

Falling Below Average

Why Iowa Taxes Are Competitive

Peter S. Fisher

February 2007

Iowa Fiscal Partnership

www.iowafiscal.org

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

Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans. IFP reports are available on the web at <http://www.iowafiscal.org>.

The Iowa Fiscal Partnership is part of the State Fiscal Analysis Initiative, a network of state-level organizations and the Center on Budget and Policy Priorities to promote sound fiscal policy analysis. IFP work is supported by the Annie E. Casey Foundation and the Stoneman Family Foundation.

The Iowa Policy Project

Formed in 2001, the Iowa Policy Project promotes public policy that fosters economic opportunity while safeguarding the health and well-being of Iowa's people and the environment. Based in Mount Vernon, IPP's principal office is at 120 N. Dubuque St. #208, Iowa City, IA 52245.

Child & Family Policy Center

Established in 1989 to better link research and policy on issues vital to children and families and to advocate for evidenced-based strategies to improve child outcomes, the Child & Family Policy Center works at the community, state and national levels on child and family policy issues. CFPC is located at 1021 Fleming Building, 218 Sixth Ave., Des Moines, IA 50309.

The Author

Peter S. Fisher is research director of the Iowa Policy Project. He is a Professor in the Graduate Program in Urban and Regional Planning at the University of Iowa. A national expert on public finance, his reports are regularly published in State Tax Notes and refereed journals. Fisher's analysis of tax and economic development policy issues are widely circulated, including his 2005 book for the Economic Policy Institute, *Grading Places: What Do the Business Climate Rankings Really Tell Us?*

Iowa Fiscal Partnership

February 2007

Falling Below Average *Why Iowa Taxes Are Competitive*

By Peter S. Fisher

Iowans pay less than the national average for state services, according to new Census information that provides the latest evidence of Iowa's competitive standing.

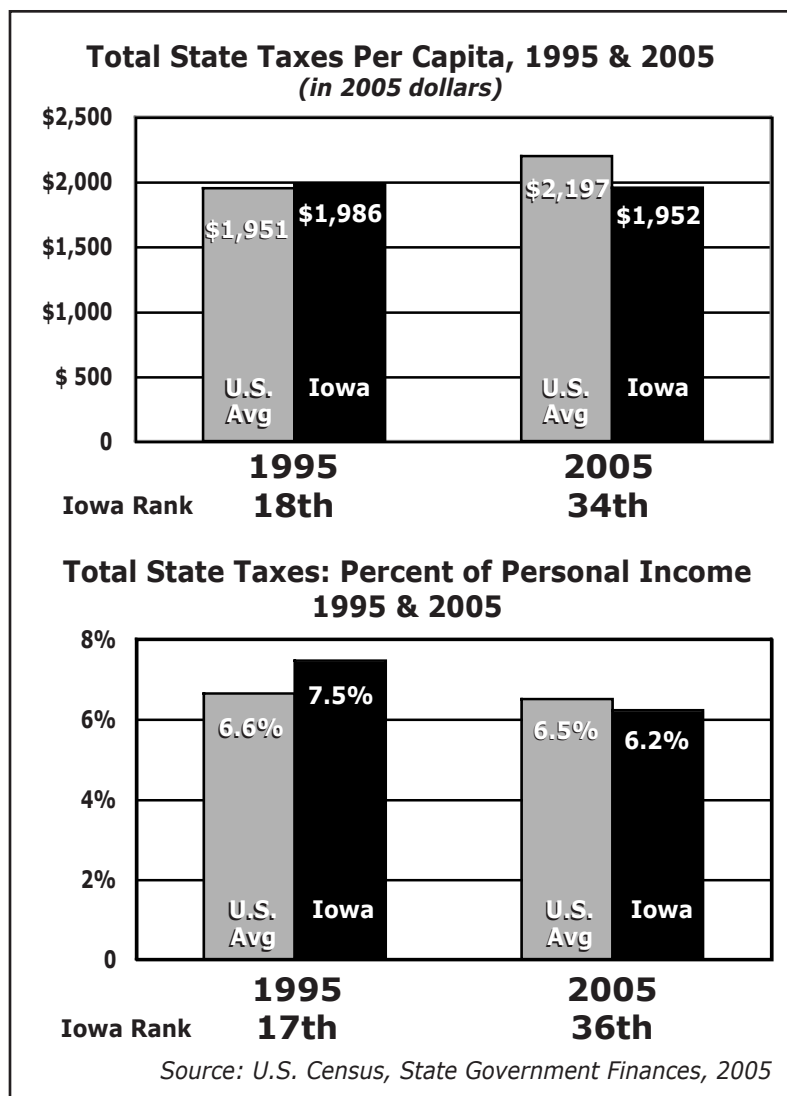
The level of taxation is usually measured in two ways: on a per capita basis, and as a percent of personal income (the total annual income earned by Iowa residents).

By those measures:

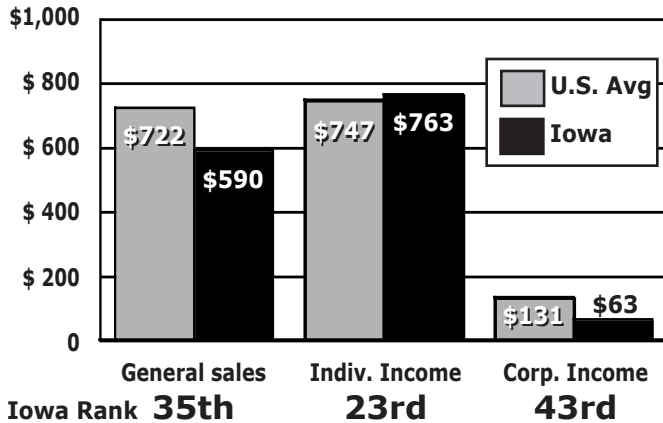
■ **Per capita:** Overall, the state of Iowa collected about \$1,952 per capita in fiscal year 2005, compared to \$2,197 on average for all states. State Rank: 34th. This compares with \$1,986 collected in Iowa in 1995 (in inflation-adjusted dollars) and \$1,951 for the U.S. average that year. Iowa ranked 18th in 1995.

■ **Percent of personal income:** Iowa taxes represented 6.2 percent of personal income in 2005, down from 7.5 percent in 1995. In 1995, Iowa ranked 17th on this measure and was above the national average of 6.6 percent. By 2005 the national average had changed little, but Iowa's rank had fallen to 36th.¹

The changes in Iowa's tax position should not be surprising. An earlier IFP report found: "Between 1995 and 2004, the cumulative effect of all tax changes was to reduce taxes by just 2.3 percent across all states, but by 10.9 percent in Iowa."² The result of this tax-cutting is that Iowa actually collects less per person, in inflation-adjusted dollars, to finance state services in 2005 than it did in 1995. That state revenues have not kept up with growth in the state economy is reflected in the decline in state taxes as a percent of the income generated by that economy. By that measure, taxes have fallen 17 percent (from 7.5 percent to 6.2 percent of income).

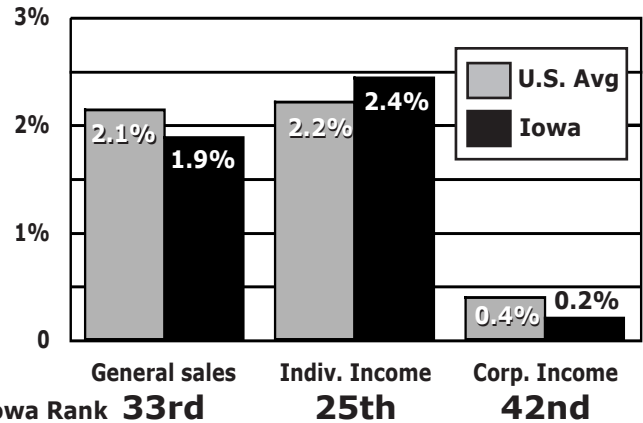


State Taxes Per Capita in 2005



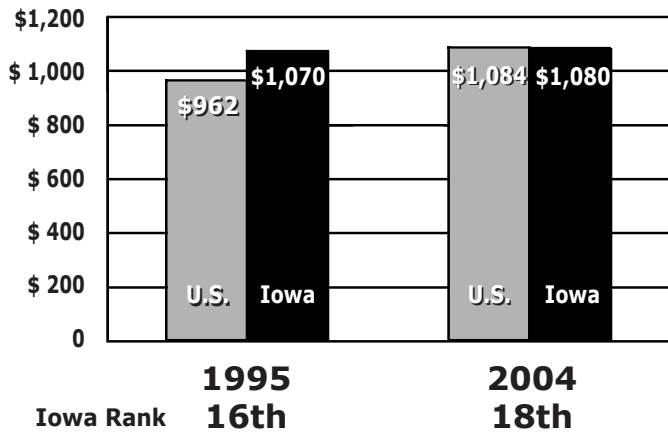
Source: U.S. Census, State Government Finances, 2005

State Taxes as Percent of Personal Income, 2005



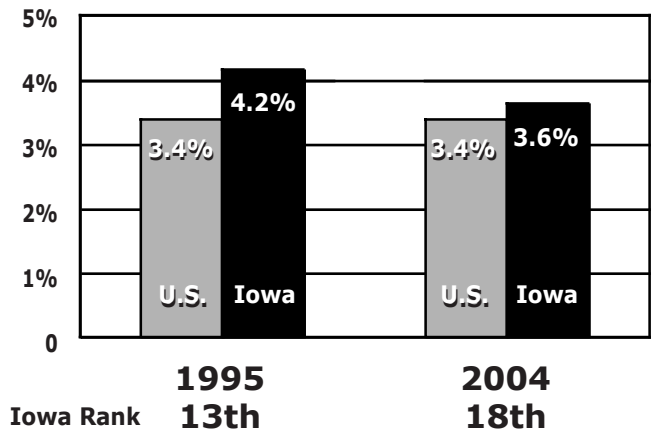
Source: U.S. Census, State Government Finances, 2005

Property Taxes Per Capita: Iowa and U.S. (in 2004 dollars)



Source: U.S. Census, Census of Governments, State and Local Government Finances, 1995 and 2004

Property Taxes as a Percent of Personal Income: Iowa and U.S.



If we consider three major state taxes — general sales and use tax, the individual income tax, and the corporate income tax — we find that Iowa's rank on all three fell between 1995 and 2005. By 2005, only for the individual income tax did Iowa collect at or slightly above the national average amount, and ranked 23rd or 25th, depending on the measure. Iowa's corporate income tax is among the lowest in the country; we collect about half what the average state collects per capita or as a percent of income, and rank 42nd or 43rd.

New figures for local government tax collections will not be released until late this summer. Data for fiscal year 2004 showed that property taxes in Iowa are about equal to the national average on a per-capita basis, and a little above the national average as a percent of income. Iowa ranked 18th among the states on both measures in 2004. While per-capita property taxes rose \$122 in inflation-adjusted terms for the U.S. as a whole between 1995 and 2004, they rose only \$10 in Iowa. Property taxes declined significantly as a share of income in Iowa over this period. Thus both state revenues and local property taxes fell as a share of the state economy.

Iowa is also among the lower-tax states in the region. Iowa collected less in total state taxes per capita in 2005 than five of the seven surrounding states, and less than four of the seven in taxes as a percent of personal income.

State Tax Collections in Fiscal Year 2005
Iowa and Surrounding States

	Per Capita				Percent of Personal Income			
	Total Taxes	General Sales	Individual Income	Corporate Income	Total Taxes	General Sales	Individual Income	Corporate Income
Minnesota	3,105	822	1,240	183	8.4%	2.2%	3.4%	0.5%
Wisconsin	2,383	732	990	142	7.3%	2.2%	3.0%	0.4%
Nebraska	2,165	865	795	113	6.7%	2.7%	2.4%	0.3%
Illinois	2,074	565	623	171	5.8%	1.6%	1.8%	0.5%
Kansas	2,044	727	749	91	6.4%	2.3%	2.3%	0.3%
Iowa	1,952	590	763	63	6.2%	1.9%	2.4%	0.2%
Missouri	1,651	525	695	38	5.4%	1.7%	2.3%	0.1%
South Dakota	1,435	804	0	64	4.5%	2.5%	0.0%	0.2%

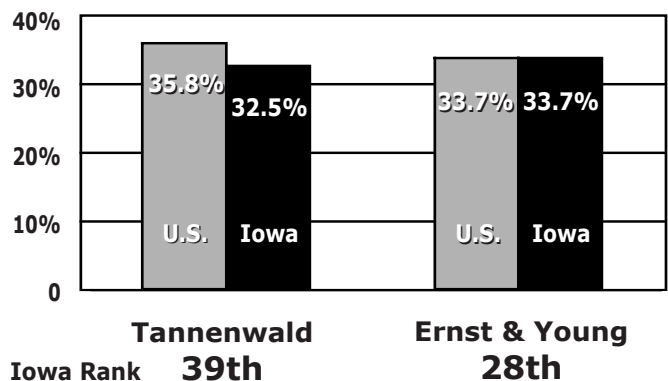
Source: U.S. Census, State Government Finances, 2005

Taxes on Business

Individual income, sales and property taxes are collected from businesses as well as households. While the Census does not separate out the business portion of these taxes, other researchers have provided good estimates of the overall level of business taxation in Iowa compared to other states. Probably the best comparisons available are estimates by Robert Tannenwald, an economist at the Boston Federal Reserve Bank.³

For FY2000, Tannenwald found that business taxes in Iowa as a share of business profits were below the national average, and that Iowa ranked 38th among the states on that measure. Data developed by Ernst and Young for the same year (cited in Tannenwald) found Iowa's tax rate to be equal to the national average, and the state's ranking was 28th. Ernst and Young also computed state and local business taxes as a percent of state personal income; on that measure Iowa ranked 23rd in 2000 and 26th in 2003.

Business Taxes as a Percent of Profits, 2000



As the Iowa Legislature debates various approaches to reducing property taxes for owners of commercial property, it is important to keep in mind that the overall tax climate for business in the state is competitive. The businesses in Iowa that occupy commercial real estate are taxed either under the corporate income tax or the individual income tax (if the business is a partnership, proprietorship, LLC, or subchapter S corporation). As we have seen above, Iowa's personal income tax level is about average, and the corporate income tax in Iowa is well below average. The overall level of business taxation is about average.

Any discussion of Iowa's property tax system as it affects commercial property should also include the property tax abatements and TIF incentives that are part of that system. Commercial property currently represents 39 percent of the overall state tax base, but 64 percent of the taxable valuation under TIF. While 9.4 percent of valuation statewide is under a TIF (up from 8.3 percent in three years), 15.5 percent of commercial valuation is tiffed (up

from 13.5 percent). It is not known how much of the commercial TIF revenue is returned to commercial property owners through abatements or was used to subsidize commercial development up front. We do know that about 21 percent of total TIF indebtedness in fiscal 2005 was for tax rebates.⁴ We also know that \$223 million in property tax revenue will be diverted through TIF in fiscal year 2007.⁵

Iowa's competitiveness for new commercial investment is not measured by average property taxes; the wide availability of tax abatements and TIF subsidies means many new commercial properties are paying much less than the full rate. If local governments believe that property taxes are hindering the attraction of new corporate headquarters or offices of a financial firm, for example, they have the tools to reduce those taxes. In some instances, TIF has been used to rebate nearly all of the property taxes on a new commercial property for over 10 years.

The argument for commercial tax reduction may be one of fairness: Existing commercial businesses pay property taxes on 100 percent of value most years, compared to less than 50 percent for residential property, and unless the business expands it is not eligible for tax abatements or TIF rebates. The overuse of TIF, in fact, makes this problem worse. Tax revenue diverted through TIF must be offset by higher city, school and county taxes on all property in order to maintain public services. TIF actually forces higher tax rates: To meet its budget, a school district must levy enough on other properties to make up for the tax base lost through TIF. Thus any discussion of commercial property tax reductions should focus on restoring parity among old and new commercial property as much as between residential and commercial classes. Prohibiting the use of TIF subsidies for retail uses, and other limitations on the area, uses and duration of TIFs, would help keep property taxes lower in general.

Conclusions

Since 1995, Iowa has cut state taxes to a much higher degree than the average state, to the point that state taxes are now below average by most measures. Between 1995 and 2005, Iowa's overall rank fell from 17th highest in taxes as a percent of income to 36th. The tax cuts that led to this decline were also responsible for a substantial shift in costs to local governments and to those paying tuition at state community colleges and universities, as IFP has reported elsewhere.⁶ While the state ranks 18th in property taxes, overall property tax levels are about equal to the national average.

Any discussion of commercial property taxes, or any other particular tax, should be viewed in light of the overall tax situation in Iowa. Owners of commercial property face either corporate income taxes in Iowa that are much lower than in the average state, or individual income taxes, where Iowa ranks in the middle of the states. Furthermore, commercial property represents 64 percent of the property valuation under TIF, and much of the newer commercial property benefits from TIF rebates or other incentives.

¹ Iowa sales and individual income taxes were adjusted to take into account a slight underreporting of revenue to the Census for those taxes in fiscal 2005. According to Jeff Robinson of the Legislative Services Agency, general sales and use taxes reported by the Census were \$23 million too low, and individual income taxes were \$5 million too low.

² Charles Bruner and Mike Crawford, *The State Fiscal Crisis, 2001-2004: Comparing Responses of Iowa and Other States*. September 2004, the Iowa Fiscal Partnership.

³ Robert Tannenwald, *Massachusetts Business Taxes: Unfair? Inadequate? Uncompetitive?* Federal Reserve Bank of Boston, 2004.

⁴ "Tax Increment Financing Outstanding Obligations Report – 2005." Issue Review, Fiscal Services Division, Iowa Legislative Services Agency, March 20, 2006.

⁵ "Tax Increment Financing." Powerpoint presentation by Jeff Robinson of the Fiscal Services Division, Iowa Legislative Services Agency, Dec. 4, 2006.

⁶ See *Our Vanishing Budgets*, Iowa Fiscal Partnership, February 2005, and "No Longer a Leader," Charles Bruner and Mike Crawford, Iowa Fiscal Partnership, November 2006, both available at www.iowafiscal.org <<http://www.iowafiscal.org>>.