

## **More Millions for Millionaires**

### **Flat-Tax Option Showers Benefits at High Incomes — Services Face New Cuts**

By Peter S. Fisher

Tax legislation pending in the Iowa House would shower most benefits on higher income Iowans, while reducing revenues by over half a billion dollars.

Already for the coming fiscal year, \$277 million — two-thirds of the increased revenue to the general fund — is going to be funneled to commercial and industrial property tax relief. This will leave the state short of funds to adequately finance education and other services, before the new legislation would strip the general fund of another \$482 million.

House File 604 would give taxpayers a choice each year: File income taxes using current law, or a new flat rate option. Under the flat rate option, the tax is 5 percent of all “base income,” where that is defined more broadly than current taxable income (no deduction for federal taxes), but allows the deduction of all federal interest, all retirement income, and a larger standard deduction.

Higher income Iowans would benefit most — Iowa tax filers with adjusted gross income of \$40,000 or less (representing over half of all taxpayers) get just 6 percent of the \$373 million in tax cuts for tax year 2015 under this bill, for an average of just \$30 savings per tax filer (see Table 1).<sup>1</sup> Nearly two-thirds of the \$373 million goes to those with income of \$100,000 or more, representing just 1 in 6 taxpayers. Of that group, Iowa’s millionaires — representing just four-tenths of 1 percent of taxpayers — get 10 percent of the total benefit, or \$5,463 each.

Iowa’s millionaires get 183 times the average benefit of those under \$40,000 in income (Figure 1). Those with \$1 million or more income get on average a 15 percent tax cut; other taxpayers average 11 percent.

**Table 1. Tax Savings from HF604 Flow Mostly to High Income Iowans**

Adjusted Gross Income	Returns		Tax Reduction		
	Total Number	Percent of Total	Average per Return	Total Dollars	Percent of Total
\$40,000 or less	812,029	51.7%	\$ 30	\$ 24,251,969	6.5%
\$40,001 to \$100,000	493,967	31.5%	194	95,620,101	25.6%
\$100,000 to \$1 million	254,453	16.2%	801	203,726,381	54.6%
Over \$1 million	6,943	0.4%	5,463	37,930,816	10.2%

*Source: Letter from the Iowa Department of Revenue to Jeff Robinson, Legislative Services Agency, March 26, 2015. Note: This table omits \$11.5 million in tax benefits for 2,542 composite returns with unknown AGI. This amount is part of the \$373 million total tax reduction.*

None of this should be surprising given provisions in the bill. Key points:

- The flat tax option cuts the top rate — which applies to income over \$69,225 — by 44 percent.
- The tax rate on taxable incomes below \$13,851, now between 0.36 percent and 4.5 percent, would actually be higher under the flat tax.

- While the flat tax option does eliminate the deductions for federal taxes, itemized deductions, and Iowa capital gains (features of the current tax that benefit primarily higher income taxpayers), it also eliminates all taxes on pension income.

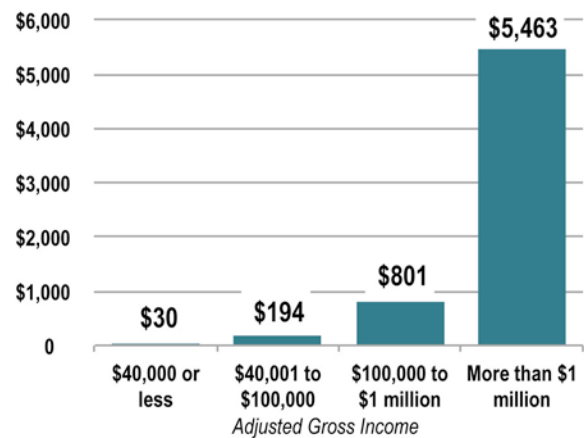
Since current law already exempts all of Social Security benefits and the first \$6,000 per person of pension income, eliminating the rest of the tax on pensions primarily benefits higher income seniors. The flat tax option also eliminates all tax credits, some of which (such as the Child and Dependent Care Credit and the Earned Income Tax Credit) are worth more to lower income taxpayers.

Moving to a flat tax does nothing for tax simplification. Claims to the contrary are entirely disingenuous. The bill does not substitute a simpler tax for the current calculation; it offers taxpayers the *option* of filing under the current system or the alternative flat tax. Thus taxpayers will have to figure their tax both ways to determine which one works to their advantage. This additional complication also increases the cost of tax administration by an estimated \$796,000.<sup>2</sup>

The bill will almost certainly cost the state’s general fund more than the estimates provided in the Department of Revenue tables. As the DOR points out, giving taxpayers an option provides an opportunity for taxpayers to game the system by filing under the current law one year and the flat option the next. For example, a taxpayer could have extra federal tax withheld during 2015 and then file Iowa income tax for 2015 under current law, deducting all those extra federal taxes and reducing Iowa tax. In April 2016 the taxpayer receives a large federal refund because of overpaying for 2015. But the taxpayer files Iowa tax for 2016 using the flat rate option and so does not have to add the refund to Iowa taxable income as would be required under current law. The entire amount of the federal refund, deliberately inflated by the taxpayer, thus represents Iowa income that should be taxable but escapes Iowa income tax entirely. The DOR had no way of knowing the extent of such gaming and so could not include its effects in its revenue estimates.

In sum, the flat tax bill is a very expensive effort to sharply cut taxes, mostly for upper income Iowans, and especially for millionaires. It would put a large hole in state finances for years to come, undermining the state’s ability to maintain a quality education system.

**Figure 1. Average Tax Cut for Millionaires  
183 Times the Cut for Majority of Taxpayers**



Source: Letter from the Iowa Department of Revenue to Jeff Robinson, Legislative Services Agency, March 26, 2015.

<sup>1</sup> The \$373 million is the amount for tax year 2015 — that is, the reduction in taxes owed for income received during calendar 2015 on tax returns filed by April 2016. The Department of Revenue has translated tax year losses into fiscal year losses. The reduction for FY2015 is estimated at \$482 million, then settles down to around \$400 million for each of the next three fiscal years.

<sup>2</sup> Letter from the Iowa Department of Revenue to Jeff Robinson, Legislative Services Agency, March 26, 2015.

Note: This Policy Brief, originally circulated March 25, 2015, was revised March 26 with new estimates from the Department of Revenue, which previously had estimated a larger benefit than shown here to filers with adjusted gross income greater than \$1 million.

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