



Secret Checks No More — Report Identifies Big Takers

Disclosure from State: 133 Firms, No Income Taxes, \$43 Million in Checks

Initially promoted when adopted in the mid-1980s as a way to support start-up companies to invest in research in Iowa, the Research Activities Credit clearly is missing its intended audience. As shown in a report today from the Iowa Department of Revenue, the largest beneficiaries and vast majority of benefits of this program went to large multinational corporations.

The report illustrates the folly of one of the frequent claims about tax credits: that they do not cost anything, supposedly because they represent revenues that the state forgoes to encourage a particular activity. This argument is in error not only because lost revenues have the same impact as direct spending on the budget bottom line, but in the case of the “refundable” Research Activities Credit, the state Treasury must sometimes cut a check, paid directly to companies. As the points below illustrate, this is the vast majority of the way the RAC is distributed — as checks.

Key Numbers

From the Department of Revenue report today, here are some key points:

- 133 companies received RAC checks and paid no state corporate income tax in 2010.
- Those 133 companies together had about \$2.2 million in taxes erased by the RAC — but received “refunds” of tax credit amounts in excess of their tax liability.
- 95.2 percent of RAC claims — from both the regular credit and the supplemental credit — were paid out as “refunds” in the total amount of \$43 million.
- 88 percent of RAC claims went to nine companies, in the combined amount of \$39.7 million.
- The three largest RAC claimants received at least \$30.7 million in “tax credit refund” checks.¹

Key Players

The Department of Revenue report shows nine firms made over \$500,000 in RAC claims in calendar 2010. Here are the amount of their claims and their percentage of all corporate claims:

■ Rockwell Collins	\$ 14,213,205	31.4%
■ Deere & Co.	\$ 12,797,619	28.3%
■ DuPont	\$ 5,949,495	13.2%
■ John Deere Construction	\$ 2,198,830	4.9%
■ Monsanto	\$ 1,848,480	4.1%
■ Pfizer	\$ 942,184	2.1%
■ Skyworks Solutions	\$ 896,127	2.0%
■ Vermeer Manufacturing	\$ 862,725	1.9%
■ Interstate Power	\$ 576,438	1.3%

The Department’s report does not break out the refund amounts for individual RAC claimants.

What is the RAC?

The Research Activities Credit equals 6.5 percent of the Iowa share of research costs qualified for federal income tax purposes. A supplemental RAC award before July 1, 2010, could double that credit; after that date, supplemental RAC awards have been capped at lower amounts.

How do refunds work?

The common understanding of “refunds” and taxes does not apply with tax credits. If a credit is refundable, such as the RAC, the recipient can receive a check from the state for the amount over and above the amount of tax due. So the tax is first erased, and then remainder is provided as a check. For example, a company with \$100,000 in tax due but a \$500,000 RAC credit would receive a \$400,000 check.

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Key Implications for Policy

No one has argued that these firms are doing anything improper; rather, the policy question for Iowa lawmakers is whether these subsidies, made through the tax code and not with the scrutiny of the regular appropriations process, are the best use of those funds. This question is particularly relevant when Iowans have been coping with severe budget cuts and losses of services, including a 10 percent across-the-board budget cut in FY10.

IFP research in recent years, including the past week — see <http://www.iowafiscal.org/110209-corpntaxes.html> — has illustrated that business taxes in Iowa are quite low in comparison with most states, contrary to common political arguments at the Iowa State Capitol.

One of the reasons for confusion on this issue is that the Iowa corporate income tax rate appears high at 12 percent, but Iowa's many tax credits and other provisions of tax law make the effective rate much lower. In addition, when considered together with local taxes, especially the much-maligned property tax, Iowa taxes on business remain well below the national average.

Despite a favorable climate for business, the 2010 annual report on the Research Activities Credit shows Iowa offers benefits beyond low taxes. On this one credit program alone, more than \$43 million was paid out to 133 corporate entities that paid no income tax — at a time working families in Iowa are struggling with rising health and fuel costs in tight household budgets, and seeing real or threatened cuts in critical public services including education. By shedding light on this credit, budget discussions can include a better look at all options on the table.

Other Resources

IFP has produced research examining specifically the Research Activities Credit, including:

- “Spotlight on Secret Checks,” <http://www.iowafiscal.org/2008docs/080204-RAC-bgd.pdf>, and
- “Perks for the Most Profitable” <http://www.iowafiscal.org/2008docs/080416-RAC.pdf>.

A 2008 report from the Department of Revenue also has examined the issue. Official DOR reports on tax credits can be found at <http://www.iowa.gov/tax/taxlaw/creditstudy.html>.

All of this research raised serious questions about how such large sums of money were being spent outside the appropriations process. Because this spending occurred through the tax code, much of the information was kept secret except for aggregate information provided by the Department of Revenue.

In 2009, concerns about this spending resulted in passage of legislation, signed by Governor Chet Culver, to require more public information so that Iowans and state lawmakers could give such spending more scrutiny. The first report, issued in February 2009, covered only a six-month period, for the last half of that year. As the Department had noted publicly, the July 1 start date for the period covered by that report encouraged some companies to avoid the first-year disclosure by filing claims before July 1. Thus, the first report was of limited value in understanding which companies were benefiting most from the RAC.

The 2010 report documents the first full year's worth of information required by the 2009 law: total RAC claims, total supplemental RAC claims, total amounts of RAC claims paid as “refunds,” amounts of RAC credits claimed against both corporate and individual income tax, and the names of RAC claimants in excess of \$500,000.

¹ Overall, those three companies had claims of \$32.9 million. At a maximum, according to the Department of Revenue report, corporate credits were used to erase \$2.2 million in tax liability, leaving the rest of credits to be paid out as “refunds.” If all of that \$2.2 million were used by the top three beneficiaries to erase taxes, those three firms received \$30.7 million in refunds. It is possible that some of the \$2.2 million was used by other companies to excuse taxes, however, so the \$30.7 million may understate the amount of checks paid to those three firms.

Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint budget and tax policy initiative of two nonpartisan, Iowa-based organizations, the Iowa Policy Project in Iowa City and the Child & Family Policy Center in Des Moines. Find IFP on the web at www.iowafiscal.org.