FINAL REPORT

ECONOMIC DEVELOPMENT SERVICE DELIVERY SYSTEM INTERIM STUDY COMMITTEE

Presented to the Legislative Council
and the Iowa General Assembly
January 1995

Prepared by the Legislative Service Bureau

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ECONOMIC DEVELOPMENT SERVICE DELIVERY SYSTEM

INTERIM STUDY COMMITTEE

JANUARY 1995

AUTHORIZATION AND APPOINTMENT

The Economic Development Service Delivery System Study Committee was established by the Legislative Council in 1994 and authorized to hold two days of meetings. The Committee was subsequently granted an additional meeting day by the Legislative Council.

STUDY COMMITTEE CHARGE

The Committee was given the following charge by the Legislative Council:

Examine the service delivery system for economic development programs and study the relationship between local and state governments and businesses in utilizing financial and tax incentives as economic development tools. Study the need for the benefits of a compact with other states regarding economic noncompetition and the steps necessary to implement such a compact, if desirable. Make recommendations for ways to improve the economic development service delivery system and any changes, if necessary, to state financial and tax incentives. The Study Committee shall hold a joint meeting with the State and Local Tax Review Study Committee to consider issues relating to the machinery and equipment tax and Subchapter S Corporations.

COMMITTEE MEMBERS

Senator Tony Bisignano, Co-chairperson
Representative Roger Halvorson, Co-chairperson
Senator Allen Borlaug
Senator Richard Drake
Senator Randal Giannetto
Senator Tom Vilsack
Representative Tom Baker
Representative Joe Ertl
Representative Christopher Rants
Representative Richard Running

COMMITTEE PROCEEDINGS

The Committee held three meetings, on September 12, 1994, October 10, 1994 (a joint meeting with the State and Local Tax Review Study Committee), and December 16, 1994. The Committee heard testimony from the Departments of Economic Development and Revenue and Finance and from a number of individuals regarding Iowa's economic development service delivery system and Iowa's tax climate for businesses.

MEETING -- SEPTEMBER 12, 1994

Mr. David Lyons, Director, Iowa Department of Economic Development, discussed the approach and philosophy of the Department regarding service delivery as follows: (1) to deliver economic development services in an efficient manner; (2) to deliver services to those individuals and businesses most in need; (3) to be global in outlook; (4) to be state-of-the-art; (5) to work in a cooperative mode; and (6) to make programs more responsive to communities. Mr. Lyons also introduced several members of the Department and discussed the activities of the several divisions within the Department. As part of the Business Development Division's presentation, the Committee viewed a demonstration of the Department's "I Media" interactive computerized database.

Mr. Holmes Foster, Director, Iowa Business Investment Corporation, discussed the history of small business investment companies, noting that these companies are intended to be used to leverage up to three times the capital invested in the company for investments in small businesses. Mr. Foster also discussed legislation proposed during the 1994 Session which would provide tax credits for corporations, financial institutions, and insurance companies to invest private capital in a qualified venture capital company, which would then invest in small businesses.

Ms. Linda Shaut and Ms. Deb Calvert spoke to the Committee from the perspective of the Professional Developers of Iowa. They discussed the experiences of Professional Developers of Iowa's business attraction activities and the need to improve Iowa's business climate, particularly in regard to repealing the property tax on machinery and equipment and lowering Iowa's corporate and personal income tax rates. They noted that even though Iowa's income tax rates are effectively reduced by federal deductibility, the high top rate can create a hurdle to attracting businesses.

Mr. Kent Sovern, League of Iowa Municipalities, told the Committee that housing is critical to economic development and that programs restricting assistance to only low-income and moderate-income housing is a concern to cities.

Mr. Tom Simmering, Partner, Simmering-Cory, Inc., and Iowa Codification, Inc., discussed his perceptions on the Community Development Block Grant Program as it affects small and medium cities. In particular, Mr. Simmering was concerned that there is insufficient staff working with the Economic Development Set-Aside program, which results in delays in processing applications. He also recommended that the low-income and moderate-income requirements for tax increment financing for housing be eliminated, especially for small communities, as the requirements restrict communities' ability to fund the type of housing they feel is needed.

Mr. Doug Elliot, Director, East-Central Iowa Council of Governments and Vice-chair, Iowa Association of Regional Councils, discussed the involvement of the Regional Councils in economic development issues. Mr. Elliot noted the Councils' concern with the lack of availability of financing for small businesses in extremely small communities and that many economic development programs require a certain level of job creation that many small communities and employers are not able to reach.

MEETING -- OCTOBER 10, 1994

The second meeting of the Committee was held jointly with the State and Local Tax Review Study Committee.

Mr. David Lyons discussed the Department of Economic Development's proposal to eliminate the property tax on machinery and equipment by reducing the amount of the tax by three percent per year for ten years. Mr. Lyons explained that eliminating the tax would eliminate an impediment to investment by the high technology, high wage businesses that Iowa wants to attract and will help existing Iowa businesses maintain their market position. The cost of the Department's plan is estimated at $163 million over the ten-year period. The proposal also contains a provision for state reimbursement for any decrease in school aid funding caused by the phaseout of the tax and for a partial reimbursement to cities and counties for lost property tax revenue. Mr. Lyons explained to the Committees that it is anticipated that increased industrial activity due to the elimination of the tax will cause an increase in commercial and industrial property tax revenues which will reduce the amount of reimbursement necessary by the state.

Mr. Carl Castelda, Deputy Director, Department of Revenue and Finance, explained the current scheme of taxation of Subchapter S Corporations in Iowa. The scheme of taxation subjects a resident shareholder of a Subchapter S Corporation to tax on the shareholder's share of income derived from the corporation which income is not subject to apportionment between Iowa and another state in which the corporation is conducting business. Regular business corporations that are not Subchapter S Corporations may apportion income between states for Iowa tax purposes. Mr. Castelda also discussed alternatives to the current method of Subchapter S Corporation taxation.

Mr. William Brown, Partner, Brown, Winnick, et al., Law Firm, discussed the Subchapter S Corporation taxation proposal contained in the Senate version of House File 2415 from the 1994 Session. Mr. Brown explained to the Committees that he feels that this proposal would provide targeted economic development benefits to the state for several reasons, including removing the incentive in current Iowa tax law for Subchapter S Corporation shareholders to move out of state.

MEETING -- DECEMBER 16, 1994

Mr. Dennis Harbaugh, Director of the Industrial Site Location Program (ISLP) at the External Services Division of the University of Northern Iowa described the program's history and current activities and demonstrated the program's multimedia presentation system to the Committee. The ISLP is funded by grants from the Farmers Home Administration and is intended to help lower site location costs for companies seeking to locate in communities of 30,000 or less population. The Committee also heard from Mr. David Lyons, Director of the Iowa Department of Economic Development and Mr. Harbaugh regarding the coordination efforts underway between the Department's site location program and the ISLP.

Mr. Lyons and several staff from the Department of Economic Development also discussed the Department's legislative proposals. Mr. Lyons told the Committee that the proposals focus on four areas: (1) improving the climate for business in Iowa; (2) increasing community involvement and opportunities in economic development; (3) increasing workforce accessibility; and (4) providing better tracking of the rate of return to the state from its investments in economic development.

MATERIALS

The Committee considered a number of materials, including the following, which are on file with and available upon request to the Legislative Service Bureau:

1. Proposed bill draft LSB 4201SC, relating to corporate, franchise, and insurance premiums tax credits for entities investing in a qualified venture capital company and providing retroactive applicability date provisions.

2. Handouts regarding the proposal by the Department of Economic Development regarding the phaseout of the property tax on machinery and equipment.

3. "Examination of Issues Relating to Taxation in Iowa of S Corporations", prepared by the Iowa Department of Revenue and Finance.

4. "Proposed Targeted Subchapter S Proposal", prepared by William C. Brown, Brown, Winnick, et al., Law Firm.

5. "Economic Development Policy Survey", Arizona Department of Revenue, Econometrics Section, August 23, 1994.

6. Draft of the Investing in People Report, dated August 11, 1994, by Jeff Nall, Iowa Department of Economic Development.

RECOMMENDATIONS

The Committee discussed the testimony heard by the Committee and the other information presented for consideration. The Committee approved the following recommendations:

1. The Committee supports the drafting of legislation which would:

   A. Enhance Iowa's economic climate by phasing out the property tax on machinery and equipment on both new and existing equipment (M&E) in the shortest possible period of time, but not exceeding six years.

   B. Protect Iowa's local governments during this phaseout by:

      (1) Reimbursing the majority of lost M&E revenue over a significant period of time, but not less than ten years.
      (2) Providing a mechanism which would guarantee these reimbursements for the full ten years.
      (3) Fully funding any "gap" created in local school aid formula funding.
      (4) Protecting tax increment financing, job training, and other local government agreements in existence at the time of enactment.
      (5) Creating a "safety net" which would provide additional reimbursements to communities where non-M&E revenue does not grow as quickly as necessary to offset the M&E phaseout.

   C. Enhance continued economic development and property tax relief by:
      (1) Supporting the continuation of, and flexibility within, the New Jobs and Income Program, tax increment financing, and the Community Economic Betterment Program during the M&E phaseout period.
      (2) Supporting additional state funding to relieve county mental health costs during the period of M&E phaseout and beyond.

2. The Committee supports the expansion of innovative ways to address both the shortage of venture capital and the shortage of available housing in Iowa.

3. The Committee supports continued development of a seamless economic development broker system utilizing current economic development system components, e.g., the Wallace Technology Transfer Foundation and the Heartland Technology Network.