Iowa General Assembly

Legislative Tax Expenditure Committee

Legislative Services Agency – Legal Services Division

LEGISLATIVE TAX EXPENDITURE COMMITTEE

Meeting Dates: November 27, 2017

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

November 27, 2017

Co-chairperson: Senator Randy Feenstra

Co-chairperson: Representative Guy Vander Linden

Overview. In 2010, Iowa Acts, ch. 1138 (SF2380), 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 2017, the committee is required to review the Targeted Jobs Withholding Tax Credit, the Innovation Fund Investment Tax Credit, the Iowa Fund of Funds Program, the School Tuition Organization Tax Credit, the funding of urban renewal projects with increased local option sales and services tax revenues, and the Tuition and Textbook Tax Credit.

Targeted Jobs Withholding Tax Credit. Mr. Paul Stueckradt, Iowa Economic Development Authority (IEDA), summarized the Targeted Jobs Withholding Tax Credit (TJC), which was enacted as a pilot program to help Iowa border cities compete with neighboring states in attracting business investment and creating new jobs. The current pilot project cities are Sioux City, Fort Madison, Council Bluffs, Burlington, and Keokuk. TJC diverts up to 3 percent of the gross wages paid by an eligible employer to pilot cities on a quarterly basis for up to 10 years. Awarded businesses must relocate to Iowa, create or retain at least 10 new jobs at or above the hourly wage threshold for the city, or invest at least $500,000 within a pilot city. Mr. Stueckradt explained how the program funds are used by the pilot cities, and detailed historical changes to the TJC, including significant changes that increase oversight by IEDA in the TJC.

Dr. Zhong Jin, Iowa Department of Revenue (IDR), summarized comparable programs from other states, and provided data on the TJC awards and claims during the program's history. In total, there have been 64 TJC awards totaling $45.7 million, and $27,477,401 in claims. Dr. Jin analyzed these awards and claims by year, pilot city, and industry. Dr. Jin also 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 and 4,048 of pledged, created or retained jobs among all pilot project cities. Dr. Jin analyzed this total capital investment and jobs by pilot city, and compared each city's share of the total TJC awards to its share of total capital investment. Finally, Dr. Jin provided information on the competition for healthcare investment in Sioux City as a case study on the effectiveness of the TJC program, though he stressed the limitations of such a case study on proving effectiveness, and summarized an incidence analysis as to which persons receive the tax savings or share in the benefit resulting from the TJC.

Innovation Fund Investment Tax Credit. Ms. Jenny Klein, IEDA, provided an overview of the Innovation Fund Investment Tax Credit Program available to investors who invest in a certified innovation fund. The tax credit is equal to 25 percent of the investor's equity investment in cash. Not more than $8 million in tax credits may be awarded each fiscal year, and the tax credit is part of the $170 million annual tax credit cap of the IEDA. Ms. Klein discussed historical changes to the credit, including 2013 changes that increased the amount of the credit from 20 percent to 25 percent, removed the requirement that taxpayers wait 3 years to claim a credit, and made the credit transferrable one time. Ms. Klein also discussed requirements for a fund to become certified under the program. There are currently two certified innovation funds. Under current law, the sunset date for certification of new funds is June 30, 2018. IEDA is proposing that the sunset date be extended another five years to June 30, 2023, and proposes shifting some of the program's $8 million annual tax credit cap to the Tax Credit for Investment in Qualifying Businesses (also referred to as the Angel Investor Tax Credit), another IEDA tax credit program with a $2 million annual tax credit cap.

Mr. Aaron Barker, IDR, provided an overview of the venture capital market in the United States and compared Iowa's Innovation Fund Investment Tax Credit to similar investment tax credits in other states. He also outlined Iowa's Tax Credit for Investment in Qualifying Businesses, and compared it to similar tax credits in other states. Mr. Barker provided data on the $19.4 million total investment in certified innovation funds to date, as well as data on innovation fund tax credit awards and claims by fiscal year, including amounts transferred and the tax types against which the credit is claimed. There have been 348 tax credit awards to date, with $19,975 being the average award, and $11,170 being the average claim. Mr. Barker stated he attempted an economic analysis of investment incentive tax credits to determine whether Iowa's tax credit increases the amount of venture capital going to early-state companies in Iowa, but stressed the difficulties and barriers to answering that question due to a variety of factors. As an alternative approach, Mr. Barker looked to a state-by-state analysis of investment incentive tax credits and startup growth to estimate the impact on total investment deals and startup growth using data collected by PricewaterhouseCoopers and the Kauffman Foundation. 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 also found that the impact of such a tax credit on startup growth rate was insignificant. In looking at the question of whether having an investment incentive tax credit increases the percentage of small businesses that scale-up 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 overall such a connection exists, but only in geographic areas outside the Midwest. Mr. Barker stated his 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 stated he was unable to imply causation among his results.

Iowa Fund of Funds Program. Dr. Amy Rehder Harris, IDR, provided a history and structure of the Iowa Fund of Funds (FOF) program, and updated the committee on the program's current status. FOF 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. FOF is invested in a portfolio of private venture capital funds. Dr. Harris described the various entities and actors involved in the FOF. 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 FOF 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 FOF 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 FOF defaulting on the line of credit, the lenders and the FOF entered into negotiations, assisted by IDR and the Iowa Attorney General's Office. The resulting agreement cured the loan default, avoided an immediate call on the full $57 million in contingent credits at $20 million per year, preserved the $26 million investment portfolio, capped future FOF expenses, and created a second lien in favor of the state for redeemed tax credits. Dr. Rehder Harris also outlined additional provisions of the agreement. As part of the winding down process for the FOF, $11.3 million in tax credits were issued and transferred in FY 2012-2013, $12.8 million in tax credits were issued and transferred in FY 2013-2014, and $1.1 million in tax credits were issued and transferred in 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, comprised of $25.2 million in tax credits, $0.3 million in fees, and $5.0 million 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.

School Tuition Organization Tax Credit. Dr. Anthony Girardi, IDR, summarized Iowa's School Tuition Organization (STO) Tax Credit enacted in 2006 and provided data on the tax credits and tuition grants awarded to date. The tax credit equals 65 percent of a taxpayer's voluntary contribution to a qualifying STO that provides tuition grants to eligible low-income students to attend private school in Iowa. Qualifying STOs are required to represent more than one school, and contributions cannot directly benefit any student designated by the taxpayer. The total amount of STO tax credits that may be issued each tax year is capped. This tax credit cap has been raised three times since the program's inception and has been set at $12 million per tax year since tax year 2014. The overall tax credit cap is allocated among STOs based on enrollment at represented schools. Credit claims are allowed against the individual income tax and, since 2009, the corporate income tax. An STO may award up to 25 percent of allocated credits to corporate donors. The credits are not transferrable or refundable, but do allow a five-year carryforward. Nonresidents and part-year residents must apportion the credit based on their Iowa-source income. The STO tax credit is the only credit requiring such apportionment. Dr. Girardi provided data on the 12 existing STOs. These STOs represent 146 schools in Iowa with a total enrollment of 33,740, or about 99 percent of Iowa's private school children. Dr. Girardi also provided data on similar tax credit programs in other states, and data on STO tax credit awards and claims. Since 2006, approximately $137.47 million in qualifying donations have been made to Iowa STOs, resulting in 31,516 tax credit awards for a total tax credit amount of $89.39 million. Finally, Dr. Girardi provided historical data on the issuance of tuition grants by STOs, including the types of recipients of the grants. Dr. Girardi noted that while poverty guidelines are used to establish eligibility for a tuition grant under the program, each STO determines whether to award specific tuition grants based on financial aid need as calculated by the 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, an 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, and examined whether tuition grants funded through state tax credits save state money through lower public education spending.

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. Dr. Girardi noted the other states that authorize similar programs. 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 is reduced by the amount of the increment. The other cities and unincorporated areas 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. Dr. Girardi provided data showing that 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. 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 to help with the renovation of an existing retail store. Dr. Girardi identified some of the criticisms of the program from the Iowa State Association of Counties and the Iowa Policy Project. He stated that cities generally regard LOST TIF as a helpful tool in a broader development strategy.

Tuition and Textbook Tax Credit. Mr. John Good, IDR, summarized Iowa's Tuition and Textbook Tax Credit. The 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 credit is nonrefundable and there is no carryforward. Mr. Good provided historical data on the credit including number of claimants and total amount of tax credits. Mr. Good also 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 Iowa households with dependents between age 5 and age 21 are claiming the credit. Although many of those households may not have eligible students, many households are likely missing the tax benefit. Finally, Mr. Good noted that the highest utilization rates of the tuition and textbook tax credit appear to coincide with the location of private schools.

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.

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