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Iowa governor's race: Candidate views differ on effect of corporate tax cuts

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• May 9, 2010

Republican governor candidates' proposals to cut taxes for corporations would result in a smaller state government providing fewer services - and also could introduce greater inequities in Iowa's tax system, some experts say.

Former Gov. Terry Branstad would halve the corporate income tax. State Rep. Rod Roberts and business consultant Bob Vander Plaats would eliminate it.

Cutting or ending corporate taxes would trigger a cascade of impacts and reactions. Whether the changes would be helpful or harmful can depend as much on perspective and ideology as economics. The potential impacts and counterarguments:

- It would create a flurry of business activity that would, in turn, create thousands of jobs, the candidates and some economists say. Other experts say the connection between corporate tax cuts and economic development isn't so clear.

- Iowa's small businesses would pay disproportionately high taxes compared with large corporations, especially if the state continues to award hundreds of millions in tax incentives to large businesses, some tax experts say. (The candidates say they also would cut some tax credits.) Corporate tax lawyers argue that their clients are in essence now subject to double taxation.

- It would shift more of the burden of paying for government to individuals and families and would squeeze those with lower incomes most, opponents say. This point boils down to whether you think it's fairer to tax everyone about the same percentage or to tax higher incomes at a higher percentage.

- The loss of revenue from the corporate tax would worsen state government's budget picture, potentially leading to more layoffs of state workers and service cuts, opponents say. Proponents say increased private-sector jobs will mean more people

paying taxes and higher revenues for the state in the long run. A wild card: Tax officials predict businesses will rush to reorganize as corporations take advantage of reduced or eliminated taxes. That could create a bigger budget hole than expected.

It's estimated that corporate taxes will provide \$187 million in state revenue this budget year, or 3.5 percent of the total. Corporate taxes have been a volatile revenue source for Iowa, diminished by a proliferation of business tax credits and exemptions that allow some businesses to pay little or no taxes.

Main debate: Will cutting corporate taxes create jobs?

Advocates of cutting taxes and government spending say that businesses with more money at their disposal will create jobs, and consumers with more money to spend will rev up the retail economy.

"It would be a good thing for Iowa in general," said Jim Swift, chief executive officer of Holmes Murphy, a risk management and insurance brokerage firm with headquarters in Des Moines. "We need jobs. We need more people paying taxes."

By cutting corporate taxes, "it's like putting up a neon sign up that says, 'We're open for business. Big corporations, put your jobs here,'" said Chris Edwards, director of tax policy studies at the Cato Institute, a research group in Washington, D.C. The group is officially nonpartisan but has roots in the nation's conservative movement. "Competitively, it's a huge thing for states to do."

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Other experts aren't so sure.

"Different people give different answers, but the most common answer is that there is no obvious linkage between the level of different taxes and economic development," said Matthew Gardner, executive director for the Institute on Taxation and Economic Policy, another nonpartisan research group in Washington.

Iowa ranks 36th among states in the amount collected per capita in corporate taxes. Wyoming, Nevada and South Dakota have no corporate income taxes. All three ranked below Iowa in gross domestic product, the total value of all goods and services produced, according to 2008 census statistics. Iowa ranked 30th; Nevada, 31st; South Dakota, 47th; and Wyoming, 49th.

Would erasing corporate taxes be fair to other businesses?

Elimination of Iowa's corporate income taxes would not lower taxes for tens of thousands of small Iowa businesses, which are taxed under a different system than corporations, state tax officials said.

Many small businesses are set up as S-corporations or limited liability corporations, which generally do not pay corporate taxes. Instead, those businesses pay income taxes through their owners' personal tax filings.

Corporations are typically larger businesses with 75 or more shareholders. They file taxes as C-corporations and pay state corporate income tax.

There were nearly 28,500 C-corporations in the fiscal year that ended June 30, 2008, according to the Iowa Department of Revenue.

In comparison, more than 62,000 LLCs are registered to do business in Iowa, according to the Iowa secretary of state's office, which oversees the registration process. Neither state agency keeps track of the number of S-corporations, but officials said there are thousands.

If corporate taxes were eliminated, Iowa could expect a stampede of businesses reorganizing to file as corporations, Gardner said.

"It's the sort of loophole that you could drive a bus through, and I think plenty of enterprising people would immediately do so," he said.

Branstad, who has recommended cutting corporate taxes by half, acknowledged that tax law treats corporations and most small businesses differently. But he said he would work to help smaller businesses save on taxes, too. There are already tax advantages for smaller companies to file as S-corporations, he noted.

One idea would be to allow small businesses to exempt their state taxes on their federal tax return, a n idea commonly known as federal deductibility.

Roberts and Vander Plaats also acknowledged that smaller businesses would not directly benefit from the elimination of corporate taxes. However, both said small firms would benefit indirectly through additional economic activity.

"It's that principle of the rising tide lifting all boats," Roberts said. "As that capital works its way into the economy from the larger corporations, it does work its way down to smaller businesses."

Small-business owner Betsey Qualley, who owns a cat grooming business, questions the fairness of ending corporate taxes.

When she opened her Des Moines business, Smitten Kitten, 2½ years ago, she organized it as a limited liability corporation. So she pays taxes on the business's earnings through her individual tax filing and not as a corporation.

If the state eliminated corporate taxes, Smitten Kitten would continue to pay business taxes while large corporations would not.

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"It's obvious. A small business is more in need of assistance than a corporation," Qualley said.

Corporate tax lawyers counter that S-corporations and LLCs already pay lower percentages of their earnings in taxes than corporations.

Essentially, corporations are taxed twice on earnings, even though some companies escape the taxes through tax breaks or different methods of accounting, said Joe Kristan of Roth and Co., which helps businesses with accounting and tax planning issues. Corporations pay the corporate tax before earnings are distributed to shareholders or company officials. The company officials then pay taxes on their earnings. In an LLC or S-corporation, the earnings are directly distributed to the owners of the company, who pay taxes as an individual but not as a corporation.

Elimination of the corporate tax would, in many ways, help build tax equality, Kristan said.

"You can come up with ways to repeal the corporate tax without making some kind of inequity for smaller businesses," he said.

Would cuts be fair to individual taxpayers?

Iowa's poorest 20 percent of families pay 11 percent of their income in local and state taxes, while the top 5 percent of wage earners pay 6 to 8 percent, according to a study released last year by the Institute on Taxation and Economic Policy.

Gardner, the institute's executive director, said ending corporate taxes would most likely prompt cash-strapped state government to increase fees in some areas or shift costs to local governments. County and city governments and schools in turn would most likely increase property taxes or fees to offset cuts to their budgets.

If Iowa politicians are concerned about tax fairness, they should first consider eliminating loopholes that allow some companies to skip most or all of their taxes, he said.

Tax-cut proponents counter that increased economic activity creates increased opportunities for all income levels.

"When there's more money to circulate in the private sector of the economy, everyone benefits," said Ed

Failor Jr., president of Iowans for Tax Relief, a Republican-leaning group based in Muscatine. "At the end of the day, there will be rich people always, but guess what they're doing that you and I are not? They are taking risks."

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NO, I have some rules!

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