

Iowa Fiscal Partnership

Executive Summary

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Looking Behind the Curtain

Unveiling the Problem of Tax Expenditures in Iowa

By Victor Elias and Charles Bruner

Economic development is a major focus of state policy for which Iowa has spent hundreds of millions of dollars. Investments are made through appropriations programs such as the Iowa Values Fund, and through special provisions in the state tax code such as the research activities credit. While costly, the effectiveness of such expenditures through the tax code is difficult to evaluate, as there are almost no reporting requirements and the individual recipients of these tax breaks remain confidential.

These Iowa tax breaks provide very large benefits to specific businesses, essentially at other taxpayers' expense. Iowa law provides no public disclosure of the beneficiaries of these tax breaks nor any ongoing review of whether the breaks have produced any public benefits. The annual cost is unknown because these breaks – often called “incentives” – are not tracked and do not require annual appropriations or annual review. Once enacted, these tax breaks become entitlements that continue unabated until the General Assembly acts to change or repeal them. Increasingly, Iowa lawmakers have sought to promote economic development through the tax code, which makes disclosure and accountability regarding these tax expenditures even more essential.

Unlike traditional state spending, tax expenditures do not receive the scrutiny of the appropriations process. Most tax expenditures are permanent changes to the tax code. Lawmakers rarely review whether these preferential tax provisions are costing more than was anticipated, or to see if they are accomplishing their goals.

Economic Development Tax Expenditures

An increasing array of tax credits and incentives have been enacted by the Iowa General Assembly over the last decade to promote economic development. Here is a sample:

● **Research Activities Credit** — Enacted in 1985, this allows businesses to claim an income tax credit equal to 6.5 percent of increased spending on research activities. Fiscal impacts for this credit were consistently underestimated, and illustrate the need for ongoing accountability. **Price tag: \$208.5 million.**

What is a tax expenditure?

● In 2002, an anonymous Iowa firm received an \$11 million check from the Iowa treasury as part of its claim for a **research activities tax credit** initially projected to be a small cost to the state.

● In 2004, Iowa adopted tax law making businesses retroactively eligible for **bonus depreciation** on investments already made, with a potential cost to the state in the tens of millions of dollars.

Both are “**tax expenditures.**”

In its “Iowa Tax Expenditures 2000, Phase I Report,” the Iowa Department of Revenue described tax expenditures as “preferential provisions in tax law that produce reductions in tax from that which would be imposed without the provision. They take the form of special exclusions, exemptions, deductions, credits, and deferrals.”

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- **Bonus Depreciation** — Passed in September 2004 in a special legislative session with very little public discussion and no official fiscal analysis, bonus depreciation allowed businesses to depreciate up to 50 percent of certain assets acquired after Sept. 11, 2001, and placed into service by the end of 2004. Thus, businesses only knew they would have this break for less than four months. Given the time required to plan a major investment, eligible purchases likely were already planned. Most of the benefits rewarded investments that had been made before the bill passed. **Price tag: Unknown.**
- **Range of Provisions** — In addition to the research credit and bonus depreciation, the array of tax provisions for economic development includes the New Jobs and Income Program, the Housing Enterprise Zone Program, and several more. **Price tag: Over \$155 million annually (all economic development credits).**

Model and Neighboring State Responses for Accountability

The first tool for holding tax expenditures accountable is adequate public disclosure. A number of states make public the tax claims and benefits derived from specific tax expenditures. Such a law would enable Iowans to identify which firm received the \$11 million benefit from the research activities credit.

The second tool for accountability is a regular review of whether such provisions offer public benefits that merit continued use. This can include sunset clauses (expiration dates), regular reviews by a tax expenditure commission, and reporting requirements for tax filers about expected economic impacts.

Model legislation by Good Jobs First sets out other key ingredients for good accountability, including:

- Quality job standards that require family supporting wages with health-care benefits to avoid hidden costs to taxpayers for social safety net programs.
- Clawback provisions to recapture funds, either appropriations or tax breaks, from companies that do not accomplish the agreed-upon goals.

Recommendations for Iowa

Iowa does not require full disclosure of all costs of its economic development tax expenditures. Iowa has issued only one tax expenditure report (in 2000). In 2005 the General Assembly did require the Iowa Department of Revenue to develop a system to track and analyze tax credits. The first preliminary status reports and program effectiveness evaluations should be ready by the end of December 2006. All business tax credits for economic development will be tracked and consolidated by taxpayer for the first time. While taxpayer-specific data will remain confidential, useful reports will be possible.

Iowa legislation should include the following regarding tax expenditures for economic development:

- An annual Economic Development Tax Expenditure Report, showing all such tax expenditures, shall be provided to the General Assembly within three months of the close of the state's fiscal year.
- All data in the Economic Development Tax Expenditure Report and the state's new tax credits tracking system shall be public record under Iowa's Public Records law and made available online through a searchable data base.
- A searchable data base of economic development tax expenditures, by company, shall be available to the public online within three months of the close of the state's fiscal year.
- Sunset provisions for each economic development tax expenditure shall be included to force a review of its annual cost and to determine if it is accomplishing the intended public purpose.
- Provisions should assure the state's ability and authority to recapture tax credits from businesses that do not accomplish stated goals.

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