consumption or heated food to take out. This means that all or virtually all fast food restaurant sales are taxed—avoiding the absurd rule of earlier years in some states that if a hamburger was eaten in the establishment or the parking area the sale was taxable, but if carried to the nearest sidewalk the purchase was tax free.

Other Borderline Food Items. A few states exempt all food—anything edible. Even with this rule there are some interpretative
problems, for example, with dietary supplements. But at least 11 states keep soft drinks, candy and chewing gum taxable, and North Dakota also taxes tea and coffee. The adding of so-called snack foods in California in 1992 led to substantial complaints, and the provision was repealed by initiative in November 1992. The line between these "snacks" and other foods is by no means a clear-cut one; for example, salted nuts may be held to be exempt, chocolate covered nuts taxable. Answers can be given to all such questions, but correct application of tax is another matter, and audit is inevitably complicated.

Other states--particularly Colorado, Maine, Pennsylvania and the District make all "grocery store" items exempt--but this does not solve the borderline problem.

All states are required, by Federal law, to exempt purchases made with food stamps.

In summary: Food exemption is perhaps the major mistake the states have made in their sales tax structures, costing substantial revenue, adding administrative and compliance problems, and deviating from the basic rule of uniformity of treatment of all consumption expenditures. Large volumes of expenditure of persons above the lowest income levels are freed from tax for no justification whatsoever.

Formula Reporting

In earlier decades, formula reporting for firms having many exempt and taxable sales was relatively common. Typically, grocery stores were not required to keep exact records of food and nonfood sales, but were

1California, Connecticut, Illinois, Indiana, Iowa, Kentucky, Maryland, Minnesota, New Jersey, Nevada, North Dakota.
allowed to calculate these sales on the basis of relative purchase of each type, adjusted for markup differences. But currently such reporting occurs only in a few instances in any formal way, but undoubtedly some firms, especially small ones, may do so in practice. The states in which formula reporting is allowed include the following:

California, the pioneer in formula reporting, still permits grocery stores to report taxable and exempt sales on the basis of purchases, subject of course to audit. But the state reports that 70 to 80 percent of all sales in the state in this field are subject to scanner computer linked cash register systems, and vendors report on actual sales.

Maine, once also a major authorizer of formula reporting under a Classified Permit System, reports that only about 250 firms still use the system, in contrast to thousands in the past.

Texas permits a limited amount of formula reporting in the grocery field. North Dakota, which once allowed the system, now disallows it. Ohio does not permit it in any general way, but does in some specialized areas, such as vending machine operation. Other states do not authorize it; in fact if auditors in Connecticut suspect firms are using it, an audit is triggered. The shift away reflects primarily the great increase in the use of scanners, which facilitates keeping exact records, and the generally better operation of the tax in the sectors of retailing involved. This system made sense in the past; there is now relatively little need for it.
THE ALTERNATIVE APPROACH TO REDUCING BURDEN
ON THE POOR AND REGRESSIVITY

Several states have used for a number of years an alternative system for improving equity of the sales tax, and a few states used it and then replaced it by food exemption. These systems provide credit against state income tax with a refund of excess of credit over income tax liability, or a direct payment without relation to the income tax. The system differs somewhat among states.

The systems are as follows:

Hawaii: There are three elements: a flat rate credit, one that goes to all residents, $55, designed to offset tax on food; a graduated one that phases out at $30,000 income level; and an additional one designed to offset tax on medical expenses, a credit of tax on actual medical expenses, limited, except for the elderly, to $200 per return. The credit ranges from $55 per exemption for lower incomes to $10 for the highest eligible incomes.

Idaho: A "grocery" credit of $15 to $30 a year, credit against income tax, available only to those filing income tax returns, plus persons over 62, who can file for a refund. The system works effectively but the amounts of credit are far too low in terms of present price levels. The form is reproduced in Figure 1.

Kansas: The system operates separately from the income tax, but in conjunction with the homestead exemption under the property tax. The refund is available only to families with household income less than $13,000, the amounts varying with the number of persons in the household, ranging from a low of $20 to a high of $190 plus $30 per person in excess of six. The household must contain one child under 18,
1990 CLAIM FOR REFUND OF UNUSED GROCERY CREDIT

This Space For State Use Only

In accordance with Section 63-3024A, Idaho Code, I am applying for a refund of the unused portion of the grocery credit to which I am entitled for 1990. I certify that I was a resident of Idaho for the entire year of 1990. I also certify that, as indicated by the check marks below, I am blind, and/or a disabled veteran, and/or age 62 or older on December 31, 1990.

PLEASE PRINT OR TYPE

Name (If Joint Return, Give First Names and Initials of Both) ________________

Last Name ________________

Your Social Security Number ________________

Present Home Address (Number and Street, Including Apartment Number, or Rural Route) ________________

City, Town, or Post Office, State and Zip Code ________________

Spouse’s Social Security Number ________________

DO NOT REMOVE LABEL - (Enter correct information if label is not correct)

(If label is not attached, print or type information.)

1. Did you file a Claim for Refund of Unused Grocery Credit for 1989? ________________

□ YES □ NO

NOTE: If you have not previously filed for the unused grocery credit on Form 24, send verification according to instructions 5, 6, 7, or 8 on the back of this form.

If you are filing for more than one year at the same time and age verification is required, please attach a copy of the verification to each year’s form.

2. Do you own your own home? ________________

□ YES □ NO

3. Total amount of 1990 Gross Income ________________

DO NOT REPORT SOCIAL SECURITY BENEFITS OR VETERANS ADMINISTRATION DISABILITY PENSIONS.

4. (a) Are you required by Idaho law to file an Idaho income tax return because of the amount of your gross income listed on line 3? (See instruction 10 on the back of this form.) ________________

□ YES □ NO

(b) If you marked "Yes" on line 4(a), you should claim this credit on Form 40.

DO NOT FILE THIS FORM. You will receive the same credit on Form 40.

(c) If you marked "No" on line 4(a), did you or are you going to, file an Idaho Resident Income Tax Return (Form 40) for 1990 to claim a refund of withheld income taxes or for any other reason? ________________

□ YES □ NO

(d) If you marked "Yes" on line 4(c), and if you are blind, a disabled veteran, or age 62 or older, you may claim the grocery credit on Form 40. Do not file this Form for 1990.

IMPORTANT: Proof of age must be provided if this is the first time you or your spouse has filed a claim.

PLEASE COMPLETE THE FOLLOWING INFORMATION.

5. Date of birth

YOURSELF

Month ________________ Day ________________ Year ________________

SPouse

Month ________________ Day ________________ Year ________________

6. Under age 62 ________________

7. Blind ________________

8. Disabled veteran ________________

9. Age 62, 63 or 64 ________________

10. Age 65 or older ________________

11. Enter Grocery Credit (see Instruction 11 on back)

Full-year resident $15, $30, $45, or $60 ________________

If a Joint Claim is Filed, Signatures of BOTH Husband and Wife are Required

Signature of Claimant 1 ____________________________

Home Phone ______ Date __________

Signature of Claimant 2 ____________________________

Home Phone ______ Date __________

It is a felony to file a false claim or to assist another to do so. Idaho Code Section 18-2706 and 63-3075(c).
INSTRUCTIONS
FORM 24, CLAIM FOR REFUND OF UNUSED GROCERY CREDIT, 1990
FILE THIS CLAIM WITH THE IDAHO STATE TAX COMMISSION, P.O. BOX 56, BOISE, IDAHO 83756,
ON OR BEFORE APRIL 15, 1991

1. WHO IS ELIGIBLE TO FILE THIS CLAIM? Persons eligible to receive Unused Grocery Credit Refunds must be:

a. Residents of the State of Idaho for the entire year of 1990, AND
b. Age 62 or older on December 31, 1990, OR
c. Blind OR
d. A disabled American veteran of any war engaged in by the United States, whose disability is recognized as a service-connected disability of 10% or more, or who receives a pension for non-service-connected disabilities, according to laws and regulations administered by the Veterans Administration, and substantiated by a signed statement from the V.A.

2. ARE YOU FILING A FISCAL YEAR RETURN? When persons file income tax returns for a fiscal year rather than a calendar year, the claim for Unused Grocery Credit must cover the same fiscal year which is indicated in the space near the top of the form.

3. NAME AND ADDRESS. If you received a Form 24 with a label attached, do not remove it, but correct it if necessary. If you do not receive a form with a label, print your name, address and social security number in the space provided.

4. ARE YOU FILING A JOINT CLAIM? Under the community property laws, the claim of a married couple must be made in the names of both spouses, even though one spouse is not eligible.

5. IS THIS THE FIRST YEAR YOU HAVE FILED THIS FORM? If this is the first time you or your spouse has filed a claim, you must provide proof of age. If the claim is filed in person at a Tax Commission office, proof of age may be presented at that time. If your claim is mailed, enclose a PHOTOCOPY of a document which shows your date of birth, such as:

a. Driver's license       e. Medical record
b. Birth certificate      f. Fishing or hunting license
c. Hospital record        g. Armed Services record
d. Church record

DO NOT ENCLOSE ORIGINAL DOCUMENTS

6. ARE YOU A DISABLED VETERAN? Enclose a PHOTOCOPY of a document which establishes the percentage of your disability. Do not enclose an original document.

7. ARE YOU OR YOUR SPOUSE BLIND? Verification of blindness is required unless proof was submitted with the claim filed for the prior year. A certificate from a physician or optometrist, or a PHOTOCOPY of same, must accompany the claim when proof is required.

8. ARE YOU FILING THIS CLAIM FOR A DECEASED PERSON? You may file a claim for a deceased person who was living during part of the year and who was qualified under Instruction 1. A claim must be filed by the surviving spouse or personal representative of the estate. Applicants must attach a copy of Federal Form 1310. Proof of death is required and can be shown by a copy of a death certificate, a newspaper obituary or funeral service folder.

9. TOTAL AMOUNT OF 1990 GROSS INCOME. On line 3, enter the total amount of income you received in 1990. Do not include any Social Security benefits or V.A. disability pensions.

10. FILING REQUIREMENTS. You must file an Idaho income tax return if your gross income is at least:

$1,000 Married person, filing separate return
1,000 Dependent, claimed on parent's return, with unearned income of $1,000 or more
3,300 Single person, under 65
3,300 Unmarried Head of Household, under 65
4,300 Single person, 65 or older
4,300 Unmarried Head of Household, 65 or older
4,400 Qualifying widow(er), under 65
5,400 Qualifying widow(er), 65 or older
5,400 Married couple filing jointly, both under 65
6,400 Married couple filing jointly, one spouse 65 or older
7,400 Married couple filing jointly, both spouses 65 or older

11. ENTER AMOUNTS ON LINE 11 AS FOLLOWS:

a. Claimant under age 62, and blind  $15.00
b. Claimant under age 62, disabled veteran $15.00
c. Claimant age 62, 63 or 64  $15.00
d. Husband eligible claimant as above, wife not eligible  $15.00
e. Wife eligible claimant as above, husband not eligible  $15.00
f. Husband and wife both eligible under a, b or c above  $30.00
g. Single claimant age 65 or older  $30.00
h. Husband 65 or older, wife NOT eligible under a, b or c above  $30.00
i. Wife 65 or older, husband NOT eligible under a, b or c above  $45.00
j. Husband 65 or older, wife eligible under a, b or c above  $45.00
k. Wife 65 or older, husband eligible under a, b or c above  $60.00
l. Husband and wife both age 65 or older  $60.00

12. CLAIMANT UNABLE TO SIGN. If a person is unable to sign his claim, the notation "unable to sign" should be entered in the space for signature and the claim may be signed by the spouse or, if there is no spouse, by a person acting for the claimant. Any person acting for the claimant, other than the spouse, must state his name, address and relationship to the claimant. Examples would be a legally appointed guardian, son, daughter, registered nurse, physician, hospital administrator, or manager of a nursing home.

Do You Need Help Completing Your Return?
Call or Visit Your Nearest Tax Commission Office.

BOISE — Phone 334-3660
3131 W. State St.

COEUR D'ALENE — Phone 765-3662
1910 N.W. Blvd. / Suite 100

IDAHO FALLS — Phone 525-7116
150 Shoup Ave. / Suite 16

LEWISTON — Phone 799-3491
1118 F. Street

POCATELLO — Phone 236-6244
640 Pershing

TWIN FALLS — Phone 733-7153
1038 Blue Lakes Blvd. N. / Suite C
a person over 55, or one blind or disabled. Direct payment of the refund is made. Income is defined much more broadly than income for income tax purposes.

New Mexico: A credit against income tax, for sales tax paid on food and medical items, with refund, granted if income is under $10,000 single, 16,000 married, as shown in the following table:

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
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<tbody>
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<td>But Not Over</td>
<td>But Not Over</td>
<td>But Not Over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ 0</td>
<td>$ 0</td>
<td>$ 0</td>
<td>$ 0</td>
<td>$4,500</td>
</tr>
<tr>
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<td>6,000</td>
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<td>14,000</td>
<td>16,000</td>
<td>9,000</td>
<td>10,500</td>
<td>7,000</td>
</tr>
<tr>
<td>16,000</td>
<td></td>
<td>10,500</td>
<td>8,000</td>
<td></td>
</tr>
</tbody>
</table>

Vermont: This is the only state now to provide a credit and also exempt food (Massachusetts did for a time). Credit is available up to the income level of $25,000, the credit depending upon the number of
exemptions and the income, as shown in the table. The largest possible credit is $121.

<table>
<thead>
<tr>
<th>Modified Adjustment to Vermont Gross Income</th>
<th>Exemptions</th>
<th>6 or more</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,000 to $25,000</td>
<td>28</td>
<td>33</td>
</tr>
<tr>
<td>10,000 to 14,999</td>
<td>44</td>
<td>52</td>
</tr>
<tr>
<td>5,000 to 9,999</td>
<td>53</td>
<td>61</td>
</tr>
<tr>
<td>0 to 4,999</td>
<td>70</td>
<td>81</td>
</tr>
</tbody>
</table>

South Dakota: A refund is provided only for persons over 65 or disabled, with income under $9,000 if living alone, combined family income under $20,000 if not living alone.

In 1992, 7452 applications were received for sales and/or property tax refunds; 6532 applicants received sales tax refunds. A total of $925,089 was paid out in sales tax refunds.

Wyoming: Persons 65 and over or disabled, with income under $10,000 if single, $14,000 if married, are entitled to a maximum refund of $630 if single, $723 if married, each reduced by the percentage that the actual income exceeds $6,000 per year for a single person, $8,000 for a married person. Since Wyoming does not have a personal income tax, a direct payment is made.

Others: Oklahoma provides a refund for persons with incomes under $12,000, equal to $40 times the number of personal exemptions. Georgia provides a tax credit (with refund) equal to $26 times the number of dependents if income is under $6,000, with a graduated scale up to $5 per dependent from $15,000 to $19,999 income. Unlike the systems in
most states, neither of these are directly established in terminology suggesting that they are designed to offset tax on minimum expenditures on food and medicine, but rather as income tax adjustments designed to lessen burden on the poor.\(^1\)

The credit system offers several advantages over a food exemption. First, the revenue loss to attain the desired equity objective is much less as the credit does not rise with income and can be phased out as income rises. A study of the Connecticut food exemption showed that only $500 million annual revenue loss went to persons in low income groups.

Secondly, the credit avoids the adverse effect of food exemption of making the revenue from the tax less stable—an important element from the state’s revenue standpoint.

The credit system also avoids the complications for vendors and the state arising from the food exemption.

A final advantage to tourist states is the ability to export a portion of the state sales tax to tourists, who do not get the credit but would benefit from the exemption of food, as stressed by Bradford Case and Robert Ebel.\(^2\)

The credit system is not without its limitations. First, it has much less political appeal, partly because all families receive benefit from food exemption, only persons in the lower income levels with the

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\(^1\)An enquiry by the senior author to the Revenue Commissioner in Georgia brought the response that there is no provision designed to offset tax on food on the lower income groups!

typical credit system, and many lower income persons do not understand the credit system.

The final major consideration is that many persons eligible for the credit may not apply for it. This has been a matter of serious concern in Kansas, in which only 34 percent of the families eligible for the refund apply. The Kansas credit system provides a direct refund, not a credit against income tax. By contrast, Hawaii estimates that 84 percent of those eligible apply for the credit. New Mexico, which has extensively publicized its low income comprehensive tax credit program, estimates that between 85 percent and 95 percent of those eligible apply.

Another weakness in several of the states, such as Kansas, South Dakota and Idaho, is that not all families are eligible—in general only the elderly and disabled. Thus the system does not lessen regressivity for all low income families. Furthermore, in these states, the amount of the credit is so small that it can scarcely be regarded as compensating lower income families for sales tax on basic expenditures. Phasing out the refund as income rises lessens the revenue drain, but complicates operation.

OTHER EXEMPTIONS

There are several other commodity exemptions.

Electricity for Residential Use

The picture of treatment for household electricity is not simple. With certain exceptions, the pattern is as follows, as of 1993:
Taxable: 15 states
Taxable by sales tax but lower rate: 2 (Louisiana, Utah)
Taxable except in winter months: 2 (Wisconsin, Minnesota)
Exempt from sales tax but subject to special utility tax: 6
Exempt from sales tax: 20 states (in one, subject to local tax)

The rationale for exemption is by no means clear. Expenditures on electricity for residential use are certainly consumption expenditures, and no more "necessary" than those on many other commodities. The exemption does of course lessen the absolute burden on the lower income groups. The exemption creates no particular operational problems except when other uses of electricity are taxable, and the line between residential and nonresidential use is not always easily drawn.

Medicines and Other Health Items

The most widespread exemption of consumption goods is that of prescription medicines, plus, typically, some medical appliances. Only New Mexico provides no exemption, but grants a credit against income tax. In eight states, the exemption applies to all medicines, including over the counter ones--Florida, Illinois (taxed at 1%), Maryland, Minnesota, New Jersey, New York, Pennsylvania and Rhode Island. Note that all are in the Mid Atlantic area, plus Florida and Illinois. Exemption of prescription medicines has strong justification in the sense that family expenditures on these items differ widely among families at given income levels, and represent expenditures that persons make because of adversity. Few operational problems are created if the exemption is confined to prescription purchases. Adding over the counter sales creates numerous border line interpretative questions and complicates correct application of tax and audit. The distinctions between medicinal ointments and suntan lotions, baby oil, and face cream
are difficult to define and apply. There is little need for exempting over the counter purchase of aspirin, for example, and persons requiring large amounts can obtain prescriptions.

**Commodities Subject to Excises**

It has often been argued that particular goods should not be subject to more than one tax by the same taxing jurisdiction. Accordingly there has been some tendency to exempt from sales tax goods subject to state excises, primarily motor fuel, alcoholic beverages and cigarettes. The treatment currently is as follows:

**Motor Fuel.** Ten states tax motor fuel subject to excise, that is, fuel for highway use:

- Arizona
- California
- Georgia (taxed at one percentage point less than the basic rate)
- Hawaii
- Illinois
- Indiana
- Michigan
- New York
- South Carolina
- West Virginia

In most of the states exempting motor fuel, the exemption applies only if the fuel is subject to the excise tax, but in Missouri all is exempt. South Carolina exempts for farm use.

This exemption costs the states substantial revenue, and has by usual standards little justification. The motor fuel excise is primarily earmarked or budgeted for highway use.\(^1\) There is no possible justification by any criteria for exempting gasoline purchases from

contributing toward general state revenue. Any exemption creates some compliance and audit problems. It is far simpler to apply both taxes to motor fuel than to exempt from the sales tax.

Liquor and tobacco products (cigarettes). These are much more commonly subject to the sales tax as well as to the excises, partly because there is less organized opposition. Only Mississippi exempts alcoholic beverages from the sales tax, and Virginia exempts sales of liquor in state stores. Only Colorado and Texas exempt cigarettes, and Minnesota taxes them at a special higher rate. These exemptions are particularly troublesome because cigarettes and now much liquor are sold through stores also making sales of taxable commodities.

Other Fuel

Tax treatment of other fuel is almost equally divided between taxation and exemption. Seventeen states tax, 19 plus the District, exempt, and six tax partially; Minnesota and Wisconsin do not tax in the cold months, Idaho does not tax fuel for heating, California and Alabama tax certain fuels only, and Louisiana taxes at one-half the basic rate.

Telephone Service

The pattern on telephone service is also mixed. Seventeen states exempt, two tax at lower than the basic rate, three by special utility levies. Thus 31 states tax at regular rates, but primarily only local service; only in recent years have states (now 18) extended the tax to interstate long distance calls. In the case of Goldberg v. Sweet,¹ the U.S. Supreme Court upheld an Illinois tax on interstate phone calls that

originated or terminated in Illinois and were charged to an Illinois address. The tax was questioned on the grounds that interstate commerce was being subjected to state taxation. The court held that this was not the case, that no apportionment among the states was possible, and that the credit Illinois would allow in the event the transaction was taxed in another state prevented double taxation. Three tax only local service charges.

There is little justification for exemption of telephone service by usual equity standards and revenue is lost unnecessarily.

**Clothing**

The pattern on taxation of clothing has not changed significantly in the last decade. Six states (Connecticut, Massachusetts, Minnesota, New Jersey, Pennsylvania, Rhode Island) provide at least some exemption. All are states that entered the sales tax field relatively late, and all except Minnesota are in the Mid Atlantic and New England regions. Five of the states exempt all clothing with minor exceptions, such as sports and formal wear. Massachusetts limits the exemption to clothing selling for less than $175, also taxing all sports and specialty wear. Connecticut exempts clothing selling for less than $75 and clothing for children under 10.

This is one of the most objectionable exemptions ever devised. Studies show that consumer expenditure patterns are progressive, not regressive, on clothing. There are major problems of delineation of clothing and other items. Exempting clothing designed for children under a certain age is particularly troublesome, as long experienced in the Canadian provinces. Drawing a line on the dollar selling price
creates interpretational problems (can the coat and the trousers of a man's suit be treated separately, thus going under the dividing line), and a "notch" problem.

Publications

The general pattern of the states is to exempt newspapers but to tax periodicals and books. But the treatment is by no means uniform. As of 1993, 31 states plus the District exempt newspapers, in one state only if delivered on a route. The exemption originated not as a matter of principle, but for convenience when most papers sold for five or ten cents, and many of the sales were made by newsboys and at news stands on the streets or by display boxes. But little change in the tax has occurred as the price of papers has gone up; with usual sales today, there is no reason for the exemption to continue. On other periodicals, the opposite pattern holds. Over the counter sales are taxable in almost all states, with a few exceptions (New York, Ohio, Pennsylvania) but subscriptions are typically not taxed, either by law (for example, Connecticut, Nebraska, North Dakota, Texas, Virginia), or, in practice, because of the interstate nature of the subscription industry. There is no logic to exemption, but there is no simple way to catch all subscriptions, and to catch only those made through in-state entities is highly discriminatory. Books are typically taxable (in many countries they are not), but several states exempt bibles and similar religious items (Florida, Georgia, New York, Pennsylvania). To exempt subscriptions to religious periodicals while others are taxed has been held to be unconstitutional, but this rule has not yet applied to
hibbles.\textsuperscript{1} The current status of differential treatment of various media is obscure.\textsuperscript{2} Several states, at least ten, exempt the sale of textbooks to students, in a few states only if sold to the school.

Sale of paper, ink, and the like to publishers is typically subject to sales tax, even if the product is exempt. There have been many controversies over the status of various intermediate goods involved in the printing process, such as proof, art work and photographs, and the court interpretations have varied widely.\textsuperscript{3}

By the logic of a sales tax, there is little justification for any of the exemptions. But they arose in part for operational reasons, as for example of newspapers, or because of interstate complications, and elimination of them is difficult.

CONCLUSIONS

Only two exemptions of commodities, food and motor fuel, substantially reduce the state sales tax revenues. Both exemptions can be regarded as mistakes in policy, food exemption because it costs far more revenue than the alternative credit against income tax and refund approach, motor fuel because the argument that two taxes should not be applied to particular commodities is not logically applicable in this instance. But they are firmly entrenched in the tax structures and politically are difficult to change. The exemption of medicines, if

\textsuperscript{1}Texas Monthly Inc. V. Bullock, 489 US1, 109 Sct 890 (1984).

\textsuperscript{2}Note C. James Judson and C. David Jennings, "First Amendment Limitations on Sales and Use Taxation," in Fox, ed., Sales Taxation, op. cit., Chap. 9.

\textsuperscript{3}Hellerstein and Hellerstein, State Taxation, op. cit., pp. 13-30 to 13-38.
confined to prescriptions and a few specialized items, is the most defensible commodity exemption. The states have not provided many exemptions beyond these that are significant revenue wise, but most accomplish little in terms of usual standards of taxation.

There is an unfortunate tendency in some states to add exemptions, one by one, in every legislative session, often with complications created for operation of the tax and little gain in terms of principle.