

Tax breaks are often low-road, unsuccessful tools for prosperity

Why carveouts in the income tax code for specific jobs, life circumstances are a bad idea

Taxes have one purpose: to fund public services that benefit everyone and reflect the state's priorities and values. They should be rooted in well-established tax principles (see box, next page).

Proposals now in the Legislature would make special deals for people in specific professions or life circumstances that run counter to good policy:

- ▶ New resident tax credit, HSB 63, a credit for all income tax for four years for someone establishing residency in the state and who is not receiving public assistance.
- ▶ New graduate tax credit, HSB 63, a credit for all income tax for four years for a recent graduate of an Iowa-based college, community college, university or apprenticeship program.
- ▶ Nurse preceptor (licensed nurse who supervises nursing students) tax credit, HF 157, \$1,000 tax credit.
- ▶ Child care providers, HF 47, full exemption of wages from income tax.
- ▶ Providers of services to disabled individuals, SF7, full exemption of wages from income tax.

More such proposals may be coming. Many are well-intended efforts to address very real challenges, for example, a shortage of workers for demanding, low-wage jobs in child care and direct care, or the challenge of retaining Iowa students who graduate college and leave the state.

However, tax policy is a poor tool for solving these problems. In the end, the tax breaks proposed this session are likely to undermine the intended result by eroding the state's ability to provide services that promote opportunity for the very same Iowans the tax breaks attempt to benefit.

When a helping occupation — such as child care or direct care — can't pay enough to attract or retain workers, the answer is for the state to help raise pay and enhance the services that help workers fill the gap. If we want to attract and retain young adults, the answer is to offer the quality of life — safe, active neighborhoods, outdoor recreation, public amenities and good schools — they want.

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Income taxes should be based on the amount of income, not the source

Proposals may be counterproductive

People wanting to lure or retain Iowa graduates, or boost the child care system, risk doing the opposite by pushing special income-tax breaks. Tax breaks cost money that cannot go to public schools, the environment, child care assistance or Medicaid.

These breaks may well also result in lower take-home pay for these Iowans than if legislators were to focus

on policies that boost incomes instead of cutting services. People who do not earn a lot are not paying a lot in income tax in the first place.

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It also leaves people in other low-paying occupations to help pay the bill — and encourages them to get in line for a break of their own, driving a vicious cycle of reduced revenue and reduced services.

What's more, the tax breaks are another step toward reckless plans to fully eliminate the income tax. Lawmakers will slash state revenues by as much as half if the income tax is eliminated, guaranteeing cuts in education, health care, child care and environmental quality.

Ability to pay is fundamental to tax fairness

Iowa lawmakers already have acted to erode tax fairness. Like most states, Iowa's state and local tax system, all governed by state law, has long taxed lower-income Iowans at a higher rate than middle- and higher-income Iowans. This is known as a "regressive" tax structure. Of those taxes — income tax, sales tax and property tax — only income tax was "progressive," with higher rates at higher incomes.

The 2022 income-tax changes now being phased in through 2026 will take away that last nod to equity and severely reduce revenue. With a 3.9 percent flat-rate income tax, someone making \$300,000 in taxable income will pay the same percentage in tax as someone at \$30,000. But someone making \$300,000 can afford to pay more than 3.9 percent, while the lower-income person may not be able to do so and still provide for their family.

By further advantaging those at the top of the income distribution, these changes favor white Iowans over Iowans of color, who are overrepresented at the lower end of the distribution due to long-standing discrimination in housing, education and employment.

Principles for Evaluating State Tax Policy and Proposals

▶ Fairness and ability to pay

Those with more income should pay a higher percentage in tax. Those with similar means should pay similar taxes, regardless of the source of their income.

▶ Revenue Adequacy

Taxes must produce sufficient revenue to finance essential state and local services.

▶ Public Benefit/Economic Efficiency

Tax "incentives" should promote a public purpose and not distort economic decisions.

▶ Competitiveness

Iowa's overall tax system should not be significantly out of line with other states.

▶ Stability and Predictability

A tax base should be stable and predictable over the business cycle.

▶ Simplicity

Tax laws should be easy to understand, comply with, administer and audit.

▶ Transparency and Accountability

Taxpayers should be able to see how public funds are provided and used.

Taxes do not drive location choices

The House bill focusing on new residents and new graduates — HSB 63 — follows the same fallacy used to sell the massive 2022 tax cuts, that cutting taxes would keep people in the state. Research suggests otherwise. In fact, investments in services that improve quality of life and economic opportunity are more likely to succeed.¹

Targeted tax breaks are a destructive trend

Basing tax liability on factors such as type of income means that people in similar economic situations are not treated the same. Iowa has tried this. The state already had significant exemptions for pension income and a full exemption for Social Security

¹ Michael Mazerov, Center on Budget and Policy Priorities, "Tax-Related Migration Is Grossly Exaggerated: a Research Preview," Jan. 10, 2023. <https://www.cbpp.org/blog/tax-related-migration-is-grossly-exaggerated-a-research-preview>

income — even before the additional breaks passed in 2022. As part of the 2022 tax bill, Iowa expanded those generous tax preferences for retirees, no matter their amount of retirement income.

So, someone making \$60,000 in retirement income pays no tax on it — but someone making \$60,000 working a job (or two jobs) will pay state income tax on that. The slate of bills with special carveouts proposed this session would gamble further on a bet that has not paid off.

Advocates should seek high-road policy

Iowa has pursued a low-road strategy of cutting taxes over the last 25 years with no or little regard for the opportunity costs. Investments in the very services that expand opportunity for all have been held low (K-12 education, child care, health and environmental and workplace protection) or even cut (state universities).

The last five years alone have included three income-tax cut packages, with more planned by the current leadership — along with new property tax cuts that will harm local services.

Advocates for public services should be wary of long-term harms from special income-tax cuts for people in their specialty, and weigh them against the benefits of enhancing services by structuring a tax system that does not pretend we can get something for nothing.