Fiscal Note

Fiscal Services Division

HF 715 – Department of Revenue Omnibus (LSB1239HV)
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Fiscal Note Version – New

Description

House File 715 is composed of 15 divisions. The Bill relates to taxes and the administrative procedures of the Department of Revenue (Department). The Bill has various effective dates, including immediate effective dates and retroactive applicability dates.

Divisions with No Projected Fiscal Impact

- **Division II — Bonus depreciation and increased expensing clarification.**
- **Division III — Tax filing status clarification, conformity to federal tax return.**
- **Division V — Tax year (TY) 2026 tax rate reference correction.**
- **Division VI — Department Director settlement authority, tax assessment appeal period, and sales tax return examination period.**
- **Division VII — Tax preparer identification number requirement.**
- **Division VIII — Department setoff fee authority.**
- **Division XI — Department electronic communications rules.**
- **Division XIII — Composite return filing for financial institutions subject to bank franchise tax.**

Divisions with Minor Projected Fiscal Impacts

- **Division I — Contribution and designation due dates.** Current Iowa law allows a taxpayer to make tax-deductible contributions to an Iowa educational savings plan trust (529 account) for a tax year up to the due date of the tax return for that tax year (April 30). The Bill extends the contribution deadline if the taxpayer lives in an area that has been declared a natural disaster area by the Governor and the Department Director has extended the tax return filing deadline for the disaster area. The Bill also makes the same deadline allowance for beneficiary designations for a first-time homebuyers savings account. The 529 account deadline extension will allow taxpayers to make deductible 529 account contributions for the previous tax year that they would not be able to make without the law change. The annual number of taxpayers benefiting from this change is expected to be minimal, and the State General Fund fiscal impact is projected to be low.
- **Division IV — Individual income tax withholding.** The Bill rewrites Iowa Code section 422.16 relating to income tax withholding agents and the withholding of Iowa income tax from the wages and other income of residents and nonresidents. The changes do not alter income tax liability, but the changes may alter when and if income tax is withheld. Changes to withholding may result in fiscal impacts across fiscal years as income tax withheld in one fiscal year often becomes a component of the tax liability calculation for a tax return filed in the following fiscal year.
- **Division IX — Homestead Property Tax Credit.** The Bill rewrites the definition of “owner” as it relates to qualifications for the Homestead Tax Credit. While much of the rewrite is to improve clarity, the change also allows persons who own a home but do not own the land on which the home is located to be considered an owner regarding credit qualifications. This change is projected to increase the total number of owners qualifying for the property tax credit. The statewide number of owners of homes who do not own the land on which the

home is located is not known. For every 100 such homes, the annual fiscal impact on the State General Fund Homestead Tax Credit appropriation would be an increase of approximately $14,000.

- **Division X — Elderly and Disabled Property Tax Credit.** Current Iowa law includes the term "any pension or annuity" within the definition of "income" that is used to determine eligibility for the Elderly and Disabled Property Tax Credit. The Bill adds language listing specific types of pension and annuity income, including income received pursuant to a farm tenancy agreement covering real property. The language may result in a change in the number of people qualifying for the State-funded property tax credit and the associated rent reimbursement payment and manufactured and mobile home tax reductions. The Department reports that the change will codify current practice related to the determination of income.
- **Division XIV — Retired farmer income exclusions.** The Bill amends the definition of "materially participated" in regard to two Iowa individual income tax preferences available to farmers (Iowa Code section 422.7(13) and (14)). Under current law, the definition cites federal law. The amendments make inapplicable to the definition a provision of federal law that relates to a taxpayer who died or is the surviving spouse of a deceased taxpayer. While the fiscal impact of this change to the State General Fund is likely less than $100,000, the impact to specific taxpayers could be significant.
- **Division XV — Transfers of individual income surtax.** The income surtax for schools applies a surtax to the State individual income tax liability of income taxpayers who reside in a school district where the surtax is in place. When received, surtax amounts are deposited to the State General Fund. Under current practice, accumulated surtax is moved out of the General Fund to a separate fund monthly, with 75.0% to 85.0% of the transfers for a fiscal year (a total of $118.3 million in FY 2022) transferred during the months of March through June. The following December and February, moneys within the separate fund are distributed to the school districts that had a surtax in place for the previous tax year. The Bill codifies a scheduled monthly transfer of surtax from the General Fund to the separate fund. The change does not have a projected General Fund fiscal impact as long as the codified schedule does not change the fiscal year to which any of the monthly transfers out of the General Fund to the separate fund are recorded.

Division XII Background — Transfers from a 529 Account to a Roth IRA

The Bill creates a new individual income tax exemption for qualified transfers out of a taxpayer's 529 account to a Roth Individual Retirement Account (Roth IRA) of the 529 account beneficiary. The new exemption will apply to a maximum of $35,000 transferred from a 529 account. To qualify for the exemption, the 529 account must have been in existence for at least 15 years and the transferred contributions must not have been made within the most recent 5 years.

Federal law allows the creation of 529 accounts that must be used to pay for the qualified educational expenses of the account beneficiary. Federal law does not provide a tax benefit when the contribution is made, but investment increases in the account value are not taxed as long as the proceeds are used for a qualified educational purpose. Unlike federal law, Iowa allows taxpayers to deduct 529 account contributions from their Iowa income when the contribution is made. At both the federal and State level, 529 account withdrawals that are not for a qualified purpose are subject to income tax.

At both the federal and State level, a Roth IRA allows a taxpayer to contribute money to a retirement account without any up-front tax benefit, and then make tax-free qualified withdrawals of the original contributions and the investment growth.

Congress recently added a new qualified use for 529 account proceeds. Beginning with TY 2024, 529 account withdrawals that transfer money to a Roth IRA of the beneficiary will not be subject to federal income tax as long as the amount withdrawn does not represent contributions made to the account within the past 5 years and as long as the account has been in existence for at least 15 years. Once in a Roth IRA, the transferred funds can be withdrawn tax-free as long as the withdrawal is a qualified Roth IRA distribution.

Division XII Assumptions and Fiscal Impact — Transfers from a 529 Account to a Roth IRA

This fiscal impact calculation is based on an analysis completed by the federal Joint Committee on Taxation on December 22, 2022. The analysis concluded that the 529 account change will reduce federal individual income tax revenues by the following amounts:

- TY 2023 = $6.0 million
- TY 2024 = $85.0 million
- TY 2025 = $166.0 million
- TY 2026 = $182.0 million
- TY 2027 = $215.0 million
- TY 2028 = $240.0 million

The federal estimates were converted to State General Fund impacts using the following assumptions:

- The share of federal tax statistics represented by Iowa taxpayers is assumed to be 0.8%.
- The average marginal federal tax rate is assumed to be 12.48%.
- The marginal Iowa individual income tax rate is assumed to be:
  - TY 2023 = 6.00%
  - TY 2024 = 5.70%
  - TY 2025 = 4.82%
  - TY 2026 and after = 3.90%
- Tax year impacts will occur in the fiscal year in which the tax year ends (TY 2023 impacts will occur in FY 2024).

The creation of a new tax exemption for transfers from a 529 account to a Roth IRA is projected to reduce General Fund revenue by the following amounts:

- FY 2024 = $0.1 million
- FY 2025 = $0.3 million
- FY 2026 = $0.5 million
- FY 2027 = $0.5 million
- FY 2028 = $0.5 million
- FY 2029 = $0.6 million

The above fiscal impact is attributed to taxpayers transferring excess funds in existing 529 accounts to the Roth IRAs of beneficiaries. Longer term, the change to State taxation may create a tax incentive to establish personal 529 accounts for taxpayers who do not have plans for additional education but desire a tax-advantaged vehicle for retirement savings. To accomplish this, a taxpayer could create a 529 account with the taxpayer as the beneficiary. Contributions to the account would earn a State tax deduction, effectively exempting the amount of the original contribution from State income tax. Once the account has existed for 15 years, the taxpayer may transfer funds out of the 529 account to a Roth IRA where the original contribution and any investment growth will be shielded from Iowa income tax through Iowa's full retirement income exemption. It is not clear whether an existing account may have the beneficiary changed to accelerate this type of transfer.

If the creation of 529 accounts (or the beneficiary change for existing accounts, if allowed) becomes a common feature of Iowa tax-advantaged financial planning, the fiscal impact in later years could become substantial.

Sources

Department of Revenue
Joint Committee on Taxation
Legislative Services Agency analysis

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The fiscal note for this Bill was prepared pursuant to Joint Rule 17 and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.

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