



Iowa Policy Project ROADMAP for OPPORTUNITY

Reining in the cost of business tax subsidies

It has become a familiar story: Tax breaks and tax expenditures growing at a pace that spending on traditional state priorities cannot match. This growth continues on autopilot, year after year, with little scrutiny and often with weak justification.

The cost of business tax credits under the income tax grew from \$214 million in Fiscal Year 2015 to \$244 million in FY19, and is projected to be \$287 million for FY20.¹ The commercial and industrial property tax cuts enacted in 2013 have added significantly more to that estimate. The business property tax credit enacted in that legislation, which will remain at \$125 million every year, will bring the overall state cost of business tax credits to more than \$400 million by FY20. In other words, **business tax credits in total will have about doubled in six years.** (See graph.)

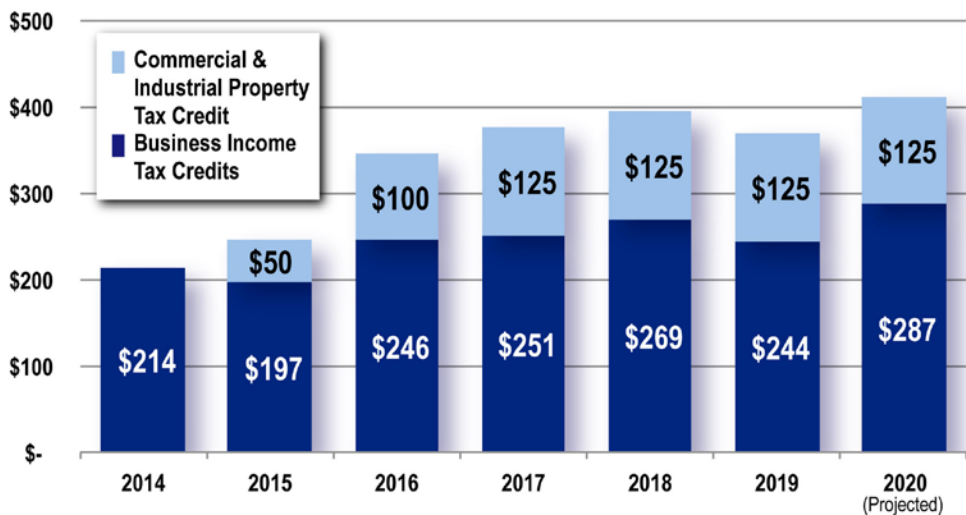
Destination:

More sensible use of tax dollars:

- Saving taxpayer dollars now spent without accountability.
- Making revenue available to public purposes such as education and public safety.

Related business breaks would drive total spending on subsidies to business much higher. Iowa in recent years has spent \$152 million annually to **backfill local public revenues** lost when commercial and industrial property assessments were rolled back to 90 percent of actual value, a tax break to business.² Revenue losses from the state's failure to enact combined reporting to

Cost of Business Tax Credits Doubles in Six Years
Annual Cost in Millions of Dollars by Fiscal Year



Sources: Iowa Department of Revenue, Contingent Liabilities Reports, Table 9: December 2019 and previous years; Summary of FY2017 Budget and Governor's Recommendations, LSA - Fiscal Services, January 14, 2016, p. 63.

plug loopholes in the corporate income tax amount to an estimated \$200 million.³ The state also spends nearly \$60 million annually backfilling the loss of tax base to school districts as a result of city and county use of **tax increment financing**, much of which reduces the costs of business development.⁴ The total cost of business subsidies, in other words, approaches \$800 million, even without other so-called tax expenditures, such as the state's use of single-factor apportionment.

Tax credits have the same impact on the state's bottom line as any other spending. Such spending comes outside the normal budget process where agencies, advocates and constituents

make proposals that lawmakers vote up or down, on the record. Tax credits, with few exceptions, cause spending outside that competition.

By contrast, spending on PK-12 schools — a larger share of the budget — was held to about 1.8 percent average annual growth in the per-pupil budget cost from FY2011-20. Proposals by Governor Reynolds and legislators for FY2021, ranging from 2.1 percent to 2.5 percent growth, would keep the 10-year average at or below that 1.8 percent. These percentage increases, held below schools' cost increases, render meaningless the governor's rhetoric⁵ about new funding levels. Funding increases held below the growing cost of providing a service are not real increases.

Evaluations Have Not Produced Reform

Because tax credits are not part of the annual budget process, they escape scrutiny in the competition for state funds. The Iowa Department of Revenue does review and analyze the performance of all tax credits on a rolling basis, each credit coming up for review every five years. But there is little evidence that legislators take those analyses seriously. Moreover, a comprehensive review of tax credits in 2010 resulted in a number of recommended changes, including a five-year sunset for all credits, caps on all credits, and ending refundability of the Research Activities Credit (RAC).⁶ None of these changes were seriously considered in the Statehouse. The 2019 session of the Iowa Legislature produced another promise to review tax credits — a promise that in 2020 remains not only unfulfilled, but apparently not a priority for leadership. The RAC has continued to grow, from about \$45 million in 2010 to \$55 million in 2018 according to annual reports on the credit,⁷ with most of that amount each year going as “refunds” of unused tax credits (not of excess taxes paid) to corporations that paid no corporate income tax to the state of Iowa. In every year since these full-year annual reports were required, from 2010 through 2018, refunds have accounted for between 68 percent and 95 percent of corporate RAC claims, and very large claimants — corporations with claims over \$500,000 in a year — made between 81 percent and 91 percent of those claims.

Policy Alternatives: Real reform is needed more than ever

State spending on business subsidies necessarily comes at the expense of other budgetary priorities, including education, health, and public safety. Investments in education and infrastructure, the building blocks of a strong economy, suffer when the annual budget debates start out with a billion dollars already committed to business incentives.

¹ The following tax credits listed in the Iowa Department of Revenue Contingent Liabilities Reports are included in our analysis as business tax credits: Enterprise Zone Programs, High Quality Jobs Program, Historic Preservation, Industrial New Job Training Program (260E), Research Activities, Targeted Jobs, Venture Capital, Accelerated Career Education, Redevelopment, Renewable Chemical Production, Renewable Energy, Wind Energy Production, Biodiesel Blended Fuel, E15 Gasoline Promotion, E85 Gasoline Promotion, Ethanol Blended Gasoline, Ethanol Promotion. With the exception of Historic Preservation, this list is in line with credits classified as “business incentives” by the Iowa Department of Revenue in their most recent tax expenditure study. <https://tax.iowa.gov/reports/2010-iowa-general-fund-tax-expenditures-excel>.

² Legislative Services Agency, *Summary of the Governor's Budget Recommendations FY2021*. Jan. 16, 2020, page 212.

³ Iowa Department of Revenue, 2017.

⁴ Legislative Services Agency, *FY 2018 Annual Urban Renewal Report*, February 15, 2019, p. 24. About 15 percent of TIF expenditure in FY18 went directly for business projects; it is not known how much of the 63 percent that went to property acquisition, roads, bridges, utilities, and water or wastewater treatment plants was associated with business development.

⁵ Governor Kim Reynolds, Condition of the State address, January 14, 2020. <https://governor.iowa.gov/press-release/gov-reynolds-delivers-condition-of-the-state>.

⁶ Governor's Tax Credit Review Panel, *State of Iowa Tax Credit Review Report*, January 2010.

⁷ Iowa Fiscal Partnership, Big companies take the most with lucrative research credit,” February 20, 2019. <http://www.iowapolicyproject.org/2019Research/190222-RAC-bgd.html>.