

RIPPLES FROM A REVENUE STREAM Sustainable and Fair Funding for Natural Resources in Iowa

Iowa's landscape is defined by its natural resources, which support some of the highest volumes of agricultural production in the nation. Despite this dependence on natural resources, Iowa has one of the nation's lowest levels of environmental funding. Environmental protection programs in Iowa experienced budget cuts during the state fiscal crisis that followed the 2001 recession and, in many cases, have never returned to pre-crisis funding levels.¹ In order to address a persistent lack of sustainable and adequate funding for natural resources, legislators created a study committee in 2006 to identify and evaluate funding needs and potential revenue solutions. In 2008, this committee recommended the adoption of a constitutional amendment to dedicate three-eighths of 1 cent in sales tax revenue to support increased natural resources funding.² During the 2008 legislative session, the Senate passed Joint Resolution 2002, proposing a constitutional amendment that would — after a second legislative approval and passage through a statewide referendum — dedicate this portion of an increase in the state sales tax to such a purpose. The constitutional amendment itself would not cause the sales tax to rise; it would simply designate what must be done with the revenue if and when the sales tax is increased by the Legislature.

General sales taxes disproportionately affect low-income households, which end up paying a higher percentage of their household income in sales taxes each year than upper-income taxpayers. This is because the sales tax is paid on purchases from the first dollar of income, and many basic necessities, such as clothing and household goods, are taxed. By contrast, the income tax is assessed on the basis of a taxpayer's income, and a base level of income needed to support essential living costs is exempted from taxation. As a result, income tax payments make up smaller portions of low-income household income in Iowa than do the payments of upper-income households.

PROGRESSIVE vs. REGRESSIVE

A tax is considered *regressive* if it ignores someone's ability to pay that tax.

In practice, this means that the tax payments will take up a greater share of the incomes of taxpayers at the lower end of the income scale while taking up a smaller share of taxpayer income's at the upper end of the income scale. As incomes rise, tax payments decrease as a percentage of those incomes.

On the other hand, a tax is *progressive* if tax payments as a share of income rise along with increases in income. This links a taxpayer's ability to pay a tax to the amount of tax levied.

Of the three major state and local taxes in Iowa, only the income tax is progressive. The sales tax is substantially regressive and the property tax is roughly proportional.

Figure 1 and Table 1 on page 2 of this backgrounder illustrate the impacts by income group for Iowa state and local taxes.

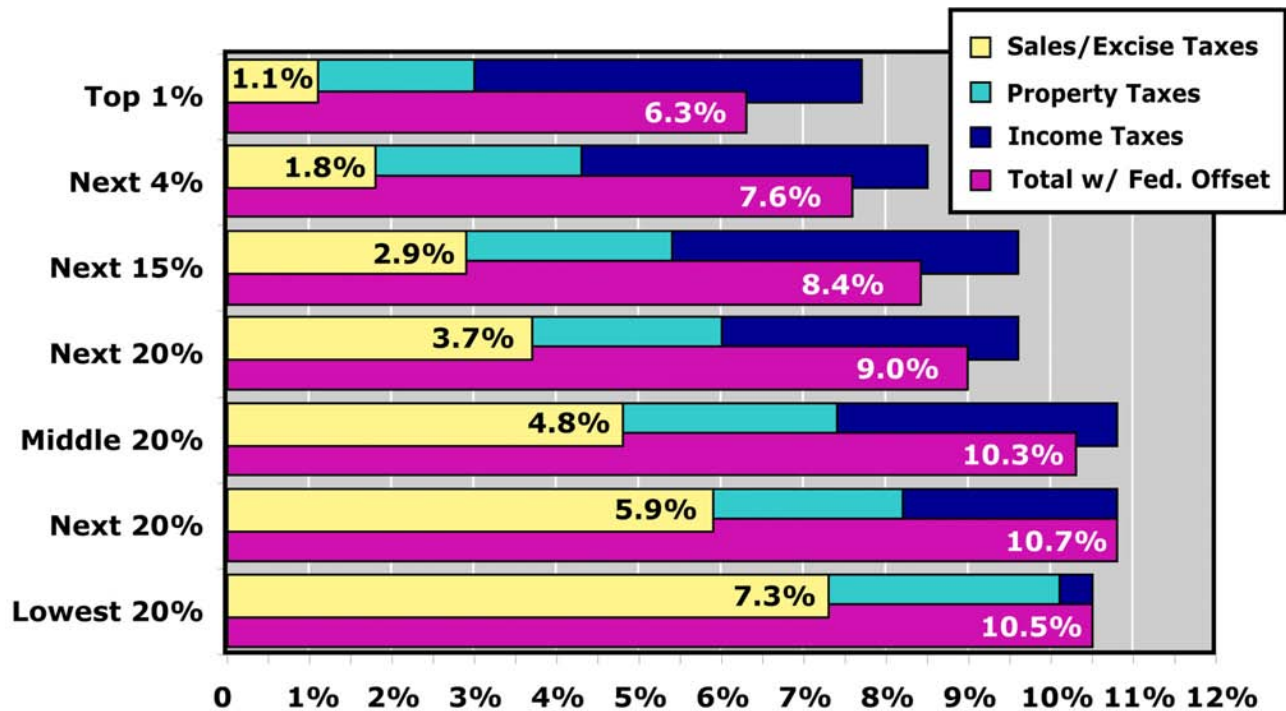
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Figure 1. Iowa's State & Local Taxes Favor High-Income Earners



Source: Institute on Taxation and Economic Policy, 2008

Table 1. Iowa's State & Local Taxes Favor High-Income Earners
Taxes by Share of Income, Non-Elderly Taxpayers

Income Group	Lowest 20%	Next 20%	Middle 20%	Next 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$16,000	\$16,000-\$33,000	\$33,000-\$50,000	\$50,000-\$78,000	\$78,000-\$127,000	\$127,000-\$320,000	\$320,000-plus
Avg Income	\$8,600	\$24,500	\$41,300	\$62,600	\$96,500	\$183,800	\$831,100
Sales/Excise Taxes	7.3%	5.9%	4.8%	3.7%	2.9%	1.8%	1.1%
Property Taxes	2.8%	2.3%	2.6%	2.3%	2.5%	2.5%	1.9%
Income Taxes	0.4%	2.6%	3.4%	3.6%	4.2%	4.2%	4.7%
Total Taxes	10.5%	10.7%	10.8%	9.7%	9.7%	8.4%	7.7%
Total With Federal Offset*	10.5%	10.7%	10.3%	9.0%	8.4%	7.6%	6.3%

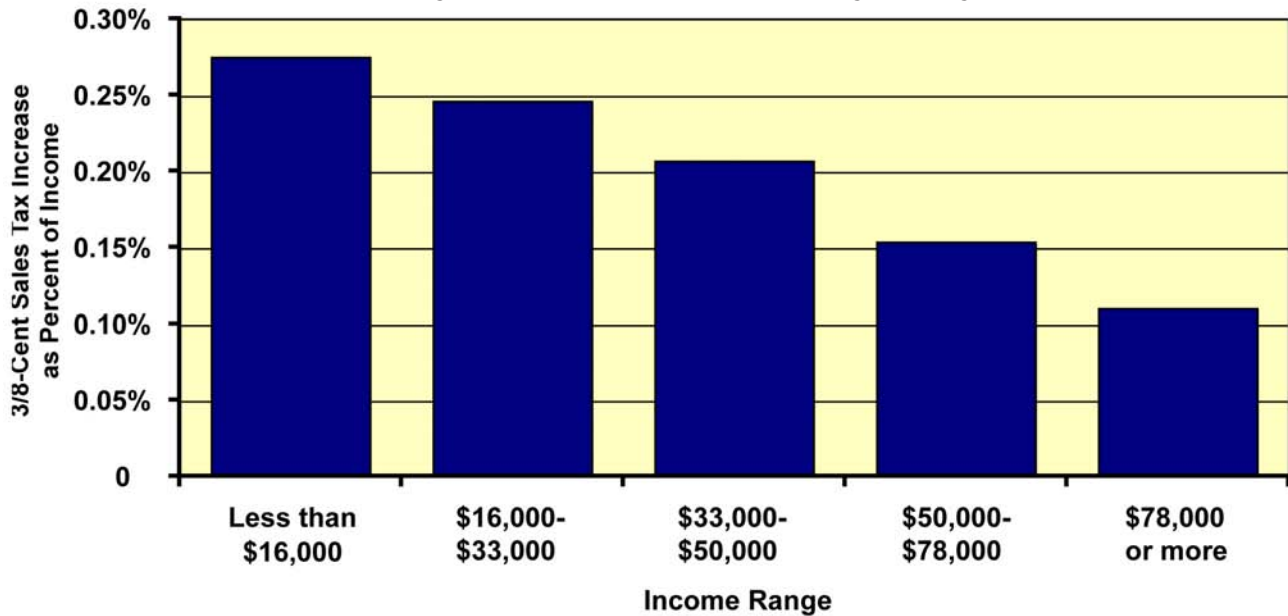
Source: Institute on Taxation and Economic Policy, 2008

As Figure 1 and Table 1 show, Iowa families in the lowest income quintile pay 7.3 percent of their annual income in sales taxes, while families with incomes in the top 20 percent pay between 2.9 percent and 1.1 percent of their income in sales taxes. The share of income paid in sales taxes declines as income increases. In fact, the regressive nature of the state sales tax is largely responsible for the regressive structure of Iowa's tax system as a whole. Iowans with an average income of only \$24,500 pay nearly 11 percent of their income in state and local taxes, while Iowans with an average income of \$831,000 (in the top 1 percent of taxpayers in Iowa), pay only 6.3 percent of their income in state and local taxes.

* Both income and property taxes are deductible on a person's federal income tax return. For those who itemize deductions, income and property taxes paid in Iowa are partly offset by a reduction in federal income taxes.

Increases in the state sales tax disproportionately impact low-income Iowans at the same time that they make the whole tax system less fair. Figure 2 below shows how the share of taxes paid overall would change as a result of a three-eighths-cent increase in the state sales tax.

**Figure 2. Effect of Sustainable Funding Sales Tax Increase Greatest at Low Incomes
Taxes by Share of Income, Non-Elderly Taxpayers**



Source: Institute on Taxation and Economic Policy, 2008

The share of income taken up by sales tax payments for taxpayers in the lowest income quintile would increase from 7.3 percent to almost 7.6 percent as a result of adding three-eighths of 1 cent for sustainable natural resources funding to the state sales tax. Although this may appear to be a small increase, it is nearly three times greater than the increase in sales taxes as a share of income that the top quintile of income earners would experience. Table 2 also shows the increased sales tax in dollars for each group of taxpayers.³ For instance, a taxpayer in the middle quintile earning \$41,300 a year would pay an additional \$85 in sales taxes each year, while a taxpayer in the upper quintile earning \$150,690 a year would pay an additional \$166 in sales taxes.⁴

**Table 2. Impact of 3/8-Cent Sales Tax Increase at Low Incomes
Less in Dollars, But More as Share of Income**

Income Group	Lowest 20%	Next 20%	Middle 20%	Next 20%	Top 20%
Income Range	Less than \$16,000	\$16,000- \$33,000	\$33,000- \$50,000	\$50,000- \$78,000	\$78,000- plus
Avg Income	\$8,600	\$24,500	\$41,300	\$62,600	\$150,690
3/8-Cent Sales Tax Increase as Percent of Income	0.27%	0.25%	0.21%	0.15%	0.11%
Dollar Amount of Increase	\$24	\$60	\$85	\$96	\$166

Source: Institute on Taxation and Economic Policy, 2008

Iowa Policy Project analyses of funding to protect Iowa's natural resources have demonstrated a clear need to make this funding sustainable and long-term. (See: *Gambling With Iowa's Soil and Water*,

November 2007, and *Investing in Iowa's Environment*, December 2006.) Too often in the past, natural resources funding has lost out to state budget cuts or has been raided to pay for other public programs. At the same time, any sustainable funding source should also be fair to all Iowa taxpayers, particularly low-income families who already pay a disproportionate share of their income in state and local taxes. If sales tax increases must occur, they need to be paired with measures such as an expansion of the state Earned Income Tax Credit (EITC), which provides working families with a refundable tax credit based on their earnings. If designed properly, this expansion would compensate low-income families for increases in their sales tax payments. Policymakers could also not choose to raise the sales tax and generate funding from another source such as by closing corporate tax loopholes that allow multistate corporations to shift Iowa profits out of state to reduce their state corporate income tax liability.

Protecting Iowa's natural resources can work with a commitment to not disproportionately tax low-income families in our state. However, it requires careful tax policy design.

¹ For instance, Iowa's Resource Enhancement and Protection (REAP) program provides funding to the Department of Natural Resources (DNR) to acquire and manage public lands, upgrade parks and preserves, and promote environmental education, monitoring and research. Although never fully funded to statutorily-authorized levels, REAP was the target of severe cuts in during the fiscal crisis, when a program for acquiring conservation lands was eliminated and funding declined 82 percent between 2001 and 2003. In other cases, environmental protection funds were transferred into the general fund in order to balance the state's budget. For a full discussion of state environmental funding trends, see: Galluzzo, Teresa (2006). *Investing in Iowa's Environment: Budget Trends 1997-2006*. The Iowa Policy Project. Available from: <http://www.iowapolicyproject.org/2006docs/061213-EnvSpend.pdf>.

² Sustainable Funding for Natural Resources Study Committee (2008). Final Report. Available from: <http://www.legis.state.ia.us/lsadocs/IntComHand/2008/IHDLA081.PDF>.

³ Data displayed in Table 2 has been revised to reflect changes in the assessment of motor vehicle use tax that took effect July 1, 2008. Rather than changing in conjunction with the sales and use tax, the motor vehicle use tax will remain a 5 percent fee. This analysis uses data from the 2006 Consumer Expenditure Survey, Table 32. Midwestern region by income before taxes to estimate motor vehicle purchase expenditures and taxes by income quintile and adjust for the fact that motor vehicle use taxes will not rise as a result of a constitutional amendment to fund natural resources.

⁴ The impact on consumers of an increase in the state sales tax includes both the direct cost of the sales tax, as well as the indirect cost of higher prices that businesses have passed on to consumers as a result of having to pay an increased sales tax on business purchases. The share of the total impact that is due to increases in indirect costs varies according to income quintile and ranges from about 29 percent for the lowest quintile to 25 percent for the upper quintile.



The Iowa Fiscal Partnership is a budget policy analysis initiative of the Child & Family Policy Center and the Iowa Policy Project, two Iowa-based, nonprofit, nonpartisan organizations. IFP reports are available at www.iowafiscal.org.