2015 Iowa Tax Expenditure Study: Initial Release

February 2017

Introduction

The 2015 Iowa Tax Expenditure Study provides information on the revenue impact of tax credits, exemptions, deductions, nontaxable transactions, or other deviations from the operation or collection of a tax in Iowa. This initial release presents tax expenditures related to the State's sales and use tax as well as the property tax levied at the local level. Future releases will include information on other tax types including the corporation income tax and the individual income tax. The Department has completed a similar study for 2000, 2005, and 2010.

This Study is designed to provide expenditure information in a manner that is consistent with the definitions used in Iowa Code Section 2.48 (2017). In preparing this report, 233 separate types of transactions or property were identified as tax expenditures for 2015. This release quantifies the impact of 196 of these tax expenditures. For 37 other tax expenditures, lack of data or concern about taxpayer information disclosure prevented release. We note, however, that not all items that are defined as tax expenditures under Iowa Code Section 2.48 are considered tax expenditures under a normal tax structure. For example, items purchased for resale and many business inputs are exempt from sales tax consistent with the generally accepted principle that sales tax should apply only to final purchases by consumers.

Data Presentation

This study is the initial release of a comprehensive tax expenditure study by the Iowa Department of Revenue for 2015. A description of the fields presented in the spreadsheets is provided on page 4. Historical rates and other information about the tax types covered in this study release are provided on pages 5 through 8.

Purpose of the Tax Expenditure Study

Government programs funded through direct appropriations are subject to periodic review as part of the state budget process. Programs funded through special features or omissions of the tax code, such as nontaxable events, tax exemptions, tax credits, tax deductions, and income tax exclusions, generally escape such examination. Therefore, this study is intended to provide more information about these features of the Iowa tax statutes and to improve government accountability.

The estimates presented in this study are for taxable events occurring in calendar year 2015 and are based upon the most recent data available adjusted to reflect the levels of activity in 2015, if necessary. For income tax and sales and use tax, the estimates are based only upon the impact on receipts of the State of Iowa and only upon receipts going into the General Fund. Impacts on local option income surtaxes or local option sales taxes are not estimated. For this initial release of the study, tax expenditures are limited to those related to sales and use as well as property taxes.

Categories of Tax Expenditures

This tax expenditure report categorizes each expenditure by the intent of the provision. Some exemptions are in place to avoid double taxation while others reflect conscious policy decisions to pursue a certain social, economic, or environmental goal.

Administrative: This category notes expenditures that are nontaxable or exempt because taxability would result in double taxation or the taxation of an incidental transfer. Examples include the exemption for interstate sales or prepaid merchandise cards as well as the nontaxable status of property transferred in corporate mergers.

Agricultural Input: This category exempts most personal property used by farmers to produce or an input which becomes food or fuel including items that are depleted in the creation of food or fuel. Examples include grain dryers, commercial fertilizer and lime, and agricultural feed.

Business Incentive: This category provides benefits to businesses in the interest of facilitating economic and/or employment growth. Examples include the reduced tax rate on construction equipment, the High Quality Job Program Sales Tax Refund, and the Workforce Housing Tax Incentive Sales Tax Refund.

Business Input: This category exempts items used in a business's production process to avoid levying taxes at each link in a supply chain. Examples include electricity to private water companies, inert gases used in manufacturing, and packaging containers.

Charitable Organization Support: This category exempts certain items sold by or sold to certain nonprofits generally engaging in activities in the public interest, or for items sold to support educational, religious, or charitable activities. Examples include exemptions for sales to nonprofit hospice facilities, Community Action Agencies, or private art centers.

Consumer Benefit: This category exempts or reduces the tax rate for items commonly purchased by consumers, often items considered necessities. Examples include food sales for human consumption, medical services, and residential utilities.

Environmental: This category exempts or reduces the tax rate for sales or property that promotes the health of wildlife, reduces pollution, or facilitates the transition to renewable energy. Examples include the sales and property tax exemption for solar energy equipment, the exemption of pollution control and recycling property, or the property tax exemption for native prairie and wetlands.

Government: This category exempts items or property sold to, sold by, or owned by any level of local, state, or the federal government. Examples include sales by the Legislative Services Agency or the Department of Cultural Affairs as well as refunds for materials used in the construction of government buildings.

In addition to some sales being exempt from tax, other sales are subject to different tax rates or different taxes entirely; an example is hotel rooms are subject to a five percent tax rate. Because these characteristics of the tax code reduce revenue compared to the rate paid on other taxable purchases or property, these are also identified as tax expenditures.

Regardless of approach, selection of particular tax expenditures is still a subjective process. For example, tax changes that alter the timing of when revenues or expenses are realized for tax purposes are not treated as tax expenditures. Although an attempt was made to be as inclusive as possible within the general criteria, there remains potential for additional tax expenditures to be identified in the future.

How the Tax Expenditures Have Been Estimated

Two primary assumptions have been used for the Iowa tax expenditure study that are generally consistent with the assumptions used for calculating tax expenditures in other states and by the federal government. The first of these assumptions is that economic behavior is not altered. By definition, tax expenditures are sometimes created in order to bring about an expected result or to encourage a particular behavior. Estimates in this study are done assuming that the elimination of the tax expenditure will not otherwise change behavior. This assumption avoids the necessity for making subjective assumptions about behavior and the possibility of inconsistency in methods and outcomes. Such analysis is beyond the scope of this study.

The second assumption used in this study is that tax expenditures are independent of other tax provisions. The fiscal impact of one tax provision can affect the fiscal impact of another tax provision. For example, under the individual income tax, eliminating a nonrefundable credit such as the personal credit could result in taxpayers being able to utilize more of other nonrefundable credits, but the estimate of the tax expenditure value for each credit assumes all other credits remain in place.

Another important issue to note is that tax expenditure estimates are not the same as budgetary fiscal estimates. Although the provided estimates of tax expenditures indicate the magnitude of the revenue gain from the repeal of specific provisions, actual budgetary fiscal impacts of legislative changes may produce different results. The primary reason for this variance is the use of different basic economic assumptions or time periods when compiling the estimates. Another reason for possible differences is the assumption of independence when calculating tax expenditures contrasted with budgetary fiscal estimates that are often considered in the context of other changes.

In calculating each tax expenditure preference was given to internal data when available. If unavailable, the 2012 Economic Census published by the US Census Bureau was frequently used. Other data sources include industry data identified on the internet or gathered through phone calls and emails, the Agricultural Census published by the US Department of Agriculture, other federal data, or comparable data from other states. Although data sources often are consistent across studies, large changes in estimates over time may reflect a change in data source.

The General Fund estimates in this study relate to expenditures estimated for the 2015 calendar year for sales and use tax. For property tax, the estimates relate to property valuations or assessments for calendar year 2013 that would correspond to tax bills due in 2015.

Tax Expenditure Data Fields

The fields in the various Tax Expenditure files are the following:

Title: Expenditure name

Tax Type: Tax base affected by the expenditure

Expenditure Type: Exemption; Partial Exemption; Credit; Deduction; Federal Base (expenditure is a result of the State of Iowa coupling with the Internal Revenue Code)

Iowa Code Citation: Chapter and section containing the expenditure

Iowa Administrative Code Citation: Chapter and section containing the rules used to administer the expenditure

Description: Details about the expenditure

Data Source: Primary source of data for calculating the expenditure; if data could not be found, could not be disclosed, or is included in the estimate for another expenditure, that is indicated here

Expenditure Category: Broad group of expenditure purpose; see full list on page 2

Assessment Change Value: Property Tax Only – Estimated change in the assessment of property values subject to various property tax levy rates as a result of the exemption; rounded to the nearest one hundred thousand

Tax Expenditure Value: Estimated reduction in General Fund taxes collected as a result of the exemption, credit, or deduction; rounded to the nearest one hundred thousand; entry is listed as minimal if significantly under $100,000

Revenue Diverted: Vehicle Registration Fee Only – Revenue diverted from the General Fund to a special fund; in this instance, the Road Use Tax Fund

Tax Base Descriptions and History

Before considering any exceptions to the tax base, a general description of the current tax base and rates and a short history are provided. The following descriptions cover the taxes considered in this study.

Sales and Use Taxes

Both the Iowa sales tax and the use tax were enacted in 1934. Sales tax is imposed on the gross receipts from the sale of tangible personal property sold at retail and of enumerated services. The use tax is meant to complement the Iowa sales tax. The general rule is that a transaction is subject to Iowa use tax when it is completed outside the State but involves tangible personal property sold for use in Iowa. The principle also applies to the sale of taxable services purchased outside of Iowa for use in Iowa. Any transaction where sales tax has been paid, at a rate equal to or higher than the Iowa sales tax rate, is exempt from use tax.

The sales and use tax rate in 2015 equaled six percent and was applied to most purchases of goods and a select group of services. One percentage point of the Iowa sales and use tax is appropriated to school infrastructure and property tax relief. Additionally, a local option sales tax may apply with a maximum rate of one percent for a maximum State and local sales tax rate of seven percent. The local option sales tax is a local government tax and is not taken into consideration in the estimates presented. The history of the Iowa sales and use tax rate is presented in the table below.

History of Iowa Sales and Use Tax Rates

Date of Change	Tax Rate
April 1, 1934	2.00%
July 1, 1955	2.50%
July 1, 1957	2.00%
October 1, 1967	3.00%
March 1, 1983	4.00%
July 1, 1992	5.00%
July 1, 2008	6.00%

Sales and Use Tax and Normal Tax Structure:
The normal sales and use tax structure, as discussed by the National Conference of State Legislatures, would levy the statewide tax rate on all tangible personal property and all services at the point of final consumption. Because most purchases of inputs by businesses, including agricultural businesses, are not at the point of final consumption, exemption of those purchases is not a deviation from the normal tax structure. However, given that the impact of business and agricultural input exemptions is of interest to policymakers, estimates are provided. Similarly, other tax expenditures are also not deviations from the normal sales and use tax structure

because they are in place to avoid double taxation; these estimates are categorized as administrative.

In Iowa, all tangible personal property is taxable unless explicitly listed as exempt in the Iowa Code. Conversely, all services are nontaxable unless explicitly listed as taxable in the Iowa Code. Iowa taxes more services than some states, but many business services, such as accounting, engineering, and legal services, remain nontaxable. New in the 2015 report, many nontaxable services are included as tax expenditures, but because these are not taxed by statute, no specific Iowa Code citation identifies these services as tax expenditures.

During calendar year 2015, sales tax, retailers use tax, and consumers use tax receipts totaled $2.74 billion.

Property Tax

In Iowa, the property tax is used only by local government entities that are permitted by State statute to impose the tax. The property tax is levied on the taxable value of real property. The consolidated tax rate differs in each locality and is a composite of county, city, school district, and special levy authorities.

Tax Base and Rates:
The tax levy rates are expressed in dollars and cents per $1,000 of assessed valuation. The property tax due and payable in a fiscal year is determined by multiplying the consolidated levy rate by the assessed value of the property. The assessed value of the property is that determined as of January 1 of the year preceding the year in which the fiscal year begins, i.e., 18 months prior, adjusted by the applicable rollback. The consolidated levy rate is the total levy rates of all levy-authority jurisdictions in which the property is located.

Assessment:
Real property is placed in one of four classes: agricultural, residential, commercial, or industrial. Commercial property includes buildings containing three or more separate residences, except condominiums, multiple housing cooperatives, and certain non-profit housing. Effective assessment year 2015, multiresidential was introduced as a fifth property class.

Most real property is assessed locally by either the county or city assessor. The assessment year starts on January 1 of each calendar year. Every two years in the odd-numbered year, local assessors are required to revalue all real property in their jurisdictions. Also every two years in the odd-numbered years, the Department of Revenue issues equalization orders. In this process, the Department of Revenue reviews the level of assessment of property within each class of property, excluding industrial. If the aggregate assessed valuation of that class of property is at least five percent above or below the actual valuation of that class of property as determined by the Director as set out in the abstract of assessment, the Department of Revenue orders the equalization of the levels of assessment of that class of property.

Tax base assessment for taxable real property is one hundred percent of market value. The foundation for agricultural property is productivity value rather than market value.

Central Assessment:
All lands, buildings, machinery, and equipment belonging to electric companies (including rural cooperatives), gas companies (including pipelines), railway companies, and telephone/telegraph companies are assessed by the Department of Revenue and subject to property taxation by local governments.

For assessment years beginning January 1, 1999 and after, central assessment of entities involved in the production, delivery, and transmission of electricity and natural gas was replaced with an excise tax on their production, delivery, and transmission. The excise tax rates vary annually by service area. An annual statewide property tax is also imposed, at a rate of three cents per $1,000 of assessed value, on all property subject to the excise tax.

Equalization:
In order to prevent wide variations between assessments statewide of real property in any one class, the equalization process takes place in each odd-numbered year. As the first step of the process, which is carried out in its entirety by the Department of Revenue, the Department conducts a statewide review of the level of assessment of property within each class, except industrial, for every jurisdiction. If the aggregate assessed valuation of a class of property within a jurisdiction is at least five percent above or below the market value of that class of property as established through statistical analysis and abstract of assessment submissions, equalization of that class of property is required. Equalization is accomplished by increasing or decreasing the aggregate valuations of certain classes of property within jurisdictions by a percentage necessary to adjust the level of assessment to actual value. Equalization orders are restricted to equalizing the aggregate valuations of entire classes of property and may not adjust the valuations of individual properties. Equalization is not considered a tax expenditure but rather an establishment of a tax base.

Rollback:
The taxable value of property may be a percentage of the assessed value as a result of statewide limitations on annual growth in assessed value. The statewide limitation on growth is three percent annually (eight percent annually for utilities). Increases in the assessment of residential and agricultural property are tied to each other. The annual increase in each class of property is limited to the smaller of the two increases in either class of property. In November of each year, the Director of Revenue certifies the limitation percentages to county auditors. The rollback percentage is multiplied by the assessed value to obtain the taxable value of the property less any exemptions or partial exemptions.

Property Tax Normal Tax Structure:
The normal property tax structure, as discussed by the National Conference of State Legislatures, is considered to be the levying of the relevant jurisdiction's tax rate on the full market value of all real property, including land and water rights, buildings, structures, substances contained in or growing upon the land, machinery used in manufacturing, etc. In Iowa, the normal tax structure is defined to not include any tax on personal property or inventories. If a property tax credit is funded through an appropriation, then that amount is noted as a budgeted tax credit.

During fiscal year 2015, property tax receipts totaled $4.98 billion.