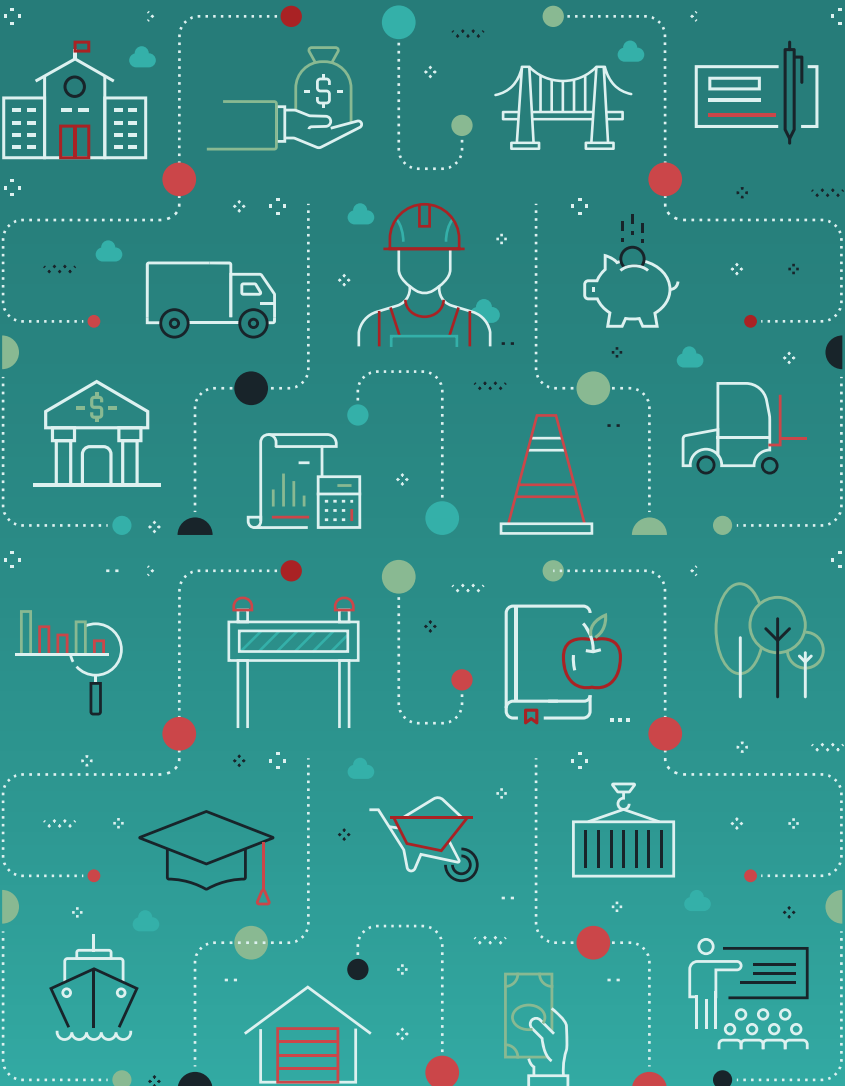


The Alabama Tax and Budget Handbook



3rd Edition
2026

ALABAMA 
Arise

The Alabama Tax and Budget Handbook
Third Edition
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About Alabama Arise

Alabama Arise is a statewide, member-led nonprofit organization advancing public policies to improve the lives of Alabamians who are marginalized by poverty. Arise's membership includes faith-based, community, nonprofit and civic groups, grassroots leaders and individuals from across Alabama. Arise's members select its annual legislative agenda, focusing on the issues that matter most to alleviate poverty and its effects.

To learn more about Arise, visit alarise.org.

Alabama Arise envisions an Alabama...

...where all people have resources and opportunities to reach their potential to live happy, productive lives, and each successive generation is ensured a secure and healthy future.

...where all government leaders are responsive, inclusive and justice-serving, and the people are engaged in the policymaking process.

...where all people live with concern for the common good and respect for the humanity of every person.

About this handbook

Alabama Arise published the first edition of *The Alabama Tax and Budget Handbook* in 2005 to help educate the public about how our state's taxes and budgets work and how they affect our everyday lives. Arise published a second edition in 2015 and now a third edition in 2026. This third edition includes changes that have occurred in the decade since the previous edition – and reflects our ongoing commitment to building a better Alabama for all.

This handbook concludes with a glossary of terms commonly encountered in tax and budget debates. Terms that appear in **boldface** type throughout the handbook are defined in the glossary.

To request additional copies of this handbook or to request a presentation about this handbook's contents, email info@alarise.org or call the Alabama Arise office at **334-832-9060**.



Acknowledgments

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Introduction

The common good

We're all in this together. All of us – people of every race, gender, age, income and background – benefit from a network of services from our local, state and national governments. From garbage collection to fire protection, from roads to schools, from public health to public safety, our **tax** dollars support the daily upkeep of our common good.

The 50 state governments are vital links in this network. It's a solemn trust: Each state is responsible for ensuring the safety, general well-being and education of its people. And each state government carries out this responsibility in its own way.

As Alabamians, many of us studied our state government in fourth grade and learned a little more about it in other classes. But until we're out making a living, paying taxes and voting, these lessons may seem disconnected from our everyday lives. *The Alabama Tax and Budget Handbook* is designed to make that connection. The handbook breaks down state finances into basic functions that affect every taxpayer: What do our tax dollars pay for? How does state spending work? Where does the state get its money?

The handbook also looks at how those functions measure up – in relation to residents' needs and abilities, in fairness and equity for all residents, and in comparison to the performance of other states. And the handbook offers ideas for making Alabama's finances fairer, simpler, more adequate for meeting our needs and more easily communicated to the public.

This is the third edition of the handbook. Alabama Arise developed the first handbook in 2005 and updated it in 2015 to reflect changes in the 10 years since the original edition. This new edition incorporates recent changes to state law and expands our discussion of Alabama's budgeting process. This edition also reflects Alabama Arise's commitment to racial equity by delving into the racist history of our tax system and exploring the disparate impact of **budget** and tax decisions on Alabama's residents of color.

What are the origins of Alabama's tax structure?

Alabama's deeply regressive and upside-down tax system is the legacy of the state's history of slavery and segregation. It's a history and a tax system that Alabama shares with many of our neighboring Southern states. And it's a history and a tax system "linked to [S]outhern states' continuing underinvestment in public services with a willful austerity that inhibits opportunities for the region's residents to thrive," according to the Institute on Taxation and Economic Policy (ITEP).

Immediately following the Civil War and the end of legalized slavery, Alabamians elected many Black citizens to the Legislature. These new lawmakers adopted a new state constitution that, according to historian Wayne Flynt, was "devoted to raising additional **revenue**, providing universal education [and] expanding state services[.]" During this period, these Black legislators and many white allies made significant investments in public services across Alabama, particularly education. These attempts to expand opportunities for everyday citizens led to tremendous racial and political tensions.

After the **Reconstruction** period ended, a newly empowered white-majority state government wrote a new constitution that segregated schools, slashed taxes, reduced public services and limited the political power of Black people. The 1901 constitution cemented these provisions, and more, in place. This constitution was designed explicitly to disenfranchise Black people, reinstitute the racist system of white supremacy and limit the state's ability to tax a major source of white wealth: land.

Alabama's 1901 constitutional convention intentionally excluded Black representatives. Instead, the **Planters** and **Big Mules** dominated the convention. The Planters were large landowners, mostly from the **Black Belt**. The Big Mules were industry leaders in the banking, railroad and industrial sectors. These two groups joined forces at the convention, where the main question was whether the new document would strip voting rights only from Black people or if it also would restrict the influence of poor white people.

INTRODUCTION

Delegates chose the latter option and wrote a constitution that sought to perpetuate the system of white supremacy that had dominated Alabama prior to Reconstruction. The delegates did not try to hide their ultimate goal in drafting the 1901 constitution. As the convention president said during his opening address: “And what is it that we want to do? Why, it is, within the limits imposed by the [f]ederal Constitution, to establish white supremacy in this [s]tate.”

Many newspapers warned that the 1901 constitution, if ratified, would result in inadequate funding of Alabama’s public education system. Some delegates, however, intentionally sought to deny the right to a public education, believing that providing Black people with a quality education would threaten the system of white supremacy. Many delegates also believed Black people would gain the most from services like public schools. Therefore, the 1901 constitution’s drafters ensured that generations of policymakers would lack both the money and the power to invest adequately in services that might disproportionately benefit Black people. These racist impulses, combined with protections for the property interests of the Planters and Big Mules, resulted in a severe cap on **property taxes**. That cap limited available funding to support public schools and other services.

During the Civil Rights Movement, activists and lawyers were able to get many of the overtly racist sections of the 1901 constitution stricken. And in 2022, Alabama voters approved a recompilation of the constitution that removed many of these stricken sections entirely. But mounting successful challenges to the tax policies embedded in the document has proved much harder. For example, the 1901 constitution capped state property taxes at 6.5 **mills**, a limitation that is still in effect today. The constitution also limited the **home rule** of counties and cities, including their ability to increase their own local property taxes.

There is no question that the cumulative effect of these property tax limitations has been to restrict funding for public education, especially in rural counties in Alabama’s Black Belt, disproportionately harming Black children. To this day, the state constitution concentrates taxation power in the Legislature, then and now dominated by white representatives.

In 1939, the Legislature passed a **law** creating a 2% state **sales tax**, which has increased to 4% over time. The state constitution requires counties to get the Legislature's approval to increase many categories of sales taxes, just like with property taxes. Cities, meanwhile, can increase sales taxes without having to ask for legislative permission. But the constitution makes it much harder for cities and counties to increase property taxes, requiring the Legislature's approval and then approval in a voter referendum.

Because it's easier for localities to adjust sales taxes than property taxes, cities and counties often rely heavily on sales taxes to fund local services like roads and fire protection. And because sales taxes are highly regressive, their impact lands disproportionately on Alabamians with the lowest incomes.

The tax that best offsets **regressive taxes** like sales taxes is the state **income tax**. In 1935, Alabama approved a **graduated income tax** that was quite progressive. That year, when the state began taxing incomes of \$3,600 or more for a family of four, teachers earned around \$500, and only about 7,000 people in Alabama earned enough to be subject to the new tax. But since then, income tax brackets haven't kept up with **inflation**. What originally was enacted as a **progressive tax** has now become essentially a **flat tax** that no longer offsets the regressive effects of state and local sales taxes.

Alabama's tax system continues to worsen racial and ethnic income disparities, ITEP found in a 2020 unpublished analysis. Black and Hispanic families in our state face higher effective **tax rates** than white families but have lower average incomes. ITEP found that Black families paid 7.8% of their incomes in state and **local taxes**, compared to a statewide average of 7.3%. The organization's analysis concluded that Alabama was among the worst performing states in racial inequities embedded in the tax system.

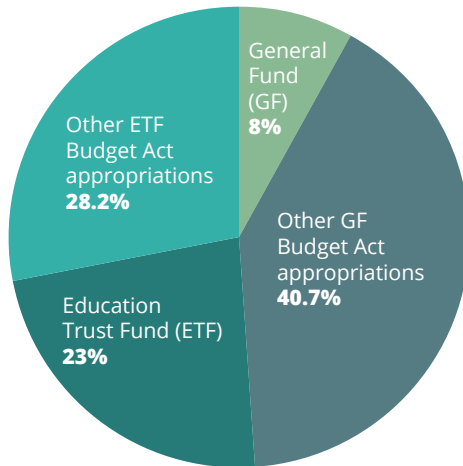
Alabama's current tax structure was created by the same 1901 constitution that sought to entrench our state's long history of segregation and racial discrimination. To make our tax structure more adequate and fairer, we will have to confront and address the impulses that drove these decisions made more than a century ago.

Budget Overview

How does state spending work?

One state, two separate budgets

Of the Legislature's \$39.1 billion in total **appropriations** for **fiscal year** (FY) 2022, about \$20 billion came under the **Education Trust Fund (ETF) Budget Act** for education-related services. Another \$19 billion came under the **General Fund (GF) Budget Act** for all other services. Lawmakers also separately appropriated about \$40 million in tobacco settlement money under the Children First Trust Fund to GF and ETF agencies (*not shown on the chart*). About 69% of total appropriations were **earmarked**, or set aside for a specific purpose, before lawmakers allocated them. Another 23% were designated for the ETF, though not earmarked for a particular purpose within it. Altogether, 92% of state revenue – everything outside the \$3.1 billion **General Fund** – was restricted to some extent in how it could be spent.



General Fund (GF)	\$3.1 billion
Other General Fund Budget Act appropriations	\$15.9 billion
Education Trust Fund (ETF)	\$9.0 billion
Other ETF Budget Act appropriations	\$11.0 billion
Total FY 2022 appropriations	\$39.1 billion

In addition to state funds, the annual appropriation bills include federal funds sent to the state, "local" university funds (tuition, ticket sales, etc.) and some tax revenues that local governments spend on schools. Based on data from the Executive Budget Office.

It takes significant state and federal money to keep Alabama's vital services running. Most of this money flows through the State Treasury. State agencies use the Treasury like a bank account. State and federal dollars appropriated by the Legislature are deposited there, and each agency draws out the money it's been authorized to spend. Every penny the state spends goes through a formal budget process that involves the Legislature, the governor and state agencies.

Each year, the Legislature authorizes almost all state funding by passing two major pieces of legislation: the Education Trust Fund (ETF) Budget Act, which funds education-related services, and the General Fund (GF) Budget Act, which funds everything else the state does. (Lawmakers also pass several smaller budget **bills** annually.) Both major budgets include state tax revenues, as well as other state revenues like fines and **fees** and federal dollars. Each budget is divided into two parts: the smaller part controlled by the Legislature (**discretionary funds**) and the more significant part set aside by law for particular uses (earmarked funds). All federal funds are considered earmarked because the federal government, not the Legislature, decides where they can be spent. Because the Legislature must spend every dollar in the ETF on education-related programs, only the discretionary part of the General Fund budget is not earmarked.

An artist rendering of the new Alabama State House in Montgomery.



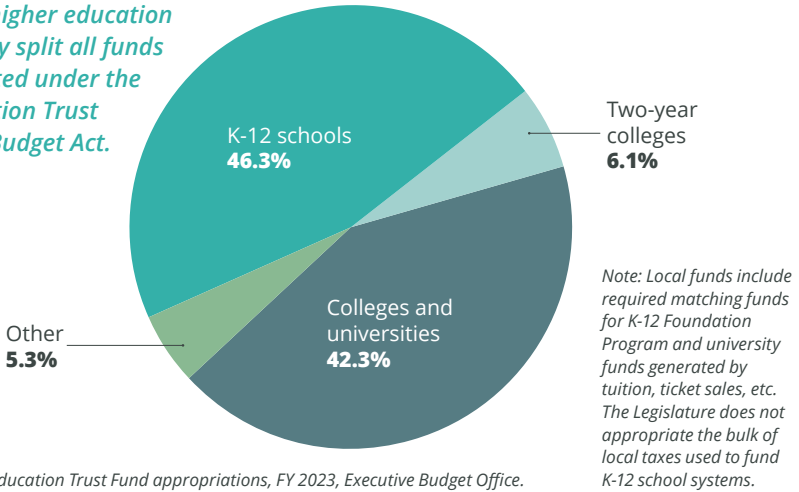
BUDGET OVERVIEW

What the two budgets pay for

Education Trust Fund Budget Act

\$23.1 billion in state, federal and local funds for FY 2023

K-12, higher education roughly split all funds allocated under the Education Trust Fund Budget Act.

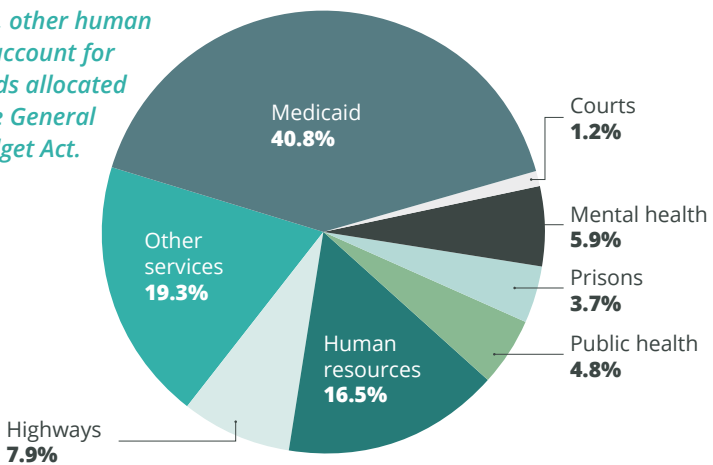


Source: Education Trust Fund appropriations, FY 2023, Executive Budget Office.

General Fund Budget Act

\$20.8 billion in state, federal and local funds for FY 2023

Medicaid, other human services account for most funds allocated under the General Fund Budget Act.



Source: General Fund appropriations, FY 2023, Executive Budget Office.

The annual Education Trust Fund Budget Act:

- Provides financing for all state education spending.
- Can be used only for education. Most funds are earmarked for particular education expenses, but lawmakers have some discretion over the areas of education on which the rest is spent.
- Often is referred to as simply the Education Trust Fund (ETF).

The annual General Fund Budget Act:

- Provides financing for all non-education programs.
- Primarily appropriates earmarked federal and state funds, including state gasoline tax revenues, which have been set aside for roads, bridges and traffic enforcement since 1952 under Amendment 93 of the state constitution.
- Includes the only state revenues that are not earmarked at all.
- Often is referred to as simply the General Fund (GF).

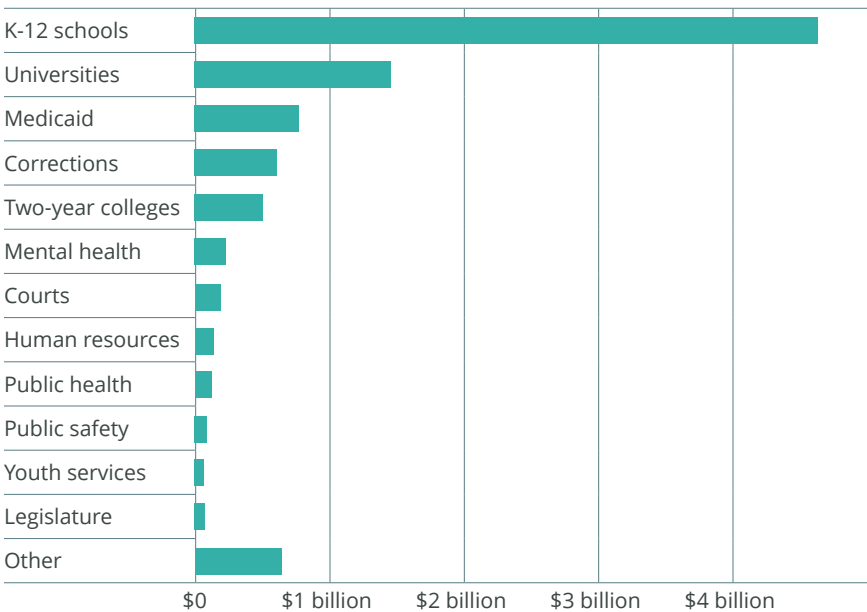
The General Fund Budget Act allocates funding for Medicaid, mental health, public health and other vital services that make life better for people and communities across Alabama.



BUDGET OVERVIEW

What state dollars pay for: Things that benefit all of us

Education, health care, public safety and other vital services support economic growth and make our state a better place to live and work. Alabama spent \$6.5 billion from the Education Trust Fund on K-12, colleges, universities and other education-related services in FY 2022. The same year, Alabama provided \$2.2 billion in funding for **Medicaid**, mental health, courts and other non-education services from the General Fund. Of the total \$8.8 billion, more than 75% of the funding went to K-12 schools and universities, easily exceeding the amount that went to Medicaid, corrections and other General Fund services. Here's a look at what state dollars supported:



Based on data from the Executive Budget Office.

In FY 2022, Alabama spent \$6.5 billion from the Education Trust Fund, mostly on K-12 and higher education. This easily exceeded the amount that went to Medicaid, corrections and other vital services from the General Fund.

In passing the General Fund Budget Act each year, the Legislature is most concerned with the discretionary funds (dollars that are not earmarked) that make up what legislators call the General Fund (GF). Even though this money amounts to only a small portion of total GF Budget Act spending, it's the portion that lawmakers are free to debate and divide up to help meet the state's many competing needs. The Legislature seeks input from agency leaders and the general public in assessing these needs.

In most states, the Legislature has relatively wide latitude in deciding how to spend the money from state taxes. But Alabama lawmakers' choices are much more limited. Over the years, Alabama voters have placed severe restrictions on how tax dollars are used by designating them (in constitutional amendments and statutes) for specific purposes. While this earmarking can help safeguard against misuse of state funds, it also can prevent legislators from creating a budget that adequately meets current needs for education, public health and other services that improve lives and build Alabama's economy.

Tax expenditures reduce funding for essential needs

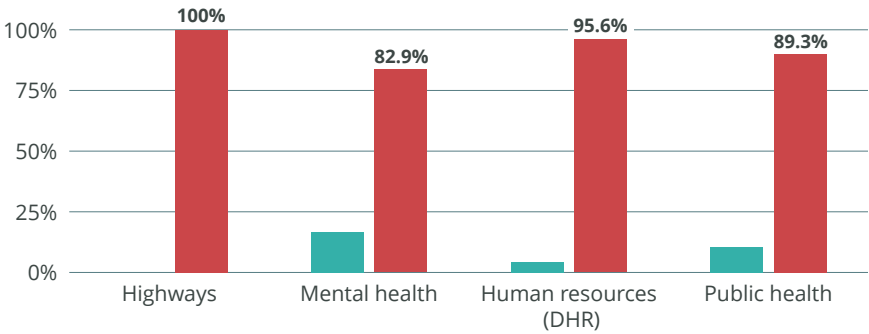
State tax incentives, tax credits and tax exemptions significantly affect state budgets by reducing the amount of money the Legislature can appropriate. These **tax expenditures** benefit specific companies, businesses or individuals and can total hundreds of millions of dollars annually. The Legislature routinely passes dozens of bills each year that exempt items such as farm supplies from sales taxes, direct tax credits to new and existing businesses, and create broad tax credits that reduce essential revenue.

One example of a tax credit with a significant budget impact is the CHOOSE Act, enacted in 2024. The law provides eligible parents with up to \$7,000 per child each year for private schools and up to \$2,000 per child each year for homeschooling. Those credits are available even for parents whose children never attended a public school. The CHOOSE Act will divert between \$150 million and \$200 million a year from public schools through 2027-28. That amount is enough to pay for up to 2,500 teachers every year. And the cost could grow in future years if lawmakers increase or remove the income cap for eligibility.

Earmarked vs. appropriated funds

Some major agencies in Alabama depend significantly more on earmarked funds than on appropriations from the Legislature. This ensures stable funding for services, but it reduces the Legislature’s ability to create a budget meeting current needs.

Many key services in Alabama get most of their funding through earmarks



Share of appropriated vs. earmarked funds under the FY 2024 General Fund Budget

■ Appropriated funds ■ Earmarked funds

Based on data from the Executive Budget Office.

When revenues fall below the amount needed to maintain services, the state must choose from a short list of options: Find one-time revenue sources, tap **reserve funds**, cut services or raise taxes. The state constitution prohibits Alabama from using money in any earmarked account to pay for other services. (Imagine not being able to use the money you budgeted for a birthday party to have a leaky roof repaired!) Alabama does have several “rainy day” reserve funds that have helped prevent **proration**, or mid-year service cuts, during the last decade. The most significant of these came in the **Rolling Reserve Act**, which was passed in 2011 and revised several times since. The law caps annual education spending and moves any remaining funds into reserve accounts and an account that can be used for non-recurring expenditures.

Most other states have much more flexibility in allocating spending for different programs. Reducing earmarking would make Alabama's budgets more responsive to changing needs and priorities. But most earmarking changes would require amending the constitution or writing a new one. Constitutional amendments require voter approval, which may be difficult to get because many voters support earmarking as a check on legislative power.

Racial inequity at a glance

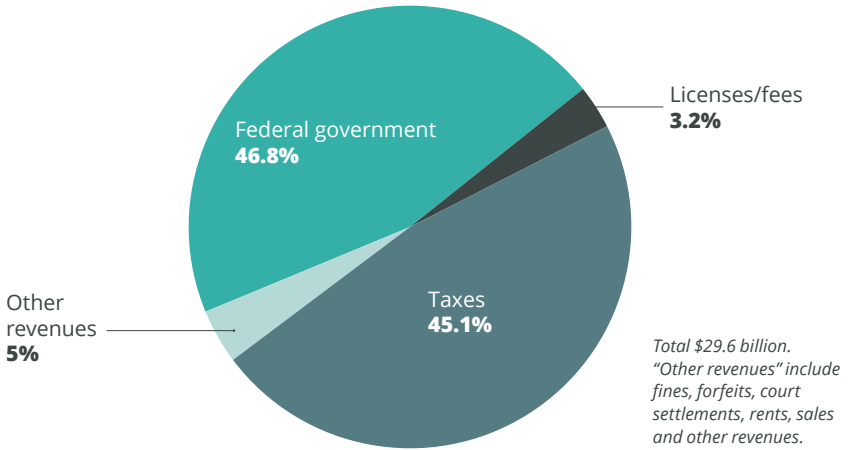
Alabama's seven constitutions have recognized the importance of public education and, until 1955, encouraged education. Following the U.S. Supreme Court's landmark *Brown v. Board of Education* decision, however, Alabama revised its constitution to say that "nothing in this Constitution shall be construed as creating or recognizing any right to education or training at public expense." This was a direct act of defiance intended to maintain a racial hierarchy and the vestiges of white supremacy in Alabama. Though courts ruled school segregation unconstitutional, subsequent cases have failed to establish a clear right to equitable education funding throughout the state. Education funding in Alabama still varies widely based on the wealth, and racial makeup, of local communities – especially when it comes to revenues from local property taxes.



BUDGET OVERVIEW

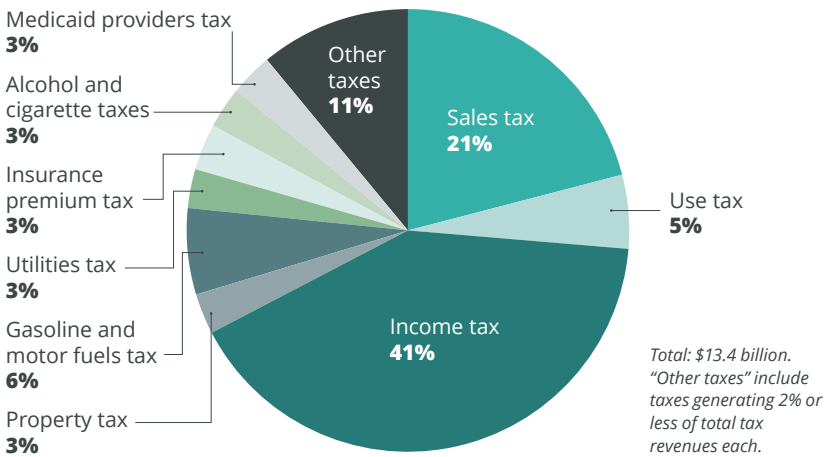
What Alabama takes in

State revenue by source in Alabama, FY 2021



Source: Based on data from the Annual Comprehensive Financial Report (2021), Alabama Comptroller's Office.

State tax collections by source in Alabama, FY 2021



Source: Based on data from the Annual Comprehensive Financial Report (2021), Alabama Comptroller's Office.

Where does the state get its money?

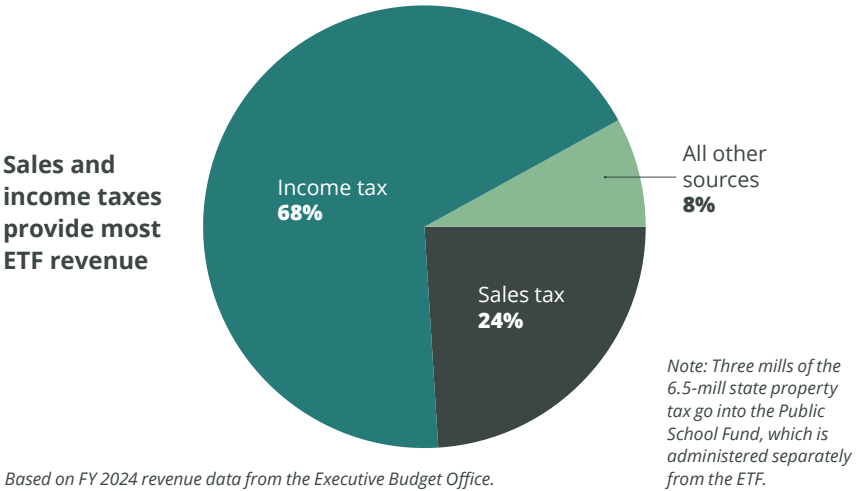
- 1. From us** – More than half of all the money Alabama takes in every year comes from taxes and fees that individuals and businesses pay. The lower graph on page 18 shows the share of this revenue that each state tax garners. (Note: The graph does not include local tax revenues, which in recent years have equaled a little less than half of the amount collected by the state. In Alabama, as in most other states, the property tax is mainly a local tax.) For a look at how state taxes work, see page 20.
- 2. From the federal government** – More than 45% of Alabama’s budget dollars (\$2.25 of every \$5 the state spends) comes from Washington, D.C. This is higher than in most other states. On average, states receive 35% of their budgets from the federal government. (Worth noting: During the COVID-19 pandemic, states witnessed an increase in federal financial support. Historically, only about one-fourth to one-third of states’ budgets have come from the federal government.) These are dollars that the federal government provides to help the state support basic services like education, health care and transportation. Most federal grants require a state contribution: When Alabama spends a certain amount on a particular area, the federal government will provide “matching” funds. The more the state spends, the bigger the **federal match** (up to a point).

Because Alabama’s state spending is so low, we often contribute little more than the minimum amount necessary to receive federal matching funds. In some areas, we forfeit the federal match altogether by failing to provide a state match. Most other states take better advantage of the match by contributing more state dollars to federally supported programs. A prime example: Alabama is one of only two states providing no state money for public transportation. That means our state forfeits tens of millions of federal dollars every year. It’s money that could support buses, trains, ride-sharing services and other efforts to help thousands of families stay connected. Even a modest state investment would help Alabama draw down tens of millions of federal dollars to help families get to work, the doctor’s office or wherever else they need to go.

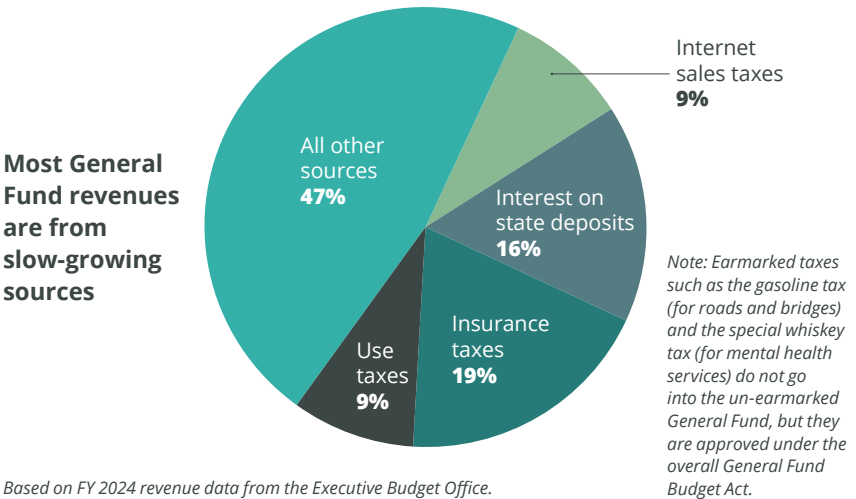
Because Alabama’s state spending is so low, we often contribute little more than the minimum amount necessary to receive federal matching funds.

Most state tax revenues go into the ETF or General Fund

The two big taxes that grow with the economy mostly flow into the Education Trust Fund (ETF). ETF revenues were a little more than \$10.4 billion in fiscal year 2024.



The General Fund (GF) gets its revenues from a hodgepodge of other sources, most of which are slow-growing. GF revenues were a little more than \$3.4 billion in fiscal year 2024.



In Alabama, some state programs and services have more adequate funding than others, and some years have more adequate funding than others. Tax revenues that grow with the economy (major taxes on consumers and workers, such as sales taxes and income taxes) are largely earmarked for the ETF. This imbalance has improved in recent years because revenues from internet sales taxes (called the **simplified sellers use tax**) have increased, providing new “growth taxes” for the General Fund. In addition, post-pandemic revenue growth has allowed lawmakers to continue funding state services while enacting a one-time income tax rebate and a permanent reduction in the state sales tax on groceries. These revenue increases may not be sustainable in the long term, however, and income taxes and most state sales taxes remain earmarked for education.

Other state services under the GF continue to get the leftovers – an assortment of minor taxes, interest and fees, many on businesses, that often grow at a sluggish rate. The slow growth keeps services like Medicaid and corrections permanently shortchanged as costs continue to grow. There’s also a disadvantage to the ETF’s reliance on sales and income taxes: In bad years, they can shrink. Many states, including Alabama, set aside money in good years in a **rainy day fund** to help them in bad years.

Alabama has created rainy day funds by drawing from the **Alabama Trust Fund** – which gets revenue from offshore oil and gas drilling – and by using money that exceeds the ETF spending cap under the Rolling Reserve Act for school infrastructure and one-time expenses like buses and textbooks. Alabama also has established a **Budget Stabilization Fund** in the ETF where revenues in excess of the appropriation cap are transferred and a **General Fund Budget Reserve Fund** in which up to \$100 million can be deposited to prevent proration. In 2023, the Legislature created a new education reserve fund called the **Educational Opportunities Reserve Fund**.

Despite these improvements, Alabama’s inadequate budgets for core services point to a deeper problem that can’t be fixed easily: The state doesn’t have enough money each year to support state services adequately or to expand services to meet a growing population or address new needs. This built-in shortfall is called a **structural deficit**. A more adequate tax system would bring in enough stable revenue to help prevent shortfalls and give legislators more leeway to respond when they occur.

BUDGET OVERVIEW

The structural deficit shows how our state's fiscal system has failed to keep up with changing times. In the budget crisis of 1933, the Legislature began dealing with revenue shortfalls by using proration, or cutting current spending (except for teacher and state employee salaries) across the board. By requiring the governor to use proration to avoid deficit spending, the law spares legislators from making tough decisions on which services should bear the brunt of cuts. For schools, though, the effect can be dramatic: Ordered in June to cut \$10 million in spending for a budget year that ends Sept. 30, a system may be forced to choose between replacing worn-out roofs or replacing old math books. Alabama has used proration 18 times since 1975 but has not had to prorate the education budget since the Rolling Reserve Act was passed in 2011. However, the state had to borrow from the Alabama Trust Fund during recent difficult budget years and had to draw money from the ETF Budget Stabilization Fund during the pandemic recession.

Racial inequity at a glance

Alabama's funding of our court system relies heavily on money collected from the users of the system. These fees include civil and criminal court costs charged against people – disproportionately Black – caught in the legal system. Some of these court costs are sent to the state General Fund (GF) and help fund local courts and related agencies. In 2022, Alabama's state court cost collections were more than \$60 million. While the exact appropriation of these fees is unclear, the \$60 million collected equaled 28% of the GF appropriation to Alabama's trial courts.

This heavy reliance on court costs to support the justice system negatively impacts the state. It encourages law enforcement and courts to focus on collecting revenue to support their operations. People of color and people with low incomes are disproportionately caught up in the justice system, in large part due to overpolicing in these communities (rather than either group committing crimes at rates higher than their counterparts). As a result, the weight of funding our courts falls heaviest on the people least able to pay. A 2018 study by Alabama Appleaseed found that more than 80% of people surveyed gave up necessities like rent, food, medical bills and child support to meet their court debt.

The Alabama state budget process

Each year, the governor prepares a financial plan and introduces two major budget bills: a General Fund (GF) bill and an Education Trust Fund (ETF) bill. In the plan, the governor outlines budget priorities, revenue projections and updates on the past fiscal year, which runs from Oct. 1 to Sept. 30. The governor drafts the plan after considering each state agency's programmatic and financial objectives. The plan also includes recommended revenue measures to ensure a **balanced budget**. The governor must present a proposed budget to the Legislature on or before the second legislative day of each **regular session** of the Legislature.

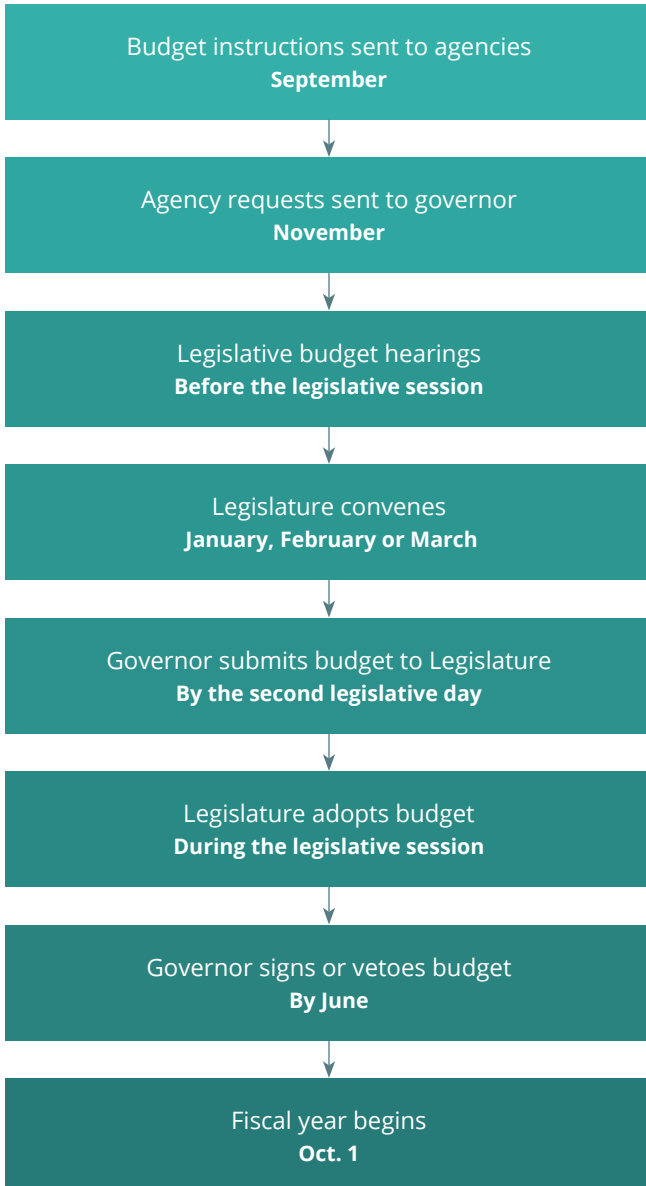
After receiving the **governor's budget proposal**, the Legislature:

- Considers the governor's recommended plan.
- Adopts alternatives or revisions to the governor's plan.
- Passes legislation to authorize budgets for the next fiscal year.

After the introduction of the governor's plan, the Legislature has until the end of a regular session to pass the budgets. This period of approximately three months – a comparatively short timeframe for consideration and passage of the state's multi-billion-dollar GF and education budgets – is the critical period for public comment on the state's spending priorities. During a regular session, the Legislature meets (usually on Tuesdays and Thursdays) for a maximum of 30 meeting days during a period of 105 calendar days. If lawmakers fail to pass one or both of the budgets during the regular session, the governor may call the Legislature back for a **special session**.

Both the House and Senate have separate budget committees that review and vote on the ETF and GF budgets. These budget committees often make significant changes to the governor's proposed budget. State agencies, the governor's Department of Finance and the **Legislative Services Agency (LSA)**'s Fiscal Division appear before these subcommittees with reports and recommendations. These committee hearings are the one of the best times for Alabamians to voice their opinions. The committees most often meet on Wednesdays.

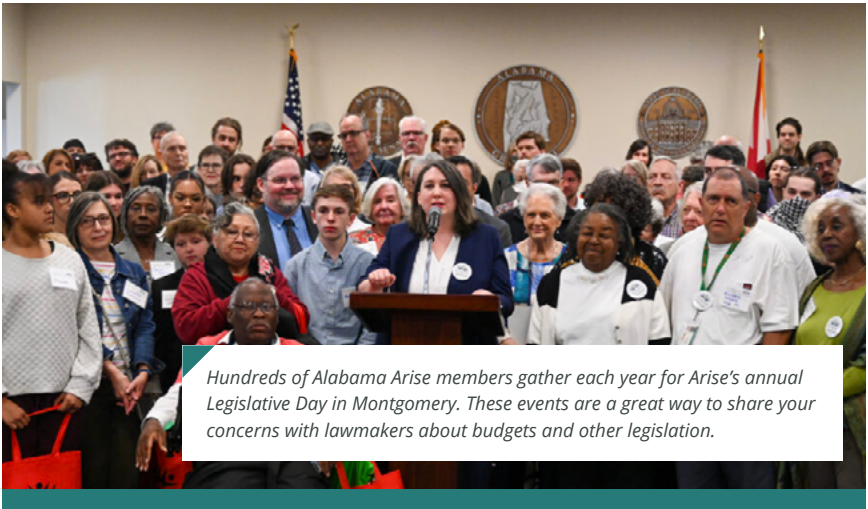
The Alabama budget process



Alabamians can voice their opinions on the budgets by:

- Calling their legislators' district or Montgomery office number.
- Writing a letter.
- Meeting with their legislators or a member of their staff.
- Sending an email.
- Requesting a public hearing on a budget expenditure.
- Testifying at a scheduled public hearing on a budget.

Each **chamber** discusses and votes on the budget bills separately. It is common practice for one major budget to “originate” in either the House or Senate and the other major budget to begin in the other chamber. The committees considering the budgets review the governor’s proposals and any changes approved by the other chamber. Then they make changes themselves and send revised budget bills (usually in the form of **substitute bills**) to the chamber floors for additional modification and votes. Usually there are differences between the budget bills passed by the House and by the Senate. In these cases, the bills often are referred to a joint committee (called a **conference committee**) where differences can be resolved. Each chamber then must approve the conference committee’s report before sending the final legislation to the governor for a signature, **veto** or **executive amendment**. If the governor signs the budget bill into law, or if the Legislature overrides the governor’s veto, the bill becomes an **act**.



Hundreds of Alabama Arise members gather each year for Arise's annual Legislative Day in Montgomery. These events are a great way to share your concerns with lawmakers about budgets and other legislation.

How could Alabama improve its budgeting process?

In 2014, the Center on Budget and Policy Priorities rated Alabama as “low” in using fiscal planning tools that could improve our budgeting process. While the analysis had some limits and the state has made some improvements since then, Alabama still fails to use many tools available in other states that could improve how we write our budgets. Some of the areas where Alabama could improve its budgeting process include:

- **Forecast revenues into the future.** Alabama passes a future budget based, in large part, on revenues collected during the current budget year. State leaders often have a good idea of what economic conditions and revenues may look like in the next year but have no formal process to forecast revenues for several years. A more deliberate approach involving outside experts could help Alabama plan for future budgets and needed revenue.
- **Prepare fiscal notes with multiyear projections.** Bills considered by the Legislature that will cost or save the state money must be accompanied by a **fiscal note** from the LSA describing the bill’s financial impact on the state. These fiscal notes, however, are often vague and limited in detail. More robust data would help lawmakers understand the financial implications of legislation they’re considering.
- **Get a stronger current-year baseline on services.** Alabama’s budgets are based in part on requests prepared by state agencies and submitted to the governor each fall. These plans, however, are not readily available to the public and often lack detailed analysis of the cost of existing and anticipated services. Stronger and more specific estimates of the cost to extend current services into future years would help the governor and Legislature determine future revenue needs. In addition, greater transparency would allow Alabamians adequate time to weigh in, strengthening elected officials’ ability to ensure they are adequately responding to and funding the needs of the people.

In 2014, the Center on Budget and Policy Priorities rated Alabama as “low” in using fiscal planning tools that could improve our budgeting process.

- **Seek independent consensus revenue forecasts.** The **Executive Budget Office (EBO)** prepares **revenue forecasts** for the governor, and the Legislative Services Agency's Fiscal Division prepares them for the Legislature. In past years, these forecasts could diverge widely between the House and Senate. More recently, forecast differences between the LSA and EBO have been minor, and the two chambers generally agree on their revenue projections. But Alabama still should include outside, independent experts in their revenue estimates, such as experts from the state's major universities. Including outside experts in the revenue forecasting process could make the process more objective and reduce politicization.
- **Enhance fiscal flexibility through gradual earmarking reform.** Make Alabama's budget process more agile and responsive to the state's evolving needs and priorities by pursuing a measured approach to earmarking reform. Policymakers should seek to strike a balance between preserving the benefits of earmarking and providing the state's budget with necessary adaptability. This approach could include doing the following:

 - **Initiate a comprehensive review of Alabama's existing earmarking practices.** Identify programs and areas where earmarking can be gradually reduced or modified to allow for greater spending flexibility. This analysis should take into consideration both short-term budgetary requirements and long-term strategic goals.
 - **Consider a phased approach to earmarking reform.** Begin by identifying non-essential or outdated earmarks that can be modified without requiring constitutional amendments. This approach would allow for incremental changes that could lead to a more flexible budget over time.
 - **Implement pilot projects to showcase the positive outcomes of earmarking reform in specific sectors.** Highlighting the improved allocation efficiency, responsiveness to pressing issues and overall positive impact on the state's well-being would be important steps toward broader reform.

Tax Overview

How do state taxes work?

Regressive taxes



Regressive = The less you make, the higher percentage of your income you pay in taxes. This is widely agreed to be unfair.

Example: Alabama's general sales tax

Proportional (or flat) taxes



Proportional = Everyone pays the same percentage of income in taxes, no matter how much they earn. Some call it equal treatment, but people with low incomes feel the biggest pinch.

Example: Georgia's individual income tax

Progressive taxes



Progressive = The more you make, the highest percentage of your income you pay in taxes. Many consider this to be the fairest distribution of tax impact. It also can offset the effects of regressive sales taxes.

Example: Maryland's individual income tax

Most people would consider a tax system to be unfair if those who earned less paid a higher percentage of their income in taxes than those who earned more. But that's exactly how regressive taxes work.

As we've seen, Alabamians contribute to the funding of public services by paying taxes on their income, purchases, property and business operations. The next sections of this handbook will explain the basic principles of tax policy and examine the nuts and bolts of Alabama taxes.

Most people probably would agree that taxes should be "fair." But what does tax fairness look like? From the vantage point of our own individual budgets, fairness may seem to be "lower taxes for me." From the vantage point of the common good, however, economists have developed some basic tools for measuring tax fairness.

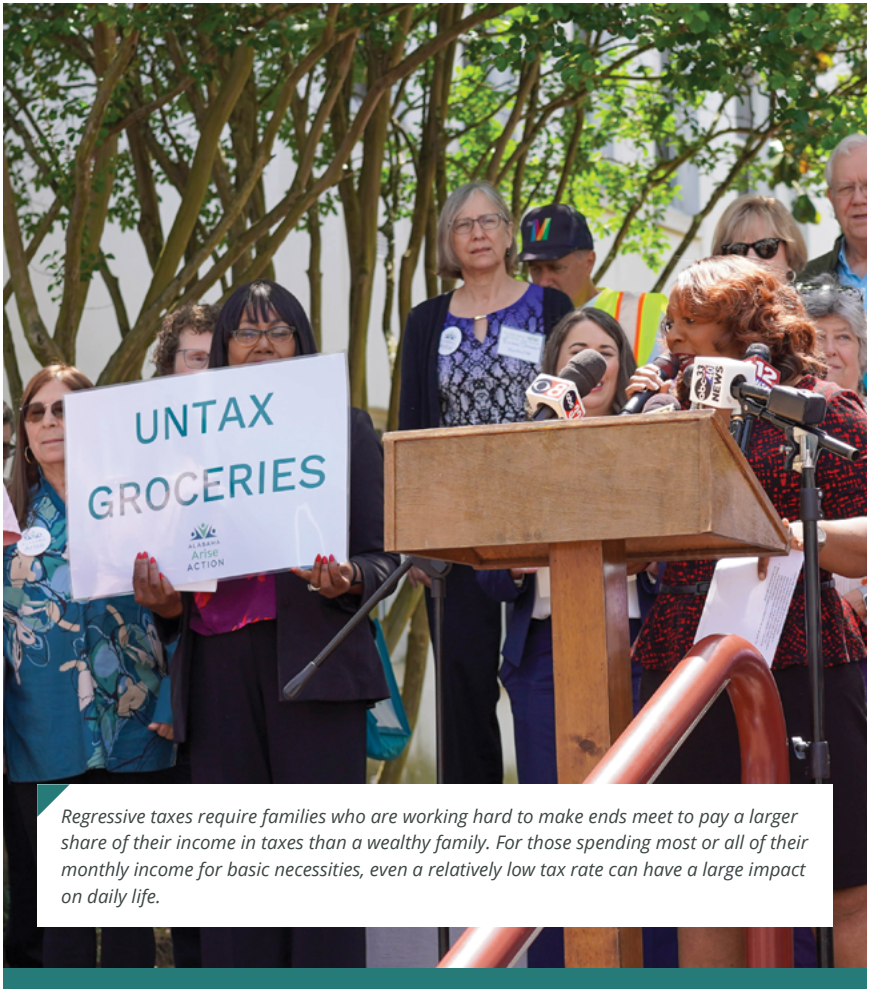
The charts on page 28 illustrate three ways that any given tax can affect the total pool of taxpayers:

- A **regressive tax** requires people who make less money to pay a bigger share of their income than people who make more.
- A **proportional tax** (or flat tax) requires the same percentage of income from everyone, regardless of how much they earn.
- A **progressive tax** requires people who make more money to pay a bigger share of their income than those who make less.

Most people would consider a tax system to be unfair if those who earned less paid a higher percentage of their income in taxes than those who earned more. But that's exactly how regressive taxes work. They reduce the standard of living of families with low and middle incomes, while affluent families are not similarly affected. The sales tax is a regressive tax, because people with low incomes spend most of their income on goods that are taxed. Property taxes also are often regressive, especially in areas where home values are increasing more rapidly than incomes for the lowest-paid workers. Alabama's regressive tax system taxes families with low incomes deeper into poverty, while demanding less of wealthy people, who have enjoyed the vast majority of the state's income growth in recent decades.

TAX OVERVIEW

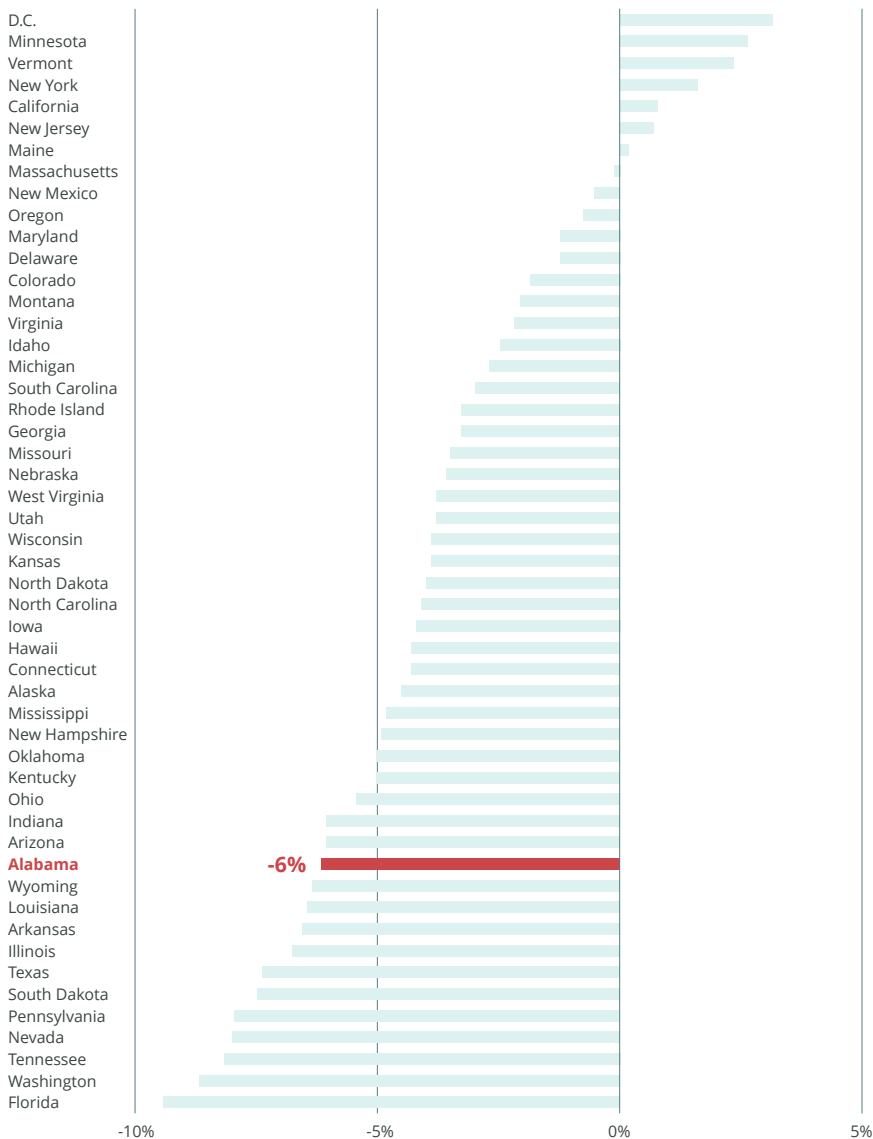
Proportional taxes also are inequitable in practice. Requiring families who are working hard to make ends meet to pay the same share of their income in taxes as a wealthy family results in vastly different consequences for each. For those who must spend most or all of their monthly income for basic necessities, even a relatively low tax rate can have a large impact on daily life. For wealthier taxpayers with more discretionary income, however, a tax at the same percentage will not have the same impact. Alabama's income tax is close to proportional.



Regressive taxes require families who are working hard to make ends meet to pay a larger share of their income in taxes than a wealthy family. For those spending most or all of their monthly income for basic necessities, even a relatively low tax rate can have a large impact on daily life.

Upside down: Alabama's taxes are more regressive than most

The further to the left the state's number, the more regressive its tax system is. Alabama's tax system is the 12th most regressive in the country, according to the Institute on Taxation and Economic Policy's Tax Inequality Index.



Source: Institute on Taxation and Economic Policy, Who Pays?, 7th ed. (2024)

TAX OVERVIEW

Progressive taxes are the fairest taxes. Families with low incomes can be exempted entirely by providing all taxpayers with an **exemption** large enough to cover the basic cost of living. Tax rates also can be **graduated** – meaning they rise along with income – so that families at middle and high incomes pay taxes fairly related to what they can afford. At both the state and federal levels, personal income taxes can be, and typically are, designed to be progressive taxes.

All state tax systems are different. But government leaders, economists and advocacy groups have identified several principles that mark a healthy tax system:

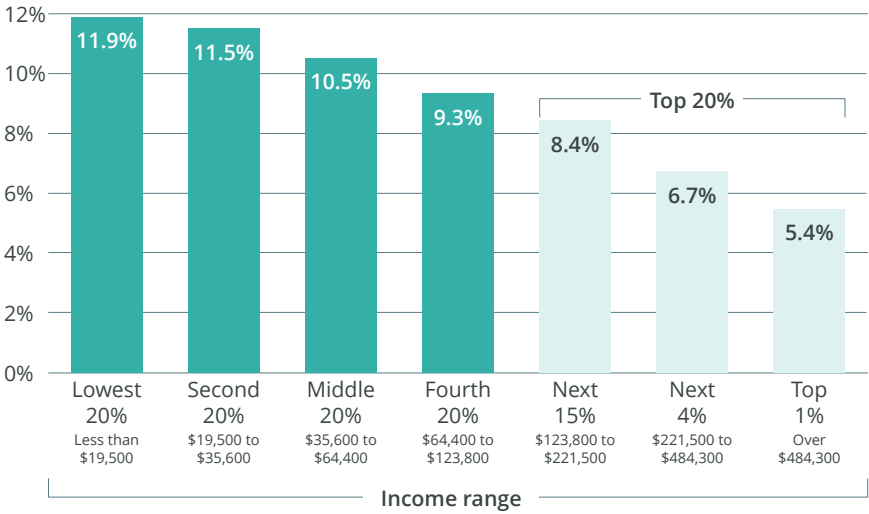
- *Fairness* – Does the tax system require people to contribute to the cost of public services on the basis of their ability to pay?
- *Adequacy* – Does the tax system raise enough money, in the short term and the long term, to finance needed public services? Does earmarking prevent revenues from being spent as needed?
- *Simplicity* – Does the tax system have confusing tax loopholes? Is it easy to understand how our state's taxes work and to file a basic income tax return?
- *Transparency* – Is information about the tax system readily available to the public? Can taxpayers see that all businesses and individuals pay a fair share?



By these measures, what kind of health rating does Alabama's tax system deserve? Read on to find out how our tax system compares to those of other states and how each tax affects the whole system. Spoiler alert: We have a lot of work to do.

The less you make, the more you pay: Alabama state and local taxes

State and local taxes as a share of family income



Income Group	Top 20%						
	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$19,500	\$19,500 to \$35,600	\$35,600 to \$64,400	\$64,400 to \$123,800	\$123,800 to \$221,500	\$221,500 to \$484,300	Over \$484,300
Average Income in Group	\$11,600	\$26,500	\$48,400	\$90,000	\$153,100	\$285,800	\$903,100
Sales & Excise Taxes	7.2%	6.6%	5.5%	4.4%	3.4%	2.3%	1.3%
General Sales-Individuals	4.1%	4.1%	3.5%	2.8%	2.2%	1.4%	0.7%
Other Sales & Excise-Ind.	2.1%	1.6%	1.1%	0.8%	0.6%	0.4%	0.2%
Sales & Excise-Business	1%	1%	0.9%	0.8%	0.7%	0.6%	0.5%
Property Taxes	2.5%	1.6%	1.5%	1.4%	1.3%	1.2%	1%
Home, Rent, Car-Individuals	2.2%	1.4%	1.2%	1.1%	1%	0.8%	0.5%
Other Property Taxes	0.3%	0.3%	0.2%	0.3%	0.3%	0.4%	0.5%
Income Taxes	1.9%	3%	3.2%	3.3%	3.4%	3.1%	2.9%
Personal Income Taxes	1.9%	3%	3.2%	3.3%	3.4%	3%	2.8%
Corporate Income Taxes	0%	0%	0%	0%	0%	0.1%	0.1%
Other Taxes	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Total Taxes	11.9%	11.5%	10.5%	9.3%	8.4%	6.7%	5.4%

Note: Graph and tables show 2024 Alabama law at 2023 income levels. Source: Institute on Taxation and Economic Policy, Who Pays?, 7th ed. (2024).

How does Alabama's tax system measure up?

Alabama's tax structure is among the nation's most unfair, according to the 2024 edition of ITEP's *Who Pays?* report, an analysis of the tax systems in all 50 states. (See whopays.org for the full report.) ITEP's calculation includes both state and local taxes and excludes households where the primary tax filer or their spouse is aged 65 or older, because older adults often benefit from tax provisions unavailable to most other people. If you compare Alabama's chart on page 33 with other states' charts in *Who Pays?*, two things stand out:

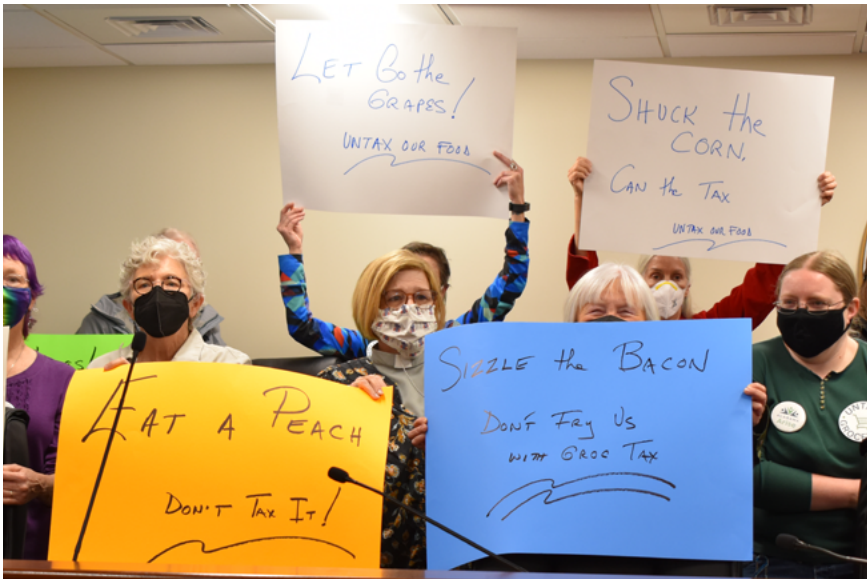


- **We rely heavily on regressive sales taxes.** Alabama has high state and local sales tax rates. We continue to tax groceries (though at a lower rate than other consumer goods), which account for a large share of spending for households with low incomes. And we tax relatively few services, which people with higher incomes tend to buy more often.
- **Our income tax is only moderately progressive compared to other states.** Alabama's income tax is almost flat for all but the lowest-paid 20% of families, so it doesn't offset our steeply regressive sales tax. We're better off on this measure than states without an income tax, like Florida and Tennessee, but not by much. And our income tax is even less fair than flat taxes used in some states, largely because of some generous tax breaks for the highest earners.

The result for Alabama is an upside-down tax system in which the less you make, the more you pay. The lowest-paid fifth of Alabamians pay nearly 12% of their incomes in state and local taxes, while the wealthiest 1% pay just 5.4%. Adding to the upside-down nature of this structure, Alabama is the only state to allow a full **federal income tax (FIT) deduction** on state individual income taxes. This tax break's benefits flow disproportionately to wealthy households.

Alabama has an upside-down tax system in which the less you make, the more you pay.

All four legs of our state tax system need repair. Alabama made its income tax slightly less regressive in 2006 and 2022, but it remains mostly flat. While Alabama took historic steps to reduce the state grocery tax in 2023 and 2025, our sales taxes still remain high, taxing low-paid workers deeper into poverty. Our property taxes have changed little since the end of segregation and provide large tax breaks to wealthy owners of timber and agricultural land. And our **corporate income taxes** have numerous loopholes that allow many of the wealthiest corporations operating in Alabama to pay nothing. The following sections look at each of these taxes – how they work, how they measure up and how we could improve them.



Alabama Arise members have advocated for tax reform for decades, and they have allowed nothing to get in the way of that work – even a pandemic. Arise supporters rallied in Montgomery in 2022 to urge legislators to remove the state sales tax from groceries. Alabama lawmakers took two important steps in that direction in 2023 and 2025, reducing the state grocery tax from 4% to 2%.

Income Tax

Feeling the pinch

Alabama's nearly flat income tax can't offset our regressive sales taxes. As a result, the lowest-paid 20% of Alabama residents pay more than twice the share of their incomes in state and local taxes that the top 1% pay. It's an upside-down tax system: It reduces the consumer spending that fuels economic growth and makes it harder for Alabamians with low and middle incomes to get ahead.

The lowest-paid 20% of Alabama residents pay more than twice the share of their incomes in state and local taxes that the top 1% pay.



How does Alabama's income tax work?

A 1933 amendment to the Alabama Constitution authorized the state to create a tax on personal income and set a limit of 5% for the tax rate. The Legislature enacted that tax in 1935, establishing three income tax rates for individuals that are still in place today:

- Yearly **taxable income** of up to \$500 is taxed at 2%.
- Income from \$501 to \$3,000 is taxed at 4%.
- Income of \$3,001 and above is taxed at the top rate, 5%.

Most states define their income tax by statute, meaning their legislatures can change it. But major parts of Alabama's income tax are written into our constitution, which is much harder to change.

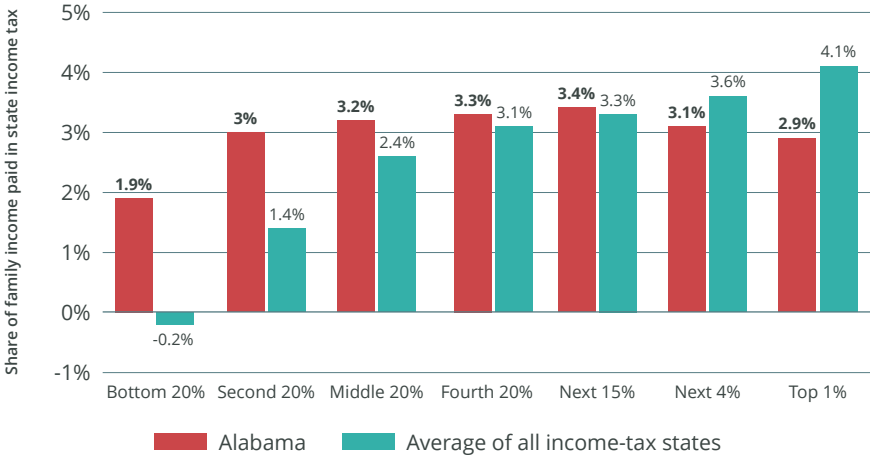
Ideally, an income tax should be the most progressive tax, because it's the easiest one to structure to help offset regressive taxes. When it began in 1935, Alabama's graduated system of income tax rates was very progressive. That year, when the state began taxing incomes of \$3,600 or more for a family of four, teachers earned around \$500. Only about 7,000 people (less than a quarter of 1% of the population then) earned enough to be taxed. But since then, the system hasn't kept pace with inflation.

Like most states, Alabama uses exemptions and **deductions** to exclude everyone's most basic costs of living from taxation. This is especially important to low-income taxpayers, for whom this small amount is a large share of income. But our exemptions and deductions are lower than in many other states.

The 1935 law set **personal exemptions** of \$1,500 for single adults and \$3,000 for married couples. It also set a **dependent deduction** that lawmakers increased in 2006 and again in 2022. The **standard deduction**, for taxpayers who don't claim **itemized deductions**, was added in 1951 and has increased three times, most recently in 2022 when the standard deduction increased to \$3,000 for single adults and \$8,500 for couples. Taxpayers can itemize if their deductions exceed the standard deduction. (See the chart on page 38 for Alabama's deductions by income level.)

Starts high, ends low: Alabama's upside-down income tax

For Alabamians with low incomes, the state income tax is much higher than in other states. But for the highest earners, it's much lower.



Source: Institute on Taxation and Economic Policy, Who Pays?, 7th ed. (2024).

Better, but we still have work to do

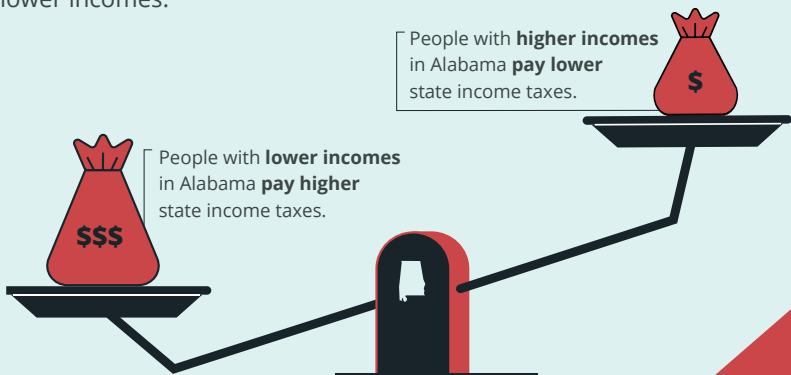
In 2022, Alabama increased its income tax threshold – the income where one begins to pay income tax – from \$12,500 to \$13,500 for a family of four by expanding deductions. Even so, Alabama still taxes families with low incomes deeper into poverty.

Income Level	Standard Deduction	Dependent Deduction	Personal Exemption	Tax Threshold
Below \$25,550	\$8,500	\$2,000	\$3,000	\$13,500
\$25,551-\$50,000	Phase down to \$5,000	\$2,000	\$3,000	\$13,499-\$10,000
\$50,001-\$100,000	\$5,000	\$1,000	\$3,000	\$9,000
\$100,000 and above	\$5,000	\$600	\$3,000	\$8,600

Racial inequity at a glance

While Alabama's income tax system appears essentially flat, Alabama doesn't tax many sources of income received by wealthier (and disproportionately white) taxpayers. Many of these tax breaks are available to older adults no matter what their income or wealth. Because of these tax breaks, many seniors with higher incomes pay less in income taxes than do younger, working families. The targeting of these special tax breaks also increases racial disparities because of demographics and historic inequities in wealth accumulation. As a result, white retirees have around seven times as much untaxed retirement wealth as do Black retirees.

Nearly all defined-benefit retirement income is exempt from Alabama income tax. This includes state retirement benefits for teachers and state employees, U.S. civil service retirement, judicial retirement, military retirement, federal government retirement, **Social Security** and some private retirement benefits. Alabama does not count inheritance as income and only counts the increased value of stocks and bonds when they are sold. These exemptions, along with the deduction for federal income taxes, allow many wealthy people in Alabama to pay much lower state income taxes than wage earners do. Because white people are much more likely to receive defined-benefit retirement benefits, own stocks and bonds, inherit wealth and pay higher federal income taxes, they are more likely to benefit from Alabama's income tax structure than are Black people or people with lower incomes.



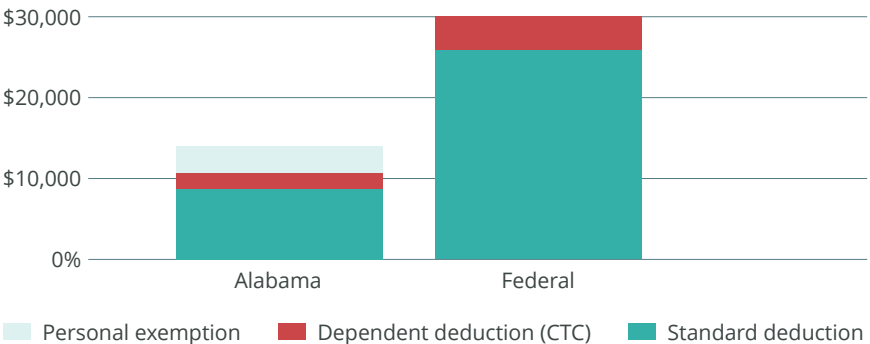
How does Alabama’s income tax measure up?

Most states have made sure that people below the federal **poverty line** don’t have to pay income taxes. Alabama begins taxing a two-parent family of four at an income of \$13,500. It’s an improvement from the pre-2006 level (just \$4,500), but it’s still less than half of poverty-line wages (about \$31,800 in 2024). Alabama’s income tax threshold is one of the nation’s lowest. By contrast, Mississippi doesn’t start taxing such a family until they make \$19,600 per year, and Georgia doesn’t start until they make \$32,000.

In Alabama, families with low and high incomes pay income taxes at the same rate: 5% on taxable income above \$3,000. Most Alabama taxpayers pay at the top rate. In 2023, most of Alabama’s taxpayers paid around 3% of their income in state income taxes. Even the Alabama families with the lowest incomes pay 1.9% of their income. Nationally, many families with the lowest incomes pay less than 0% in state income taxes (depending on the availability of refundable tax **credits**), while the top 1% pay 4.1%. But in Alabama, the top 1% pay an average of 2.9% of their income in state income taxes, barely more than the 1.9% paid by taxpayers with the lowest incomes.

Anatomy of a tax threshold

The tax threshold – the income where one begins to pay income tax – is a sum of tax deductions and exemptions. Here’s how it worked when applied to 2022 Alabama and federal taxes for a two-parent household of four. (In 2017, Congress ended the federal personal exemption, significantly increased the standard deduction and replaced the dependent deduction with an increased Child Tax Credit.)



Few other states impose an income tax nearly as high as Alabama does on a two-parent family of four at the poverty line. Alabama's income tax on such a family in 2024 was \$838. That family pays no federal income tax, and in most states would pay no state income tax at all.

Alabama's income tax system is unfair for three reasons:

First are our out-of-date deductions. Despite an increase in 2022, our standard and dependent deductions are still below those in many other states. Alabama's standard deduction for individuals (\$3,000) is less than a quarter of the federal one; the maximum for couples (\$8,500) is less than half. Alabama's standard deduction is not tied to inflation, which means its value will continue to decline over time.

Second is a big tax break we give the highest earners. Alabama is the only state that allows taxpayers to deduct all of their federal income taxes before calculating their state taxes. A 1965 constitutional amendment entrenched this federal income tax (FIT) deduction. The FIT deduction gives higher-income earners a special break, because they can deduct more from their Alabama taxes than those who earn a lower income and pay less federal tax. Alabama forgoes about \$1.26 billion of its potential income tax revenue because of this lopsided deduction, and 86% of the tax break's value goes to the highest-paid 20% of taxpayers.

Third, Alabama also allows Social Security contributions to be deducted. In theory, this should help people with low incomes, who pay a higher share of their income toward Social Security. The catch is that the deduction is available only to those who itemize deductions, which excludes most people with low or middle incomes.

Unlike the federal government and many states, Alabama doesn't give targeted tax breaks to people with less income. This is in contrast to the 31 states and the District of Columbia that have followed the federal example and created state-level Earned Income Tax Credits (EITCs), which allow many taxpayers with low incomes to receive a credit against taxes owed or a tax refund if they do not owe taxes. Alabama has not created an EITC, a failure that makes it harder for families with low incomes to get ahead and makes our income tax more unfair.

How could we improve our income tax?

Because much of Alabama's income tax structure is spelled out in the constitution, changing it would require changing the constitution. If Alabama's income tax more closely followed the system of exemptions and deductions used at the federal level and in many other states, working families would have more money available to spend. That would boost the economy and improve their quality of life. The following proposals would help modernize our income tax and make it fairer:

- **Make income taxes less regressive and more progressive.** Ensure people who make more money pay a larger share of their income in taxes than those who make less. Alabama's state income tax rates top out at low income levels, making our income tax practically a flat tax. Transitioning to a more progressive system that requires households with higher incomes to pay a more equitable share of tax revenues would expand economic opportunity for families with lower and middle incomes. And it would make funding for vital public services more equitable and sustainable.
- **Reform out-of-date deductions.** Update Alabama's standard and dependent deductions to align with modern economic realities and periodically adjust them for inflation to prevent their gradual erosion over time. This should include increasing the personal exemption and standard and dependent deductions. The state also should conduct a comparative analysis with deductions in other states to determine appropriate adjustments or link these dollar amounts to federal levels. These changes would allow Alabama's deductions and exemptions to keep pace with increases in the cost of living.
- **Eliminate the federal income tax (FIT) deduction.** Repeal the provision that allows taxpayers to deduct federal income tax payments before calculating their state taxes. This lopsided deduction disproportionately benefits higher-income earners and results in a significant loss of revenue that could support public schools.

The federal income tax (FIT) deduction is a huge tax loophole for the wealthiest Alabamians

Average estimated value of FIT deduction for Alabamians at given income levels



Lowest-paid 20%
Average income \$12.5K
FIT value = \$8



Middle 20%
Average income \$56K
FIT value = \$129



Highest-paid 1%
Average income \$1.6M
FIT value = \$16,583

Source: Institute on Taxation and Economic Policy, December 2025.

- **Review Social Security contribution deductions.** Examine the eligibility criteria for deducting Social Security contributions. Expand access to this deduction beyond itemizers to ensure it benefits a broader range of people with low and middle incomes. These changes would help ensure the deduction benefits those who need it most.
- **Establish a state Earned Income Tax Credit (EITC).** Introduce a state-level EITC program similar to the federal EITC and equal to at least 10% of the federal EITC amount. This credit would help low-paid working families make ends meet and help offset the regressive effects of Alabama’s high sales tax. This initiative also would provide a targeted reduction to lower-income taxpayers by allowing them to receive a credit against taxes owed or as a tax refund. Alabama can and should model this program after successful EITC programs in other Southern states like Louisiana, Oklahoma and Virginia.
- **Gradually increase standard deductions.** Phase in a plan that gradually increases standard deductions for individuals and couples. This would help rebalance Alabama’s upside-down tax system to be more equitable toward people with lower and moderate incomes. Policymakers also should enact higher-rate tax brackets for millionaires.

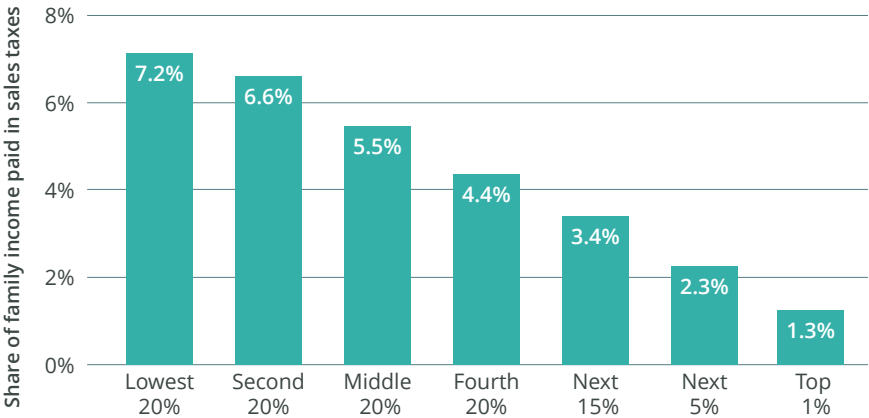
Sales Taxes

Sales taxes: The key driver of Alabama's upside-down tax system

Should wealthy people pay at a lower tax rate than everyone else? Most Alabamians would answer with a resounding “no.” Yet that’s exactly the result that our state’s tax system produces. Families with low incomes in Alabama pay more than twice the share of income in state and local taxes that the top 1% do.

By far the biggest cause is our state’s overreliance on sales taxes. They apply to a wide range of consumer goods, including necessities like food and clothing. And the tax on a \$20 item is the same whether you make \$20,000 or \$20 million. (See page 47 for more on Alabama’s grocery tax.) As a result, the sales tax takes the biggest bite out of the budgets of families with low incomes, who must spend most of what they make on items subject to sales tax just to get by.

Upside-down: Sales taxes are highest for Alabamians with the lowest incomes



Graph shows 2024 tax law in Alabama at 2023 income levels.
Source: Institute on Taxation and Economic Policy, *Who Pays?*, 7th ed. (2024).

Families with low incomes in Alabama pay more than twice the share of income in state and local taxes that the top 1% do.

How do Alabama's sales taxes work?

The Legislature established the current state sales tax in 1939 at 2% on retail sales of tangible personal property like clothing, appliances, toys, food and over-the-counter drugs. The sales tax is defined by statute rather than the constitution. That means the Legislature can increase or decrease it without a vote of the people. Twenty years after introducing the tax, lawmakers increased it to 3% and expanded it to include entertainment. In 1963, legislators raised the sales tax to 4%. Lawmakers voted unanimously in 2023 to reduce the state sales tax on groceries to 3%. In 2025, lawmakers approved a second state grocery tax reduction, to 2%.

The state also **levies** some **special sales taxes** (in the form of **excise taxes**, **privilege taxes** and **use taxes**) on certain products, including gasoline. Special sales taxes on products that some people consider to be vices, such as tobacco and alcohol, often are called "**sin taxes.**" Over the years, the Legislature has found it easier to justify increasing this kind of tax than the general sales tax. By contrast, Alabama always has taxed cars at a lower rate (2%).

In 2015, Alabama adopted the simplified sellers use tax (SSUT) to collect sales tax on items purchased over the internet. Online sellers (such as Amazon and eBay) voluntarily collect the SSUT of 8%. Unlike the state sales tax on items purchased in a brick-and-mortar store, the SSUT is divided by formula between the state, counties and municipalities. As of early 2023, state and local governments had received \$365 million in SSUT revenues.

Most Alabamians also pay municipal (or city) and county sales taxes to support services ranging from schools to parks to police. Local governments set the rate for these taxes but must follow state law in specifying what to tax. Combined municipal, county and state sales taxes range from 7% in the Kansas community (in Walker County) to 11.5% in Tuskegee and Shorter (in Macon County). The Legislature has granted municipal governments the authority to increase sales taxes without a vote or even a hearing. (Counties can act on their own to increase sales taxes used for schools, but not for other purposes.) In 2025, the Alabama Legislature also gave counties and municipalities the authority to decrease their local sales tax on groceries.

SALES TAXES

In theory, the sales tax applies to all retail transactions – that is, purchases by the final consumer. In Alabama, this means purchases of goods and entertainment, but not other services that account for an increasing share of consumer spending. Like almost all states, Alabama exempts some “essentials” like rent and prescription drugs. In 2023, the Legislature reduced the state sales tax on food to 3%, followed by another reduction to 2% in 2025. But Alabama still applies the full sales tax to many other essentials like shoes, clothing and over-the-counter medicines.

Racial inequity at a glance

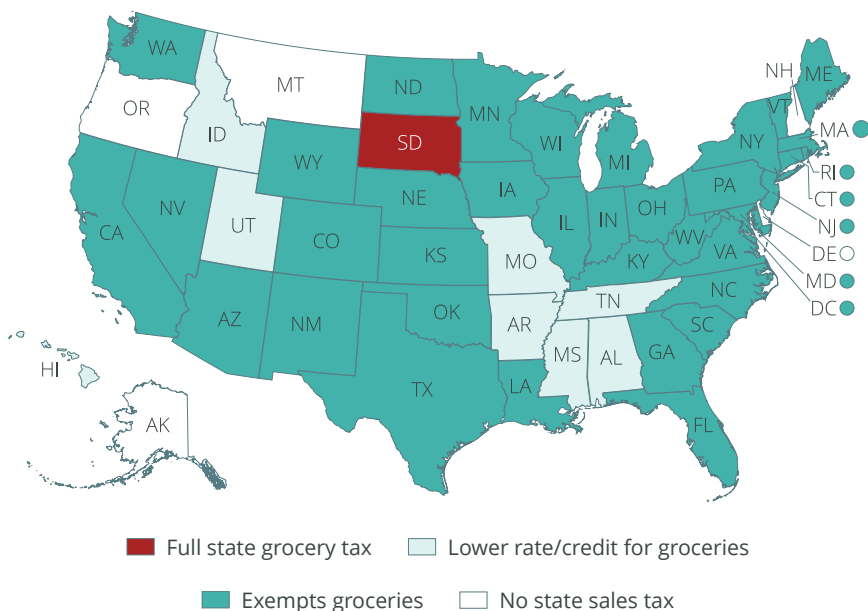
The Alabama Constitution limits the ability of cities and counties to raise revenue needed to provide basic services for their residents. Services like fire protection, roads and streets, libraries, schools, parks, public safety and infrastructure like water and sewage service all require local funding. But Alabama has limited localities’ ability to make even the most basic decisions for themselves, including decisions on how to raise the revenue they need. While counties have some limited self-governance, local governments still cannot raise most taxes without permission from the Legislature. However, cities can set their own local sales tax rates without having to ask legislative permission, and counties can adjust local sales taxes for schools. These limitations force many cities and counties to rely on this regressive tax to provide basic services.

Like many other provisions of Alabama’s constitution, the denial of home rule to cities and counties has a racialized history. The Constitution of 1875, passed immediately after Reconstruction, placed most of the power in the state in the hands of the Planters and Big Mules who ran the state government. These restrictions remained in both the 1901 constitution and the 2022 recompilation. This restricted the ability of Black-majority communities to make decisions for themselves. In recent years, the “preemption” of local authority has denied Birmingham the right to increase its minimum wage, restricted the ability of localities to remove Confederate monuments and denied Montgomery the ability to apply an occupational tax on people who work in the city but live in predominantly white suburbs.

Taxing survival: Alabama is 1 of 9 states still taxing groceries

It's an exclusive list, but Alabama shouldn't be proud to be on it. Alabama is one of only nine states still collecting a state sales tax on groceries. Of the 45 states with a general sales tax, 36 exempt groceries entirely, and eight others (including Alabama as of 2023) either charge a reduced tax rate or offer a tax credit to help families with low incomes offset grocery tax payments.

By taxing groceries, Alabama adds to the cost of a basic necessity of life. That hurts the economy by leaving shoppers with less money to buy meat, vegetables and other products. It hurts working families by making it harder for them to get ahead. And it hurts Alabama by fueling an upside-down tax system that requires people with low and middle incomes to shoulder too much of the cost of education, health care and other public services that benefit all of us.



Note: Sources: AARP, “10 States That Tax Groceries in 2025” (updated Feb. 6, 2025); Mississippi Today, “Starting Tuesday: Mississippi gas taxes go up, grocery taxes go down” (June 29, 2025).

How do Alabama's sales taxes measure up?

We pay sales taxes in small bits throughout the year, unlike once-a-year property and income tax payments. This fact can mask the sales tax's severe impact on Alabamians who are working hard to make ends meet. In fact, the sales tax is the most regressive of the three major taxes (income, property and sales), because it consumes a much greater portion of the household budget for families with low and middle incomes than for wealthy people.

Alabama's state sales tax rate (4%) is lower than that of most states. However, when you add in local sales taxes, the combined sales tax rate (averaging 9%) is among the nation's highest. Sales and excise taxes in Alabama provided 45% of all state and local revenue in 2023, the 12th highest share nationwide, according to the Institute on Taxation and Economic Policy.

Our sales tax continues to apply almost entirely to goods and entertainment, even as spending patterns shift more toward services. Families with low incomes pay a sales tax on laundry detergent, while wealthier families can get their clothes dry-cleaned tax-free. Luxury services like landscaping, house cleaning or interior design are not taxed either.

Alabama is one of a shrinking minority of states still taxing groceries. While the state grocery tax reductions that went into effect in 2023 and 2025 were a vital step forward on tax justice, Alabama is still one of only nine states with any state tax on groceries. Shoppers who buy \$100 worth of food in Pensacola pay \$100. But in Montgomery, that same food costs \$108.

Fortunately, sales taxes don't apply to food bought with food assistance under the **Supplemental Nutrition Assistance Program** (SNAP), formerly known as food stamps. But SNAP benefits cover only a portion of grocery purchases for most families who receive them. Families with low incomes must pay for the rest of their food out of pocket. Alabama continues to tax those groceries, albeit at a reduced rate.

Alabama is still one of only nine states with any state tax on groceries. Shoppers who buy \$100 worth of food in Pensacola pay \$100. But in Montgomery, that same food costs \$108.



Families with low incomes pay a sales tax on laundry detergent, while wealthier families can get their clothes dry cleaned tax-free. Luxury services like landscaping, house cleaning or interior design are not taxed either.



How could we improve our sales taxes?

As the most regressive of the major taxes, the sales tax works best when balanced by a progressive income tax. That's a problem in Alabama, because our nearly flat income tax does not come close to offsetting the regressive sales tax. The best way to reduce the sales tax's impact on families with low and middle incomes would be to collect a larger share of the funding for public services from the income tax and local property taxes.

Alabama can modernize its sales tax system to make the tax less regressive and better reflect current spending patterns. Policy changes that would advance these goals include:

- **Modernize sales taxes on goods and services.** Reduce or eliminate sales taxes on essential goods to avoid taxing people with low incomes into poverty. Policymakers should find a way to eliminate the sales tax on groceries while ensuring adequate funding for public education. Alabama also can generate additional revenue by broadening its tax base to include services primarily purchased by households (not businesses) and "digital goods" like video and music streaming services.
- **Expand the sales tax base to include more services.** Broaden the sales tax base to include a wider range of personal and professional services, which would help the state preserve revenue lost by decreasing the tax on food and other necessities. The state should identify and assess services that can be included in the tax base without disproportionately increasing sales taxes on individuals with low incomes.
- **Adopt a progressive approach to taxing services.** Implement a progressive approach to taxing services, considering the ability to pay and potential impact on households with low incomes. Graduated tax rates on luxury services used by the wealthiest households could help maintain fairness and reduce the sales tax's regressive nature.

The best way to reduce the sales tax's impact on families with low and middle incomes would be to collect a larger share of the funding for public services from the income tax and local property taxes.

Providing tax exemptions for services like health care, education and basic utilities could help ease potential negative impacts on Alabamians with low incomes.



- **Target exemptions for essential services.** While expanding the tax base, provide exemptions for essential services that directly impact families' well-being. Exempting services like health care, education and basic utilities could help ease potential negative impacts on Alabamians with low incomes. Lawmakers also could offset existing sales taxes or future sales tax increases with refundable income tax credits that gradually phase out as income increases.
- **Regularly review and adjust sales tax rates.** Establish a mechanism for regular review and adjustment of the sales tax system to accommodate changing consumption patterns and economic trends. This flexibility would help ensure Alabama's tax system remains effective and responsive over time.
- **Conduct a cross-state comparison.** Analyze sales tax structures in other states that already have expanded their tax base to include services. Policymakers can learn from those states' experiences and tailor policy recommendations to suit Alabama's economic and social environments.

Property Taxes

Property tax arithmetic, lesson 1

Q. What is a mill?

A. A mill is 1/10 of a cent. A 1-mill tax is a \$1 tax per \$1,000 of value.

Q. Why doesn't a 1-mill tax on a \$100,000 house work out to \$100?

A. Because the tax office doesn't apply the tax to the market value of the house. It uses an assessment rate to figure the assessed value, and then it subtracts the homestead exemption.

Appraised value of house:	\$100,000
Times home assessment ratio (10%):	x .10
Assessed value of house:	\$10,000
Minus homestead exemption:	- \$4,000
Value of house for tax purposes:	\$6,000

Q. Is that why our property taxes are so much lower than in every other state?

A. It's not just the assessment ratio. Alabama also has low local millage rates. The big part of your property tax bill is the local share, but for most Alabamians, local property tax is unusually low compared to other parts of the country. Here is an example:

State property tax: .0065 (6.5 mills) x \$6,000 =	\$39
Sample local tax (40 mills): .04 x \$6,000 =	+ \$240
Sample combined property tax on \$100,000 house in Alabama =	\$279

Q. Why do I sometimes hear that our state property tax is high?

A. Typically, property taxes are local taxes. Property taxes at the state level are rare. Alabama's 6.5-mill state tax is low, but it's higher than zero. Even if the state portion is, for example, only 1/7 of your property tax bill, that's still more than in states where it's zero.

How do Alabama's property taxes work?

The 1901 Alabama constitution established a property tax of 6.5 mills to help fund the state government. That was 30 years before our state had income or sales taxes. More than a century later, the state property tax rate has not changed.

Property tax is applied to real estate, motor vehicles and boats as a millage rate. A mill is 1/10 of a cent, so a 1-mill tax amounts to \$1 of tax per \$1,000 of taxable property value. Three mills of the revenue from Alabama's 6.5-mill state property tax is earmarked for the Public School Fund, which helps pay for school construction projects, while the rest supports other services.

The 6.5-mill state property tax is a small part of your property tax bill. The larger part is your local property tax, which pays for public schools and local services like parks and fire protection. In 2020, local property taxes generated nearly 86% of total property tax revenues in Alabama. By state law, each school district must have at least 10 mills of local tax dedicated to education. Local property taxes (excluding the state one) vary widely depending on where you live, ranging from 19.5 mills in rural Coosa County to 109 mills in Mountain Brook (in Jefferson County). Even so, Alabama's average local property taxes are the lowest in the country.

Local governments regularly assess the value of property for both state and local tax purposes. The **assessed value** is the portion of the **appraised value** (or fair market value) that the government uses to calculate the amount of property tax. (See the graphic at left.)



Property tax arithmetic, lesson 2

Q. Do businesses pay more tax on their properties than I pay on my home in Alabama?

A. Yes. Suppose your block had a \$100,000 owner-occupied house, a \$100,000 child care center and a \$100,000 electrical substation.

Value of \$100,000 house for tax purposes (see lesson 1):	\$6,000
Value of \$100,000 child care center for tax purposes (assessment ratio for businesses is 20%):	\$20,000
Value of \$100,000 substation for tax purposes (assessment ratio for utilities is 30%):	\$30,000

Q. What happens if the house isn't owner-occupied?

A. Rental property is taxed as business property, so it doesn't qualify for a homestead exemption. A \$100,000 rental home would be valued at \$20,000 for tax purposes. Compare that to the \$6,000 for an owner-occupied home. Landlords are free to pass the cost of property tax on to tenants in the form of higher rents, though that might not always be possible in more competitive rental markets. Some states offer a rebate to renters to help offset these indirect taxes.



Alabama taxes property at only a fraction of its value. Since the so-called **Lid Bill** capped property tax collections in 1978, the state has used the following system of **property classifications** for assessing taxes:

- Utility company property is assessed at 30% of fair market value.
- Commercial property is assessed at 20%.
- Individually owned vehicles are assessed at 15%.
- Farms, timberland and owner-occupied residential property are assessed at 10%. Huge corporate farms and timber holdings are treated the same as 100-acre family farms. The **homestead exemption** exempts from property taxes (except countywide school taxes and school district taxes) the first \$4,000 of an owner-occupied home's assessed value (an amount equal to \$40,000 of appraised, actual value).

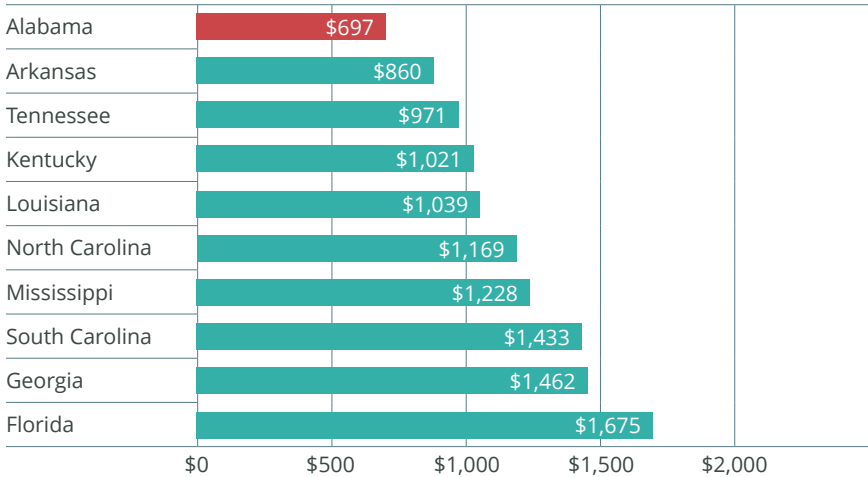
If Alabama taxed residences at their full value, a 1-mill tax on a \$100,000 house would be \$100. But the state taxes homes on only 10% of their value, so a \$100,000 home is assessed at a taxable value of \$10,000. (See the "lesson 1" graphic on page 52.) The homestead exemption lowers the tax even further, meaning you don't pay on the first \$4,000 of the amount subject to tax.

Alabama has numerous property tax exemptions for older adults and people who are blind or disabled. In fact, some Alabamians who are aged 65 and older or who have disabilities pay no property tax at all. Senior married couples who have a **gross income** of less than \$12,000 are exempt from all state and county property taxes on their homestead and up to 160 acres of land. Alabamians who are blind or permanently disabled are exempt from all property taxes.

PROPERTY TAXES

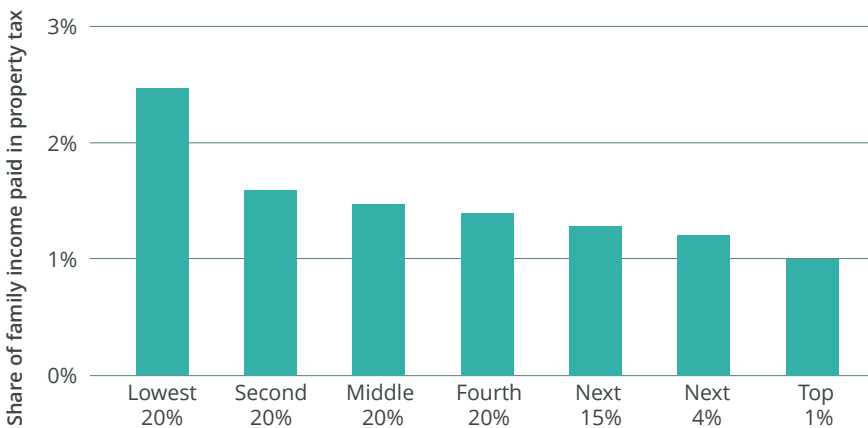
Alabama property taxes: Low overall, but higher for people with low incomes

Alabama's per-person property tax collections are the nation's lowest



Property tax collections per capita for select Southern states, FY 2022. Source: Public Affairs Research Council of Alabama, "How Alabama Taxes Compare, 2024" (Jan. 27, 2025)."

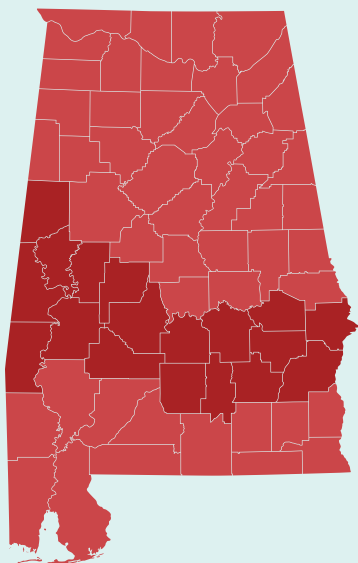
Property taxes are especially low for the wealthiest Alabamians



Graph shows 2024 tax law in Alabama at 2023 income levels. Source: Institute on Taxation and Economic Policy, *Who Pays?*, 7th ed. (2024).

Racial inequity at a glance

The racial impact of property taxes is complex. The most important source of household wealth for most people is homeownership. In part because of low property tax rates, Alabama's Black homeownership rate is the nation's fifth highest at 50.1% of households. This promotes higher rates of household and intergenerational wealth. But racial disparities in both tax assessment and property valuations reduce the benefits of a high homeownership rate.



Several counties in Alabama's Black Belt, a region with high poverty rates and a predominantly Black population, have property tax valuations well above the average for all Alabama counties. And because Alabama earmarks most property taxes for education, Black families are disproportionately harmed by underfunded schools. Many rural Black Belt counties lack a strong economic and retail base, limiting sales taxes and other revenues for education. Coupled with constitutional restrictions on property tax rates, this forces many counties to increase home assessments to fund their schools.

Alabama needs to find a solution that supports homeownership, while reducing unfair tax assessment of Black-owned property and providing adequate funding for public schools in rural communities.

Alabama's Black Belt region includes these 18 counties:

Barbour	Dallas	Marengo	Russell
Bullock	Greene	Montgomery	Sumter
Butler	Hale	Perry	Wilcox
Choctaw	Lowndes	Pickens	
Crenshaw	Macon	Pike	

How do Alabama's property taxes measure up?

Alabama property owners overall pay the lowest combined local and state property taxes in the United States. In fact, the average combined taxes could double and still be below the national average. There are two main reasons for this ranking:

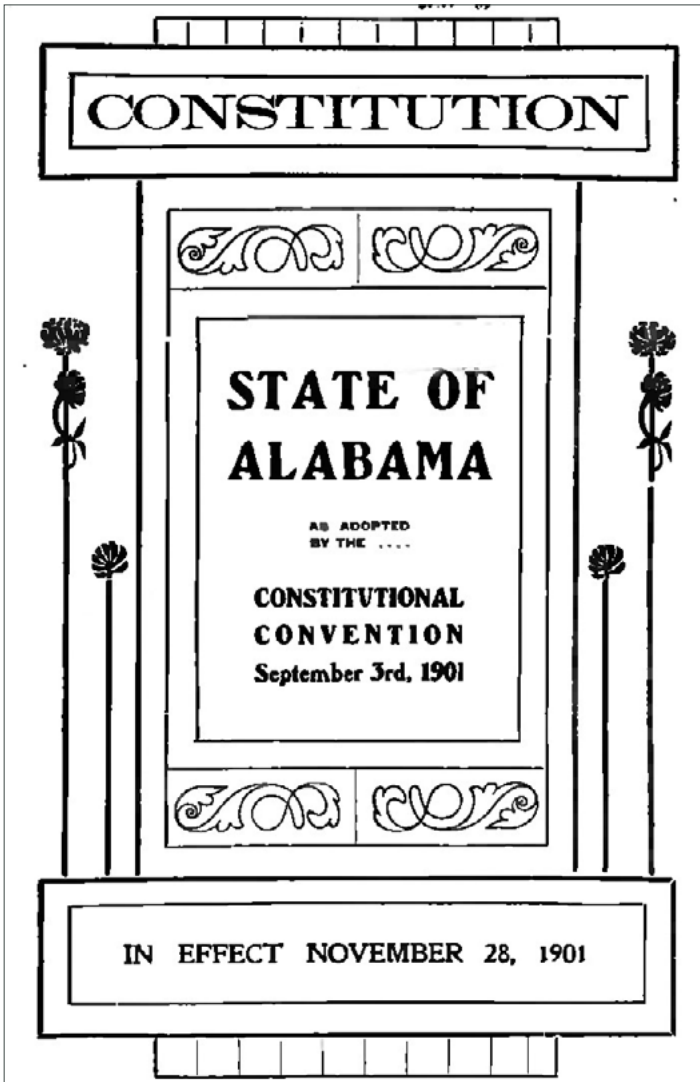
First, Alabama's agricultural property tax breaks are poorly targeted.

In the 1970s, rapid expansion of commercial and residential development increased the value of rural land near cities and towns. To keep property taxes on farms from skyrocketing, the Legislature created a set of formulas to assign discounted values based on **current use** of land. Alabama's current use formulas allow landowners to pay far less than they would in other states. The maximum value per farm acre (for the best land) is \$532 – unchanged since 1982. The maximum value per timber acre is \$827.

Alabama's agricultural landscape has changed in the last 40 years. Today, owners of giant corporate farms and timber holdings take advantage of discounts originally designed to protect smaller farmers. These discounts lead to severely undertaxed timberland, which contributes to the underfunding of health care, education and other valuable investments. Alabama places no limit on the size of a farm that benefits from reduced property tax rates. Georgia, by contrast, has a 2,000-acre limit on farms that qualify for a current use exemption. This cap protects family farmers while still ensuring equitable taxes on large corporate landholders. Alabama counties tax timberland at rates one-half of those paid by owners in similar counties in Florida, and only one-third of those paid by owners in similar counties in Georgia, Tennessee and Mississippi, according to a 2020 study by researchers at Auburn University and other institutions.

The severe undertaxing of Alabama's timberland primarily benefits wealthy landowners – often large, profitable corporations – with limited ties to the community where their property is located. Nearly 60% of Alabama timberland is owned by people living outside of the county where the land is located. Alabama's share of foreign-owned agricultural land in 2023 was 8%, more than twice the national average, according to the U.S. Department of Agriculture.

Second, Alabama's constitution makes it hard for localities to raise property taxes but easier for them to increase sales taxes. Wealthy landowners and industrialists built barriers into the state's 1901 constitution to shelter property from adequate taxation. Those barriers still exist, and the Lid Bill of 1978 made them even tougher.



How could we improve our state property tax?

Keep in mind: Alabama's per-person property tax collections are the lowest in the nation. To fill the resulting funding gap, many communities have high sales taxes, which make our tax system more regressive. We need a better approach.

The property tax reforms below would help restore balance to Alabama's upside-down tax system. Large landholders would pay more, while small-scale farmers would pay less. And Alabamians' overall property taxes still would remain below the national average.

- **Evaluate and update the state property tax rate.** Property taxes are primarily a local revenue source but are subject to complex web of state restrictions. Many of these limits were erected by the 1978 Lid Bill and forgo revenue by providing large tax breaks to huge corporate landowners and wealthy homeowners. By contrast, the best form of relief are **circuit breakers**, which limit property tax liability to a certain share of income for households and renters with low and moderate incomes. In addition, many wasteful and ineffective property tax abatements for businesses need to be repealed.
- **Increase overall property tax rates.** Modest increases could generate a large amount of new revenue to strengthen public schools in communities across Alabama. One pathway would be to tax business property at the same **assessment ratio** as **utility property**. The state also could raise the minimum local millage rate for public schools from 10 mills to 20 mills.
- **Protect homeowners with low incomes by increasing the homestead exemption.** Excluding the first \$50,000 of a home's value from state taxes would provide a 25% increase in this exemption.
- **Protect small-scale farmers by creating a "farmstead exemption."** This could be done by increasing the homestead exemption for a farmer's home, or by creating a **farmstead exemption** that would protect average-sized family farms. Another option would be to create a new farmstead exemption for a certain number of specified improvements (such as irrigation systems).

- **Adjust property taxes on timberland to bring them in line with surrounding states.** Out-of-state investors own a substantial share of Alabama timberland, and they pay roughly a third of the property tax that their counterparts in Georgia and Mississippi do. Current use formulas set the value of Alabama timberland between \$360 to \$827 per acre depending on productive capacity. Alabama assesses timberland at 10% of these values for tax purposes, while the comparable figure is 40% in Georgia. Increasing the assessment rate to 20% for timberland holdings above 500 acres would protect most family timberland owners while raising revenue for counties to meet local needs.

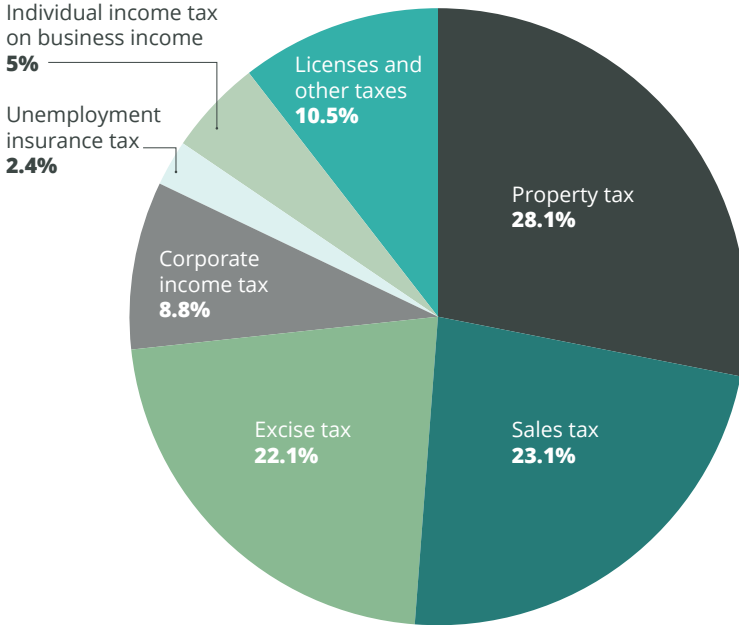
Out-of-state investors own a substantial share of Alabama timberland, and they pay roughly a third of the property tax that their counterparts in Georgia and Mississippi do.



Business Taxes

What taxes do businesses pay in Alabama?

Types of state and local business taxes as a share of total business taxes paid in Alabama



Source: Ernst & Young LLC, state-by-state estimates of total state and local business taxes for FY 2020 (October 2021).

How does Alabama tax businesses?

Business taxes provide the important “fourth leg of the stool” of our tax system. Alabama’s business taxes were restructured in 1999 after courts ruled the old system unconstitutional because it taxed out-of-state companies at a higher rate.

Today's structure relies on two taxes:

First, the corporate income tax is a 6.5% tax on the taxable profits of corporations doing business in Alabama. Like all states, Alabama is barred by federal law from taxing all of the income of multistate companies. Each state uses apportionment rules – based on the share of business activities that take place in the state – to divide these companies' profits into in-state and out-of-state portions. A 2021 change in Alabama's **apportionment** rule moved some manufacturing profits into the out-of-state portion, further reducing corporate income taxes owed to Alabama.

In place of the income tax, insurance companies pay taxes on premiums. Utility companies pay both income taxes and taxes on gross receipts.

Second, the business privilege tax is a tax on the company's net worth. In Alabama, this tax is capped at \$15,000 a year. (That's a problem. See page 66 to learn why.)

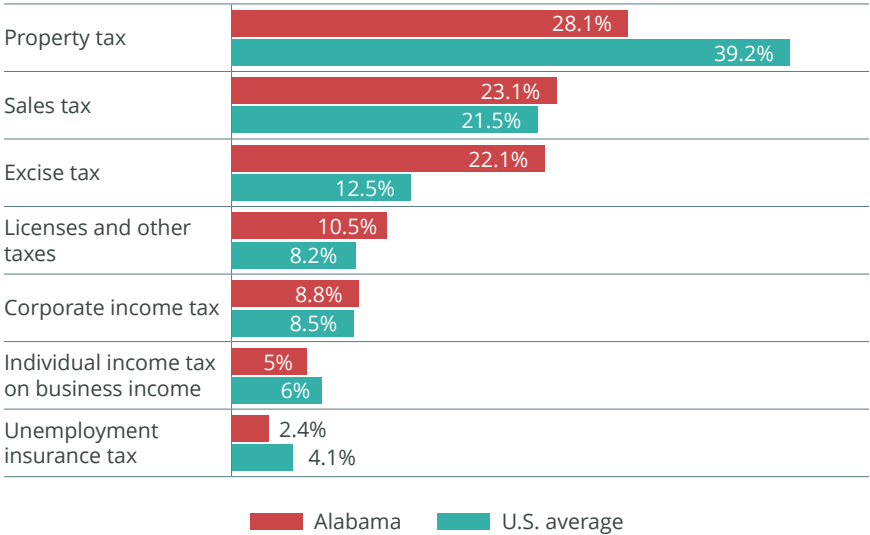
Businesses pay other state and local taxes as well:

- Nearly a quarter of the tax dollars that businesses pay are for state and local sales taxes on items purchased for their own use or consumption. The sales tax does not apply to "inputs to production" or goods offered for resale. For example, Alabama taxes the pizza sold by a restaurant, but the restaurant does not pay state tax on the flour or other raw ingredients. Businesses pay an excise tax on motor fuels for business use.
- Businesses pay at least twice the rate of property tax that homeowners pay. Business property is taxed on 20% of appraised value, and utility property is taxed on 30%.
- Businesses contribute to employees' **payroll taxes** for unemployment insurance, workers' compensation and disability insurance.

A 2021 change in Alabama's apportionment rule moved some manufacturing profits into the out-of-state portion, further reducing corporate income taxes owed to Alabama.

How Alabama's business taxes compare nationally

State business tax collections in Alabama and nationwide, FY 2020



Source: Ernst & Young LLC, state-by-state estimates of total state and local business taxes for FY 2020 (October 2021).

This graph reveals some striking ways in which Alabama's business taxes differ from national patterns:

- Alabama is sharply below average in its reliance on the property tax for business tax revenues.
- The state is sharply above average in use of business excise (e.g., motor fuel) taxes.
- Unemployment insurance taxes account for a lower share of business taxes in Alabama than the national average.
- Alabama businesses pay more in sales taxes than the national average, reflecting the state's high overall sales tax rate.
- Licenses and fees account for a higher percentage of business taxes in Alabama than the national average, adding to strain on small businesses.

Racial inequity at a glance

Alabama offers significant subsidies and tax breaks to companies operating, expanding or locating in economically disadvantaged areas of the state called “enterprise zones.” Enterprise zones originally were classified as geographic areas (like Alabama’s Black Belt) suffering from high unemployment, low educational attainment levels, population decline or other signs of economic distress. In 2019, however, Alabama expanded its definition of “enterprise zone” to include any Alabama county with a population of less than 50,000. As a result, 45 of Alabama’s 67 counties have become eligible for tax incentives and exemptions originally targeted to the most economically disadvantaged areas of the state.

Despite the expansion of eligibility for these subsidies, Alabama remains one of the poorest states in the nation, as economic development has remained close to stagnant in many parts of the state. In 2023, Good Jobs First (GJF) assessed the relationship nationwide between race, ethnicity and corporate subsidies. The group’s findings indicated that states that provide economic development subsidies in the way that Alabama does often exacerbate racialized inequality. These kinds of subsidies often disproportionately transfer public wealth to white male executives and the companies they run, according to GJF.

Downtown Selma



How do Alabama's business taxes measure up?

Alabama's corporate income tax collections declined as a share of revenue between 2005 and 2015 but have since increased to account for 11.2% of tax revenues for the ETF. State and federal corporate tax laws and loopholes have been the major driver of changes in corporate income tax collections. Federal corporate tax law affects Alabama's tax collections because the two often are linked by state law.

Yet Alabama provides many special business tax breaks of its own. For example, Alabama is the only state to let corporations deduct all of their federal income taxes from state taxable income. (Missouri allows a partial deduction.) This lowers the effective tax rate (the tax as a share of profits) dramatically. On the surface, Alabama's 6.5% corporate income tax rate is higher than the rate in neighboring states. But the effective rate (including the federal income tax deduction) may be significantly lower.

Recent legislation has proposed eliminating the federal income tax deduction while reducing the corporate income tax rate, making Alabama a more competitive location for new businesses. Other legislation passed in recent years allowed corporations to exclude federal COVID-19 relief funds as income when calculating their state taxes.

Alabama is one of a declining number of states (16 now, down from 25 in 2015) that levy a business privilege tax. But Alabama caps the tax, unlike most other states with a business privilege tax. Companies above the cap pay taxes on a lower share of their net worth – an advantage of being big. Because it's based on net worth instead of profits, the privilege tax is less sensitive to economic changes than the income tax – and less susceptible to tax avoidance techniques. A bill to eliminate Alabama's business privilege tax nearly passed the Legislature in 2022.

On the surface, Alabama's 6.5% corporate income tax rate is higher than the rate in neighboring states. But the effective rate (including the federal income tax deduction) may be significantly lower.



Alabama would see an overall revenue gain of \$371 million a year if we adopted domestic and worldwide combined reporting, according to a 2025 estimate from the Institute on Taxation and Economic Policy.

Many multistate corporations are able to avoid state income taxes due to how they are allowed to treat income earned, or spent, in other states or nations. In 28 states and the District of Columbia, state laws requiring **combined reporting** of out-of-state income and expenses address this problem. By requiring this information on a state income tax return, states can ensure that corporate income is appropriately reported and required taxes are paid on that income. Despite legislative efforts, Alabama still does not require combined reporting, allowing creative accounting to reduce income taxes owed here. Alabama would see an overall revenue gain of \$371 million a year if we adopted domestic and worldwide combined reporting, according to a 2025 estimate from the Institute on Taxation and Economic Policy.

Businesses also benefit from **economic incentives**, usually in the form of tax breaks, intended to encourage location or expansion in Alabama. Recent changes in state law have increased the employment and wage standards that companies must meet in exchange for incentives – and have improved the state's ability to hold companies accountable for failing to meet commitments. Still, much work remains to ensure full transparency in reporting the costs and benefits. Legislation passed in 2023 improved transparency somewhat, but it remains difficult to track which corporation received incentives or how those incentives benefited workers or the state. Alabama lost almost \$179 million from incentives in 2023, Good Jobs First estimated based on state and federal tax reports, with our largest cities and counties losing an additional \$231 million in tax revenue that year.

How could we improve our business taxes?

Businesses benefit from vital public infrastructure like education and roads just as individuals and families do. Numerous changes to Alabama's business taxes could make them fairer and ensure businesses pay an equitable share of the cost to maintain and enhance the common good:

- **Remove the deduction for federal income tax payments and drop the corporate income tax rate to 6%.** The current 6.5% rate really amounts to 4.2% when factoring in the deduction for federal income tax payments.
- **Raise the cap on the business privilege tax so the largest and most profitable corporations will compete more fairly with smaller ones.** Even with this change, Alabama's business tax levels would remain below those of most other states.
- **Adopt combined tax reporting for businesses and their subsidiaries.** By treating a company and all of its related enterprises as one taxpayer, Alabama could keep a business from deducting payments to its own subsidiary from its state taxes. This change also could prevent corporations from shifting taxable in-state earnings to other states to avoid Alabama taxes. Alabama should embrace the approach taken by 28 states and the District of Columbia to require accurate reporting of out-of-state income and expenses.
- **Restore Alabama's three-factor apportionment formula for calculating corporate income tax liability.** Until 2021, Alabama's formula accounted for companies' shares of payroll, property and sales located in the state. But the current formula, known as "single sales factor," is based solely on sales. Many states that have adopted a single sales factor formula have seen significant decreases in corporate income tax revenue.

By treating a company and all of its related enterprises as one taxpayer, Alabama could keep a business from deducting payments to its own subsidiary from its state taxes.

- **Decouple Alabama’s business taxes from the federal tax code so that tax breaks or increases given by Congress do not automatically apply to state business taxes.** This would allow the Legislature to decide for itself if a particular tax break is good for Alabama.
- **Limit tax incentives for luring companies to Alabama.** Many companies rank tax breaks low among the reasons they choose to locate in a state, but they still bargain for the best incentive plan they can get. Numerous studies show the most effective incentives are a skilled workforce, a good education system and other quality-of-life measures. Large corporations should pay their fair share to support those investments.

Businesses benefit from vital public infrastructure like education and roads just as individuals and families do. Alabama should ensure businesses pay an equitable share of the cost to maintain and enhance the common good.



Tax Policy Solutions for the Long Haul

How could we make our tax code more fair?

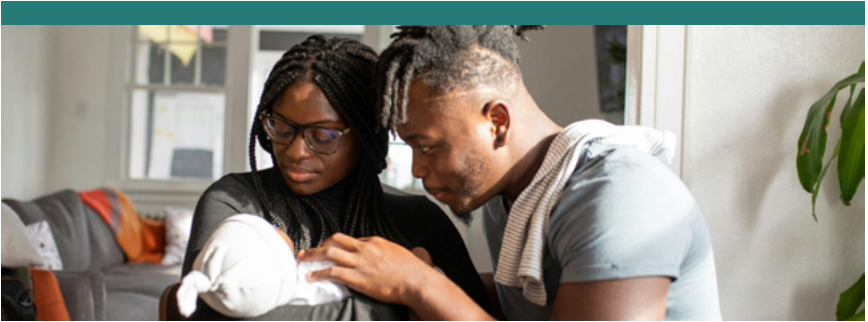
Alabama can move forward by changing its outdated, imbalanced approach to raising revenue. Our state's current approach is not helping workers get ahead, and it is not adequately funding education, health care and other vital services that help make widely shared prosperity possible. Alabama should consider numerous reforms to make its upside-down tax system more just, equitable and resilient.

Income tax: Because much of Alabama's income tax structure is spelled out in the constitution, changing it would require changing the constitution. If Alabama's income tax more closely followed the system of exemptions and deductions used at the federal level and in many other states, working families would have more money available to spend. That would boost the economy and improve their quality of life. The following proposals would help modernize our income tax and make it fairer:

- Make income taxes less regressive and more progressive.
- Reform out-of-date deductions.
- Eliminate the federal income tax (FIT) deduction.
- Review Social Security contribution deductions.
- Establish a state Earned Income Tax Credit (EITC).
- Gradually increase standard deductions.

Sales taxes: Alabama can modernize its sales tax system to make the tax less regressive and more reflective of current spending patterns. Policy changes that would advance these goals include:

- Modernize the sales tax on goods and services, including eliminating the grocery tax.
- Expand the sales tax to include more services and digital goods.
- Adopt a progressive approach to taxing services.
- Target exemptions for essential goods and services.
- Regularly review and adjust sales tax rates.
- Conduct a cross-state comparison.



Property taxes: Numerous property tax reforms would help restore balance to Alabama’s upside-down tax system. Large landholders would pay more, while small-scale farmers would pay less. And Alabamians’ overall property taxes still would remain below the national average. These reforms include:

- Evaluate and update the state property tax rate.
- Increase overall property tax rates.
- Protect homeowners with low incomes by increasing the homestead exemption.
- Protect small-scale farmers by creating a “farmstead exemption.”
- Adjust current use formulas to make them fairer.

Business taxes: A number of changes to Alabama’s business taxes could make them fairer and increase the amount of money for vital services, which businesses benefit from as much as individuals and families. These include:

- Remove the deduction for federal income tax payments and reduce the corporate income tax rate to 6%.
- Raise the cap on the business privilege tax so the wealthiest corporations will compete more fairly with smaller ones.
- Adopt combined tax reporting for businesses and their subsidiaries.
- Restore Alabama’s three-factor apportionment formula for calculating corporate income tax liability.
- **Decouple** Alabama’s business taxes from the federal tax code so that tax breaks or increases given by Congress do not automatically apply to state business taxes.
- Limit tax incentives for luring companies to Alabama.

New rules: What to watch for in new tax proposals

We can use four criteria to assess plans to improve Alabama's taxes:

1. Fairness: Do they lower taxes for those who pay too much and increase taxes for those who pay too little?

- Will wealthy people and highly profitable companies pay their fair share? Alabamians with low incomes pay more than twice the share of income that the top 1% pay in state and local taxes.
- Will new plans tax low-paid workers deeper into poverty? Hurdles in Alabama's constitution make it hard to raise new revenue through income or property taxes. But it's easy to increase sales taxes, driving "the least of these" deeper into poverty and forcing them to shoulder an even greater share of the cost of the public services that benefit us all.

2. Adequacy: Do new plans meet the needs of a growing population?

- Do the plans help end the state's structural deficit? Simply put, will they pay the bills? Stagnant income sources can't keep pace with rising costs. One way to keep up with the changing times would be to extend our sales and use taxes to cover the services that account for an increasing share of consumer spending. We also could revise how we tax corporations so that the largest and most profitable pay their fair share of state taxes. And we can adjust our individual income taxes so that the wealthiest households pay their fair share while allowing more robust tax deductions for working families.
- Do the plans allow flexibility to address changing needs? As technology evolves and the population grows, Alabama must be able to keep up. Can our public schools educate our children properly when policymakers continue to redirect a growing share of their funding to private schools and homeschooling? Can one of the nation's most limited Medicaid programs adequately serve aging and working populations? Can our overcrowded, brutal and inadequate prisons provide real rehabilitation and second chances for returning citizens? If we want a better tomorrow, we need to invest in it today.

- Does Alabama have adequate reserves? Or have we set too much aside in reserve that could be used to fund critical services for our residents? Do our multiple reserve accounts meet the needs of the people, or are they confusing and duplicative? We should take a careful look at our reserve funds to see if they serve our residents' best interests or if they could be streamlined and revised.

3. Simplicity: Can people file a basic tax return?

- Is it easy to understand how taxes work? As lobbyists and special interests push new tax measures, our income tax form gets more complicated. Key principles can keep the system simpler.
- Does our tax system have confusing loopholes? A hodgepodge of tax breaks for some but not others makes our system inefficient. Worse yet, legislators sometimes create preferences for certain industries without revealing who would benefit.

4. Transparency: Can we see that everyone pays a fair share?

- Does the budget process let the public follow the money from tax collection through spending? Policymakers should set rules that ensure everyone pays a fair share in taxes. Do we know how much money is available for the state to spend on core services? And how can we ensure state agencies have what they need to provide vital services to families who are struggling to make ends meet?
- Is the state required to list tax breaks in a format that is clear and understandable? Alabama's budgets reveal our values and priorities. But many tax breaks pushed through by powerful lobbyists can be virtually invisible. While Alabama provides a report on tax breaks, it's difficult to read and understand. Most residents aren't going to read audit reports to find tax breaks offered by state and local governments. Alabama's tax expenditure report is a good first step, but it needs improvements to become truly accessible to the public.

Bottom line: Does our government reflect our values?

We need strong public services and inclusive public policies to meet the needs of our people. We create governments to promote the common good, to do together what we can't accomplish alone – educating and protecting and planning and building a better future for everyone. If we hope to move forward, we have to change our broken, upside-down approach to taxes and budgets.

By getting involved, Alabamians can require their policymakers to be responsive to the needs in our communities. Our residents deserve a government that gives everyone a voice, an economy that offers everyone a chance to get ahead, and an Alabama that works for all of us.



A group of grassroots leaders trained by Alabama Arise and Alabama Values pose at their 2024 Think Big Alabama graduation. Arise will continue to invest in new leadership so that everyone can push for the state budgets and taxes that we all need to thrive.

Alabama Tax and Budget Glossary

This glossary includes keywords used in *The Alabama Tax and Budget Handbook*, as well as other terms commonly encountered in tax and budget debates. Terms that are italicized in the definitions are defined elsewhere in this glossary.

act – a *bill* that has become *law*.

adjusted gross income – total annual earnings after subtracting certain expenses (such as qualified retirement contributions) but before subtracting *deductions* and *exemptions*. Compare taxable income.

ad valorem – a Latin phrase meaning “according to value.” See property tax.

Alabama Department of Revenue – the state agency that administers *tax* programs and collects taxes in Alabama. The federal tax authority is the *Internal Revenue Service*.

Alabama Trust Fund – a savings fund established to capture future *revenues* from sales of offshore drilling rights and from royalties on the resulting gas production.

apportionment – the process of determining what percentage of businesses' profits are subject to a given state's *corporate income tax* or other business *taxes*.

appropriation – an amount of money approved by the Legislature for a certain purpose. See also conditional appropriation; supplemental appropriation.

appraised value – an expert opinion of the current market value of a property.

assessed value – a *tax* assessor's determination of property value, based on *appraised value* and lowered in Alabama by a *property classification* factor.

assessment ratio – a formula set by *law* to determine the portion of a property's *appraised value* that is subject to *tax*. See also property tax.

balanced budget – an income and spending plan for which projected income is equal to or greater than projected spending. Alabama *law* requires the Legislature to balance the *budget* every year.

GLOSSARY

Big Mule – a political term coined in 1926 to describe influential wealthy industrialists and utility executives who influenced Alabama politics. *See also* Planters.

bill – a proposed piece of legislation to be considered by the Legislature for passage (or enactment) into *law*. *See also* act.

Black Belt – Alabama’s Black Belt area is part of a larger national Black Belt region that stretches from Texas to Virginia. This region has historically been home to “the richest soil and the poorest people” in the United States.

budget – a spending plan for a *fiscal year*. *See also* governor’s budget proposal.

Budget Stabilization Fund – a reserve balance that is set aside during good economic times to protect the state *budget* from cyclical changes in revenues and expenses that may occur during poor economic times.

business privilege tax – a *tax* on the net worth of companies doing business in Alabama. The business privilege tax replaced the franchise tax in 1999.

chamber – a deliberative assembly within a legislature that generally meets and votes separately from the legislature’s other chambers. In Alabama, a chamber refers to either the House of Representatives or the Senate.

circuit breakers – a targeted *property tax* reduction program that operates like an electric circuit breaker, which cuts off the flow of current before an electrical surge can cause damage. Circuit breaker programs account for ability to pay when calculating a property tax bill and cap property tax payments that exceed a certain percentage of income.

combined reporting – a *tax* practice that treats a “parent” corporation and its subsidiaries as one corporation for *corporate income tax* purposes. Many large corporations avoid taxes by artificially moving profits out of the states where they are earned and into states where they will be taxed either at lower rates or not at all. States that have adopted combined reporting can prevent many of these tax avoidance strategies.

conditional appropriation – an amount of money approved by the Legislature for a particular purpose only if funds become available later in the *fiscal year*.

conference committee – a legislative committee composed of House and Senate members that meets to reconcile differences in legislation that has passed both *chambers*.

corporate income tax – a *tax* on the net income of a corporation located in Alabama or deriving income from sources within Alabama.

credit (also called *tax credit*) – a direct, dollar-for-dollar reduction in *taxes* owed. A credit reduces the amount of tax owed on income, while a *deduction* reduces the amount of income that is subject to taxation.

current use – the valuation of certain qualifying properties at a reduced amount based upon their use as farmland or timberland.

decouple (also called *de-link*) – to break the connection between a state’s *tax code* and certain provisions of the federal tax code.

deduction (also called *tax deduction*) – an expense (such as a charitable gift or mortgage interest) subtracted from *adjusted gross income* while figuring *taxable income*. See also itemized deduction; standard deduction.

dependent – a person, usually a family member, who is supported financially by another person.

dependent deduction – an amount excluded from *taxable income* in Alabama to help offset a taxpayer’s cost to support a child or other *dependent*. On federal *income tax* returns, this reduction is claimed through a *personal exemption*.

discretionary funds – money that is available to spend on things that are not considered necessary but that may be useful.

earmarking – the practice of setting aside – through constitutional provision or statutory law – *revenues* from particular sources for particular purposes.

earned income – money received in payment for a job or through self-employment and reported to the *Internal Revenue Service* (IRS) and the state for tax purposes.

Earned Income Tax Credit (EITC) (also called *earned income credit* or *EIC*) – a refundable *credit* for low-income taxpayers who earn income above a given amount. “Refundable” means taxpayers get the full amount of the credit no matter the size of their *tax* bill. State EITCs often are set at a percentage of the federal EITC and can help offset the *regressive* effects of *sales taxes*.

economic incentives – cash or near-cash assistance (such as *tax* benefits, reductions, subsidies and rebates) provided on a discretionary basis to attract or retain business operations.

Education Trust Fund (ETF) – state *revenues* set aside for public education and related services at all levels. *Compare* General Fund.

Education Trust Fund Budget Act – annual legislation that provides the spending plan for federal, state and some local *revenues* set aside for education. *Compare* General Fund Budget Act.

Educational Opportunities Reserve Fund – a fund created in 2023 that could help offset future shortfalls in the state’s *Education Trust Fund*.

excise tax – a *special sales tax* that is *levied* on the purchase of a particular type of product or service, such as alcohol, tobacco or gasoline.

executive amendment – suggested changes to a vetoed *bill* that the house in which it originated must make for the governor to sign it into *law*. *See* veto.

Executive Budget Office (EBO) – a division of the state’s Department of Finance that prepares the *governor’s budget proposal*, administers legislative *appropriations*, estimates *revenues* for *budget* preparation and assists in drafting appropriation *bills*.

exemption – a portion of income on which no tax is imposed – usually intended to help shield the basic costs of living from taxation. *See also* farmstead exemption; homestead exemption; personal exemption.

farmstead exemption – a proposed tax code provision that would exempt a certain share of *assessed value* for calculating *property tax* on an owner-occupied farm. *See also* homestead exemption.

federal income tax (FIT) deduction – a *deduction* that allows taxpayers to write off their federal *income tax* payments on their state income taxes. Alabama is the only state to allow a full federal income tax deduction.

federal match – refers to a cost-sharing mechanism in which a portion of a project’s costs are paid by federal funds. Matching funds are typically stated as a percentage of the total project cost.

federal poverty measure – See poverty line.

fee – a fixed charge for a privilege or service.

fiscal note – an analysis of how a *bill* would increase or decrease the revenues available to fund state or local services. The Fiscal Division of the *Legislative Services Agency* prepares fiscal notes for the Alabama Legislature.

fiscal year (FY) – an annual accounting period. Like the federal fiscal year, Alabama’s fiscal year runs from Oct. 1 through Sept. 30 and is designated by the calendar year in which it ends. For example, fiscal year 2040 will start in October 2039.

flat tax (also called *proportional tax*) – a tax that is *levied* at the same rate on all levels of income. *Compare* graduated tax; progressive tax; regressive tax.

General Fund (GF) – state *revenues* that are not *earmarked* and that provide for most public services except education. *Compare* Education Trust Fund.

General Fund Budget Act – annual legislation that provides the spending plan for federal and state *revenues* supporting all non-education programs.

governor’s budget proposal – a suggested allocation of state money that the governor presents to the Legislature by the second legislative day of each *regular session*.

graduated tax – a type of *progressive tax* in which the *tax rate* is higher as the value of the taxed income or item increases.

gross income – the sum of all wages, salaries, profits, interest payments, rents and other forms of earnings, before any *deductions* or *taxes*. *Compare* adjusted gross income; taxable income.

home rule – implies that each level of government has a separate realm of authority. The state constitution could grant home rule, which would provide more ability for local governments to address local issues.

GLOSSARY

homestead exemption – a provision in the *tax codes* of Alabama and other states that reduces the *assessed value* of a primary residence by a set amount for the purpose of calculating *property tax*. *See also* farmstead exemption.

income tax – a *tax on earned income and unearned income*.

inflation – growth in the price level of goods and services, measured as an annual rate.

Internal Revenue Service (IRS) – the federal agency responsible for collecting *taxes* and administering tax programs. Alabama's state tax authority is the *Alabama Department of Revenue*.

itemized deduction – an individual expense (such as mortgage interest, charitable gifts or payments for medical services) that lowers *taxable income*. Taxpayers itemize if their *deductions* exceed the *standard deduction*.

law – a legal document (constitution, *act*, regulation, ordinance, etc.) that sets rules governing a particular activity.

Legislative Services Agency (LSA) – a nonpartisan state agency that provides objective fiscal analysis (including information about *tax* and *budget* matters), legal advice and *bill* drafting services to Alabama legislators.

legislative session – a period when the Legislature meets, either in *regular session* or in *special session*.

levy – to impose a *tax or fee* on a person, business or other entity.

Lid Bill – a 1978 amendment to the Alabama Constitution that lowered the *assessment ratio* for farm, forest and residential property to 10% of *appraised value*, established a *current use* provision and capped the amount of *property tax* that can be collected overall.

local tax – a *tax* imposed by a local government to fund services such as water treatment, fire protection and garbage collection.

Medicaid – a health insurance program, funded by federal and state governments and operated by the state, for people with incomes below a certain level – primarily children, older adults, and people with disabilities in Alabama. *Compare* Medicare.

Medicare – a federal health insurance program for adults aged 65 and older and for people with disabilities. *Compare* Medicaid.

mill – one-tenth of a cent. A one-mill *tax* is equivalent to \$1 per \$1,000 of value.

millage rate – the number of *mills* that a locality or state *levies* on property within its authority.

payroll tax – a *tax* on wages that is used to finance unemployment insurance, worker compensation, disability insurance, *Social Security* and *Medicare*.

personal exemption – an amount excluded from the *taxable income* of any taxpayer who cannot be claimed as a *dependent* by another taxpayer.

Planters – members of the Legislature, typically from the *Black Belt*, who controlled the Alabama Legislature along with the *Big Mules* in the early 1900s.

poverty guidelines – standards issued by the U.S. Department of Health and Human Services to measure eligibility for certain federal programs. The guidelines are based on the *poverty thresholds* but are simpler and more current.

poverty line (formally called the *federal poverty measure*) – a U.S. government standard used to classify people as “poor.” There are two versions: *poverty thresholds* and *poverty guidelines*. Both versions vary with family size and ages.

poverty thresholds – standards issued by the U.S. Census Bureau to estimate the number of people living in poverty. The thresholds, issued in late summer for the previous calendar year, are more detailed than *poverty guidelines*.

progressive tax – a *tax* that requires people who make more money to pay a bigger share of their income than those who make less. A tax can be made progressive by the use of graduated rates, *exemptions*, *deductions* or *credits*. *See also* graduated tax; *compare* regressive tax.

GLOSSARY

property classification – a set of categories of real estate defined by state *law* for the purpose of assigning *assessment ratios* for *property tax*.

property tax (also called *ad valorem* tax) – a *tax* that a state or local government *levies* on the *assessed value* of property.

proportional tax – See *flat tax*.

proration – the process of cutting agency *budgets* equally across the board when *revenues* fall short of expectations.

Public School Fund – a state fund that helps pay for public school construction and renovation projects. The Public School Fund receives 3 *mills* of *revenue* from the state *property tax*.

rainy day fund (also called *reserve fund*) – money set aside in a *budget* or borrowed from a government account for emergency use.

Reconstruction – the period after the Civil War during which attempts were made to redress the inequities of slavery and its political, social and economic legacy and to solve the problems arising from the readmission to the Union of the 11 states that had seceded.

regressive tax – a tax that requires people who make less money to pay a bigger share of their income than people who make more money. *Compare* progressive tax.

regular session – the annual period when the Alabama Legislature meets, limited to 30 meeting days within a period of 105 calendar days beginning in the first quarter of the year. *Compare* special session.

reserve fund – See *rainy day fund*.

revenue – money collected by a government from the public in *taxes* and *fees*.

revenue forecast – predicts *revenue* over a certain time period, usually one year.

Rolling Reserve Act – a 2011 state law that limits *Education Trust Fund* spending based on average *revenue* growth in prior *budget* years. Revenue in excess of the spending cap goes toward an account designed to prevent *proration* or toward capital expenses like school bus purchases or school building repairs.

sales tax – a *tax* that a state or locality *levies* on the retail price of an item, collected by the retailer.

simplified sellers use tax (SSUT) – allows eligible sellers to participate in a program to collect, report and remit a flat 8% sellers *use tax* on all sales made into Alabama.

sin tax – a *tax* that is *levied* on products or activities that some people consider to be vices, such as cigarettes, liquor or gambling.

Social Security – a social insurance program that provides most of the nation’s workforce with retirement, disability and survivor benefits.

special sales tax – a *tax* charged on certain goods or activities that is higher than the normal *sales tax*.

special session – a convening of the Legislature, limited to 12 meeting days within 30 calendar days, that the governor calls for a specific purpose. Any measures not included in the “call” require a two-thirds majority vote in both *chambers* to pass. *Compare* regular session.

standard deduction – a fixed amount that taxpayers who do not claim *itemized deductions* can subtract from *adjusted gross income* to reduce their *taxable income*.

structural deficit – the inability of a government’s *revenue* system to keep up with normal cost increases resulting from factors like *inflation* and population growth. The *General Fund* has had a structural deficit for decades.

substitute bill – a version of a *bill* offered by a legislative committee. If adopted, the substitute replaces the original bill or resolution.

supplemental appropriation – an amount of money approved by the Legislature to meet current needs that were not met in the *budget* passed in an earlier session.

GLOSSARY

Supplemental Nutrition Assistance Program (SNAP) – a program that provides food assistance benefits to help people with low incomes supplement their grocery budgets.

tax – an amount charged by a government on income, goods, property, services or activities to help pay for public services like education and public safety.

tax expenditure – potential *revenue* forgone through tax *credits* and *exemptions*.

tax rate – the percentage of a given level of income or value paid in *taxes*.

tax threshold – the lowest income level subject to the *income tax*.

taxable income – amount of income subject to *income tax* (after subtracting all *deductions* and *exemptions*). *Compare* adjusted gross income.

unearned income – income (such as dividends, interest or rental *fees*) that does not result directly from the recipient's labor. *Compare* earned income.

use tax – a *tax* on goods bought outside a locality or state for use inside it. The use tax is equivalent to a *sales tax* on such goods. It is commonly discussed in the context of internet or mail-order purchases.

utility property – all property and assets of a company and its subsidiaries used principally in electric, natural gas and water operations.

veto – the power of the governor to refuse to approve a *bill* and thus prevent its enactment into *law*. In Alabama, if a majority of the members elected to each chamber vote to approve a vetoed bill as the Legislature passed it – a process known as overriding a veto – the bill becomes a law despite the governor's veto. *See also* executive amendment.



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