

Why Sierra Club cares about tax credits

As Iowa's legislature has tightened the state budget over the last few years, the tax credits given to businesses, particularly to the largest corporations operating in the state, have been growing.

When a tax credit is authorized, the credit effectively is an expenditure of tax-payer money. It reduces the amount of revenue collected by the state. All things equal, other tax payers have to make up the difference when a credit is given.

The important thing is that parts of government that we care about are not adequately funded when tax credits reduce the tax collections. Right now, water quality improvements are not funded, the Department of Natural Resources is severely underfunded, higher education is underfunded, we have flooding concerns across the state that need financial support, we have made little effort as a state to reduce climate change effects, the courts are underfunded, on and on. Although some of these issues are policy related, they are also related to having limited funds available to solve them.

Furthermore, we have absolutely no idea if we, the taxpayers, are getting our money's worth for the credits that are awarded. We simply do not know if the tax credits doing what we want them to do.

Policy Considerations

Tax credits can be divided into two categories – social tax credits and business development tax credits. In fiscal year 2019, the tax credits reached \$373 million.

Several conclusions can be drawn about business development tax credits:

1. None of the tax credits go through a cost-benefit analysis at any stage – from prior to implementation to periodic reviews. That also includes the social tax credits.
2. There is a tax shift from beneficiaries to those who do not benefit.
3. The tax credit scheme is complex.
4. The tax credits extended to businesses in some counties is much greater than those in other counties. For example, some of Polk County's businesses that have benefited from large tax credits include Apple, Google, and Facebook, all very large international corporations.



5. The tax credit system picks winners and losers. Sometimes one company can benefit from tax credits while its competitors do not qualify. Smaller businesses often do not have access to tax credits. Often older businesses who have been established in the state do not qualify for tax credits while businesses moving in do.
6. Tax credit law is not consistent among the various tax credits. Some tax credits have caps on the amount of money that the state returns; others have no caps. Some tax credits have to be approved before they can be claimed; others do not have a pre-approval process.
7. Although the Department of Revenue keeps track of some of the pre-authorized tax credits, including the amounts and length of time that the credit can be claimed. It appears that some businesses forget that they have the tax credit due. The Department of Revenue does not send out statements of the amount remaining. That means that tax credits are left on the table.
8. There has been a massive growth in tax credits since 1983 when a series of tax credits were created in response to the farm crisis and recession. From that point onward, the legislature has created many new tax credits programs.
9. There is no central place to find the amount of money that the state spends on economic development. Some of the money is funded directly to Iowa Economic Development; some is spent through other agencies. Cities and counties invest in tax incentives for economic development. Federal grants also fund economic development in Iowa.
10. Business tax credits can be sold or used as collateral.
11. Some tax credits, such as the Research Activities Tax Credit, result in multi-million dollar refund checks to some of the largest corporations in the state, meaning that these corporations pay no income tax at all and, in fact, receive a payment. In 2019, the refund checks due to business tax credits was \$211 million.



Since 2017, all state and local governments that prepare their financial statements following the Generally Accepted Accounting Principles (GAAP) must report the amount of revenue that is forgone due to economic development tax abatement programs. The disclosure is done via a Government Accounting Standards Board (GASB) 77 note.¹ A report with no amount means that there was no revenue diverted to those programs or that the amount was not material. Failure to show an amount could also mean that the entity is not complying with the reporting

¹ Christine Wen, “Disclosing Tax Revenue Lost to Corporate Welfare: Are Local Governments Backsliding on Compliance”, Good Jobs First, May 29, 2020. See www.goodjobsfirst.org/blog/disclosing-tax-revenue-lost-corporate-welfare-are-local-governments-backsliding-compliance

requirement. One way you can verify that by cross-checking the city disclosure notes with the county and school district reports.²

Conclusions

It makes sense that the costs and benefits of the individual tax credits should be reviewed. In 2019, an interim committee of the legislature was assigned the responsibility to review the tax credits. The committee did not look into the tax credits in any detail.

There is no question that taxes matter to businesses. Tax credits can reduce the prices customers pay for products and services. Tax credits may also allow the business to increase wages. A business that is looking to locate or expand in a state can use the tax rates in the state as part of their decision.

There is no question that the tax credit policy is complex. Unraveling it will require a significant investment in researching the tax credits. Some of the tax credits that have been granted will exist for 20 years. Without further caps or retirements of some or all of the credits, the amount of money returned as tax credits will continue to grow. In the meantime, the programs that Sierra Club supports will continue to be underfunded.



² Christine Wen, “Nine Common Reasons Governments Decline to Provide Tax Abatement Disclosures”, Good Jobs First, June 29, 2020. See www.goodjobsfirst.org/blog/nine-common-reasons-governments-decline-provide-tax-abatement-disclosures

Glossary of Tax Credit Terminology

Administrative tax credit – Administrative tax credits are designed to avoid double taxation.

Automatic tax credit – A tax credit that can be claimed by any eligible taxpayer is called an automatic tax credit.

Awarded tax credit – Some tax credits are given by a state agency after the tax payer applies for the tax credit. These are awarded tax credits.

Caps – A cap is the maximum amount of money that can be spent on a given tax credit in a fiscal year or calendar year. Some awarded tax credits have a cap. Currently several awarded tax credits in aggregate have a cap.

Carryforward periods – For some tax credits, there is a length of time that the tax credit can be carried forward before it expires. That length of time is called a carryforward period.

Carryforward tax credits – For some tax credits, if there is not enough tax liability to use the full amount of the tax credits, then the taxpayer can claim the remaining amount of the tax credit on the next year's state income taxes.

Contingent liabilities report – Three times a year, the Department of Revenue creates a report of the tax credits that can be claimed in the current fiscal year. Both business development tax credits and social tax credits are shown on this report. This report is used to estimate that amount of revenue that will be collected by the state. The report lists the liability for each tax credit, such as the New Jobs and Income Program, the Ethanol Promotion Tax Credit, Research Activities Tax Credit, and so on.

Contractual obligations – An awarded tax credit is memorialized in a contract, which is called a tax credit certificate.

Nonrefundable tax credits – Non-refundable tax credits reduce the amount owed to the government. If the nonrefundable tax credit reduces the amount of tax owed to zero, the balance of the tax credit is not paid to the taxpayer.

Oversubscribed tax credits – An oversubscribed tax credit occurs when applicants have applied for more tax credits than the legislature has authorized for that tax credit, in dollar amounts.

Property tax abatement – Property tax abatements reduce or eliminate the amount of property taxes that are paid. The abatement is usually applied to new construction or major improvements.

Refundable tax credits - Refundable tax credits reduce the amount owed to the government plus if the refundable tax credit reduces the amount of tax owed to zero, the balance of the tax credit is paid to the taxpayer. Some refundable tax credits may limit the amount of the refund.

Single-year tax credit – A tax credit that can be taken in a given year and cannot be carried over to future years is called a single year tax credit.

Social tax credit – Social tax credits are used to influence or support personal individual taxpayer decisions. These taxes include the adoption tax credit, charitable conservation contribution tax credit, early childhood development tax credit, earned income tax credit, child and dependent care tax credit, and others.

Sunset – Some tax credits have dates when the tax credit is no longer available because the law set a termination date, hence it is sunset. The legislature can reauthorized a tax credit that has been terminated.

Tax credit – A tax credit is an amount of money that can be subtracted from taxes owed to the government. Tax credits reduce the taxes owed. They are not based on the income of the taxpayer nor are they subject to the tax rates.

Tax credit certificate – A tax credit certificate is a piece of paper that details the awarded amount of the tax credit. It serves as a contract and authorizes the taxpayer to make tax credit claims.

Tax increment financing - Tax increment financing is a scheme whereby a developer of a building project, the owner of a business, industry, or an investor group are able to fund the project by diverting some of their property taxes to pay for the project. The project can be a remodeling project, a building addition, or a new building. It can be commercial property or housing units.

Transferability – Some tax credits can be transferred from one taxpayer to another. The recipient can claim the full amount of the credit on their state income taxes. When a tax credit is transferred, the Department of Revenue must be contacted and a revised tax credit certificate is issued. The original owner does not pay income taxes on the sale of the tax credit and the new owner is not allowed to deduct the cost of the transferred tax credits on their Iowa tax returns.

Unclaimed tax credits – When tax credits are awarded, but are never claimed on income taxes, they are called unclaimed tax credits. Tax credits may be unclaimed because they expired before the taxpayer has enough tax liability to claim them; others are forgotten by the taxpayer.

Undersubscribed tax credits – An undersubscribed tax credit occurs when applicants have applied for fewer tax credits, in total dollar-amount, than the legislature has authorized for that tax credit.

Waitlisted – For some of the tax credits, when the cap for the tax credit has been met, other businesses who want the tax credit are put on a list until the next fiscal year or the next calendar year.

Appendix: Iowa Tax Credit Programs

Iowa's Tax Credit Programs – currently available to businesses and individuals.³

1. Accelerated Career Education Program: for employers sponsoring training at community colleges
2. Adoption Tax Credit: for individuals who incur adoption expenses
3. Assistive Device Tax Credit: for businesses making investments in assistive devices for disability workplace accommodation
4. Beginning Farmer Tax Credit: for taxpayers who lease agricultural assets to beginning farmers
5. Biodiesel Blended Fuel Tax Credit: per gallon credit given to retail dealers selling biodiesel blended fuel
6. Charitable Conservation Contribution Tax Credit: for taxpayers making a charitable donation of real property for conservation purposes
7. Child and Dependent Care Tax Credit: for individuals who have child and dependent care expenses
8. E15 Plus Gasoline Promotion Tax Credit: a per gallon credit given to gasoline retailers selling E15 or higher gasoline, but not E85
9. E85 Gasoline Promotion Tax Credit: a per gallon credit given to gasoline retailers dealers selling E85
10. Early Childhood Development Tax Credit: a credit of 25% of the first \$1,000 of expenses paid for early childhood development expenses for each dependent three to five years old
11. Earned Income Tax Credit: a credit for individual taxpayers who qualify for the federal earned income tax credit; it is 15% of the federal earned income tax credit
12. Endow Iowa Tax Credit: This credit is 25% percent of an endowment gift up to \$100,000 for a single taxpayer to a community foundation.
13. Ethanol Promotion Tax Credit: available to retail dealers who sell biofuels and who meet a threshold based on their annual sales; the credit is based on the amount of pure ethanol gallons sold
14. Farm to Food Donation Tax Credit: A taxpayer who donates food to a food bank or emergency feeding organization can claim a tax credit of 15% of the value of the donation.
15. Geothermal Heat Pump Tax Credit: a tax credit equal to 20% of the federal residential energy efficient property tax credit allowed for geothermal thermal heat pumps
16. High Quality Jobs Program: tax credits to companies that create high-paying jobs and make capital investments
17. Historic Preservation Tax Credit: a 25% tax credit for expenditures made in the rehabilitation of eligible historic properties
18. Iowa Industrial New Jobs Training Program: for businesses creating new positions that require employee training; the businesses divert their withholding taxes to the community college providing the training
19. Redevelopment Tax Credit: This credit is for investing in redeveloping a brownfield or grayfield site.
20. Renewable Chemical Production Tax Credit Program: a tax credit of \$0.05 per pound of renewable chemicals produced from biomass feedstock

³ Note, local governments can also grant tax credits, such as tax increment financing. Those grants are not included in this list.

21. Renewable Energy Tax Credit (476C): a tax credit given to a producer or purchaser of energy from a renewable energy facility
22. Research Activities Tax Credit: a tax credit available to taxpayers who increase research activities in manufacturing, life sciences, software engineering, or aviation and aerospace. The business must claim a Federal Research Credit.
23. School Tuition Organization Tax Credit: a credit of 65 percent of the cash contribution made to a school tuition organization
24. Solar Energy System Tax Credit (422.11L): a credit is available to taxpayers who install solar energy systems. Residential installations are no longer eligible for this credit.
25. Targeted Jobs Tax Credit from Withholding: a pilot program for businesses in four cities that provides a withholding credit of 3% of the gross wages paid to each employee under the withholding agreement and requires that the funds be used for an urban renewal project related to the employer.
26. Tuition and Textbook Tax Credit: a credit for parents who have children in kindergarten through twelfth grade attending an Iowa school of 25% of the first \$1,000 paid for each dependent for tuition and textbooks
27. Venture Capital Tax Credit – Innovation Fund: a credit for investments by businesses applying novel or original methods to manufacture a product or delivery a service
28. Venture Capital Tax Credit – Iowa Fund of Funds: a tax credit allowed for investments made into the Iowa Fund of Funds when the actual rate of return on these investments does not meet the rate of return guaranteed to investors
29. Venture Capital Tax Credit – Qualifying Business: a credit that is 25% of the equity investment made into a qualifying business
30. Volunteer Firefighter and Emergency Medical Services Personnel and Reserve Peace Officer Tax Credit: a credit is available to volunteer firefighters, volunteer emergency medical services personnel, and reserve peace officers
31. Wind Energy Production Tax Credit (476B): a credit awarded to electrical production facilities that produce electricity from wind
32. Workforce Housing Tax Incentive Program: a tax credit is available for completing a qualifying housing project in Iowa

Expired Tax Credit Programs – some of these programs may still be claimed by taxpayers, due to contracts or carry forward regulations

1. Custom Farming Contract Tax Credit: This credit, awarded to taxpayers hiring beginning farmers to perform custom contract farm work, was repealed as of December 31, 2017.
2. Enterprise Zone Program: This program encouraged business to invest in or expand in Iowa's economically distressed areas, called Enterprise Zones, through local and state tax credits, refunds and exemptions. This program was repealed in 2014.
3. New Capital Investment Program: This program was replaced by the High Quality Jobs Program.
4. New Jobs and Income Program: This program was replaced by the High Quality Jobs Program.
5. Taxpayers Trust Fund Tax Credit: This credit was repealed effective December 31, 2017. Its purpose was to distribute surplus funds to taxpayers.
6. Venture Capital Tax Credit – Venture Capital Funds: This credit, 6% of the equity investment made in a venture capital fund, was repealed in 2010.

Sources

Jeff Robinson, “State General Fund Tax Credits”, Legislative Services Agency Fiscal Services Division, October 30, 2019

Jeff Robinson, “Income Tax Credits – Fiscal Impact Background”, Legislative Services Agency Fiscal Services Division, October 22, 2019

Dr. Amy Rehder Harris, “Iowa Income Tax Credits Evaluation”, Iowa Department of Revenue, Power Point presentation to Tax Credit Review Committee, October 30, 2019

Dr. Amy Rehder Harris, “Iowa Income Tax Credits Mechanics”, Iowa Department of Revenue, Power Point presentation to Tax Credit Review Committee, October 30, 2019

Mike Mertens, “Tax Credit Sunsets and the State Budget”, Iowa Department of Revenue, Power Point presentation to Tax Credit Review Committee, October 30, 2019

Angela Gullickson, “Contingent Liabilities Report and the Budget”, Iowa Department of Revenue, Power Point presentation to Tax Credit Review Committee, October 30, 2019

“Tax Credits Contingent Liabilities Report”, Iowa Department of Revenue, October 14, 2019

Iowa Department of Revenue, “Tax Credits Users’ Manual: A Descriptive Guide to Iowa’s State Tax Credits”, October, 2020