MINUTES
Tax Expenditure Committee

Monday, November 27, 2017

MEMBERS PRESENT

Senator Randy Feenstra, Co-chairperson
Senator Joe Bolkcom
Senator Michael Breitbach
Senator Pam Jochum
Senator Roby Smith

Representative Guy Vander Linden, Co-chairperson
Representative Dave Jacoby
Representative Jerry A. Kearns
Representative Zach Nunn
Representative Matt W. Windschitl

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I. Procedural Business

Call to Order. The Tax Expenditure Committee was called to order at 9:03 a.m. on November 27, 2017, in Room 103, Supreme Court Chamber, of the State Capitol.

Adjournment. Upon conclusion of the presentations, a public comment period, and discussion by the committee on November 27, 2017, the meeting was adjourned at 12:45 p.m.

II. Charge and Introductory Comments from Co-chairpersons

Charge. The Legislative Tax Expenditure Committee was established in 2010. The committee is required to conduct regular reviews of all tax credit, withholding credit, and revenue division programs. For 2017, Iowa Code section 2.48 requires the committee to review the Iowa Fund of Funds Program, the targeted jobs withholding credit, funding of urban renewal projects with increased local sales and services tax revenues, the school tuition organization tax credit, the tuition and textbook tax credit, and the innovation fund investment tax credit.

Introductory Comments. Co-chairpersons Vander Linden and Feenstra each made brief introductory comments.

III. Targeted Jobs Withholding Tax Credit

Mr. Paul Stueckradt, Iowa Economic Development Authority (IEDA), summarized the targeted jobs withholding tax credit (TJC), which was enacted in 2006 as a pilot program to help Iowa border cities, within the city's urban renewal areas, compete with cities in neighboring states in attracting business investment and creating new jobs. The program allows up to 3 percent of gross wages paid by an eligible employer to be directed to pilot cities on a quarterly basis for up to 10 years. An eligible employer must be relocating to Iowa from another state and creating jobs at or above the hourly wage threshold for the city, or must be an existing Iowa business creating or retaining at least 10 jobs at or

above the hourly wage threshold for the city, or must be an existing Iowa business making a qualifying investment of $500,000 within a pilot city.

Funds are to be used by the pilot city for “a project related to the employer.” Typically, the funds are returned to the business for use in an expansion or relocation project. An amount of the credit must be matched by a private donor, the pilot city, the business, or a combination of all three. If the project will increase the city’s tax revenues, the pilot city is required to contribute at least 10 percent of the required match.

The pilot project had an initial sunset date for new agreements of 2010, but was later extended to June 30, 2013. Changes to the program in 2009 included a requirement that the maximum amount of withholding tax credits awarded be specified in the withholding agreement and cannot exceed qualifying investment, an IEDA authorization to approve or deny a withholding agreement if the agreement fails to meet the statutory requirements of the program, a prohibition on cities using the program to compete for jobs against other Iowa cities, and reporting requirements for cities detailing the amount of payments, jobs created or retained, and investment by the employer. In 2011, the program was expanded to allow an award of credits to businesses for retained jobs. Additional changes to the program in 2013 included elimination of the requirement that the employer be located within an urban renewal area, increased oversight by IEDA, and extension of the sunset to June 30, 2018.

According to Mr. Stueckradt, the most significant changes to the program have involved increased oversight by IEDA including a requirement that the IEDA Board approve awards, authorization for IEDA to negotiate the terms of the award, the requirement that IEDA be a party to the agreement, and IEDA’s responsibility for assessing compliance for retained jobs after 18 months and for created jobs and investment after three years. Program agreements in the past were 10 years in length but

following recent changes the length of the agreements are now negotiated and are typically between five and 10 years.

Dr. Zhong Jin, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, Iowa Department of Revenue (IDR), summarized comparable programs from other states. Dr. Jin noted that the results of the analysis are preliminary and that final results would be in a forthcoming report by IDR. In determining whether another state's program is comparable, Dr. Jin looked to whether the program is refundable or otherwise not limited by the business's income tax liability, whether the program includes a jobs component, and whether the tax credit is calculated as a percentage of the payroll of the associated jobs. Using those criteria, Dr. Jin identified 17 states that have similar programs, including neighboring states Nebraska, Missouri, and Illinois. However, Illinois' program is currently set to expire in 2017. Nebraska offers a credit of between 3 and 6 percent of the gross wages of the qualified employees, and Missouri provides a credit based on 100 percent of the individual income tax withheld for qualified employees.

Dr. Jin provided data on the TJC awards during the program's history. There have been 64 TJC awards made totaling $45.7 million. For fiscal years 2006-2007 through 2016-2017, the approximate annual amounts of TJC awards were two awards totaling $845,700, 15 awards totaling $5.7 million, nine awards totaling $8 million, two awards totaling $2.6 million, eight awards totaling $15.7 million, eight awards totaling $5.5 million, four awards totaling $3.8 million, 10 awards totaling $2.2 million, five awards totaling $1.2 million, and one award totaling $176,648, respectively.

Of the total $45.7 million in TJC awards, Burlington has received six awards totaling $7.2 million, Council Bluffs has received five awards totaling $2.4 million, Fort Madison has received five awards totaling $9.5 million, Keokuk has received five awards totaling $7.5 million, and Sioux City has received 43 awards totaling $19.2 million. When these claims are broken down by industry, it equates to roughly 55.7 percent

manufacturing, 19.1 percent health care, 9.6 percent wholesale, 4.4 percent construction, 2.2 percent finance, 2.1 percent professional service, 2 percent information, 1.6 percent transportation, 0.5 percent administrative service, 0.4 percent retail, and 2.3 percent classified as other service.

Dr. Jin provided data on the number of jobs and the amount of investment pledged by participating businesses in each of the pilot cities. To date, there has been a total of $634,181,705 of pledged capital investment among all pilot project cities. Sioux City businesses have a total of $113,911,469 pledged capital investment, 525 pledged created jobs, 1,014 pledged retained jobs, and an average awarded credit per job of $12,254. Fort Madison businesses have a total of $93,933,375 pledged capital investment, 656 pledged created jobs, 457 pledged retained jobs, and an average awarded credit per job of $8,493. Council Bluffs businesses have a total of $300,580,000 pledged capital investment, 88 pledged created jobs, 56 pledged retained jobs, and an average awarded credit per job of $16,738. Burlington businesses have a total of $79,748,261 pledged capital investment, 63 pledged created jobs, 538 pledged retained jobs, and an average awarded credit per job of $12,059. Keokuk businesses have a total of $46,008,600 pledged capital investment, 93 pledged created jobs, 558 pledged retained jobs, and an average awarded credit per job of $11,525.

Among the pilot cities, the share of award to capital investment ranges from 0.8 percent to 16.8 percent with an average of 7.2 percent and the average awarded credit per job is $11,309. Dr. 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 awards made totaling $45,600,611, claims made totaling $27,477,401, and an average ratio of claim to award of 60.3 percent.

Burlington businesses have made 88 claims totaling $5,952,604, Council Bluffs businesses have made 51 claims totaling $730,875, Fort Madison businesses have made 121 claims totaling $5,996,476, Keokuk businesses have made 64 claims totaling $2,943,710, and Sioux City businesses have made

852 claims totaling $11,853,736. Data provided by Dr. Jin also included each city's average amount of all claims per year, percentage of statewide claims, and each city's ratio of claims to awards.

Although acknowledging the important policy question of whether the TJC program helps Iowa compete, Dr. Jin asserted that analysis of this question is not possible without knowing the competing incentives offered by neighboring states to businesses considering locating in pilot cities over the decade. Additionally, the characteristics of certain industries do not limit competition to neighboring states and the number of projects in most cities is too small to measure actual impact.

Dr. Jin provided information on the competition for health care investment in Sioux City as a case study. Dr. Jin chose this example because competition for health care investment and jobs is primarily because such businesses will serve the same market of people in a geographic area. Sioux City has issued approximately $8 million of the city's awards to health care businesses. That amount represents 34.2 percent of the city's total awards. During the period of time between 2006 and 2015, Woodbury County and Plymouth County saw a 522 net job gain in health care. Health care providers with TJC awards in Sioux City pledged 307 jobs between 2007 and 2015, comprising 41.2 percent of the net job gain.

Dr. Jin then compared the health care industry changes between those counties in Iowa to the three neighboring counties in South Dakota. During the period of time between 2006 and 2015, the increase in the number of establishments was eight for the counties in Iowa (2 percent growth rate) and 95 for the counties in South Dakota (64.6 percent growth rate). The increase in the number of jobs was 522 for the counties in Iowa (5.4 percent growth rate) and 2,093 for the counties in South Dakota (75.4 percent growth rate). The average wage level growth for the counties in Iowa was 39.3 percent and for the counties in South Dakota was 39.6 percent. Dr. Jin determined that while the TJC program made significant contributions in job creation and retention in pilot cities, it was not enough to offset the advantage of other states with faster growth in jobs.

Dr. Jin also summarized an incidence analysis as to which persons receive the tax savings or share in the benefits resulting from the credit. The TJC program requires the credit revenues to be used to fund businesses' capital investment, but Dr. Jin looked to determine if the benefit could be shared among business owners, employees, customers, and landlords. Dr. Jin examined whether any wage gains experienced by the employees within the TJC program group can be attributed to credit and program benefits by comparing employees from nonparticipating businesses from the same cities and the same industries. Dr. Jin asserted that TJC raises the average wage per employee by 1.27 percentage points. Dr. Jin did caution that his analysis only includes larger employers with more than 50 employees in the facilities. Dr. Jin further asserted that his analysis suggests that a large portion of tax benefits of the TJC program stays in Iowa through higher wages.

In response to questions from members of the committee, Dr. Jin explained that similar credits in neighboring states are typically not limited to only those cities or areas near the states' borders, explained some of the market factors relating to the use of such credits by particular industries, and noted South Dakota's lack of income tax and population growth as significant factors for location decisions in the health care industry relative to neighboring Iowa counties. Mr. Stueckradt noted that while there has been only one award in 2017, additional awards may be in the works and approved by the board.

IV. Innovation Fund Investment Tax Credit

Ms. Jenny Klein, Legislative Liaison and Compliance Counsel, IEDA, provided an overview of the Innovation Fund Investment Tax Credit Program. The tax credit is available to investors who invest in a certified innovation fund. The investment must be in the form of cash for equity. The credit amount is 25 percent of the investor's equity investment. The program has a total of $8 million available every fiscal year, under the $170 million IEDA tax credit cap. A tax credit issued under the program is transferable

one time and has a five-year carryforward. Additionally, investors are not permitted to receive a credit for the same investment in a qualifying business.

Prior to the 2013 Legislative Session, no innovation funds sought certification and no credits were issued. The 2013 changes increased the tax credit from 20 percent to 25 percent, allowed taxpayers to claim the tax credit for the tax year in which the investment is made rather than waiting for three tax years after the investment was made, made the credit transferable one time, and added additional eligibility requirements for innovation fund certification. To be eligible, a fund must invest in businesses with a principal place of business in Iowa that are early-stage companies or innovation businesses (advanced manufacturing, biosciences, or information technology). The fund must also seek to secure private funding sources for its investments, must provide multiple rounds of funding and early-stage private sector funding to innovative businesses with a high growth potential, and must focus on businesses that show a potential to produce commercially viable products or services within a reasonable period of time.

Additional requirements for potential certified funds include a requirement for rigorous evaluation approach of all prospective investments, a collaborative relationship with the Regents institutions, and a collaborative relationship with IEDA and other state and local development entities. Finally, the fund must obtain at least $15 million in binding investment commitments within a year of certification and it must invest at least $15 million in Iowa companies. Currently, the two certified innovation funds are Next Level Ventures Fund I, LLLP and River Glen Capital Partners. River Glen Capital Partners has met the certification requirements but has yet to receive the $15 million in minimum investment.

Under current law, the sunset date for certification of new funds is June 30, 2018. IEDA is proposing extending the sunset date another five years from June 30, 2018, to June 30, 2023, and is proposing shifting some of the $8 million per fiscal year allocation to angel investor tax credits (Iowa Qualifying Business Investment Tax Credit). Currently, there is $10 million available for both the angel investor tax

credit and the innovation fund tax credit. The angel investor tax credit is becoming increasingly popular and is expected to be fully utilized this tax year.

Mr. Aaron Barker, Fiscal and Policy Analyst, Tax Research and Program Analysis Section, IDR, provided an overview of the venture capital market in the United States, of which Iowa currently represents about 0.03 percent. Nationally, there is approximately $60.9 billion in venture capital investment. Most venture capital is invested in coastal states, likely due to high-profile companies from coastal states (e.g., Facebook, Google, etc.). This results in investors in coastal areas not considering investing in Iowa companies and Iowa startups. However, investment incentive tax credits like the innovation fund tax credit encourage all investors to consider Iowa companies.

Currently, 24 states have similar active investment tax credits to Iowa's. Rates for the tax credit range from 10 percent to 50 percent, with 14 states having a higher rate than Iowa and nine states having an equal or lower rate. The most common rate is 25 percent. Much of the variance between tax credits lies with the annual award caps, ranging from $150,000 per year to no cap at all. Mr. Barker provided details for various similar programs from other states. Kentucky's investment fund tax credit was enacted in 1998, provides a 40 percent credit for investment in an approved fund, and is capped at $3 million in awards per calendar year, which is shared with an angel investment tax credit. The Kentucky program also provides that the credits are nonrefundable, transferable for nonprofits, and include a 15-year carryforward. North Dakota's angel investor tax credit, enacted in 2017, has different rates for investments in funds that invest in out-of-state companies (25 percent) versus in-state companies (35 percent). In addition, awardees are limited to $45,000 in awards per year, with a lifetime cap of $500,000. Furthermore, the North Dakota program's credits are nonrefundable, nontransferable, and have a five-year carryforward, and each fund is limited to $5 million in credits under the program.

Mr. Barker also outlined the current Iowa qualifying business investment tax credit (also referred to as angel investor tax credit). That credit is a 25 percent credit to investors that invest in qualifying businesses. There is a $100,000 credit limit per calendar year for a household and $500,000 limit among investors in any one business. This Iowa program also has a cap of $2 million per fiscal year among all awardees and is refundable to investors filing individual income tax returns, but is nonrefundable to investors filing corporation income, franchise, insurance premium, or moneys and credits tax returns. For comparison, Mr. Barker also described the criteria and requirements for other angel investment tax credit programs in Illinois, Wisconsin, Nebraska, and Minnesota.

Under the Iowa Innovation fund Tax Credit Program, since its enactment through the end of FY 2016-2017, $19.4 million has been invested by Next Level Ventures among seven companies. Additionally, between the time of investment and the end of May 2017, the seven companies added a net total of 94 Iowa employees and one of the seven reduced Iowa employment. Accordingly, $65,372 in tax credits was authorized for each employee hired through the end of FY 2016-2017. Of the seven companies receiving investments, four companies were founded five or fewer years before receiving initial investment, and three companies were founded 10 or more years before receiving initial investment.

Mr. Barker provided the committee with data on innovation fund tax credit awards by fiscal year, which yielded an average tax credit award of $19,975 for the 348 awards that have been made to date. The average amount of each claim during that time, however, has been $11,170. The committee was also provided with additional data on the transfers of innovation fund tax credits since 2014. During that time, there have been 77 transfers totaling $1,400,864, which is approximately 20 percent of the total awards. Innovation fund tax credit claims are primarily claimed against individual income tax liability (56.5 percent of total claimed amount), but the tax credit is also claimed against corporation income tax (9.2 percent), fiduciary income tax (0.8 percent), insurance premium tax (16.4 percent), and the moneys

and credits tax (17.1 percent). The average amount of each claim differs greatly by tax type, ranging from $657 to $44,193.

Mr. Barker has attempted to conduct an economic analysis of investment incentive tax credits to determine whether Iowa's tax credit increases the amount of venture capital going to early-stage companies in Iowa. Mr. Barker acknowledged the difficulties and barriers in answering this question due to the short time frame of the program, a lack of data on Iowa investments outside of the program, and having only one operating innovation fund with seven invested companies. As an alternative, Mr. Barker looked to a state-by-state analysis of investment incentive tax credits to estimate impact on total investment deals and startup growth using data collected by PricewaterhouseCoopers. Mr. Barker outlined the data sets used in the analysis, the variables considered, and the controls implemented. Overall, Mr. Barker found the impact to be insignificant when determining whether an investment incentive tax credit increases the number or average size of venture capital investment deals in a state and found insufficient evidence to conclude that having a tax credit significantly increased the number or average size of venture capital deals in a state.

Mr. Barker's analysis of startup growth utilized data calculated and presented by the Kauffman Foundation from 1982 to 2016. The three variables analyzed as part of this review were the state's startup growth rate over five years, small business scale-up rate, and high growth company density. Mr. Barker looked at data from the 48 contiguous states from 2010 to 2016 and controlled for certain characteristics such as location. In looking at the question of whether having an investment incentive credit increases the growth rate of small businesses or startups in the preceding five years, Mr. Barker found that the impact of a tax credit on startup growth rate was insignificant, location control variables did not impact significance, and a lagged or nonlagged implementation date did not impact significance. In looking at the question of whether having an investment incentive tax credit increases the percentage of small businesses that scaleup operations and become mid-sized businesses, Mr. Barker found

inconclusive results based on the specifications used. Finally, in examining the question of whether having an investment incentive tax credit increases the concentration of high growth companies, Mr. Barker determined that such a connection exists, but only in geographic areas outside the midwest. Mr. Barker's analysis yielded mixed results, finding the impact on deals to be insignificant, but the impact on some growth metrics to be significant. Overall, Mr. Barker was unable to imply causation among those results, noting the short time frame (2010 to 2016) and delayed implementation of tax credits, as well as an acknowledgment that taxes are only one factor for an investment decision.

In response to questions from committee members, Mr. Barker noted that Minnesota had not repealed its program, but instead had failed to fund it for the current year. Mr. Barker also discussed the additional factors impacting business growth in Iowa, including capable workforce and changing technologies as two of the primary factors. Ms. Klein identified some of the hurdles in getting other funds interested in the program and seeking certification and reiterated IEDA's proposal to combine the caps for the Innovation Fund Program and the Angel Investor Program and authorize the board's modification of each program's cap.

V. Iowa Fund of Funds Program

Dr. Amy Rehder Harris, Administrator and Chief Economist, Tax Research and Program Analysis Section, 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, create jobs, diversify the state's economy, and leverage funds for venture capital investment with state backing through tax credits.

Fund of Funds is invested in a portfolio of private venture capital funds. Dr. Rehder Harris noted the difference in investment structure compared to the Innovation Fund Investment Tax Credit Program,

which invests directly in businesses. Each portfolio fund made a commitment to consider equity investments in Iowa businesses and maintain a physical presence within Iowa, while innovation funds must invest in startups with a principal place of business in Iowa. The fund of funds tax credits were contingent, while the innovation fund tax credits result from every investment.

The program consisted 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), receives returns for reinvestment, and has no financial interest but is eligible for annual management fees. 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.

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. 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. Administrative rules relating to the requirements for issuance of the credits went into effect following a challenge by the banks. 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 seven-to-nine-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 no later than December 2027, instead of 2052.

As part of the winding down process for the Iowa Fund of Funds, $11.3 million in tax credits was issued and transferred in FY 2012-2013, $12.8 million in tax credits was issued and transferred in FY 2013-2014, and $1.1 million in tax credits was issued and transferred in both FY 2015-2016 and FY 2016-2017. In December 2016, the last tax credit certificate was issued and transferred. Starting in July 2017, the bank loan was retired and the state's repayment period began. The state's lien against the Fund is $30.5 million, accounted for as $25.2 million in tax credits, $0.3 million in fees, and $5.0 million to date in interest. The future payouts from funds will accrue to the state; however, there is uncertainty in venture capital markets and whether the state will be made whole.

VI. School Tuition Organization Tax Credit

Dr. Anthony Girardi, Senior Fiscal and Policy Analyst, Tax Research and Program Analysis Section, IDR, summarized Iowa's school tuition organization (STO) tax credit that was enacted in 2006 and provided data on the tax credits and tuition grants awarded to date. The nonrefundable tax credit is awarded to taxpayers who make voluntary cash contributions to one of 12 qualifying STOs that provide tuition

grants for private schools to specified low-income students in Iowa. An STO is required to represent more than one school. A contribution cannot, however, directly benefit any student designated by the taxpayer. The tax credit equals 65 percent of the contribution.

STO tax credits are capped at a total of $12 million for tax year 2017 and subsequent tax years. The cap has been raised three times since the program's first full year of existence. The overall tax credit cap is allocated among STOs based on enrollment at represented schools. Tax credit claims are allowed against the individual income tax and, since 2009, the corporation income tax. The law allows each STO to award up to 25 percent of allocated tax credits to corporate donors. The tax credits are nontransferable and nonrefundable, but do allow a five-year carryforward. Persons claiming the tax credit who are nonresident or part-year residents must apportion the credit and any portion of the tax credit apportioned to out-of-state income cannot be claimed or carried forward. The STO tax credit is the only awarded tax credit with this treatment. In 2015, there were 24 awards to nonresident individuals totaling $111,000; tax credits subject to this treatment totaled $44,000.

Under Iowa law, each STO must be a 501(c)(3) charitable organization, allot at least 90 percent of the annual revenue to tuition grants, and register with IDR. As of 2017, there were 12 STOs representing 146 schools with a total enrollment of 33,740. The STOs represent about 99 percent of the private school children in Iowa.

Dr. Girardi provided information on similar tax credit programs in other states. There are 17 other states that have some type of scholarship tax credit program. Statewide caps for those states range from $1.5 million in Rhode Island to $699 million in Florida, while Louisiana has no statewide cap and Arizona has two programs, only one of which has a statewide cap, while the other has an individual taxpayer cap. Eight states place a dollar amount cap on the eligible donation by the individual income taxpayer. For example, Montana has a $150 cap and Pennsylvania has a $750,000 cap. The percentage of the

donation eligible for the tax credit ranges between 50 and 100 percent, with seven states allowing 100 percent. Only Louisiana allows a refundable tax credit. Kansas has a similar program to Iowa's but it is only allowed to be claimed by businesses.

The average tax credit award in Iowa for the last 11 years was $2,839 and the median award was $650. Since 2006, approximately $137.47 million in donations has been received, and 31,516 tax credit awards have been issued for a total tax credit amount of $89.39 million. In 2016, there were $18.46 million in donations, and 3,484 tax credits awarded totaling $12 million, which resulted in an average credit award of $3,444 and a median credit award of $976. Dr. Girardi provided information on the amount of tax credit claims that have been carried forward and the amount that have expired since 2006.

Dr. Girardi also detailed the history of the issuance of tuition grants by STOs from the 2006-2007 school year through the 2016-2017 school year. During the 2016-2017 school year, 10,771 tuition grants were issued at an average grant amount of $1,583. Approximately 32.2 percent of the total enrollment of the covered schools received a tuition grant. Dr. Girardi provided analysis of the types of recipients of the tuition grants based on data voluntarily submitted by STOs, information regarding the tuition grant eligibility guidelines, and data regarding the full tuition costs for the covered private schools. Dr. Girardi also noted that while poverty guidelines are used to establish eligibility for a tuition grant, financial aid need is used to determine the tuition grant amount. Procedures for calculating financial aid need are determined by each STO. An STO is permitted to provide tuition grants to all eligible students even if the demonstrated need is zero.

Dr. Girardi provided data and analysis of the 2015-2016 school year tuition grant recipients based on family income and financial need and the percentage of need and tuition met by the tuition grant. He also provided analysis of the historical trends for the share of tuition grant dollars provided to categories of income and the average amount of tuition grants based on income category. Dr. Girardi examined

whether tuition grants funded through state tax credits save state money through lower public education spending by calculating the estimated net fiscal impact. Dr. Girardi estimated that 30 percent of tuition grant recipients would, without that support, attend public school. For this percentage of recipients, the tuition grant represents at least 70 percent of the full cost of tuition. In addition, financial aid need represents the total cost of tuition for more than 30 percent of tuition grant recipients. At a 30 percent substitution rate, Dr. Girardi estimated that the state's public school financing costs have been reduced by more than $12 million over the amount of STO tax credits awarded. Under the $12 million cap, at least 15 percent of tuition grant recipients must move from public to private schools as a result of the program in order for the fiscal value to equal the fiscal cost. In response to several questions from committee members, Dr. Girardi offered some information on how modifications of the tax credit cap or the credit amount might impact both the use of the tax credit and the number of tuition grant recipients.

VII. Funding of Urban Renewal Projects with Increased Local Option Sales and Services Tax Revenues

Dr. Girardi provided an overview of the structure and use of 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. Generally, an urban renewal area is a slum area, blighted area, economic development area, or combination of the areas which the local governing body designated as appropriate for an urban renewal project. Other states that authorize similar programs include Colorado, Connecticut, Illinois, Kansas, Kentucky, Mississippi, Missouri, New Jersey, Oklahoma, Pennsylvania, Tennessee, Texas, Utah, and Washington, as well as the District of Columbia.

A city may, by ordinance of the city council, create a LOST TIF district for the purpose of funding projects located within an urban renewal area. However, since 2012, a city must have prior approval of the county. The city council designates the amount of TIF revenue to be used, which may be all or a

portion of total TIF revenues. A LOST TIF remains in effect until the urban renewal area designation ends, or 20 years after the base year, whichever is earlier. The LOST distribution for the county based on the statutorily prescribed formula based on population and specified historical property tax revenue collected is reduced by the amount of the increment. The other cities and unincorporated area of the county imposing the LOST will continue to receive only the base year amount from sales in the LOST TIF district as long as the LOST TIF is in effect.

The cities of Spencer, Davenport, Stuart, and Red Oak have established a LOST TIF in Iowa. Dr. Girardi provided the current distribution percentages for LOST revenue for those counties in Iowa that have a LOST TIF. Dr. Girardi explained the administration of a LOST TIF and provided a hypothetical example of distribution of LOST revenue and the impact of a LOST TIF. The amount of LOST revenue diverted for urban renewal projects has grown during the years of 2014 through 2017, but remains a small percentage of the total LOST revenue in those counties. In 2014, the total amount of LOST revenue in counties with LOST TIFs was $31,805,300, with $32,200 (0.1 percent) being diverted for urban renewal projects. In 2017, the total amount of LOST revenue in counties with LOST TIFs was $34,000,800, with $94,500 (0.3 percent) being diverted for urban renewal projects.

Cities with LOST TIFs report various purposes for the revenue, including attracting new retail development as part of a broader strategy of mixed economic development, attracting new tenants to vacant retail space, and helping with the renovation of existing retail stores. Dr. Girardi identified some of the criticisms of the program from the Iowa State Association of Counties and the Iowa Policy Project. Dr. Girardi stated that cities generally regard LOST TIF as a helpful tool in a broader development strategy.

VIII. Tuition and Textbook Tax Credit

Mr. John Good, Fiscal and Policy Analyst, Tax Research and Program Analysis Section, IDR, summarized Iowa's Tuition and Textbook Tax Credit. The tax credit is equal to 25 percent of the first $1,000 of eligible education expenses per dependent. Qualified expenses include tuition, textbooks, fees, and equipment; however, homeschooling expenses do not qualify. To be eligible, the dependent must be in grades kindergarten through 12th grade at an accredited Iowa school. The tax credit is nonrefundable and there is no carryforward.

During the period of time from 1999 through 2005, the number of claimants and the total amount of tax credits claimed rose steadily, but both have leveled off for the 10 years since 2005. In 2015, there were 118,348 households (258,409 eligible dependents) that claimed the tax credit for a total of $15.5 million in tax credits. The average tax credit claim was $131 per household and 8.2 percent of those households claimed the $250 maximum per dependent, accounting for $4.3 million or 27.7 percent of 2015 tax year tax credits. Mr. Good analyzed the distribution of tax credit claims by household income level, number of dependents, and geographic distribution. Mr. Good noted that 33.8 percent of households claim the tax credit among all Iowa households with dependents between age five and age 21. Although many of those households may not have eligible students, still many households may likely be missing the tax benefit. The highest utilization rates of the tuition and textbook tax credit appear to coincide with the location of private schools. The school district area with the highest utilization rate (56.3 percent) is Pella. The school district area with the highest number of tax credit claims (5,932) is Des Moines. The school district area with the highest average tax credit amount ($354) is Rock Valley. The school district area with the highest average tax credit amount per pupil ($163) is Boyden-Hull.

IX. Public Comment and Committee Discussion

Following conclusion of the presentations, there were no comments offered by members of the public. Committee members discussed what potential legislative proposals might be offered during the 2018 Legislative Session and the co-chairpersons acknowledged that the types of proposals would be determined, in part, based on actions of Congress, and the overall state budget condition.

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 Internet site: www.legis.iowa.gov/committees/meetings/documents?committee=594&ga=ALL

1. Innovation Fund Tax Credit 2017, Department of Revenue.
2. Innovation Fund Tax Credit 2017, Economic Development Authority.
3. Iowa Fund of Funds Program 2017, Department of Revenue.
4. Local Option Sales Tax Increment Financing 2017, Department of Revenue.
5. School Tuition Organization Tax Credit 2017, Department of Revenue.
6. Targeted Jobs Withholding Tax Credit 2017, Economic Development Authority.
7. Targeted Jobs Withholding Tax Credit 2017 REVISED, Department of Revenue.
8. Tuition and Textbook Tax Credit 2017, Department of Revenue.
9. Tuition and Textbook Tax Credit Brief, Department of Revenue.
10. Volunteer Firefighter, EMS, & Reserve Peace Officer Tax Credit Brief, Department of Revenue.
11. Farm to Food Donation Tax Credit Brief, Department of Revenue.

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