Common Good **Iowa**
Bold Policy for Families & Communities

March 2021

Bad tax policy — at twice the price

Senate tax proposal jeopardizes over $450 million in COVID relief for Iowa

Senate File 576 was already a terribly costly tax bill that Iowa cannot afford. Now, it appears to be twice as costly as assumed — jeopardizing hundreds of millions of dollars in federal funds otherwise allocated to Iowa from the federal COVID relief package, the American Rescue Plan.

The federal COVID relief package signed March 11 by President Biden includes a provision that could reduce Iowa's benefit by $1 for every dollar[1] given away in new net tax cuts through 2024. It creates, effectively, a reverse match. Where a matching program might reward a new state investment with an equal amount of assistance, the ARP legislation does the opposite if a state disinvests: Cause a net cut in state tax revenue, lose an equal amount in ARP aid.

State Senate bill includes significant, new net tax cuts:

- **Inheritance tax phaseout**: Iowa's inheritance tax **already fully exempts** lineal relatives (children, grandchildren, parents). Phasing out the state inheritance tax for siblings, cousins and other relatives — and nonrelatives, nonresidents and corporations — would cost $17.9 million in FY 2022, $40.8 million in FY 2023, $65.5 million in FY 2024 alone.[2] (Full repeal is expected to cost $102.3 million in FY 2027 and similar levels beyond that year.)
- **Accelerating future scheduled tax cuts**: In 2018, lawmakers approved "revenue triggers" that would ignite reductions in tax rates. SF 576 would repeal those triggers — new action that puts lower tax rates into effect Jan. 1, 2023, and reduces revenue. These triggers in individual and corporate income taxes, and the bank franchise tax, would cost an estimated $110.1 million in FY 2023 and $223.6 million in FY 2024.[3]

We focus here on FY 2022 through FY 2024 because those fiscal years are totally within the "covered period" of the federal COVID relief package and those tax revenue cuts are projected to be $457.7 million. A share of the $122 million in tax cuts in FY 2025 also would be counted.

American Rescue Plan bars COVID relief to pay for state tax cuts

Now this is where the federal COVID law comes in. The law, which will provide an estimated $1.38 billion to Iowa for various approved uses, has a caveat: Any changes in law that cause revenue cuts (tax cuts) during the covered period of March 3, 2021, through Dec. 31, 2024, will reduce the COVID relief by the same amount. Here is the language in the law:

> "A State or territory shall not use the funds … to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase."

The law goes on to order that any state failing to comply will have to repay "the amount of the applicable reduction to net tax revenue attributable to such violation." In other words, a clawback of the COVID relief equaling the state tax reduction. **Thus, the intentional revenue cut of over $450 million from FY 2022-24, as SF 576 provides, is doubled by the loss of federal COVID support in the same amount. That adds up to an over $900 million total loss.**

Official guidance from the Treasury Department will provide certainty of the impact of the law — one reason to wait to make any changes. But there are other reasons.

The intentional revenue cut of over $450 million is doubled by the loss of federal COVID support in the same amount. That adds up to over $900 million in total revenue loss.

The inheritance tax cuts are irresponsible. Already, immediate family members receive all bequests up and down the family line without a dime in state tax. Current law makes generous inheritance tax exemptions that already protect family wealth. The changes would give shirttail relatives, nonrelatives — even nonresident nonrelatives — tax-free windfalls.

The income-tax cuts rest on inaccurate representations about Iowa taxes, denying the undeniable fact that Iowa taxes remain below average for business, and have been cut repeatedly for individuals, particularly high-income individuals. At the same time, critical services including education have been chronically shortchanged.

Iowa needs more fairness in its tax system without slashing revenues regardless of the impacts on public services. This approach is not sustainable for a state that wants to lure — let alone keep — families and good, clean businesses.

We already knew Iowans would pay for this approach. Now, with a reduction of anticipated help in the COVID recovery from the federal government, we may pay doubly for it.

---

[1] Nicholas Johnson, "Rescue Plan Protects Against Using Federal Dollars to Cut State Taxes," Center on Budget and Policy Priorities, March 11, 2021. https://www.cbpp.org/blog/rescue-plan-protects-against-using-federal-dollars-to-cut-state-taxes

[2] Iowa Legislative Services Agency, Fiscal Note for SF576, March 12, 2021.

[3] Ibid.