OFFICE OF AUDITOR OF STATE
STATE OF IOWA

Mary Mosiman, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

NEWS RELEASE

Contact: Mary Mosiman
515/281-5835
or Tami Kusian
515/281-5834

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Auditor of State Mary Mosiman today released a report on the ethanol retailers' tax credit program and the Research Activities Credit (RAC) tax credit program administered by the Iowa Department of Revenue (IDR) for the period January 1, 2002 through December 31, 2014, which is the most recent data available. The review was conducted in conjunction with the audit of the financial statements of the State of Iowa and in accordance with Chapter 11 of the *Code of Iowa* to identify all tax credit programs administered by the State and review a selected number of tax credit programs to determine whether tax credits awarded meet the intent of the programs, return on investment (ROI) is calculated and evaluated, and administration of the programs complies with applicable *Code* sections.

<u>Ethanol Retailers' Tax Credits</u> – Mosiman reported the ethanol retailers' tax credit program is established by the *Code of Iowa* to help meet the State's goal of replacing 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020. The tax credits are claimed by individual or corporate taxpayers who are retail dealers of gasoline or who are shareholders in a retail dealer and include the:

- Ethanol Blended Gasoline Tax Credit (EBGC),
- Ethanol Promotion Tax Credit (EPTC),
- E15 Plus Gasoline Promotion Tax Credit (E15GC), and
- E85 Gasoline Promotion Tax Credit (E85GC).

EBGC expired January 1, 2009 and was replaced with EPTC. A combined total of approximately $27.65 million of EPTC, E15GC, and E85GC was claimed on 6,044 tax returns submitted to the IDR for tax years 2006 through 2014. Of that amount, approximately $18.44 million, or 66.7%, was refunded to taxpayers. According to a representative of the IDR, the data for tax years 2013 and 2014 is incomplete and subject to change by the IDR as additional verification is completed. The number of claims and amount of EPTC, E15GC, and E85GC claimed for tax years 2006 through 2014 as of December 29, 2015 are as follows.

Tax Year	EPTC		E15GC		E85GC	
	Number	Amount	Number	Amount	Number	Amount
2006	-	$ -	-	$ -	109	$ 518,811
2007	-	-	-	-	150	975,863
2008^	83	1,109,560	-	-	205	1,367,715
2009	974	4,621,280	-	-	303	1,303,418
2010^	894	3,748,167	3	1,296	237	1,510,179
2011	698	3,318,197	27	18,243	268	1,117,878
2012	514	1,936,436	57	34,049	260	1,392,358
2013	418	2,038,781	74	56,205	262	1,650,697
2014	254	474,109	61	56,813	193	396,829
Total	3,835	$ 17,246,530	222	$ 166,606	1,987	$ 10,233,748

^ - Certain EPTC and E15GC claims were made in the 2008 and 2010 tax years, respectively, because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins.

Research Activities Tax Credits – Mosiman reported the RAC tax credit program, including supplemental RAC, is established under sections 15.335, 422.10, and 422.33(5) of the *Code of Iowa* to increase research activities in the State. The RAC tax credit was authorized beginning with the 1985 tax year, and the supplemental RAC tax credit was authorized beginning with the 1994 tax year. However, comprehensive claim data for the RAC and supplemental RAC tax credits is not available from the IDR for tax years 1985 through 2001. The number of claims and total RAC and supplemental RAC claimed by taxpayers on tax returns submitted to the IDR for tax years 2002 through 2014 as of December 30, 2015 are as follows. As previously stated, according to a representative of the IDR, the data for tax years 2013 and 2014 is incomplete and subject to change by the IDR as additional verification is completed.

Tax Year	RAC		Supplemental RAC		Total	
	Number	Amount	Number	Amount	Number	Amount
2002-2005^	602	$ 124,934,000	60	$ 39,182,191	662	$ 164,116,191
2006	943	30,731,665	174	13,070,815	1,117	43,802,480
2007	1,276	35,671,858	484	19,052,467	1,760	54,724,325
2008	1,127	33,647,023	131	17,106,935	1,258	50,753,958
2009	899	33,749,477	144	15,845,384	1,043	49,594,861
2010	1,025	38,210,808	141	15,821,698	1,166	54,032,506
2011	1,924	42,602,716	165	15,557,708	2,089	58,160,424
2012	1,239	46,794,166	134	8,232,957	1,373	55,027,123
2013	1,367	39,195,544	123	6,647,735	1,490	45,843,279
2014	1,124	15,082,992	113	4,774,077	1,237	19,857,069
Total	11,526	$ 440,620,249	1,669	$ 155,291,967	13,195	$ 595,912,216

^ - Because the IDR did not comprehensively track tax credits prior to the 2006 tax year, the number of claims and total RAC and supplemental RAC claimed for tax years 2002 through 2005 are summarized based on a report issued by the IDR in January 2008.

Of the approximately $440.6 million of RAC claimed, approximately $358.4 million, or 81.3%, was refunded to taxpayers for tax years 2002 through 2014. In addition, approximately $100.9 million, or 86.9%, of the $116.1 million of supplemental RAC claimed was refunded to taxpayers for tax years 2006 through 2014. Because the IDR did not comprehensively track tax credits prior to the 2006 tax year, the amount of supplemental RAC refunded to taxpayers was not available for tax years 2002 through 2005.

Mosiman reported specific expectations or goals were not established by the Legislature when creating the ethanol retailers' or RAC tax credit programs. However, in accordance with section 2.48 of the *Code of Iowa*, the Legislative Tax Expenditure Committee (Committee) is required to calculate the ROI for each of the State's tax credits at least every 5 years to determine whether the benefits of the tax credits are worth the State's cost of providing the tax credits. The Committee reviewed the EPTC, E15GC, and E85GC tax credits in 2014 and is scheduled to review the RAC and supplemental RAC tax credits in 2016. The IDR completes periodic evaluations of the ethanol retailers' tax credit program and the RAC tax credit program, including supplemental RAC, to assist the Committee with its responsibilities. However, because no specific expectations or goals were established for these programs, there is no comprehensive method in place to measure their success.

Based on the procedures performed, ROI is not currently calculated for the ethanol retailers' tax credit program or the RAC tax credit program, including supplemental RAC. As a result, it is not possible to determine the extent, if any, to which the ethanol retailers' tax credit program helps in meeting the State's goal of replacing 25% of all petroleum used in the formulation of gasoline or the RAC tax credit program helps increase research activities and research related employment in the State. In addition, the economic impact of these programs is difficult to measure because sufficient verifiable data may not be available for the ethanol retailers' tax credit program and the available data for the RAC tax credit program, such as jobs associated with the research and the results of the research, are not easily measured.

Mosiman recommended the IDR, in conjunction with the Committee, establish expectations and goals for the ethanol retailers' and the RAC tax credit programs, including supplemental RAC. In addition, Mosiman recommended the IDR develop a method to calculate ROI and measure the success of the ethanol retailers' and the RAC tax credit programs, including supplemental RAC. The IDR should ensure the economic impact data collected for the ethanol retailers' and the RAC tax credit programs supports the calculation of ROI and verify the information provided to ensure the accuracy of future ROI calculations performed by the Committee.

A copy of the report is available for review in the Office of Auditor of State and on the Auditor of State's web site at: https://auditor.iowa.gov/reports/1560-8990-BRP2.

# # #

A REVIEW OF THE ETHANOL RETAILERS' TAX CREDIT PROGRAM AND THE RESEARCH ACTIVITIES TAX CREDIT PROGRAM ADMINISTERED BY THE IOWA DEPARTMENT OF REVENUE

FOR THE PERIOD JANUARY 1, 2002 THROUGH DECEMBER 31, 2014

1560-8990-BRP2

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OFFICE OF AUDITOR OF STATE
STATE OF IOWA

Mary Mosiman, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

Auditor's Transmittal Letter

To the Governor, Members of the General Assembly
and the Director of the Iowa Department of Revenue:

In conjunction with our audit of the financial statements of the State of Iowa and in accordance with Chapter 11 of the *Code of Iowa,* we have conducted a review of the ethanol retailers' tax credit program and the Research Activities Credit (RAC) program administered by the Iowa Department of Revenue (IDR) for the period January 1, 2002 through December 31, 2014, which is the most recent data available. We reviewed these programs to determine whether the ethanol retailers' and RAC tax credits awarded meet the intent of the programs, return on investment (ROI) is calculated and evaluated, and administration of these programs complies with the applicable sections of the *Code of Iowa* and rules of the Iowa Administrative Code (IAC). In conducting our review, we performed the following procedures:

(1) Obtained a listing of all tax credit programs currently administered by the State and reviewed the programs' descriptions to determine the nature and intent of the available tax credits.

(2) Reviewed the "State of Iowa Tax Credit Review Report" prepared by the Department of Management, in consultation with other state agencies, to determine which state agencies are responsible for administering tax credits, which tax credits had sunset dates and subsequent disposition of the tax credits.

(3) Interviewed personnel from the IDR and the Iowa Economic Development Authority (IEDA) and reviewed applicable laws, rules, and guidelines to gain an understanding of the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, and determine if ROI is measured for these programs.

(4) Interviewed personnel from the IDR and the IEDA to determine the intended purpose of the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, and identify the monitoring and evaluation procedures implemented for ethanol retailers' tax credits and RAC tax credits, including supplemental RAC, awarded under the applicable sections of the *Code of Iowa* and rules of the IAC.

(5) Evaluated internal controls to determine whether adequate policies and procedures were in place and operating effectively.

(6) Reviewed tax credit reports and other relevant information available from IDR's Tax Credits Tracking and Analysis System, such as "Iowa's Biofuel Retailers' Tax Credits: Tax Credits Program Evaluation Study," "Iowa's Research Activities Tax Credit: Tax Credits Program Evaluation Study," the "Tax Credits Contingent Liabilities Report," and the "Tax Credits Users' Manual: A Descriptive Guide to Iowa's Tax Credits," to determine the extent and results of previous evaluations of the ethanol retailers' tax credit program, the RAC tax credit program, including supplemental RAC, and ROI.

(7) Tested selected ethanol retailers', RAC, and supplemental RAC tax credit claims for compliance with the applicable sections of the *Code of Iowa* and rules of the IAC and reviewed the selected tax credit claims to determine if the intended purpose of the programs was met.

(8) Examined the “Retailers Motor Fuel Gallons Annual Report” completed by the IDR for tax years 2009 to 2014 to determine compliance with section 452A.33(2) of the *Code of Iowa*.

(9) Examined the RAC annual reports completed by the IDR for tax years 2009 to 2014 to determine compliance with sections 422.10(6) and 422.33(5)(h) of the *Code of Iowa*.

Based on these procedures, we determined specific expectations or goals were not established by the Legislature when creating the ethanol retailers’ and RAC tax credit programs or by the IDR for administration of the programs. In accordance with section 2.48 of the *Code of Iowa*, the Legislative Tax Expenditure Committee (the Committee) is required to calculate the ROI for each of the State’s tax credits at least every 5 years to determine whether the benefits of the tax credits are worth the State’s cost of providing the tax credits. The Committee reviewed the EPTC, E15GC, and E85GC tax credits in 2014 and is scheduled to review the RAC and supplemental RAC tax credits in 2016. We determined the IDR completes periodic evaluations of the ethanol retailers’ and RAC tax credit programs to assist the Committee with its responsibilities. However, because no specific expectations or goals were established for the ethanol retailers’ tax credit program or the RAC tax credit program, there is no comprehensive method in place to measure their success.

Based on our procedures, ROI is not currently calculated for the ethanol retailer’s tax credit program or the RAC tax credit program, including supplemental RAC. As a result, it is not possible to determine the extent, if any, to which the ethanol retailers’ tax credit program helps in meeting the State’s goal of replacing 25% of all petroleum used in the formulation of gasoline or the RAC tax credit program helps increase research activities and research related employment in the State. In addition, the economic impact of these programs is difficult to measure because sufficient verifiable data may not be available for the ethanol retailers’ tax credit program and the available data for the RAC tax credit program, such as jobs associated with the research and the results of the research, are not easily measured.

We have developed certain recommendations and other relevant information we believe should be considered by the Governor, the General Assembly, and the Iowa Department of Revenue.

We would like to acknowledge the assistance and many courtesies extended to us by the officials and personnel of the Iowa Department of Revenue and the Iowa Economic Development Authority throughout our review.

Mary Mosiman

MARY MOSIMAN, CPA
Auditor of State

January 5, 2016

Introduction

According to the "Tax Credits Tracking and Analysis System Report to the General Assembly December 2005" prepared by the Iowa Department of Revenue (IDR), "Many of the programs that are funded through the use of tax credits have annual reporting requirements. The requirements, however, are not consistent across all programs. There is currently no means to efficiently match information related to the awarding and claiming of tax credits. These deficiencies in existing monitoring and reporting systems make it difficult to account for the amounts of State tax revenue foregone because of the different types of tax credits. Evaluating the effectiveness of the tax credit programs in promoting the goals for which they were created is even more difficult."

Because these deficiencies existed prior to December 2005, the Legislature authorized the IDR to establish the Tax Credits Tracking and Analysis System (TCTAS) to track tax credit awards and claims. The goal of TCTAS is to provide a central repository for information concerning the award, use, and effectiveness of tax credits. In addition, the IDR was directed by the Legislature to perform periodic evaluations of the various tax credits administered by the State. As a result, the IDR implemented the "IA 148 Tax Credits Schedule" in calendar year 2006. Many of the State's tax credits are claimed by taxpayers on this schedule, including the ethanol retailers' tax credits and the Research Activities Credit (RAC), which allows the IDR to identify the various tax credits claimed by taxpayers. Tax credits allow taxpayers to reduce their tax liability by applying tax credits against individual income tax and/or corporate income tax owed. Tax credits, such as Child and Dependent Care, Earned Income, and Tuition and Textbook, are claimed on a separate line on a taxpayer's tax return and are not included on the "IA 148 Tax Credits Schedule."

The IDR also implemented the "Tax Credits Users' Manual: A Descriptive Guide to Iowa's State Tax Credits" (Manual). The Manual includes references to the applicable sections of the *Code of Iowa* authorizing each of the 37 tax credits currently administered by the State, the related administrative rules, the year enacted or modified, a program description, any certification requirements and other relevant information, such as transferability provisions and which tax credits are refundable. **Appendix A** includes a brief summary of each tax credit program currently administered by state agencies and the State's community colleges, except the ethanol retailers' and the RAC tax credit programs, which are discussed in this report.

On November 19, 2009, Governor Culver requested a review of all state tax credits as a result of concerns identified with the Film, Television and Video Production Promotion Program. The Directors of each Department responsible for the administration of a tax credit were directed to submit a review of their Department's tax credits and join the Tax Credit Review Panel (Panel), along with the Department of Management. All tax credits were reviewed to address oversight, accountability, transparency, public reporting, cost-benefit, transferability, refundability, and which tax credits should be continued, modified, and/or eliminated. The Panel issued a report dated January 8, 2010 which included an in-depth review of all existing tax credits. **Appendix B** includes definitions of key terms and a brief summary of the findings and recommendations included in the Panel's report.

<u>Ethanol Retailers' and RAC</u> – The focus of this report is the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, authorized by the *Code*. **Table 1** summarizes the tax credits included in the ethanol retailers' tax credit program and their effective dates.

Table 1

Tax Credit	Effective Date
Ethanol Blended Gasoline Tax Credit (EBGC)	01/01/02
E85 Gasoline Promotion Tax Credit (E85GC)	01/01/06
Ethanol Promotion Tax Credit (EPTC)	01/01/09
E15 Plus Gasoline Promotion Tax Credit (E15GC)	07/01/11

The IDR is responsible for administering the ethanol retailers' tax credit program and the RAC tax credits, and the IEDA is responsible for administering the supplemental RAC tax credits.

Purpose – The purpose of the ethanol retailer's tax credit program is to help meet the State's goal of replacing 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020, and the purpose of the RAC tax credit program is to increase research activities in the State. To administer the authorized tax credits and regulations specified in the *Code*, the IDR established certain rules within Chapter 42, "Adjustments to Computed Tax and Tax Credits," and Chapter 52, "Filing Returns, Payment of Tax, Penalty and Interest, and Tax Credits," of the Iowa Administrative Code (IAC) [701] Revenue.

Claimants – Ethanol retailers' tax credits and RAC tax credits may be claimed against a taxpayer's individual income tax liability or against a corporation's income tax liability. In accordance with the applicable sections of the *Code*, a taxpayer is eligible to claim ethanol retailers' tax credits if he/she is a retail dealer who sells and dispenses ethanol blended gasoline through a motor fuel pump located at the retail dealer's retail motor fuel site. To qualify for RAC tax credits, businesses must conduct qualified research in the State as defined by section 41 of the U.S. Internal Revenue Code. RAC tax credits are incremental credits, which means only research expenditures exceeding a base amount are eligible. Supplemental RAC tax credits are only available to businesses receiving awards from the IEDA under either an Enterprise Zone or High Quality Jobs Program agreement. In addition, individual and corporate taxpayers must comply with the relevant rules within the IAC.

Ethanol Retailers' Tax Credits – **Table 2** summarizes the number of claims and the amount of EBGC claimed for tax years 2001 through 2009. Because the IDR did not comprehensively track tax credits prior to the 2006 tax year, the number of claims and total EBGC claimed for tax years 2001 through 2005 are summarized based on a report issued by the IDR in January 2009. As a result, the information provided by the IDR for January 1, 2002 through December 31, 2005 may not be complete. Beginning with the 2006 tax year, the IDR began recording tax credit claim information in TCTAS. EBGC was effective January 1, 2002 and expired January 1, 2009. Because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins and the fiscal year for certain taxpayers differs from the calendar year, certain claims filed for the 2001 and 2009 tax years, respectively, included EBGC.

Table 2

	EBGC	
Tax Year	**Number**	**Amount**
2001-2005	5,250	$ 16,944,673
2006	973	6,355,745
2007	1,057	7,408,347
2008	1,068	5,751,392
2009	7	46,647
Total	8,355	$ 36,506,804

Table 3 summarizes the number of claims and the amount of E85GC, EPTC, and E15GC claimed for tax years 2006 through 2014 as recorded by the IDR in TCTAS as of December 29, 2015.

Table 3

Tax Year	E85GC Number	E85GC Amount	EPTC Number	EPTC Amount	E15GC Number	E15GC Amount
2006	109	$ 518,811	-	$ -	-	$ -
2007	150	975,863	-	-	-	-
2008^	205	1,367,715	83	1,109,560	-	-
2009	303	1,303,418	974	4,621,280	-	-
2010^	237	1,510,179	894	3,748,167	3	1,296
2011	268	1,117,878	698	3,318,197	27	18,243
2012	260	1,392,358	514	1,936,436	57	34,049
2013*	262	1,650,697	418	2,038,781	74	56,205
2014*	193	396,829	254	474,109	61	56,813
Total	1,987	$ 10,233,748	3,835	$ 17,246,530	222	$ 166,606

^ - Certain EPTC and E15GC claims were made in the 2008 and 2010 tax years, respectively, because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins.

* - According to a representative of the IDR, the data for tax years 2013 and 2014 is incomplete and subject to change by the IDR as additional verification is completed.

<u>RAC Tax Credits</u> – **Table 4** summarizes the number of claims and the amount of RAC and supplemental RAC claimed for tax years 2002 through 2014. The RAC tax credit was authorized beginning with the 1985 tax year, and the supplemental RAC tax credit was authorized beginning with the 1994 tax year. However, comprehensive claim data for the RAC and supplemental RAC tax credits is not available from the IDR for tax years 1985 through 2001. As previously stated, the IDR did not comprehensively track tax credit claims prior to the 2006 tax year. As a result, the information presented for January 1, 2002 through December 31, 2005 is based on a report issued by the IDR in January 2008 and may not be complete. The information presented for tax years 2006 through 2014 is as recorded by the IDR in TCTAS as of December 30, 2015.

Table 4

Tax Year	RAC Number	RAC Amount	Supplemental RAC Number	Supplemental RAC Amount	Total Number	Total Amount
2002-2005	602	$ 124,934,000	60	$ 39,182,191	662	$ 164,116,191
2006	943	30,731,665	174	13,070,815	1,117	43,802,480
2007	1,276	35,671,858	484	19,052,467	1,760	54,724,325
2008	1,127	33,647,023	131	17,106,935	1,258	50,753,958
2009	899	33,749,477	144	15,845,384	1,043	49,594,861
2010	1,025	38,210,808	141	15,821,698	1,166	54,032,506
2011	1,924	42,602,716	165	15,557,708	2,089	58,160,424
2012	1,239	46,794,166	134	8,232,957	1,373	55,027,123
2013*	1,367	39,195,544	123	6,647,735	1,490	45,843,279
2014*	1,124	15,082,992	113	4,774,077	1,237	19,857,069
Total	11,526	$ 440,620,249	1,669	$ 155,291,967	13,195	$ 595,912,216

* - According to a representative of the IDR, the data for tax years 2013 and 2014 is incomplete and subject to change by the IDR as additional verification is completed.

Objectives, Scope and Methodology

Our review was conducted to determine whether:

- The ethanol retailers' and the RAC tax credit programs were administered in accordance with the *Code of Iowa*, IAC, and IDR guidelines,
- The ethanol retailers' and the RAC tax credit programs are meeting the intent of the Legislature, and
- Return on investment (ROI) was measured and the overall economic impact of the ethanol retailers' and the RAC tax credit programs was determined.

To gain an understanding of the ethanol retailers' and the RAC tax credit programs, we:

- Obtained a listing of all tax credit programs currently administered by the State and reviewed the programs' descriptions to determine the nature and intent of the available tax credits.
- Reviewed the "State of Iowa Tax Credit Review Report" prepared by the Department of Management, in consultation with other state agencies, to determine which state agencies are responsible for administering tax credits, which tax credits had sunset dates, and subsequent disposition of the tax credits.
- Interviewed personnel from the IDR and the IEDA and reviewed applicable laws, rules, and guidelines to gain an understanding of the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, and determine if ROI is measured for these programs.
- Interviewed personnel from the IDR and the IEDA to determine the intended purpose of the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, and identify the monitoring and evaluation procedures implemented for ethanol retailers' tax credits and RAC tax credits, including supplemental RAC, awarded under the applicable sections of the *Code* and rules of the IAC.
- Evaluated internal controls to determine whether adequate policies and procedures were in place and operating effectively.
- Reviewed tax credit reports and other relevant information available from IDR's TCTAS, such as "Iowa's Biofuel Retailers' Tax Credits: Tax Credits Program Evaluation Study," "Iowa's Research Activities Tax Credit: Tax Credits Program Evaluation Study," the "Tax Credits Contingent Liabilities Report," and the "Tax Credits Users' Manual: A Descriptive Guide to Iowa's Tax Credits," to determine the extent and results of previous evaluations of the ethanol retailers' tax credit program, the RAC tax credit program, including supplemental RAC, and ROI.
- Tested selected ethanol retailers', RAC, and supplemental RAC tax credit claims for compliance with the applicable sections of the *Code* and rules of the IAC and reviewed the selected tax credit claims to determine if the intended purpose of the programs was met.
- Examined the "Retailers Motor Fuel Gallons Annual Report" completed by the IDR for tax years 2009 to 2014 to determine compliance with section 452A.33(2) of the *Code*.
- Examined the RAC annual reports completed by the IDR for tax years 2009 to 2014 to determine compliance with sections 422.10(6) and 422.33(5)(h) of the *Code*.

Ethanol Retailers' Tax Credits

As previously stated, the IDR is responsible for administering the ethanol retailers' tax credit program, including EBGC, E85GC, EPTC, and E15GC, and reviewing the ethanol retailer's tax credits reported by taxpayers on their tax returns as earned and actual tax credits claimed to ensure compliance with the requirements of the applicable sections of the *Code*. In accordance with the applicable sections of the *Code*, ethanol retailers' tax credits in excess of the taxpayers' tax liability are refundable. In lieu of claiming a refund, taxpayers may elect to have excess ethanol retailers' tax credits applied to their tax liability for the following tax year.

To administer the authorized ethanol retailers' tax credits and regulations specified in the *Code*, the IDR established certain rules within the following chapters within IAC [701] Revenue:

- Chapter 42, "Adjustments to Computed Tax and Tax Credits," which applies to individual taxpayers and
- Chapter 52, "Filing Returns, Payments of Tax, Penalty and Interest, and Tax Credits," which applies to corporate taxpayers.

<u>EBGC</u> – EBGC was the first ethanol retailers' tax credit authorized by the Legislature and was established in 2001 under section 422.11C of the *Code* (repealed by its own terms effective January 1, 2009). EBGC was administered by the IDR from January 1, 2002 through December 31, 2008. However, EBGC expired January 1, 2009 and was replaced by EPTC, which is discussed in further detail later in this report.

In accordance with rules 701-42.16 and 701-52.19 of the IAC, effective for tax years beginning on or after January 1, 2002, EBGC could be claimed against a taxpayer's individual income tax liability or against a corporation's income tax liability for retail dealers of gasoline. The taxpayer must have operated at least one retail motor fuel site at which more than 60% of the total gallons of gasoline sold and dispensed through one or more motor fuel pumps was ethanol blended gasoline. In addition, EBGC had to be calculated separately for each retail motor fuel site operated by the taxpayer. According to the IAC, "The amount of the credit for each eligible retail motor fuel site is two and one-half cents multiplied by the total number of gallons of ethanol blended gasoline sold and dispensed through all motor fuel pumps located at that retail motor fuel site during the tax year in excess of 60 percent of all gasoline sold and dispensed through motor fuel pumps at that retail motor fuel site during the tax year."

To claim EBGC, taxpayers were required to submit form "IA 6478: Iowa Ethanol Blended Gasoline Income Tax Credit" to the IDR. In addition, starting with the 2006 tax year, taxpayers claiming EBGC were also required to submit the "IA 148 Tax Credits Schedule" to the IDR.

We obtained a summary of the number of claims, the total amount claimed, and the total amount refunded for EBGC in accordance with section 422.11C(5) of the *Code* from the IDR as of December 29, 2015. **Table 5** summarizes the number and amount of EBGC claimed and the total amount refunded by tax year for tax years 2001 through 2009. As previously stated, the IDR did not comprehensively track tax credit claims prior to the 2006 tax year. As a result, the information presented for January 1, 2002 through December 31, 2005 is based on a report issued by the IDR in January 2009 and may not be complete. The information presented for tax years 2006 through 2009 is as recorded by the IDR in TCTAS as of December 29, 2015. Because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins and the fiscal year for certain taxpayers differs from the calendar year, certain claims filed for the 2001 and 2009 tax years, respectively, included EBGC.

Table 5

Tax Year	EBGC Claimed Number	EBGC Claimed Amount	Amount Refunded	Percentage Refunded
2001-2005	5,250	$ 16,944,673	^	^
2006	973	6,355,745	3,786,443	59.6%
2007	1,057	7,408,347	3,968,938	53.6
2008	1,068	5,751,392	4,076,332	70.9
2009	7	46,647	23,424	50.2
Total	8,355	$ 36,506,804	11,855,137	60.6%

^ - The amount refunded is not available from the IDR for tax years 2001 through 2005.

As illustrated by the **Table**, approximately $11.9 million, or 60.6%, of the $19.6 million of EBGC claimed for tax years 2006 through 2009 was refunded to taxpayers.

E85GC – Chapter 1142 of the 2006 Iowa Acts established the goal that biofuels would replace 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020. To help meet that goal, the Legislature authorized additional ethanol retailers' tax credits, including EPTC and E85GC. The Legislature authorized E85GC under section 422.11O of the *Code*. Effective January 1, 2006, E85GC is available to retail dealers of gasoline who sell E85 gasoline through motor fuel pumps during the tax year. Rules 701-42.33 and 701-52.30 of the IAC define E-85 gasoline as ethanol blended gasoline formulated with a minimum percentage of between 70% and 85% of volume of ethanol. E85GC applies to qualifying gallons sold on a companywide basis and has a sunset date of January 1, 2018 under section 422.11O(8) of the *Code*.

E85GC may be claimed against a taxpayer's individual income tax liability or against a corporation's income tax liability. In accordance with section 422.11O(2)(a) of the *Code*, a taxpayer is eligible to claim E85GC if he/she is a retail dealer who sells and dispenses ethanol blended gasoline through a motor fuel pump located at the retail dealer's retail motor fuel site during the tax period for which the tax credit is claimed. In addition, individual taxpayers must comply with rule 701-42.46 of the IAC and corporate taxpayers must comply with rule 701-52.43 of the IAC.

In accordance with rules 701-42.33 and 701-52.30 of the IAC, E85GC for both individual and corporate taxpayers is calculated by multiplying the total number of E85 gallons sold by the following rates:

- 25 cents for tax years 2006 through 2008,
- 20 cents for tax years 2009 and 2010,
- 10 cents for tax year 2011, and
- 16 cents for tax years 2012 through 2017.

To claim E85GC, taxpayers submit form "IA 135: E85 Gasoline Promotion Tax Credit," which documents the calculation of the tax credit earned, and the "IA 148 Tax Credits Schedule," which documents the actual tax credit claimed, to the IDR.

We obtained a summary of the number of claims, the total amount claimed, and the total amount refunded for E85GC in accordance with 422.11O and 422.33(11B) of the *Code* from the IDR as of December 29, 2015. However, according to a representative of the IDR, the tax credit claim information for tax credits claimed in 2013 and 2014 is still being reviewed and verified by the IDR. As a result, it is subject to change by the IDR when the review is complete. **Table 6** summarizes the number and amount of E85GC claimed and the total amount refunded by tax year for tax years 2006 through 2014 as recorded by the IDR in TCTAS as of December 29, 2015.

Table 6

Tax Year	E85GC Claimed Number	E85GC Claimed Amount	Amount Refunded	Percentage Refunded
2006	109	$ 518,811	219,571	42.3%
2007	150	975,863	254,395	26.1
2008	205	1,367,715	1,041,808	76.2
2009	303	1,303,418	959,052	73.6
2010	237	1,510,179	1,180,230	78.2
2011	268	1,117,878	849,081	76.0
2012	260	1,392,358	937,346	67.3
2013	262	1,650,697	1,238,904	75.1
2014	193	396,829	270,144	68.1
Total	1,987	$ 10,233,748	6,950,531	67.9%

As illustrated by the **Table**, approximately $7.0 million, or 67.9%, of the $10.2 million of E85GC claimed for tax years 2006 through 2014 was refunded to taxpayers.

<u>EPTC</u> – As previously stated, Chapter 1142 of the 2006 Iowa Acts established the goal that biofuels would replace 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020. To help meet that goal, the Legislature authorized additional ethanol retailers' tax credits, including EPTC and E85GC. EPTC was established under section 422.11N of the *Code* and replaced EBGC effective January 1, 2009. The Legislature established a sunset date of January 1, 2021 for EPTC under section 422.11N(10) of the *Code*.

EPTC may be claimed against a taxpayer's individual income tax liability or against a corporation's income tax liability. In accordance with section 422.11N(3) of the *Code*, a taxpayer is eligible to claim EPTC if he/she is a retail dealer who sells and dispenses ethanol blended gasoline through a motor fuel pump located at the retail dealer's retail motor fuel site during the tax period for which the tax credit is claimed. In addition, individual taxpayers must comply with rule 701-42.39 of the IAC and corporate taxpayers must comply with rule 701-52.36 of the IAC.

In accordance with rules 701-42.39(2) and 701-52.36(2) of the IAC, EPTC for both individual and corporate taxpayers is calculated by multiplying the retail dealer's total ethanol gallons sold by the tax credit rate, which is adjusted based upon the retail dealer's biofuel threshold percentage disparity. The "biofuel threshold percentage disparity" means the positive percentage difference between the retail dealer's biofuel threshold percentage and the biofuel distribution percentage.

Rules 701-42.39(1) and 701-52.36(1) of the IAC define "biofuel distribution percentage" as the sum of the retail dealer's total ethanol gallons sold plus the retail dealer's total biodiesel gallons sold expressed as a percentage of the retail dealer's total gasoline gallons sold. The biofuel threshold percentage which must be used in calculating EPTC is dependent on the aggregate number of gallons of motor fuel sold by a retail dealer during a determination period, as summarized in **Table 7**.

Table 7

Tax Year	More than 200,000 Gallons Sold	200,000 Gallons or Less Sold
2009	10%	6%
2010	11	6
2011	12	10
2012	13	11
2013	14	12
2014	15	13
2015	17	14
2016	19	15
2017	21	17
2018	23	19
2019	25	21
2020	25	25

After the biofuel threshold percentage disparity has been determined, rules 701-42.39(2) and 701-52.36(2) of the IAC established the rates to be used in calculating EPTC for tax years 2009 through 2020 as summarized in **Table 8**.

Table 8

Biofuel Threshold Percentage Disparity	Tax Credit Rate per Gallon for Tax Year: 2009 – 2010	2011	2012 - 2020
0%	6.5 cents	8 cents	8 cents
0.01% to 2.00%	4.5 cents	6 cents	6 cents
2.01% to 4.00%	2.5 cents	2.5 cents	4 cents
4.01% or more	0 cents	0 cents	0 cents

For tax years beginning prior to January 1, 2011, EPTC was to be calculated separately for each retail motor fuel site operated by the taxpayer in accordance with rules 701-42.39(2)(d) and 701-52.36(2)(d) of the IAC. However, the biofuel threshold percentage disparity was calculated on a statewide basis based on the total ethanol gallons sold in Iowa. The taxpayer determined the ethanol gallons sold at each retail motor fuel site and multiplied the total ethanol gallons sold by the applicable tax credit rate based on the statewide biofuel threshold percentage disparity.

For tax years beginning on or after January 1, 2011, the retail dealer is able to calculate the biofuel distribution percentage, biofuel threshold percentage disparity, and EPTC on a company-wide or site-by-site basis in accordance with section 422.11N(4)(a) of the *Code* and rules 701-42.39(2)(e) and 701-52.36(2)(e) of the IAC. The method used on the first tax return submitted for a tax year beginning on or after January 1, 2011 must be used for subsequent tax years unless the retail dealer petitions the IDR to change the method.

To claim EPTC, taxpayers submit form "IA 137: Ethanol Promotion Tax Credit," which documents the calculation of the tax credit earned, and the "IA 148 Tax Credits Schedule," which documents the actual tax credit claimed, to the IDR.

We obtained a summary of the number of claims, the total amount claimed, and the total amount refunded for EPTC in accordance with sections 422.11N(8) and 422.33(11A) of the *Code* from the IDR as of December 29, 2015. However, as previously stated, according to a representative of the IDR, the tax credit claim information for tax credits claimed in 2013 and 2014 is still being reviewed and verified by the IDR. As a result, it is subject to change by the IDR when the review is complete. **Table 9** summarizes the number and amount of EPTC claimed and the total amount refunded by tax year for tax years 2008 through 2014 as recorded by the IDR in TCTAS as of December 29, 2015.

Table 9

Tax Year	EPTC Claimed Number	EPTC Claimed Amount	Amount Refunded	Percentage Refunded
2008	83	$ 1,109,560	632,780	57.0%
2009	974	4,621,280	3,137,960	67.9
2010	894	3,748,167	2,297,219	61.3
2011	698	3,318,197	2,292,976	69.1
2012	514	1,936,436	1,178,291	60.8
2013	418	2,038,781	1,452,514	71.2
2014	254	474,109	425,348	89.7
Total	3,835	$ 17,246,530	11,417,088	66.2%

As illustrated by the **Table**, approximately $11.4 million, or 66.2%, of the $17.2 million of EPTC claimed for tax years 2008 through 2014 was refunded to taxpayers. As previously stated, because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins, certain claims filed for the 2008 tax year included EPTC.

E15GC – The Legislature authorized E15GC in 2011 under section 422.11Y of the *Code*. Effective for eligible gallons sold on or after July 1, 2011, E15GC is available to retail dealers of gasoline who sell blended gasoline classified as E15 or higher, except E85 gasoline, through motor fuel pumps during the tax year. Rule 701-52.43 of the IAC defines E15 plus gasoline as ethanol blended gasoline formulated with a minimum percentage of between 15% and 69% of volume of ethanol, if the formulation meets the standards provided in section 214A.2 of the *Code*. E15GC applies to qualifying gallons sold on a companywide basis and has a sunset date of January 1, 2018 under section 422.11Y(9) of the *Code*.

E15GC may be claimed against a taxpayer's individual income tax liability or against a corporation's income tax liability. In accordance with section 422.11Y(3)(a) of the *Code*, a taxpayer is eligible to claim E15GC if he/she is a retail dealer who sells and dispenses ethanol blended gasoline through a motor fuel pump located at the retail dealer's retail motor fuel site during the tax period for which the tax credit is claimed. Individual taxpayers must comply with rule 701-42.46 of the IAC and corporate taxpayers must comply with rule 701-52.43 of the IAC. In addition, a retailer is eligible to claim E15GC in combination with EPTC and/or E85GC for the same tax year in accordance with section 422.11Y(6) of the *Code*.

In accordance with rules 701-42.46 and 701-52.43 of the IAC, E15GC for both individual and corporate taxpayers is calculated by multiplying the total number of eligible gallons sold by 3 cents for calendar years 2011 through 2017, except for the period June 1 through September 15 which increases to 10 cents effective January 1, 2014. To claim E15GC, taxpayers submit form "IA 138: E15 Plus Gasoline Promotion Tax Credit," which documents the calculation of the tax credit earned, and the "IA 148 Tax Credits Schedule," which documents the actual tax credit claimed, to the IDR.

We obtained a summary of the number of claims, the total amount claimed, and the total amount refunded for E15GC in accordance with 422.11Y and 422.33(11D) of the *Code* from the IDR as of December 29, 2015. However, as previously stated, according to a representative of the IDR, the tax credit claim information for tax credits claimed in 2013 and 2014 is still being reviewed and verified by the IDR. As a result, it is subject to change by the IDR when the review is complete. **Table 10** summarizes the number and amount of E15GC claimed and the total amount refunded by tax year for tax years 2010 through 2014 as recorded by the IDR in TCTAS as of December 29, 2015.

Table 10

Tax Year	E15GC Claimed Number	E15GC Claimed Amount	Amount Refunded	Percentage Refunded
2010	3	$ 1,296	1,185	91.4%
2011	27	18,243	5,235	28.7
2012	57	34,049	4,947	14.5
2013	74	56,205	25,774	45.9
2014	61	56,813	32,142	56.6
Total	222	$ 166,606	69,283	41.6%

As illustrated by the **Table**, $69,283, or 41.6%, of the $166,606 of E15GC claimed for tax years 2010 through 2014 was refunded to taxpayers. As previously stated, because the tax year for certain taxpayers is based on the calendar year in which the fiscal year begins, certain claims filed for the 2010 tax year included E15GC.

Selected Tax Credit Claims – We obtained a detailed listing of all EBGC, E85GC, EPTC, and E15GC tax credits claimed by taxpayers on forms "IA 6478: Iowa Ethanol Blended Gasoline Income Tax Credit" for tax years 2001 through 2008 and "IA 135: E85 Gasoline Promotion Tax Credit," "IA 137: Ethanol Promotion Tax Credit," and "IA 138: E15 Plus Gasoline Promotion Tax Credit," for tax years 2008 through 2013 from the IDR. In addition, we obtained the ethanol retailers' tax credits claim data reported by taxpayers to the IDR on the "IA 148 Tax Credits Schedule" in conjunction with their tax returns for tax years 2006 through 2012 as of September 29, 2014.

We judgmentally selected 144 ethanol retailers' tax credits reported by taxpayers for tax years 2001 through 2013 to determine compliance with the requirements of the applicable sections of the *Code* and rules of the IAC, including:

- 62 EPTC claims,
- 60 EBGC claims,
- 19 E85GC claims, and
- 3 E15GC claims.

In addition, we reviewed the tax returns for the selected taxpayers to verify the ethanol retailers' tax credits reported were correctly calculated and claimed in accordance with the requirements of the *Code*, the IAC, and IDR's tax form instructions. As a result, we determined the IDR complied with the requirements of the applicable sections of the *Code* and rules of the IAC for the claims selected, and the ethanol retailers' tax credits were correctly calculated and claimed in accordance with the requirements of the *Code*, the IAC, and IDR's tax form instructions for the selected tax returns.

<u>Reporting</u> – In accordance with section 452A.33(1) of the *Code*, each retail dealer is required to report its total motor fuel gallons sold by each fuel type on a company-wide and site-by-site basis to the IDR. Specifically, rule 701-67.27 of the IAC requires each retail dealer to submit a retailer gallons report detailing the number of motor fuel gallons sold, including ethanol, during the previous calendar year to the IDR by January 31. The retailer gallons report must include:

- Total gasoline gallons sold and total ethanol gallons sold, including each classification and sub-classification listed in section 452A.31 of the *Code*, as follows:
  - Total ethanol blended gasoline gallons sold from all motor fuel pumps operated by the retail dealer in Iowa during a 12-month period beginning January 1 and ending December 31, including the following sub-classifications:
    - Total ethanol blended gasoline gallons sold, other than E-85 gasoline, and
    - Total E-85 gasoline gallons sold.
  - Total non-blended ethanol gasoline gallons sold.
- Total diesel fuel and biodiesel fuel gallons sold, including each classification and sub-classification listed in section 452A.31 of the *Code*, as follows:
  - Total diesel fuel gallons the retail dealer sold and dispensed from all motor fuel pumps operated by the retail dealer in Iowa during a 12-month period beginning January 1 and ending December 31, as follows:
    - Total biodiesel blended fuel gallons sold and
    - Total diesel fuel gallons sold which are not biodiesel or biodiesel blended fuel.

In accordance with section 452A.33(2) of the *Code* and rule 701-67.27 of the IAC, the IDR must submit an annual report to the Governor and the Legislative Services Agency (LSA) on the total number of motor fuel gallons reported as sold by all of the State's motor fuel retailers on or before April 1. The "Retailers Motor Fuel Gallons Annual Report" submitted by the IDR must, at a minimum, include the aggregate:

- Gasoline gallons sold, including all classifications and sub-classifications reported to the IDR by all retailers,
- Diesel fuel gallons sold, including all classifications and sub-classifications reported to the IDR by all retailers,

- Ethanol distribution percentage, and
- Biodiesel distribution percentage.

We reviewed the "Retailers Motor Fuel Gallons Annual Report" submitted by the IDR to the Governor and LSA for calendar years 2009 through 2014 for compliance with the requirements of the *Code* and the IAC. As a result, we determined the IDR complied with the annual reporting requirements.

As previously stated, legislation approved in 2006 established the goal that biofuels would replace 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020. Section 452A.31(8) of the *Code* defines the aggregate biofuel distribution percentage formula to be used to measure the progress toward meeting that goal as the sum of all retailers' total ethanol gallons sold plus all retailers' total biodiesel gallons sold divided by all retailers' total gasoline gallons sold.

According to IDR's "2014 Retailers Motor Fuel Gallons Annual Report," total 2014 biofuel gallons sold accounted for 11.4% of the State's retail motor fuel sales, an increase of 0.7% from the 2013 biofuel distribution percentage of 10.7% reported by the IDR. Based on the 11.4% reported by the IDR for 2014, the biofuel distribution percentage would need to increase by 13.6%, or approximately 2.7% per year, in calendar years 2015 through 2019 to meet the 25% goal by January 1, 2020. See **Finding A**.

Research Activities Credit

As previously stated, the IDR is responsible for administering the RAC tax credit program and reviewing the RAC and supplemental RAC tax credits reported by taxpayers on their tax returns as earned and actual tax credits claimed to ensure compliance with the requirements of the applicable sections of the *Code*. In addition, the IEDA awards supplemental RAC tax credits to businesses which have applied for and are approved to receive supplemental RAC tax credits under either an Enterprise Zone or a High Quality Jobs Program agreement.

To administer the authorized the RAC and supplemental RAC tax credits and regulations specified in the *Code*, the IDR established certain rules within the following chapters within IAC [701] Revenue:

- Chapter 42, "Adjustments to Computed Tax and Tax Credits," which applies to individual taxpayers and
- Chapter 52, "Filing Returns, Payments of Tax, Penalty and Interest, and Tax Credits," which applies to corporate taxpayers.

<u>RAC</u> – The Legislature authorized the RAC tax credit program under sections 422.10 and 422.33(5) of the *Code*, effective January 1, 1985, for the purpose of increasing research activities in the State. In addition, for tax years beginning on or after January 1, 1991, RAC became a permanent tax credit. As a result, the State tax credit will continue even if the temporary federal research activities tax credit is allowed to expire. To qualify for the RAC tax credit program, businesses must conduct qualified research in the State as defined by section 41 of the U.S. Internal Revenue Code, as follows:

- "Qualified research" means research:
  - with respect to which expenditures may be treated as expenses under section 174 of the U.S. Internal Revenue Code,
  - which is undertaken for the purpose of discovering information which is technological in nature, and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
  - for which substantially all of the activities constitute elements of a process of experimentation for a purpose related to a new or improved function, performance or reliability, or quality.

- Undertaken to discover information that is technological in nature; and
- Aimed at the development of a new product.

In accordance with sections 422.10(1)(a)(2) and 422.33(5)(b) of the *Code* and rules 701-42.11 and 701-52.7 of the IAC, the "state's apportioned share of qualifying expenditures for increasing research activities" must be the ratio of the qualified expenditures in Iowa to total qualified expenditures multiplied by the total qualifying expenditures for increasing research activities. Qualified research expenditures include:

- Wages for qualified research services performed in Iowa.
- Cost of supplies used in conducting qualified research in Iowa.
- Rental or lease cost of personal property used in Iowa in conducting qualified research. If personal property is used both within and outside of Iowa in conducting qualified research, the rental or lease cost must be prorated between Iowa and non-Iowa use by the ratio of days used in Iowa to total days used both within and outside of Iowa.
- 65% of contract expenses paid by a corporation to a qualified organization for basic research performed in Iowa.

Based on a review of the required tax form used by taxpayers to claim the RAC tax credit, only the expenditure amounts are required to be reported when claiming the RAC tax credit. No additional narratives or descriptions of the research conducted or impact statements regarding the effect of the research on Iowa-based employment or the Iowa economy are submitted. Although a taxpayer may have qualifying expenditures for increasing the research activities in the State of Iowa, the research outcome(s) may also benefit multiple other states. See **Finding A**.

However, RAC is an automatic tax credit allowing any taxpayer meeting the eligibility requirements of the RAC tax credit program, including qualified research expenditures, to claim the tax credit on an Iowa tax return. RAC is an incremental tax credit; therefore, only expenditures for research activities conducted in Iowa which exceed a base amount are eligible for the tax credit. In accordance with section 41 of the U.S. Internal Revenue Code, the base amount equals the average annual gross receipts of the taxpayer for the 4 taxable years preceding the year for which the tax credit is being claimed multiplied by a fixed-base percentage which, in general, is the aggregate qualified research expenses as a percentage of the aggregate gross receipts of the taxpayer for the applicable taxable years. However, the base amount can never be less than 50% of the qualified research expenses for the tax credit year. Currently, the RAC tax credit equals 6.5% of qualified research expenditures exceeding the larger of a base amount or 50% of current year expenditures.

The qualified research expenditures eligible for RAC are determined using the base amount calculated for the federal tax credit for increasing research activities. The incremental qualified research expenditures identified are multiplied by the ratio of Iowa research expenditures to total U.S. research expenditures, and the resulting "total Iowa qualified research expenses" are multiplied by 6.5% to calculate the Iowa RAC tax credit.

In accordance with rules 701-42.11(3)(b) and 70-52.7(3)(b) of the IAC, taxpayers could elect to use the Iowa Alternative Incremental Research Credit (AIRC) method for calculating RAC for tax years 2000 through 2009. Similar to the federal AIRC, the Iowa AIRC was calculated by comparing research expenditures to average annual Iowa gross receipts rather than average annual U.S. gross receipts and equaled the sum of the following:

- 1.65% of research expenditures above 1% but not greater than 1.5% of average Iowa gross receipts in the 4 previous years,
- 2.2% of research expenditures above 1.5% but not greater than 2.0% of average gross receipts, and
- 2.75% of research expenditures exceeding 2.0% of average gross receipts.

These percentages were periodically increased to reflect the increases made to the federal AIRC percentages. Taxpayers were not required to use the same calculation method on both their federal and state tax returns.

In accordance with section 422.10(1)(b) of the *Code*, beginning with the 2010 tax year, taxpayers claiming RAC tax credits could elect to calculate the tax credit amount using either the regular method or the Iowa Alternative Simplified Credit (IASC) method. In accordance with section 41(c)(5) of the U.S. Internal Revenue Code, taxpayers using the IASC method first total their current year Iowa qualified research expenses. If Iowa qualified research expenses were not incurred in any of the 3 previous years, the total current year Iowa qualified research expenses are multiplied by 1.95% to arrive at the RAC amount which may be claimed.

However, if Iowa qualified research expenses were incurred in any or all of the previous 3 years, those expenses must be totaled, divided by 6, and subtracted from the total current Iowa qualified research expenses. The resulting amount is then multiplied by 4.55% to arrive at the RAC amount which may be claimed. Taxpayers were not required to use the same calculation method on both their federal and state tax returns. According to an IDR representative, most businesses claiming RAC tax credits use the IASC method.

<u>Supplemental RAC</u> – The Legislature authorized supplemental RAC under section 15.335 of the *Code*, effective May 1, 1994. As previously stated, supplemental RAC is only available to businesses receiving awards from the IEDA under either an Enterprise Zone or High Quality Jobs Program agreement. Supplemental RAC is in addition to, not in lieu of, the RAC administered by the IDR. In addition, effective July 1, 2009, supplemental RAC is subject to the aggregate tax credit limit for tax credit programs administered by the IEDA.

Prior to July 1, 2010, supplemental RAC equaled an additional 6.5% of qualifying incremental research expenditures, allowing taxpayers to as much as double the RAC tax credit. However, in accordance with rules 261-59.12(7) and 261-175.4(3) of the IAC, the IEDA could negotiate a supplemental RAC tax credit amount different, but no more, than the tax credit amount calculated using 6.5%.

Effective July 1, 2010, supplemental RAC is based on the gross receipts of program participants and may be claimed over a 5-year period if the total amount of the award has not been claimed previously. In accordance with section 15.335 of the *Code*, the supplemental RAC percentage for businesses with annual gross revenues:

- equal to or less than $20 million calculating the RAC tax credit using the regular calculation method is up to an additional 10% of current year Iowa qualified research expenses.
- exceeding $20 million calculating the RAC tax credit using the regular calculation method is up to an additional 3% of current year Iowa qualified research expenses.
- equal to or less than $20 million calculating the RAC tax credit using the IASC method is 7% of qualified research expenses exceeding 50% of average Iowa qualified research expenses in the 3 previous years, or 3% of current year Iowa qualified research expenses.
- exceeding $20 million calculating the RAC tax credit using the IASC method is 2.1% of qualified research expenses exceeding 50% of average Iowa qualified research expenses in the 3 previous years, or 0.9% of current year Iowa qualified research expenses.

According to a representative of the IEDA, supplemental RAC is typically based on 50% of the research and development expenditures of the business, which is the percentage the IEDA considers to be qualified. However, this percentage may exceed 50% if the business is able to substantiate a higher percentage. The IEDA representative further stated supplemental RAC is usually negotiated by the IEDA. IEDA personnel review the ability of the business to perform under the proposed Enterprise Zone or High Quality Jobs Program agreement and complete a calculation based on initial information provided by the business prior to approving supplemental

RAC. In addition, IEDA personnel request previous RAC and supplemental RAC claim information from the IDR to help establish a reasonable award amount. The results of the negotiations and related information obtained from the IDR are documented by the IEDA. See **Finding A**.

Although the RAC tax credit program, including supplemental RAC, is only applicable to qualifying business research expenditures, individuals with ownership interests in pass-through entities, such as limited liability corporations, S corporations, and partnerships, may qualify to claim a portion of the tax credits earned by one or more businesses in accordance with section 422.10(5) of the *Code*. Tax credit certificates are issued by the IEDA to businesses which have been awarded supplemental RAC tax credits under the RAC tax credit program. Each tax credit certificate is assigned a unique tax credit certificate number and contains the taxpayer's name, address, tax identification number, and the amount of tax credits awarded. Taxpayers must submit the tax credit certificate with their tax return for the tax year in which it is used to claim supplemental RAC.

The IDR reviews relevant supporting documentation, including the tax credit certificate issued by the IEDA, indicating the contract under which supplemental RAC tax credits were awarded and related information in the tax credit award report provided by the IEDA. For awards made on or after July 1, 2009, the supplemental RAC tax credits, in conjunction with other tax credits awarded by the IEDA, are limited by the aggregate tax credit limit established by the Legislature under section 15.119 of the *Code*. If a claim includes supplemental RAC, IDR personnel verify the claim amounts do not exceed the maximum approved by the IEDA. According to an IDR representative, during the review of claims including supplemental RAC, IDR personnel request clarification from the IEDA compliance team as needed.

To claim RAC and supplemental RAC, if applicable, taxpayers submit the "IA 148 Tax Credits Schedule," which documents the number of the tax credit certificate issued by the IEDA, and one of the following supporting forms, which include calculation of the tax credit earned:

- IA 128: Iowa Research Activities Tax Credit,
- IA 128A: Iowa Alternative Incremental Research Activities Credit (for tax years 2000 through 2009), or
- IA 128S: Iowa Alternative Simplified Research Activities Tax Credit.

In accordance with sections 422.10(4), 422.33(5)(f), and 15.335(8) of the *Code*, RAC and supplemental RAC tax credits in excess of the taxpayers' tax liability may be refunded, including interest. In addition, in lieu of claiming a refund, taxpayers may elect to have excess RAC and supplemental RAC tax credits applied to their tax liability for the following tax year.

We obtained a summary of the number of claims, the total amount claimed, and the total amount refunded by the IDR under the RAC tax credit program, including supplemental RAC, as of December 30, 2015. The RAC tax credit was authorized beginning with the 1985 tax year, and the supplemental RAC tax credit was authorized beginning with the 1994 tax year. However, comprehensive claim data for the RAC and supplemental RAC tax credits is not available from the IDR for tax years 1985 through 2001. In addition, as previously stated, the IDR did not comprehensively track tax credit claims prior to the 2006 tax year. As a result, the information presented for January 1, 2002 through December 31, 2005 is based on a report issued by the IDR in January 2008 and may not be complete.

According to a representative of the IDR, beginning with the 2006 tax year, all calculations of RAC and supplemental RAC are verified as the claim data is collected from the tax forms submitted. In addition, the IDR relies on the review and audit of RAC tax credit claims submitted by taxpayers performed by the Internal Revenue Service. The information presented for tax years 2006 through 2014 is as recorded by the IDR in TCTAS. However, as previously stated, according to a representative of the IDR, the tax credit claim information for tax credits claimed in 2013 and 2014 is still being reviewed and verified by the IDR. As a result, it is subject to change by the IDR when the review is complete. **Table 11** summarizes the number of claims, the amount of RAC and supplemental RAC claimed, and the RAC and supplemental RAC refunded by tax year for tax years 2002 through 2014.

Table 11

	RAC		Supplemental RAC		Total Refunds	
Tax Year	**Number**	**Amount**	**Number**	**Amount**	**RAC**	**Supplemental RAC**
2002-2005^	602	$ 124,934,000	60	$ 39,182,191	$ 119,800,000	^
2006	943	30,731,665	174	13,070,815	26,435,561	12,829,633
2007	1,276	35,671,858	484	19,052,467	31,608,846	18,849,473
2008	1,127	33,647,023	131	17,106,935	28,844,838	16,706,528
2009	899	33,749,477	144	15,845,384	27,981,665	15,721,239
2010	1,025	38,210,808	141	15,821,698	26,643,506	10,026,348
2011	1,924	42,602,716	165	15,557,708	28,079,463	9,195,199
2012	1,239	46,794,166	134	8,232,957	30,371,543	7,494,330
2013	1,367	39,195,544	123	6,647,735	28,016,088	5,602,171
2014	1,124	15,082,992	113	4,774,077	10,613,376	4,509,590
Total	11,526	$ 440,620,249	1,669	$ 155,291,967	$ 358,394,886	100,934,511

^ - Supplemental RAC refund information is not available from the IDR for tax years 2002 through 2005. In addition, the RAC refunds were reported by the IDR in millions.

As illustrated by the **Table**, approximately $358.4 million, or 81.3%, of the $440.6 million of RAC claimed for tax years 2002 through 2014 was refunded to taxpayers. In addition, approximately $100.9 million, or 86.9%, of the $116.1 million of supplemental RAC claimed for tax years 2006 through 2014 was refunded to taxpayers.

<u>Selected Tax Credit Claims</u> – We obtained a detailed listing of all RAC and supplemental RAC tax credits claimed by taxpayers for tax years 2006 through 2012 as of July 3, 2014 from the IDR. According to a representative of the IDR, the data for the 2013 tax year was not provided because it had not been verified by the IDR at that time. We selected 25 RAC tax credits and 5 supplemental RAC tax credits to determine compliance with the requirements of the applicable sections of the *Code*, rules of the IAC, and IDR tax form instructions. In addition, we reviewed the tax returns for the selected taxpayers to verify the RAC and supplemental RAC tax credits reported were correctly claimed in accordance with the requirements of the *Code*, the IAC, and IDR's tax form instructions. As a result, we determined the IDR complied with the requirements of the applicable sections of the *Code* and rules of the IAC for the claims selected, and the RAC and supplemental RAC tax credits were correctly reported and claimed in accordance with the requirements of the *Code*, the IAC, and IDR's tax form instructions for the selected tax returns.

<u>Reporting</u> - In accordance with sections 422.10(6) and 422.33(5)(h) of the *Code* and rules 701-42.11(4) and 701-52.7(7) of the IAC, the IDR must submit an annual report to the Legislature by February 15 on the RAC tax credits and supplemental RAC tax credits, if applicable, claimed by individuals and corporations. The annual report must include the:

- total amount of RAC tax credit claims,
- total amount of supplemental RAC tax credit claims,
- total amount of RAC and supplemental RAC tax credits refunded to taxpayers,
- allocation of RAC tax credits claimed against individual income tax and RAC tax credits claimed against corporate income tax, and
- names of those taxpayers claiming RAC tax credits in excess of $500,000 and the amount of RAC tax credits each of those taxpayers claimed.

We reviewed the RAC tax credit program annual reports submitted by the IDR to the Legislature for calendar years 2009 through 2014 for compliance with the requirements of the *Code* and the IAC. As a result, we determined the IDR complied with the annual reporting requirements.

Department Evaluation

Return on Investment (ROI) – During the 2005 legislative session, the Legislature directed the IDR to perform periodic evaluations of the various tax credit programs, including evaluation of economic impact, to:

- provide a comparison of Iowa's tax credits to similar federal and other states' tax credits,
- summarize information related to the usage of Iowa's tax credits, and
- evaluate the economic impact of the tax credits.

As a result, the IDR periodically obtained, summarized, analyzed, and reported on tax credit information as required. However, a calculation of, and report on, ROI was not specifically required by the *Code*, and the IDR did not implement procedures to calculate or evaluate ROI. See **Finding A**.

In January 2008, the IDR completed the "Iowa's Research Activities Tax Credit: Tax Credits Program Evaluation Study." The "Economic Analysis of the RAC in Iowa" section of the January 2008 evaluation stated, in part, ". . .based on the analysis presented here, it is not possible to conclusively say whether the RAC in Iowa does or does not cause businesses to change their behavior regarding research activities, and in turn benefit the Iowa economy." In addition, the "Future Work" section of the January 2008 evaluation stated, in part:

> "This study offers a close look at the corporate income tax claims for the Research Activities Tax Credit in Iowa over the twenty years of its existence. Given lack of historical claims data, the analysis of individual income tax claims for RAC was limited to the last four tax years. In the future, data collected from the IA 148, beginning with the 2006 tax year, should allow for a more complete capture and thus better assessment of the RAC claims that are taken against individual income taxes.
>
> The economic analysis section was a first cut at trying to discern any impacts of the RAC on the Iowa economy. The state-level analysis revealed conflicting results depending on the comparison group and the economic impact measure, and thus did not produce any conclusive results about the impact of the credit. It is possible the limited size of the samples considered and the limited variability in the characteristics of the credit hampered the analysis. Comparing Iowa's credit against a larger group of states may provide a better test of these concerns. Hopefully this study will raise discussion and generate ideas for improved analysis that could be carried out in the future.
>
> This study also made no attempt to discern differential impacts between the automatic and supplemental RAC. Because the supplemental credits account for as much as 36 percent of RAC claim dollars each tax year, it would be useful to assess whether the additional dollars provide real incentives to increase research activities in Iowa or research-related employment. Direct contact with firms via surveys or interviews may provide valuable information about the impact of the RAC on the State economy and work force, and in particular, details needed to determine whether the supplemental credit is a useful addition to the incentives offered by DED [currently IEDA] and administered through the income tax system."

Although the Legislature established the RAC tax credit program, including supplemental RAC, to increase research activities or research-related employment in the State, the legislation does not specify expectations or goals for RAC or supplemental RAC. In addition, the IDR did not establish any criteria to measure the success of the RAC tax credit program. As a result, it is not possible to determine the extent, if any, to which the RAC tax credit program helps increase research activities and research-related employment in the State. We concur with the conclusion included in the January 2008 evaluation that future evaluations should include an assessment of the impact of supplemental RAC tax credits on research activities or research-related employment in the State. See **Finding A**.

In January 2009, the IDR completed the "Iowa's Biofuel Retailers' Tax Credits: Tax Credits Program Evaluation Study," including all of the ethanol retailers' tax credits, except for E15GC which was not established until 2011. The conclusion included by the IDR in the January 2009 evaluation stated, in part:

> "Although biofuel consumption in Iowa has increased steadily since 2002, this study found no overwhelming evidence that the current biofuel retailers' tax credits have played a major ongoing role in that increase. . . . Counties within Iowa reporting a higher share of retailers claiming the current EBGC credit did not have a significantly higher share of gasohol sales. However, that analysis relied on a single year of less-than-complete retailers' sales data. The analysis should be revisited once information collected from retailers through the 2008 Retailers Motor Fuel Gallons Annual Report is available, particularly if response rates are higher or the quality of the data appears to be better. Because retailers face no penalty for not filing the report, IDR continues to rely on voluntary compliance by respondents.
>
> The structures of the biofuel retailers' tax credits are such that very little of the benefit is likely passed on to the consumer, either because there exists so much uncertainty as to what credit amount the retailer will receive per gallon of biofuel sales or there exists such a long lag between the time of sale of the fuel and the receipt of the credit that the retailer would have a hard time affording passing on the credit through lower sales prices. Credits administered through the motor fuel tax system rather than the income tax system could possibly address the timing problem that currently exists. It will be interesting to watch if retailers' behavior changes as the EBGC is replaced with the EPTC this year [2009] given the more complex structure of the latter credit, but potentially higher credit rate for biofuel sales, and as the E85GC begins its slow phase-down.
>
> Using national biofuel growth assumptions made by the Energy Information Administration, the study forecasts that 16.5 percent of Iowa's petroleum consumption will be replaced by biofuels in 2020. That number falls short of the Legislative goal of 25 percent. Based on the analysis in this study, it was assumed that the existence of the biofuel retailers' tax credits would not lead biofuel consumption in Iowa to grow more quickly relative to that expected at a national level. It seems reasonable that as energy technology changes over the next few years, the Legislature may want to reassess that goal and the tax credits created to meet it."

As previously stated, the IDR relies on retailers to voluntarily comply with the reporting requirements specified by section 452A.33(1) of the *Code*. However, the information provided by the retailers is essential for the IDR to evaluate the progress toward the 25% replacement goal established by the Legislature. As a result, the analysis included in the annual report submitted to the Governor and LSA may not be reliable. Currently, retailers face no penalty for not filing the required report. See **Finding B**. In addition, during the January 2009 evaluation, the IDR determined the uncertainty regarding the amount of the EPTC and the delay between the time of sale and the receipt of the tax credit benefits from both EPTC and E85GC directly affected the retailers ability to pass on the tax credit benefit to consumers through lower prices, which has a direct effect on the ROI of the ethanol retailers' tax credits. In part, the IDR evaluation stated these concerns exist because the ethanol retailers' tax credits are administered through the income tax system rather than the motor fuel tax system. See **Items for Further Consideration**.

As previously stated, legislation approved in 2006 established the goal that biofuels would replace 25% of all petroleum used in the formulation of gasoline sold within Iowa by January 1, 2020. According to IDR's "2014 Retailers Motor Fuel Gallons Annual Report," biofuel gallons sold only accounted for 11.4% of the State's retail motor fuel sales. Although this increased from 2013, an additional increase of approximately 2.7% per year is needed in calendar years 2015 through 2019 to meet the established goal. The Legislature established the ethanol retailers' tax credit program to help meet the goal; however, the legislation does not specify expectations or goals for each ethanol retailer tax credit. As a result, it is not possible to determine the extent, if any, to which the ethanol retailers' tax credit program helps in meeting the 25% replacement goal. We concur with the conclusion included in the January 2009 evaluation that the Legislature should periodically reassess the 25% replacement goal and the tax credits created to meet it. See **Finding A**.

In January 2010, the Panel issued a report including an in-depth review of all existing tax credits. Within this report, the Panel stated the refundability of RAC tax credits is not equitable and causes RAC tax credits to be more costly than comparable tax credits in surrounding states. In addition, the Panel reported refundability increases the fiscal impact of a tax credit because a tax credit claim is not limited to the tax generated on the income earned by the taxpayer. As a result, a taxpayer may receive a refund even though the taxpayer has no tax liability and paid no Iowa income taxes. The Panel also concluded it was unreasonable for the State to be providing successful, larger corporations refund checks for RAC tax credits which exceeded the tax liability owed to the State. Therefore, the Panel recommended elimination of refundability for large companies, defined as those with gross receipts in excess of $20 million yearly, and provision of a 5-year carry-forward for their research investment. However, the RAC and supplemental RAC tax credits remain refundable for all taxpayers. See **Items for Further Consideration.**

During the 2010 legislative session, the Legislature authorized section 2.48 of the *Code* which established the Legislative Tax Expenditure Committee (the Committee) to review tax incentive programs based on a schedule summarized in section 2.48(3) of the *Code*. The Committee completed a review of the RAC tax credit program in 2011 and a review of the E85GC, EPTC, and E15GC tax credits in 2014. Section 2.48(4) of the *Code* requires no more than 5 years pass between reviews. As a result, the Committee is scheduled to review the RAC tax credit program again in 2016.

In accordance with section 2.48(2)(a)(2) of the *Code*, the Committee must submit a report to the Legislative Council containing the results of each review of a tax credit program, including a statement of the policy goals and an ROI calculation for the tax credit program reviewed. Calculating ROI includes analyzing the cost to and the benefits realized by the State for providing the tax credit program and reaching a conclusion as to whether the benefits of the tax credit program are worth the cost to the State of providing the tax credit program. The report submitted by the Committee to the Legislative Council may also include recommendations for better aligning tax credit programs with the original intent of the legislation that enacted them.

According to representatives of the IDR, the basic methodology used by the IDR in completing tax credit program evaluations is as follows:

- Establish clear definitions of the tax credit.
- Analyze similar tax credits established by other states and similar federal tax credits, such as the RAC.
- Complete a literature review to research and analyze information related to the credit.
- Complete a summary of tax credit claims, transfers, and refunds, as applicable.
- Examine characteristics and timing of the taxpayers claiming the credits.
- Attempt to analyze related economic activity and impact as possible. The IDR typically considers economic impact based on surveys and other analysis, such as case studies showing changes in economic activity in areas close to projects receiving tax credit awards.

In December 2011, the IDR submitted "Iowa's Research Activities Tax Credit: Tax Credits Program Evaluation Study" to the Committee in accordance with section 2.48 of the *Code*. The December 2011 RAC evaluation:

- provided data on corporate and individual RAC and supplemental RAC tax credit claims and the underlying qualified expenditures,
- compared wages paid by businesses claiming RAC tax credits to other businesses in the same industry,
- discussed changes made to the federal and State RAC tax credits since 2008,
- attempted to analyze the impact of the RAC tax credit program on research-related employment within the State and to measure businesses' perceived benefits of the RAC tax credit program, and

- presented an update on the RAC tax credit programs offered by other states and a review of recent literature on RAC tax credit programs in the U. S. and around the world.

The December 2011 RAC evaluation stated, in part, "Unfortunately, it is not possible to measure the extent to which the credit drives the amount of research conducted in Iowa because there is . . . no recent time period where Iowa did not offer the credit." In addition, the conclusion of the December 2011 RAC evaluation stated:

> "This evaluation . . . took advantage of the claim information captured via the IA 148 Tax Credits Schedule, introduced in tax year 2006, to provide a more complete picture of who claims the credit and what companies earn the credit. In tax year 2009, the most recent complete tax year, $45.9 million in credits were claimed, resulting in $43.5 million paid in refunds. Companies performing qualified research in Iowa reported over $1.17 billion in research expenditures in the state during tax year 2009, with wages paid to Iowans comprising two-thirds of those expenditures. However, an analysis of wages paid by companies with credit claims did not show those companies pay higher average wages to employees compared to companies in the same industry with no credit claims.
>
> Other key results presented in this study reflected information gathered through the IDR Survey on Research Activities. [To obtain information regarding the jobs associated with research, in what other states claimants conduct research, the results of the research, and the impact of the tax credit on claimants' decisions to conduct those activities in Iowa, IDR surveyed 517 companies making at least one claim to RAC during tax years 2006 through 2009.] For the 37 percent of companies that responded to the survey, three-fourths indicated their research activities were limited to Iowa, while the remaining one-fourth reported conducting 45 percent of U.S. research in Iowa. Companies reported that the state business tax climate is an important factor when making decisions about where to locate or expand research efforts; however, quality of the labor force, quality of life for employees, and low labor costs were also important. Survey respondents indicated that 65 percent had been successful in creating a new product line or service during the last four years as a result of their research activities in Iowa and 35 percent reported receiving one or more patent [sic]. Of the companies identified as starting business in Iowa in 2006 or later, just over 1 percent were identified as making an RAC claim through tax year 2009 indicating that the credit is not heavily utilized by start-up companies.
>
> Comparing Iowa's credit rules to neighbors and other states in which survey respondents indicated they were most likely to also perform research reveals that Iowa's credit rules offer the highest claim for the hypothetical large, multi-state research firm. This firm has the highest level of research expenditures of all the hypothetical firms considered and a relatively low state tax liability. Therefore, Iowa's refundable credit and the flat credit rate result in the highest credit of all states considered. Over 60 percent of research expenditures claimed in Iowa are reported by businesses that have the same characteristics of this large, multi-state research firm.
>
> This evaluation study presents a large amount of information about RAC credits claimed by taxpayers and credits earned by taxpayers, much provided directly by the companies making those credit claims. Hopefully the study can inform future decisions about this credit for the State of Iowa."

Based on a review of the December 2011 RAC evaluation and discussions with representatives of the IDR, we determined the economic impact of the RAC tax credit program is difficult to measure and sufficient verifiable data may not be available to ensure an accurate, reliable ROI can be calculated. For example, data, such as the jobs associated with the research and the results of the research, are not easily measured. As a result, although the RAC tax credit program has been in place since 1985, the IDR cannot easily measure and conclude on the success of the RAC tax credit program. In addition, because the ROI of the RAC tax credit program is not currently calculated, it is not possible to measure the economic impact of the reduced tax liability or tax refund created by the RAC tax credits. See **Finding A**.

In December 2014, the IDR submitted "Iowa's Biofuel Retailers' Tax Credits: Tax Credits Program Evaluation Study" to the Committee in accordance with section 2.48 of the *Code*. The December 2014 evaluation repeated the concerns included in the January 2009 evaluation regarding voluntary compliance by retailers with the reporting requirements and the ability of retailers to pass on the tax credit benefit to consumers through lower prices. As a result, the ability of the IDR to evaluate the ROI of the ethanol retailers' tax credit program did not improve from 2009 to 2014. See **Items for Further Consideration**. In addition, the conclusion of the December 2014 evaluation stated, in part:

> "The goal of the . . . tax credits currently available for biofuel retailers in Iowa is to promote biofuel sales to help the state achieve the goal of replacing 25 percent of all petroleum used in the formulation of gasoline consumed in Iowa with biofuels by 2020. Claims of the EPTC demonstrate a decreasing trend between tax years 2009 and 2012, mainly reflecting fewer retailers were able to qualify for the tax credit as the biofuel distribution thresholds increased. However, both the number of claimants and claim amounts for the . . . E85GC increased from 2006 to 2012. The rise in E85GC claims reflects an increase in the sales of E85. . . . Despite an increase in claims between 2011 and 2012, the newest biofuel retailers' tax credit, the E15GC, is still quite small compared with the other . . . tax credits.
>
> The statewide biofuel distribution percentage has increased slowly, from 7.9 percent in 2007 to 10.7 percent in 2013. Using national biofuel growth assumptions made by the Energy Information Administration and retailers' sales data in 2013, the study forecasts that approximately 13 percent of Iowa's petroleum used in gasoline will be replaced by biofuels in 2020, falling short of the Legislative goal of 25 percent."

Based on a review of the December 2014 ethanol retailers' tax credits evaluation and discussions with representatives of the IDR, we determined the economic impact of the ethanol retailers' tax credit program is difficult to measure and sufficient verifiable data may not be available to ensure an accurate, reliable ROI can be calculated. As a result, the IDR cannot easily measure and conclude on the success of the ethanol retailers' tax credit program. In addition, because the ROI of the ethanol retailer's tax credit program is not currently calculated, it is not possible to measure the economic impact of the reduced tax liability or tax refund created by the ethanol retailers' tax credits. See **Finding A**.

<u>Tax Credit Limits</u> – Prior to July 1, 2009, there was no limit in place for the supplemental RAC tax credit. However, during the 2009 legislative session, the Legislature established the aggregate tax credit limit under section 15.119 of the *Code* for the business-related tax credits, including supplemental RAC, administered by the IEDA. For fiscal year 2010, the aggregate tax credit limit was authorized at $185 million for IEDA's tax credit programs, including supplemental RAC. This limit was subsequently reduced by the Legislature from $185 million to $120 million for fiscal years 2011 and 2012 and increased to $170 million for fiscal years 2013 through 2016. Because the RAC tax credit is not included under the aggregate tax credit limit, it may be claimed by any taxpayer with qualified research expenditures.

The Panel stated in its January 2010 report the EPTC and E85GC tax credits are also not included under the aggregate tax credit limit. In addition, the Panel reported the aggregate tax credit limit established for the business-related tax credits allows the State to manage its general fund budget more effectively, but State lawmakers need a more effective method of determining the impact of the tax credit programs on the State's general fund budget. As a result, in its January 2010 report, the Panel recommended combining all business-related tax credit programs under the aggregate tax credit limit, including, but not limited to, the ethanol retailers' and the RAC tax credit programs. However, because the ethanol retailers' and the RAC tax credit programs are administered by the IDR, not the IEDA, it would not be reasonable to incorporate them under the aggregate tax credit limit. Rather, tax credit limits should be established by the Legislature specifically for those programs to be administered by the IDR.

According to representatives of the IDR, establishing tax credit limits would require additional administration by the IDR and the administrative costs for these programs would increase. In addition, the representatives of IDR stated tax credit limits on the ethanol retailers' tax credits may hinder the State's ability to achieve the 25% replacement goal established by the Legislature. However, the IDR representatives stated it may be reasonable to establish a limit for the RAC tax credits on a first-come, first-served basis up to a maximum amount for each tax year. If a tax credit limit is established for the RAC tax credit program, it could be monitored similar to the process the IEDA currently performs for the supplemental RAC tax credits. See **Finding C**.

Findings and Recommendations

We reviewed the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, to determine compliance with the applicable sections of the *Code* and rules of the IAC for tax years 2002 through 2014. We also reviewed the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, to determine if the Iowa Department of Revenue and/or Iowa Economic Development Authority measure the ROI. As a result, we identified certain findings and recommendations relating to the ethanol retailers' and the RAC tax credit programs, including supplemental RAC, which should be considered by the Iowa Department of Revenue, the Iowa Economic Development Authority, and the Legislature.

FINDING A – Return on Investment (ROI)

During the 2005 legislative session, the Legislature directed the IDR to perform periodic evaluations of the various tax credit programs. However, a calculation of, and report on, ROI was not specifically required by the *Code*. As a result, the IDR did not implement procedures to calculate or evaluate ROI.

During the 2010 legislative session, the Legislature authorized section 2.48 of the *Code* which established the Committee to review tax incentive programs, including calculation of ROI. The Committee is to submit a report to the Legislative Council containing the results of each review of a tax credit program, including a statement of the policy goals and an ROI calculation for the tax credit program reviewed.

<u>Ethanol Retailers' Tax Credits</u> – In January 2009, the IDR issued an evaluation report on the ethanol retailers' tax credit program. However, because neither the legislation establishing the program nor the IDR specifies expectations or goals, it is not possible to determine the extent, if any, to which the ethanol retailers' tax credit program helps in meeting the 25% replacement goal established by the Legislature. In addition, we concur with the conclusion included in the January 2009 evaluation that the Legislature should periodically reassess the 25% replacement goal and the tax credits created to meet it.

In December 2014, the IDR issued a subsequent evaluation report on the ethanol retailers' tax credit program. However, based on a review of available information and discussions with representatives of the IDR, we determined the economic impact of the ethanol retailers' tax credit program is difficult to measure and sufficient verifiable data may not be available to ensure an accurate, reliable ROI can be calculated. As a result, the IDR cannot easily measure and conclude on the success of the ethanol retailers' tax credit program. In addition, because ROI is not currently calculated, it is not possible to measure the economic impact of the reduced tax liability or tax refund created by the ethanol retailers' tax credits. In addition, in the December 2014 evaluation, the IDR estimated, under current policies, the likelihood for the State to achieve the 25% replacement goal by January 1, 2020 is slim.

<u>Research Activities Tax Credits</u> – In January 2008, the IDR issued an evaluation report on the RAC tax credit program. However, because neither the legislation establishing the RAC tax credit program nor the IDR specifies expectations or goals, it is not possible to determine the extent, if any, to which the RAC tax credit program helps increase research activities and research-related employment in the State. In addition, we concur with the conclusion included in the January 2008 evaluation that future evaluations should include an assessment of the impact of supplemental RAC tax credits on research activities or research-related employment in the State.

In December 2011, the IDR issued a subsequent evaluation report on the RAC tax credit program. However, based on a review of available information and discussions with representatives of the

IDR, we determined the economic impact of the RAC tax credit program is difficult to measure and sufficient verifiable data may not be available to ensure an accurate, reliable ROI can be calculated. As a result, the IDR cannot easily measure and conclude on the success of the RAC tax credit program. In addition, because ROI is not currently calculated, it is not possible to measure the economic impact of the reduced tax liability or tax refund created by the RAC tax credits.

Based on a review of the required tax form used by taxpayers to claim the RAC tax credit, we also determined only the expenditure amounts are required to be reported when claiming the RAC tax credit. No additional narratives or descriptions of the research conducted or impact statements regarding the effect of the research on Iowa-based employment or the Iowa economy are submitted. Although a taxpayer may have qualifying expenditures for increasing research activities in the State of Iowa, the research outcome(s) may also benefit multiple other states.

In addition, according to a representative of the IEDA, supplemental RAC is typically based on 50% of the research and development expenditures of the business, which is the percentage the IEDA considers to be qualified. However, this percentage may exceed 50% if the business is able to substantiate a higher percentage. The IEDA representative further stated supplemental RAC is usually negotiated by the IEDA. Currently, there is no method in place to measure the economic impact of the negotiated supplemental RAC.

<u>Recommendation</u> – The IDR should establish expectations or goals for the ethanol retailers' and the RAC tax credit programs to facilitate effective measurement and evaluation of the costs and benefits to the State of providing these programs. In addition, the IDR, in conjunction with the Committee, should develop a method to calculate ROI and measure the success of the ethanol retailers' and the RAC tax credit programs. The IDR should ensure supporting documentation is maintained for all ROI calculations and sufficient, verifiable data is obtained to ensure an accurate, reliable ROI can be calculated. If the ROI and success of the ethanol retailers' and the RAC tax credit programs cannot be measured, the Legislature should consider whether the ethanol retailers' tax credits and the RAC tax credits should be continued.

<u>Response</u> – To the extent provided by law, IDR endeavors to gather data that is relevant to evaluate each tax credit program to measure whether identified goals are being met. For example, IDR's 2014 report on the ethanol retailers' credit discussed progress toward the 25%-by-2020 statutory goal, to the extent that data was available. IDR agrees that effectiveness of a tax credit program cannot be evaluated without defined, measurable goals for the tax credit. IDR's ability to establish program goals and to gather information for measuring return on investment is limited by the authority granted in each statute. Here, the statutes for the RAC and the Ethanol Retailers' Tax Credits do not provide a framework for evaluation in that manner. See Iowa Code §§ 422.11N, 422.11O, and 422.11Y (the ethanol promotion credit statutes) and Iowa Code §§ 422.10 and 15.335 (the RAC and Supplemental RAC statutes). IDR believes that the legislature should establish goals against which IDR may then evaluate the success of the program.

IDR is willing to request additional information from tax credit applicants where appropriate and within our statutory authority. Without further statutory definition of the program goals or information to be evaluated, it is not appropriate for IDR to request information that is outside of our statutory authority. Furthermore, if the legislature wishes to establish specific goals or information to be evaluated, we recommend that the legislature provide specific penalties for failure to comply with the information requirements, such as denial of the credit.

<u>Conclusion</u> – Response acknowledged. In the absence of legislative change, IDR should implement procedures to measure the success of the ethanol retailers' and RAC tax credit programs to the best of its ability.

FINDING B – Annual Reporting Requirement

In accordance with section 452A.33(1) of the *Code*, each retail dealer is required to report its total motor fuel gallons sold by each fuel type on a company-wide and site-by-site basis to the IDR. Specifically, rule 701-67.27 of the IAC requires each retail dealer to submit a retailer gallons report detailing the number of motor fuel gallons sold, including ethanol, during the previous calendar year to the IDR by January 31. Because the retailers currently face no penalty for not submitting the required report, the IDR must rely on voluntary compliance by the retailers. However, the information provided by the retailers is essential for the IDR to evaluate the progress toward the 25% replacement goal established by the Legislature. As a result, the analysis included in the annual report submitted to the Governor and LSA may not be reliable.

Recommendation – The IDR should consider whether a penalty should be established to enforce retailers' compliance with the reporting requirements. If a penalty cannot be assessed, the IDR should implement sufficient alternate procedures to obtain verifiable information to be used for its analysis.

Response – The Legislature contemplated a penalty during the 2011 session, but failed to pass that penalty. (See 2011 House File 451, LSB1832HV (disallowing claims to the biofuel retailers tax credits for retailers who failed to complete the annual report)). Absent an enactment of this or similar legislation, IDR does not believe it has the authority to assess a penalty for failure to follow the reporting requirements.

IDR has implemented other measures to improve data collection in recent years. During 2015, IDR dedicated resources to improve the largely paper process of data collection beginning with the 2015 annual report. Although large retailers have filed retail station data using an electronic process since the beginning of the annual report data collection, in 2015 an online form was developed to allow electronic data collection directly from the hundreds of smaller retailers, eliminating the potential for data entry error by IDR staff. Paper reports were still accepted, but 58 percent of retailers filed electronically during the initial year. IDR also increased contact with the retailers to encourage completion. These steps pushed up the completion rate to 93.2 percent – the highest in six years.

Conclusion – Response accepted.

FINDING C – Tax Credit Limits

Prior to July 1, 2009, there was no limit in place for the supplemental RAC. However, during the 2009 legislative session, the Legislature established the aggregate tax credit limit under section 15.119 of the *Code* for the business-related tax credits, including supplemental RAC, administered by the IEDA. For fiscal year 2010, the aggregate tax credit limit was authorized at $185 million for IEDA's tax credit programs, including supplemental RAC. This limit was subsequently reduced by the Legislature from $185 million to $120 million for fiscal years 2011 and 2012 and increased to $170 million for fiscal years 2013 through 2016. Currently, the ethanol retailers' tax credits and the RAC tax credit are not included under this limit.

In its January 2010 report, the Panel recommended combining all business-related tax credit programs under the aggregate tax credit limit, including, but not limited to, the ethanol retailers' and the RAC tax credit programs. However, because the ethanol retailers' and the RAC tax credit programs are administered by the IDR, not the IEDA, it would not be reasonable to incorporate them under the aggregate tax credit limit. Rather, tax credit limits should be established by the Legislature specifically for those programs administered by the IDR.

Recommendation – The IDR and the Committee, in conjunction with the Legislature, should implement tax credit limits for the ethanol retailers' and the RAC tax credit programs administered by the IDR.

Response – Aggregate limits can only be administered through an application process which turns these automatic credits into awarded credits. Per-taxpayers caps are another way to limit the fiscal impact of the programs. Aggregate or per-taxpayer caps could be structured in a number of different ways, and IDR is willing to work with the legislature to discuss how such caps could be implemented.

Conclusion – Response accepted.

Items for Further Consideration

As a result of our review, we identified the following items for further consideration:

- According to IDR's January 2009 evaluation of the ethanol retailers' tax credits, it is likely very little of the benefit from the tax credits is passed on to the consumer by the retailers. Because there is significant uncertainty regarding the EPTC amount the retailers will receive and there is a significant delay between the time of sale and the receipt of the tax credit benefits from EPTC, E85GC, and E15GC, the retailers' ability to lower sales prices is affected. In addition, the ethanol retailers' tax credits are currently administered through the income tax system rather than the motor fuel tax system, which contributes to the concerns identified by the IDR. The December 2014 evaluation of the ethanol retailers' tax credits repeated the concerns included in the January 2009 evaluation. The Governor and the Legislature should consider whether the ethanol retailers' tax credits should be administered by the IDR through the motor fuel tax system to address the concerns which currently exist.

- In the January 2010 report issued by the Panel, the Panel reported the refundability of RAC tax credits is not equitable and causes RAC tax credits to be more costly than comparable tax credits in surrounding states. In addition, the Panel reported refundability increases the fiscal impact of a tax credit because a tax credit claim is not limited to the tax generated on the income earned by the taxpayer. As a result, a taxpayer may receive a refund even though the taxpayer has no tax liability and paid no Iowa income taxes. The Panel also concluded it was unreasonable for the State to be providing successful, larger corporations refund checks for RAC tax credits which exceeded the tax liability owed to the State.

  The Panel recommended elimination of refundability for large companies, defined as those with gross receipts in excess of $20 million yearly, and provision of a 5-year carry-forward for their research investment. However, the RAC and supplemental RAC tax credits remain refundable. The Governor and the Legislature should consider whether the RAC and supplemental RAC tax credits should remain refundable. If so, they should consider whether it should be refundable for all eligible taxpayers or limited based on an established threshold.

A Review of the
Ethanol Retailers' Tax Credit Program and
the Research Activities Tax Credit Program

A Review of the
Ethanol Retailers' Tax Credit Program and
the Research Activities Tax Credit Program

Staff

This review was conducted by:
Annette K. Campbell, CPA, Director
Jennifer Campbell, CPA, Manager
Mark C. Moklestad, CPA, Senior Auditor

Tamera S Kusian

Tamera S. Kusian, CPA
Deputy Auditor of State

Appendices

A Review of the
Ethanol Retailers' Tax Credit Program and
the Research Activities Tax Credit Program

Summary of Current Tax Credit Programs Administered by the State

The Tax Credits Users' Manual includes a summary of the 37 tax credits currently administered by state agencies, including the Iowa Economic Development Authority (IEDA), the Iowa Department of Revenue (IDR), the Iowa Agricultural Development Authority (IADA), and the Iowa Utilities Board (IUB). In addition, the State's community colleges administer certain tax credits. Tax credits may be:

- Automatic – The tax credit may be claimed on an Iowa return by any taxpayer meeting the eligibility requirements for the program.
- Awarded – The tax credit is awarded by an administering state agency in accordance with eligibility and administrative requirements contained in relevant chapters of the Iowa Administrative Code (IAC).
- Transferable – The tax credit may be sold to other taxpayers to reduce their tax liability. See **Appendix B** for additional information.
- Refundable – The tax credit can reduce the taxpayer's tax liability below zero. As a result, it is possible to receive a tax refund from this type of tax credit. See **Appendix B** for additional information.
- Carried forward – The tax credit can be claimed on future tax returns. The carry forward time period for tax credits vary and are established by specific sections of the *Code of Iowa*.
- Sunsetted – The tax credit may be repealed by the Legislature on a certain date, as required by the relevant section of the *Code*. See **Appendix B** for additional information.

The State Historic Preservation Office within the State Historical Society of Iowa, a division within the Department of Cultural Affairs, is responsible for administering the Historic Preservation and Cultural and Entertainment District Tax Credit Program. The purpose of the program is to encourage rehabilitation of historic properties throughout the State by providing a 25% tax credit for investments made by corporations or individuals in the rehabilitation of eligible historic properties.

The IEDA is primarily responsible for administering or monitoring the following tax credits:

- Accelerated Career Education Program (ACE) – This withholding credit is administered by Iowa's community colleges and provides credits for employers which sponsor training programs at community colleges.
- Assistive Device – This tax credit is available to taxpayers who make investments in assistive devices which allow for disability workplace accommodations and applies to corporate income tax.
- Endow Iowa – This tax credit is equal to 25% of a taxpayer's endowment gift (up to 5% of the aggregate annual award limit, or $300,000, for a single taxpayer) to a qualified community foundation. Endow Iowa applies to corporate income tax, individual income tax, franchise tax, insurance premium tax and monies and credits tax.
- High Quality Jobs Program (HQJP) – HQJP provides tax benefits to eligible companies which create high-paying jobs and make capital investments. HQJP replaced the New Jobs and Income and the New Capital Investment Programs. The amount of tax incentives awarded is dependent on the number of jobs created or retained and the qualifying investment made. Actual award amounts are based on the business' level of need, the quality of the jobs, the percentage of created jobs defined as high-quality and the economic impact of the project. This tax credit applies as follows:

- The investment tax credit and the sales tax refund are administered in the same manner as the EZ tax credit.
- The value-added property tax exemption allows communities to exempt all or a portion of the actual value added by improvements to real property directly related to jobs created or retained by the location or expansion of the approved business and used in the operations of the approved business. The exemption may be allowed for a period not to exceed 20 years beginning the year the improvements are first assessed. Improvements include new construction and rehabilitation of and additions to existing structures. The exemption applies to all taxing districts in which the real property is located. The community is to provide the IEDA and the local assessor with a copy of the resolution adopted by its governing body which indicates the estimated value and duration of the authorized exemption.
- The corporate tax credit for certain sales tax paid by a third-party developer allows approved businesses to claim a corporate tax credit up to an amount equal to the sales and use tax paid by a third-party developer under Chapter 423 of the *Code* for gas, electricity, water/sewer utility services, goods, wares/merchandise or services rendered, furnished or performed to/for a contractor or subcontractor and used in the fulfillment of a written contract relating to the construction or equipping of a facility of the approved business. Taxes attributable to intangible property and furniture and furnishings shall not be refunded.

- Innovation Fund – A 25% tax credit is allowed for investments in an innovation fund approved by the IEDA. This fund is focused on making investments in businesses applying novel or original methods to manufacture a product or deliver a service. Innovation Fund applies to corporate income tax, individual income tax, franchise tax, insurance premium tax and monies and credits tax.
- Iowa Industrial New Jobs Training Program – This program, administered by Iowa community colleges, assists businesses which are creating new positions with new employee training. Participating companies divert withholding tax which would be remitted to the IDR to a community college to pay for training for company employees.
- Redevelopment – This tax credit is available to taxpayers investing in redeveloping a brownfield or grayfield site. A brownfield site is defined as an abandoned, idled or underutilized industrial or commercial facility where expansion or redevelopment is complicated by real or perceived environmental contamination. A grayfield site is defined as a property which has been developed and has infrastructure in place but the property's current use is outdated or prevents a better or more efficient use of the property. Such property includes vacant, blighted, obsolete or otherwise underutilized property. This tax credit applies to corporate income tax, individual income tax, franchise tax, insurance premium tax and monies and credits tax.
- Targeted Jobs – A withholding tax credit is available to employers who enter into an agreement with pilot project cities approved by the IEDA. Current pilot project cities include Burlington, Council Bluffs, Fort Madison, Keokuk and Sioux City. Because Fort Madison and Keokuk are in the same county and have a total population of fewer than 45,000, they are considered as one pilot city due to changes in the legislation in 2007. This tax credit had a sunset date of June 30, 2013, which was extended to June 30, 2018.
- Venture Capital – Qualified Business or Community-Based Seed Capital Fund – A tax credit is allowed for 20% of the equity investment made in a qualifying business or community-based seed capital fund approved by the IEDA. This credit is focused on "angel investors" who make investments in start-up companies. Effective July 1, 2011, the program has an award cap of $2 million per fiscal year and the administration of the credit was moved from the Iowa Capital Investment Board to the IEDA.
- Workforce Housing Tax Incentive Program – Tax incentives under this program are available to taxpayers who complete a housing project in Iowa. Eligible projects include

four or more single-family dwelling units, one or more multiple dwelling unit buildings each containing three or more individual dwelling units, or two or more dwelling units located in the upper story of an existing multi-use building. The project consists of rehabilitation, repair, or redevelopment at a brownfield or grayfield site that results in new dwelling units, the rehabilitation, repair, or redevelopment of dilapidated dwelling units, the rehabilitation, repair, or redevelopment of dwelling units located in the upper story of an existing multi-use building, or the new construction, rehabilitation, repair, or redevelopment of dwelling units in a distressed workforce housing community. The program went into effect July 1, 2014.

Although the IDR is indirectly involved in the administration and reporting of all tax credits, it is directly responsible for administering the following tax credits, in addition to the ethanol retailers' tax credits and Research Activities Credits which are included in this report:

- Adoption – This tax credit is available in an amount equal to the qualified adoption expenses paid or incurred by the taxpayer during the tax year associated with the adoption of a child. The maximum amount allowed is $2,500 per adoption, defined as the permanent placement in Iowa of a child by a qualifying agency. This tax credit is available for tax years beginning on or after January 1, 2014.
- Biodiesel Blended Fuel – This tax credit is available to retail dealers who sell biodiesel blended fuel through motor fuel pumps during the tax year. This tax credit had a sunset date of December 31, 2012, which was extended to December 31, 2017.
- Charitable Conservation Contribution – This tax credit is available to individual and corporate taxpayers who make an unconditional charitable donation of a qualified real property interest located in Iowa to a qualified organization exclusively for conservation purposes.
- Child and Dependent Care – This tax credit is available to individual taxpayers who have eligible child and dependent care expenses. Eligible taxpayers must have net income of $45,000 or less.
- Claim of Right – This tax credit may be taken if there was income repaid in the current tax year which was reported and taxed on a prior Iowa tax return. Taxpayers claim the credit, if eligible, on their individual income tax return.
- Early Childhood Development – This tax credit is equal to 25% of the first $1,000 of expenses paid for early childhood development expenses for each dependent age 3 years to 5 years. This tax credit is only available to taxpayers whose net income is less than $45,000. If the taxpayer claims Early Childhood Development, the taxpayer cannot claim Child and Dependent Care.
- Earned Income – This tax credit is available to individual taxpayers who qualify for the federal earned income tax credit and equals 7% of the federal earned income tax credit. During the 2013 legislative session, this tax credit was coupled with the permanent increases in the federal earned income tax credit and increased to 14% for the 2013 tax year and 15% for tax years beginning on or after January 1, 2014.
- Farm to Food Donation – This tax credit is available to taxpayers producing a food commodity and donating that commodity to an Iowa food bank or an Iowa emergency feeding organization. Farm to Food Donation applies to corporate income tax and individual income tax. This tax credit, created during the 2013 legislative session, is effective for tax years beginning on or after January 1, 2014.
- Franchise – If a financial institution elects to file as an S corporation for federal income tax purposes and have its income taxed directly to the shareholders, those shareholders qualify for a franchise tax credit equal to their pro-rata share of the Iowa franchise tax paid by the financial institution. The franchise tax credit applies to corporate income and individual income tax.

- Geothermal Heat Pump – This tax credit is available for individual income tax equal to 20% of the federal residential energy efficient property tax credit allowed for geothermal heat pumps provided in section 25D(a)(5) of the U.S. Internal Revenue Code for residential property located in Iowa. The federal tax credit is available for property placed in service before January 1, 2017. As a result, the Iowa tax credit will be available for tax years 2012 through 2016. These tax credits do not require an award. Taxpayers claim the tax credit, if eligible, on their individual income tax return.

- Minimum – A taxpayer may be eligible for the minimum tax credit if they paid Iowa minimum tax in previous years based on tax preferences and adjustments. The tax credit is limited to the extent the regular tax less all "other nonrefundable" tax credits exceeds the alternative minimum tax for a tax year.

- Motor Vehicle Fuel – An income tax credit is allowed for the amount of Iowa motor fuel tax paid relating to purchases for off-road use made by individuals and corporations. This tax credit is allowed for taxpayers who do not have a motor fuel refund permit.

- S Corporation Apportionment – Individual resident shareholders of S corporations which conduct business within and outside of Iowa can claim an S corporation apportionment tax credit. This tax credit is structured to tax the S corporation on the greater of income attributable to Iowa under the single sales factor or actual distributions by the S corporation less federal income tax. The intent is to treat S corporations similar to C corporations which are entitled to apportion income within and outside of Iowa.

- School Tuition Organization – This tax credit is available for 65% of the amount of a voluntary cash contribution made by a taxpayer to a school tuition organization. The contribution cannot be used for the direct benefit of any dependent of the taxpayer or any other student designated by the taxpayer.

- Solar Energy System – This tax credit is available for individual income tax and corporate income tax for solar energy systems installed on a residence or business located in Iowa. Total tax credits awarded for systems installed during a calendar year cannot exceed $1.5 million. Awards are made on a first-come, first-served basis.

- Taxpayers Trust Fund – This tax credit is available in any year in which the Iowa Taxpayers Trust Fund balance exceeds $30 million. The first year it was available was the 2013 tax year for all individuals who file an Iowa income tax return by October 31, 2014. The tax credit amount, calculated each year by the IDR, equals the amount of the transfer divided by the number of eligible taxpayers who filed timely returns during the prior tax year. The credit is nonrefundable, but is claimed after all credits have been claimed against the individual income tax imposed. Therefore, only taxpayers with an Iowa tax liability can claim the tax credit.

- Tuition and Textbook – This tax credit is available to individual taxpayers who have 1 or more dependents attending grades kindergarten through 12 in an accredited Iowa school. This tax credit does not apply to home schooling expenses.

- Venture Capital – Iowa Fund of Funds (IFOF) – A contingent tax credit is allowed for investments made into the IFOF. The tax credit is only allowed to the extent the actual rate of return on these investments does not meet the rate of return guaranteed to investors. Tax credits are awarded only when investors present mature investment certificates and the Iowa Capital Investment Board certifies the return is lower than the guaranteed rate of return.

- Volunteer Firefighter and Volunteer Emergency Medical Services Personnel – Effective January 1, 2013, this tax credit is applicable to individual income tax for volunteer firefighters and volunteer emergency medical services personnel. A volunteer firefighter must be an active member of an organized volunteer fire department in Iowa who has met the minimum training standards established by the Fire Service Training Bureau. Volunteer emergency medical services personnel must be individuals who are trained to provide emergency medical care and who are certified as first responders and have been issued a certificate by the Iowa Department of Public Health.

The IADA is responsible for administering the Beginning Farmer tax credit, an agricultural assets transfer tax credit allowed for agricultural assets which are subject to a lease or rental agreement. The renter must qualify as a beginning farmer, and the lease must have a term of at least 2, but not more than 5, years. This tax credit equals 7% of the amount paid to the taxpayer under the agreement or 17% of the amount paid to the taxpayer from crops or animals sold under an agreement in which the payment is exclusively made from the sale of crops or animals.

The IUB is responsible for administering the following tax credits:

- Renewable Energy – This tax credit is available for a producer or purchaser of energy from an eligible renewable energy facility approved by the IUB. A power-purchase agreement is signed between the purchaser and producer which sets forth which party will receive the tax credit. The tax credit can also be received for renewable energy produced for on-site consumption by the producer provided the facility is capable of producing no less than three-fourths of a megawatt. A renewable energy facility includes a wind energy conversion facility, a biogas recovery facility, a biomass conversion facility, a methane gas recovery facility or a solar energy conversion facility located in Iowa and placed in service between July 1, 2005 and January 1, 2015. This tax credit has a sunset date of December 31, 2021.
- Wind Energy Production – This tax credit is for electrical production facilities which produce electricity from wind and are approved as eligible by the local board of supervisors and the IUB. The IDR determines the amount of the tax credits and issues the tax credit certificates, which authorize credits to be claimed by eligible applicants. Wind energy production can be claimed by a qualified facility which was originally placed in service on or after July 1, 2005 but before July 1, 2012.

A Review of the
Ethanol Retailers' Tax Credit Program and
the Research Activities Tax Credit Program

Summary of the Tax Credit Review Panel's January 2010 Report on Tax Credits

- Accountability and Transparency – The public does not have the information needed to analyze and discuss the effectiveness of the state's tax credit programs. The Panel recommended the Revenue Estimating Conference make available a list of the types and amounts of tax credit claims at each meeting to clearly identify what is being "spent" for that year in the form of tax credits.
- Return on Investment – Each tax credit program should be evaluated using sound cost-effectiveness analysis techniques which incorporate appropriate assumptions. Key considerations to be taken into account should include whether the public investment produced greater business activity by the recipient and whether the tax credit produced a net increase in economic activity.
- Transferability – The ability to transfer tax credits complicates tracking of tax credits, creates uncertainty about when tax credits will be claimed and siphons resources from tax credit recipients through brokerage fees. In addition, the individual or entity which ultimately benefits from the tax credit is not the entity targeted by the program or undertaking the intent of the program. Once a tax credit is transferred, there is limited recourse for the State to recover funds claimed in instances where the business awarded the original tax credit does not fulfill the contracted obligations or if the tax credit was awarded in error. The Panel recommended the State eliminate the ability to transfer all tax credits. At the time of the report, 7 of the 36 tax credits were transferable, including:
    - Redevelopment,
    - Housing investment tax credit within an EZ,
    - Film, Television and Video Production Promotion (subsequently repealed),
    - Historic Preservation,
    - Renewable Energy,
    - Venture Capital – IFOF and
    - Wind Energy Production.
- Capping – In fiscal year 2010, the former Governor proposed a global cap on all uncapped tax credits. The Legislature approved this proposal by adopting a $185 million global cap. However, 7 business-related programs, with no separate individual cap, were not included in the global cap. It is very difficult to have any predictability and stability for the state budget without caps on the tax credit programs. The Panel recommended moving all business-related credits under the $185 million cap for the IEDA.
- Sunsetting – Economic challenges facing the State change regularly and, as a result, the tax credit programs should be reviewed regularly. Having an opportunity to review the effectiveness of a tax credit program on a regular basis would help ensure the State does not maintain a program which is not providing economic activity, creating jobs, helping businesses or achieving the desired results. The Panel recommended the State require a 5 year sunset for each tax credit program to allow policy makers and the public to know which tax credit programs are achieving desired results. At the time of the report, 25 of the 36 tax credit programs did not have a sunset.
- Refundability – This allows a taxpayer with a tax credit claim in excess of any tax liability to receive the difference as a payment with the filing of a tax return. This increases the fiscal impact of a tax credit because a claim is not limited to the tax generated on the income earned by the taxpayer. A taxpayer may receive a refund even though the taxpayer has no tax liability and paid no Iowa income taxes. The Panel recommended the refundability provision of the Research Activities tax credit be eliminated for large companies, defined as those with gross receipts in excess of $20 million annually, and, instead, allow these companies a 5-year carryforward for their research investment.