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Governor Reynolds’ flat-income tax plan: Not flat, not fair

New breaks for the wealthy, increasing inequities in Iowa’s state and local tax system

By Peter Fisher, Research Director

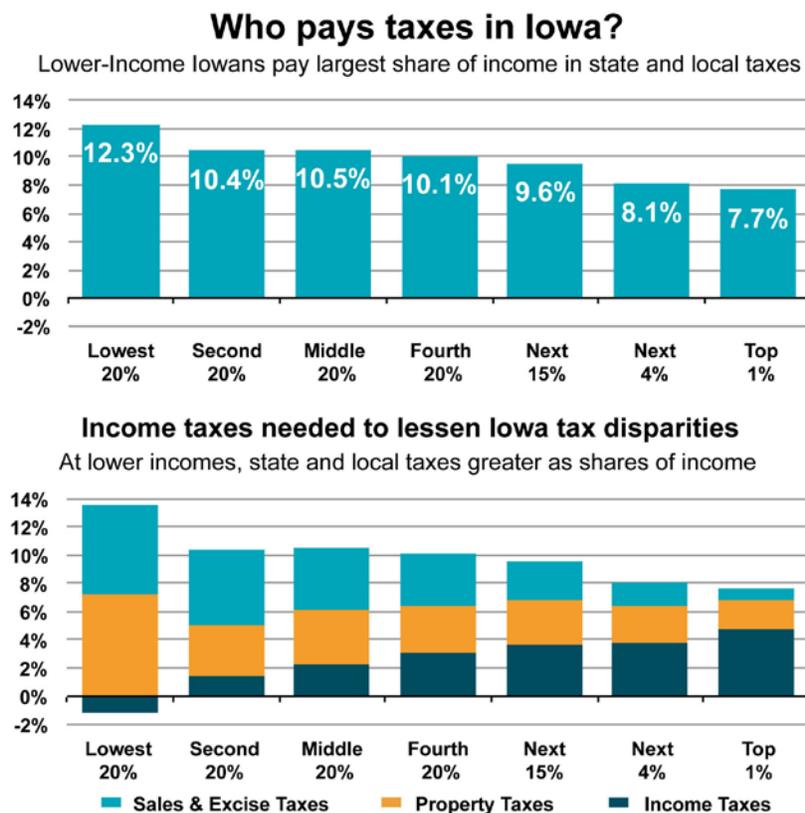
Iowa’s tax system is upside down: Those with the lowest income pay a higher percentage of their income in state and local taxes than those at the top. Along comes the governor with a “flat tax” proposal that she has defined as “fair.” In fact, it would make things worse with a tax system that is heavily weighted in favor of those who have the highest incomes. It would make the Iowa system even less flat, more skewed in favor of the rich.

A flat tax approach — not focused on one tax — would take the same share of income from everyone, not 8 percent from the rich and 12 percent from the poor as Iowa’s system does now (graph at right).

When you break out the pieces of the Iowa system (bottom graph), the role of the income tax is clear: It is the principal tax paid at higher incomes, and it lessens the disparity caused by the property and sales taxes.

For a “flat” system overall, Iowa would raise income taxes for those at the top, cut the sales tax, and/or provide a renters’ credit for property taxes. Instead, Iowa lawmakers

over the last 25 years have cut income taxes, raised sales taxes, and targeted property tax cuts to businesses. These choices have compounded inequities while reducing resources to provide critical public services in education, health care, child care, environmental quality, public safety and more.



Examples of the imbalance

Consider an elderly couple living on \$20,000 in Social Security, or a single mom earning \$10 an hour and trying to cover rent, food and child care out of \$20,000 a year. Both fall in the bottom 20 percent of Iowa families in terms of income and pay about 12 percent of their income in taxes, but little or nothing in income tax. Mostly they pay sales taxes and, as part of their rent, property taxes.

Now consider a retired hedge fund manager with an income of \$500,000 a year, mostly from stocks and bonds and a generous pension. That person would fall in the top 1 percent of Iowa taxpayers, paying about 8 percent of income in state and local taxes.

If the governor were truly interested in a flat tax system as “fair,” she would take a much broader approach, toward the entire state tax system for individuals and families.

According to the Department of Revenue analysis of the Governor’s proposal, when fully phased in by 2027, less than 1 percent of the total tax cut is directed to the bottom fifth of Iowa income tax filers, whose average savings are less than a dollar per week. The richest 2.3 percent — those with over \$250,000 in taxable income — would get almost 36 percent of the cuts. For the millionaires, the average cut is \$68,000, or \$1,316 a week. Two-thirds of the cuts go to those making over \$100,000 per year — the richest 14 percent of Iowa taxpayers.

Conclusion

Instead of flattening Iowa’s tax system, the governor’s proposal moves us a long way in the other direction. The hedge fund manager gets a huge income tax cut. The top tax bracket would fall from 6.5 percent to 4.0 percent, a 38 percent reduction, and all private pension income would be exempt.

The low-earning single mom, or the retired couple on Social Security, would get little or nothing. They would continue to pay sales taxes and property taxes as they do now, but the income-tax cut would make no difference in their household budget — while hurting services that matter to them.

Meanwhile, the state general fund will lose about \$1.6 billion a year. It will become even harder to adequately fund public schools, or to expand affordable housing or child care or elderly services. The hedge fund manager, of course, couldn’t care less. But the retired couple or the single mom will be worse off than before.

The governor’s tax proposal is not flat, and its impacts certainly are not fair.

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