

A \$40 Million Budget Hole — Persistent and Growing *Research Activities Credit: Poster Program for Reform*

Each year, Iowans learn a little bit more about the use of the state's most lucrative business tax credit program, the Research Activities Credit (RAC). And each year, they also learn a little more about what they do not know — but could know, with better accounting in a public format.

As the Iowa Fiscal Partnership has reported for years, Iowa's RAC is in practice a far different benefit from the one envisioned when it originally passed, in 1985. Designed to support start-up companies to do research, this increasingly costly program primarily benefits very large companies, with little scrutiny. Since 2009 more information has been available about the RAC, because a new law requires a state report by each February 15 on both individual and corporate claims against income tax.

The reports show this tax credit is used relatively little in the way one might expect of a tax credit: to reduce taxes. Rather, the credit is used mostly to provide subsidies, sometimes in the millions of dollars, to corporations that actually pay little or no income tax.

All annual reports filed as a result of the 2009 law are on the Department of Revenue's Tax Credits Tracking and Analysis System page, at <http://www.iowa.gov/tax/taxlaw/credittstudy.html>. The first report was for a partial year; reports for calendar year 2010 and after offer full-year information. The tables below provide a summary of the full-year reports.

What is the RAC?

The Iowa Research Activities Credit (Chapter 422.10, Iowa Code) is equal to 6.5 percent of a company's Iowa-apportioned share of qualified research expenditures.

Expenditures that qualify are based on federal rules. A recipient may also receive a supplemental RAC. Firms with annual gross revenues under \$20 million are eligible for a larger percentage supplemental credit than firms with gross revenues above \$20 million.

The amount of a credit in excess of taxes owed is refunded to the recipient in the form of a state check.

Table 1. Most of Corporate RAC is Paid in Checks — Not to Reduce Taxes

	Corporate Claims Number			Corporate Claims Amount			<i>Percent of RAC Claims Paid as 'Refund Checks'</i>
	2012	2011	2010	2012	2011	2010	
RAC	178	181	160	\$35,640,422	\$31,245,684	\$29,318,232	70.6% 94.3% 95.2%
Supplemental RAC	12*	16*	17*	\$10,414,774	\$16,327,031	\$15,907,882	
Total				\$46,055,196	\$47,572,715	\$45,226,114	
	RAC Paid as Checks			RAC Paid as Checks			
RAC	130	131	133	\$27,541,506	\$28,607,498	\$27,308,295	
Supplemental RAC	11*	15*	17*	\$4,973,634	\$16,275,682	\$15,724,359	
Total				\$32,515,140	\$44,883,180	\$43,032,654	

* Note: Supplemental RAC recipients are also recipients of regular RAC, so claim numbers are not added.

Table 2. Claimants Over \$500,000 Receive Largest Share of Benefit

	By number of claims			By amount of claims			By amount paid as checks		
	2012	2011	2010	2012	2011	2010	2012*	2011*	2010*
Claimants over \$500K	9	7	9	\$42,058,813	\$38,597,202	\$40,285,103	\$28,518,757	\$35,907,667	\$38,091,643
Other Claimants	169	174	151	\$3,996,383	\$8,975,513	\$4,941,011	\$3,996,383	\$8,975,513	\$4,941,011
Total	178	181	160	\$46,055,196	\$47,572,715	\$45,226,114	\$32,515,140	\$44,883,180	\$43,032,654
Percent of total for large claimants	5.1%	3.9%	5.6%	91.3%	81.1%	89.1%	87.7%	80.0%	88.5%

* Note: In the Claimants over \$500K line, the three columns on the far right in the table list the minimum amount of the subsidy paid as checks, not used to reduce tax, for companies that do not pay any state income tax. State disclosure law does not individually sort out the actual amount of claims for those firms that are paid as "refund" checks; this a conservative estimate.

In summary, the 2012 report showed that 178 corporations claimed a total of \$46.1 million from the RAC — covering both the regular RAC and the supplemental credit. Of those credits, \$32.5 million was paid to 130 claimants as refunds, which means the recipients paid no state income tax because they had more credits than tax liability.

Table 3. Top Claimants Gain Year After Year, 2010-12

The law also requires reporting the identities of claimants of more than \$500,000. Table 3 provides information from the 2010¹, 2011² and 2012³ annual reports disclosing big claimants and amounts claimed. A stronger disclosure would also state how much of each of those large claims was paid as a "refund," (a check). It also would require corporations to report on changes in economic activities and investments in the state (the primary purpose for any business subsidy). These large claimants are highly profitable companies. Rockwell Collins, for example, had \$609 million in profits in 2012, while Deere posted over \$3 billion in profits and Dupont \$2.8 billion.⁴ This raises serious questions about the need for state help to cover what may be considered normal expenses, and whether the credits have resulted in any benefits to Iowa.

	2012	2011	2010	3-Year Total
Rockwell-Collins	\$ 13,848,248	\$ 14,313,898	\$ 14,213,205	\$ 42,375,351
Deere & Co.	\$ 11,901,351	\$ 11,762,241	\$ 12,797,619	\$ 36,461,211
Dupont	\$ 8,539,712	\$ 7,762,928	\$ 5,949,495	\$ 22,252,135
John Deere Const.	\$ 3,360,694	\$ 2,162,782	\$ 2,198,830	\$ 7,722,306
Monsanto	\$ 1,743,342	\$ 1,305,188	\$ 1,848,480	\$ 4,897,010
Vermeer	\$ 775,020	\$ 622,650	\$ 862,725	\$ 2,260,395
CNH America LLC	\$ 703,842			\$ 703,842
Kemin Industries	\$ 615,147			\$ 615,147
Skyworks	\$ 571,457	\$ 667,515	\$ 896,127	\$ 2,135,099
Pfizer			\$ 942,184	\$ 942,184
Interstate Power			\$ 576,438	\$ 576,438
Total 500K Claimants	\$ 42,058,813	\$ 38,597,202	\$ 40,285,103	\$ 120,941,118
Total Taxes Erased by RAC — All Corps	\$ 13,540,056	\$ 2,689,535	\$ 2,193,460	\$ 18,423,051
Min. Total Checks to Top Corporations	\$ 28,518,757	\$ 35,907,667	\$ 38,091,643	\$ 102,518,067

Note: Minimum Total Checks means the minimum amount that the corporations with over \$500,000 in claims received as a subsidy after all corporate income tax owed was eliminated. Claims include both the regular RAC and the Supplemental RAC.

Source: Iowa Department of Revenue

According to the Department of Revenue, the cost of this program — about \$50.5 million for individual and corporate claims in 2012 — is projected to push above \$70 million by FY2017.⁵

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.

¹ <http://www.iowa.gov/tax/taxlaw/RACreport10.pdf>

² <http://www.iowa.gov/tax/taxlaw/RACreport11.pdf>

³ <http://www.iowa.gov/tax/taxlaw/RACreport12.pdf>

⁴ Profits posted for 2012 by companies: Rockwell <http://investor.rockwellcollins.com/phoenix.zhtml?c=129998&p=irol-reportsannual>, Deere http://www.deere.com/en_US/docs/Corporate/investor_relations/pdf/financialdata/reports/2013/2012_annual_report.pdf and Dupont <http://investors.dupont.com/phoenix.zhtml?c=73320&p=irol-irhome>.

⁵ Tax Credits Contingent Liabilities Report, December 2012, Iowa Department of Revenue. <http://www.iowa.gov/tax/taxlaw/1212RECReport.pdf>; Table 9.