CAUTION URGED IN ELIMINATING GROCERY TAX

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Nearly every state levies state and/or local sales tax on the retail sale of goods and services, with a wide range of carve outs and exemptions from state to state for the sale of specific items. A popular, yet often economically counter-productive, exemption is on the retail sale of groceries. Thirty-two states exempt groceries from the application of their state sales tax.

As such, discussion of Oklahoma's so-called 'grocery tax,' is somewhat misleading as it implies a special tax that is only applied to groceries. In reality, the tax paid at grocery store cash registers is simply the application of the state's sales tax to purchases of food items.

A sales tax is levied on the retail sales of good and services. Economists generally agree that the most economically efficient hypothetical sales tax regime would be one with a broad tax base—that is, a sales tax that is neutrally applied to the sale of all goods and services at the point of sale, but not applied to business-to-business transactions that are properly categorized as business inputs. A broad sales tax *base* enables the tax *rate* to be lower than would be necessary to raise the same amount of revenue on a narrower base that exempts many goods and services.

Moreover, a broad base neutrally applied limits distortions in economic decision making. That is, compared to other types of taxes (such as income tax), broad-based sales taxes generate less influence on the individuals' economic decisions. Thus, generally speaking, state's do better to rely more on broad-based sales taxes than on taxes on labor or capital investment, such as income tax or tangible property taxes. From a state revenue perspective, sales taxes tend to be a more stable revenue stream than income taxes, enabling more predictability in state budgeting.

Consequently, policies that undermine sales tax reliance are undesirable, and must be justified with appeal to some other desirable outcome. **Proposals to exempt groceries from Oklahoma's sales tax, if not justified by some competing consideration, move the state's tax system in an uncompetitive direction**. Proponents of exempting groceries from sales tax typically offer greater tax progressivity as the desired outcome that justifies the policy. The argument is that grocery taxes hit lower income individuals harder as a greater percentage of their income must be used to purchase essentials like food. Recent analysis by the Tax Foundation, however, undermines this claim. In reality, the lowest income households experience ***9 percent more sales tax liability*** under a sales tax with a grocery exemption than one with groceries in the base. The study explains why this is so:

> [The] narrative [that grocery taxes are regressive], however superficially compelling, is marred by several flaws. Most importantly, it either neglects or fails to appreciate the full impact of the universal policy of exempting from sales tax any purchases made using federal food-purchasing assistance programs, primarily the Supplemental Nutrition Assistance Program (SNAP), but also the more narrowly targeted Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). States' receipt of federal grants to administer these Food and Nutrition Service-funded benefits is contingent upon exempting these purchases from sales tax, and all states do so—even if groceries are otherwise in the sales tax base. This policy alone dramatically reduces taxable consumption for the lowest income deciles.
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> Additionally, the conventional wisdom underestimates the degree to which higher consumption of groceries does scale with income. Higher earning households purchase not only more, but higher qualities of, groceries.

> Low-income households, in fact, are more likely to purchase taxable substitutes to what states classify as groceries, a category that traditionally only covers unprepared foods. For lower-income working families, prepared foods—rotisserie chickens, deli items, fast food, and more—are often more economically efficient than buying raw ingredients and making home-cooked meals, but prepared foods are taxed, whereas ingredients are exempt when states adopt a grocery tax exemption. The result is that a household in the fifth decile spends almost 70 percent more than a household in the first decile, and a household in the top decile spends over three times as much as a household in the lowest.[1]

Of the 45 states with a sales tax, seven include food items in its base at the regular sales tax rate, including Oklahoma. Arkansas, Illinois, Missouri, Tennessee, Utah, and Virginia tax food items at a lower rate.

Another form of relief for low-income grocery sales taxpayers is through a grocery tax credit. Oklahoma is one of four states that utilize this targeted means of relief. Hawaii, Idaho, and Kansas are the others. Oklahoma's Sales Tax Relief Credit is $40 per person for individuals making $20,000 or less or $50,000 if an individual or spouse has a physical disability and cannot work or is 65 or older.

Conclusion

Taken in the aggregate, exempting groceries from Oklahoma's sales tax would not make Oklahoma's tax system more competitive, and to the extent doing so shifts the state in the direction of less reliance on sales tax revenue and more reliance on income tax revenue, actually makes Oklahoma ***less*** competitive.

In sum, the elimination of the state sales tax on groceries:

- Fails to accomplish the perceived goal of providing tax relief for lower income families,
- Places a reliance on income tax collections, which is more volatile, and
- Costs Oklahoma $370.33 million in revenue, which could be used in a more impactful way.

If the goal of eliminating the grocery sales tax is to provide relief for lower income families, then a better avenue for policymakers is updating the sales tax relief credit for inflation.

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[1] Tax Foundation: The Surprising Regressivity of Grocery Tax Exemptions