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## LEGAL UPDATE

Legal Services Division



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### LEGISLATIVE TAX EXPENDITURE COMMITTEE — DECEMBER 3, 2021

**Purpose.** *Legal updates are prepared by the nonpartisan Legal Services Division of the Legislative Services Agency. A legal update is intended to provide legislators, legislative staff, and other persons interested in legislative matters with summaries of recent meetings, court decisions, Attorney General Opinions, regulatory actions, federal actions, and other occurrences of a legal nature that may be pertinent to the General Assembly's consideration of a topic. Although an update may identify issues for consideration by the General Assembly, it should not be interpreted as advocating any particular course of action.*

**Overview.** In 2010 Iowa Acts, ch. 1138 (SF 2380), established the Legislative Tax Expenditure Committee under Iowa Code §§2.45(5) and 2.48. The committee is required to conduct regular reviews of tax credit, withholding credit, and revenue division programs. The committee may review any tax expenditure at any time but is required to review specific tax expenditures during specified years. However, due to the pandemic, the committee did not meet during the 2020 calendar year and did not review the tax credits scheduled to be reviewed. Therefore, the committee reviewed the tax credits scheduled to be reviewed in both 2020 and 2021. Senator Dan Dawson and Representative Lee Hein served as co-chairpersons of the committee.

**State Chief Economist.** Dr. Robin Anderson, State Chief Economist, Department of Revenue (DOR), introduced herself to the committee and spoke broadly about the tax credit analysis program within the DOR. Dr. Anderson emphasized that the studies conducted by the department are objective and are not intended to be value judgments of the tax credits. Dr. Anderson also stated that the Pew Charitable Trusts concluded the state of Iowa excels at rigorously measuring the economic and fiscal impact of tax incentive programs.

**High Quality Jobs Program.** Ms. Debi Durham, Director, Economic Development Authority, and Dr. Zhong Jin, Senior Fiscal and Policy Analyst, DOR, each made presentations on the High Quality Jobs Program (HQJP). Director Durham provided historical data on the amount of capital investments made and direct and indirect jobs created. From January 2011 through June 2021, total capital investments by eligible businesses under the HQJP total \$18,537,146,692 which resulted in 75,017 direct and indirect jobs in Iowa. Director Durham provided the committee with the industry sector breakdown under the HQJP, and noted that manufacturing constitutes over 67 percent of the projects.

Dr. Jin described the HQJP's major components, which consist of investment tax credits, sales and use tax refunds, the supplemental research activities tax credits, corporation income tax credits for third party sales tax, property tax exemptions, and grants. He provided data on tax incentives for tax years 2011-2021 by total claims, awards and claims by tax incentive component, awards by industry, and employment impact. Dr. Jin concluded the HQJP has a positive and statistically significant impact on industry employment and a positive and statistically insignificant impact on employment in counties where awards have occurred.

**Beginning Farmer Tax Credit.** Ms. Estelle Montgomery, Fiscal and Policy Analyst, DOR, provided background information on the beginning farmer tax credit. The program is capped at \$12 million per year. The tax credit is available to an owner of an agricultural asset that is subject to lease or rental by a beginning farmer, and the amount of tax credits that may be awarded to an eligible taxpayer shall not exceed \$50,000 per year per agreement. An asset owner may have multiple agreements, and the credit is nonrefundable and nontransferable except upon death. The credit is allowed if the asset owner and beginning farmer are related. Since 2007, there have been \$40.8 million in claims that incorporate 3,851 agreements and 1,004 beginning farmers.

**Charitable Conservation Contribution Tax Credit.** Mr. John Good, Senior Fiscal and Policy Analyst, DOR, presented a report on the tax credit for charitable conservation contributions (CCC) available against the individual and corporate income tax for certain qualifying contributions to conservation organizations in the form of conservation donations and 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. The tax credit is nonrefundable and nontransferable, but may be carried forward for up to 20 years. Mr. Good stated the counties with the most CCC land tend to be in northeast and north central areas of the state, or near the Neal Smith Wildlife Refuge. Mr. Good noted the tax credit claimants tend to be older, higher-income individuals, and residents of Iowa.

**New Jobs Tax Credit.** Dr. Jin presented background information and statistical analysis of 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 with an Iowa community college and who create jobs with a certain base employment level. Dr. Jin noted that 50 percent of the new job tax credit claims were associated with three community colleges: Kirkwood Community College, Des Moines Area Community College, and Indian Hills Community College. The utilization of the credit has been trending downward and only 8 percent of the companies eligible to claim the credit actually made a claim.

**Administrative Tax Credits.** Ms. Karen Tigges, Fiscal and Policy Analyst, DOR, presented an overview of the following administrative tax credits:

- **Fuel Tax Credit.** The tax credit is based on the amount of Iowa fuel tax paid for off-road use and is refundable and nontransferable. From 2015-2019, total claims averaged \$3.9 million per year. Approximately 19,000 claims are made each year, averaging \$200 per claimant. Eighty-eight percent of the claims submitted were related to agriculture.
- **Assistive Device Tax Credit.** The credit is available against the corporate income tax. The credit equals 50 percent of the first \$5,000 expended by a corporation for obtaining assistive device technology to aid an employee with a disability. This tax credit has never been claimed.
- **Claim of Right Tax Credit.** The credit is available to individual taxpayers who are required to repay income in the current tax year that was reported and taxed on a prior tax year. 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. Tigges provided background on the credit including the number of claims, amount claimed, and average claim.
- **S Corporation Apportionment Tax Credit.** The credit is 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 corporate income tax. Ms. Tigges provided data by year on the number of tax credit claims made and the total amount of tax credits available and claimed.
- **Alternative Minimum Tax Credit.** The credit is available against the individual, corporate, and franchise taxes, and is equal to the amount of extra Iowa alternative minimum tax (AMT) paid by the taxpayer in previous years. In order to claim the credit, the taxpayer must not owe AMT in that same tax year. The credit is nonrefundable and may be carried forward indefinitely. Ms. Tigges gave a brief background of the Iowa AMT and the federal AMT credit. She analyzed the average amounts of AMT paid and the number of AMT credits claimed each year. She noted the Iowa AMT is repealed for tax years beginning on or after January 1, 2023.

**Property Tax Credits.** Ms. Montgomery presented an overview of the following property tax credits:

- **Homestead Property Tax Credit.** This 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 is allowed per taxpayer. The 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. In fiscal year 2021, the credit was fully funded at a cost of \$127.4 million.
- **Disabled Veteran Homestead Property Tax Credit.** This credit was enacted in 1990 as a component of the homestead property tax credit that only applies to a military veteran, including certain family members

of a military veteran, if the veteran meets certain disability rating requirements or received their homestead under certain federal provisions relating to adaptive housing for disabled veterans. The tax credit applies to a one-half acre or less of urban land or 40 acres or less of rural land, and equals 100 percent of the property tax on the homestead. In fiscal year 2021, there were 5,250 claimants of the credit and it was fully funded at \$15.3 million.

- **Elderly and Disabled Property Tax Credit.** This credit was enacted in 1983 and is available to homeowners and renters who are at least 65 years of age, or totally disabled, and who have household income below a certain threshold amount depending upon the number of persons in the household. The household income is indexed to inflation and the tax credit decreases as the taxpayer's household income increases. In 2021, the property tax credit was funded at \$4.3 million, and the rent reimbursement credit was funded involving 19,035 claimants totaling \$13.4 million in credits.
- **Military Service Property Tax Exemption.** The credit was enacted in 1987 and provides property tax relief to qualified veterans through a property tax exemption that exempts the first \$1,842 of taxable value of property owned by a veteran. Exemption extends to surviving spouses. The population claiming this credit is declining. In 2021, the credit was fully funded at \$1.7 million.
- **Agricultural Land Property Tax Credits.** The agricultural land property tax credit was enacted in 1939 and the family farm tax credit was enacted in 1990; both apply to land used for agricultural or horticultural purposes in tracts of 10 acres or more. In 2021, the credit was funded at 20 percent, which equals \$143.9 million. The family farm property tax credit has the same purpose as the agricultural land tax credit but only extends to owners who actively farm the land. In 2021, the credit was funded at 14 percent, which is \$70.5 million.
- **Business Property Tax Credits.** The business property tax credit was enacted in 2013. The credit is available for commercial, industrial, or railroad property. In order to qualify for the credit, the property must be one or more contiguous parcels in the same county, be the same property class, and have the same ownership. The credit continues until ownership changes. The credit funding is capped by law at \$125 million.
- **Commercial and Industrial Property Replacement Claims.** The commercial and industrial property replacement claims were enacted in 2013. The credit is based upon the statutory reduction in the assessed valuation of all commercial and industrial property. In fiscal year 2021, the credit funding was \$152.1 million. Also, in 2021, the methodology for calculating and apportioning commercial and industrial property tax replacement claims for fiscal years beginning on or after July 1, 2022, but before July 1, 2029, was changed, and the appropriation was eliminated for fiscal years beginning on or after July 1, 2029.

**Franchise Tax Credit.** Ms. Tigges stated the credit is nonrefundable and 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 and the income then passes through to the shareholders of the S corporation who are also subject to tax. The tax credit generally equals the shareholder's pro rata share of the Iowa franchise tax paid by the financial institution. Ms. Tigges provided examples of the taxation of financial institutions in other states, and profiled franchise taxpayers based upon adjusted gross income from 2013-2020. For fiscal year 2020, the net franchise tax revenues equaled \$66.5 million, and franchise tax credit claims equaled 40.5 percent of the franchise tax revenues.

**Earned Income Tax Credit.** Mr. Good 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, provided history of the Iowa EITC, and provided information on similar credits in other states. He also provided numerous historical data points for the Iowa EITC, including the number of claimants by tax year, the amounts paid as refunds, 2019 claims by filing status, the number of dependents impacted, and claimant's household adjusted gross income. Mr. Good provided reasons for taxpayers moving in and out of the EITC from tax years 2010-2019, and the poverty status of 2019 Iowa EITC claimants with and without EITC. He stated approximately \$750 million in EITC claims have been claimed since 1990.

**Research Activities Tax Credit.** Mr. Cody Schmidt, Fiscal and Policy Analyst, DOR, 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 incremental 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 EDA under the HQJP. Mr. Schmidt provided background information on RAC including its relationship to the federal RAC. He described the two calculation methods for the RAC: the regular method and the alternative simplified method. Mr. Schmidt then provided statistical data regarding the tax credits earned by tax year and by calculation method, and the amounts and percentages paid as refunds. In 2020, there was \$81.9 million in refunds. Mr. Schmidt also presented some analysis of the impact of such credits.

**Committee Discussion.** The co-chairpersons thanked the presenters and several members of the committee discussed the RAC and some expressed a desire to comprehensively review this tax credit.

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