

## IOWA STATE AND LOCAL TAXES IN 2006: NATIONAL COMPARISONS

David J. Peters, Ph.D.

*Assistant Professor of Sociology, College of Agriculture and Life Sciences*

In the current economic recession taxation is a fundamental concern for most citizens and policymakers. Governments are struggling to raise revenues to support programs while at the same time seeking to stimulate the economy through tax reductions to increase disposable income. Taxation is one policy “lever” government can use to minimize the impact of economic downturns<sup>1</sup>. Although governments use a number of revenue sources to support their operations, a sizable share of their revenues come from taxes. In Iowa, roughly 41 percent of state and local government revenues come from taxes, with the rest coming from various charges and federal transfers.

Overall, Iowans pay less in total state and local taxes than do residents of most other states. Despite this fact, taxation is a continuing subject of debate within the state. The objective of this bulletin is to provide basic information about Iowa’s state and local tax revenues and how Iowa compares to other states. Since the mix of taxes is just as important as the overall level of taxation, states are compared along various types of taxes on income (individual and corporate), wealth (property), and consumption (sales and miscellaneous).

### SOURCE DATA ON REVENUES

This analysis uses data from the Annual Survey of State and Local Government Finances, produced by the U.S. Census Bureau. This survey contains comprehensive and consistent statistics on revenue, expenditure, debt, and assets for state and local governments across the United States. Although these data are the best source for state-by-state comparisons, the data are

### IOWA REVENUES AND TAXES AT A GLANCE

#### Revenue Sources

- 41.3% from taxes
- 27.6% from charges and miscellaneous revenues
- 18.2% from federal transfers
- 12.9% from insurance trust revenues

#### Total State and Local Taxes

- 36<sup>th</sup> highest in U.S. at 7.9% of the tax base
- \$3,457 per person, 32<sup>nd</sup> highest in U.S.
- Low - Iowans pay less than the national average

#### Property Taxes

- 19<sup>th</sup> highest in U.S. at 2.6% of the tax base
- \$1,143 per person, 22<sup>nd</sup> highest in U.S.
- Average - Iowans pay about the national average

#### Sales Taxes

- 38<sup>th</sup> highest in U.S. at 2.6% of the tax base
- \$1,126 per person, 41<sup>st</sup> highest in U.S.
- Low - Iowans pay less than the national average

#### Individual Income Taxes

- 30<sup>th</sup> highest in U.S. at 1.9% of the tax base
- \$837 per person, 26<sup>th</sup> highest in U.S.
- Average - Iowans pay about the national average

#### Miscellaneous Taxes

- 34<sup>th</sup> highest in U.S. at 0.6% of the tax base
- \$254 per person, 32<sup>nd</sup> highest in U.S.
- Average - Iowans pay about the national average

#### Corporate Income Taxes

- 42<sup>nd</sup> highest in U.S. at 0.2% of the tax base
- \$96 per person, 42<sup>nd</sup> highest in U.S.
- Low - Iowans pay less than the national average

somewhat lagged in being from 2006. This presents a challenge as the current recession has affected state economies and budgets. Therefore, some caution should be used in applying the 2006 data to current conditions.

In order to make meaningful comparisons across states with different types of governmental organizations, some of the data is aggregated. State and local taxes are reported together rather than separately, since the responsibilities of local governments differ across states. Individual and business taxes are also reported together, since many governments make no distinction between who pays the tax. Taxes paid by residents and non-residents are reported together since it is not usually feasible separate the two, especially in the case of sales taxes.

## ESTABLISHING A BASIS FOR COMPARISON

Comparing taxes across states may seem straightforward, but states differ widely in terms of population, economic size, and tax structure. The key task is to determine an appropriate base number from which to compare tax collections across states. This number is referred to as the tax base. One commonly used base method is *population*, which compares taxes collected per person (also called per capita). Although this method is easily understood, it is a poor measure because it does not take into account the income of the state, since government levies taxes on income and consumption, not people. Another commonly used base method is *income*, which compares tax collections as a percentage of total personal income. This method is also easy to understand and addresses the drawbacks of the population base method. However, the income base method fails to include business profits into the tax base, thus is less than ideal since governments can tax individual as well as business income.

To address these limitations, this analysis uses a *GDP+Transfers* base method, which compares tax collections as a percentage of state gross domestic product, minus taxes of production and imports, plus personal transfers. State gross domestic product (GDP) is a value-added concept that is the sum of incomes earned by labor and capital, less the costs incurred in the production of goods and services. It includes the wage and salary earnings of workers, the incomes earned by proprietors, and the profits earned by corporations and businesses. Personal income transfers are included to reflect transfer payments to individuals not included in GDP, such as retirement, medical, income maintenance, unemployment insurance, and veterans benefits.

In this analysis, the *GDP+Transfers* method is used to estimate the tax base of each state. Tax collections as a percentage of the tax base are used to compare the level of taxation across states. To permit comparisons to previously published rankings, the *per capita* base method is also included in the analysis. Data on GDP, personal transfers, and population are taken from the Regional Economic Accounts produced by the U.S. Bureau of Economic Analysis.

## SOURCES OF STATE AND LOCAL GOVERNMENT REVENUE

In the minds of most people, government is almost wholly funded through taxes. While this is true to some degree, most governments use a variety of non-tax sources to fund operations. The sources of state and local government revenues for Iowa are presented in Table 1. In Iowa, state and local governments together generated \$24.840 billion in revenues in 2006.

- *Taxes* generate 41.3 percent of all state and local government revenues, which is slightly under the national average of 43.7 percent. About 67 percent are collected by Iowa state government and 33 percent by local governments.
- *Charges and miscellaneous revenues* (including fees for education, health, and utilities) generate 27.6 percent of all revenues, and this is higher than the national average of 24.5 percent. Over 50 percent of these are collected by local governments in Iowa.
- *Federal intergovernmental transfers* account for 18.2 percent of all state and local revenues, below the 16.5 percent national average. About 9 percent of federal transfers go to local governments in Iowa.
- Lastly, *insurance trust revenues* (including unemployment, workers compensation, and state pensions) generate 12.9 percent of all revenues, which is lower than the national average of 15.3 percent. In Iowa, none of these trust revenues are collected by local governments.

In Iowa, taxes generated \$10.256 billion in state and local government revenues in 2006, with local governments accounting for \$4.138 billion of the total. Taken together, state and local taxes constitute 41.3 percent of total revenues, coming from a variety of tax sources.

- *Property taxes* account for 13.7 percent of revenues totaling \$3.392 billion. All property taxes in Iowa are collected by local governments.
- *Sales taxes* account for nearly equal share at 13.5 percent all revenues totaling \$3.342 billion. Local governments generate roughly 18 percent of total collections.
- *Individual income taxes* account for 10 percent of all revenues totaling \$2.483 billion. Local governments in Iowa collect about 3 percent of this total, mainly through income tax surcharges levied by school districts.
- *Miscellaneous taxes* account for 3.0 percent of revenues totaling \$755 million. Local governments generate only 9 percent of total collections.
- *Corporate income taxes* account for the smallest share, at 1.1 percent of all revenues totaling \$285 million. No local governments collect corporate income taxes.

**Table 1. Iowa State and Local Government Revenues 2006.**

Source	Iowa 2006	Percent of Revenues		Percent Local Sources	
		Iowa	US Avg	Iowa	US Avg
Federal Intergovernmental	\$4,510,932,000	18.2%	16.5%	9.4%	12.1%
Taxes - Property	\$3,391,938,000	13.7%	13.1%	100.0%	96.7%
Taxes - Sales	\$3,342,043,000	13.5%	15.1%	18.2%	19.2%
Taxes - Individual Income	\$2,482,891,000	10.0%	9.8%	2.8%	8.5%
Taxes - Corporate Income	\$284,976,000	1.1%	1.9%	0.0%	10.3%
Taxes - Miscellaneous	\$754,608,000	3.0%	3.7%	8.8%	29.0%
Charges	\$4,234,913,000	17.0%	12.2%	52.4%	59.0%
Miscellaneous Revenue	\$1,638,247,000	6.6%	7.4%	38.8%	42.1%
Utility & Liquor Revenue	\$983,193,000	4.0%	4.8%	83.3%	83.9%
Insurance Trust Revenue	\$3,216,358,000	12.9%	15.3%	0.2%	12.5%
<b>TOTAL REVENUES</b>	<b>\$24,840,099,000</b>	<b>100.0%</b>	<b>100.0%</b>	<b>33.2%</b>	<b>36.0%</b>

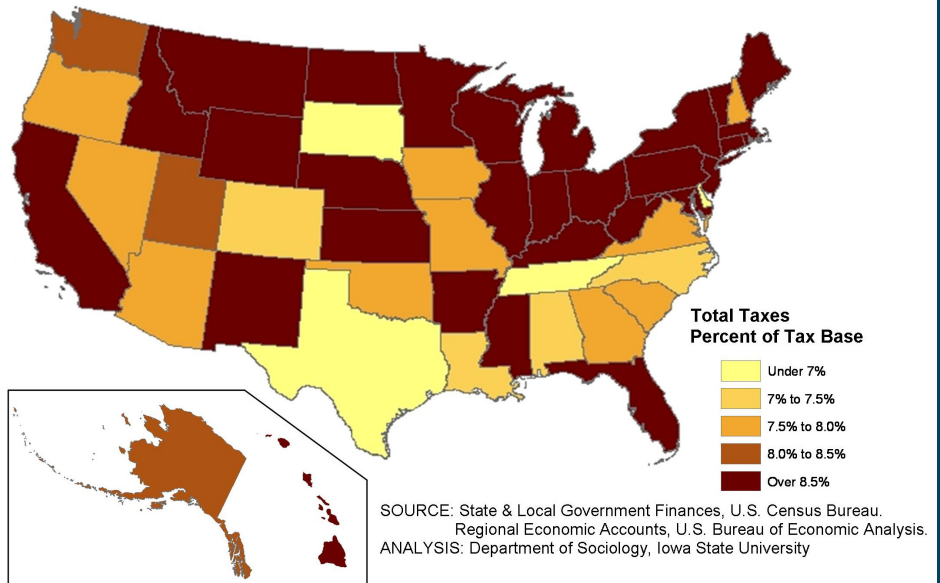
## TOTAL TAXES – NATIONAL COMPARISONS

There is a wide range of variation across states in the overall level and mix of taxation. Total state and local tax collections are highest (10% or more of tax base) in Maine, New York, Vermont, Wyoming, New Jersey, and Hawaii. Conversely, total taxes are lowest (7% or less) in Texas, Tennessee, South Dakota, Delaware, and the District of Columbia.

States in the northeast tend to have the higher levels of property taxes, while southern states tend to have the lowest. Sales tax collections are highest in Hawaii and Washington, and are lowest in Delaware and Oregon.

Taxes on individual income as a share of the tax base are greatest in Maryland, New York, and Oregon. On the other hand, there is no tax on personal income in Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

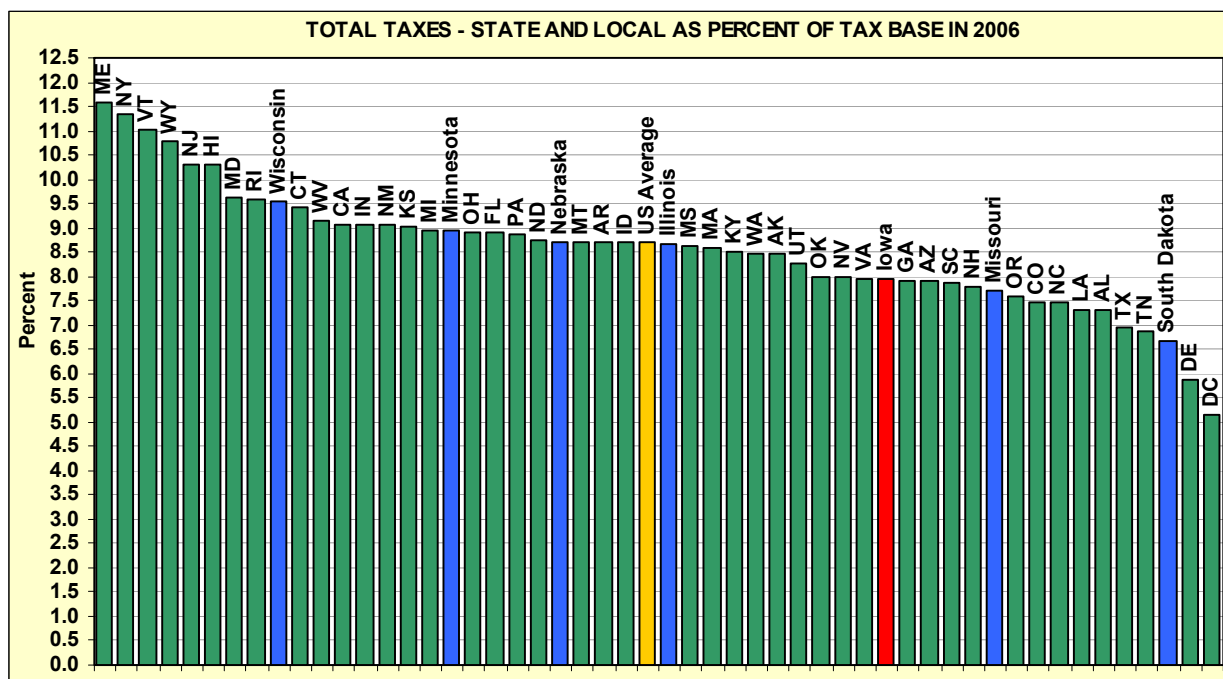
Miscellaneous tax collections are highest in states with large energy and mining industries, and are largely generated through excise or extraction taxes.



Corporate income taxes as a share of the economy are highest in Alaska, New Hampshire, New York, and West Virginia. There is no or negligible income tax on businesses in Nevada, Texas, Washington, and Wyoming.

Iowa ranks 36<sup>th</sup> highest in the nation on total state and local taxes, accounting for 7.9 percent of the state's tax base. This is lower than the national average of 8.7 percent, indicating that Iowa residents and businesses pay less in taxes than those in most other states. In terms of taxes per person Iowa ranks 32<sup>nd</sup> in the nation at \$3,457 per capita.

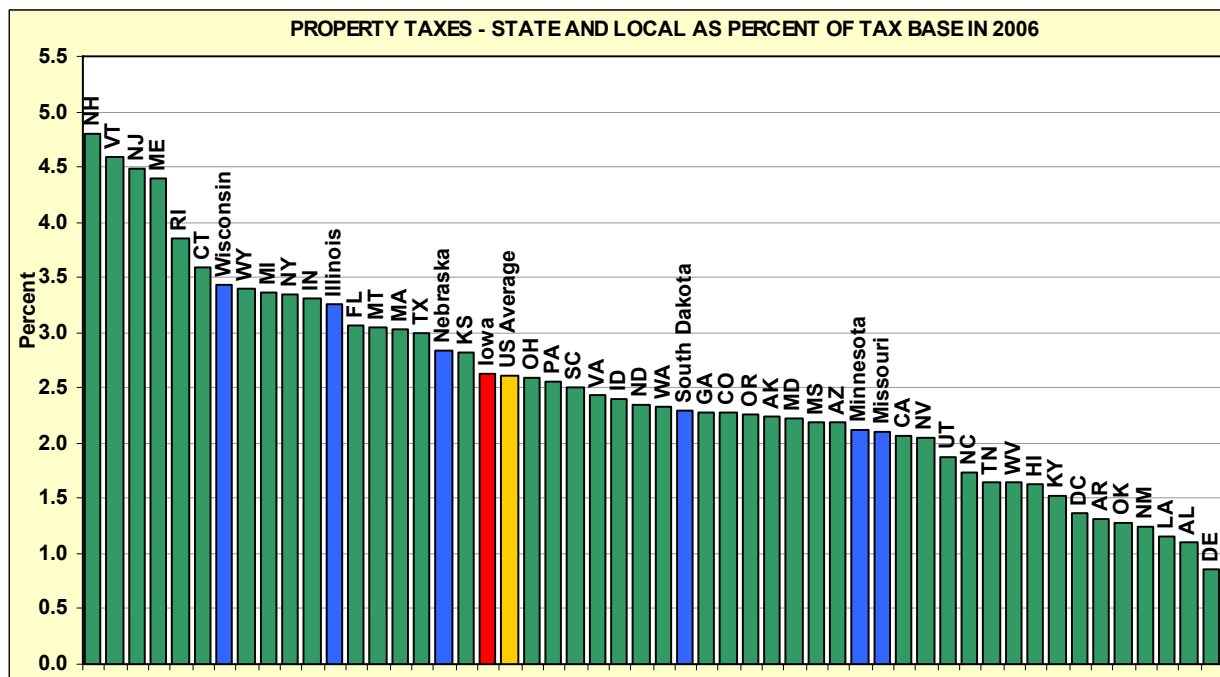
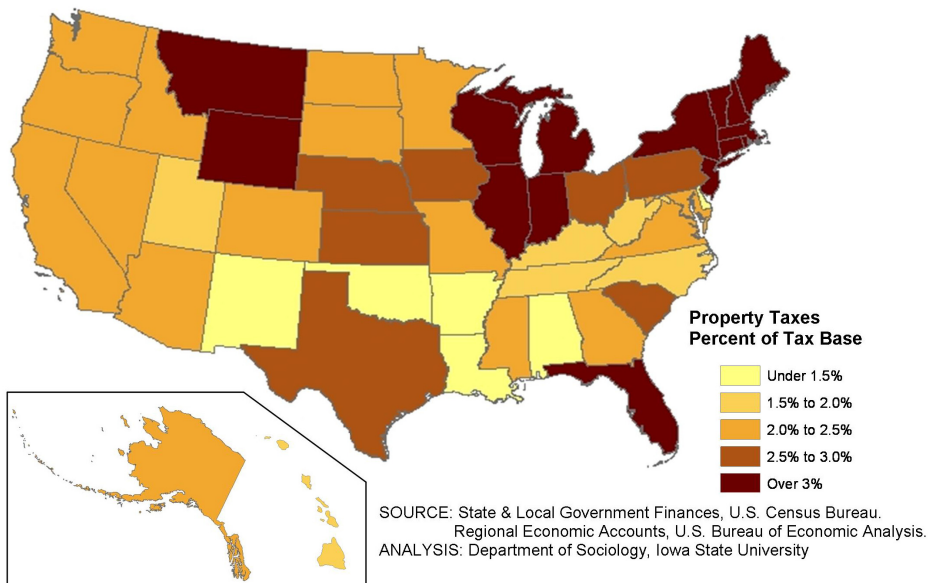
Iowans pay less in taxes as do taxpayers in Wisconsin, Minnesota, Nebraska, and Illinois. However, they also pay much more than taxpayers in South Dakota. Of Iowa's neighboring states, Wisconsin had the highest share at 9.5 percent, placing it 9<sup>th</sup> highest in the nation. Higher shares are also found in Illinois, Nebraska, and Minnesota ranging from 8.5 to 9 percent of the tax base. Missouri's tax share is nearly identical to Iowa's at 7.7 percent placing it 41<sup>st</sup> in the nation. South Dakota has the lowest share (6.7%) placing it 49<sup>th</sup> in the nation.



## PROPERTY TAXES – NATIONAL COMPARISONS

Iowa's property taxes place it 19<sup>th</sup> highest in the nation. Iowa residents and businesses pay about the same in property taxes than those in most other states. Property tax collections account for 2.6 percent of the state's tax base, which is identical to the national average. In terms of property taxes per person Iowa ranks 22<sup>nd</sup> in the nation at \$1,143 per capita.

Residents of our surrounding states in Wisconsin, Illinois and Nebraska pay more in property taxes than do Iowans. On the other hand, Iowans tend to pay more than do people and businesses in Missouri, Minnesota and South Dakota. Wisconsin has the 7<sup>th</sup> highest property tax share (3.4% of base), followed by Illinois (3.3%) at 12<sup>th</sup> highest. Nebraska has slightly higher property taxes at 2.8 percent of tax base, while South Dakota has a slightly lower share at 2.3 percent. Minnesota and Missouri both have much lower shares than Iowa at 2.1 percent, placing them 35<sup>th</sup> and 36<sup>th</sup> highest in the nation.

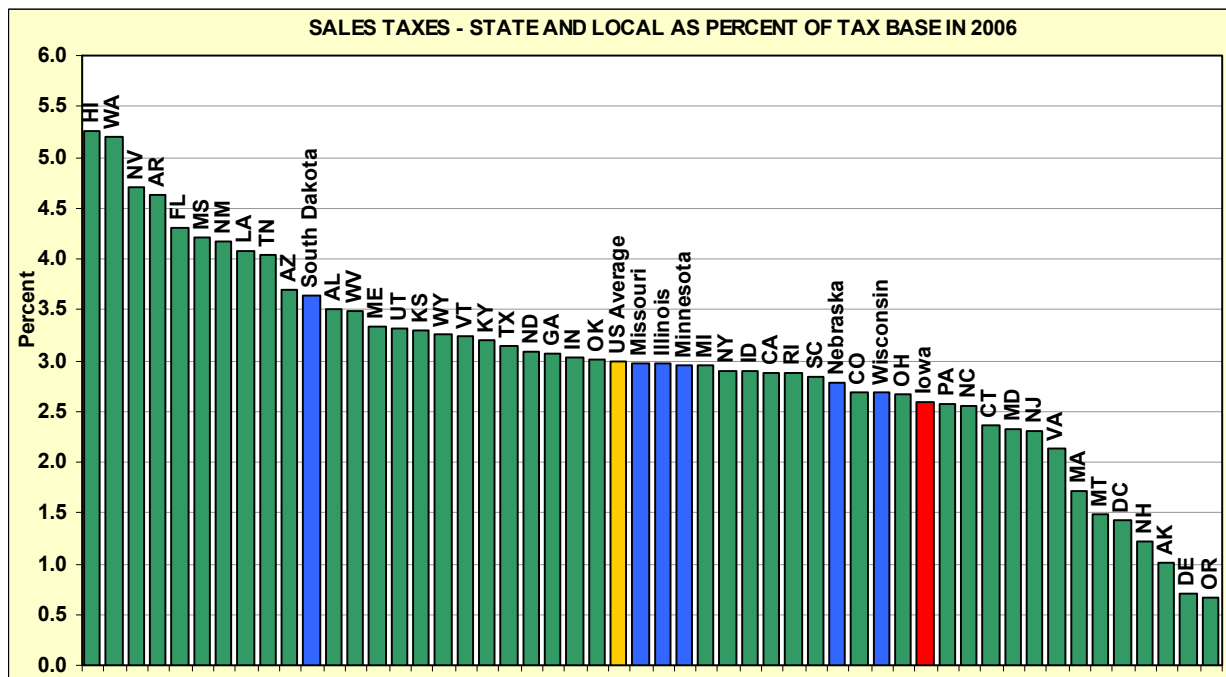
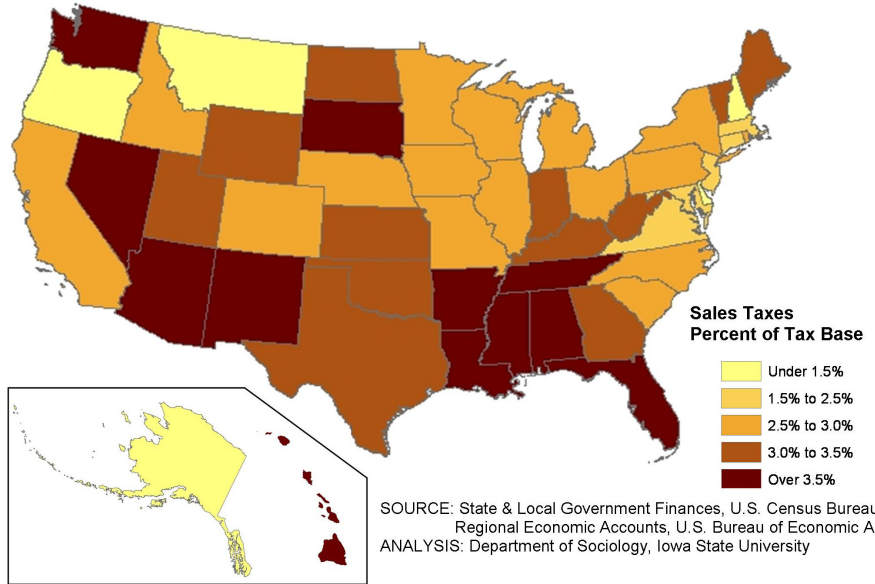




## SALES TAXES – NATIONAL COMPARISONS

In terms of state and local sales taxes, Iowa ranks low at 38<sup>th</sup> highest in the nation. Sales tax collections account for 2.6 percent of Iowa's tax base, which is lower than the national average of 3 percent. In terms of sales taxes per person Iowa ranks 41<sup>st</sup> in the nation at \$1,126 per capita. These rankings indicate that Iowans pay much less more in sales taxes than do residents of most other states.

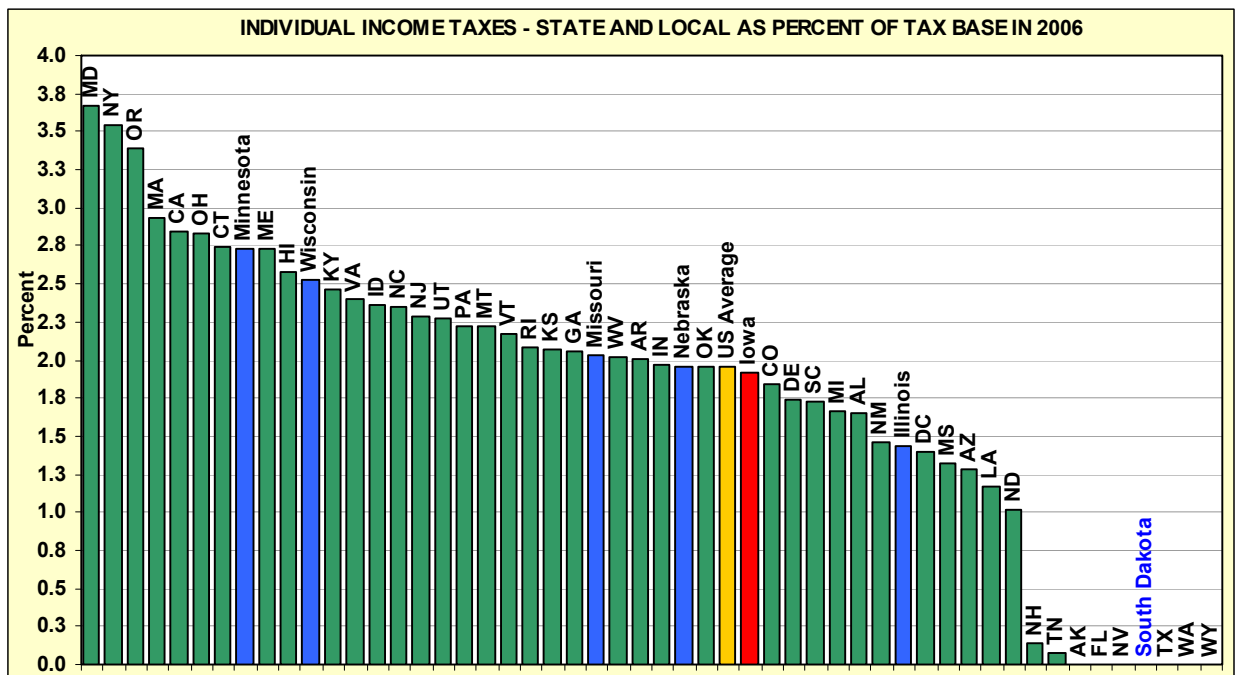
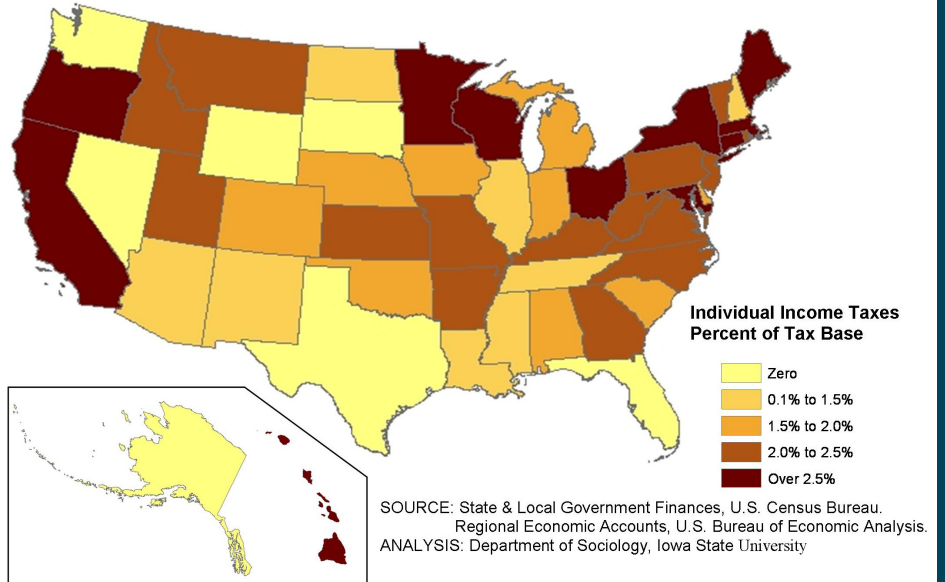
Iowans pay less in sales taxes than do residents in surrounding states. Taxpayers in South Dakota, typically a low tax state, pay much more in sales taxes (3.6%) than do Iowans, placing them 11<sup>th</sup> highest in the nation. Sales taxes are also larger in Missouri, Illinois and Minnesota, coming in at 3 percent of their tax base, which is identical to the national average. Residents in Nebraska (2.8%) and Wisconsin (2.7%) pay slightly higher rates than Iowans, as a share of the tax base.



## INDIVIDUAL INCOME TAXES – NATIONAL COMPARISONS

Iowa has relatively low individual income taxes, accounting for only 1.92 percent of the state's tax base, which is slightly lower than the national average of 1.95 percent. This places Iowa 30<sup>th</sup> highest in terms of individual income tax collections, indicating that residents pay less than do residents of most other states. In terms of individual income taxes per person Iowa ranks 26<sup>th</sup> highest in the nation at \$837 per capita.

Of Iowa's neighboring states, both Minnesota (2.73%) and Wisconsin (2.53%) have much higher shares placing them 8<sup>th</sup> and 11<sup>th</sup> highest in the nation, respectively. Missouri (2.02%) and Nebraska (1.97%) have income tax shares that are nearly identical or slightly higher than Iowa's. Conversely, Illinois has a much lower individual income tax rate at 1.44 percent of their tax base, placing it 37<sup>th</sup> highest in the nation. South Dakota has no individual income tax, placing it among the lowest income taxed states in the nation.

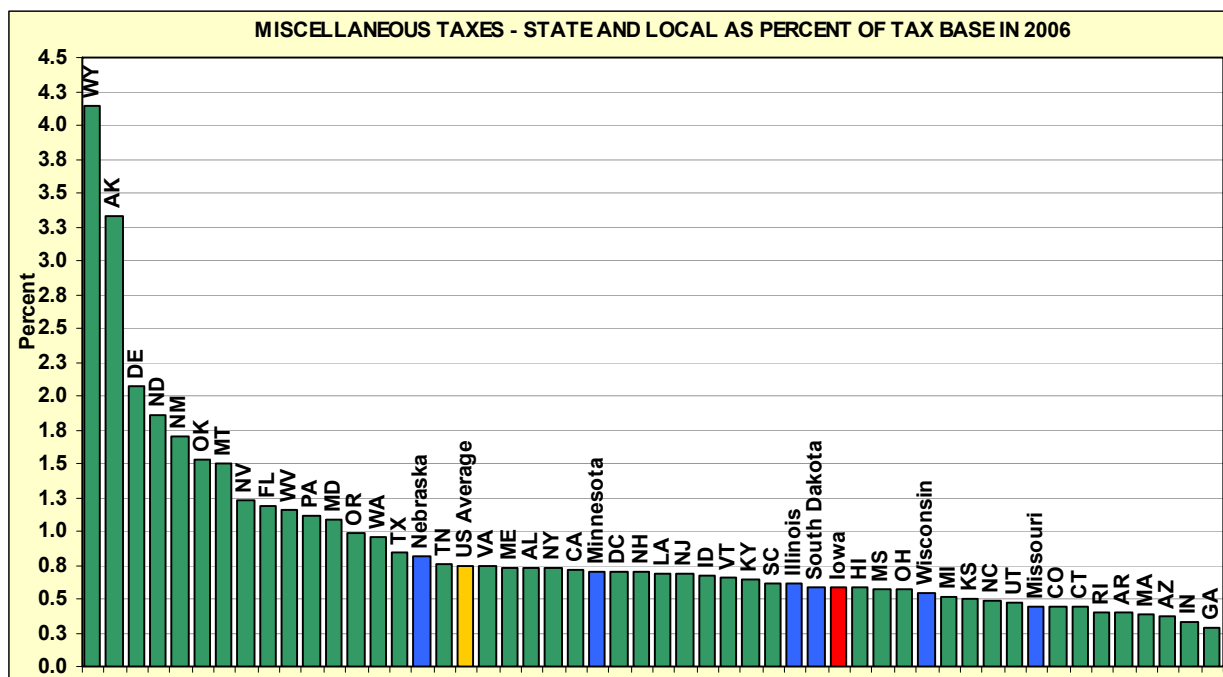
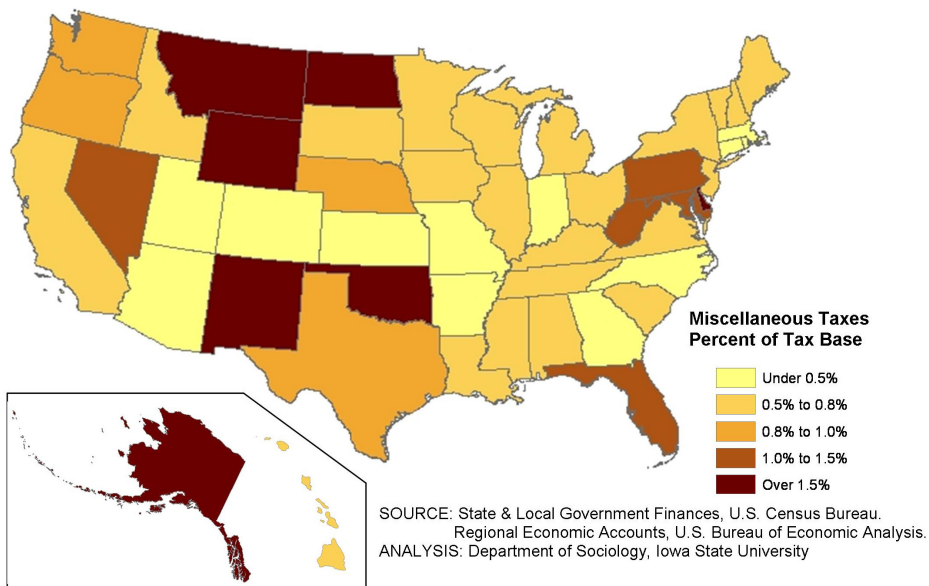




## MISCELLANEOUS TAXES – NATIONAL COMPARISONS

Iowa has the 34<sup>th</sup> highest rate of state and local miscellaneous tax collections in the nation. These taxes account for 0.58 percent of the state's tax base, which is much lower than the national average of 0.75 percent. In per person terms Iowa ranks 32<sup>nd</sup> highest in the nation at \$254 per capita. High taxes on the mining industry in several states (Wyoming, Alaska, North Dakota, and New Mexico) tend to make the national average much higher.

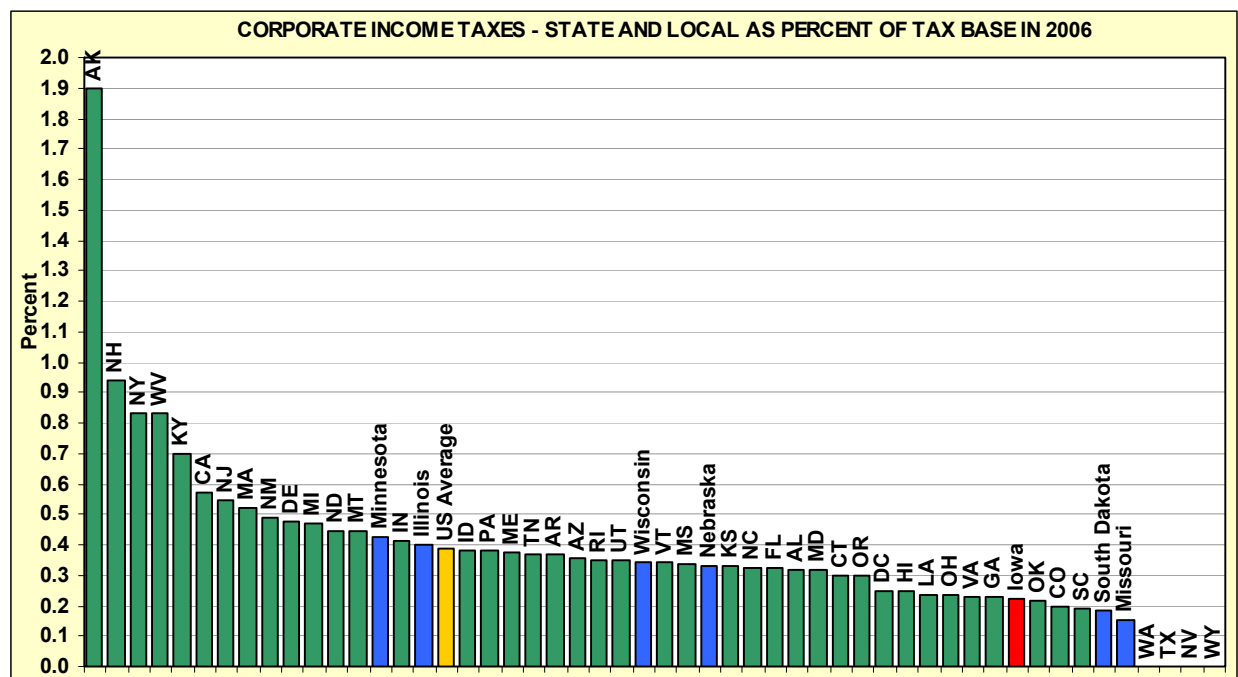
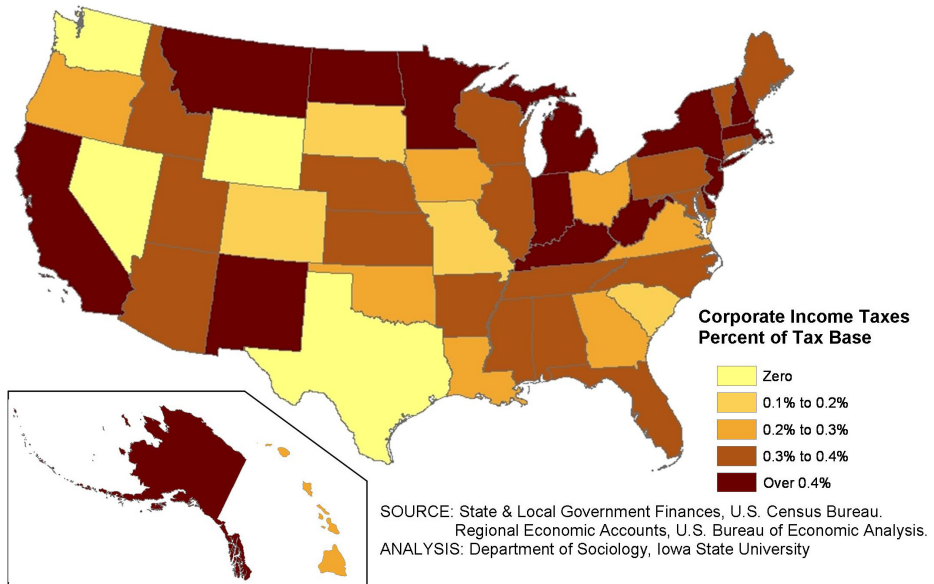
Of the surrounding states, taxpayers in Nebraska and Minnesota pay higher miscellaneous taxes than do Iowans, but those in Missouri tend to pay much lower rates. Miscellaneous taxes account for 0.82 percent of the tax base in Nebraska (16<sup>th</sup> highest) and 0.71 percent in Minnesota (23<sup>rd</sup> highest), both higher than Iowa rates. Illinois, South Dakota and Wisconsin all have shares very similar or slightly higher than those in Iowa, ranging between 0.55 and 0.6 percent. Missouri (0.45%) has the lowest miscellaneous tax share, placing it 45<sup>th</sup> in the nation.



## CORPORATE INCOME TAXES – NATIONAL COMPARISONS

In Iowa, collections of corporate income taxes account for only 0.22 percent of the state's tax base, which is much lower than the national average of 0.39 percent. This places Iowa 42<sup>nd</sup> in the nation. As a share of the tax base, Iowa has some of the lowest corporate income taxes in the nation, indicating that businesses pay much less here than they do in most other states. In terms of corporate income taxes per person Iowa also ranks 42<sup>nd</sup> at \$96 per capita.

Of our neighboring states, businesses in Minnesota (0.43%) and Illinois (0.40%) pay much more in corporate income taxes than do their counterparts in Iowa, placing them in the top 15 highest states. Wisconsin and Nebraska businesses also pay higher income taxes (around 0.34%). However, South Dakota (0.18%) and Missouri (0.15%) businesses pay lower income taxes than in Iowa, placing these states 46<sup>th</sup> and 47<sup>th</sup> highest in the nation.



## SUMMARY AND POLICY RECOMMENDATIONS

Although taxation is a concern for many Iowa residents and policymakers, only 41 percent of state and local government revenues come from taxes. In addition, Iowans tend to pay less in taxes than do taxpayers of most other states. Iowa only ranks 36<sup>th</sup> highest in total state and local taxes, accounting for 7.9 percent of the state's tax base. Iowa still ranks low when measured using different methods. In terms of taxes per person, Iowa ranks at 32<sup>nd</sup> highest in the nation at \$3,457 per capita. All of these rates are lower than the national averages.

- In Iowa, property and sales taxes contribute about 14 percent each to total state and local revenues, each generating about \$3.4 billion in 2006. Iowa residents and businesses pay about the same in property taxes as those in most other states, with Iowa having the 19<sup>th</sup> highest share in the nation. Iowa's neighboring states of Wisconsin, Illinois, and Nebraska have higher shares; while South Dakota, Minnesota, and Missouri have lower shares of the tax base. In terms of sales taxes, Iowa ranks low at 38<sup>th</sup> highest in the nation. All of Iowa's surrounding states have higher sales tax collections as a share of the economy.
- Individual income taxes account for nearly 10 percent of all revenues, generating \$2.5 billion in 2006. Iowa has relatively low individual income tax collections as a share of the tax base, placing the state 30<sup>th</sup> highest in the nation. Of our neighboring states Minnesota and Wisconsin have higher income tax collections, and Nebraska and Missouri have very similar collections. South Dakota has no individual income tax.
- Miscellaneous taxes generated \$755 million in revenues in 2006, accounting for almost 3 percent of all state and local government revenues. Iowa ranks 34<sup>th</sup> highest in the nation on these taxes, meaning businesses and residents tend to pay much less than those in other states. Nebraska and Minnesota tend to have slightly higher collections than Iowa, while Missouri tends to have slightly lower collections.
- Lastly, corporate income taxes account for a very small share of total revenues, generating only \$285 million or about 1 percent of all revenues. Iowa falls in the lower tier of states, having only the 42<sup>nd</sup> highest corporate income taxes in the nation. Except for Missouri and South Dakota, all of Iowa's neighboring states have much higher business income taxes. By contrast, Missouri and South Dakota have the lowest rates in the nation – any states with lower rates do not levy a corporate income tax.

Revenue and tax structures can be compared along two main economic and political criteria: tax productivity and tax equity<sup>2</sup>. Governments should consider both criteria when making decisions regarding revenue generation, not just their political acceptability. First, taxes can be judged on their potential to generate revenue, termed their **tax productivity**. *Elastic taxes* are those that expand or contract as the overall economy or population grows or declines. Income taxes are a typical example of elastic taxes. *Inelastic taxes* are those that remain relatively stable regardless of changes in the economy or population. Sales and excise taxes are good examples of inelastic taxes. The advantage of elastic taxes is they grow at least as fast as the economy or population, thereby reducing the need for frequent

tax rate changes. However, the main disadvantage of elastic taxes is they tend to decline much faster than downturns in the economy or population. During recessions, such as the one currently affecting the country, this can lead to sharp drops in revenues forcing cutbacks in government services. Inelastic taxes, on the other hand, are generally more stable in times of economic downturns. Although these taxes provide a stable revenue source, they typically do not grow fast enough to fund most government operations.

Second, taxes can be judged according to principles of **equity and fairness**, such as who should pay and how much. Obviously, such judgments are subject to debate and are inherently political, but they constitute an important part of evaluating tax structures. The equity of taxes can be judged on whether they are horizontal or vertical. *Horizontal equity* requires equal tax treatment of people in similar circumstances. Thus, all persons having the same level of wealth should pay the same amount in taxes, regardless of how they derive their wealth. By contrast, *vertical equity* deals with the fairness of how tax liabilities are distributed among people of different circumstances. Thus, persons with the same level of wealth but with different circumstances will pay different amounts of taxes. Vertical equity is typically based on the ability-to-pay principle, where people are expected to contribute to the costs of government based on their overall wealth and situation.

Horizontal and vertical equity is inherent in the different types of tax structures adopted by governments. *Progressive tax structures* vary the tax burden depending on a person's wealth, so that the tax burden proportionally increases as wealth increases. *Regressive tax structures* also vary tax burden in relation to wealth but in the opposite direction, so the tax burden proportionally decreases as wealth increases. *Proportional tax structures* do not vary the tax burden depending on wealth, so everyone pays the same rate regardless of wealth. In general, tax structures that favor lower and middle income households rely more heavily on progressive taxes (income taxes) and less on regressive taxes (usually sales taxes) or proportional taxes (typically property taxes).

In summary, when crafting tax policy it is important to evaluate the entire system of taxation, not just specific taxes. All taxes have inherent inequalities, so governments must rely on a mix of taxes so these inequalities do not become especially burdensome on specific groups. Governments should have a mix of progressive, regressive and proportional taxes. In addition, governments should have a mix of elastic and inelastic taxes to have a stable revenue base that is capable of growing in economic expansions, yet robust to withstand economic downturns.

*For more information contact:*

David J. Peters, Ph.D.

*Assistant Professor of Sociology  
College of Agriculture and Life Sciences  
Iowa State University*

303 East Hall  
Iowa State University  
Ames, IA 50011-1070

TEL: 515-294-1122  
FAX: 515-294-2303  
dpeters@iastate.edu

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<sup>1</sup> Lee, R.D. and R.W. Johnson. 1998. *Public Budgeting Systems*. Gaithersburg MD: Aspen Publishers.

<sup>2</sup> Rabib, J., W.B. Hildreth and G.J. Miller. 1996. *Budgeting Formulation and Execution*. Athens GA: Carl Vinson Institute of Government, University of Georgia.

