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Fiscal Note

Fiscal Services Division

SF 350 – Economic Development Authority Tax Policy Changes (LSB1212SV)
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Fiscal Note Version – New

Description

Senate File 350 relates to economic development tax credit programs administered by the Economic Development Authority.

- Division I – Creates a new Renewable Chemical Production Tax Credit. This Division is effective on enactment and applies retroactively to January 1, 2015.
- Division II – Modifies the Qualifying Businesses and Community-Based Seed Capital Fund Tax Credit Programs.
- Division III – Modifies the Entrepreneur Investment Awards Program.
- Division IV – Modifies the sales tax refund requirements for housing businesses qualifying under the **Workforce Housing Program** by changing the definition of "project completion" to be the date when the Economic Development Authority notifies the Department of Revenue that all the requirements under Iowa Code section **15.354** have been met. Under current requirements, "project completion" is defined under Iowa Code section **15.331A(2c)**. This provision of the Division is effective on enactment and applies retroactively to July 1, 2014.
- Division IV – Allows the Economic Development Authority to extend project completion deadlines under the Redevelopment and Housing Enterprise Zone Tax Credit programs if the subject project suffered a catastrophic fire during calendar year 2014. The Younkers Building in downtown Des Moines experienced a fire in March 2014.

Background – Renewable Chemical Production Tax Credit

The new Renewable Chemical Production Tax Credit created in this Bill is equal to 5.0 cents per pound of qualified renewable chemicals produced by an eligible producer on or after the effective date of the Bill. Specific requirements include:

- The building block chemical to which the production tax credit applies must be produced from biomass feedstock and must not be produced as food, feed, or fuel. In addition, the chemical produced must be composed of at least 50.0% renewable organic material. Under certain restrictions, qualified chemicals may also be food additives, pharmaceuticals, or vitamins.
- The Bill lists a total of 39 building block chemicals that will be eligible for the credit, and the Economic Development Authority may extend the credit to additional chemicals by rule.
- The producer of the chemical must be a for-profit business located in Iowa, and the business must organize, expand, or locate in Iowa on or after the effective date of the Bill. The Bill is effective on enactment.

Following the calendar year of production, the eligible business must apply to the Economic Development Authority for the credit, based on the pounds of qualified chemicals produced during the year.

Assuming all eligibility requirements are met, the EDA will issue a tax credit certificate to the business in an amount equal to 5.0 cents per pound of qualified chemicals produced. Annual per-business limits apply, and the business is limited to a maximum of five years of credits.

The EDA may issue up to $15.0 million of production credits each fiscal year. If the $15.0 million cap is reached in a fiscal year, qualified credit applications are placed on a wait list for allocation from the next fiscal year's $15.0 million. Any unused credits within the annual $15.0 million cap do not carry forward to the next fiscal year. Tax credits are not available for any chemical produced after calendar year 2025.

The $15.0 million available for the production tax credit is included under the EDA $170.0 million annual aggregate tax credit limit (Iowa Code section **15.119**). The EDA is allowed to charge a fee to be paid by the business applying for the tax credit. The fee is equal to $500 per application, and 0.05% of the tax credit amount that is redeemed by the taxpayer.

Background - EDA Aggregate Tax Credit Cap

Iowa Code section **15.119** limits the total amount of tax credits that may be authorized by the EDA under seven tax credit programs to no more than $170.0 million in a fiscal year. These include:

- High Quality Job Creation Program
- Enterprise Zone Program
- Assistive Device Tax Credit Program
- Qualifying Business and Community-Based Seed Capital Tax Credits
- Innovation Funds Program
- Redevelopment Tax Credit
- Workforce Housing Tax Credit

The EDA has the authority to exceed the $170.0 million limit by as much as $34.0 million in a fiscal year, but any excess reduces the aggregate cap for the succeeding fiscal year.

Background - Types of Income Tax Credits

The Iowa Code offers various tax credits to encourage or reward different activities. The tax credits generally fall into the following categories of redemption value to the taxpayer:

- Single-year tax credits. Tax credits that must be redeemed in the tax year issued. Any unredeemed tax credits expire unused.
- Carryforward tax credits. Tax credits that may be used in the year issued, and if the amount exceeds the taxpayer's tax liability, unused credits may be used against tax liability in future tax years.
- Transferable tax credits. Tax credits that may be sold or otherwise transferred to another taxpayer. The taxpayer receiving the transferred tax credit may then use the credit to reduce tax liability.
- Refundable tax credits. Tax credits that may be used to offset tax liability, and if the amount of the credit exceeds tax liability, the remaining amount is refunded.
- Sale/Use tax refunds. Tax credits that result in the taxpayer receiving a refund for all or a portion of the sales and use tax paid.

Refundable tax credits are the most valuable to taxpayers, as even taxpayers with no income tax liability can benefit by filing a tax return that includes the refundable tax credit. Refundable tax credits are directly comparable to appropriations, and refundable tax credits typically see redemption rates that equal 100.0% of tax credit awards. This situation also applies to sales/use tax refunds.

Transferable tax credits are similarly valuable, but the taxpayer receiving the original credit may need to sell the credit to benefit, and there are typically transaction costs involved that keeps the original taxpayer from benefitting financially from the full value of the credit. However, this does not reduce the value of the tax credit, and transferred tax credits typically are redeemed near 100.0% of the awarded value.

Tax credits that are not refundable or transferable, but that may be carried forward for a stated number of tax years require that the receiving taxpayer have sufficient Iowa income tax liability over a period of years to fully benefit from the credit. This type of tax credit often takes several tax years to become fully redeemed, and some credits will expire unused in instances where the taxpayer does not have sufficient Iowa income tax liability across the allowed time frame. This type of tax credit typically sees a redemption percentage well below 100.0% of the awarded amount.

Single-year tax credits can be the least valuable, as their value is capped by the tax liability of the taxpayer for that one fiscal year. If the tax credit amount is small, the redemption percentage may approach 100.0%. But if the tax credit amount is large, then the redemption percentage can be expected to be low.

Background – Tax Estimate Payments

Individual taxpayers remit tax payments in three forms. For wages and certain other income, taxes are withheld from the income and the tax is remitted directly to the State. In an instance where there is no withholding required, the taxpayer is likely required to remit quarterly estimate payments. Finally, ultimate tax liability for a taxpayer is reconciled when the tax return for the tax year is filed. Filing of a tax return usually results in either a payment due, or a tax refund, depending on whether the combination of withholding and estimate payments was sufficient for that taxpayer that year.

The tax system is similar for corporations and banks, except there is no withholding concept. All payments are made through quarterly estimate payments and the filing of tax returns. For insurance companies, taxes for the current calendar year are due in June and August, with final reconciliation when tax returns are filed the following March.

Once taxpayers (individual, corporate, bank, or insurance company) become confident their ultimate tax liability for a tax year will be lower than previously assumed, as in the instance of taxpayers earning refundable tax credits, they can be expected to lower their tax estimate payments for that year.

Because refundable tax credits are like cash to any taxpayer, regardless of tax liability, the award of a refundable tax credit has an immediate impact on net General Fund revenue through decreased estimate payments.

Assumptions

New Renewable Chemical Production Tax Credit

- The Bill is effective on enactment and applies to qualified chemicals produced on or after that date. While the Economic Development Authority and the Department of Revenue must adopt rules for the chemical tax credit program, qualified chemicals produced after enactment but prior to final rule adoption will still qualify for the tax credit.
- Current production levels in Iowa of the types of chemicals to which this Bill applies are not known, nor are the future production levels. It is assumed that beginning in calendar year 2016, qualified chemical production will be at least 300.0 million pounds, sufficient to utilize the entire $15.0 million annual tax credit cap. Calendar year 2015 qualified production is assumed to be 140.0 million pounds, equal to $7.0 million in tax credit awards.
- Tax credits earned in a calendar year will be awarded in the spring of the next calendar year. Companies will redeem awards through reduced estimate payments and final tax returns.
- Tax credits awarded under the new tax credit program are refundable. Therefore, they are anticipated to be redeemed at a rate of 100.0% of the amounts awarded by the Authority. To estimate the impact of the new tax credit, the following tax credit redemption pattern is used:
  - For calendar year 2015 production, 10.0% redeemed in FY 2016 through reduced estimate payments, 90.0% redeemed through the tax return process.
  - For calendar year 2016 production and after, 25.0% redeemed through reduced estimate payments, 75.0% redeemed through the tax return process.

- Credits expiring unredeemed = 0.0%

Reduced High Quality Jobs Tax Credits

- To make room within the existing EDA $170.0 million aggregate tax credit cap, it is assumed that the Authority will reduce the annual cap allocation to the High Quality Jobs Program by $7.0 million for FY 2016 and by $15.0 million for FY 2017 and after.
- Tax credits awarded under the High Quality Jobs Program are generally not refundable or transferable. Therefore, they are redeemed at a rate well below 100.0% of the amounts awarded by the Authority. To estimate the impact of reduced tax credit awards under the High Quality Jobs Program, the following tax credit redemption pattern is used:
  - Fiscal year of award = 3.0%
  - Second year = 8.0%
  - Third year = 8.0%
  - Fourth through sixth year = 4.0%
  - Seventh through tenth year = 3.0%
  - Credits expiring unredeemed = 57.0%

Venture Capital Tax Credit Changes

The Bill makes several changes to the Venture Capital Tax Credit - Qualifying Business or Community-Based Seed Capital Fund Tax Credit programs. The fiscal impact of the changes is the result of making the tax credits refundable for individual taxpayers. The total amount of tax credits that may be awarded in a year does not change. Tax credit redemptions are assumed to increase from the current level of 81.5% of awarded credits to 95.0%.

Fiscal Impact

The fiscal impact of this Bill is the result of changing from tax credit programs that are not refundable to tax credit programs that are refundable. Refundable tax credits are redeemed much quicker, and at a much higher rate, than nonrefundable tax credits. While the changes to the tax credits contained in this Bill fall under the overall $170.0 million annual aggregate tax credit cap for EDA programs, the changes will result in redemption of a much higher percentage of the awarded tax credits. This change in the redemption pattern reduces net General Fund revenue and impacts the State General Fund balance sheet.

Senate File 350 - Estimated EDA Tax Credit Changes

In Millions of Dollars

	Reduction in High Quality Jobs Program Tax Credit Redemptions	New Renewable Chemical Production Tax Credit Redemptions	Change in Venture Capital Tax Credit Redemptions	Estimated Combined Impact on Net General Fund Revenue
FY 2016	$ 0.2	$ -0.7	$ -0.2	$ -0.7
FY 2017	1.1	-10.1	-0.2	-9.2
FY 2018	2.3	-15.0	-0.2	-12.9
FY 2019	3.2	-15.0	-0.3	-12.1
FY 2020	3.8	-15.0	-0.3	-11.5
FY 2021	4.4	-15.0	-0.3	-10.9
FY 2022	4.9	-15.0	-0.3	-10.4
FY 2023	5.3	-15.0	-0.3	-10.0

The EDA is authorized to charge a $500 application fee and a fee equal to 0.5% of tax credits redeemed. This fee structure also applies to the High Quality Jobs Program. Since tax redemptions under the new Renewable Chemical Production Tax Credit are assumed to be higher than under the High Quality Jobs Program, the 0.5% fee should produce approximately $38,000 more in annual fee revenue for the Authority, beginning in FY 2017.

Division III modifies the Entrepreneur Investment Awards Program. This Program is funded by the Entrepreneur Investment Awards Program Fund. While the Program is modified, the amount available to award is not. This Division does not have a fiscal impact.

The provision in Division IV related to the definition of completion date for sales tax refunds is considered a technical change and has no fiscal impact.

The provision in Division IV related to a project extension related to a 2014 fire does not have a fiscal impact. While the extension does allow the project to receive tax credits that it would not otherwise qualify for, the tax credits involved are for programs under the EDA aggregate tax credit cap and the credit type (refundable, transferable, nonrefundable) is not changed. This provision does not have a fiscal impact.

The Department of Revenue indicates that the enactment of the new Renewable Chemical Production Tax Credit will require the development of a new component to the Department's Tax Credit Award, Claim & Transfer System. This one-time development cost is estimated by the Department to be $140,000.

Sources

Department of Revenue
Economic Development Authority

/s/ Holly M. Lyons

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The fiscal note for this bill was prepared pursuant to **Joint Rule 17** and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.