



The Watchdog

A Legislative Update from Iowans for Tax Relief



Friday, February 2, 2007

4th Week of Session

Governor Culver's Budget Increases Real Spending by 10.5% and Proposes nearly \$180 Million in Tax Increases

ONCE AGAIN, THE SENIOR LIVING TRUST FUND IS USED TO FUND OTHER SPENDING PROGRAMS:

Governor Culver delivered his budget message this week and outlined a proposal that increases state spending in real terms by 10.5%. In order to balance his enormous spending increases, the Governor proposes nearly \$180 million in tax increases.

Worse, his budget once again delays the repayment of the Senior Living Trust Fund by using money that is, by law, dedicated to that fund for new spending programs.

Here are the details:

TAX INCREASES

1. Cigarette Tax: Governor Culver proposed a one dollar per pack increase in the cigarette tax. The current tax is 36 cents per pack. Thus, the proposed new tax of \$1.36 per pack is a 278% increase in the cigarette tax.

The Governor proposes making this change effective on April 1, 2007 (meaning it would raise revenue for the current fiscal year as well as future years).

He estimates the tax increase will generate new revenue of \$32.3 million for FY07 and \$179.2 million for FY08.

The Board of Directors of Iowans for Tax Relief has determined our organization will neither support or oppose this proposed increase in the cigarette tax.

However, we do have serious reservations concerning the revenue estimate and the danger of spending 100% of this increase in either supplemental appropriations for FY07 or the new budget for FY08.

Based on the experience of other states and on natural human behavior, it is dangerous to assume the revenue will be collected anywhere close to the Governor's estimate.

Iowa currently experiences a significant cross border advantage with Illinois in regards to our cigarette tax. Without question, Illinois smokers are purchasing massive quantities of Iowa cigarettes and our state budget is the beneficiary of that activity.

An increase of the size suggested by Governor Culver would eliminate that tax advantage and the cross border buying that went with it. As those sales dry up, that revenue dries up with it.

In regards to Missouri, the opposite effect is likely. Currently, Missouri has a lower tax than Iowa, but the difference is marginal such that there is relatively little activity wherein Iowa smokers are making the effort to buy cigarettes in Missouri.

However, with the increase proposed by the Governor, there would be a tax difference of more than one dollar per pack and that WILL create a significant incentive for Iowa smokers to purchase their cigarettes in Missouri.

Plain and simple, this proposed tax increase will fall far short of projections and will leave



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CIGARETTE TAX, continued...

a huge hole in the Governor's budget that will have to be made up in other ways.

Thus, Iowans for Tax Relief strongly believes it would be a mistake for our Legislators to include this revenue in any supplemental budget proposals or in the budget being drafted for FY08.

The prudent choice would be to dedicate this revenue to the state's cash reserve for one year to determine the true revenue impact of the tax increase before ever committing these resources to state spending programs.

2. Corporate Income Taxes: Governor Culver proposes a significant tax increase on some of Iowa's largest businesses and employers through a technique called combined reporting.

According to his budget, this change in the method of collecting corporate income taxes would generate \$25 million in additional revenue for the state.

However, according to discussions with those representing some of the largest employers that would be hit with this tax increase, the actual tax increase will likely exceed \$100 million.

Iowans for Tax Relief OPPOSES this proposed tax increase on Iowa businesses.

This proposed tax increase makes little sense and is totally inconsistent with our economic development programs. On one hand, Iowa taxpayers contribute \$50 million annually to the Iowa values fund to provide incentives

and discounts to encourage businesses to locate, expand, or simply remain in Iowa. On the other hand, Governor Culver is proposing a massive tax increase that does just the opposite by raising the cost of doing business in Iowa on those same types of businesses.

In essence, Culver is proposing to punish those businesses and big employers who have already chosen to locate and invest in Iowa to the direct benefit of other businesses who have, to date, found the cost of doing business in Iowa such a burden that they require government assistance to consider locating here.

SPENDING INCREASES

Despite the fact state revenue is growing at the rate of 6.5% (nearly double the rate of inflation), Governor Culver proposes a budget with a real spending increase of 10.5% (nearly three times the inflation rate).

Watch for a future edition of **The Watchdog** for a detailed analysis of the Governor's budget from Iowa State Auditor David Vaudt.

However, a few highlights of that budget proposal are:

- the Senior Living Trust is left \$103.2 million short of being fully repaid;
- \$70 million additional for teachers salaries;
- \$20 million for universal preschool;
- \$40 million to shift funding for Property Tax Credits back to the General Fund;
- \$61 million increase in Medicaid (includes expansion of the program; and
- \$122.5 million left for salary increases for state government employees.

The Watchdog is a weekly update of issues which are being considered by the Iowa Legislature. It is a service to members of Iowans for Tax Relief. Permission is granted to forward this to any interested individuals.

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