REPORT OF THE LEGISLATIVE TAX EXPENDITURE COMMITTEE TO THE LEGISLATIVE COUNCIL

June 2013

Meeting. Members of the Legislative Tax Expenditure Committee of the Legislative Council met on December 12, 2012.

Tax Expenditure Review. The committee received presentations and conducted a review of all of the following:

I. Iowa Fund of Funds Program, Agreement to Cure Default

Dr. Amy Rehder Harris, Manager, Tax Research and Program Analysis Section, Iowa Department of Revenue (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, and leverage funds for venture capital investment with state backing through tax credits. The amount of $100 million in contingent tax credits was originally authorized, with not more than $20 million 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.

The program consists of several entities and actors. The Iowa Capital Investment Board, a public entity, 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 tax-exempt entity, acts as the general partner of the fund, selects the fund manager (Cimmaron Capitol Associates I, LLC), and receives returns for reinvestment. Finally, Iowa Designated Investor, Inc., is the entity which makes the investments in the fund and holds the contingent tax credits.

Each portfolio fund in which the fund invests is required to make a commitment to consider equity investments in businesses located within Iowa and maintain a physical presence within Iowa. 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. 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 in December 2027, instead of 2052.

II. Review of School Tuition Organization Tax Credit

Ms. Angela Gullickson, IDR, summarized Iowa's School Tuition Organization (STO) Tax Credit and provided data on the tax credits and scholarships awarded to date. The nonrefundable tax credit is awarded to taxpayers who make voluntary cash contributions to a qualifying STO that provides scholarships to low-income students. The school tuition organization tax credits are capped at a total of $8.75 million for tax year 2012 and subsequent tax years. Ms. Gullickson provided information on similar tax credit programs in other states. The average tax credit award in Iowa for the last six years was $2,427 and the median award was $650. Between 2009 and 2011, the average number of tax credit awards each year was 3,008. Since 2006, nearly $43.8 million in donations has been received, generating over $41.4 million in scholarships for an average of 9,209 students each school year. The average scholarship has been $899. Ms. Gullickson also stated that 5.4 percent of donations have been used for administrative expenses. Effective July 1, 2009, tax credit awards could be made to corporations. In the two full tax years that corporations could make donations, they averaged less than 2 percent of all tax credit awards. Ms. Gullickson also analyzed the distribution of tax credit awards by taxpayer type, number of dependents, and geographical distribution.

III. Review of Tuition and Textbook Tax Credit

Mr. Bob Rogers, IDR, summarized Iowa's Tuition and Textbook Tax Credits. The credit is equal to 25 percent of the first $1,000 of eligible education expenses per dependent. To be eligible, the dependent must be in grades kindergarten through 12th grade at an accredited Iowa school. The credit is nonrefundable.

Mr. Rogers provided information on similar tax credit programs in other states. Mr. Rogers also analyzed the distribution of tax credit claims by income level, number of dependents, and geographic distribution. In 2010, there were 121,393 households (233,986 eligible dependents) that claimed the credit for a total of $15.3 million in credits. The average credit claim was $126, with 9.4 percent of all the claimants claiming the maximum credit possible ($250). Mr. Rogers noted that credit claimants were concentrated at the middle and upper levels of income and offered possible explanations for such concentrations.

IV. Report on the Maximum Aggregate Tax Credit Limit for Certain Economic Development Programs

Mr. Tim Whipple, Economic Development Authority (EDA), provided a summary of the maximum aggregate tax credit cap that is placed on certain economic development programs. The cap was enacted in 2009 and originally set at a maximum amount of $185 million per fiscal year. The cap was subsequently amended to reduce the cap to

$120 million and to add more tax credit programs under the cap. The programs currently subject to the cap include the High Quality Jobs Program, Enterprise Zone Program, Housing Enterprise Zone Program, assistive device credit, Brownfield Program, innovation fund credit, and community-based seed capital fund credit. Mr. Whipple also provided information on the maximum aggregate cap allocations and awards for fiscal years 2009-2010 through 2012-2013. The total actual credit awards made for fiscal years 2009-2010 through 2011-2012 for programs and credits under the cap were $104,400,000, $68,600,000, and $119,409,708, respectively. The total credit awards made through November of fiscal year 2012-2013 are $65,270,320.

V. Review of the Targeted Jobs Withholding Tax Credit Program

Mr. Zhong Jin, IDR, summarized the Targeted Jobs Withholding Tax Credit (TJC), which was enacted in 2006 as a pilot program to help Iowa border cities compete with cities in neighboring states in attracting business investment and creating new jobs. The pilot project had an initial sunset date for new agreements of 2010, but was later extended to June 30, 2013, and amended to allow two eligible cities within the same county with a population of fewer than 45,000 to be considered one pilot project city, to prohibit pilot project cities from using the TJC to compete with other Iowa cities, to allow retained jobs to be eligible for the TJC, and to prohibit governmental entities from participating in the program.

The current pilot project cities are Sioux City, Fort Madison, Council Bluffs, Burlington, and Keokuk. In order to qualify for the TJC in those cities, a business must relocate to Iowa, create at least 10 new jobs, retain at least 10 new jobs, or make an investment of at least $500,000. Businesses must secure matching financial support from a private donor, a business, or the pilot project city. Also, wages of eligible employees must equal or exceed the average county wage. Retail businesses are excluded from program eligibility. The TJC operates by diverting 3 percent of the gross wages paid by an employer to each employee in awarded businesses located in urban renewal areas to pilot project cities for 10 years. All amounts credited to the pilot project cities are to be used for an urban renewal project related to the employer.

Mr. Jin provided data on the TJC awards. There have been 39 TJC awards made totaling $37.6 million. For fiscal years 2006-2007 through 2011-2012, the total TJC awards were $800,000, $5.7 million, $8 million, $2.6 million, $14.7 million, and $5.7 million, respectively. Mr. Jin also provided data on the actual TJC claims made on the awarded amounts and provided data based on the type of industry. Mr. Jin also provided comparison data on the investment and jobs pledged over the life of these 10-year agreements and the amount of investment actually made and jobs created to date by the awarded businesses. Businesses have pledged $550.7 million in investment and have invested $138.1 million, have pledged to create 1,034 new jobs and have created 574, and have pledged to retain 2,340 jobs and have retained 1,855. Mr. Jin estimates that the jobs created and retained attributable to the TJC have resulted in a positive net fiscal impact on the general fund of $2,612,963 in fiscal year 2011-2012.

VI. Review of Local Option Sales Tax Increment Financing

Mr. Joel Phipps, IDR, analyzed the 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. The cities of Spencer, Davenport, and Red Oak have each established a LOST-TIF in Iowa. Only Spencer currently has any LOST-TIF receipts. Illinois, Kansas, Minnesota, Missouri, and South Dakota also have some form of sales tax TIF.

Mr. Phipps explained the administration of a LOST-TIF. IDR establishes the base year LOST revenues and is responsible for calculating and distributing TIF funds in future years. IDR calculates the amount of LOST revenues generated by retail businesses in the LOST-TIF for each quarter and deposits any amount over the base year amount in a special fund to be used for urban renewal projects located in the urban renewal area. In absence of the LOST-TIF, all regular LOST revenues would have been distributed among the participating areas of the LOST according to the existing population and tax levy-based formula. A LOST-TIF may remain in effect until the urban renewal area ends, or 20 years after the base year, whichever is earlier.

VII. Urban Renewal and Tax Increment Financing Reporting Demonstration

Mr. Jeff Robinson, Fiscal Services Division, Legislative Services Agency, and Ms. Carrie Johnson and Mr. Ted Nellesen, Iowa Department of Management, provided the committee with an update of the internet site development for the urban renewal reporting requirements enacted in 2012 Acts, chapter 1124 (HF 2460). The committee was provided a brief demonstration of the internet site's functionality and a summary of the data being collected from the jurisdictions required to report under the new law. The presenters noted that a large majority of the local governments have already completed or substantially completed their reports for the first fiscal year. The public internet site can be viewed at https://solr.legis.iowa.gov/tif/public.

Respectfully submitted,

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Senator Joe Bolkcom, Co-chairperson

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Representative Thomas R. Sands,
Co-chairperson