

The Iowa Journal #318
Proposals to Change Iowa's Tax Credit Incentives
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Yeager: On The Iowa Journal ...

Governor Culver: The tax credit review panel issued their report. So, I ask you to act on their recommendations and do all you can to make these credits work exactly as the legislature intended.

Yeager: How will a call for tax reforms and tax credits affect Iowa's business climate? And how do such incentives affect the state's budget and the ability to pay for the services Iowans depend upon? And in a preview of an upcoming Iowa Public Television series, we'll head to north central Iowa's Pilot Knob state park.

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From river to river, border to border this is The Iowa Journal. Here is Paul Yeager.

Yeager: Hello and welcome to The Iowa Journal. Encouraging private business development while still raising enough state revenue to take care of the public's business is a tricky balancing act. There are various incentives used to entice companies to move to Iowa or stay here. But the one incentive in the cross hairs for the past year has been tax credits. After accusations the film industry misused Iowa's film tax credits, Governor Culver ordered a comprehensive review of all the state's tax credit programs and asked lawmakers to approve the recommendations of the Tax Credit Review Panel. But before we get into what should and should not be done to Iowa's various tax credit offerings, here is a basic primer we first aired in November, on just how a tax credit works and how they're used.

It wasn't that long ago that The Iowa Journal reported on Iowa's newest growth industry, moviemaking. It was fueled by generous state income tax credits -- for producers and investors. The Iowa legislature enacted those tax credits in 2007. By fall 2009 there was trouble. Irregularities with the film tax credits caused the governor to put the program on hold and call for a review of all the state's tax credits.

The film tax credit is actually only one of more than 30 credits the Iowa legislature has created for businesses, organizations or individuals. They are used to stimulate the biodiesel and ethanol industry, the rehabilitation of historic properties, research, the creation and retention of jobs, donations to local communities and much more.

So how does a tax credit work? For starters it's different than a deduction and that is important. A deduction is subtracted from income. Once the income is calculated and the deductions are taken then the tax is determined. A tax credit is subtracted from the tax that is due. It works the same for individuals and businesses.

Some tax credits are claimed. Just as any person who files a return can claim a \$40 individual credit, businesses can claim credits allowed in the law. Some other tax credits are awarded to companies by different government entities if they meet specific criteria such as promising to create a certain number of jobs. The film industry credits were awarded.

Some footnotes on awarded credits: A business won't necessarily claim all the credits it is granted. If a company fails to do that it promised, in some instances the state can take the money back -- called a clawback provision. And awarded tax credits can be capped, so there is a limit to how much the awarding agency may authorize.

The Department of Revenue reports to the legislature, the governor and the public how much is claimed in the aggregate for the various business tax credit programs. But an individual company's information is not released, with one recently enacted exception.

The report is called the Tax Credits Contingent Liabilities Report -- what it estimates the state might lose in revenue because of tax credits -- for businesses and individuals. The October 2009 report found potential liabilities growing significantly.

Major contributors to that growth were five tax credits aimed at businesses. In fiscal year 2010, those programs alone are expected to be \$233.8 million, with another \$73 million in movie credits under review.

Yeager: There are many tax credit programs that we did not go over in the video story but are noteworthy to mention and are contentious ones in the legislature this session. Two of them are the so-called "refundable" and non-refundable" tax credits.

The refundable tax credit is not a refund as most people understand it. For example, Business A has calculated its tax as \$1,000. It has a refundable type of tax credit of \$1,500. That means the business won't owe any tax. And since the credit is labeled refundable, the state also writes Business A a check for another \$500.

With a non-refundable credit, Business B has the same tax liability of \$1,000 and a tax credit worth \$1,500. Business B won't owe any taxes either, but it will not get a payment. It may be able to roll \$500 worth of credit to next year's taxes in many cases.

Yeager: Tax credits are complicated and they do cost money. The question is, do the benefits outweigh the costs? And how much should government spend to create jobs and how does that cost impact the state's budget and the various services the state provides to lowans?

Yeager: With us to discuss those questions and more Senator Joe Bolckcom, a democrat from Iowa City. He is also Chair of the Senate Ways and Means Committee. Ed Wallace is President of the Iowa Taxpayers Association which represents the interests of over 150 businesses in the state. And next to him is Victor Elias, a senior policy associate with the Child and Family Policy Center and also with the Iowa Fiscal Partnership advocating for tax credit reform.

Yeager: Gentlemen, welcome to the program. Good to have you. Victor, I want to ask the first question to you. We may have already lost some people who have clicked through and they heard the word tax credit. Why should the viewer care or any Iowan care about this subject?

Elias: I think if people care about the future of their state, care about the fiscal crisis that we're in right now, balancing the budget while maintaining the ability to provide essential state services then tax credits are a part of that. We have to look at a balanced solution to this fiscal problem that we're facing and a budget is made up of two sides, what it spends through appropriations and what is raised through revenues. Tax credit affects how much revenue we have to meet our needs.

Yeager: And if certain things aren't raised or overspent then other programs are probably not going to get money whether it's services that the states provides?

Elias: That is correct.

Yeager: Senator, I know I'm going to take a wild guess that the governor knows how to get a hold of you when you're chair of the ways and means committee on the senate side. He's got a certain list of things that he wants to see when he's talking about review of all of these panels. He'd like to see the ability to transfer or sell credits to another party for tax relief, he'd like to make more information to the public, the transparency issue, develop a means for calculating a return on the state's investment, eliminate a refundable credit, establish a five year sunset for credit programs, those are just the highlights. So, how do you decide how realistic what the governor wants is going to happen?

Bolckcom: Well, I think Governor Culver deserves a lot of credit for the work of his department heads in putting together what is probably the most comprehensive review, even though it was a short-term review, of kind of the state of the tax credit situation here in the state. The main pieces of that are the need for more transparency and accountability for this spending and really the need to develop a process in the legislature and the executive branch to evaluate whether taxpayers are getting their money's worth for this more than \$500 million in state spending which is the fastest growing part of state government. It's grown about 350% over the last five years and the governor's leadership on this is really important, I think, to making sure we're getting our bang for the buck.

Yeager: Ed, so what happens if all of these things pass, those five keys? What happens if all of those go into effect?

Wallace: I think that I agree with Senator Bolkcom, I think that the exercise in putting together a review was a good one. I will say this, though, with regard to the recommendations there are a number of moving variables with regard to the recommendations and not all of them I think are the best thing for business. When we think about business, our companies in the state of Iowa, we're looking for predictability and stability especially with growing unemployment and a number of folks out of work, we want to hire people and when we do that we want to make sure that those are sustainable jobs and the tax credits and different economic development programs are helping with that.

Yeager: But at least now you kind of know what the processes are and what the blueprints are but if you get a whole new piece of legislation that all these businesses have to go through isn't that going to cause more potential problems down the road if there would be big changes?

Wallace: Some of those changes I know that the legislature is going to examine and they're right in the middle of it right now. Obviously the business community is paying close attention to the recommendations and I concur with Senator Bolkcom that accountability and transparency are very, very important. I think the last thing we want to do, however, is send an economic development message that is not congruent with our state's mission. So, we're going to examine this throughout this session.

Yeager: Ed, what happens if -- I guess I asked you that question already -- Victor, what happens if we have three targets that you would like to see passed or not passed? If you had to pick those from where you sit what would you like to see happen?

Elias: Well, I think the transparency is very important. We don't know or won't have the ability to figure out if we're getting our money's worth out of credits if we don't know who is getting them, how much they're getting and what they are accomplishing. So, maybe that's number one. I think another important one is the recommendation on the refundability of the research activities credits. Aside from the film credit that's probably about the largest credit, it's about \$70 million last year. Most of that is what is called refundable, it's given back in the form of checks to companies that don't pay any income tax. If you get a check back you're not paying any corporate income tax. We don't know who is getting that money, how much they are getting. There was a report by the Department of Revenue in January of 2008 that found no evidence that it is accomplishing additional research that would not have occurred anyway. So, it's a very costly one and in light of our budget situation I think that is another one that needs to be looked at. I think also getting the return on investment and getting rid of transferability. Transferability is a leaky process that usually tax credits are sold about 80 cents on the dollar and a broker gets his fee, it's not even benefiting the intended recipient totally but it's costing the state the same amount of money.

Yeager: Well, what happens if we go ahead and cut 10% -- we had to do 10% in this building, we had to do 10% at the Department of Revenue -- okay, what about economic development? Should they have a 10% cut on the tax credits they offer?

Bolkcom: Well, unlike the appropriations side of the budget where we fund K-12 schools and community colleges and public universities and our healthcare programs and public safety, where members of the general assembly go line by line, program by program to make sure they're working, this \$500 million worth of annual spending has virtually little oversight on an annual basis, 30 programs created over about the last 30 years and I think that people have come to the realization that this spending ought to be on the table and ought to take its fair share of reductions as we look at cutting kids in K-12 and all the other spending. So, I think there's an awareness from the business community about the downturn in revenue and a willingness to look at pitching in and doing their fair share. But we have a lot of work to do, I think, over the next few years to really put a process in place in the general assembly to take three or four of these credits a year and do a thorough examination to make sure we're getting our money's worth.

Yeager: Would we be having this conversation if it wasn't for the -- which prompted the discussion more, the film tax issue or the state budget problem?

Bolkcom: I think the state downturn in revenues is a significant new development and I think that's probably the driver. But clearly people saw the film credit as what's going on with these other credits and are we on top of the other credit programs. And so I think those two things together.

Yeager: The gentleman on the other side of the table wanted to answer that one too.

Wallace: There's no question that we're talking about tax credits and that side of the ledger due in part to the budget shortfall that we've had. We've had record spending over the last three years. Obviously we've had the economic downturn that provided a \$400 million, \$500 million revenue shortfall. But at no time have we stopped spending at the same level we had in 2007. So, I think that certainly prompted a lot of the review and I concur that the film tax credit piece had something to do with it as well.

Yeager: Some critics would say, well, if there was that problem in abuse of that credit maybe we need to be -- maybe there's other abuses going on, on other credits. Is that a fair statement?

Wallace: I think that on the whole a lot of these credit programs are administered wrong. In fact, one that was cited by Victor, research activities credit, an absolutely marvelous program that has created thousands of jobs and above county median wage jobs, jobs of tomorrow, future jobs, not only that but we know from Department of Economic Development data that we spend \$54 million a year on research activities credited for over \$1 billion of economic activity in and around Iowa.

Yeager: So, we have almost close to 34, something like that I think is the tax credit number, over 30 and that number was 10 not that long ago. Are we on an overreliance on credits to help spur development?

Wallace: I think that we're certainly in an arms race with other states. We have a lot of other states that are saying, given the economic downturn and given the unpredictability in the economy we're going to grow our incentive programs, we're going to do everything we can to bring quality jobs to our respective states. I think Iowa is doing the best they can in that regard and we need to make sure that our programs work, are transparent and do have a return on investment.

Yeager: All right, Victor, same question.

Elias: I think, well, a few things. Number one is the situation we're in now is not because of wild spending. We are actually spending about the same if not a little less of our state's personal income, a portion of our economy, on state spending now is about the same as it was 10 years ago. What we're really facing is a problem of revenues, the recession holding off revenues, the explosion in tax credits and tax expenditures, tax cuts is reducing our revenue. In terms of the research credit, I have to come back and say that the Department of Revenue found no evidence that it was the research credit that was creating the research. Companies have to do research if they're going to remain competitive in this world. You can see recently Pioneer talked about the increase in their research.

Yeager: And an opportunity to go against a competitor.

Elias: And making up for research they hadn't done vis-à-vis Monsanto in previous years and the research credit was there all along. So, you can't say it was the research credit that caused it.

Yeager: I think we've gotten Ed's attention.

Wallace: Much of the research that's in the state is done privately but a lot of the research jobs, like I said, are jobs of the next century and jobs that are sustainable. But we've got expansion projects all over the state because of the research that we do. We've got a refundable credit, we've got an idea credit, we've got the attention of people around the country that this is the place that we want to grow biosciences, we want to grow aerospace and we certainly want to do all that we can to take care of existing industry. People have chosen to be here and made long-term commitments and I think the state needs to keep up their part of the promise.

Yeager: All right, Senator, I need to ask you about overreliance. Are we overreliant on these credits whether it's from Iowa City, the eastern half, western half of the state?

Bolkcom: Well, clearly this part of the state budget has grown dramatically the last five years, faster than any other part of state government at 350% increase. In some areas we have very generous programs. I think Iowans would expect us to have strong economic development programs to compete with other states. But in the case of the research activity credits probably the most generous credit in the country, fully refundable, and I think we need a robust research activity credit. But I think the question is what is the balance of how much is enough to make sure we can maintain these important businesses in the state and I think Iowans want to make sure we

have good programs. But I don't think we're going to be putting any more money on the table than we need to. Legislators are great at creating programs to create economic development. We have not done a good job of evaluating after they have been in place a few years to see if they're actually working. What is needed more than anything is a very rigorous review to make sure they're working. It is alleged that some of these programs are working but we need to sit down and put the numbers together, get our research together from our Department of Revenue who has the capacity to help legislators understand these benefits.

Yeager: Well, what are the two parts -- try to break it as simple as you can -- what are the two big factors on the side of this scale trying to weigh it down? Is it the transparency issue? Or is it the need for growth? How do they balance? And how do you, as a lawmaker, try to get those two even?

Bolkcom: I think when you talk to lowans about it a lot of people feel like we've spent too much money on this, they think that over the last few years -- it may be more what has happened on Wall Street with AIG and General Motors, but there is a great deal of concern that taxpayer money has gone to the wealthiest corporations in this country. So, I think there's some appetite from lowans about where is our money going. So, transparency, the Department of Economic Development right now has quite a nice Web site, they are making it better to show the awards that have been given to Iowa businesses and what kind of jobs have been created at what kind of wage rates. I think we need to build on that and make that more accessible to the public. But I also think that we need to think about the legislative process and putting aside actual legislative time for rigorous review and accountability. We have seven appropriation subcommittees that meet jointly six weeks out of the session that pour over the education budget, the transportation budget, all that spending and we have no time dedicated by the legislature to pay attention to \$500 million worth of spending every year in complicated programs to create jobs and I think we need -- the legislature needs to do a better job on that and I think this review, the film credit mess and the downturn in revenue has got people's attention to do that.

Yeager: It's got Ed's attention here.

Wallace: I think a lot of times when you look at some of these review processes we get ourselves into the back and forth and academic understanding of it. I think that it's important now to listen to business leaders, especially with an unemployment rate of 6.7% and 115,000 unemployed lowans and even more lowans that are underemployed, listen closely to those business leaders and listen to what they are saying. Senator Bolkcom mentions \$500 million worth of tax credits, that is on a \$6.3 billion budget total. Obviously I think that rigorous oversight is necessary but at the same time if we start to cut and cap and otherwise modify programs that work I think we're certainly sending the wrong economic development message.

Elias: I think there's a misperception that tax credits is what drives economic development and business location decisions. And really taxes, state and local taxes make up two or three percent of the business' expenses. Area Development Magazine, their survey of corporate executives looked at what goes into your business location decisions. Number one was transportation access

to markets. Number four was a highly skilled workforce. Corporate taxes, corporate income taxes were down by number ten. If we are going to be cutting the state spending that generates the educated workers through our K-12 education system, retraining adult workers with a new economy, most of the workers for the next 20 years are already in the workforce but they're not really trained for the new economy. So, if we are going to be facing a budget crisis, cutting the investments that we're making in our future then you can give business all the tax credits in the world and new ones won't come here and ones that are here won't stay here. You must have the quality of life and the educated workforce they need to get the job done so they can be profitable, that's real economic development.

Wallace: I agree with Victor and I think we need to certainly train our workforce for the jobs of tomorrow and I think that we've got credit in place called our 260 workforce development training programs. The skill sets that we have had for years and years and years are certainly not to the skill sets that we need moving forward. So, retraining workers within the private sector and also showing them new skills is certainly going to be helpful for long-term valuability.

Yeager: I would imagine that we talk about transparency and we talk about trying to get as much public input on some of these things. But I'm going to guess, Ed, that you're going to tell me that some of these companies don't necessarily want to see all of that sunshine because it is kind of bright, we don't know who every company is and what all money they get. What is the pushback on business of saying, we don't need to have as much light let into this story?

Wallace: I think one the whole the businesses are very open to transparency, accountability. You get into the linguistics back and forth but they want to be the good corporate citizen and do what's right. I think that sometimes we do find ourselves getting into a problem when we talk about putting out proprietary information. Certainly from an Iowa Taxpayers Association perspective we believe in the sanctity of a tax return and that is confidential information and I think the Iowa Department of Revenue certainly agrees with that. I think putting out information in the aggregate is helpful but then we are using taxpayers dollars to spur growth and so we'd be certainly advocates of that.

Yeager: We're under two minutes already, hard to believe we're flying through. I'm going to leave you with a final question that I want all three of you to answer. Is it important to keep tax credits when we talk about the economic development toolbox?

Bolkcom: Yes, I think there's no question we need a good set of economic development programs so that employers from other states or other states don't steal Iowa's employers. But I do think we need to make sure the programs we've created work and I think at this point in time we're not able to clearly state that each of these investments in the \$400 million to \$500 million we're spending every year is getting bang for the buck. I think the public demands it now more than ever. Where we're sacrificing basic investments in education and healthcare this spending needs to come under the same kind of scrutiny and it will be working together with the business community to try and find a way to make sure these things are accountable and working. We need good working programs now more than ever given this economy and the unemployment

and we need to get people back to work.

Yeager: Okay, 30 seconds each. Victor?

Elias: I think that the tax credits are part of the solution to economic development. They have to be targeted, they have to be time limited, they have to be reviewed to see if they are accomplishing what they are intended to accomplish but they can't be so costly that it impairs our ability to educate our children and provide for a future.

Yeager: You have 30 seconds.

Wallace: I think it's important for the legislative leaders to work with the business community as they examine these pieces moving forward through the remainder of the session and I do think it extremely important to listen to business leaders as they outline how best we can create jobs.

Yeager: All right, Ed Wallace, thank you so very much. Next to him is Victor Elias and across the table Joe Bolkcom. Gentlemen, thank you so very much for coming in on this discussion for The Iowa Journal.

Yeager: Before we go we do want to share with you an excerpt from an upcoming Iowa Public Television program. It's called "Iowa's Simple Pleasures" and the program host is Dan Kaercher and he's traveling the state looking for out-of-the-way places he finds interesting and he's going to show those to you. The first one we're going to show you tonight as he heads to north central Iowa and Hancock County and Pilot Knob state park.

Dan Kaercher: Well, today we're here in north central Iowa not far from I-35 on Highway 9 near Forest City exploring Pilot Knob State Park and I'm just waiting for my tour guide, Park Ranger Deb Coates. Where are you Deb? Hey there we go! Deb, Dan Kaercher.

Deb Coates: Hi Dan!

Dan Kaercher: Looking forward to my tour.

Deb Coates: Hop in!

Dan Kaercher: Tell me a little bit about what we're going to see today at Pilot Knob.

Deb Coates: Well, first I'm going to take you to the observation tower and then I'm going to take you to the amphitheater, the open air amphitheater and then I'm going to take you to the sphagnum bog.

Dan Kaercher: A sphagnum bog. That sounds interesting. Let's go!

Deb Coates: Okay!

Dan Kaercher: Boy, this shade feels pretty cool on a hot day like this.

Deb Coates: Yeah, there's a lot of shade in Pilot Knob.

Dan Kaercher: How tall -- how high are we right now?

Deb Coates: This is the second highest point in Iowa. It's 1450 feet above sea level.

Dan Kaercher: And there's the tower. That is so fantastic. How tall is the tower itself?

Deb Coates: The tower itself is 30 feet. They wanted to make it 40 feet but the weather got too bad. So, they had to quit their -- what they were doing.

Dan Kaercher: And this is the CCC back in the Depression days?

Deb Coates: Yeah, back in 1934.

Dan Kaercher: '34. Beautiful.

Deb Coates: And it's lasted this many years.

Yeager: "Iowa's Simple Pleasures" premieres March 15th, but you can learn more right now by going to the Web site, iptv.org/iowastories. That's it for this edition of The Iowa Journal. My name is Paul Yeager. Thank you so very much for joining us.

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