Legislative Services Agency – Legal Services Division

LEGISLATIVE TAX EXPENDITURE COMMITTEE

Meeting Dates: December 19. 2016 | November 30, 2016

Purpose. *This compilation of briefings on legislative interim committee meetings and other meetings and topics of interest to the Iowa General Assembly, written by the Legal Services Division staff of the nonpartisan Legislative Services Agency, describes committee activities or topics. The briefings were originally distributed in the Iowa Legislative Interim Calendar and Briefing. Official minutes, reports, and other detailed information concerning the committee or topic addressed by a briefing can be obtained from the committee's Internet page listed above, from the Iowa General Assembly's Internet page at https://www.legis.iowa.gov/, or from the agency connected with the meeting or topic described.*

LEGISLATIVE TAX EXPENDITURE COMMITTEE

December 19, 2016

Co-chairperson: Senator Joe Bolkcom
Co-chairperson: Representative Tom Sands

Overview. In 2010, Iowa Acts, ch. 1138 (SF 2380), established the Legislative Tax Expenditure Committee under Iowa Code §§2.45(5) and 2.48. The committee is required to conduct regular reviews of tax credit, withholding credit, and revenue division programs. The committee may review any tax expenditure at any time but is required to review specific tax expenditures during specified years. In 2016, the committee is scheduled to conduct two meetings and is required to review (1) the homestead property tax credit, (2) the elderly and disabled property tax credit, (3) the agricultural land property tax credit, (4) the business property tax credit, (5) the military service property tax credit, (6) the commercial and industrial property tax replacement claims, (7) the high quality jobs program, (8) the research activities tax credit, (9) the franchise tax credit, and (10) the earned income tax credit. The first six topics and others were reviewed at the committee's first meeting, held on November 30, 2016.

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 (pre-reorganization), 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.

Finally, 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.

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.

Research Activities Credits. 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. He 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. 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. 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.

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 refundable tax credit equal to 15 percent of the federal EITC. Mr. Good summarized the qualifications for the federal EITC, and provided history on 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, including 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 as it compares to the minimum wage and federal poverty guidelines.

Committee Discussion and Public Comment. The committee discussed the presentations made during the meeting. During the public comment period several members of the public expressed views on the RAC and the EITC, including but not limited to views on the desire to comprehensively review the effectiveness of the RAC and the desire for maintaining refundability of that credit.

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Internet Site: https://www.legis.iowa.gov/committees/committee?ga=86&groupID=594

November 30, 2016

Co-chairperson: Senator Joe Bolkcom
Co-chairperson: Representative Tom Sands

Overview. In 2010, Iowa Acts, ch. 1138 (SF 2380), established the Legislative Tax Expenditure Committee under Iowa Code §§2.45(5) and 2.48. The committee is required to conduct regular reviews of all tax credit, withholding credit, and revenue division programs. The committee may review any tax expenditure at any time but is required to review specific tax expenditures during specified years. In 2016, the committee is scheduled to conduct two meetings and is required to review the homestead property tax credit, the elderly and disabled property tax credit, the agricultural land property tax credit, the business property tax credit, the military service property tax credit, the commercial and industrial property tax replacement claims, the High Quality Jobs Program, the research activities tax credit, the franchise tax credit, and the earned income tax credit.

Property Tax Credits. Dr. Tony Girardi, Senior Fiscal Policy Analyst, Research and Program Analysis Section, Iowa Department of Revenue (IDR), presented an overview of the following property tax credits and benefits:

- **Homestead Property Tax Credit.** This tax credit was enacted in 1937 and is available to Iowa residents who own a home in Iowa and occupy that property for at least six months of the year. Special occupancy rules apply for active duty military personnel and persons confined to nursing homes or other similar facilities. Only one homestead is allowed per taxpayer. The tax credit, when fully funded by the state, equals the amount of property taxes owed on the first $4,850 of taxable value of the homestead. This equates to a statewide average homestead property tax credit of $170. The tax credit application is made to the local assessor, and the IDR reimburses each county for its total claim amount through a standing unlimited appropriation. The tax credit has been fully funded by the state for the previous three fiscal years (FY 2014-FY 2016), and Dr. Girardi provided data on those claim amounts. However, the average state funding rate for the previous decade is 73 percent. Dr. Girardi explained the procedure used to prorate the tax credit claims when the state funding is capped.
- **Disabled Veteran Homestead Property Tax Credit.** This tax credit was enacted in 1990 as a component of the homestead property tax credit that only applies to a military veteran, including certain family members of a military veteran, if the veteran meets certain disability rating requirements or received their homestead under certain federal provisions relating to adaptive housing for disabled veterans. The tax credit applies to a maximum of one-half acre of urban land or 40 acres of rural land, and equals 100 percent of the property tax on the homestead. Dr. Girardi provided data on the tax credit amounts and number of claimants for FY 2016 and FY 2017, and explained recent amendments to the tax credit that removed the income limitation and expanded eligibility.
- **Elderly and Disabled Property Tax Credit.** This tax credit was enacted in 1983 and is available to homeowners and renters who are at least 65 years old, or totally disabled, and who have household income below a certain threshold amount ($22,584 for 2017). The household income threshold is indexed to inflation each year and the tax credit rate decreases as the taxpayer's household income increases. Dr. Girardi analyzed the 2017 tax credit rate schedule by household income. Homeowners receive a property tax credit and apply annually with the county treasurer. Renters receive a rent reimbursement and apply annually with IDR. The maximum property tax credit/rent reimbursement is $1,000 per year. Both are funded by the state through a standing unlimited appropriation, and Dr. Girardi provided data on the claim amounts for the previous three fiscal years (FY 2014-FY 2016). He also explained the procedures for paying claims and for prorating claims when the state funding is capped.
- **Military Service Exemption and Tax Credit.** This tax benefit was enacted in 1987 and provides property tax relief to qualified veterans through a property tax exemption that exempts the first $1,842 of taxable value ($2,778 for World War I veterans) of property owned by the veteran. The state reimburses the counties for the property tax reduction associated with the tax rate of $6.92 per $1,000 of valuation, and the counties forgo the remaining amount of property tax associated with the tax exemption. Dr. Girardi discussed the state funding for these claims over the previous three fiscal years (FY 2014-FY 2016), the tax exemption distribution by county, and the average number of veterans benefitting each year from the exemption.
- **Agricultural Land Property Tax Credits.** The agricultural land tax credit, enacted in 1939, and the family farm tax credit, enacted in 1990, both apply to land used for agricultural or horticultural purposes in tracts of 10 acres or more, and land less than 10 acres if contiguous to qualifying land of 10 acres or more. The family farm tax credit additionally requires ownership and active farming of the land. The credits are used to offset school taxes in school districts where the tax rate exceeds $5.40 per $1,000 of valuation. Both credits are funded by the state through a standing limited appropriation of $39.1 million, $10 million of which is allocated to the family farm tax credit. Dr. Girardi discussed fiscal year data on the tax credits by request and demand, state appropriation amount, and funding level. The average state funding for the credit over the last 14 years for the agricultural land tax credit and the family farm tax credit is 20 percent and 16 percent, respectively. Dr. Girardi noted that if the state were to fully fund these tax credits in FY 2017, it would cost an estimated $170 million.

- **Business Property Tax Credits and Commercial and Industrial Property Replacement Claims.** The business property tax credit and the commercial and industrial property replacement claims were both enacted in 2013. The business property tax credit applies to qualifying commercial, industrial, and railroad property units, and is funded by the state through a standing limited appropriation which began at $50 million for FY 2013, increased to $100 million in FY 2014, and has been set at $125 million since FY 2015. The tax credit application is made by the property owner and continues until ownership changes. Dr. Girardi discussed the tax credit calculation and provided data on tax credit distribution by county, and provided fiscal year data on the tax credits by state funding, maximum assessed valuation and credit, total units receiving the credit, and the percentage of property units with an assessed valuation that is less than the maximum. The commercial and industrial property replacement claims were established to backfill the phased-in 10 percent rollback for commercial and industrial property classes. The claims were funded by the state through a standing unlimited appropriation through FY 2017, but will be capped at $152.1 million per year after FY 2017 and claims will be prorated accordingly. Dr. Girardi presented historical data on state funding for the replacement claims by amount and by county.

Sales Tax Levy for the Secure an Advanced Vision for Education (SAVE) Fund. Dr. Amy Rehder Harris, Administrator and Chief Economist, Tax Research and Program Analysis Section, IDR, presented an overview of the SAVE Program, a 1 percent statewide sales tax dedicated to the SAVE Fund enacted in 2008 to replace the 1 percent school infrastructure local option sales tax previously adopted by all 99 counties. Since FY 2015, 97.9 percent of the SAVE Fund revenues are distributed to school districts on a per-pupil basis, and 2.1 percent are distributed to the Property Tax Equity and Relief (PTER) Fund to provide tax relief to certain school districts that have an adjusted additional levy rate above the statewide average. Dr. Harris provided fiscal year data on per-pupil funding and PTER funding, and described the IDR's role in collecting, calculating, and distributing the SAVE Fund dollars. Dr. Harris also provided data on the historical and projected future SAVE Fund revenue amounts, including the projected future growth in the per-pupil SAVE distribution. Finally, Dr. Harris provided sample data on the estimated impact that several sales tax exemptions have on the SAVE Fund dollars and, more specifically, the per-pupil SAVE distribution.

Mr. Kent Ohms, Legislative Analyst, Fiscal Services Division, Legislative Services Agency, provided a short overview of the Department of Education's SAVE Annual Report for FY 2015, and used that report and other sources to present data on historical SAVE Fund revenues and expenditures for FY 2011-2015, as well as FY 2015 data on revenues and expenditures by school enrollment category, and expenditures by function and object.

Committee Discussion. The committee discussed the presentations made during the meeting and the tax expenditures that are scheduled for review at the next committee meeting on December 19, 2016.

Next Meeting. The next committee meeting will be held in Room 103, Statehouse, on Monday, December 19, 2017, beginning at 10:00 a.m.

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