

Iowa's Businesses Already are Taxed Lightly

Once again, lawmakers are hearing complaints about the competitiveness of Iowa's tax system. And once again, tax cuts for business are on the agenda in Des Moines. Yet the fact of the matter is that business taxes in Iowa are already relatively low. Whether one focuses only on the corporate income tax, or the whole range of taxes falling on business, Iowa's state and local taxes are well below average, and have been for some time.

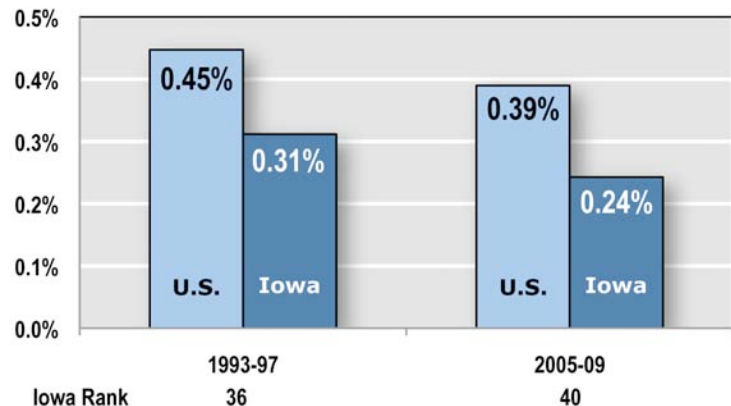
Iowa's corporate income tax in recent years has been considerably lower than the national average level of taxation and lower than all but 11 states. How can this be when the top tax rate — 12 percent — is the highest in the nation? The answer is simple: That 12 percent tax rate is applied to only a small portion of a company's profits in Iowa. Iowa is one of only four states that allows a portion of federal corporate income taxes to be deducted from income. On top of this, Iowa determines how much of a multi-state firm's profits are taxable in Iowa solely on the basis of sales in Iowa. The majority of states take into account a firm's payroll and property in the state as well as sales. 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 profits. Finally, Iowa offers a range of generous tax credits that further reduce corporate tax liability.

The best summary measure of the level of corporate income taxation from one state to another, 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 fraction fell from 0.31 percent in the mid-1990s to 0.24 percent over the last five fiscal years, as shown in Figure 1.

On this measure, Iowa's rank among the 50 states fell from 36th to 40th. (For the most recent year, 2009, Iowa ranked 36th.) In both periods, Iowa has taxed well below the average for all 50 states. Similarly, the conservative Tax Foundation found that Iowa ranks 43rd among the states in its level of corporate income taxation, measured as corporate taxes paid per capita on average for fiscal years 2004-2008 (and 36th for 2008).¹ Since rates have not changed, Iowa's decline in corporate income tax collections relative to other states is likely due in significant part to Iowa's adoption of additional tax credits, most significantly making the Research Activities Credit a refundable credit.

The corporation income tax is only part of the picture, to be sure. Businesses also pay local property taxes on their buildings (but not on machinery and equipment, including computers), and they pay some sales taxes. Many

Figure 1. Few States Tax Businesses Less Than Iowa
State Corporate Income Tax: Percent of Private Sector GDP



Sources: IPP analysis of data from the U.S. Census, State Government Tax Collections; and the Bureau of Economic Analysis, Gross Domestic Product by State.

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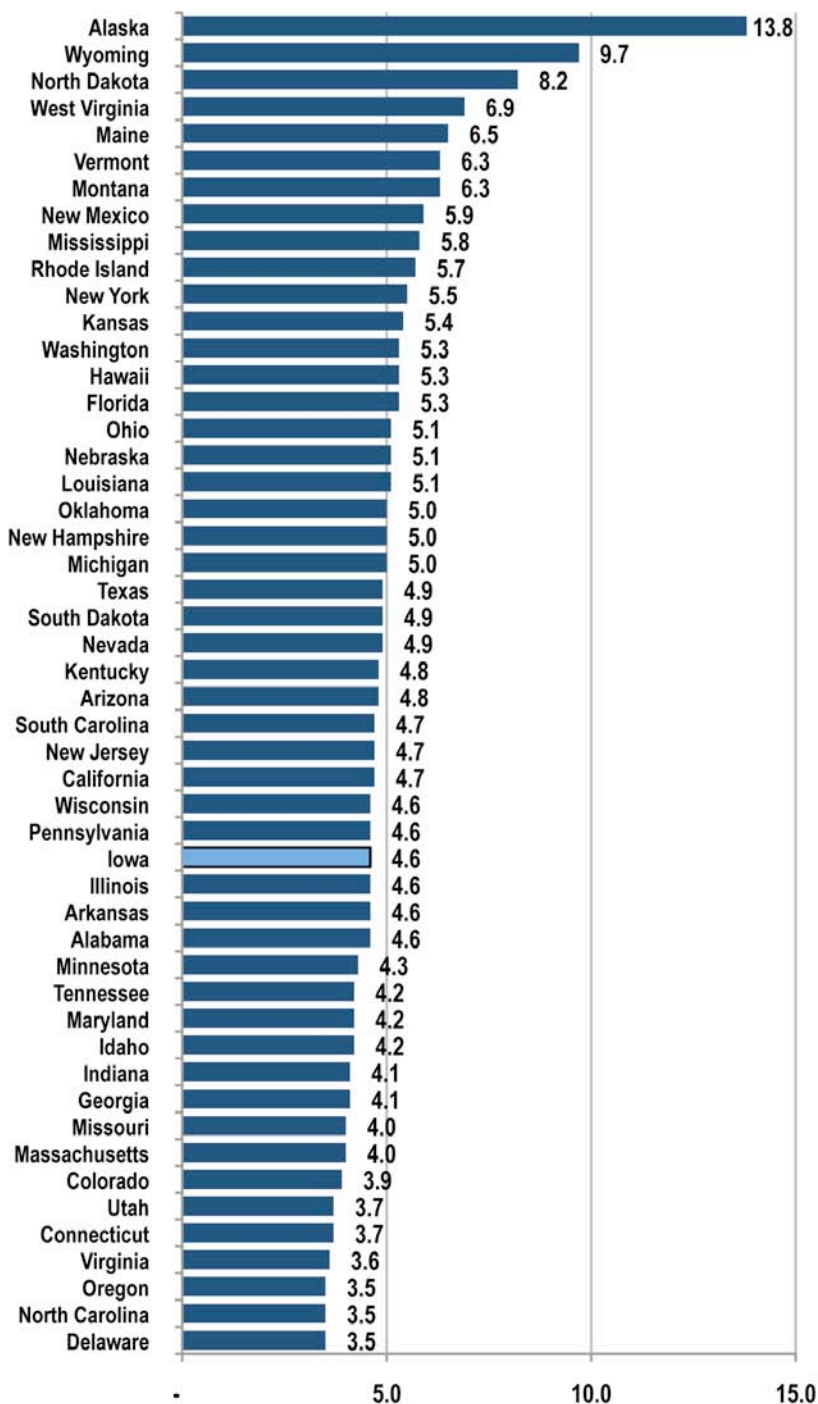
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businesses are proprietorships, partnerships, or “S-Corporations,” and as such do not pay corporate income taxes. Instead, the net profits from the business — after deducting all business expenses — are added to other income the owners might have and then taxed under the individual income tax. 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. 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 six other states for 30th; as the table below shows, in only 15 states were business taxed at a lower rate.

Clearly, there is no case that businesses in Iowa are taxed too heavily relative to other states, whether one considers just the corporate income tax, or all state and local taxes falling on business. In fact, Iowa’s business taxes are low.

Figure 2. Iowa Also Ranks Low Including Local Taxes
State and Local Business Taxes:
Percent of Private-Sector GDP, FY2009



Source: Ernst and Young for the Council on State Taxation. Total state and local business taxes: State-by-state estimates for fiscal year 2009. March 1, 2010. Available at:

<http://www.cost.org/StateTaxLibrary.aspx?id=17768>

¹ Tax Foundation, State Corporate Income Tax Collections Per Capita, Fiscal Year 2004-2008, at <http://www.taxfoundation.org/taxdata/show/281.html>