

## Connecting the Dots: Tax Breaks and School Funding

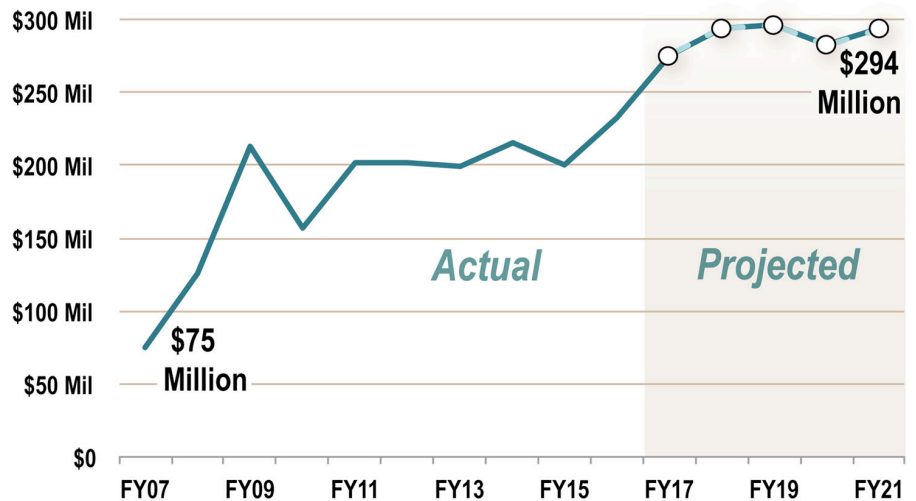
*Iowa's revenue shortfall largely self-inflicted — education, other priorities suffer*

By Peter Fisher and Mike Owen, Iowa Policy Project

Iowa legislators frequently use projections of scant revenue growth to defend what has become chronic underfunding of education and other priorities. What they seldom acknowledge is that their dilemma is largely self-inflicted. A penchant for tax cuts over the past 20 years has left the state with a long-term revenue shortfall.

Indeed, the Revenue Estimating Conference in October projected that the state would take in \$72 million less in FY2017 than it had projected in March. Adding \$33 million to the cost of Medicaid privatization announced last month leaves the state with \$100 million less for current obligations than lawmakers expected when they approved a budget offering schools only a 2.25 percent increase in per-pupil spending (State Supplemental Aid, or SSA). Over the last seven years, SSA has averaged below 2 percent. These trends are unlikely to improve for schools without large cuts elsewhere in the budget — or addressing the elephant in the room: rampant spending on business subsidies.

### Iowa's Growing Spending on Business Tax Credits



Iowa Fiscal Partnership

Source: Iowa Department of Revenue Contingent Liabilities Reports

### Business tax credits create part of the problem

Why is revenue growth a problem when Iowa has recovered better than most states from the Great Recession? Answers can be found in the growth in business tax breaks. Business tax credits drained \$200 million from the state treasury in fiscal year 2015, grew to \$232 million in FY16, and are expected to cost \$275 million this year. The six largest credits (or groups of credits) account for 87 percent of the total (see table).

### Business Tax Credits Projected for FY17

	\$ Millions
Research Activities Credits	\$ 64.5
Industrial New Jobs Training Program	42.5
Historic Preservation Credit	52.9
High Quality Jobs Program	37.4
Ethanol and Biodiesel Credits	20.0
Enterprise Zone Programs	22.0
All other business credits	36.0
<b>TOTAL</b>	<b>\$275.2</b>

Spending on business tax credits has grown 267 percent since 2007. Caps on individual credits and groups of credits have done little to slow growth. The cost of credits has far outstripped growth in general fund spending overall.

### ***New tax breaks have worsened the problem***

Recent measures have added greatly to the problem. The massive commercial and industrial property tax bill passed in 2013 was responsible for a \$268 million cut in funds that otherwise would have been available to adequately fund education, natural resource programs, and other priorities in FY16. The impact in the current year was projected at \$304 million.<sup>1</sup> The property tax breaks are larger than the sum of all business tax credits.

Assuming the property tax estimate holds, the combined cost of those business tax breaks identified above will drain about \$579 million in revenue from the state general fund this fiscal year. At a time when the state is struggling to fund education at all levels, those business tax breaks take on added importance. And they tell us something about the state's priorities.

### ***Iowa business taxes are already quite competitive***

Iowa has been right in the middle of the pack in how it taxes business for a long time. The most recent study of state and local taxes on business as a percent of state GDP by Ernst and Young and the Council on State Taxation shows that Iowa taxes business at 4.5 percent of GDP, just below the national average.<sup>2</sup> A study by Anderson Economic Group in 2015 found Iowa's effective tax rate on businesses to be 8.7 percent of profits, which placed it 32<sup>nd</sup> among the states, and again below the national average.<sup>3</sup>

### ***State and local taxes have little effect on business location decisions***

State and local taxes are less than 2 percent of total costs for the average corporation. As a result, even large cuts in state taxes are unlikely to have an effect on the investment and location decisions of businesses, which are driven by more significant factors such as labor, transportation, and energy costs, and access to markets and suppliers.

### ***Tax breaks erode support for public investments in our future***

The proliferation of tax incentives and business tax cuts over the past two decades has resulted in several hundred million dollars each year cut from the state budget. This has undermined the state's ability to support quality education, from preschool through public colleges and universities. This poses serious consequences for state economic growth and prosperity.

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<sup>1</sup> Legislative Services Agency, Fiscal Services Division. *Summary of FY2017 Budget and Department Requests*. December 2015, pp. 17 and 55. Includes the effect of SF 295 on state school aid as originally estimated.

<sup>2</sup> Ernst and Young and the Council on State Taxation, *Total state and local business taxes: State-by-state estimates for fiscal year 2014*. <http://www.cost.org/Page.aspx?id=69654>

<sup>3</sup> Anderson Economic Group, *2015 State Business Tax Burden Rankings*.  
[http://www.andersoneconomicgroup.com/Portals/0/AEG%20Tax%20Burden%20Study\\_2015.pdf](http://www.andersoneconomicgroup.com/Portals/0/AEG%20Tax%20Burden%20Study_2015.pdf)

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