MINUTES
Tax Expenditure Committee

Monday, December 19, 2016

MEMBERS PRESENT:

Senator Joe Bolkcom, Co-chairperson
Senator William A. Dotzler Jr.
Senator Randy Feenstra
Senator Herman C. Quirmbach
Senator Roby Smith

Representative Tom Sands, Co-chairperson
Representative Jerry A. Kearns
Representative Matt W. Windschitl

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CONTENTS

I. Procedural Business

Call to Order. The Tax Expenditure Committee (committee) was called to order at 10:06 a.m. on December 19, 2016, in Room 103 (Supreme Court Chamber) of the State Capitol.

Adjournment. Upon conclusion of the presentations, public comments, and committee discussion, the meeting was adjourned at 1:34 p.m.

II. Introductory Comments from Co-chairpersons

Co-chairperson Bolkcom thanked Co-chairperson Sands for his service on the committee and friendship over their legislative careers. Co-chairperson Sands concurred with Co-chairperson Bolkcom's comments and remarked about the ability of members of opposing parties to agree on issues but also remaining professional when disagreeing.

III. High Quality Jobs Program

Ms. Debi Durham, Director, Iowa Economic Development Authority (IEDA), and Dr. Zhong Jin, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, Iowa Department of Revenue (IDR), each made presentations on the High Quality Jobs Program (HQJP). Director Durham spoke broadly about the purpose of the HQJP and its various tax and other incentives, and provided historical data on the amount of direct assistance and tax credit awards made under the HQJP to eligible businesses both before the IEDA underwent a substantial reorganization in 2012, and after such reorganization. From October 2005 through June 2012 (prereorganization), IEDA provided $60,340,400 of direct financial assistance and made $537,622,067 in tax credit awards. From July 2012 through November 2016 (post-reorganization), IEDA provided $36,962,500 in direct financial assistance and made $327,265,163 in tax credit awards. This financial assistance and tax credit data was then analyzed according to the number of jobs created or retained, and amount of capital investment made, by eligible businesses under HQJP agreements. Finally, Director Durham discussed several case studies from eligible businesses that have entered into HQJP agreements with IEDA.

Dr. Jin described the HQJP's state tax incentives consisting of the investment tax credit, the sales and use tax refund, and the supplemental research activities tax credit, and provided data on those tax incentives for tax years 2006-2014 by total claims, average claims, claims by tax type, claims by industry, and claim share for all projects by award year. He described several reasons why a portion of the tax incentive awards go unclaimed by the eligible businesses. Dr. Jin next analyzed HQJP projects that were completed in good standing from 2005 through 2010, meaning the eligible business completed the project and fulfilled the agreement, including the five-year performance and maintenance period of the agreement, without being put into default by IEDA. This group comprises 110 projects which were awarded a total of $196.9 million of tax incentives, $115.4 million of which have been claimed to date. The proportion of tax incentives claimed for these projects was analyzed by award year and incentive type.

Dr. Jin explained how he examined the effectiveness of the HQJP using historical and other data in an attempt to answer several questions related to whether the HQJP creates an incentive to invest in Iowa, whether the HQJP's investments have a measurable economic impact on the local economy, and whether the HQJP provides an incentive in location choices. He stressed the natural limits of engaging in such an examination using the available data because it is difficult to know how the economy would have behaved in the absence of the HQJP. Dr. Jin explained his experiments, including his hypotheses, testing approaches and measurements, analysis examples, estimation results, and caveats. Dr. Jin stated that his analysis suggests the HQJP can likely serve to incentivize investment decisions between states, and that HQJP projects do spur additional economic activity.

Committee members asked Dr. Jin to provide additional details on his statistical methodologies and what limitations existed when identifying control groups for similar tax incentives. Additional committee discussion centered on the types of jobs being created and retained under the program and the types of benefits associated with those jobs and whether a cause and effect relationship existed with the program and the businesses utilizing the program. Director Durham provided examples of the application and approval procedures used by IEDA and the Economic Development Board. Director Durham also provided an update on the information technology compatibility updates for IEDA and specifically for the HQJP. Committee members also discussed the priorities identified by business groups within the state, including a strong priority for developing a qualified workforce and a goal of finding balance in the package of incentives being offered in the state.

IV. Franchise Tax Credit

Dr. Mandy Jia, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the franchise tax credit, which is a nonrefundable administrative tax credit available to shareholders of financial institutions organized as S corporations. It is provided to avoid double taxation because S corporation financial institutions are themselves subject to the franchise tax. The tax credit generally equals the shareholder’s pro rata share of the Iowa franchise tax paid by the financial institution. Dr. Jia explained the history, calculation, and key features of the tax credit. She also explained the structure and calculation of the Iowa franchise tax, the taxation of financial institutions in other states, a profile of franchise tax taxpayers in tax year 2014, and the historical distribution of Iowa franchise tax revenues. Dr. Jia analyzed franchise tax revenues versus tax credit claims, as well as franchise tax credits available, claimed, and expired by tax year. For fiscal years 2007-2015, annual Iowa franchise tax revenues averaged $31.5 million, and annual Iowa franchise tax credit claims averaged $15.5 million. Tax credit claims were also analyzed by residency status and income group. Finally, Dr. Jia provided options for potential administrative changes to eliminate the tax credit.

V. Research Activities Tax Credit

Dr. Tony Girardi, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the Iowa research activities tax credit (RAC) and the Iowa supplemental research activities tax credit (Supplemental RAC), which are refundable tax credits for increases in qualifying expenditures associated with research conducted in Iowa. The RAC is an automatic credit for those taxpayers who meet the requirements, while the Supplemental RAC is awarded by the IEDA under the HQJP. Dr. Girardi provided background information on the RAC, including its relationship to the federal research activities tax credit.

Dr. Girardi also described the two calculation methods for the RAC, the regular method and the alternative simplified method. The regular method has been available since 1985, and the alternative simplified method has been available since 2010. Taxpayers may choose either method in calculating their RAC. Dr. Girardi estimated that each method is used by about half of the claimants. He also described the calculation of the Supplemental RAC, including recent changes made in 2011 which vary the tax credit rate according to the taxpayer’s gross revenues.

Dr. Girardi gave an overview of the federal research activities credit and similar credits in other states. Committee members asked Dr. Girardi about the characteristics of other states’ credits and how Iowa’s credit compared, particularly to neighboring states and states viewed as competitors. He then provided statistical data regarding the tax credits earned by tax year and by calculation method, and the amounts and percentages paid as refunds. Finally, Dr. Girardi explained how he examined the effectiveness of the tax credits using historical and other data in an attempt to answer several questions related to the impact of the availability of the alternative simplified calculation method on firms' research spending, the impact of calculation changes to the tax credits, and the research spending generated by the tax credits in Iowa.

Committee members discussed whether the companies claiming the credit view the RAC as a factor in deciding the amount of research to conduct or whether it only impacts where the research is being conducted. Committee members also expressed concern over the level of oversight and auditing of expenditures that qualify for the RAC and whether the RAC should be focused on new businesses rather than established businesses.

VI. Earned Income Tax Credit

Mr. John Good, Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the Iowa earned income tax credit (EITC), which is a refundable tax credit equal to 15 percent of the federal EITC. Mr. Good summarized the qualifications for the federal EITC, and provided history regarding the Iowa EITC and information on similar credits in other states. He also provided numerous historical data for the Iowa EITC, including the number and amount of claims by tax year and amounts paid as refunds; and tax year 2014 claims by filing status, number of dependents, age, household adjusted gross income, and county. He noted that many Iowa EITC claimants also receive other state assistance, and provided some information on that assistance and the number of Iowa EITC claimants receiving that assistance. Mr. Good provided longitudinal data on Iowa EITC claimants' future utilization of the Iowa EITC after the first year it is claimed by that person. This included comparison data between one-year and long-term Iowa EITC claimants, the average claim each year, the major reasons for moving in and out of claiming the Iowa EITC, and the average wage growth of the claimants. Finally, Mr. Good analyzed several Iowa EITC data sources relating to characteristics of EITC claimants as such data compares and correlates to the minimum wage and federal poverty guidelines.

VII. Public Comment and Committee Discussion

Committee members noted the significance of this year's committee having the first group of credits and expenditures being reviewed for a second time, but also acknowledged that much of the committee's time has been spent learning about the credits without much committee analysis and deliberation. The committee heard briefly from Mike Owen, Executive Director of the Iowa Policy Project, and Victor Elias regarding the availability and quality of research being conducted by the Department of Revenue and by other policy-focused groups on the credits reviewed by the committee.

VIII. 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/committees/committee?ga=86&groupID=594

1. Earned Income Tax Credit - Department of Revenue
2. Franchise Tax Credit - Department of Revenue
3. High Quality Jobs Program - Department of Revenue

4. High Quality Jobs Program Presentation - Economic Development Authority
5. High Quality Jobs Program Report - Economic Development Authority
6. Research Activities Tax Credit - Department of Revenue

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