
FISCAL TOPICS

Fiscal Services Division

October 22, 2019



Ground Floor, State Capitol Building

Des Moines, Iowa 50319

515.281.3566

Income Tax Credits — Fiscal Impact Background

When the General Assembly debates the creation, elimination, or modification of Iowa income tax credits, the fiscal impact of the proposal is estimated by the Legislative Services Agency and presented through the Fiscal Note process. An important consideration in that process is the timing of any impact on State revenues. The timing of any fiscal impact depends not only on when the change becomes effective, but also on the type of tax credit up for consideration. The following information provides general background on the different factors that must be considered when determining the best estimate of when a particular income tax credit change may impact State revenue.

Economic Development Incentive Requirements

Tax credits administered by the Economic Development Authority (EDA) generally have specified requirements that must be met before the awarded tax credits may be issued to the beneficiaries. Those requirements typically take time, and in the instance of large construction projects, they often take more than one year to complete. The fiscal impact calculation for a tax credit program must take into consideration the time between the awarding of tax credits and the actual redemption of those credits. This type of timing adjustment is equally important for tax credits administered by other agencies, such as the State Historic Preservation and Cultural and Entertainment District Tax Credit Program administered by the Department of Cultural Affairs.

EDA Aggregate Tax Credit Cap

For many of the tax credit programs administered by the EDA, the total tax credits awarded in a fiscal year is limited. 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. 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. The programs included under the EDA aggregate cap include:

- High Quality Jobs 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
- Renewable Chemical Production Tax Credit

Any change to a tax credit program under this cap, or any additional program added under the cap, may not have an additional fiscal impact since the overall amount of tax credits issued does not change. However, changes to programs under the aggregate cap may have a revenue impact if an analysis at the time of the estimates concludes that the aggregate cap will not be fully utilized in upcoming years under existing law. An additional fiscal impact for a program change under the cap may be calculated if the

More Information

Department of Revenue Tax Credit List:

tax.iowa.gov/sites/default/files/idr/Tax_Credits_Users_Manual_2018.pdf

LSA Staff Contact: Jeff Robinson (515.281.4614) jeff.robinson@legis.iowa.gov

proposed change alters the redemption pattern of available tax credits.

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 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 tax incentives awarded as 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 keep 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 at 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.

Timing of Tax Credit Impact on State General Fund Revenue

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 by the employer to the State. For income with no withholding required, the taxpayer may be 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 that 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 quarterly estimate payments.