REPORT OF THE LEGISLATIVE TAX EXPENDITURE COMMITTEE
TO THE LEGISLATIVE COUNCIL
June 22, 2017

I. Committee Proceedings

The Legislative Tax Expenditure Committee conducted two meetings at the Statehouse during the 2016 Interim on Wednesday, November 30, 2016, and Monday, December 19, 2016. Senator Joe Bolkcom and former Representative Tom Sands served as co-chairs of both meetings.

II. November 30, 2016, Meeting

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

A. Property Tax Credit and Claims

1. Homestead Property Tax Credit. Dr. Tony Girardi, Senior Fiscal Policy Analyst, Iowa Department of Revenue (IDR), provided an overview of the criteria and operation of the homestead property tax credit under Iowa Code chapter 425. The homestead tax credit was enacted in 1937 and is available to Iowa residents who own a home in Iowa and occupy that property for at least six months of the year. Special occupancy rules apply for active duty military personnel and persons confined to nursing homes or other similar facilities. Only one homestead tax credit is allowed per taxpayer and the credit may be applied for with the local assessor.

The tax credit, when fully funded by the state, equals the amount of property taxes owed on the first $4,850 of taxable value of the homestead. This equates to a statewide average homestead property tax credit of $170. The tax credit application is made to the local assessor, and the IDR reimburses each county for its total claim amount through a standing unlimited appropriation. The tax credit has been fully funded by the state for the previous three fiscal years (FY 2014-2016). The total state funding amount was $131.7 million in FY 2014, $131.4 million in FY 2015, and $135.9 million in FY 2016. Dr. Girardi explained the reduction in funding during FY 2015 to be the result of an assessment limitation imposed on residential property. Despite fully funding the credit in recent years, the average state funding rate for the previous decade is 73 percent. Dr. Girardi explained the procedure used to prorate the tax credit claims when the state funding is capped.

The homestead credit provided to certain disabled veterans was enacted in 1990 as a component of the homestead property tax credit. The credit operates similarly to other homestead credits under Iowa Code chapter 425, but the credit is only available to a military veteran, including certain family members of a military veteran, if the veteran meets certain disability rating requirements or acquired the homestead under certain federal provisions relating to adaptive housing for disabled veterans. The disability thresholds for the credit are a permanent service-connected disability rating of 100 percent, as certified by the United States Department of Veterans Affairs, or a permanent and total disability rating based on individual unemployability that is compensated at the 100 percent disability rate, as certified by the United States Department of Veterans Affairs.

The disabled veteran homestead property tax credit applies to a maximum of one-half acre of urban land or 40 acres of rural land, and equals 100 percent of the property tax on the homestead. Dr. Girardi explained recent amendments to the tax credit that removed the income limitation and expanded eligibility. In the two most recent fiscal years, there were 2,128 claimants of the credit with a total state cost of $5.3 million and 2,261 claimants of the credit with a total state cost of $5.8 million, respectively.

2. Elderly and Disabled Property Tax Credit. The elderly and disabled property tax credit was enacted in 1983 and is available to homeowners and renters who are at least 65 years old, or totally disabled, and who have household income below a certain threshold amount ($22,584 for 2017). Dr. Girardi explained that the credit amount does not increase as the result of age once the claimant reaches the minimum age requirement. The household income threshold is indexed to inflation each year and the tax credit rate decreases as the taxpayer's household income increases. Dr. Girardi analyzed the 2017 tax credit rate schedule by household income.

Homeowners receive a property tax credit and apply annually with the county treasurer. Renters receive a rent reimbursement and apply annually with IDR. The maximum property tax credit/rent reimbursement is $1,000 per year. Both are funded by the state through a standing unlimited appropriation. According to Dr. Girardi, the total cost to the state for the elderly and disabled property tax credit was $5.1 million in FY 2014, $5.0 million in FY 2015, and $4.9 million in FY 2016. He also explained the procedures for paying claims and for prorating claims when the state funding is capped.

Dr. Girardi also provided cost data related to the elderly and disabled rent reimbursement refunds. For FY 2014, there were 29,969 claimants with a total state cost of $18.4 million, and an average refund amount of $615. For FY 2015, there were 30,588 claimants with a total state cost of $19.1 million, and an average refund amount of $626. For FY 2016, there were 32,410 claimants with a total state cost of $19.6 million, and an average refund amount of $606.

3. Military Service Property Tax Credit. The military service property tax credit was enacted in 1987 and provides property tax relief to qualified veterans through a property tax exemption that exempts the first $1,852 of taxable value ($2,778 for World War I veterans) of property owned by the veteran. The state reimburses the counties for the property tax reduction associated with the tax rate of $6.92 per $1,000 of valuation, and the counties forgo the remaining amount of property tax associated with the tax exemption.

Dr. Girardi discussed the state funding for these claims over the previous three fiscal years (FY 2014-2016), the tax exemption distribution by county, and the average number of veterans benefiting each year from the exemption.

4. Agricultural Land and Family Farm Property Tax Credits. The agricultural land tax credit, enacted in 1939, and the family farm tax credit, enacted in 1990, both apply to land used for agricultural or horticultural purposes in tracts of 10 acres or more, and land less than 10 acres if contiguous to qualifying land of 10 acres or more. The family farm tax credit additionally requires ownership and active farming of the land. The credits are used to offset school taxes in school districts where the tax rate exceeds $5.40 per $1,000 of valuation. Both credits are funded by the state through a standing limited appropriation of $39.1 million, $10 million of which is allocated to the family farm tax credit. Dr. Girardi discussed fiscal year data on the tax credits by request and demand, state appropriation amount, and funding level. The average state funding for the credit over the last 14 years for the agricultural land tax credit and the family farm tax credit is 20 percent and 16 percent, respectively. Dr. Girardi noted that if the state were to fully fund these tax credits in FY 2017, it would cost an estimated $170 million.

5. Business Property Tax Credit and Commercial and Industrial Property Tax Replacement Claims. The business property tax credit and the commercial and industrial property replacement claims were both enacted in 2013. The business property tax credit applies to qualifying commercial, industrial, and railroad property units, and is funded by the state through a standing limited appropriation which began at $50 million for FY 2013, increased to $100 million in FY 2014, and has been set at $125 million since FY 2015. The tax credit application is made by the property owner and continues until ownership changes. Dr. Girardi discussed the tax credit calculation and provided data on tax credit distribution by county, and provided fiscal year data on the tax credits by state funding, maximum assessed valuation and credit, total units receiving the credit, and the percentage of property units with an assessed valuation that is less than the maximum. From assessment year 2013 to assessment year 2015, the percentage of property units receiving the credit that have an assessed value that is less than the maximum has grown from 36 percent to 70 percent as the annual appropriation increased to the $125 million level.

The commercial and industrial property replacement claims were established to backfill the phased-in 10 percent rollback for commercial and industrial property classes. Railroad property was also provided a phased-in 10 percent rollback, but that value is not included in the backfill funded through the replacement claims. The claims were funded by the state through a standing unlimited appropriation through FY 2017, but will be capped at $152.1 million per year after FY 2017 and claims will be prorated accordingly. Dr. Girardi presented historical data on state funding for the replacement claims by amount and by county.

B. Sales Tax Levy for the Secure an Advanced Vison for Education (SAVE) Fund

Dr. Amy Rehder Harris, Administrator and Chief Economist, Tax Research and Program Analysis Section, IDR, presented an overview of the SAVE Program, a 1 percent statewide sales tax dedicated to the SAVE Fund enacted in 2008 to replace the 1 percent school infrastructure local option sales tax previously adopted by all 99 counties. Since FY 2015, 97.9 percent of the SAVE Fund revenues are distributed to school districts on a per-pupil basis, and 2.1 percent are distributed to the Property Tax Equity and Relief (PTER) Fund to provide tax relief to certain school districts that have an adjusted additional levy rate above the statewide average. Dr. Harris provided fiscal year data on per-pupil funding and PTER funding, and described the IDR's role in collecting, calculating, and distributing the SAVE Fund dollars. Dr. Harris also provided data on the historical and projected future SAVE Fund revenue amounts, including the projected future growth in the per-pupil SAVE distribution. Finally, Dr. Harris provided sample data on the estimated impact that several sales tax exemptions have on the SAVE Fund dollars and, more specifically, the per-pupil SAVE distribution.

Mr. Kent Ohms, Legislative Analyst, Fiscal Services Division, Legislative Services Agency, provided a short overview of the Department of Education's SAVE Annual Report for FY 2015, and used that report and other sources to present data on historical SAVE Fund revenues and expenditures for FY 2011-2015, as well as FY 2015 data on revenues and expenditures by school enrollment category, and expenditures by function and object.

III. December 19, 2016, Meeting

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

A. High Quality Jobs Program

Ms. Debi Durham, Director, Iowa Economic Development Authority (IEDA), and Dr. Zhong Jin, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, each made presentations on the High Quality Jobs Program (HQJP). Director Durham spoke broadly about the purpose of the HQJP and its various tax and other incentives, and provided historical data on the amount of direct assistance and tax credit awards made under the HQJP to eligible businesses both before the IEDA underwent a substantial reorganization in 2012, and after such reorganization. From October 2005 through June 2012 (prereorganization), IEDA provided $60,340,400 of direct financial assistance and made $537,622,067 in tax credit awards. From July 2012 through November 2016 (postreorganization), IEDA provided $36,962,500 in direct financial assistance and made $327,265,163 in tax credit awards. This financial assistance and tax credit data was then analyzed according to the number of jobs created or retained, and amount of capital investment made, by eligible businesses under HQJP agreements. Finally, Director Durham discussed several case studies from eligible businesses that have entered into HQJP agreements with IEDA.

Dr. Jin described the HQJP's state tax incentives consisting of the investment tax credit, the sales and use tax refund, and the supplemental research activities tax credit, and provided data on those tax incentives for tax years 2006-2014 by total claims, average claims, claims by tax type, claims by industry, and claim share for all projects by award year. He described several reasons why a portion of the tax incentive awards go unclaimed by the eligible businesses. Dr. Jin next analyzed HQJP projects that were completed in good standing from 2005 through 2010, meaning the eligible business completed the project and fulfilled the agreement, including the five-year performance and maintenance period of the agreement, without being put into default by IEDA. This group comprises 110 projects which were awarded a total of $196.9 million of tax incentives, $115.4 million of which have been claimed to date. The proportion of tax incentives claimed for these projects was analyzed by award year and incentive type.

Dr. Jin explained how he examined the effectiveness of the HQJP using historical and other data in an attempt to answer several questions related to whether the HQJP creates an incentive to invest in Iowa, whether the HQJP's investments have a measurable economic impact on the local economy, and whether the HQJP provides an incentive in location choices. He stressed the natural limits of engaging in such an examination using the available data because it is difficult to know how the economy would have behaved in the absence of the HQJP. Dr. Jin explained his experiments, including his hypotheses, testing approaches and measurements, analysis examples, estimation results, and caveats. Dr. Jinstated that his analysis suggests the HQJP can likely serve to incentivize investment decisions between states, and that HQJP projects do spur additional economic activity.

B. Franchise Tax Credit

Dr. Mandy Jia, Senior Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the franchise tax credit, which is a nonrefundable administrative tax credit available to shareholders of financial institutions organized as S corporations. It is provided to avoid double taxation because S corporation financial institutions are themselves subject to the franchise tax. The tax credit generally equals the shareholder's pro rata share of the Iowa franchise tax paid by the financial institution. Dr. Jia explained the history, calculation, and key features of the tax credit. She also explained the structure and calculation of the Iowa franchise tax, the taxation of financial institutions in other states, a profile of franchise tax taxpayers in tax year 2014, and the historical distribution of Iowa franchise tax revenues. Dr. Jia analyzed franchise tax revenues versus tax credit claims, as well as franchise tax credits available, claimed, and expired by tax year. For fiscal years 2007-2015, annual Iowa franchise tax revenues averaged $31.5 million, and annual Iowa franchise tax credit claims averaged $15.5 million. Tax credit claims were also analyzed by residency status and income group. Finally, Dr. Jia provided options for potential administrative changes to eliminate the tax credit.

C. Research Activities Tax Credit

Dr. Girardi, IDR, presented a report on the Iowa research activities tax credit (RAC) and the Iowa supplemental research activities tax credit (Supplemental RAC), which are refundable tax credits for increases in qualifying expenditures associated with research conducted in Iowa. The RAC is an automatic credit for those taxpayers who meet the requirements, while the Supplemental RAC is awarded by the IEDA under the HQJP. Dr. Girardi provided background information on the RAC, including its relationship to the federal research activities tax credit.

Dr. Girardi also described the two calculation methods for the RAC, the regular method and the alternative simplified method. The regular method has been available since 1985, and the alternative simplified method has been available since 2010. Taxpayers may choose either method in calculating their RAC. Dr. Girardi estimated that each method is used by about half of the claimants. He also described the calculation of the Supplemental RAC, including recent changes made in 2011 which vary the tax credit rate according to the taxpayer's gross revenues.

Dr. Girardi gave an overview of the federal research activities credit and similar credits in other states. He then provided statistical data regarding the tax credits earned by tax year and by calculation method, and the amounts and percentages paid as refunds. Finally, Dr. Girardi explained how he examined the effectiveness of the tax credits using historical and other data in an attempt to answer several questions related to the impact of the availability of the alternative simplified calculation method on firms' research spending, the impact of calculation changes to the tax credits, and the research spending generated by the tax credits in Iowa.

D. Earned Income Tax Credit

Mr. John Good, Fiscal Policy Analyst, Tax Research and Program Analysis Section, IDR, presented a report on the Iowa earned income tax credit (EITC), which is a refundable tax credit equal to 15 percent of the federal EITC. Mr. Good summarized the qualifications for the federal EITC, and provided history regarding the Iowa EITC and information on similar credits in other states. He also provided numerous historical data for the Iowa EITC, including the number and amount of claims by tax year and amounts paid as refunds; and tax year 2014 claims by filing status, number of dependents, age, household adjusted gross income, and county. He noted that many Iowa EITC claimants also receive other state assistance, and provided some information on that assistance and the number of Iowa EITC claimants receiving that assistance. Mr. Good provided longitudinal data on Iowa EITC claimants' future utilization of the Iowa EITC after the first year it is claimed by that person. This included comparison data between one-year and long-term Iowa EITC claimants, the average claim each year, the major reasons for moving in and out of claiming the Iowa EITC, and the average wage growth of the claimants. Finally, Mr. Good analyzed several Iowa EITC data sources relating to characteristics of EITC claimants as such data compares and correlates to the minimum wage and federal poverty guidelines.

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/perma/051120171679.

A. November 30, 2016, Meeting:

1. Property Tax Credits, Tony Girardi, PhD, Iowa Department of Revenue

2. Secure an Advanced Vision for Education (SAVE), Amy Rehder Harris, PhD, Iowa Department of Revenue

3. Legislative Report, FY 2015 SAVE Annual Report, Iowa Department of Education

4. FY 2015 Certified Annual Report, SAVE Fund Expenditures by Function and Object, Kent Ohms, Fiscal Division, Legislative Services Agency

5. SAVE Annual Report Five Years, Kent Ohms, Fiscal Division, Legislative Services Agency

6. SAVE Annual Report by Enrollment Category FY 2015, Kent Ohms, Fiscal Division, Legislative Services Agency

B. December 19, 2016, Meeting:

7. Earned Income Tax Credit, Department of Revenue

8. Franchise Tax Credit, Department of Revenue

9. High Quality Jobs Program, Department of Revenue

10. High Quality Jobs Program Presentation, Economic Development Authority

11. High Quality Jobs Program Report, Economic Development Authority

12. Research Activities Tax Credit, Department of Revenue

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Respectfully submitted,

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Senator Randy Feenstra,
Co-chairperson

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Representative Guy Vander Linden,
Co-chairperson