Iowa Fiscal Partnership

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Who Pays Iowa Taxes? New Report Shows Fairness Problems

IOWA CITY, Iowa (Nov. 18, 2009) — Moderate- and low-income Iowans pay more of their income in state and local taxes than the rich do, according to a new report that prompted fresh calls for state income-tax reform.

"No one would ever design an income tax with lower tax rates for the best-off taxpayers," noted Matthew Gardner, executive director of the Institute on Taxation and Economic Policy (ITEP) and lead author of the report.

"But that is exactly what Iowa's tax system overall does: It allows the very wealthiest individuals to contribute less of their income, on average, than middle- and lower-income families must pay. In other words, Iowa has an unfair, regressive tax system."

According to the report, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States":

- Iowa families earning less than $20,000 — the poorest fifth of Iowa non-elderly taxpayers — pay 11.0 percent of their income in Iowa state and local taxes.
- Middle-income Iowa taxpayers — those earning between $37,000 and $56,000 — pay 10.0 percent of their income in Iowa state and local taxes.
- The richest Iowa taxpayers, with income averaging $989,200 — pay a much smaller share — 7.4 percent — of their income in Iowa state and local taxes.
- The federal tax deduction for state taxes further drops the top-level payment to 6.0 percent, while low-income taxpayers see no benefit.

Iowa Fiscal Partnership (IFP) analysts said the new report further demonstrates the need for personal income-tax reform, which was discussed in 2009 but never came to a vote in the Iowa General Assembly.

Progressive vs. Regressive Taxation

Iowa's system offers examples of all three typical labels used to describe how taxes affect people at different incomes: "regressive" taxes, which take a larger share of the incomes of those who have the least than of those with greater ability to pay; "proportional" taxes, which affect a similar share of income for all taxpayers; and "progressive" taxes, which increase as a share of the taxpayer's rising income. Policy trends in the state — toward increases in the sales and property taxes and cuts in the income tax — have produced a system that expects greater shares of the household budgets of low- and moderate-income taxpayers than from their higher-income neighbors.

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"Iowa taxes are not fair toward low- and moderate-income working families. It's an old problem and a persistent one. For Iowa to treat the majority of its residents fairly, we need income-tax reform to confront the realities of this report," said Peter Fisher, research director of the Iowa Policy Project, which formed the nonpartisan IFP with the Child & Family Policy Center (CFPC) in Des Moines.

Fisher said the report confirmed Iowa's reliance on "regressive" taxes — sales and excise taxes, and property taxes — which fall heavier as a share of income on lower-income families, and the weak progressivity of the state income tax. (see box, p.1)

Charles Bruner, executive director of CFPC, noted Iowa's income tax system taxes many moderate income working Iowa families who owe no federal income tax. A recent report by the Center on Budget and Policy Priorities noted Iowa's income tax starts so quickly that even a family in poverty may owe state income tax. (See http://www.cbpp.org/cms/index.cfm?fa=view&id=2976)

The report illustrates inequities by type of tax, with sales and excise taxes taking 6.5 percent of low-income budgets and 4.5 percent at middle incomes, but less than 1 percent from the highest earners. Property taxes take 3.7 percent at low incomes, more than twice that of the highest earners. While low-income earners pay little in income tax, earners in the top 1 percent pay 4.8 percent while middle-income earners pay 3.1 percent.

"These reports confirm that while the income tax is the only progressive tax in Iowa's mix, it could be improved to lessen the overall unfairness of Iowa's tax system," Bruner said.

As the ITEP report notes, Iowa is one of only six states offering a deduction for federal income taxes paid — and only three including Iowa offer full deductibility. This feature does not help low-income Iowans and offers the greatest benefits to the highest-income people.

The ITEP report, which examined household tax impacts in all states, notes that fairness of state taxes is determined by two factors: the mix of tax types, and the structure of each tax.

"In the 10 most regressive states, a telling feature is that six have little or no income tax, two have a flat-rate income tax, and two have a low top rate," Fisher said. "That means the wealthiest taxpayers, those who are doing quite well in or out of a recession, are receiving a big break at the expense of other taxpayers, or of lost public services.

Fisher noted the report focuses only on taxes as a share of income of non-elderly taxpayers.

"One of the good things about this ITEP analysis is that it doesn't look at the source of income, because that should not matter," Fisher said. "At the same time, by focusing only on non-elderly taxpayers, it understates the inequities of Iowa's personal tax structure, which has a very significant slant toward persons with retirement income. It doesn't make sense that two households making the same income are treated differently for tax purposes, but that is the system we have."

The Iowa Fiscal Partnership is a nonpartisan tax and budget policy analysis initiative between IPP and another nonprofit organization, the Child & Family Policy Center in Des Moines. IFP reports are at www.iowafiscal.org.

The Institute on Taxation and Economic Policy, formed in 1980 and based in Washington, is a nonprofit, nonpartisan research and education organization that works on government taxation and spending policy issues. ITEP is on the web at www.itepnet.org.

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