# REPORT OF THE LEGISLATIVE TAX EXPENDITURE COMMITTEE
# TO THE LEGISLATIVE COUNCIL
# July 12, 2016

## I. Committee Proceedings

The Legislative Tax Expenditure Committee conducted two meetings at the Statehouse during the 2015 Interim on Wednesday, November 18, 2015, and Wednesday, December 9, 2015.

## II. November 18, 2015, Meeting

The committee received presentations and conducted a review of the following:

## A. Overview of Franchise Tax and Moneys and Credits Tax

Dr. Amy Rehder Harris, Administrator and Chief Economist, Tax Research and Program Analysis Section, Iowa Department of Revenue (IDR), presented an overview of the franchise tax imposed on financial institutions and the moneys and credits tax imposed on credit unions. The franchise tax is imposed at a flat rate of 5 percent on the "net income" of financial institutions in Iowa. Net income is measured similarly to the corporation income tax, with one notable difference being that the franchise tax net income includes earnings on all government securities. S corporations are subject to the franchise tax at the entity level, but Iowa provides a franchise tax credit to shareholders to avoid double taxation. There are 13 tax credits available against the franchise tax.

The moneys and credits tax is imposed on credit unions at the rate of one-half cent on each dollar of a credit union's required legal and special reserves less an annual $40,000 exemption amount. The tax is imposed by the county board of supervisors and collected by the county treasurer. Proceeds are shared between cities, counties, and the state according to a statutory formula and depending on the location of the credit union. There are nine tax credits available against the moneys and credits tax.

Dr. Harris provided a hypothetical comparison of the two taxes and provided data on the number of entities paying the taxes, annual tax revenues, and tax credit claims by amount and type.

## B. Agricultural Assets Transfer Tax Credit and Custom Farming Contract Tax Credit

Ms. Lori Beary, Community Development Director, Iowa Finance Authority (IFA), provided background information on the agricultural assets transfer tax credit and the custom farming contract tax credit, which together comprise the Beginning Farmer Tax Credit Program administered by the Iowa Agricultural Development Authority (IADA), a division of IFA. Both credits are nonrefundable but may be carried forward for up to 10 years. IFA may not issue more than $12 million in total credits each year under the program, and may not issue more than $50,000 per taxpayer, per credit.

The agricultural assets transfer tax credit is available to owners of agricultural assets (land, equipment, breeding livestock) who lease those assets to qualified beginning farmers. Ms. Beary outlined the age, residency, ownership, training, net worth, and other requirements to qualify as a beginning farmer under the credit, and the requirements for a lease to qualify under the credit. The credit equals 7 percent for a lease made on a cash basis and 17 percent for a lease made on a crop share basis, with an additional percentage point available if the beginning farmer is a military veteran. Ms. Beary explained how the tax credit is calculated for both a cash rent lease and a crop share lease.

The custom farming contract tax credit was enacted in 2013 for landowners who hire beginning farmers for custom work. The credit equals 7 percent of the amount paid on the contract, with an additional percentage point available if the beginning farmer is a military veteran. Ms. Beary outlined the requirements that the landowner, beginning farmer, and contract must satisfy in order to qualify for the credit.

Ms. Beary provided data on the total number of tax credit certificates and tax credit amounts issued under the Beginning Farmer Tax Credit Program. Additionally, she explained the 2015 marketing efforts undertaken by IFA in relation to the program, including attendance at certain workshops and conferences, and the placement of advertisements in certain publications.

Dr. Anthony Girardi, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, provided background information on the Beginning Farmer Tax Credit Program, including recent legislative changes, eligibility for both credits under the program, and similar state and federal tax incentive programs. Dr. Girardi compared beginning farmers and established farmers on a range of topics including farm type, farm production, federal payments received, farm income, major occupation, length of experience, age, and farm net worth. He provided data on tax credit awards and claims by year for each tax credit and for the entire Beginning Farmer Tax Credit Program. Additionally, Dr. Girardi analyzed projects (leases and contracts) under the program per beginning farmer and per land owner, and also analyzed agricultural assets transfer tax credit leases by county and acre, as a percentage of harvested cropland per county, and as a percentage of tenant-operated acres by county. He also provided data on annual agricultural asset transfer tax credit lease income, and data to demonstrate how tax credit amounts are related to crop yields and prices. Finally, the three different types of agricultural asset transfer tax credit leases (cash rent, crop share, hybrid) were analyzed according to number, acreage, and percentage by county.

## C. Charitable Conservation Contribution Tax Credit

Mr. John Good, Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the charitable conservation contribution (CCC) tax credit available against the individual and corporate income tax for certain qualifying contributions to conservation organizations in the form of conservation easements, bargain sales of land, or easement bargain sales. The credit is equal to 50 percent of the fair market value of the qualifying donated property, not to exceed $100,000 per taxpayer, per contribution. The tax credit is nonrefundable and nontransferable, but may be carried forward for up to 20 years. Amounts not qualifying for the tax credit may be claimed as an itemized charitable deduction. Mr. Good compared Iowa's CCC tax credit to similar CCC tax credits in other states and to similar federal tax incentives. He also provided data on donations by county and donee organization. The tax credits were analyzed according to year, household adjusted gross income, claimant's age and residency, and the number, amount, and the timing of the claims. Mr. Good further analyzed the tax credit's cost to the state and its usage in relation to all similar donations. Finally, Mr. Good discussed some conclusions from his analysis, notably that donations are clustered in geologically significant areas of the state, that claimants tend to be older, higher-income individuals, that over 80 percent of claimants are Iowa residents, and that the 20-year carryforward appears to be sufficient for most claimants to fully utilize the credit.

## D. New Jobs Tax Credit

Mr. Zhong Jin, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented background information and statistical analysis on the new jobs tax credit. The new jobs tax credit was originally enacted in 1985 and is available against the individual or corporate income tax for taxpayers who enter into an Industrial New Jobs Training Program contract with an Iowa community college and who create jobs above a certain base employment level. The tax credit equals 6 percent of the taxable wages of each created job, not to exceed the qualifying taxable wage for unemployment purposes ($27,300 in 2015). The tax credit is nonrefundable and nontransferable but may be carried forward for up to 10 years. Mr. Jin analyzed the number and amount of tax credit claims by tax year and tax type, and compared the new jobs tax credit claims to investment tax credit claims. The investment tax credit is a different tax credit available under the High Quality Jobs Program, which is a highly utilized job creation program administered by the Economic Development Authority (EDA).

Mr. Jin used data gathered from the Industrial New Jobs Training Program database maintained by EDA to categorize tax credits according to their association with each community college and the industry within which each claiming business operates. He used this database and Iowa Workforce Development unemployment insurance payment data to present three different estimates of jobs created from the new jobs tax credit. Mr. Jin compared business growth rates of Industrial New Jobs Training Program participants with and without new jobs tax credit claims. Finally, he highlighted that on average only one-third of businesses eligible to claim the new jobs tax credit actually do so.

Mr. Tim Whipple, General Counsel, EDA, spoke briefly on the new jobs tax credit and EDA's relationship to the credit. EDA neither awards new jobs tax credits nor administers the associated Industrial New Jobs Training Program, but it does play a limited role in reviewing the program. Mr. Whipple expressed support for a legislative review of the new jobs tax credit, especially given its 30-year existence, and stressed that such a review should be done in the context of all the state's current job creation programs. He noted that in recent years many tax incentives for job creation have been consolidated within EDA in an effort to increase effectiveness and efficiency, and reduce duplication.

## E. Assistive Device Corporate Tax Credit

Mr. Whipple additionally provided a brief background of the assistive device corporate tax credit, which is equal to 50 percent of the first $5,000 expended by a corporation for obtaining assistive device technology to aid an employee who is an individual with a disability. The tax credit is awarded by EDA. Mr. Whipple noted that the tax credit was originally available under both the individual and corporate income taxes. Both credits were repealed by the General Assembly in 2009 (see 2009 Iowa Acts, ch. 179, §§134, 151), but the Governor item vetoed the repeal of the corporate tax credit. Mr. Whipple stated that the corporate tax credit has never been claimed.

## F. Iowa Alternative Minimum Tax Credit

Ms. Angela Gullickson, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the Iowa alternative minimum tax (AMT) credit available against individual, corporate, and franchise taxes, and equal to the amount of Iowa AMT paid by the taxpayer in previous years. In order to claim the AMT credit, the taxpayer must not owe AMT in that same tax year. The AMT credit is nonrefundable and may be carried forward indefinitely. Ms. Gullickson gave a brief background of the Iowa AMT and the federal AMT and AMT credit and then reviewed how the AMT and AMT credit are imposed or offered in other states. She also analyzed the amounts of AMT paid and AMT credits claimed by year and tax type, and categorized the percentage of total individual taxpayers paying AMT or claiming the AMT credit by adjusted gross income.

## G. Claim of Right Tax Credit

Ms. Gullickson additionally presented a report on the claim of right tax credit, available to individual taxpayers who are required to repay income in the current tax year that was reported and taxed on a prior Iowa tax return. The credit is equal to the amount of tax paid on the repaid income and is refundable and nontransferable. Alternatively, a taxpayer may deduct the repaid income from Iowa net income. Ms. Gullickson provided background on the federal claim of right tax credit and similar tax credits in other states. She analyzed the tax credit and alternative tax deduction according to year, number of claims, amount claimed, and average claim.

## H. S Corporation Apportionment Tax Credit

Dr. Harris presented a report on the S corporation apportionment tax credit available to individual taxpayers who are shareholders of an S corporation that conducts business in Iowa and other states. In lieu of including all the S corporation income in net income and then claiming the out-of-state tax credit for taxes paid on that income to other states, S corporation shareholders may apportion the relevant income in the same manner as C corporations do under the corporation income tax. The S corporation apportionment tax credit equals the amount of total income tax attributable to S corporation income earned outside of Iowa.

Dr. Harris outlined some of the benefits of the S corporation apportionment tax credit and discussed how other states apportion income from pass-through business entities. She provided data by year on the number of tax credit claims made, the total amount of tax credits available and claimed, the average tax credit claim, and the percentage of available tax credits claimed. She also provided data on the household adjusted gross income distribution for all taxpayers versus claimants of the S corporation apportionment tax credit.

## I. Fuel Tax Credit

Ms. Gullickson provided a report on the fuel tax credit available against the individual and corporate income taxes equal to the amount of Iowa fuel tax paid relating to purchases for tax-exempt off-road uses. The tax credit is refundable and nontransferable. Ms. Gullickson examined how neighboring states handle the overpayment of fuel taxes, described the requirements for claiming the tax credit and the manner in which it is claimed, and provided data by year on the number of fuel tax credit claims, the total amount of fuel tax credits claimed, and the average fuel tax credit claim.

## III. December 9, 2015, Meeting

The committee received presentations and conducted a review of the following:

## A. Update on Reporting for Tax Increment Financing

Mr. Jeff Robinson, Senior Fiscal Analyst, Fiscal Services Division, Legislative Services Agency (LSA), presented a preliminary report on tax increment financing (TIF) reporting data for FY 2014-2015. Mr. Robinson provided a brief history of the TIF reporting requirements and the reports released to date. TIF reporting requirements were enacted in 2012 and require local governments with existing urban renewal areas to annually report a variety of data to the Department of Management through a state Internet site to be incorporated into a report to be submitted to the General Assembly and the Governor. He noted that as of December 6, 2015, a total of 412 of an expected 475 reports (86.7 percent) have been filed by local governments for FY 2014-2015. Mr. Robinson provided aggregate data on the financial status of TIF revenue and data on the amount and type of debt reported by local governments, including data on the 10 local governments with the highest reported TIF debt. He noted that the data presented to the committee is preliminary and that final numbers would be presented in the LSA's annual report released in early 2016.

## B. School Tuition Organization Tax Credit

Dr. Harris provided background information and statistical analysis on the school tuition organization (STO) tax credit, which was first reviewed by the committee in 2012. The STO tax credit is a nonrefundable tax credit equal to 65 percent of the amount of voluntary cash contributions made to qualifying STOs that provide tuition grants to eligible students. Donors are prohibited from directing contributions to a specific student or school, but can choose a specific STO. In order to be eligible to receive a tuition grant from an STO, a student must live in an Iowa household whose total income does not exceed three times the federal poverty level. Tuition grants cover all or part of the tuition at an accredited nonpublic elementary or secondary school. Dr. Harris provided historical data on STO tax credit aggregate award caps since its inception (currently $12 million per year), described the administrative process by which IDR annually allocates this aggregate cap among the STOs, and provided data on how the tax credit cap will be allocated among the existing STOs in 2016. Dr. Harris also described the STO annual reporting requirements and IDR's monitoring requirements. She provided data on STO tuition grants; STO tax credit awards and claims by taxpayer type, number, and amount; and the timing of STO tax credit claims per available tax year.

## C. Volunteer Fire Fighter, Emergency Medical Services Personnel, and Reserve Peace Officer Tax Credit

Dr. Harris provided background information and statistical analysis on the tax credit available to volunteer fire fighters, emergency medical services (EMS) personnel, and reserve peace officers for voluntary services performed in Iowa. This nonrefundable tax credit equals $100 per volunteer per year and is prorated for those who serve for less than an entire year. Taxpayers may only claim the credit for one type of service. She described eligibility requirements under the credit for volunteer fire fighters, volunteer EMS personnel, and reserve peace officers. She also provided data on tax credit claims for both 2013 and 2014 by filing status, adjusted gross income, and county.

## D. Solar Energy Tax Credits

Dr. Harris provided background information and statistical analysis on the solar energy tax credit, a nonrefundable tax credit available for solar energy systems installed at a residence or business in Iowa. The credit is equal to 60 percent of the related federal credits for installations occurring in 2015, reduced to 50 percent for installations occurring on or after January 1, 2016. The federal credits are scheduled to expire at the end of 2016, which would also end the availability of the state credits. The credit is limited to $5,000 for each separate residential installation and $20,000 for each separate business installation. The credit also has an aggregate cap of $5 million per year. Dr. Harris explained the solar tax credit application requirements and provided data on tax credit awards by installation type, number of awards, average award, installation year, and location of installation. She also analyzed tax credit claims by tax type and amount carried forward. Additionally, she noted that the solar tax credit application process has been moved entirely online into IDR's tax credit award claim and transfer system (CACTAS), the online system supporting the tax credit administration responsibilities of IDR and other state agencies that facilitate tax credit award programs. She stated that CACTAS eliminates time-consuming data entry and makes the review process more efficient.

## E. Machinery and Equipment Sales and Use Tax Exemptions

Dr. Harris and Ms. Victoria Daniels, Public Information Officer and Legislative Liaison, IDR, discussed the machinery and equipment sales and use tax exemptions in Iowa Code sections 423.3(47) and 423.3(48), and the recent administrative rule changes related to these exemptions proposed in ARC 2178C and ARC 2239C. Ms. Daniels provided a brief historical background on IDR's proposed administrative rule changes, previous efforts to address these issues through legislation, and the estimated fiscal impact of these rules to state tax revenues. Dr. Harris provided data and statistical analysis of the estimated impact these administrative rules may have on sales and use tax revenues transferred to local governments. The changes are expected to reduce local option sales tax (LOST) revenues and the amount of tax revenue transferred to the Secure an Advanced Vision for Education (SAVE) Fund, and have the potential to reduce the amount of funds transferred to flood mitigation projects under Iowa Code chapter 418 and to reinvestment district projects under Iowa Code chapter 15J because those programs rely on new sales tax revenues. She explained the limitations on using sales and use tax return data to estimate impacts to specific local governments, and discussed the assumptions IDR made in producing its estimates. Dr. Harris discussed the share of manufacturing in flood mitigation districts and provided data on the statewide distribution of sales and use tax liability by tax type for all permit holders and for manufacturers, the estimated retail taxable sales by business group in the flood mitigation districts, and the share of taxable retail sales remitted by manufacturers among the flood mitigation districts compared to statewide. Additionally, she provided data on the potential revenue impact to SAVE and the Property Tax Equity and Relief Fund, and translated those impacts into an estimated impact per pupil.

## IV. Materials Filed with the Legislative Services Agency

The following materials listed were distributed at or in connection with the meetings and are filed with the Legislative Services Agency. The materials may be accessed from the "Committee Documents" link on the committee's Internet Site:
https://www.legis.iowa.gov/committees/committee?ga=86&groupID=594

### A. November 18, 2015, Meeting:

1. Beginning Farmer Tax Credit Program — Department of Revenue.
2. Beginning Farmer Tax Credit Program — Iowa Finance Authority.
3. Charitable Conservation Contribution Tax Credit — Department of Revenue.
4. Franchise Tax and Moneys and Credits Tax — Department of Revenue.
5. Fuel Tax Credit — Department of Revenue.
6. Iowa Alternative Minimum Tax Credit — Department of Revenue.
7. Iowa Bankers Association Handout.
8. Iowa Credit Union League Handout.
9. New Jobs Tax Credit — Department of Revenue.
10. REVISED Claim of Right Tax Credit — Department of Revenue.
11. S Corporation Apportionment Tax Credit — Department of Revenue.

### B. December 9, 2015, Meeting:

1. Additional Information on Tax Expenditures — Department of Revenue.
2. Local Impacts of Machinery and Equipment Sales Tax Exemption Proposed Rules — Department of Revenue.

**3.** Machinery and Equipment Sales and Use Tax Exemption Proposed Rules.

**4.** Machinery and Equipment Sales and Use Tax Exemption Statutes.

**5.** Preliminary TIF Reporting Data — Legislative Services Agency.

**6.** School Tuition Organization Tax Credit — Department of Revenue.

**7.** Solar Energy System Tax Credit — Department of Revenue.

**8.** Volunteer Fire Fighter, EMS, and Reserve Peace Officer Tax Credit — Department of Revenue.

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Respectfully submitted,

Senator Joe Bolkcom, Co-chairperson

Representative Thomas R. Sands, Co-chairperson