

Iowa Fiscal Partnership

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Who Pays Iowa Taxes? As Share of Income, Lower-Income Iowans Pay the Most

IOWA CITY, Iowa (Nov. 10, 2008) – Lower-income non-elderly households in Iowa pay a much greater share of their meager incomes in state and local taxes than high-income families pay.

A new report from the Iowa Fiscal Partnership (IFP), using data from the Institute on Taxation and Economic Policy (ITEP) in Washington, shows that the bottom 60 percent of Iowa taxpayers, on average, pay over 10 percent of their income in state and local tax. In the top 1 percent of Iowa taxpayers — those making over \$320,000 — the Iowa tax bill is 6.3 percent.

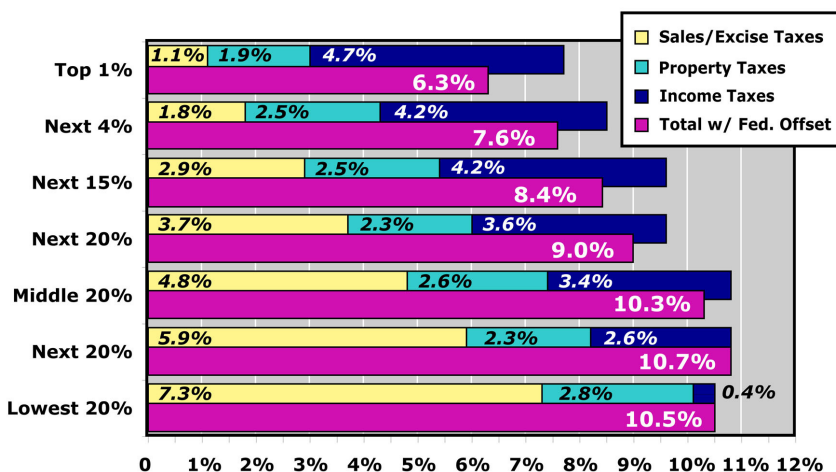
Inside those overall numbers: a marked difference in the types of taxes paid by low- and higher-income Iowans. At low incomes, the 20 percent of Iowans making less than \$16,000 per year, 7.3 percent of income goes to sales taxes and excise taxes (gas tax, for example). Those taxes only account on average for less than 2 percent of income for the 5 percent of Iowa families making \$127,000 or more, and less than 3 percent at \$78,000 or more.

“A number of policies contribute to the overall unfairness of Iowa’s tax system,” said Christine Ralston, research associate for the nonpartisan Iowa Policy Project (IPP), who authored the IFP report. “Many of those policies have been in place for decades, and with few exceptions, the major trends in Iowa policies have been only to compound the fairness issues we already had.”

“This report gives us a way to look at the effects of the entire tax system on households at various incomes, and also to sort out how individual components of the system affect those households.”

As examples, Ralston cited an across-the-board cut in income tax rates in 1998. Meanwhile, the taxes

Iowa's State and Local Taxes Favor High-Income Households



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that disproportionately fall on low-income household budgets — state sales and excise taxes — have increased steadily, along with increases in cigarette taxes and the adoption of local-option sales taxes across much of Iowa.

“The state sales tax has doubled in the last 25 years while we have made big cuts in income tax,” Ralston said. “This is not a good tradeoff if we want a tax system that better reflects a household’s ability to pay.”

According to the ITEP data, the lowest-income 20 percent of Iowans (below \$16,000 — average \$8,600) pay 10.5 percent of their income in Iowa state and local taxes, comprising income, property and sales taxes. The next 20 percent, between the incomes of \$16,000 and \$33,000, pay the most of any group, 10.7 percent in state and local tax.

Middle-income Iowans (the 20 percent of taxpayers making between \$33,000 and \$50,000 a year) pay 4.8 percent of their income in sales and excise taxes, 2.6 percent in property taxes, and 3.4 percent in income taxes. In the next quintile of taxpayers, with incomes between \$50,000 and \$78,000, 3.7 percent of income goes to sales and excise tax, 2.3 percent to property tax and 3.6 to income tax.

Above \$78,000, income taxes are the largest tax, between 4.2 percent and 4.7 percent. Property taxes as a share of income are also smaller in these ranges than for low-income Iowans. And, because they don’t have to spend as much of their income, their sales-tax percentages are far smaller — below 3 percent and close to 1 percent for some — than the range of nearly 5 percent to over 7 percent for the bottom 60 percent of taxpayers.

“Those income-tax numbers are important,” Ralston said. “We often hear a much higher number for Iowa income tax than that. These figures show that the effective income-tax rate in Iowa is nowhere near as high as some complain, because other provisions in the tax code chop it down for those high-income people most affected.”

The ITEP data also show:

- Property taxes, on average, are the lowest of the three major forms of tax for the vast majority of Iowa households as a share of income. All but the lowest-earning 20 percent pay more income taxes than they do property taxes, and all but the highest-earning 5 percent (above \$127,000) of households pay more in sales tax than in property tax.

- The federal deduction for Iowa state and local taxes steepens the difference that requires lower-income families to pay more of their income in state and local tax than higher-income families pay. Without the deduction, taxes at the bottom 40 percent don’t change, but are 1.4 percentage points higher at the top.

IPP Executive Director David Osterberg said there have been some boosts for fairness in recent years, offering hope for improvements in the coming legislative session.

“It was important for the Iowa Legislature in 2007 to expand the Earned Income Tax Credit (EITC) to help low-income working families, and in particular to make it refundable, which effectively allowed those families to recoup some taxes they paid out on sales or property,” Osterberg said.

“But the increase was pretty small — going from 6.5 percent of the federal EITC to only 7 percent. And it’s important to note that Iowa’s poverty rate has risen to 10 or 11 percent, depending on the measure. Our tax system should not compound challenges for low-income families.”

The report notes Iowa could improve fairness in its tax system by:

- Further expanding the EITC.
- Allowing local-option income taxes as an alternative to local-option sales taxes.
- Avoiding additional increases in sales taxes.

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>. <<http://www.iowafiscal.org/>>