



Iowa Tax Reform:But Some Do Not

by David Hogberg

INSTITUTE BRIEF 10-4 examined some proposals to reform Iowa taxes that State Legislators should seriously consider because they have the potential to lower the tax burden on Iowans. This one examines some tax ideas that Legislators should dismiss because they will lead to higher taxes.

The first idea that should be jettisoned is State Senator Stewart Iverson's proposed "monies and credits tax," which would tax those who put their money in the stock market or bank.¹ In 2001, Iowa enacted various tax breaks for investment, including ones for stock purchases.² A monies and credits tax could undo that. This would make Iowa a less investment-friendly state.

State leaders should also avoid an increase in the state sales tax. In mid-December, Dennis Prouty, Director of the Legislative Fiscal Bureau, was interviewed by WMT Radio. He speculated that a 1% increase in the sales tax, from 5 to 6%, would yield an additional \$300 million annually. But increasing the sales tax that amount would also increase the tax burden on Iowans. Specifically, it would increase the tax burden \$261 annually per Iowa household.³

Along these same lines, another idea that should be shelved is State Representative Chuck Gipp's proposed reform of the local option sales tax. The local option sales tax is an extra penny of sales tax that a county can add—with the approval of voters—to the state sales tax to pay for various functions including local school construction. State Representative Gipp's plan would eventually pool all revenue generated from local option sales taxes. The revenue would then be distributed more equitably on a per-pupil basis to all counties that employ the local option sales tax.⁴ What drives this reform is complaints from rural county school officials that the local option tax is unfair. They contend that rural residents fund school construction in more populous counties because rural Iowans have few places to shop other than the big retail centers located in the more populous counties.

The argument of unfairness is dubious. A Public Interest Institute study from early last year found that the five most-populous counties in Iowa paid more in state taxes than they received in education aid, while the five least-populated counties paid less in state taxes than they received in education aid.⁵ In short, tax revenue is already being redistributed from populous counties to rural ones for the purposes of education. It is not clear why furthering that trend will lead to more fairness.

However, the main problem with this proposal is that it has all the trappings of a stealth-tax increase. Under State Representative Gipp's proposal, counties will only receive money from the pool if their voters approve a local option sales tax. As a result the plan creates increased pressure on counties to do so. If Gipp's plan is adopted, county officials will likely plead with voters to approve a local option sales tax because if they don't, they will miss out on the revenue coming from the more populous

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counties. Ultimately, Iowa could have a de facto statewide 1% increase in the sales tax, thereby increasing the Iowa tax burden.

Extension of the sales tax to Internet purchases is another tax idea that should be jettisoned. Governor Tom Vilsack favors this, claiming that Iowa loses between \$80 million to \$100 million in sales taxes each year because it does not tax Internet sales. Yet that figure is very likely overstated. A report released in 2001 by the United States Government Accounting Office examined various models for estimating sales tax loss. The range of possible loss for Iowa was \$2 million to \$31 million.⁶ Whatever the amount, instituting a sales tax on Internet purchases would increase the tax burden on Iowans. Another reason to avoid a sales tax on the Internet is that the Internet commerce serves as a brake on state taxation. If Iowa shoppers think the state sales tax is too high, they can turn to the tax-free Internet. This puts pressure on state government to keep the sales tax rate down.

The impetus behind these proposals is the state budget crisis. Some state officials hope they can solve it by raising taxes. But it was overspending in the good years that led to the current crisis. The fix should be more spending cuts, not increasing the burden on Iowa taxpayers.

ENDNOTES:

¹Lynn Okamoto, "Senate Leader Urges 'Bold' Tax Changes," *Des Moines Register*, December 3, 2002, <<http://desmoinesregister.com/news/stories/c4780934/19888382.html>> (December 9, 2002).

²David Hogberg, "Invest in Iowa," *Institute Brief*, Public Interest Institute, Vol. 9, No. 2, January 2002.

³Data on Iowa households at "State and County Quick Facts," U.S. Census Bureau, September 24, 2002, <<http://quickfacts.census.gov/qfd/states/19000.html>> (December 19, 2002).

⁴David Yepsen, "Best Idea Yet: Gipp's Tax Plan," *Des Moines Register*, December 8, 2002, <<http://desmoinesregister.com/opinion/stories/c5917686/19911671.html>> (December 9, 2002).

⁵Steven B. Garrison, "Iowa's \$300,000,000 Sales Tax Increase," *Policy Study*, Public Interest Institute, No. 02-1, February 2002.

⁶United States Government Accounting Office, "Sales Taxes. Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain," *Report to Congressional Requesters*, June 2000, p. 59.

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