What would real tax reform look like?
Hint: It’s not the list they’re talking about at the State Capitol

By Peter Fisher

We should all welcome a serious discussion of tax reform in the Iowa Legislature, with one huge caveat: It should focus on real issues, not made-up ones. There are real issues: Business tax credits continue to grow much faster than other state spending, and contribute significantly to the budget shortfalls that have become an annual problem. The effectiveness of many of these credits has been questioned by studies from the Iowa Department of Revenue, by academic research, and by the Iowa Tax Credit Review Panel of 2010.¹

Reining in the credits going to businesses will not be easy. A bill was recently introduced (HSB187) to end the refundability of these credits — provisions that allow companies to receive a check from the state whenever the credit exceeds their total state income tax. The business lobby was out in full force to defend their perks.

These income tax credits total over $285 million this year.² More tax credits — $125 million for both this year and next — are part of the massive commercial property tax cuts of 2013. (In various ways, the 2013 cuts now cost the state treasury another $300 million annually.)³ Just a portion of these breaks would go a long way to solving the state’s perennial budget problem. The graph at right shows existing business income tax credits and new property tax credits together cost the state twice as much as the credits cost in 2013, leaving less to spend on critical public services.

However, there is a real danger that any savings from capping or reducing business tax credits would not be directed at improving education, reducing student debt, cleaning our water, or restoring cuts to public safety and the courts. Instead, some

Cost of Iowa Business Tax Credits Doubles in Five Years
Combined Cost: Business Credits, New State-Funded Property Tax Credits

Source: Iowa Department of Revenue, Contingent Liabilities Reports, Table 9. March 2017 and previous years; Summary of FY2018 and FY2018 Budget and Governor’s Recommendations, LSA Fiscal Services, Jan. 14, 2017, p. 218

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The Iowa Policy Project
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legislators apparently would rather spend it on a made-up problem — that Iowa’s taxes are supposedly driving corporations and individuals out of the state. This is a faulty notion for three reasons.

First, Iowa taxes are consistently found to be average among the 50 states, or below average. There have been several recent studies of Iowa’s business taxes by accounting firms. One found that Iowa state and local taxes falling on business are about average; three others found Iowa taxes to be below average (depending on the type of business) — including one report that ranked Iowa business taxes the fourth lowest in the country. State and local taxes overall represent about 5.9 percent of personal income in Iowa, just under the U.S. average of 6.0 percent.

Second, taxes have little or nothing to do with people’s decisions to move from one state to another. ALEC (the American Legislative Exchange Council), AFP (the Koch-funded Americans for Prosperity), and other right-wing groups continue to push the notion that taxes drive

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**The migration myth**

Serious research examines all of the factors leading to migration in order to identify whether taxes actually matter, after controlling for the other causes. In contrast, those pushing tax cuts, especially lowering rates for top incomes, rely on simplistic comparisons that do not even consider any other possible motivations behind migration. Travis Brown is a leading purveyor of this nonsense through his book and website called “How Money Walks,” tracking the income levels of those who migrate. But even his data show that Iowa actually lost more to high-tax Minnesota than to low-tax South Dakota. And the other three states with significant out-migration from Iowa are Sun Belt states that have long been popular destinations for reasons having nothing to do with taxes: Florida, Arizona, and Texas.

Iowa gains residents as well, of course, particularly from California, New York, and New Jersey. Those are populous states with housing costs far higher than in Iowa. Even if the migration decisions of those families were driven by costs of living rather than by jobs or proximity to family or quality of life, housing costs would be of far more significance than any tax differences.
migration patterns in an effort to validate their tax cutting approach to state economic policy. But this assertion is contradicted by research on the issue.

Over their lifetimes, the majority of Americans do not move far, with most remaining in the state they grew up in or moving to a neighboring state. Those who move farther away do so for many reasons: job availability, climate, marriage, proximity to family, housing costs, the quality of schools, and other factors, according to years of research on this issue. This research consistently finds that taxes have a negligible effect on people's decisions to move.6

Finally, decades of research have shown that state and local taxes on business are too small to have a significant effect on business investment and location decisions. All state and local taxes on businesses combined represent only about 1.8 percent of total business costs on average for all states.7

Businesses weigh most heavily the basics that comprise the other 98 percent of their cost structure: proximity to markets and to suppliers; transportation infrastructure; supply of labor with appropriate education and skills; wage and salary rates; energy costs; occupancy costs (to buy or lease space); access to supporting business services; the quality of local schools, recreation amenities, climate and other amenities important in attracting and retaining skilled labor; and proximity to university research facilities.

Instead of relying on credible academic research, or the reports by accounting firms that show business taxes are below average in Iowa, proponents of business tax cuts cite Iowa’s supposedly low "business tax climate" ranking by the Tax Foundation. Yet this ranking has been thoroughly discredited.8

The drumbeat from the right has been the same for years — we need to lower Iowa’s taxes because they are making us uncompetitive; tax cuts will drive economic growth and prosperity. It is astounding that this argument is still being made after the fiasco in Kansas. Those same national groups pushing for regressive tax changes in Iowa (ALEC, AFP) convinced the Kansas governor and legislature in 2012 that individual and business tax cuts would act like a shot of adrenaline to the state economy. Instead, tax cuts have left Kansas mired in drastic budget shortfalls, credit downgrades, and school cutbacks.9 And the predicted economic miracle turned out to be a disaster: the state changed from above average to below average growth after the tax cuts went into effect.10

We should hope for real tax reform, the kind that eliminates wasteful spending on tax breaks that provide little or no economic benefit, and that ensures a stable revenue stream to fund education and other public services important to ordinary Iowans. We should resist the use of bogus “research” to justify further tax breaks for those who need it least.

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The Department of Revenue’s evaluation studies can be found here. Reviews of academic research include those by this author on his website Grading the States, and by William Gale, Aaron Krupkin, and Kim Rueben. “The Relationship between Taxes and Growth at the State Level: New Evidence.” National Tax Journal, vol. 68, no. 4, December 2015, pp. 919-941. The Iowa Tax Credit Review Panel report can be found here.

“A Spotlight, Not a Floodlight, on Business Breaks.” Iowa Policy Points blog.

This includes $152 million estimated for FY 2017 for the Commercial and Industrial Property Tax Replacement; $125 million for the Business Property Tax Credit; and an additional $25 million in state School Foundation Aid necessitated by the reduced assessment of commercial and industrial property. See Summary of FY 2018 and FY2019 Budget and Governor’s Recommendations, LSA - Fiscal Services, January 12, 2017, p. 218; Summary of FY 2017 Budget and Governor’s Recommendations, LSA - Fiscal Services, January 14, 2016, p. 63.


Today’s Virtual House Graphic: Risky Fix to Non-Problem. Iowa Policy Points blog.

See Taxes Have Little to do with People’s Decisions to Move to or From a State. On this author’s website, Grading the States.

See State and Local Business Taxes are Not Significant Determinants of Growth. On this author’s website, Grading the States.

See The Tax Foundation’s State Business Tax Climate Index. On this author’s website, Grading the States.

See numerous blog posts from the Kansas Center for Economic Growth.

See The Lessons of Kansas. On this author’s website, Grading the States.

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Iowa Fiscal Partnership

The Iowa Fiscal Partnership (IFP) is a joint budget and tax policy initiative of two nonpartisan, Iowa-based organizations, the Iowa Policy Project in Iowa City and the Child & Family Policy Center in Des Moines. Iowa Fiscal Partnership reports are available to the public at http://www.iowafiscal.org.