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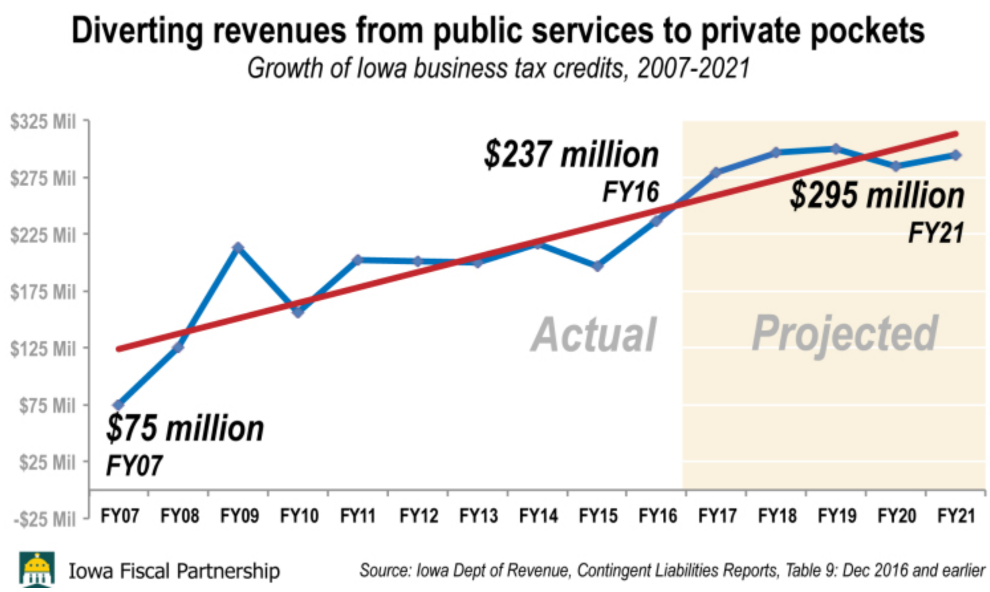
Not all tax credits are the same

Refundable EITC eases poverty for tens of thousands
Refundable RAC pads profits for big companies

Statement of Iowa Fiscal Partnership to House Appropriations Subcommittee
Mike Owen, Iowa Policy Project

First, thank you to the subcommittee for this opportunity to address some of the issues raised by HSB187. I would very quickly like to acknowledge that this discussion is, fittingly, coming before an Appropriations subcommittee. For too long, not enough people have been willing to concede that Iowa's rampant spending on business tax credits is a spending issue.

And the latter is really where we need to focus. The escalation of spending on business tax credits has been clear — and even an issue when revenue estimates decline as the bills come due.



The Iowa Fiscal Partnership, with research from both the Iowa Policy Project and Child & Family Policy Center, backed by solid official data from the Legislative Services Agency and Department of Revenue, has been illustrating these choices for Iowans for many years. Further, we have shown the value of tax credits for low-income working families, to help make work pay. Chief among those programs is the Earned Income Tax Credit. So we welcome this discussion.

This bill suggests two major changes on tax credits:

- One, it would cap tax expenditures, $400 million in FY2018, dropping by $10 million each of the following three years
- The other is that it would eliminate refundability of several tax credits, including both the Research Activities Credit (RAC) and the Earned Income Tax Credit (EITC).

In both cases, it treats all tax credits as if they are the same. They are not. This false equivalency ignores the fact that these credits, some with refundability, were all created for different purposes and produce different results. Yet to scale all of them back would increase severe inequities in Iowa's tax system that have been exacerbated by the proliferation of <u>business</u> tax credits.

The cap and first-come-first-served approach will produce a race to get the tax credits that are available, regardless of their value as something contributing to the common good or a public purpose. This creates one more uncertainty and lack of accountability on whether public dollars are being used for a public purpose, and whether priority concerns are taking precedence.

Differences in credits are evident with the largest two credits, the EITC and the RAC. The EITC is geared to help "make work pay" for low-income families. It works. Without earned income, you do not benefit. And the credit phases out as families' income reaches closer to self-sufficiency.

The RAC was designed to help entrepreneurial start-up companies, yet 90 percent of all corporate claims in 2016 — $44.3 million — were claimed by companies with over $500,000 in claims. These are very large companies. Not the intended target for the RAC, they now dominate it.

- The EITC benefits over 220,000 households, compared to about 200 corporations and less than 500 individuals through the RAC.
- The average benefit to households is a little over $300 from the EITC — but it benefits a large share of the state's households — 30 percent between tax years 2007 and 2014. But the RAC is not a benefit for anywhere near that share of businesses. Only 17 companies claimed 90 percent of the credit in 2016.
- Where refundability boosts the ability of the EITC to help low-income working families with children, the RAC is shown to be little more than a cash cow for extremely large, highly profitable corporations.
- The 17 companies that each had over $500,000 in RAC claims in 2016 also claimed at least 88 percent of the $40.4 million provided in corporate "refunds."

If the concern is generally the cost of tax expenditures, why not set clear priorities and expectations, check these against evaluations already done by the Department of Revenue, and design reforms? This is effectively what the Special Tax Credit Review Panel suggested in 2010; it is the point of implementing a five-year sunset to require renewal by the Legislature.

To get control of refundability, perhaps a place to start would be to cap refundability of all credits at some amount — perhaps $250,000 — and to eliminate it for businesses making over some gross revenue amount, something under $1 million. This would be more accountable, would save taxpayers money, and would enable the state to invest more in critical areas that now are underfunded. And, the change would not raise taxes on anyone.

Thank you for this opportunity. Several reports on both the EITC and the RAC are available at www.iowapolicyproject.org and www.iowafiscal.org. We welcome your questions.