

Iowa: Where Business Taxes are Low

Reality Contradicts Common Arguments Used to Sell New Tax Cuts

A variety of factors influence the decisions businesses make about whether they want to locate or expand within a given state. These factors include available infrastructure, the proximity to materials and customers, the skill of its workforce, and whether the state has good schools, roads, hospitals, and public safety. As we have shown elsewhere, state taxes play at best a minor role.

In Iowa, we constantly hear the same old argument that business taxes aren't competitive. It's an argument that was used to enact large tax cuts for commercial and industrial property this past year and continues to be an excuse used to justify giving away large tax credits to businesses throughout the state.

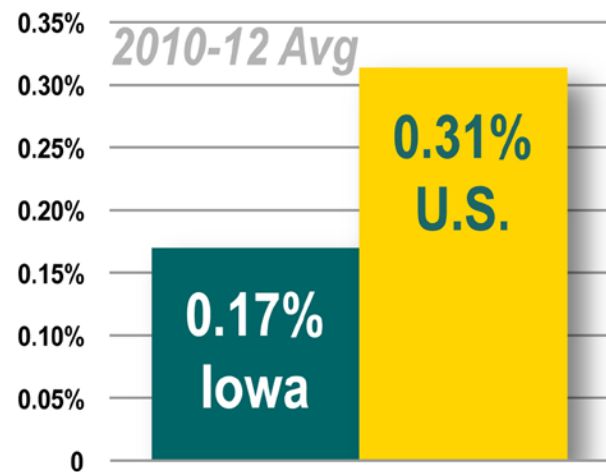
But this argument just isn't true. The entire range of taxes that fall on businesses are lower than the national average — with the corporate income tax rate lower than all but 14 states. How can this be when the top tax rate — 12 percent — is the highest in the nation? The answer is simple: That 12 percent tax rate is applied to only a small portion of a company's profits in Iowa. Iowa is one of only five states to allow a portion of federal income taxes to be deducted from income. In addition, unlike most states Iowa uses single sales factor apportionment, meaning that we ignore a corporation's payroll and property in the state and only take into account their sales within the state.

As a result, many large corporations selling nationally and worldwide earn substantial profits on Iowa operations but pay taxes on only a small fraction of those sales and their profits. On top of this, Iowa doesn't have combined reporting to plug tax loopholes; this omission makes it easy for a multistate firm to shift its profits out of state and avoid Iowa taxes. Finally, Iowa offers a range of generous tax credits that further reduce corporate tax liability.

The best measure of the level of corporate income taxation from one state to another, a measure that takes into account all features of the tax code, is the amount of tax collected as a percent of the private economic activity generated in the state, as measured by state private-sector GDP (Gross Domestic Product). In Iowa, this average from fiscal years 2010-2012 was less than two-tenths of 1 percent (0.17 percent), as shown in Figure 1.

On this measure, Iowa's rank is 36th among the 50 states for those three years and Iowa's tax level is well below the national average. Similarly, the conservative Tax Foundation found that in each of the fiscal years from 2007-2011 Iowa ranked well below average among the states in its level of corporate income taxation, measured as corporate taxes paid per capita.¹ For the most recent year in that analysis, 2011, Iowa ranked 36th.

Figure 1. Few States Tax Corporations Less than Iowa
State Corporate Income Tax as Percent of Private-Sector GDP



Source: IPP analysis of data from U.S. Census, State Govt Tax Collections; and Bureau of Economic Analysis, Gross Domestic Product by state.

The corporation income tax is only part of the picture. Businesses also pay local property taxes on their buildings (but not on machinery and equipment, including computers), and they pay some sales taxes. Many businesses or proprietorships, partnerships, or “S-corporations,” do not pay corporate income taxes. Instead, the net profits from the business — after deducting all business expenses — are reported on the owner’s personal tax returns and are assessed at their individual income tax rates. If the business has more deductions than sales, the losses are used to reduce taxable income.

A recent report sheds light on the overall level of taxation of businesses of all kinds in the 50 states during FY2012. The accounting firm Ernst and Young produces an annual report on business taxation that shows all business taxes imposed by local as well as state governments, as a percent of state private-sector GDP. On that measure Iowa was tied with one other state for 27th; as Figure 2 shows, 22 states taxed business at a lower rate, 26 states at a higher rate.

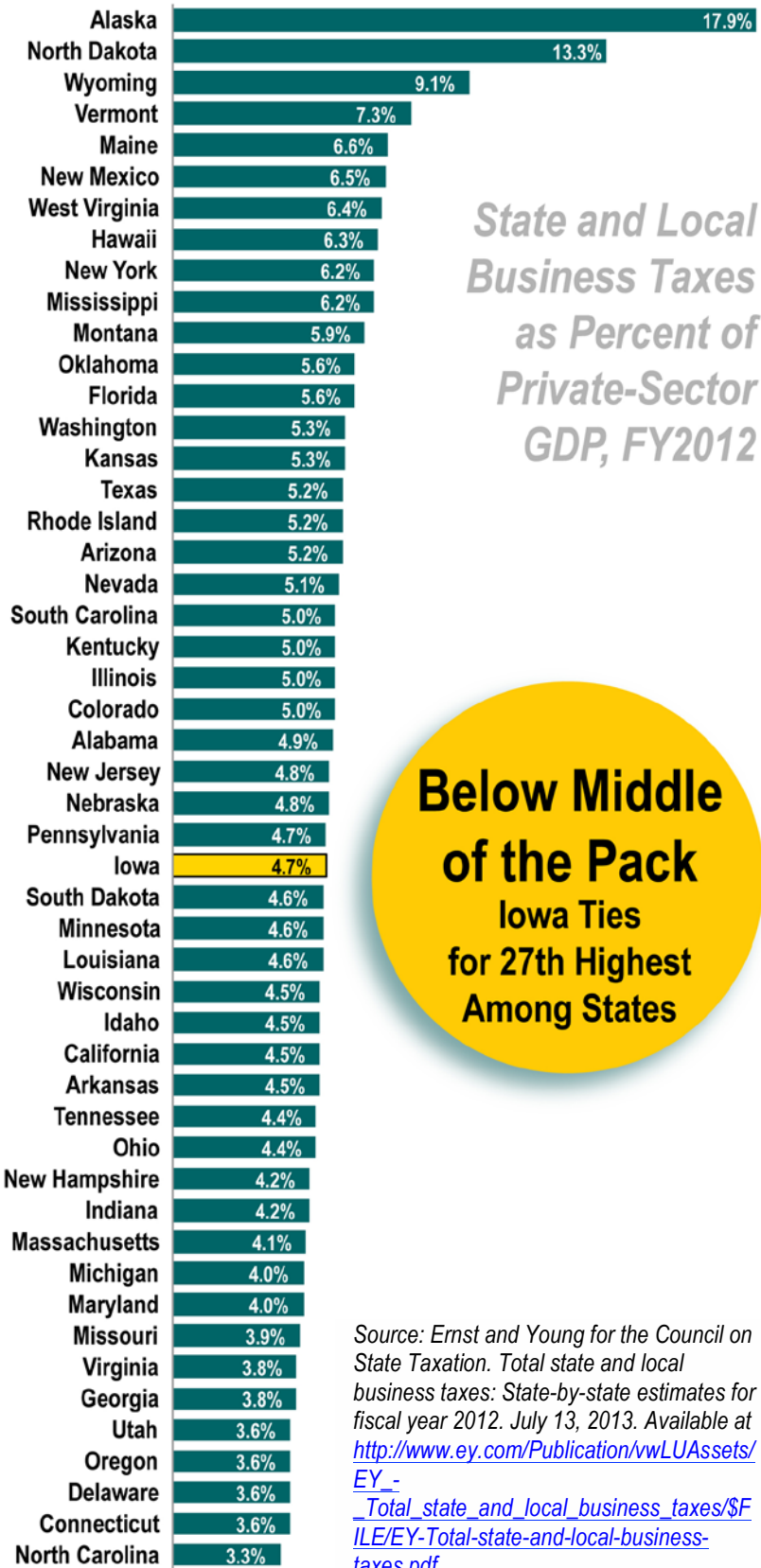
Clearly, there is no case that businesses in Iowa are taxed too high relative to other states. Whether we are looking at the entire range of taxes that fall on businesses or just the corporate income tax, the fact is that business taxes in Iowa are low.

¹ The Tax Foundation, State Corporate Income Tax Collections Per Capita, Fiscal Year 2007-2011, at <http://tinyurl.com/osrvy67>

Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint public policy analysis initiative of two nonpartisan Iowa-based groups, the Iowa Policy Project in Iowa City, and the Child & Family Policy Center in Des Moines. Reports are at www.iowafiscal.org.

Figure 2. Iowa Also Ranks Low Including Local Taxes
State and Local Business Taxes as Share of Economy



State and Local Business Taxes as Percent of Private-Sector GDP, FY2012

Below Middle of the Pack
Iowa Ties for 27th Highest Among States

Source: Ernst and Young for the Council on State Taxation. Total state and local business taxes: State-by-state estimates for fiscal year 2012. July 13, 2013. Available at [http://www.ey.com/Publication/vwLUAssets/EY_-_Total_state_and_local_business_taxes/\\$FILE/EY-Total-state-and-local-business-taxes.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Total_state_and_local_business_taxes/$FILE/EY-Total-state-and-local-business-taxes.pdf)