

GIVING AWAY THE FARM

Iowa's Tax Credit Bonanza

Since 2000, Iowa lawmakers have created 24 new tax-credit programs and expanded a number of others. Most of these tax credits are designed to stimulate business growth, sometimes through very complex systems that involve selling or transferring of these credits as well as providing them for the firms themselves. Few have received much public scrutiny. Most have been the result of significant lobbying efforts by the groups most likely to make use of them.

In December 2007, the Iowa Department of Revenue released a 31-page report, *Tax Credits and Analysis Program 2007 Report to the General Assembly*, that provides available information on the impact of these tax credits on state and local revenue and also forecasts their future costs to the treasury. Filled with a lot of fine print, the report still should be a “must read” for lawmakers, advocates, researchers and reporters concerned about Iowa’s future fiscal capacity to meet ongoing obligations.

BEYOND THE FINE PRINT

The bottom line is that, even if the state experiences high rates of economic growth, state revenue likely will fall far short of keeping pace and funding essential services, particularly if the use of these tax credits continues to grow. The tax credits are creating an additional structural imbalance in the state budget that could mean lawmakers will face chronic shortfalls annually in trying to simply maintain current levels of funding commitments, over 60 percent of which is for education.

The following are among highlights of the report:

- From fiscal year 2001 through FY07, the state increased the number of tax credits it awarded nearly fivefold – from \$111 million to \$516 million per year. These credits are not taken all at once, but spread out over a number of years, so budget impacts are mostly felt in future years.
- The enterprise zone program tax credits and the high-quality job creation program tax credits [see box, page 2] accounted for the lion’s share of this increase, growing from \$61 million in FY01¹ to \$417 million in FY07.
- Between 2000 and 2006, the costs to the state treasury in individual income-tax reductions from business-related tax credits alone grew from \$24 million to \$86 million, partly as a transfer of the credits to investors who then used them to reduce their taxes from other sources of income.
- Even if no new enterprise zone or high-quality job creation tax credits are offered from this day forward, the state’s contingent liability for these tax-credit programs (the amount it is obligated to pay out each year) is projected to grow from \$304 million in FY08 to \$437 million in FY11.

This \$133 million built-in growth in tax-credit liability clearly leaves that much less state revenue to fund education, health, human services, environmental, workforce development, and other economic development programs, as well as address the impacts of inflation.

The Iowa Policy Project

120 N. Dubuque St. #208
Iowa City, IA 52245
(319) 338-0773 • www.iowapolicyproject.org

CHILD & FAMILY POLICY CENTER

1021 Fleming Building • 218 Sixth Ave.
Des Moines, IA 50309
(515) 280-9027 • www.cfpciowa.org

Because of their present and future costs to the state treasury, it is time to take a serious look at Iowa's use of tax credits to stimulate economic growth. Tax experts generally agree that credits should be used sparingly, particularly as business incentives, with most research showing they have very limited impacts on economic decisions, can distort normal market forces and provide unfair advantages to certain businesses over others, and tend to grow in size and use away even from their intended beneficiaries. This is because tax credits, unlike general fund appropriations, often have:

- No cap or upward limit on their size and cost to the treasury. This makes them open-ended drains on the treasury.
- No public disclosure of the beneficiaries of the credits. This thwarts an ability to determine whether credits are being used as they were intended.
- No annual review or required reauthorization by the General Assembly. This stands in contrast to the review and affirmative action to continue required of other state spending.
- Limited ability to target their use to businesses where they are needed in order to grow and develop, as opposed to businesses that would have grown and developed without the credits. These become windfalls rather than true incentives.
- No connection between who makes decisions on awarding the credits and who will be expected to cover their overall costs. This makes them appear as costless benefits to those who are making decisions about them.

Reviewing Iowa's tax-credit programs requires considerable study, and the Iowa Department of Revenue is only beginning this process. Still, enough is already known about these to suggest some immediate actions. In light of the department's report and its implications, lawmakers should at least:

- **Assure public scrutiny** by enacting tax transparency legislation that provides for public disclosure of the beneficiaries of all business-directed tax credits;
- **Revise existing tax credits** in all instances where there is evidence of their excess or wastefulness, and place some ceiling on the amount of credits that can be awarded; and
- **Establish a moratorium** on the enactment of any additional tax credits.

The High Quality Job Creation Tax Credit Program

The Department of Economic Development is given the authority to award tax credits to new investments that will produce "high quality" jobs, with a tax credit of from 1 percent to 10 percent of the investment made, depending upon the number of jobs created and their pay relative to median county wages. DED makes these awards based upon the applications for the tax credits that it receives. In FY2007, the department gave out \$301 million in such awards.

In the case of limited liability corporations (LLC), where a group of investors get together to finance a business, the credits are transferred to the individual investors. A wealthy investor with a \$1 million taxable annual income could make an investment of \$500,000 into a bio-fuels project that received a 10 percent credit. That investor would then receive a state tax credit of \$50,000, which would then be used to offset \$10,000 in Iowa individual income taxes owed for each of the next five tax years. The Department of Revenue does not have reports on the beneficiaries of this credit by income level, but it is likely that a large share of credits go to such high-income individuals, who both have the most to invest and can make the most use of an income-tax credit. Much of the \$60 million in growth in business tax credit claims on the Iowa individual income tax between 2000 and 2006 likely went to those in Iowa's highest income-tax brackets.

1 Figure includes the new jobs and income program, the predecessor to the high quality job creation program, for FY2001.