

Iowa Fiscal Partnership *backgrounder*

www.iowafiscal.org

UPDATED May 3, 2006

GIVING THE RICHEST A BREAK Cutting Through the Fog of Iowa Budget Spin

The Iowa General Assembly has passed an eight-year package of tax cuts that will cost \$118 million annually when fully phased in.¹ The Iowa Fiscal Partnership (IFP) has produced earlier reports analyzing similar proposals to expand Iowa's already generous tax treatment of retirement income.² This backgrounder summarizes the fiscal impact of this new policy amid chronic budget problems, and its adherence to recognized principles for tax policy, notably: fairness, competitiveness, public benefit and economic efficiency, revenue adequacy, and stability and predictability.

A TWO-PART PACKAGE PASSED BY BOTH HOUSES:

- Eliminate remaining tax on Social Security benefits for higher-income recipients, over eight years.
- Raise income thresholds for payment of Iowa income tax to \$24,000 individual/\$32,000 couple for seniors, from the age-neutral \$9,000/\$13,500 in current law, over three years.

THE PACKAGE HELPS IOWA'S WEALTHIEST SENIORS

Given existing Iowa law, increasing the break on Social Security income would benefit *only the top one-third of recipients*.³

While the other break, raising income levels subject to tax, helps a small share of middle- and low-income seniors, the package overall is weighted to the wealthiest retirees in Iowa. Projected impacts:⁴

- **Income up to \$10,000 — average benefit \$67.** Most of that population gets nothing; only 6 percent would benefit since low-income Iowa seniors rarely pay income tax.
- **Income up to \$40,000 — average benefit \$295.** Benefit limited to 36 percent of those filers.
- **Income above \$100,000 — average benefit \$662.**

About half of the benefits go to households that are above the median income in Iowa (\$43,000⁵).

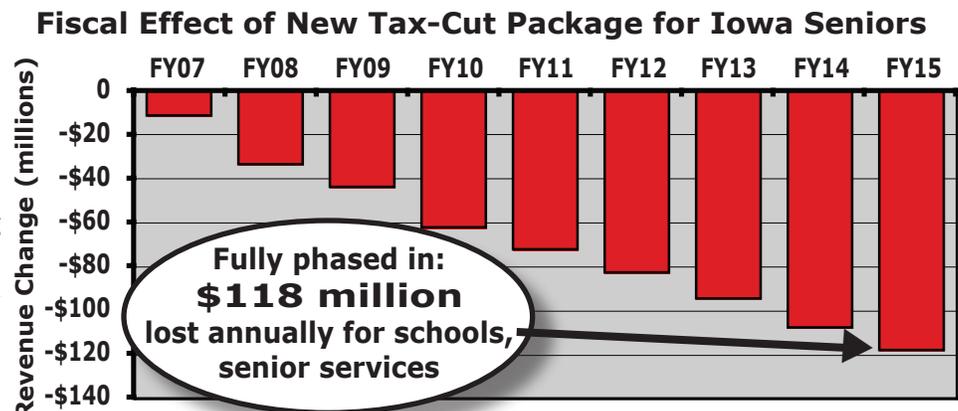
CURRENT LAW ALREADY PROTECTS LOW-INCOME SENIORS

Iowa Law Currently Exempts from Income Tax:

- \$6,000 of pension income for individuals and \$12,000 for married couples.
- **ALL Social Security benefits** for those with income up to \$25,000 (individual) or \$32,000 (couple).
- **AT LEAST HALF of Social Security benefits** for all other individuals, regardless of income.

Effects of Current Exemptions:

- **ALREADY**, 69 percent (about 7 in 10) of Social Security recipients in Iowa **pay no income tax on their Social Security benefits**.⁶ Only recipients with the highest incomes pay tax on Social Security benefits, and — even for those taxpayers — half of those benefits, or more, is not taxed.
- **ALREADY**, 45 percent of Iowans age 65 or older **pay no state income tax**.⁷



Source: Legislative Services Agency, State of Iowa

THE NEW PROPOSAL IN THE LIGHT OF TAX PRINCIPLES

Fairness

The table at right illustrates Iowa's existing substantial tax preferences for retirement income already on the books. Seniors with retirement income generally pay substantially less in state income taxes than nonseniors with equivalent incomes.

Adjusted Gross Income	Retired Individual	Working Individual	Retired Couple	Working Couple
\$20,000	none	\$ 667	none	\$ 504
\$35,000	\$ 356	\$1,503	none	\$1,485
\$55,000	\$1,572	\$2,622	\$ 640	\$2,870
\$80,000	\$2,904	\$4,185	\$2,211	\$4,840

Source: *Iowa's Personal Income Tax: Reform for Iowans at Any Age*
<http://www.iowafiscal.org/documents/050419-ifp-tax.pdf>

From this perspective, the tax cuts make the overall state tax system more regressive and create additional tax gaps between individuals with similar incomes and resources. Both violate principles of tax fairness.

Competitiveness

Some claim seniors move to states with lower taxes because of Iowa's limited tax on Social Security income. An IFP report in February showed there is no evidence that this is happening.

Public Benefit and Economic Efficiency

Seniors who struggle economically will not benefit from this tax cut. If the goal is to provide economic support to seniors who need it, expanding the elderly and disabled tax credit would better meet the need.

Stability and Predictability

Iowa is continuing to age, and the share of wealth and income of Iowa's seniors continues to grow as a share of state wealth and income. Eliminating Social Security income from taxation substantially narrows Iowa's tax base. Excluding taxation from more retirement income further narrows that base.

Revenue Adequacy

Iowa gave itself a chronic budget crisis by substantially cutting taxes and narrowing the tax base through the 1980s and 1990s. While the 2006-07 revenue upturn has provided breathing space, Iowa still faces a long-term structural budget deficit. A \$118 million income-tax cut would substantially exacerbate that deficit, making it very difficult to sustain essential services at current levels, let alone replenish the Senior Living Trust Fund and other funds from which Iowa has borrowed to make short-term budget fixes.

“Blessed are the children, for they shall inherit the national debt.”
— Herbert Hoover, 1936

¹ Iowa Legislative Services Agency, Fiscal Division.

² See “Untaxing Seniors: A ‘Solution’ in Search of a Problem.” Peter S. Fisher, Iowa Fiscal Partnership, Feb. 22, 2006. Available at <<http://www.iowafiscal.org>>. Also see editorials in several Iowa newspapers, among them *The Des Moines Register*, April 26, 2006. <<http://desmoinesregister.com/apps/pbcs.dll/article?AID=/20060426/OPINION03/604260330/1035/archive>>

³ Iowa Department of Revenue, 2001. Figures are not available to isolate the Social Security exemption portion of the new package, which includes both the Social Security tax phaseout and higher income thresholds for tax liability. Some seniors making above the proposed taxable income thresholds may also have enough income currently to pay some tax on Social Security benefits. The \$118 million estimate from the Legislative Services Agency accounts for this overlap.

⁴ Iowa Legislative Services Agency, Fiscal Division.

⁵ “The State of Working Iowa 2005.” The Iowa Policy Project, September 2005.

⁶ Iowa Department of Revenue, 2001.

⁷ Iowa Department of Revenue, 2006. See also “Untaxing Seniors: A ‘Solution’ in Search of a Problem.” Peter S. Fisher, Iowa Fiscal Partnership, Feb. 22, 2006. Available at <<http://www.iowafiscal.org>>. Another valuable resource is “Iowa's Personal Income Tax: Reform for Iowans at Any Age” Charles Bruner and Mike Crawford, Iowa Fiscal Partnership, April 2005. Available at <<http://www.iowafiscal.org/documents/050419-ifp-tax.pdf>>

The Iowa Policy Project

318 2nd Ave. N
 Mount Vernon, IA 52314
 (319) 338-0773 • www.iowapolicyproject.org

Child & Family Policy Center
 1021 Fleming Building • 218 Sixth Ave.
 Des Moines, IA 50309
 (515) 280-9027 • www.cfpciowa.org