Tax Reform in the State of Iowa

Name

Institution

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The issue of tax reform is a crucial one for all policy makers at federal and state levels. Tax reform is the process of changing tax policies to meet the developmental needs and economic changes by the government. Various reasons necessitate tax reforms, for example, simplifying the tax system or increasing the number of tax payers. In the US, both the federal and state governments are responsible for tax reforms. The US House of Representatives passed the tax reform in 2017 with the aim of overhauling business and personal taxes. The federal tax reform has impact on state taxation. According to Hendrickson (2018), with the Congress passing Tax Cuts and Jobs Act in December, the federal income tax burden was reduced for most Americans, but a majority of Iowans will incur more state tax burdens due to federal deductibility. Consequently, Iowa Governor, Kim Reynolds, presented a plan to lower tax rates and simplify tax code in Iowa. The tax reforms will be responsible for the first income tax cuts in Iowa in 20 years of up to $1.7 billion in tax relief through 2023. The purpose of this policy paper is to evaluate the latest tax reform to identify the political actors involved and the effect of the policy, and to make recommendations for policy implementation.

**Policy Background**

Tax reform constitutes one of the most complicated public policies. Furman and Barro (2018) state that the last major tax reform was passed a generation ago, and in most cases the Congress has not managed to pass new reforms to overhaul the tax system in the US. After the formation of the nation, the founding fathers resisted creating income taxes and relied on tariffs. During the Civil War era, President Lincoln advocated for taxation through Congress taxing those with personal income of over $500 at 3% and those with income of over $10,000 at 5%. Congress immediately fought the income rate, and it was repealed entirely in 1872. The 16th Amendment brought income tax once again in 1913 to support the World War. The states began collecting taxes in the 1930s, and they were responsible for offering their own tax brackets. Iowa has one of the highest tax codes in the US, with 12% for corporate tax and a sales tax rate of 6% (Kaeding, 2017). Given the high rate of taxation and the recent federal reform, Iowa had no choice but to introduce tax reforms. The changes in federal tax code in December 2017 imply that Iowans will pay $148 million more in state taxes in 2019 budget year and $192 in 2020 budget year.

**State Policy Environment and Description of Political Actors Involved**

Iowa State Legislature is a bicameral body just like the US Congress. It is composed of the senate and the House of Representatives. The senate has 50 members and the House of Representatives has 100 members. The Republicans are the major members in both houses in Iowa. The Governor acts as the chief executive officer of both houses and has the right to veto bills. The tax reform policy is debated on both houses. The governor is the leader of the executive branch, and the other members of the executive branch include lieutenant governor, state comptroller, and the attorney general. There are other departments within the executive responsible for various functions. The state comptroller and Iowa Department of Revenue have also drafted a plan to test the viability of the tax reform. The secretaries for different departments, particularly agriculture and commerce, also play a role as the taxation reform affects their departments.

Iowa tax reform bill was unveiled by Gov. Reynolds and acting Lt. Gov. Adam Gregg on February, 2018. A five-person subcommittee advanced the House Study Bill 671 aimed at changing Iowa’s tax structure drastically. Gov. Reynolds gave promises of tax reforms during her campaign with the aim of reducing personal income tax by $1.7 billion by 2023 and eliminating federal deductibility. The bill also seeks to reduce tax brackets from nine to eight. Like most bills, the tax reform policy will be discussed in senate after it has been put in the form of a bill by the drafting committee. Gov. Reynolds is the most influential figure in the tax reform policy development. She referred to the policy as the most significant tax reform package in decades. Gov. Reynolds is the first female governor in Iowa. She has worked as the Lt. Governor for the previous governor since 2011. Gov. Reynolds is influential given her many years in politics as she served as a senator before, and she will use her experience and connection to seek support for the tax reform bill.

Republicans in Iowa Capital agree with the governor that there should be a tax reform, and they want to reduce tax rates before adjourning for the year (Hendrickson, 2018). Gov. Reynolds is working closely with the legislature to provide crucial pillars for the tax reforms. Iowa senators are in the process of evaluating the possible changes to the economy that will be caused by the new changes in taxation. Gov. Reynolds has attempted to sell her policy to all Iowa lawmakers regardless of their political affiliation to ensure that the plan is comprehensive and sustainable. Nonetheless, both the Republicans and Democrats still differ on the issue that is why the Republicans presented their own proposal for tax reforms.

As of April 2018, two proposals on changing Iowa’s tax plan were developed by different stakeholders with vested interests (Powers, 2018). Another bill was proposed by the Republicans in the senate on February 2018. The second bill (senate bill) initially suggested an aggressive tax plan to cut $1.2 billion in tax annually before settling on $2 billion in tax cuts in the next 5 years. The bill also features to calculate inflation and reduction of tax rates over the years. The bill created by the Republicans suggests the reduction of tax brackets from nine to five. The difference between the bill proposed by the Governor (Reynolds’ plan) and the senate bill is in the taxation of high income earners. The senate proposal suggests that high income earners at $75,000 and above should be taxed at a final rate of 6.3%, whereas in the Reynolds’ plan, those earning $75,000 and above are in the seventh highest tax bracket taxed at a rate of 6.3%. The Reynolds’ plan has an additional tax bracket for those making $160,965 and above where they are taxed at a rate of 6.9%. The senate bill was founded on the Governor’s bill. It determines other issues such as federal deductibility, corporate tax rates, franchise taxation, agricultural taxation, and funding the taxation reforms among other crucial issues. Alternatively, the Democrats continue to be skeptical about the plan claiming that tax reforms will jeopardize the state’s economy.

As of February 28, 2018, Iowa senate approved the tax reform bill. The Republicans cheered the move as a bold move that will slash the state revenue by approximately $1.2 billion (Pfannenstie, 2018). The bill was sponsored by Sen. Randy Feenstra, a Republican from Hull, and also the Chairman of Ways and Means Committee. The bill titled “Iowa Working Families Tax Act” passed because it was supported by Republicans who form a majority of Iowa legislature.

**Policy and Political Analysis**

The tax reform has received widespread support as well as criticism from different stakeholders pointing out the advantages and disadvantages of the bill. Gov. Reynolds and Republicans who advocated for the reform state that the reform will reduce the tax burden of Iowans. The Republicans supported the tax reform after it had been introduced by the governor who claimed that it was their responsibility to shield Iowans from increasing taxes. Gov. Reynolds focused on reducing individual income tax, but the senate’s plan also reduced top corporate tax rate from 12% to 7% leading to a reduction in corporate taxes by an estimate of $267 million annually. Thus, the advantage of the reform is reduced income and corporate tax rates, and this will encourage entrepreneurship.

Another advantage of the bill is that Iowans will start experiencing tax cuts immediately in 2019. The bill will be in effect as early as 2019, but progressive reductions will be experienced over the years depending on the state revenue growth. Senators who passed the bill are open to further changes on the bill after a public hearing and other constructive criticism on the bill (Pfannenstiel, 2018).

The Democrats who opposed the bill feel that Iowa has a responsibility to balance the federal bill, and by passing the bill to get rid of federal deductibility and reduce tax rates, Iowa will neglect its responsibility. According to Rep. Todd Prichard, the bill will reduce the state’s budget drastically when the state is in the process of balancing the budget (Pfannenstiel, 2018). Iowa is in the second year of de-appropriation, and by creating over $300 million tax cuts over the next five years, Iowa will have a problem in balancing its budget.

The tax reform affects all Iowa constituencies and a host of interested parties. The public hearing took place on April 9th, 2018, at Iowa state capital building. The public and representatives from banks, interest groups and unions engaged with House committee sponsoring the bill to explore the effects of the bill on respective interests. For instance, representatives from the bank were not pleased with the new state tax code that taxed banks for their profits while credit unions enjoyed “free ride” under the new state tax code (Lynch, 2018). Alternatively, the head of the credit union was pleased with the tax reform bill.

Other interested parties such as the Iowa State Education Association also voiced their concerns. Iowa State Education Association is worried that the massive tax cuts will have negative effects on public education (Pfannestiel, 2018). Education lobbyists presented the concerns of Iowa students, parents, and members of the association. With the tax cuts, Iowa will have to reduce its spending, and the public education sector is likely to suffer the most.

The nonpartisan Iowa Policy Project (IPP) has criticized the republicans advocating for the tax reform bill claiming that it will benefit the upper class more than the middle and lower classes. Supporters of the tax reform bill used the fact that the tax cuts will benefit the public, and yet the middle class is the biggest loser. According to the Tax Policy Center (TPC), by 2025, more than 50% of the tax cuts will have gone to the top 1 percent households, whereas middle class households get modest tax reduction of less than $800 in 2018. The top 1 percent will get an average of $37,000 in 2018. The politicians often support the interests of the top 1 percent who fund their campaigns. The middle class and the lower class stand to lose a lot as they will get modest tax reduction, and yet the accessing public services will be difficult as the state’s budget will be in a crisis.

One of the interest groups that have been influential in lobbying for the tax reform bill is Iowa Taxpayers Association. The association is a business sponsored organization, hence it represents the interests of business people who want individual and corporate tax reduction. Americans for Prosperity, funded by Koch brothers, also lobbied for the inclusion of corporate side in the bill, which is why the senate proposal included corporate taxes unlike that of Gov. Reynolds (Russell, 2018).

**Intergovernmental Relations**

The tax reform affects three levels of the government. Iowa tax reform bill was inspired by the federal tax reform that overhauled the national tax code. The federal tax code meant that Iowa would pay more tax, hence Iowa tax reform was a response to the federal bill. Iowa tax reform bill is a detailed bill, three pages shorter than the federal tax reform bill (Walczak, 2018). The main issue of contention is the fact that Iowa would have paid an additional $138 million as of 2018, but with the new law, Iowa will not pay extra tax to the federal government. Iowa’s federal tax liability will fall by $1.5 billion under the new law.

The law will also repeal federal deductibility which ties Iowa’s tax code to the federal policy in many ways. With the federal deductibility, Iowa’s taxes go up when the federal tax goes down, therefore, Iowa is often penalized for federal preferential treatment such as child tax credit. Not only the federal government is affected by the reform - the local government will also feel the impact. The local government will have to make due with reduced budgets. By 2023, local governments will have lost about $7.9 million in tax help. The local governments will have to find an alternative income to fulfill their responsibilities.

**Options and Recommendations**

It is undeniable that Iowans required tax reforms in the past, which is why most of them supported Gov. Reynolds to reform Iowa’s tax code. Individual income and corporate tax rates in Iowa were higher, and Iowans wanted changes because the previous tax structure was burdensome and confusing. According to Montgomery (2018), tax reforms will increase Iowa’s competitiveness, encourage investment and save money for Iowans.

A notable recommendation of the tax reform is the elimination of wasteful spending on tax breaks that have little or no economic benefit to transform the regressive system. After the reforms, Iowa state government requires a stable revenue stream to fund public services.

Another recommendation is that economists, policy makers, and interest groups should take more time to evaluate the tax reform bill as it was passed in a hurry, and the full financial effects are yet to be understood. According to Montgomery (2018), the bill was drafted with a lack of transparency by the Republican senators without including Democrats in the process such that the full financial impact of the bill remains a mystery.

In conclusion, Iowa tax reform bill is an ambitious piece of legislation aimed at eliminating federal deductibility and reducing tax rates. The tax reform was motivated by the federal tax reforms and supported by Gov. Reynolds and other Republican representatives who believed that tax reforms would increase Iowa’s competitiveness. Some legislators and interest groups were not satisfied with the tax reform legislation, and, hopefully, their concerns will be addressed through amendments in future.

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