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BACKGROUND

A Local Option Sales Tax: Issues for Johnson County

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October 2020

In 2014, there was a vote on adoption of a 1 percent Local Option Sales Tax (LOST) in Johnson County. Iowa City proposed using 50 percent for trails, streets, and other infrastructure, 40 percent for property tax reductions, and 10 percent for affordable housing.

If all jurisdictions passed the measure, it would have raised \$20 million in revenue. About \$8.4 million of that would have been distributed to Iowa City on the basis of the formula: 75 percent distributed in proportion to the city's share of county population (by the most recent decennial U.S. Census), and 25 percent on the basis of the city's share of property taxes collected in fiscal years 1983-1985. The remainder would have gone to Coralville, North Liberty and other cities, as well as to Johnson County.

Iowa City, Coralville and North Liberty voted as a unit (as required by state law because they are contiguous) and defeated the measure 54 percent to 46 percent.¹ Solon, Swisher, Hills and Lone Tree approved it, while voters in the unincorporated areas rejected it.

The Iowa sales tax by itself is a regressive tax: the lower your income, the higher the share that goes to pay sales tax. However, this tax fairness problem can be countered if the sales tax revenue

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is used to fund services primarily benefiting low and moderate income residents. Using a substantial share for property tax reductions would not help offset regressivity; much of the property tax cuts would go to owners of commercial and industrial property and apartment buildings, which together account for about 35 percent of the city tax base.² Many of those owners do not even reside in Iowa City.

Any sales tax would be paid in part by consumers residing outside the county who shop here. However, estimates by ISU indicate that Johnson County retail sales in recent years have fallen below what is predicted on the basis of resident income, indicating the county no longer attracts significant sales from beyond its borders.³ The sales tax, in other words, would be paid largely by Johnson County residents.

A local sales tax in Johnson County now would likely raise a similar amount of revenue. Iowa City, in other words, could expect about \$8 million in new revenue. If a substantial share of that revenue were devoted to social service programs and affordable housing, the concerns about regressivity could be reduced or even eliminated. Using data from the Institute on Taxation and

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Economic Policy we estimate that a 1 percent local sales tax would cost the average household in the lowest fifth of the income distribution — those earning \$22,500 a year or less — about \$45 per year.⁴ Those in the next quintile, with income between \$22,500 and \$40,500, would pay about \$114 a year.

There are about 58,000 households in Johnson County, and 30,000 of those residences are in Iowa City. One-fifth of Iowa City households would be 6,000. The bottom 40 percent of Iowa City households would thus be contributing about \$950,000 in additional sales taxes to the countywide pool of LOST revenue.⁵ To offset that would require that the city of Iowa City dedicate a similar amount every year to social service and affordable housing programs benefiting low- and moderate-income households. While that could eliminate regressivity on average, not every lower income household will benefit from those programs.

State law has changed in the intervening years. The Legislature now requires that at least 50 percent of LOST revenues be used to reduce property taxes. That means that about \$4 million of Iowa City's share of LOST revenue would be used to reduce property taxes. Of the remaining \$4 million at least a quarter would need to go to programs benefiting low- and moderate-income households in order to offset the higher taxes they would pay. The calculations would be similar for Coralville, North Liberty, and other cities approving the tax if the regressive impact were to be offset for residents of those cities. To the extent that Johnson County used a portion of its LOST allocation to provide increased services for low- and moderate-income families throughout the county, the regressive impact would be further reduced. However, it could be more challenging to ensure that lower-income households in rural Johnson County are not harmed by LOST, since the county does not generally provide social services exclusively to residents of unincorporated areas, unless the county undertook to finance the entire offset countywide.

The impact of the 50 percent requirement for property tax reduction is not as clear as it might seem. In practice, the requirement probably is interpreted to mean that in the first year of LOST revenue, property taxes levied must be lower than they were the previous year by an amount equal to half of LOST revenues. After that, it would be difficult to establish what the property tax levy would have been in the absence of LOST. It certainly would not be logical that property taxes must never rise again, particularly in Johnson County where population growth continues at a healthy pace. If property taxes rise by 5 percent the following year, who is to say that this violates the 50 percent rule about LOST proceeds? Without LOST, would property taxes have gone up 10 percent, or not at all, or something in between? It will be difficult to prove that half of LOST proceeds do or do not continue to be used for property tax reductions. This has confused the issue just as it is getting new attention in Johnson County.

¹ <https://www.thegazette.com/subject/news/johnson-county-local-option-tax-approvedrejected-20141104>

² Iowa Department of Management, City Taxable & TIF Valuations by Class AY2017/FY2019. <https://dom.iowa.gov/document/city-taxable-tif-valuations-class-ay2017fy2019>

³ Iowa State University, Iowa Community Indicators Program. "Retail Trade Analysis Report Fiscal Year 2017: Johnson County". <https://www.icip.iastate.edu/retail/county>

⁴ Institute on Taxation and Economic Policy. *Who Pays?* Sixth Edition, 2018. <https://itep.org/whopays/iowa/> Our analysis divides the annual amount of tax estimated for an income group by 6.8 to arrive at the cost per penny of tax, since the statewide average sum of state and local sales taxes is 6.8. We assume three-fourths of spending on taxable items is spent within Johnson County and therefore subject to LOST.

⁵ Calculated as follows: 6,000 households times \$45 plus 6,000 households times \$114.

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