LEGISLATIVE SERVICES AGENCY
Serving the Iowa Legislature

MINUTES

Legislative Tax Expenditure Committee

December 12, 2012

MEMBERS PRESENT:

Senator Joe Bolkcom, Co-chairperson
Senator William Dotzler
Senator Herman Quirmbach
Senator Roby Smith

Representative Thomas Sands, Co-chairperson
Representative Dave Jacoby
Representative Steven Olson
Representative Jeff Smith
Representative Sharon Steckman

MEETING IN BRIEF

Organizational staffing provided by: Michael Duster, Legal Counsel,
(515) 281-4800

Minutes prepared by: Michael Mertens, Legal Counsel,
(515) 281-3444

I. Procedural Business

Call to Order. The Legislative Tax Expenditure Committee (committee) was called to order at 10:03 a.m. on December 12, 2012, in Room 103 of the State Capitol.

Adjournment. Upon conclusion of the presentations and discussion by the committee, the meeting was adjourned at 3:03 p.m.

II. Review of the Iowa Fund of Funds Program

Dr. Amy Rehder Harris, Manager, Tax Research and Program Analysis Section, Iowa Department of Revenue (IDR), provided a history of the Iowa Fund of Funds Program, described the structure of the program, and updated the committee on the program's current status. The program was established in 2002 to encourage venture capital investment, increase business development in Iowa, and leverage funds for venture capital investment with state backing through tax credits. The amount of $100 million in contingent tax credits was originally authorized, with not more than $20 million being redeemable in any single fiscal year. The contingent tax credits were limited to an amount equivalent to any difference between the scheduled rate of return authorized by the Iowa Capital Investment Board and the actual return received.

The program consists of several entities and actors. The Iowa Capital Investment Board, a public entity with five voting and four nonvoting members, was responsible for establishing the contingent tax credits to back investments in the Iowa Fund of Funds, Fund A, LLLP (Fund). The Iowa Capital Investment Corporation, a 501(c)(3) tax-exempt entity, acts as the general partner of the Fund, selects the Fund manager (Cimmaron Capitol Associates I, LLC), and receives returns for reinvestment. Finally, Iowa Designated Investor, Inc., is a preferred limited partner within the Fund and is the entity which makes the investments in the Fund and holds the contingent tax credits.

Each portfolio fund in which the Fund invests is required to make a commitment to consider equity investments in businesses located within Iowa and maintain a physical presence within Iowa. To date, $26 million has been invested for the Fund in venture capital funds. The investments were funded by a revolving loan with contingent tax credits as collateral. In 2010, the tax credit cap was reduced from $100 million to $60 million. In February 2011, $57 million in contingent credits were issued to secure the $40 million revolving line of credit with a February 22, 2012, maturity date. However, in fall 2011, the Fund's board learned that lenders might not renew the line of credit. Following a maturity date extension and the Fund defaulting on the line of credit, the lenders and the Fund entered into negotiations. IDR and the Iowa Attorney General's Office assisted in the agreement negotiations. The resulting agreement cures the loan default, avoids an immediate call on the full $57 million in contingent credits at $20 million per year, includes a 7- to 9-year restructuring of financing for the existing investment portfolio, preserves the $26 million investment portfolio, caps future Fund expenses, and creates a second lien in favor of the state for redeemed tax credits. In addition, the agreement provides for no new partners in the Fund, no new portfolio investments, no expansion of investments as of December 2011, and provides for distributions to lenders to satisfy loans. The agreement provides that a total of $25.6 million in tax credits will be redeemed, but the redemption is limited to $4 million each year. The Fund will expire in December 2027, instead of 2052.

Discussion. Members of the committee made comments regarding the Fund and engaged in a discussion with Mr. Jeff Thompson, Iowa Deputy Attorney General, who participated in the Fund's settlement agreement. Several committee members conveyed their disappointment with the Iowa Fund of Funds Program, but commended IDR and the Iowa Attorney General's Office for their work in negotiating the agreement to mitigate the Fund's problems. Certain committee members expressed concern with the high amount of management fees that were paid relative to the size of the Fund and questioned whether any attempt had been made to recoup a portion of the fees. Mr. Thompson said no such attempt had been made and would have been difficult because the fees were paid pursuant to private contracts between the Fund and its manager, and because the statutes governing the Fund were clear in expressing that contract rights were to be honored.

Mr. Thompson agreed with certain committee members who commented that immediately ending the Fund would have been a bad decision for the state. Mr. Thompson explained that the Fund's lenders had the right to call the loan and redeem the tax credits, which meant the Fund faced the prospect of losing the investments it had made. The current settlement gives the Fund time to realize a return on its investments, which increases the possibility that the state will recoup its investment in the long-term.

Finally, committee members expressed concern with the Fund's use of a short-term loan to finance long-term investments, with the lack of Iowa investments that were made, and with the apparent lack of new Iowa jobs that were created.

III. Review of School Tuition Organization Tax Credit

Ms. Angela Gullickson, IDR, summarized Iowa's School Tuition Organization (STO) Tax Credit and provided data on the tax credits and scholarships awarded to date. The nonrefundable tax credit is awarded to taxpayers who make voluntary cash contributions to a qualifying STO that provides scholarships to low-income students. The school tuition organization tax credits are capped at a total of $8.75 million for tax year 2012 and subsequent tax years. Ms. Gullickson provided information on similar tax credit programs in other states. There are 11 other states that have some type of scholarship tax credit program, but none of Iowa's neighboring states currently offer such a credit. The average tax credit award in Iowa for the last six years was $2,427 and the median award was $650. Between 2009 and 2011, the average number of tax credit awards each year was 3,008. Since 2006, nearly $43.8 million in donations has been received, generating over $41.4 million in scholarships for an average of 9,209 students each school year. The average scholarship has been $899. Ms. Gullickson also stated that 5.4 percent of donations have been used for administrative expenses. Effective July 1, 2009, tax credit awards could be made to corporations. In the two full tax years that corporations could make donations, they averaged less than 2 percent of all tax credit awards.

Although tax credits are awarded to households in every income class, higher income households receive the most tax credit awards in terms of dollars because they have more state tax liability. It was also noted that these donations have an impact on federal individual income tax because they qualify as federal charitable contributions. Higher income households have a higher federal income tax rate and benefit more from the federal charitable contribution itemized deduction. As a result, Ms. Gullickson estimates that a $1,000 donation would have an after-tax cost of $971 for a household with less than $20,000 in adjusted gross income, whereas the same $1,000 donation would have an after-tax cost of $44 for a household with over $1 million in adjusted gross income. Ms. Gullickson also analyzed the distribution of tax credit awards by taxpayer type, number of dependents, and geographical distribution.

IV. Review of Tuition and Textbook Tax Credit

Mr. Bob Rogers, IDR, summarized Iowa's Tuition and Textbook Tax Credits. The credit is equal to 25 percent of the first $1,000 of eligible education expenses per dependent. To be eligible, the dependent must be in grades kindergarten through 12th grade at an accredited Iowa school. The credit is nonrefundable.

Mr. Rogers provided information on similar tax credit programs in other states. Mr. Rogers also analyzed the distribution of tax credit claims by income level, number of dependents, and geographic distribution. In 2010, there were 121,393 households (233,986 eligible dependents) that claimed the credit for a total of $15.3 million in credits. The average credit claim was $126, with 9.4 percent of all the claimants claiming the maximum credit possible ($250). Mr. Rogers noted that credit claimants were concentrated at the middle and upper levels of income and offered two explanations. First, the credit does not have an income limitation. Second, the credit is nonrefundable. Mr. Rogers also noted that for the 2010 tax year there were 202,625 households that failed to take the credit even though they were eligible and had a positive tax liability. He offered two explanations. First, taxpayers may not have had any eligible education expenses, possibly because Iowa law prohibits schools from charging fees to families qualifying for free lunches. Second, taxpayers may lack knowledge about the credit.

Finally, Mr. Rogers analyzed several proposals for modification to the credit. Doubling the credit to 50 percent of eligible education expenses would have reduced general fund revenue by $14.6 million. Reinstating the credit's previous $45,000 income limitation would have increased general fund revenue by $13.3 million. Eliminating the credit and raising the dependent credit from $40 to $60 would be roughly revenue neutral. Eliminating the sales tax holiday and raising the credit to 32 percent of eligible education expenses would be roughly revenue neutral assuming the current levels of claimants.

V. Report on the Maximum Aggregate Tax Credit Limit for Certain Economic Development Programs

Mr. Tim Whipple, Economic Development Authority (EDA), provided a summary of the maximum aggregate tax credit cap that is placed on certain economic development programs. The cap was enacted in 2009 and originally set at a maximum amount of $185 million per fiscal year. The cap was subsequently amended to reduce the cap to $120 million and to add more tax credit programs under the cap. The programs currently subject to the cap include the High Quality Jobs Program, Enterprise Zone Program, Housing Enterprise Zone Program, assistive device credit, Brownfield Program, innovation fund credit, and community-based seed capital fund credit. Mr. Whipple also provided information on the maximum aggregate cap allocations and awards for fiscal years 2009-2010 through 2012-2013. The total actual credit awards made for fiscal years 2009-2010 through 2011-2012 for programs and credits under the cap were $104,400,000, $68,600,000, and

$119,409,708, respectively. The credit awards made through November of fiscal year 2012-2013 are $65,270,320.

VI. Review of the Targeted Jobs Withholding Tax Credit Program

Mr. Zhong Jin, IDR, summarized the Targeted Jobs Withholding Tax Credit (TJC), which was enacted in 2006 as a pilot program to help Iowa border cities compete with cities in neighboring states in attracting business investment and creating new jobs. The pilot project had an initial sunset date for new agreements of 2010, but was later extended to June 30, 2013, and amended to allow two eligible cities within the same county with a population of fewer than 45,000 to be considered one pilot project city, to prohibit pilot project cities from using the TJC to compete with other Iowa cities, to allow retained jobs to be eligible for the TJC, and to prohibit governmental entities from participating in the program.

The current pilot project cities are Sioux City, Fort Madison, Council Bluffs, Burlington, and Keokuk. In order to qualify for the TJC in those cities, a business must relocate to Iowa, create at least 10 new jobs, retain at least 10 new jobs, or make an investment of at least $500,000. Businesses must secure matching financial support from a private donor, a business, or the pilot project city. Also, wages of eligible employees must equal or exceed the average county wage. Retail businesses are excluded from program eligibility. The TJC operates by diverting 3 percent of the gross wages paid by an employer to each employee in awarded businesses located in urban renewal areas to pilot project cities for 10 years. All amounts credited to the pilot project cities are to be used for an urban renewal project related to the employer.

Mr. Jin provided data on the TJC awards. There have been 39 TJC awards made totaling $37.6 million. For fiscal years 2006-2007 through 2011-2012, the TJC awards were $800,000, $5.7 million, $8 million, $2.6 million, $14.7 million, and $5.7 million, respectively. Of the total $37.6 million TJC awards, Burlington has received two awards totaling $6.8 million, Council Bluffs has received three awards totaling $1.7 million, Fort Madison has received four awards totaling $9.2 million, Keokuk has received three awards totaling $7 million, and Sioux City has received 27 awards totaling $12.9 million.

Mr. Jin next provided data on the actual TJC claims made on the awarded amounts. Claims can be made quarterly with an awarded business's withholding return. To date, there have been 362 claims made totaling $7,464,733. Burlington businesses have made 18 claims totaling $1,650,731, Council Bluffs businesses have made 11 claims totaling $260,541, Fort Madison businesses have made 46 claims totaling $1,816,336, Keokuk businesses have made 14 claims totaling $734,908, and Sioux City businesses have made 273 claims totaling $3,002,216. When these claims are broken down by industry it comes to roughly 62 percent manufacturing, 14 percent health care and social assistance, 6 percent wholesale trade, and 18 percent other industries.

Finally, Mr. Jin provided comparison data on the investment and jobs pledged over the life of these 10-year agreements and the amount of investment actually made and jobs created to date by the awarded businesses. Businesses have pledged $550.7 million in investment and have made $138.1 million, have pledged 1,034 new jobs and have created 574, and have pledged 2,340 retained jobs and have retained 1,855. Mr. Jin estimates that the jobs created and retained attributable to the TJC have resulted in a positive net fiscal impact on the general fund of $2,612,963 in fiscal year 2011-2012.

Certain committee members asked the number, if any, of awarded businesses that have benefited from urban renewal projects that were funded with the wages of their employees, and how many of the jobs would have been created or retained regardless of the TJC. Mr. Jin responded that the IDR did not currently have access to that data or the ability to collect that data. Another committee member noted the large disparity between investment and jobs pledged versus the actual amounts made or created to date, and commented that the state should be better able to monitor the results and track the progress throughout the entire life of the 10-year agreement. It was noted by another committee member that the Economic Development Authority monitors these agreements and would be in a better position to provide this type of data.

VII. Review of Local Option Sales Tax Increment Financing

Mr. Joel Phipps, IDR, analyzed the funding of urban renewal projects by cities with increased local sales and services tax revenues, commonly referred to as Local Option Sales Tax (LOST)-Tax Increment Financing (TIF). To be eligible, a city must have a LOST ordinance in effect and must have established an urban renewal area. The cities of Spencer, Davenport, and Red Oak have established a LOST-TIF in Iowa. Only Spencer currently has any LOST-TIF receipts. Illinois, Kansas, Minnesota, Missouri, and South Dakota also have some form of sales tax TIF.

Mr. Phipps explained the administration of a LOST-TIF. A city is required to send IDR a list of all retail businesses collecting sales tax located in the LOST-TIF in the base year. IDR establishes the base year LOST revenues and is responsible for calculating and distributing TIF funds in future years. The city must also keep IDR apprised of any new retail businesses that are collecting sales tax in the LOST-TIF. IDR calculates the amount of LOST revenues generated by retail businesses in the LOST-TIF for each quarter and deposits any amount over the base year amount in a special fund to be used for urban renewal projects located in the urban renewal area. Urban renewal areas receive the benefit of sales growth regardless of whether the growth is a result of the urban renewal project funded by the LOST-TIF. In absence of the LOST-TIF, all LOST revenues would have been distributed among the participating areas of the LOST according to the existing population and tax levy-based formula. A LOST-TIF may remain in effect until the urban renewal area ends, or 20 years after the base year, whichever is earlier.

VIII. Urban Renewal and Tax Increment Financing Reporting Demonstration

Mr. Jeff Robinson, Fiscal Division, Legislative Services Agency, and Ms. Carrie Johnson and Mr. Ted Nellesen, Iowa Department of Management, provided the committee with an update of the website development for the urban renewal reporting requirements enacted in 2012 Acts, chapter 1124 (HF 2460). The committee was provided a brief demonstration of the website's functionality and a summary of the data being collected from the jurisdictions required to report under the new law. The presenters noted that a large majority of the local governments have already completed or substantially completed their reports for the first fiscal year. The public website can be viewed at https://solr.legis.iowa.gov/tif/public.

IX. Public Comment and Committee Discussion

During public comment periods during the morning and afternoon sessions of the meeting, several members of the public addressed the committee on a variety of tax credit issues. The committee discussed the presentations made during the meeting and discussed the need for further evaluation of each credit, particularly in light of the amount of credits currently being claimed under each of these programs.

X. Materials Filed With the Legislative Services Agency

The following materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the link on the committee's website:

https://www.legis.iowa.gov/Schedules/committeeDocs.aspx?GA=84&CID=511

1. Tax Credit CAP—Iowa Economic Development
2. School Tuition Organization Tax Credit
3. Increased Local Option Sales Tax Funding
4. Iowa Fund of Funds Contingent Tax Credits
5. Table 1 Expenditures Eligible and Not Eligible for Iowa TTC
6. Target Jobs Withholding Tax Credit
7. Tuition and Textbook Tax Credit
8. TIF Reporting Requirements Status Report

3938IC