



Note to Reader:

Legislative Guides, prepared in an objective and nonpartisan manner, provide a general survey of a particular area of the law and are intended for use primarily by members of the Iowa General Assembly and their staffs. Legislative Guides are updated periodically to reflect changes in the law. The reader is cautioned against using information contained in a Legislative Guide to draw conclusions as to the legality of a particular behavior or set of circumstances.

About the Author:

Tim Whipple, J.D., Drake University, 2007, is a Legal Counsel and has been with the Legislative Services Agency since 2007. He staffs the Ways and Means and Economic Growth Committees and drafts legislation in the areas of taxation and economic development.

Mr. Whipple can be reached by phone at (515) 281-3444 or by e-mail at:

timothy.whipple@legis.state.ia.us.

Iowa Legislative Services Agency
State Capitol
Des Moines, IA 50319

December 2010

STATE TAXATION IN IOWA: AN OVERVIEW

Table of Contents

I. Introduction.....	1
A. Purpose and Scope	1
B. A Note about References	1
II. Federal Constitutional Limitations on State Taxation	2
A. The Commerce Clause	2
1. Complementary Taxes under the Commerce Clause	4
2. State Taxation of Foreign Commerce	4
3. A Note on the Interstate Income Act of 1959	5
B. The Due Process Clause	5
C. The Equal Protection Clause	6
D. The Import-Export Clause and the Duty-of-Tonnage Clause	7
1. The Import-Export Clause	7
2. The Duty-of-Tonnage Clause	7
E. The Supremacy Clause	8
F. The First Amendment	8
III. Taxes Imposed or Administered by the State of Iowa.....	8
A. Income Taxes	8
1. The Individual Income Tax	9
2. The Corporate Income Tax	10
B. Franchise and Insurance Taxes	11
1. The Franchise Tax on Financial Institutions.....	11
2. The Moneys and Credits Tax on Credit Unions	12
3. The Gross Premiums Tax on Insurance Companies	12
4. The Underwriting Profit Tax on Marine Insurance.....	12
5. The Reciprocal Tax on Foreign Insurance Companies.....	13
C. Retail Sales and Use Taxes	13
1. A Note about the Streamlined Sales and Use Tax Agreement.....	14
2. The Sales Tax	14
3. The Use Tax.....	15
D. Special Excise Taxes.....	16
1. The State Hotel and Motel Tax	16
2. The Construction Equipment Tax.....	16
3. The Real Estate Transfer Tax	17
4. Cigarette and Tobacco Taxes	17

5. Beer, Wine, and Liquor Taxes	18
E. Motor Vehicle and Fuel-Related Taxes and Fees	18
1. Registration and Title Fees	18
2. Motor Fuel Taxes	19
3. The Environmental Protection Charge	20
4. The Automobile Rental Excise Tax	20
F. Locally Imposed Taxes Administered by the State	21
1. Local Option Hotel and Motel Taxes	21
2. Local Option Sales Taxes	21
3. Local Option Vehicle Taxes	22
4. Local Income Surtaxes	22
G. Inheritance, Estate, and Transfer Taxes	23
1. The Inheritance Tax	23
2. The Estate Tax	24
3. The Generation Skipping Transfer Tax	24
4. The Qualified Use Inheritance Tax	25
H. Other Taxes	26
1. The Unemployment Compensation Tax	26
2. The Tax on Pari-mutuel Wagering	27
3. The Tax on Gambling Games	28
4. The Tax on Dealers of Controlled Substances (The "Drug Stamp" Tax)	29
5. The Brucellosis and Tuberculosis Eradication Levy	30
IV. Tax Revenues	30
A. State Tax Revenues	30
1. FY 2009 Tax Revenues	31
2. FY 2010 Tax Revenues	32
B. Local Tax Revenues	33

State Taxation in Iowa: An Overview



I. Introduction

This Legislative Guide is entitled *State Taxation in Iowa: An Overview* and is intended to serve as a general introduction to the subject.

The Guide is one of many Legislative Guides published by the Legal Division of the Legislative Services Agency.¹ If more information on a particular tax-related topic is desired, the following Guides may also be consulted:

- State Taxation
- Road Use Tax Fund
- Local Property Tax
- Charitable Property Tax Exemption
- Urban Renewal and TIF Areas
- Education Finance
- Gambling in Iowa

A. Purpose and Scope

The purpose of this Guide is to familiarize the reader with the general landscape of taxation in Iowa, including a brief summary of the limitations on state taxation in the United States, a brief description of the taxes imposed by the state of Iowa, and an overview of the revenues generated by those taxes.

The Guide is intended to be an overview of taxation in Iowa and, while it discusses most of the taxes imposed in Iowa, it does not do so in great detail. For more in-depth treatment of a particular tax, the reader is encouraged to consult the additional Legislative Guides referenced above.

The Guide does not evaluate the fairness of Iowa taxes, recommend changes to Iowa tax law, or compare taxation in Iowa to taxation in other states. Nor does the Guide discuss the history of taxation in Iowa; it focuses instead on the current state of the law.

Finally, while the Guide is intended to inform as to the general legal issues involved with state taxation in Iowa, the reader is cautioned against relying on it as a source of legal advice or using it to prepare or file Iowa tax returns.

B. A Note about References

A number of abbreviations and shorthand references are used in this Guide:

1. "Iowa Code" refers to the 2011 Iowa Code.
2. "Internal Revenue Code" and "IRC" refer to the federal Internal Revenue Code of 1986 as in effect on January 1, 2010.
3. "Iowa Administrative Code" refers to the Iowa Administrative Code in effect on November 1, 2010.

¹ <http://www.legis.state.ia.us/Central/Guides/>



State Taxation in Iowa: An Overview

4. "CY" means calendar year.
5. "FY" means fiscal year and refers to the state fiscal year ending on June 30 of the year designated. For example, "FY 2010" refers to the state fiscal year beginning July 1, 2009, and ending June 30, 2010.

II. Federal Constitutional Limitations on State Taxation

State law is not the only body of law that impacts tax policy in Iowa. The United States Constitution contains a number of provisions that circumscribe Iowa's power to levy taxes in a federal system. Some of these provisions serve to protect the interests of the federal government and some serve to protect the interests of individual taxpayers. All of them are appropriately included in any overview of state taxation because they represent the limits of permissible action available to states in the formation and implementation of tax policy. It is helpful to understand the federal constitutional framework for state taxation because this framework has frequently impacted the design and administration of state tax laws.

A. The Commerce Clause²

Economic activity in Iowa reaches beyond the borders of the state, and the tax policies implemented here can have consequences beyond those borders as well. For this reason, the most significant of all federal constitutional limitations on state taxation is the Commerce Clause.

By its text, the Commerce Clause is an express grant of power to the United States Congress to regulate commerce "among the several states." However, the United States Supreme Court has also interpreted this clause to have a "negative" or "dormant" aspect.³ This dormant aspect gives Congress exclusive jurisdiction in the area of interstate commerce and implies that states may not use their powers of taxation to interfere with interstate commerce.⁴

The policy reasons for limiting states' power to tax have been articulated on many occasions but perhaps never better than by Chief Justice John Marshall when he said:

[T]he taxing power of the States must have some limits...It cannot interfere with any regulation of commerce. If the states may tax all persons and property found on their territory, what shall restrain them from taxing goods in their transit through the State from one port to another...or from taxing the transportation of articles passing from the State itself to another State, for commercial purposes? These cases are all within the sovereign power of taxation, but would obviously derange the measures of Congress to regulate commerce, and affect materially the purpose for which it was given.⁵

² "The Congress shall have Power...To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. Art. I, sec. 8, cl. 3.

³ Chief Justice John Marshall first used the term "dormant" with respect to the Commerce Clause in his opinion for the Court in *Gibbons v. Ogden*, 22 U.S. 1 (1824). The history of the Commerce Clause is long and complex and has implications far beyond state taxation. A full explanation of the reach of the Commerce Clause, or even of its "dormant" aspect, is beyond the scope of this Guide.

⁴ The history of the Supreme Court's application of the commerce clause to state and local taxation is also long and complex. Modern Constitutional analysis of state taxation begins with the landmark case of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

⁵ *Brown v. Maryland*, 25 U.S. 419, 448-449 (1827).

State Taxation in Iowa: An Overview



At one time in the Court's history, the Commerce Clause was interpreted as creating a zone of commerce entirely immune from taxation by the states. However, more recently, the Supreme Court has recognized that it was not the intent of the founders to "immunize such commerce from carrying its fair share of the costs of state government in return for the benefits it derives from within the State."⁶ Thus today, states may tax businesses engaged in interstate commerce but only to the extent that such activity has a connection with the state and only as long as such taxes do not place undue burdens on interstate commerce.

The Supreme Court determines whether a state tax violates the restrictions of the Commerce Clause by applying a simple four-part test:⁷

1. There must be substantial nexus between the state and the person, property, or transaction on which the tax will be imposed.⁸
2. The tax must be fairly apportioned in order to reflect the extent and nature of the taxpayer's activities within the taxing state.⁹
3. The tax must not discriminate against interstate commerce.¹⁰
4. The tax must be fairly related to the services provided by the state.¹¹

A tax that meets all four parts of this test will be considered a valid exercise of a state's taxing power notwithstanding that the tax may have an incidental impact on interstate commerce.

The modern trend in the Supreme Court's state taxation jurisprudence is not to immunize interstate commerce from taxation but rather to harmonize states' rights with the exclusive right of Congress to regulate interstate commerce. In doing so, the court has often focused on two questions:

⁶ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 461-462 (1959).

⁷ The four-part test, while having antecedents in case law, was definitively adopted as the court's primary analytical framework in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Subsequent cases have further refined the meaning and application of the test, but this case and the four-part test it endorsed remain the key precedent for evaluating the validity of state taxes under the Commerce Clause.

⁸ "Nexus" is a concept with at least two distinct, and sometimes confusing, applications under the U.S. Constitution. Under the Due Process clause, a certain minimum level of connection with a state will suffice to exercise jurisdiction over a taxpayer. Similarly, under the Commerce Clause, a taxpayer must have a certain level of connection with a state before the taxpayer is subject to taxation by that state. However, while the term "nexus" is used to describe the required level of connection under both clauses, the Supreme Court has said that the level is not the same in each context. For example, an out-of-state vendor selling goods into a state via mail order catalogs can reasonably be expected to be subject to the jurisdiction of the courts in that state without violating the concepts of fairness that underlie the Due Process Clause. In contrast, the Court has said that the Commerce Clause requires a higher level of connection before the state can impose tax obligations on that vendor. Thus, unless that out-of-state vendor has a physical presence in the state, the vendor cannot be required to collect and remit sales taxes from in-state customers, even if it would be fair for the state's courts to exercise jurisdiction over the vendor. The practical effect of this distinction is that a somewhat greater connection or "nexus" is required for state taxation than for personal jurisdiction. See *Quill Corp. v. North Dakota*, 504 U.S. 278 (1992).

⁹ One of the leading cases on fair apportionment is an Iowa case. See *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978). For a more thorough explanation of Iowa's apportionment formula, see this Guide's discussion of Iowa's corporate income tax. Also, note that sales and use taxes are not subject to the apportionment requirement. See e.g. *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175.

¹⁰ In this context, "discriminating against interstate commerce" means tax laws that attempt to favor local interests over out-of-state interests. See, for example, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) in which a tax on milk producers combined with a subsidy to in-state producers was held to discriminate against interstate commerce.

¹¹ The court has held that determining whether a tax is "fairly related" to services does not require an intensive factual inquiry into the value of state benefits received by a taxpayer and that even a general levy will be considered "fairly related" to those services necessary for providing "the advantages of a civilized society." See *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 624 (1981).



State Taxation in Iowa: An Overview

(1) Whether a state is legitimately exercising authority over the activity within its borders or whether it is attempting to reach beyond its borders to tax activity that has little connection to the state.

(2) Whether the state is attempting to favor in-state interests to the detriment of their out-of-state competitors.

1. Complementary Taxes under the Commerce Clause

Iowa, like many other states, imposes a use tax on the use of tangible personal property in the state.¹² An exemption to this use tax is allowed if sales tax has already been collected on the property. The sales and use taxes are thus said to be “complementary” to each other.

Some states, however, do not impose sales taxes and, because of a lack of nexus, Iowa cannot require out-of-state vendors to collect sales and use taxes on direct mail or internet sales to Iowa consumers.¹³ Because of that, it is common for Iowa residents to purchase property on which no sales tax has been collected or paid. If, however, the property was purchased for use in Iowa, then Iowa use tax may be owed on the purchases.

The use tax might thus appear to be an Iowa tax on goods purchased in another state or from an out-of-state vendor and, if so, would seem to overreach the state’s taxing power under the Commerce Clause. However, the Supreme Court has held that sales and use taxes do not discriminate against interstate commerce as long as the burden on in-state purchases is the same as the burden on out-of-state purchases.¹⁴ Thus, Iowa imposes both taxes at the same rate and provides a credit against the use tax for sales taxes paid to another state.¹⁵

2. State Taxation of Foreign Commerce

In an increasingly global economy, it becomes more likely that Iowa tax law will burden foreign commerce. Given the federal government’s need to “speak with one voice” in foreign affairs, the Supreme Court has strictly limited the states’ power to tax foreign commerce. In addition to the four-part test described above, a state tax also must not cause international multiple taxation or “impair federal uniformity” in the area of foreign commerce.¹⁶

The result is that, even more so than under the Interstate Commerce Clause, state tax laws must not discriminate against foreign commerce. When Iowa attempted to impose the state corporate income tax on the dividend income of foreign subsidiaries but not on the income of subsidiaries based in the United States, the Supreme Court held that it was a burden on foreign commerce even though the tax did not specifically favor Iowa businesses. According to the court, discrimination against

¹² Iowa Code § 423.5.

¹³ *Quill Corp. v. North Dakota*, 504 U.S. 278 (1992).

¹⁴ *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937).

¹⁵ Iowa Code §§ 423.2, 423.5, and 423.22.

¹⁶ *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

State Taxation in Iowa: An Overview



foreign commerce creates implications for the nation as a whole and, therefore, such decisions must be reserved to the federal government.¹⁷

3. A Note on the Interstate Income Act of 1959¹⁸

While the Supreme Court has often used the dormant aspect of the Commerce Clause to restrict state taxing powers, Congress is always free to legislate in this area and has done so.¹⁹ The Interstate Income Act of 1959 is one such instance. The Act allows certain businesses a limited exemption from state-imposed corporate income taxes. Specifically, the Act prevents a state from taxing a corporation's net income if the corporation's activities in a state are limited to the solicitation of sales of tangible personal property where the orders for those sales are approved, rejected, and filled outside the state.

The Act was passed in 1959, and its underlying policy assumptions are somewhat dated. As a result, the exemption afforded under the Act is somewhat narrow. For one thing, the Act is limited to taxes on "net income" and there is no exemption provided for other taxes, such as gross receipts taxes.²⁰ For another thing, the Act is limited to the solicitation of sales of tangible personal property. In today's economy, however, much interstate commercial activity involves the sale of services and other intangible forms of property not embraced by the term "tangible personal property." Whether Congress will ever update the Act to reflect the substantial changes in interstate commerce and state tax law since its original passage remains an open question, but, in the meantime, it is important to be cognizant of the additional limitation on state taxing power contained in the Act.

B. The Due Process Clause²¹

A state's power to tax is also subject to the limitations of the Due Process Clause. An attempt by a state to collect a tax from a taxpayer is an exercise of the state's jurisdiction over that taxpayer. In exercising such jurisdiction, states are constrained by the fairness concerns central to the Due Process Clause. The primary inquiry in this context is, given the extent and nature of the taxpayer's connections to the state, whether the taxpayer should reasonably expect to be subject to that jurisdiction.

The Supreme Court has held that, as long as there is "some minimum connection between a state and the person, property, or transaction it seeks to tax", the requirements of the Due Process Clause are satisfied.²² However, because of the different nexus requirements of the Commerce Clause and the Due Process Clause, it is possible to have

¹⁷ *Kraft General Foods, Inc. v. Iowa Dept. of Revenue*, 505 U.S. 71 (1992).

¹⁸ The Interstate Income Act of 1959 is also, and perhaps better, known as P.L. 86-272. The text of this law can be found online at <http://uscode.house.gov/> or codified at 15 U.S.C. § 381 et seq.

¹⁹ See e.g. the McCarran-Ferguson Act (15 U.S.C.A. §§ 1011 et seq.) which allows states to tax and regulate the insurance industry.

²⁰ The Multistate Tax Commission defines a gross receipts tax as "a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed." In Iowa, the franchise tax on financial institutions and the insurance premiums tax on insurance companies resemble a gross receipts tax. For more information, see the section of this Guide discussing franchise and business taxes. See Article II of the Multistate Tax Compact's suggested enabling legislation, available at <http://www.mtc.gov/About.aspx?id=76> (last accessed 10/28/2010).

²¹ No state may "deprive any person of life, liberty, or property without due process of law." U.S. Const. amend. XIV, § 1.

²² *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954).



State Taxation in Iowa: An Overview

a connection that is sufficient to satisfy due process but that is, at the same time, insufficient to justify its impact on interstate commerce.

From a practical perspective, then, states seeking to exercise their taxing power generally need to be more concerned with Commerce Clause nexus than Due Process Clause nexus. However, it should be noted that actual physical presence is always sufficient to establish both types of nexus.²³

C. The Equal Protection Clause²⁴

Another constitutional limitation on a state's power to tax is the Equal Protection Clause. In general, the Equal Protection Clause ensures that everyone has the same rights under the law.

The clause does not, however, ensure that everyone pays the same amount of taxes. For example, the Supreme Court has held that:

*[T]he States, in exercising their taxing power are subject to the requirements of the equal protection clause of the fourteenth amendment. But that clause imposes no iron rule of equality... The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to make close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value.*²⁵

The Court has also given states substantial flexibility to create tax classifications, holding that “where taxation is concerned..., the states have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation.”²⁶

In light of the substantial leeway allowed states in exercising their powers of taxation, the Supreme Court has implied that, with few exceptions, only taxes that affect “a fundamental interest” or contain “a classification based on a suspect criterion” such as race or gender are in danger of invalidation under the Equal Protection Clause.²⁷

As long as there is a legitimate purpose and as long as the classifications created are rationally related to that purpose, a state tax will not violate the Equal Protection Clause. Thus, when the Iowa Supreme Court held unconstitutional a state statute²⁸ that taxed racetrack slot machine revenues at a different rate from riverboat slot machine revenues, the United States Supreme Court unanimously overturned the ruling, upholding the Iowa General Assembly's decision to tax riverboats and racetracks differently.²⁹

²³ See the above discussion of *Quill Corp. v. North Dakota* for more information on the two types of nexus.

²⁴ No state may “deny to any person within its jurisdiction the equal protection of the laws.” U.S. Const. amend. XIV, § 1.

²⁵ *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526-527 (1959).

²⁶ *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973).

²⁷ *Exxon Corp. v. Eagerton*, 462 U.S. 176, at 195 (1983). See also *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981).

²⁸ See generally Iowa Code ch. 99F.

²⁹ *Fitzgerald v. Racing Ass'n of Central Iowa*, 539 U.S. 103 (2003). The ruling from the United States Supreme Court was limited in application to the federal Equal Protection Clause. The Iowa Supreme Court once again struck the statute down on remand, but this subsequent decision was based solely on the Iowa Constitution. See *Racing Ass'n Of Central Iowa v. Fitzgerald*, 675 N.W.2d 1 (2004).



State Taxation in Iowa: An Overview

D. The Import-Export Clause³⁰ and the Duty-of-Tonnage Clause³¹

The Commerce Clause, the Due Process Clause, and the Equal Protection Clause are obviously not confined to questions of taxation, and disputes over their proper interpretation embrace some of the most difficult issues in federal constitutional law. The Import-Export Clause and the Duty-of-Tonnage Clause, however, are expressly concerned with state taxation. Perhaps because they have the virtues of narrower scope and clearer meaning, these clauses have generated fewer cases and controversies. Yet despite their relatively low constitutional profile, they too represent important curbs on state taxing powers.

1. The Import-Export Clause

The Import-Export Clause prohibits states from laying “imposts or duties on imports or exports except what may be absolutely necessary for executing its inspection laws.” Until the 1970s, whether a shipment of goods enjoyed the protection of this clause depended on whether the goods were properly considered imports or exports.³²

Since the 1970s, however, the application of the clause has been determined by examining the nature of the state tax at issue rather than the character of the goods. Today, a state may, for example, levy an *ad valorem* property tax on imported goods as long as it is clear that the tax does not create “special protective tariffs or particular preferences for certain domestic goods” and as long as the levy does not “encourage or discourage any importation in a manner inconsistent with federal regulation.”³³

In other words, as it has with the Commerce Clause, the Supreme Court has reinterpreted the Import-Export Clause, viewing it not as a blanket immunity from state taxation but as a prohibition on discriminatory taxation and an injunction against interference with federal trade policy.

2. The Duty-of-Tonnage Clause

The Duty-of-Tonnage Clause prohibits states from imposing a tax on shipping or on the flow of goods through a port. The Supreme Court has noted that the intent of the Duty-of-Tonnage Clause “mirrors” that of the Import-Export Clause, both of which seek “to prevent states with ‘convenient ports’ from placing other states at an economic disadvantage by laying levies that would tax the consumption of their neighbors.”³⁴

Furthermore, the clause has been interpreted to embrace “all taxes and duties regardless of their name or form, and even though not measured by the tonnage of the vessel, which operate to impose a charge for the privilege of entering, trading in, or lying in a port.”³⁵ In other words, a state cannot circumvent the Import-Export Clause

³⁰ “No state shall, without the consent of Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts laid by any state on imports or exports shall be for the use of the treasury of the United States; and all such laws shall be subject to the revision and controul [sic] of the Congress.” U.S. Const. art. I, § 10, cl. 2.

³¹ “No state shall, without the consent of Congress, lay any duty of tonnage.” U.S. Const. art. I, § 10, cl. 3.

³² See *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976); *Dept. of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978).

³³ *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 286 (1976).

³⁴ *Polar Tankers, Inc. v. City of Valdez*, Docket No. 08-310 (2009).

³⁵ *Clyde Mallory Lines v. Alabama*, 296 U.S. 261, at 265-266 (1935).



State Taxation in Iowa: An Overview

restriction merely by levying a tax on a ship's carrying capacity instead of on the goods it carries.

However, the Duty-of-Tonnage Clause does not restrict a state or a municipality from charging fees for the provision of port services. For example, when the City of Keokuk, which had an exclusive right from the state of Iowa to levy "wharfage" fees on Mississippi River shipping, sought to collect such fees from interstate commercial shippers using the city's wharves, the Supreme Court upheld the arrangement, noting that "a charge for services rendered or for conveniences provided is in no sense a tax or a duty."³⁶

E. The Supremacy Clause³⁷

Another constitutional limitation on state taxation is the Supremacy Clause, which provides that the laws of the United States are "the supreme law of the land." Since 1819, this clause has been interpreted to give the federal government unqualified immunity from state taxation.³⁸ However, the immunity applies only to the government itself and not to its contractors.³⁹

F. The First Amendment⁴⁰

The final federal constitutional limitation on state taxing powers to be aware of is the First Amendment. As with many state laws, it is possible for a tax to violate the First Amendment, particularly if the tax is directed at the content of speech,⁴¹ the exercise of religion,⁴² or a certain segment of the media.⁴³ However, in general, state taxes more often implicate issues of fairness or state power than issues of speech, association, or religion.

III. Taxes Imposed or Administered by the State of Iowa

The rather long list of federal limitations discussed above nonetheless still leaves states substantial leeway to design their tax systems in ways they deem appropriate. In many states, including Iowa, this has resulted in a variety of different taxes. In summarizing these taxes for purposes of a general overview, it is helpful to group them into categories and discuss some of their general similarities as well as to highlight some of the particular details of their implementation under Iowa law.

A. Income Taxes

An income tax refers to a tax levied against a taxpayer's income. The amount of tax due is typically calculated as a certain percentage of that income. Thus, in determining tax liability, much depends on how "income" is defined and calculated.

³⁶ *Packet Company v. Keokuk*, 95 U.S. 80 (1877).

³⁷ The laws of the United States "shall be the supreme law of the land." U.S. Const. art. VI, sec. 2.

³⁸ *M'Culloch v. Maryland*, 17 U.S. 316 (1819).

³⁹ *United States v. New Mexico*, 455 U.S. 720 (1982).

⁴⁰ "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. Const. amend. I.

⁴¹ *Arkansas Writer's Project Inc. v. Ragland*, 481 U.S. 221 (1987).

⁴² *Jimmy Swaggart Ministries v. Bd. of Equalization*, 493 U.S. 378 (1990).

⁴³ *Leathers v. Medlock*, 499 U.S. 439 (1991).

State Taxation in Iowa: An Overview



Generally speaking, “income,” in the case of individuals, means total earnings, including wages, salary, profits, interest payments, and rent received. “Income” in the case of business entities generally means “net profit” which is calculated by subtracting expenses from revenues. For both individuals and business entities, the amount of income is measured over a certain period of time (e.g., calendar year, fiscal year).

1. The Individual Income Tax⁴⁴

Iowa imposes an individual income tax on the income of natural persons⁴⁵ and estates and trusts.⁴⁶ In addition, because the income of certain business entities is allowed to “pass through” to the individual owners for purposes of taxation, the tax base of the individual income tax embraces the profits of those businesses.

The tax is imposed on the amount of an individual’s “taxable income.”⁴⁷ The computation of taxable income for Iowa purposes is, in concept, relatively simple. The starting point is the taxpayer’s federal adjusted gross income (AGI) which is then modified by certain Iowa statutory adjustments⁴⁸ to arrive at the taxpayer’s “net income.”⁴⁹ Net income is in turn adjusted by either a “standard deduction” or by the applicable “itemized deductions”⁵⁰ to arrive at the amount of “taxable income.”⁵¹

Both residents and nonresidents may be liable for Iowa’s income tax.⁵² In the case of residents, both income earned in Iowa and income earned in another state are subject to the tax, although, in order to avoid double taxation, a credit is provided for a resident’s out-of-state income to the extent that income taxes have already been paid in the other state. In the case of nonresidents, only that portion of income derived from Iowa sources is subject to the tax.⁵³

In Iowa, income taxes due on wages and other income⁵⁴ subject to the tax are required to be withheld at the source by employers and withholding agents who are subject to similar requirements for federal income tax collection purposes. While this withholding requirement is often referred to as a “withholding tax,” it is technically not a separately imposed tax but rather the prepayment of individual income taxes

⁴⁴ Iowa Code § 422.5.

⁴⁵ Iowa Code § 422.5 imposes the tax on the taxable income of “every resident and nonresident of the state” but § 422.4 makes clear that “resident” and “nonresident” only apply to individuals.

⁴⁶ Iowa Code § 422.6.

⁴⁷ Iowa Code § 422.5(1).

⁴⁸ The term “adjustments” has been used in this context to reflect the fact that some of the Iowa-specific provisions adjust federal AGI “up” while others adjust it “down.”

⁴⁹ Iowa Code § 422.7. Deductions from federal AGI used to arrive at net income are sometimes referred to as “above-the-line” deductions. These deductions may be Iowa specific. For example, Iowa law provides a deduction for federal income tax paid.

⁵⁰ Iowa Code § 422.9. Deductions from net income used to arrive at taxable income are sometimes referred to as “below-the-line” deductions. For the most part, the itemized deductions available for Iowa purposes are the same as those available under the Internal Revenue Code, but, as with the above-the-line adjustments to federal AGI, there are some Iowa statutory adjustments in addition to the list of federal itemized deductions. See Iowa Code § 422.9(2).

⁵¹ Iowa Code § 422.4(16). Note, however, that the final tax liability may be even further adjusted by any tax credits for which the taxpayer is eligible. However, such adjustments are made after the applicable rate bracket is applied to the taxable income.

⁵² For information on the propriety of taxing the income of out-of-state residents, see the above discussion of the constitutional limitations on state taxation.

⁵³ Iowa Code § 422.8. Many other states have income tax laws that, like Iowa’s, allow for the taxation of the income of nonresidents. Since 2002, the Director of the Iowa Department of Revenue has had the authority, subject to approval by the General Assembly and the Governor, to make a reciprocal agreement with another state whereby each state agrees to exempt residents of the other state from payment of the first state’s income tax. However, to date, the only agreement Iowa has made is with the state of Illinois.

⁵⁴ “Other income” includes winnings from pari-mutual wagering and gambling games, and state tax is authorized to be withheld from such winnings at the source. See Iowa Code §§ 99D.16 and 99F.18.



State Taxation in Iowa: An Overview

according to calendar year estimates prepared by the Department of Revenue. Both residents and nonresidents subject to the individual income tax may be subject to these withholding requirements.⁵⁵

2. The Corporate Income Tax⁵⁶

The corporate income tax is imposed on most for-profit corporations in Iowa, including joint stock companies, associations organized for pecuniary profit, and partnerships and certain limited liability companies that are treated as corporations under the Internal Revenue Code.⁵⁷ The corporate income tax is not imposed on financial institutions or on insurance companies, both of which are subject to dedicated taxes structured specially for those types of businesses,⁵⁸ nor is the tax imposed on nonprofit organizations exempt from taxation under section 501 of the Internal Revenue Code.⁵⁹

As with the individual income tax, the corporate income tax is linked to the federal tax code. In the case of corporations, the starting point for computing income for Iowa purposes is a corporation's federal taxable income. Certain Iowa statutory adjustments are made to the federal taxable income in order to arrive at a corporation's "net income" for Iowa tax purposes.⁶⁰

Computing a corporation's net income is more complex than doing so for an individual not only because of accounting, inventory, and payroll reasons, but also because of the federal constitutional limitations on taxing interstate commerce.⁶¹ Many corporations operating in Iowa also derive income from activity attributable to other states. In taxing the income of such corporations, Iowa must determine the portion of income legitimately attributable to the corporation's Iowa activities. The process of determining that portion is known as "apportionment."⁶²

Because each state may determine for itself how to apportion corporate income, subject to the constitutional limitations on state taxation, it is possible for there to be dozens of different apportionment formulas. In the 1960s, the compliance difficulties inherent in such a scenario prompted an effort to create a standard formula for the apportionment of corporate income.⁶³ This standard formula, which many states eventually adopted, uses three "factors" to quantify the level of business activity in a state: property, payroll, and sales. The model legislation version of the formula apportions income by calculating the amount of in-state property, payroll, and sales as

⁵⁵ Iowa Code § 422.16.

⁵⁶ Iowa Code § 422.33.

⁵⁷ Iowa Code §§ 422.32(4) and 422.33(1).

⁵⁸ Iowa Code § 422.34(1). For more information on the taxation of financial institutions and insurance companies, see the section of this Guide entitled Franchise and Insurance Taxes.

⁵⁹ Iowa Code § 422.34(2).

⁶⁰ Iowa Code § 422.35.

⁶¹ For more information on the special problems posed by multistate corporations, see the above discussion of the constitutional limitations on state taxation.

⁶² Iowa's apportionment formula is codified at Iowa Code § 422.33(2). Note that the statute makes a further distinction between business and nonbusiness income. That distinction has been omitted for purposes of the general discussion of apportionment principles contained in this Guide.

⁶³ This effort was undertaken by various states which formed the Multistate Tax Compact Project. This project resulted in model legislation known as the Uniform Division of Income for Tax Purposes Act (UDITPA). Many states subsequently conformed their tax laws to this model legislation. Iowa did not. For more information, see <http://www.mtc.gov/About.aspx?id=40>.

State Taxation in Iowa: An Overview



a proportion of a corporation's worldwide amount of property, payroll, and sales. That proportion represents the share of the corporation's total income attributable to the state.

While many states use the three-factor formula to apportion corporate income, Iowa's apportionment formula uses only the sales factor, omitting payroll and property as indicators of a corporation's business activity in the state. Despite apportioning corporate income so much differently than other states, Iowa's single sales factor formula has been upheld by the United States Supreme Court in one of the leading cases on fair apportionment.⁶⁴

B. Franchise and Insurance Taxes

Technically speaking, a franchise tax is a tax levied on a company for the privilege of doing business in a state. In this respect, a franchise tax is distinct from an income tax. However, as with income taxes, the amount of franchise tax due must be determined in a way that fairly reflects the amount of activity attributable to the state, which is why a franchise tax may be imposed "according to and measured by" some measure of income in the state. As a practical matter, then, a franchise tax is closely akin to an income tax despite not technically being levied against income.

1. The Franchise Tax on Financial Institutions⁶⁵

Iowa's franchise tax is imposed only on financial institutions.⁶⁶ In this context, that includes state banks, national banking associations, trust companies, federally chartered savings and loan associations, savings banks, financial institutions chartered by the Federal Home Loan Bank Board, savings and loan associations, and production credit associations.⁶⁷ It does not, however, include credit unions which are subject to the moneys and credits tax.⁶⁸

The franchise tax is levied "according to and measured by net income." The computation of net income for a financial institution is substantially similar to computing net income for corporate income tax purposes⁶⁹ with a few adjustments.⁷⁰

⁶⁴ The constitutionality of Iowa's formula was challenged in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978). The effect of apportioning income using only the sales factor is that certain corporations benefit from the formula more than others. Whether a corporation "wins" or "loses" under a single sales factor scenario is highly dependent on where its sales occur and on where its greatest property and payroll investments are. For example, in-state corporations making a high percentage of sales out of state will have a relatively low income apportionment whereas corporations manufacturing products out of state for sale in state will have a relatively high apportionment of income. Moreover, when a corporation is subject to taxation in two or more states that use different apportionment formulas, there exists the potential for double taxation on at least a portion of the corporation's income. At least that was the theoretical allegation of the Illinois corporation that challenged the Iowa apportionment formula in *Moorman*. Nonetheless, the Supreme Court upheld the Iowa formula and declined to force all states to use the same formula, noting that such a policy should only be imposed through Congressional legislation. The *Moorman* case was decided in 1978, and, since that time, other states have begun to consider the use of a single sales factor for corporate income apportionment. However, this trend has not been without controversy. See e.g. Mazerov, Michael, *The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?* (2005), available at <http://www.cbpp.org/files/3-27-01sfp.pdf> (last accessed 10/29/2010).

⁶⁵ See generally Iowa Code ch. 422, div. V.

⁶⁶ "A franchise tax according to and measured by net income is imposed on financial institutions for the privilege of doing business in this state as financial institutions." Iowa Code § 422.60(1).

⁶⁷ Iowa Code § 422.61(1).

⁶⁸ Iowa Code § 533.329. For more information on the moneys and credits tax, see the following section of this Guide.

⁶⁹ See Iowa Code § 422.35.

⁷⁰ See Iowa Code § 422.61(3). Most of the adjustments require financial institutions to include income for purposes of the franchise tax which is not included for purposes of the corporate net income tax, such as income from government securities. This is permissible because the franchise tax is technically not imposed on net income.



State Taxation in Iowa: An Overview

The tax is due annually in an amount equal to 5 percent of the institution's net income, as computed for purposes of the franchise tax.⁷¹

2. The Moneys and Credits Tax on Credit Unions⁷²

Under Iowa law, credit unions are deemed institutions for savings, rather than financial institutions, and are subject to the moneys and credits tax. The moneys and credits tax is neither a tax on net income nor even a tax measured by net income as with the franchise tax.

Rather, state credit unions are required to hold a certain percentage of their gross income in reserve to cover losses and defaults,⁷³ and the moneys and credits tax is imposed at the rate of one-half cent on each dollar of these reserves.⁷⁴ The moneys and credits tax is thus not tied to a credit union's profitability but rather to the value of its deposits.

The tax is imposed by the county board of supervisors and collected by the county treasurer.⁷⁵ While the tax is imposed and collected locally, credit unions are regulated at the state level, and the tax rate as well as any applicable credits are also determined at the state level. Revenues from the tax are shared among state government and city and county governments.⁷⁶

3. The Gross Premiums Tax on Insurance Companies⁷⁷

The insurance companies tax is imposed at the rate of 1 percent on the gross premiums of "every insurance company or association of whatever kind or character" except fraternal beneficiary associations and nonprofit hospital and medical service corporations.⁷⁸ Mutual service corporations are liable for a closely related tax at the same rate as the insurance companies tax, although technically the tax owed by mutual service corporations is imposed on the gross amount of payments received under subscriber contracts.⁷⁹

The tax on insurance companies and mutual service corporations, like the moneys and credits tax, is neither an income tax nor a tax measured by income. Since it is imposed on the value of the premiums received, the tax is due regardless of whether the insurance company has "net income," as that term is used for purposes of the corporate income tax. In this respect, the tax resembles a gross receipts tax, or even a sales tax, more so than an income tax.

4. The Underwriting Profit Tax on Marine Insurance⁸⁰

The marine insurance tax, while also a tax on insurance companies, is somewhat different from the gross premiums tax. The marine insurance tax is imposed at the

⁷¹ Iowa Code § 422.63.

⁷² Iowa Code § 533.329.

⁷³ Iowa Code § 533.303.

⁷⁴ Iowa Code § 533.329(2)(a).

⁷⁵ Iowa Code § 533.329(2)(a).

⁷⁶ Iowa Code § 533.329(2)(b).

⁷⁷ Iowa Code ch. 432.

⁷⁸ Iowa Code § 432.1.

⁷⁹ Iowa Code § 432.2.

⁸⁰ See generally Iowa Code ch. 432A.

State Taxation in Iowa: An Overview



rate of 6.5 percent of an insurer's "taxable underwriting profit" for insurance written in the state.⁸¹ The amount of underwriting profit is calculated as a three-year average.⁸² The tax is levied on the underwriting profits of "marine insurance" policies. In other words, it is a tax on a particular type of insurance policy and is thus a more narrowly applied tax than the tax on gross premiums.

5. The Reciprocal Tax on Foreign Insurance Companies⁸³

The Iowa reciprocal tax applies only to out-of-state insurance companies doing business in Iowa and is an outgrowth of the peculiar regulatory situation of the insurance industry.

The federal government has expressly declined to regulate the insurance industry under the Commerce Clause,⁸⁴ thereby allowing the states substantial freedom to both tax and regulate insurers operating in interstate commerce. This allows each state to decide for itself how and to what extent it wishes to tax out-of-state insurers, which increases the potential for enactment of laws favoring in-state insurers at the expense of their out-of-state competitors.

Iowa's reciprocal tax seeks to discourage other states from discriminating against Iowa insurers by taxing an out-of-state insurer according to its home-state tax burden whenever the tax burden of that state is more onerous for Iowa insurers than the Iowa tax burden would be. Many states have such "retaliatory" taxes,⁸⁵ and the United States Supreme Court has expressly upheld these taxes against both Commerce Clause and Equal Protection Clause challenges.⁸⁶

C. Retail Sales and Use Taxes

A sales tax is a tax imposed on the sales price of certain commercial transactions, typically the sale or lease of tangible personal property or services. Most sales taxes are retail sales taxes targeted at the ultimate user of the property or service. For this reason, sales taxes typically exempt purchases for resale as well as purchases of business inputs in order to reduce transactional costs within the supply chain. A retail sales tax is typically levied as a percentage of the sales price of a transaction and is collected by the seller at the point of sale.

A use tax is closely related to a sales tax, and the two taxes are usually implemented as complements to each other. Like a sales tax, a use tax is imposed on the purchase price of tangible personal property and is imposed at the same percentage rate. Those items exempted from the sales tax are typically exempted from a use tax as well. If sales tax is paid in another state, the consumer typically receives credit against use tax liability for that amount.

⁸¹ Iowa Code § 432A.1.

⁸² Iowa Code § 432A.6.

⁸³ Iowa Code § 505.14.

⁸⁴ See the federal legislation known as The McCarran-Ferguson Act, codified at 15 U.S.C. §§ 1011 et seq.

⁸⁵ See generally *Construction, application, and operation of state "retaliatory" statutes imposing special taxes or fees on foreign insurers doing business within the state*, 30 A.L.R.4th 873 (Originally published in 1984).

⁸⁶ *Western & Southern Life Ins. Co. v State Bd. of Equalization*, 451 U.S. 648 (1981).



State Taxation in Iowa: An Overview

The two taxes are distinguished primarily by the fact that a use tax is intended for transactions in which no sales tax was ever collected. Such transactions may include any of the following relatively common situations in which use tax will be owed:

(1) Business One produces or purchases an item intended for resale but then uses or consumes it rather than selling it to customers.

(2) Business One purchases inventory items from an out-of-state vendor, who was not registered to collect sales or use taxes for in-state transactions. Business One sells the items to Business Two, and Business Two consumes the items in state.

(3) Online Retailer operates an Internet website through which it makes sales of tangible personal property. Online Retailer has no physical presence in the state and no obligation to collect sales or use taxes at the point of sale. Consumers purchase items on the website for their personal use in-state.⁸⁷

1. A Note about the Streamlined Sales and Use Tax Agreement⁸⁸

Iowa has both a retail sales tax and a use tax. In 2003, Iowa enacted legislation⁸⁹ to conform its sales and use taxes to the requirements of the Streamlined Sales and Use Tax Agreement.⁹⁰

The agreement is a cooperative effort between the business community and those states with sales and use taxes to simplify the collection and administration of these taxes. One of the goals of the agreement is to minimize the costs and administrative burdens for retailers who are required to collect sales and use taxes, particularly retailers that operate in many states. Another goal is to encourage Internet and mail order retailers, who may not be required to collect sales and use taxes, to voluntarily collect them on sales to customers living in participating states.⁹¹

2. The Sales Tax⁹²

Iowa's state sales tax is imposed at the rate of 6 percent,⁹³ although local governments may also impose a sales tax of up to 1 percent⁹⁴ resulting in a maximum sales tax rate of 7 percent. The tax is imposed on the sales price of "tangible personal

⁸⁷ Because of the increase in Internet commerce, this situation has become a contentious issue in state and local taxation. Collection of a use tax, because it is not collected by the seller at the point of sale, depends almost entirely on the voluntary compliance of consumers whose duty it is to remit the tax due on their purchases. However, many consumers are unaware of the obligation to pay taxes on such purchases and unfamiliar with the remittance process for them. Moreover, local businesses, who have the obligation to collect retail sales taxes, face a competitive disadvantage against on-line retailers who do not. States have responded to this situation in a number of ways. Some states have joined forces with retailers in an effort to increase voluntary collection of sales taxes by on-line retailers. This effort is known as the Multistate Streamlined Sales and Use Tax Agreement. Other states have sought to exert nexus over out-of-state sellers by passing so-called "Amazon Laws." Both have the same goal which is to induce on-line retailers to collect sales taxes at the point of sale rather than collecting use tax from consumers after the fact.

⁸⁸ <http://www.streamlinedsalestax.org/index.php?page=fags>

⁸⁹ 2003 Iowa Acts, First Extraordinary Session, ch. 2 (H.F. 683), §§ 94–203.

⁹⁰ The agreement only pertains to the collection of sales and use taxes and not to the collection of special excise taxes or other taxes imposed outside of Iowa Code chapter 423, such as the hotel and motel tax in Iowa Code chapter 423A.

⁹¹ See generally Iowa Code ch. 423.

⁹² See Iowa Code § 423.2 which imposes the sales tax on a number specific types of transactions including but not limited to sales of tangible personal property.

⁹³ Iowa's sales tax is scheduled to revert to 5 percent on January 1, 2030. See Iowa Code § 423.2(13).

⁹⁴ See Iowa Code chapter 423B for more information on local option sales taxes.

State Taxation in Iowa: An Overview



property,”⁹⁵ other specific transactions, and certain “enumerated services”⁹⁶ sold at retail in the state.

The distinction between tangible personal property and enumerated services has at least one significant consequence: the sale of tangible personal property is subject to the tax unless specifically exempted by statute whereas the sale of a service is not taxed unless it is specifically included in statute. Whether services should be treated differently than tangible personal property in today’s economy is a policy matter, but the distinction is a common one and by no means unique to Iowa.

The tax is collected at the point of sale from consumers by retailers who are required to remit the tax to the Iowa Department of Revenue which handles the administration and enforcement of the tax in a manner consistent with the provisions of the Streamlined Sales and Use Tax Agreement.⁹⁷ Most of the revenues from the tax are deposited in the General Fund of the state. After they are deposited, one sixth of the revenues are then transferred to the Secure an Advanced Vision for Education Fund.⁹⁸

3. The Use Tax⁹⁹

Iowa’s use tax, as a complement to the sales tax, is imposed at the same rate as the sales tax, currently 6 percent.¹⁰⁰ The tax is imposed on the use within Iowa of tangible personal property and services, as those terms are defined for purposes of the sales tax.¹⁰¹

With very few exceptions, items of tangible personal property and services that are exempt from the sales tax are also exempt from the use tax, as are transactions in which the sales tax has already been paid.¹⁰² Unlike the sales tax, however, the use tax is imposed upon every person using property or services within the state until the tax has been paid meaning that every subsequent purchaser of property becomes liable for the use tax if it was not paid by the prior users.¹⁰³

Whether local option sales taxes must be paid in a use tax scenario depends on where the transaction takes place. For example, when a purchase is made in another state for use in Iowa, an Iowa-imposed local option tax is not due on the transaction. In other words, Iowa does not impose a local option use tax. However, if the local option sales tax should have been collected but was not, the purchaser is responsible for remitting the uncollected local option sales tax in addition to the state use tax.¹⁰⁴

⁹⁵ “Tangible personal property” means personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses. See Iowa Code § 423.1(54).

⁹⁶ Iowa Code § 423.2(6).

⁹⁷ See Iowa Code ch. 423, subch. IV, V, and VI.

⁹⁸ Iowa Code § 423.43. For more information see the Legislative Guide on Education Finance.

⁹⁹ Iowa Code § 423.5.

¹⁰⁰ And, like the sales tax, the use tax is scheduled to be reduced to a rate of 5 percent on January 1, 2030. See Iowa Code § 423.5(9).

¹⁰¹ Iowa Code § 423.1(50), (54).

¹⁰² Iowa Code § 423.6.

¹⁰³ Iowa Code § 423.5(6).

¹⁰⁴ See Iowa Code § 423B.6(2), (3) and the Iowa Department of Revenue’s Consumer Use Tax topic at <http://www.iowa.gov/tax/educate/78535.html> (last accessed 10/29/2010).



State Taxation in Iowa: An Overview

Use taxes may be collected by businesses or directly by the Iowa Department of Revenue which is responsible for the administration and enforcement of the tax.¹⁰⁵

D. Special Excise Taxes

The term “excise tax” is somewhat vague and not susceptible to a precise, universal meaning. Broadly speaking, sales and use taxes can be considered “excise taxes” since they are taxes on consumption and are levied on a taxable event (i.e. a commercial transaction). However, those taxes traditionally thought of as excise taxes tend to have one or more of the following features or characteristics in common.

First, an excise tax is usually very specific, often targeting a particular type of transaction or class of goods. Taxes on gasoline, alcohol, and cigarettes, for instance, are usually given as examples of excise taxes. Additionally, excise taxes are often levied at a fixed amount per unit of measure rather than as a proportion of value. For example, gasoline is often taxed per gallon, beer per barrel, and tobacco per cigarette. Sales and use taxes, on the other hand, are levied as a proportion of the transaction cost. Finally, certain excise taxes may be accompanied by social disapprobation and may bear high levy rates intended as much to reduce consumption of an item as to raise revenue.

In Iowa, there are a number of taxes that would be considered special excise taxes. Some of them, like the taxes on alcohol and cigarettes, exhibit all of the characteristics described above. Others, like the hotel and motel tax, may only have the characteristic of being specifically targeted.

1. The State Hotel and Motel Tax¹⁰⁶

Hotel and motel room rentals were once taxed under the sales tax, but were removed from the sales tax base in order to maintain the same tax base for the sales tax and the use taxes. Hotel and motel room rentals are now subject to a special excise tax and not to sales and use taxes.

The tax is imposed at the rate of 5 percent on the sale price from the renting of rooms, apartments, or sleeping quarters in virtually any place where sleeping accommodations are rented to transient guests. The tax is not imposed on the gross receipts from the renting of such accommodations if rented to the same person for more than 31 consecutive days, on dorm rooms at colleges and universities, or on lodging provided at religious retreats as long as the property enjoys a religious institution exemption from property tax.

While the hotel and motel tax is now a special excise tax, it must nonetheless be administered, as nearly as possible, in the same manner as the sales tax.¹⁰⁷

2. The Construction Equipment Tax¹⁰⁸

Like hotel and motel rentals, construction equipment sales were once taxed under the sales tax, and were also removed from the tax for purposes of maintaining the

¹⁰⁵ For more information on compliance with the Iowa use tax see the Department of Revenue's website at <http://www.iowa.gov/tax/educate/78535.html>.

¹⁰⁶ See generally Iowa Code ch. 423A.

¹⁰⁷ Iowa Code § 423A.6.

¹⁰⁸ See generally Iowa Code ch. 423D.



same tax base for the sales and use taxes. Construction equipment sales are now subject to a special excise tax and not subject to sales and use taxes.

The tax is imposed at the rate of 5 percent on the sales price or purchase price of certain construction equipment, such as self-propelled building equipment, pile drivers, and motorized scaffolding, used by building contractors.¹⁰⁹ The tax is required to be administered, as nearly as possible, in the same manner as the sales tax.¹¹⁰

3. The Real Estate Transfer Tax¹¹¹

The real estate transfer tax is imposed on sales of real estate in which the market value of the property is greater than \$500. The tax is imposed at the rate of eighty cents for each \$500 of value, or fraction thereof. Transactions in which there is no consideration paid for transfer of the deed are not subject to the tax.¹¹²

While imposed on sales or transfers of real estate, the tax is not collected at the time of sale but by county recorders when the deed of transfer is recorded. Since revenues from the tax are shared with county governments, sales involving parcels in more than one county require separate declarations of value to be filed with, and separate payment of the tax to, each of the counties involved.¹¹³

4. Cigarette and Tobacco Taxes¹¹⁴

In Iowa, cigarettes and other tobacco products are taxed separately. The cigarette tax is imposed at the rate of 6.8 cents per cigarette. Since cigarettes are typically packaged in packs of 20, the effective tax rate is \$1.36 per pack. The tax is to be paid by the person making the “first sale” in the state, which means the first use or consumption of the cigarettes in this state. In addition, the cost of the tax must be added by retailers to the retail price of the cigarettes so that the burden is ultimately born by the purchaser. Proof that the tax has been paid is indicated by a stamp affixed to or imprinted on each package of cigarettes.¹¹⁵

Tobacco products other than cigarettes, such as cigars and smokeless tobacco, are subject to the tobacco products tax.¹¹⁶ The tobacco products tax is imposed at an effective rate of 50 percent on the wholesale price of tobacco products other than cigarettes, little cigars, and snuff.¹¹⁷ Despite the nominal 50 percent rate, the tax on cigars is limited to 50 cents per cigar. “Little cigars” are taxed at the same rate and in the same manner as cigarettes, rather than as tobacco products,¹¹⁸ and snuff is taxed separately at the rate of \$1.19 per ounce, or a proportion thereof for fractional amounts.¹¹⁹

¹⁰⁹ Iowa Code §§ 423D.1, 423D.2.

¹¹⁰ Iowa Code §§ 423.3(85), 423D.4.

¹¹¹ See generally Iowa Code ch. 428A.

¹¹² Iowa Code § 428A.1.

¹¹³ Iowa Code § 428A.1.

¹¹⁴ See generally Iowa Code ch. 453A.

¹¹⁵ Iowa Code §§ 453A.1, 453A.6.

¹¹⁶ Iowa Code § 453A.43.

¹¹⁷ Iowa Code § 453A.43(1).

¹¹⁸ See Iowa Code §§ 453A.42, 453A.43(1)(d).

¹¹⁹ Iowa Code § 453A.43(3),(4).



State Taxation in Iowa: An Overview

As with the sales tax, if the cigarette and tobacco products taxes are not paid or collected at purchase, a tax at the same rate may be due for the storage, use, or consumption of such products.¹²⁰ However, in the case of cigarettes, no tax is due if the quantity involved is 40 cigarettes or less.¹²¹ Failure to affix a stamp can result in civil penalties.¹²²

5. Beer, Wine, and Liquor Taxes

Upon the adoption of the 21st Amendment to the Federal Constitution and the end of the Prohibition Era, Iowa enacted legislation making the state the exclusive seller of alcohol, wine, and most beer.¹²³ Since that time, the state has largely relinquished its role as a distributor of wine and beer in favor of beer barrel and wine gallonage taxes. However, it still retains a monopoly on the wholesale distribution of liquor to retailers.¹²⁴

Under the barrel tax, beer is taxed at rate of \$5.89 per barrel of 31 gallons, or a proportional amount for each fractional part thereof.¹²⁵ Wine is taxed at the rate of \$1.75 per gallon, or a proportional amount for each fractional part thereof.¹²⁶ The barrel and wine gallonage taxes are collected from licensed wholesalers¹²⁷ who must also obtain the appropriate permits and pay the necessary fees in order to distribute beer and wine in the state.¹²⁸ While there is, technically speaking, no tax imposed on liquor sales, the state, in its exclusive role as liquor wholesaler, sells liquor to retailers at a profit. This profit is referred to as the markup and may not exceed 50 percent.¹²⁹ Whether it is properly considered a tax or not, the state's liquor markup, like the wholesale taxes on beer and wine, is ultimately passed on to consumers in the form of higher retail costs.

E. Motor Vehicle and Fuel-Related Taxes and Fees

Motor vehicle taxes and fees can also be considered special excise taxes, but for convenience and because in Iowa the bulk of the revenues from motor vehicle and fuel-related taxes and fees is reserved for deposit in the Road Use Tax Fund, these taxes and fees are discussed here separately.¹³⁰

1. Registration and Title Fees¹³¹

The owners of motor vehicles subject to registration are liable for a number of fees. First, there is a "fee for new registration" imposed on the purchase price at a rate

¹²⁰ See Iowa Code §§ 453A.1(13), 453A.43(2).

¹²¹ Iowa Code § 453A.6(2).

¹²² Iowa Code § 453A.31.

¹²³ Harrison, Leonard V. and Laine, Elizabeth. *After Repeal*, Harper & Brothers Publishers, New York, 1936, pp. 110-111, 235.

¹²⁴ See Iowa Code §§ 123.22, 123.24.

¹²⁵ Iowa Code § 123.136.

¹²⁶ Iowa Code § 123.183.

¹²⁷ Iowa Code §§ 123.136, 123.183.

¹²⁸ Iowa Code §§ 123.130, 123.134, 123.177, 123.179.

¹²⁹ Iowa Code § 123.24(4).

¹³⁰ For more information, see the LSA Legislative Guide on the Road Use Tax Fund, available at http://www.legis.state.ia.us/lsadocs/Legis_Guide/2009/LGLSL040.PDF.

¹³¹ See generally Iowa Code ch. 321.

State Taxation in Iowa: An Overview



of 5 percent.¹³² Second, there is a fee of \$20 for the issuance of a title.¹³³ Finally, there is an annual registration fee in the amount of 1 percent of the value of the vehicle plus 40 cents for each 100 pounds of weight.¹³⁴

The fee for new registration and the title fee are paid to the county treasurer when the vehicle is newly registered.¹³⁵ The annual registration fee is paid to the county treasurer when the vehicle is reregistered.¹³⁶ County treasurers are responsible for remitting the fees to the state treasurer¹³⁷ who then deposits the moneys into the Road Use Tax Fund.¹³⁸

2. Motor Fuel Taxes¹³⁹

Iowa imposes an excise tax on most types of motor fuel sold in the state.¹⁴⁰ The tax is imposed on a per gallon basis and the rate differs based on the type of fuel:

<u>Fuel Type</u>	<u>Tax Rate (Per Gallon)</u>
Gasoline	\$0.20 to \$0.21 (variable) ¹⁴¹
Ethanol blended gasoline	\$0.19 to \$0.20 (variable) ¹⁴²
E-85	\$0.17 to \$0.21 (variable) ¹⁴³
Aviation gasoline	\$0.08 ¹⁴⁴
Diesel fuel	\$0.225 ¹⁴⁵
Liquefied petroleum	\$0.20 ¹⁴⁶
Jet fuel	\$0.03 ¹⁴⁷
Other special fuels	Same rate as gasoline ¹⁴⁸

¹³² See Iowa Code § 321.105A. Until recently, Iowa imposed a 5 percent use tax on the purchase price of motor vehicles subject to registration. In 2008, the use tax was repealed in favor of the “fee for new registration.” For more information on the old use tax, see 2007 Iowa Code ch. 423, subch. III. For information on the “TIME-21” legislation that repealed the use tax, see 2008 Iowa Acts ch. 1113 (S.F. 2420).

¹³³ Iowa Code § 321.20(1).

¹³⁴ Note that there are certain exceptions to the annual registration fee and that the Department of Transportation is authorized to fix both the value and the weight of the vehicle for purposes of the fee. For more information see Iowa Code § 321.109.

¹³⁵ Iowa Code § 321.105A.

¹³⁶ Iowa Code § 321.105.

¹³⁷ Iowa Code § 321.151.

¹³⁸ Iowa Code § 321.145.

¹³⁹ See generally Iowa Code ch. 452A. For a detailed description of the administration of the motor fuel tax, see the Department of Revenue’s website at <http://www.iowa.gov/tax/educate/78509.html>.

¹⁴⁰ Iowa Code § 452A.3.

¹⁴¹ Iowa Code § 452A.3(1),(1A).

¹⁴² Iowa Code § 452A.3(1),(1A).

¹⁴³ Iowa Code § 452A.3(1B),(1C).

¹⁴⁴ Iowa Code § 452A.3(2).

¹⁴⁵ Iowa Code § 452A.3(3).

¹⁴⁶ Iowa Code § 452A.3(3A).

¹⁴⁷ Iowa Code § 452A.3(3).

¹⁴⁸ Note that compressed natural gas, when used as a special fuel, is taxed at the rate of \$0.16 per hundred cubic feet. Iowa Code § 452A.3(3),(4).



State Taxation in Iowa: An Overview

The rates for gasoline, ethanol blended gasoline, and E-85 are variable from year to year and are calculated annually by the Department of Revenue based on actual fuel distributions in the state during the prior calendar year.¹⁴⁹ However, the rates do not fluctuate outside of the ranges specified above.

The excise tax on motor fuel and special fuels is collected from suppliers and then added into the selling price when the fuel is sold to consumers.¹⁵⁰ Revenues from the excise tax on motor fuels are deposited in the Road Use Tax Fund.¹⁵¹

3. The Environmental Protection Charge¹⁵²

The environmental protection charge is a tax on the handling and storage of petroleum. When petroleum is handled and stored, some of it is inevitably “lost” in the process, causing an indeterminate amount of environmental damage. The amount of the charge is based on the amount of this loss which is referred to as “diminution” and defined as “the amount of petroleum released into the environment prior to its intended beneficial use.”

The amount of the charge is determined annually by the Iowa Comprehensive Petroleum Underground Storage Tank Board. The board determines the amount of the charge according to the following formula:

$$(\text{Volume}) \times (\text{Diminution Rate}) \times (\text{Cost Factor}) = \text{Charge}$$

“Volume” is the total amount of petroleum deposited in the tank. “Diminution rate” is set by statute at one tenth of 1 percent. “Cost factor” is an amount per gallon set annually by the board. The “cost factor” must be \$10, or an amount reasonably calculated by the board to generate \$17 million, whichever is greater.¹⁵³ Typically, the cost factor has been the amount reasonably calculated to generate \$17 million.

The charge is administered and collected like an excise tax. Depositors of petroleum collect the charge from the owners and operators of storage tanks when the petroleum is deposited in the tank, and the depositor in turn remits the amount collected to the Department of Revenue which administers the tax.¹⁵⁴ Revenues from the charge, like other motor-fuel related taxes, are deposited in the Road Use Tax Fund.¹⁵⁵

4. The Automobile Rental Excise Tax¹⁵⁶

Iowa imposes a 5 percent excise tax on the rental price of an automobile if the automobile is rented for 60 days or less and the transaction is subject to the state sales or use tax. The tax is imposed in addition to the sales tax.¹⁵⁷

¹⁴⁹ Iowa Code § 452A.3(1).

¹⁵⁰ Iowa Code § 452A.3(5),(6).

¹⁵¹ Iowa Code § 321.145.

¹⁵² See Iowa Code ch. 424.

¹⁵³ Iowa Code § 424.3.

¹⁵⁴ Iowa Code § 424.3.

¹⁵⁵ Iowa Code § 424.7(4).

¹⁵⁶ See generally Iowa Code ch. 423C.

¹⁵⁷ Iowa Code § 423C.3.



F. Locally Imposed Taxes Administered by the State

In Iowa, there are a handful of locally imposed taxes that are so closely related to certain state taxes that both the local and state taxes are administered together. In these instances, the taxes are typically imposed on the same tax base and are collected together. The revenues from the locally imposed tax are accounted for by the state and distributed back to the local governments according to their respective shares.

While closely related to their state-imposed cousins, the locally imposed versions have a couple of distinguishing features. First, the Iowa Constitution, which limits the taxing power of local governments, requires that they be specifically authorized by the state to levy a tax.¹⁵⁸ This gives the state a significant role in overseeing tax policy at the local level. Second, the legislation authorizing these taxes typically requires, or allows, some form of local electoral approval in order to be imposed (or repealed or changed).¹⁵⁹ This requires close coordination between local governments and the state agencies administering the taxes.

1. Local Option Hotel and Motel Taxes¹⁶⁰

Cities and counties may impose a hotel and motel tax at the local level.¹⁶¹ If imposed, the tax applies to the same lodging rentals as those subject to the state-imposed hotel and motel tax. The local rate may not exceed 7 percent and must be in increments of 1 or more full percentage points. When imposed by a city, the tax only applies within the corporate boundaries of the city. When imposed by a county, it only applies to the unincorporated areas of the county.¹⁶²

The hotel and motel taxes, both state and local, are collected by the lessors of lodging¹⁶³ and remitted to the Department of Revenue which then accounts for and distributes the appropriate local share back to cities and counties.¹⁶⁴

2. Local Option Sales Taxes¹⁶⁵

Cities and counties may impose a sales tax at the local level.¹⁶⁶ If imposed, the tax applies to the same sales and services as those subject to the state-imposed sales tax, with very few exceptions. The local rate may not exceed 1 percent.¹⁶⁷

In those jurisdictions imposing it, the local option sales tax is collected by retailers, along with the state-imposed sales tax, and both taxes are remitted to the Department of Revenue which then accounts for and distributes the appropriate share back to the local governments.¹⁶⁸ Because not all jurisdictions impose a local option sales tax, the cumulative rate collected by retailers differs. Where the local option sales tax is

¹⁵⁸ See the Municipal Home Rule Amendment at Art. III, sec. 38A.

¹⁵⁹ See, e.g., Iowa Code ch. 423A and 423B.

¹⁶⁰ Iowa Code § 423A.4.

¹⁶¹ The Iowa Department of Revenue maintains a list of all jurisdictions imposing local hotel and motel taxes. The list is available at <http://www.iowa.gov/tax/educate/HotelMotelTax.html> (last accessed 10/29/2010).

¹⁶² Iowa Code § 423A.4(1).

¹⁶³ Iowa Code §§ 423A.3, 423A.6.

¹⁶⁴ Iowa Code §§ 423A.6, 423A.7.

¹⁶⁵ Iowa Code ch. 423B.

¹⁶⁶ The Iowa Department of Revenue maintains a list of all jurisdictions imposing local option sales taxes. The list is available at http://www.iowa.gov/tax/educate/localoption_rates_sunsets.html (last accessed 10/29/2010).

¹⁶⁷ Iowa Code § 423B.5.

¹⁶⁸ Iowa Code §§ 423B.6, 423B.7.



State Taxation in Iowa: An Overview

imposed, the cumulative rate is 7 percent, and where only the state sales tax is imposed, the rate collected is 6 percent.

3. Local Option Vehicle Taxes¹⁶⁹

Counties may impose a local vehicle tax. If imposed, the tax applies to all vehicles subject to the state-imposed annual registration requirement and that are registered to residents of the county. The tax may only be imposed on renewals of registrations. The tax is imposed per vehicle at a rate specified in the ballot proposition approving the imposition of the tax.¹⁷⁰

The tax is collected by county treasurers with the assistance of the Department of Transportation, and the revenues are divided among city and county governments in the county based on the vehicle owner's residence.¹⁷¹

4. Local Income Surtaxes

Local income surtaxes are imposed by local governments and are collected and administered in conjunction with the state-imposed individual income tax. However, they are also somewhat different from the other local taxes discussed in this section. For example, income surtaxes are primarily a revenue option of school districts whereas local option taxes are typically imposed by cities and counties. In addition, the public approval process for the imposition of income surtaxes is often different from the local option tax process.

An income surtax differs from an income tax in that an income surtax is imposed on the amount of individual income taxes owed by a taxpayer, whereas an income tax is imposed directly on the taxpayer's income. To determine the amount of a surtax, the taxpayer first calculates the amount of income taxes owed, after all credits have been taken, and then multiplies that amount by the applicable surtax rate.¹⁷² For this reason, a surtax is frequently described as a tax on a tax.

The number and type of income surtaxes that may be imposed by local governments is limited to certain purposes. For example, a county may impose an emergency medical services (EMS) income surtax.¹⁷³ Most income surtaxes, though, are imposed by school districts which may impose them for instructional support,¹⁷⁴ educational improvement,¹⁷⁵ and physical plants and equipment.¹⁷⁶ These school district surtaxes and the EMS surtax are limited to a maximum combined rate of 20 percent of an individual's tax liability.¹⁷⁷

Because of the locally imposed nature of income surtaxes, whether and to what extent a taxpayer owes them is highly dependent on place of residence. For example, many Iowa school districts impose at least one surtax, but currently only Appanoose

¹⁶⁹ Iowa Code § 423B.2.

¹⁷⁰ Iowa Code §§ 423B.2, 321.105.

¹⁷¹ Iowa Code § 423B.3.

¹⁷² In Iowa, income surtaxes are imposed only on individual income tax liability. In some cases, such as the instructional support income surtax, the rate of tax is determined by the Department of Management, a state agency. See Iowa Code § 257.21.

¹⁷³ Iowa Code ch. 422D.

¹⁷⁴ Iowa Code §§ 257.18, 257.19.

¹⁷⁵ Iowa Code § 257.29.

¹⁷⁶ Iowa Code § 298.2.

¹⁷⁷ Iowa Code § 298.14.

State Taxation in Iowa: An Overview



County imposes the EMS surtax.¹⁷⁸ For these reasons, Iowa taxpayers report their school district and county of residence on their state income tax returns in order to determine which local surtaxes apply.

G. Inheritance, Estate, and Transfer Taxes

Sometimes referred to collectively as “death taxes,” the inheritance, estate, and generation skipping transfer taxes are imposed on certain transfers of property that occur when a person dies.¹⁷⁹ While similar in this general sense, these taxes do have somewhat different purposes and are also implemented somewhat differently. Whether a taxpayer owes one of these taxes depends on the nature of the property, the type of transfer involved, and who is to receive the property.

1. The Inheritance Tax¹⁸⁰

When a person dies, his or her property is passed to others, for example, by will or by the state’s intestacy statutes. The inheritance tax is a charge for transferring the property from the decedent owner to that person’s beneficiaries, and each beneficiary is potentially responsible for paying tax on the amount inherited. In other words, the Iowa inheritance tax, in contrast to the federal estate tax, is not a tax on the entire value of the decedent’s property but is instead a tax on each beneficiary’s share of that property.

A decedent’s property, referred to as the estate, may include real estate and tangible personal property located in the state (regardless of whether the decedent was a resident) and intangible property, if the decedent was domiciled in the state.¹⁸¹ The inheritance tax is imposed on the net market value of property passing to beneficiaries by virtually any method, including by will, by Iowa’s intestacy laws,¹⁸² and even by certain gifts made prior to a decedent’s death.¹⁸³

Since the inheritance tax is imposed on the transfer of a decedent’s property, the requirement to pay the tax may fall on any person who becomes beneficially entitled to the property that was part of the decedent’s estate.¹⁸⁴ However, there are a number of significant exemptions provided that limit the number of beneficiaries who actually owe the tax. Most significantly, for example, a decedent’s surviving spouse and lineal descendants are not required to pay the tax.¹⁸⁵ In addition, the tax is not collected on estates valued at \$25,000 or less, on property that passes for charitable, educational, or religious purposes, or on property that passes to public libraries or art galleries. Nor is the tax collected in a few other instances such as certain annuities, qualified 529

¹⁷⁸ See <http://www.legis.state.ia.us/Isadocs/IssReview/2009/IRSL003.PDF>.

¹⁷⁹ A transfer of property made during a person’s life might be subject to the federal gift tax, but Iowa does not impose a gift tax.

¹⁸⁰ See generally Iowa Code ch. 450.

¹⁸¹ Iowa Code § 450.2.

¹⁸² Note, however, that a decedent’s “probate estate” is different than that decedent’s “taxable estate.” The probate estate includes those assets which must be transferred by the court during the probate process. The taxable estate includes transfers made by other means as well. See Iowa Code §§ 450.2, 450.3.

¹⁸³ See e.g., Iowa Code § 450.3(2).

¹⁸⁴ Iowa Code § 450.5.

¹⁸⁵ Iowa Code § 450.9.



State Taxation in Iowa: An Overview

plans, and in-kind distributions of tangible personal property valued at \$5,000 or less.¹⁸⁶

The tax rate ranges from 5 percent to 15 percent, depending on the amount a person inherits and on that person's relationship to the decedent.¹⁸⁷ The Department of Revenue administers the tax.¹⁸⁸

2. The Estate Tax¹⁸⁹

The Iowa estate tax is closely related to both the inheritance tax and the federal estate tax. The Iowa estate tax is sometimes called a "pick-up tax." This is because the amount of Iowa tax owed is contingent upon the existence and amount of the federal credit for state taxes paid and because the effect of the Iowa tax, as implemented, is to direct a portion of the total estate taxes collected away from the federal government and into the coffers of state government without resulting in a net increase in the ultimate amount of taxes owed by the decedent's estate.

Depending on the date of a decedent's death,¹⁹⁰ the Internal Revenue Code may provide a credit against the decedent's federal estate tax liability for state "death taxes actually paid."¹⁹¹ Whenever such a federal credit is available, the Iowa estate tax is imposed on the net estate in an amount equal to the amount of the federal credit minus the amount of Iowa inheritance taxes paid on property included in the decedent's gross estate. Thus, the Iowa estate tax due and payable is the amount by which the maximum estate tax credit allowable for federal purposes exceeds the amount of Iowa inheritance taxes actually paid.¹⁹²

The Department of Revenue administers the tax in much the same manner as the inheritance tax, particularly with regard to its determination, imposition, payment, and collection.¹⁹³

3. The Generation Skipping Transfer Tax¹⁹⁴

Generation skipping transfer taxes are designed to address a relatively small number of situations involving certain estate planning techniques that can be used to avoid inheritance and estate taxes under certain circumstances. For example, a grandparent might place property in a trust for the benefit of a child and a grandchild. Such a trust can be structured to provide income to the child during that child's life

¹⁸⁶ Iowa Code § 450.4.

¹⁸⁷ Iowa Code § 450.10.

¹⁸⁸ Iowa Code § 450.3.

¹⁸⁹ See generally Iowa Code ch. 451. See Iowa Code § 451.13 regarding contingent implementation of this chapter.

¹⁹⁰ The federal estate tax long provided a credit if an estate had actually paid state taxes on the transfer of the estate. In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) which phased out and eventually eliminated the federal estate tax. See Pub. L. No. 107-16, available at <http://www.gpo.gov/fdsys/pkg/PLAW-107publ16/pdf/PLAW-107publ16.pdf>. As part of this legislation, the credit for state death taxes paid was eliminated in favor of a *deduction* for state death taxes paid. Without a federal credit, the Iowa estate tax could not be imposed in its current form and Iowa Code ch. 451 was repealed in 2008. See 2008 Iowa Acts, ch. 1119, § 37. However, the EGTRRA legislation provided for an automatic statutory expiration on January 1, 2011. Absent additional legislation by Congress, federal law will revert to the provisions that were in effect prior to passage of the act. In 2010, the Iowa General Assembly reenacted the Iowa estate tax and made the implementation of the tax contingent upon federal tax law once again providing for a state death tax credit. See 2010 Iowa Acts ch. 1138 (S.F. 2380).

¹⁹¹ See section 2011 of the Internal Revenue Code for more information on the state death tax credit.

¹⁹² See Iowa Code § 451.2; IRC § 2011.

¹⁹³ See Iowa Code § 451.12.

¹⁹⁴ See generally Iowa Code ch. 450A.



while not actually transferring ownership of the trust's principal until, upon the death of the child, ownership is transferred to the grandchild.

In such a circumstance, there is no transfer to the child that can be taxed under the federal estate tax. A generation has been "skipped." If the grandparent's property had been transferred to the child, the federal estate tax would have been collected on the transfer, and when the child dies, the tax would be collected again. However, when a transfer of property "skips" the child's generation and passes directly to the grandchildren, the federal estate tax is collected only once.

The federal generation skipping transfer tax¹⁹⁵ is specifically designed to address wealth transfers such as the one described above, and the Iowa generation skipping transfer tax is similar in structure to the federal version. Moreover, like the Iowa estate tax, the Iowa generation skipping transfer tax is a "pick-up tax" that uses the federal version to calculate Iowa tax liability. That is, the tax is imposed on the transfer of property included in a "generation skipping transfer," as that term is defined in the Internal Revenue Code, and the amount of tax due is equal to the amount of the maximum federal generation skipping transfer tax credit allowable for state generation skipping transfer taxes actually paid.¹⁹⁶

The tax, like the inheritance tax, must be paid by the person to whom the property is transferred. The tax is administered by the Department of Revenue in much the same manner as the inheritance tax.¹⁹⁷

4. The Qualified Use Inheritance Tax¹⁹⁸

The qualified use inheritance tax is essentially a substitute for the inheritance tax. It allows certain taxpayers inheriting real property to elect a lower property valuation for purposes of the Iowa inheritance tax.

The election is available to certain "qualified heirs"¹⁹⁹ who are transferred property that is used in farming, or in a trade or business other than farming, at the death of the decedent or the three years prior to the decedent's death. The valuation of the property and the qualification requirements are determined according to the provisions of the Internal Revenue Code.²⁰⁰

In order to make the election for Iowa purposes, the taxpayer must make a similar election for federal estate tax purposes, and the use of the property for farming or business purposes must continue for a period of 10 years following the death of the decedent. If, within those 10 years and before the death of the qualified heir, the property ceases to be used for farming or business purposes or if the qualified heir transfers the property to someone other than a relative, then the amount of inheritance

¹⁹⁵ Like the federal estate tax, the federal generation skipping transfer tax is repealed for decedents dying during CY 2010, but is reinstated as of January 1, 2011, for decedents dying after that date unless Congress extends the repeal. See generally the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901 and related regulations.

¹⁹⁶ Iowa Code §§ 450A.1, 450A.2, 450A.14.

¹⁹⁷ Iowa Code §§ 450A.5, 450A.12.

¹⁹⁸ See generally Iowa Code ch. 450B.

¹⁹⁹ A qualified heir is the spouse of the decedent, an ancestor of the decedent, a lineal descendent of the decedent, or the decedent's parent, or the spouse of any such lineal descendent. See Iowa Code § 450.1 and IRC § 2032A(e).

²⁰⁰ Iowa Code § 450B.1.



State Taxation in Iowa: An Overview

tax not paid (because of the taking of the election) becomes due and payable as if the election had never been made.²⁰¹

The tax is administered by the Department of Revenue in much the same manner as the inheritance tax.²⁰²

H. Other Taxes

There are some taxes in Iowa that are not easily categorized according to the groupings used above. Some of these taxes, such as the unemployment compensation tax and the gambling-related taxes are relatively significant state taxes while others, such as the drug stamp tax and the brucellosis and tuberculosis eradication levy are relatively obscure.

1. The Unemployment Compensation Tax²⁰³

The unemployment compensation tax is imposed on the taxable wage base²⁰⁴ of most employers²⁰⁵ in Iowa in order to finance the state's unemployment compensation program. The unemployment compensation system in the United States has both federal and state components. The Social Security Act of 1935 (Public Law 74-271) created the Federal-State Unemployment Compensation Program. The program has two main objectives: (1) to provide temporary and partial wage replacement to involuntarily unemployed workers who were recently employed; and (2) to help stabilize the economy during recessions.

The U.S. Department of Labor oversees the system, but each state administers and finances its own program. The federal government determines covered employment and imposes certain requirements on the state programs, but the states generally determine individual qualification requirements, disqualification provisions, eligibility, weekly benefit amounts, potential weeks of benefits, and the state tax structure used to finance all of the regular state benefits and half of the extended benefits. The federal component authorizes loans or advances to states with insolvent unemployment compensation programs.²⁰⁶

Iowa's Unemployment Compensation Program is administered by the Department of Workforce Development. The program imposes a tax on employers to finance benefits to unemployed workers. Revenues from the tax, referred to as "employer contributions" are held in a fund and used to pay benefits to eligible workers. Iowa uses a flexible method to determine the rate of employer contributions to this fund in order to sustain program benefits at a fiscally sound level. This method incorporates a

²⁰¹ Iowa Code § 450B.3.

²⁰² Iowa Code § 450B.7.

²⁰³ See generally Iowa Code ch. 96.

²⁰⁴ The "taxable wage base" is either two-thirds of the statewide average yearly wage or the taxable wage base for the federal unemployment tax, whichever is greater. See Iowa Code § 96.19.

²⁰⁵ In general, an employer that has one or more employees on the payroll for a portion of a day in at least 20 different weeks during the calendar year or that has payroll of at least \$1,500 or more in a calendar quarter is subject to the tax. For more information, see the definition of "employer" in Iowa Code § 96.19.

²⁰⁶ For more information on Unemployment Compensation and other federal programs, see the "Green Book" published by the staff of the United States House of Representatives' Ways and Means Committee, available at <http://www.gpoaccess.gov/wmprints/green/index.html>.

State Taxation in Iowa: An Overview



statutory mechanism for annually setting the amount of the tax on employers at a rate sufficient to meet revenue needs for the year.²⁰⁷

The rate is set according to one of eight “contribution rate tables,” each containing 21 “benefit ratio ranks.” Each employer receives a rank based on that employer’s benefit ratio.²⁰⁸ The amount the employer must contribute is set according to the employer’s benefit ratio rank and the contribution rate table in effect for the year.

Each year by September 5, the Department of Workforce Development determines which of the rate tables will be in effect for the next year.²⁰⁹ The determination is made by (1) dividing the current reserve fund ratio²¹⁰ by the highest benefit cost ratio²¹¹ and (2) using the value of the quotient obtained from (1) to find the contribution rate table associated with it.

2. The Tax on Pari-mutuel Wagering²¹²

Iowa imposes a tax on pari-mutuel wagering. Pari-mutuel wagering is a form of wagering in which all bets are “pooled” together. Unlike fixed-odds wagering, in pari-mutuel wagering the final payout amount is not known until the pool is closed. The pari-mutuel wagering method is commonly used for gambling on horse races, dog races, or other sporting events in which the participants finish in ranked order.

In Iowa, the tax is imposed at the rate of 6 percent of the gross sum wagered at each horse race meeting. The rate imposed on dog racing is either 4, 5, or 6 percent of the gross sum wagered during the dog racing season, depending on how much is wagered during that season. There is a separate tax imposed at the rate of 2 percent of the gross sum wagered on simultaneously telecast horse and dog races.²¹³ In addition, Iowa charges a license fee of \$200 per racing day for horse and dog racing.²¹⁴

The state Racing and Gaming Commission collects the tax on pari-mutuel wagering. The tax must be paid to the commission within 10 days after the close of a track’s racing season. Revenues from the tax are shared with cities and counties.²¹⁵ The state share of the tax is distributed among various funds in the state treasury or used to retire principal and interest on state bonds.²¹⁶

²⁰⁷ Iowa Code § 96.7(2)(d).

²⁰⁸ The benefit ratio is determined by dividing the employer’s five-year average unemployment benefit charges by the employer’s five-year average taxable payroll amount. This ratio is then compared to other employers to determine the rank. See Iowa Code § 96.7(2)(d).

²⁰⁹ The contribution rate table in effect for the next year is available on the Department of Workforce Development’s website at <http://www.iowaworkforce.org/ui/stawrs/70-5007.pdf>.

²¹⁰ The current reserve fund ratio is determined by adding \$150 million to the amount currently in the fund and dividing by the total wages paid in covered employment during the first four calendar quarters of the previous five calendar quarters. Iowa Code § 96.7(2)(d).

²¹¹ The benefit cost ratio is the total benefits paid for the year divided by the total wages paid during that year. Iowa Code § 96.7.

²¹² See generally Iowa Code ch. 99D.

²¹³ Iowa Code § 99D.15.

²¹⁴ Iowa Code § 99D.14(3).

²¹⁵ Iowa Code § 99D.15.

²¹⁶ Iowa Code § 8.57(6)(e).



State Taxation in Iowa: An Overview

3. The Tax on Gambling Games²¹⁷

Iowa also imposes a tax on the gross receipts from gambling games operated at racetracks, “land-based gambling structures” (e.g. casinos), and excursion boats.²¹⁸ The tax is imposed at the rate of 5 percent on the first \$1 million of receipts and 10 percent on the next \$2 million. The rate imposed on gross receipts in excess of \$3 million varies:²¹⁹

- For an excursion boat or a casino, the rate is 22 percent.
- For a racetrack located in a county where there is no excursion boat or casino, the rate is 24 percent.
- For a racetrack that is located in a county where there is an excursion boat or casino, the rate is 22 percent if the racetrack has not been issued a table games license during the fiscal year or if the racetrack’s gross receipts were less than \$100 million in the prior fiscal year.
- For a racetrack that is located in a county where there is an excursion boat or casino, that has been issued a table games license during the fiscal year (or prior fiscal year), and that had gross receipts of \$100 million or more in the prior fiscal year, the rate is 22 percent on adjusted gross receipts received prior to the operation of table games and 24 percent on adjusted gross receipts received on or after the operation of table games.²²⁰

In addition to the tax on their gross receipts, operators of gambling games are subject to certain fees. First, there is a substantial fee charged in order to obtain a license. The fee is \$5 million for a licensee locating in a county with a population of 15,000 or less, \$10 million for locating in a county with a population of more than 15,000 and less than 100,000, and \$20 million for locating in a county with a population of 100,000 or more. Twenty percent of the fee is payable upon the filing of an application for a license, and 20 percent of the remainder is payable each year for the ensuing four years.²²¹ Second, excursion boats and casinos are charged an annual license fee based on the number of people they can accommodate. The fee is equal to \$5 per person capacity.²²²

²¹⁷ See generally Iowa Code ch. 99F.

²¹⁸ Iowa Code §§ 99F.1 and 99F.3.

²¹⁹ Iowa Code § 99F.11. The history of tax rates on gambling games is long and litigious. At one time, gambling games were allowed on excursion boats but not at racetracks (or at land-based gambling structures such as casinos). In 1994, the General Assembly allowed gambling games to be conducted at racetracks but taxed them at rates as high as 36 percent while setting the top rate on excursion boats at just 20 percent. The racetracks filed suit challenging the higher tax rates. The Iowa Supreme Court held that the higher rate on racetracks violated the equal protection guarantees of both the United States and Iowa constitutions. See *Racing Assoc. of Central Iowa v. Fitzgerald*, 648 N.W. 2d 555 (Iowa 2002). The federal aspects of that decision were reversed by the United States Supreme Court which held that the different tax rates did not offend federal equal protection guarantees, and the case was remanded to the Iowa Supreme Court. See *Fitzgerald v. Racing Assoc. of Central Iowa*, 539 U.S. 103 (2003). On remand, the Iowa Supreme Court once again struck down the differential rates, this time under Iowa law only, and the United States Supreme Court declined further review of the case. See *Racing Assoc. of Central Iowa v. Fitzgerald*, 675 N.W.2d 1 (Iowa 2004). Subsequent to this litigation, the Iowa General Assembly adopted the current rate structure and authorized gambling games to be conducted at casinos in addition to racetracks and excursion boats. The question of whether the current rates offend either federal law or Iowa law has not been the subject of further litigation. For more information on the scope of the federal Equal Protection Clause, see the above discussion of the federal constitutional limitations on state taxation.

²²⁰ Iowa Code § 99F.11.

²²¹ Iowa Code § 99F.10(7).

²²² Iowa Code § 99F.5(2).



The tax on gambling games is collected by the State Treasurer and must be paid within 10 days after the close of the day when the wagers were made. Revenues from the tax are shared with cities and counties.²²³ The state share of the tax is distributed among various funds in the state treasury or used to retire principal and interest on state bonds.²²⁴

4. The Tax on Dealers of Controlled Substances (The “Drug Stamp” Tax)²²⁵

Iowa imposes a tax on dealers of controlled substances. The tax is imposed at different rates depending on the substance.²²⁶ The rates are:

- \$5 per gram of processed marijuana.
- \$250 per gram of a taxable substance, other than marijuana, that is sold by weight.
- \$750 per unprocessed marijuana plant.
- \$400 for each 10 dosage units of a taxable substance, other than marijuana, that is not sold by weight.²²⁷

A dealer of a taxable substance is prohibited from possessing, distributing, or offering the substance for sale unless the tax has first been paid. The tax is due and payable immediately upon the manufacture, production, acquisition, purchase, or possession of the taxable substance by the dealer. A stamp, label, or other official indicia that the tax has been paid must be purchased from the Department of Revenue and permanently affixed to the taxable substance. Dealers must purchase at least \$215 worth of stamps.²²⁸ A dealer is entitled to a credit if taxes on the substance have already been paid to another state.²²⁹ Revenues collected from the tax are deposited in the General Fund of the State.²³⁰

A dealer who fails to pay the tax is subject to a civil penalty equal to the amount of taxes owed as well as interest on both the taxes owed and the penalty. In addition, a failure to affix the stamp is a class D felony under Iowa law, as is affixing a counterfeit stamp.²³¹ The Director of Revenue may request and receive information about dealers of controlled substances from state and local officials and employees.²³² However, the Director of Revenue may not reveal information obtained pursuant to the administration of the tax, and such information may not be used against a dealer in a criminal proceeding.²³³

²²³ Iowa Code § 99F.11.

²²⁴ Iowa Code § 8.57(6)(e).

²²⁵ See generally Iowa Code ch. 453B.

²²⁶ Iowa Code § 453B.7.

²²⁷ A “taxable substance” is a controlled substance, a counterfeit substance, a simulated controlled substance, or marijuana, or a mixture of materials that contains a controlled substance, counterfeit substance, simulated controlled substance, or marijuana, as those terms are used for purposes of Iowa’s controlled substances laws. See Iowa Code §§ 453B.1(10), 453B.7, and 124.101(10).

²²⁸ Iowa Code §§ 453B.3 and 453B.8.

²²⁹ Iowa Code § 453B.13.

²³⁰ Iowa Code § 453B.2.

²³¹ Iowa Code § 453B.12. A class “D” felony is punishable by confinement for no more than five years and a fine of at least \$750 but not more than \$7,500.

²³² Iowa Code § 453B.15.

²³³ Iowa Code § 453B.10.



State Taxation in Iowa: An Overview

5. The Brucellosis and Tuberculosis Eradication Levy²³⁴

Iowa law requires the Secretary of Agriculture to manage a fund dedicated to the eradication of bovine brucellosis and tuberculosis. Each year on January 20, the secretary must determine whether the balance in the fund is sufficient to carry on the work of eradicating those diseases. If the balance is not sufficient, the secretary must notify the board of supervisors of each county to levy an amount sufficient to meet the Department of Agriculture and Land Stewardship's expenses.

The maximum amount of the levy is 33.75 cents per \$1,000 of assessed value of all taxable property in the county. County treasurers collect the tax and transmit the revenues to the treasurer of state who deposits them in the Brucellosis and Tuberculosis Eradication Fund.

IV. Tax Revenues

This part contains information on the amount of revenues collected under most of the taxes discussed in this Guide. The numbers reported here do not reflect the entirety of the state budget since there are significant nontax sources of revenue such as federal loans, grants and appropriations, state-imposed fees, and revenues from the operation of the State Lottery. This information is helpful in understanding the tax revenue mix but does not reflect revenue commitments. Some of the revenues reported are credited to special funds, such as motor fuel taxes to the Road Use Tax Fund, rather than to the General Fund of the State.

The numbers reported also do not include the gross amount of revenues collected. Instead, the numbers reflect the "net revenues" of the various state taxes which are the gross revenues minus refunds. Net revenue, therefore, reflects the "spendable" portion of the state's tax revenue.

A. State Tax Revenues

Tax revenues are collected and reported on a fiscal year basis, and money is appropriated on a fiscal year basis. The state of Iowa's fiscal year runs from July 1 to June 30.

The annual revenues collected from the various taxes imposed by the state of Iowa vary greatly from tax to tax depending on the tax base and the effective rate. In addition, the amount of revenues from each tax can fluctuate greatly from year to year based on economic conditions, even if the rate and the tax base are unchanged.

²³⁴ Iowa Code § 165.18.

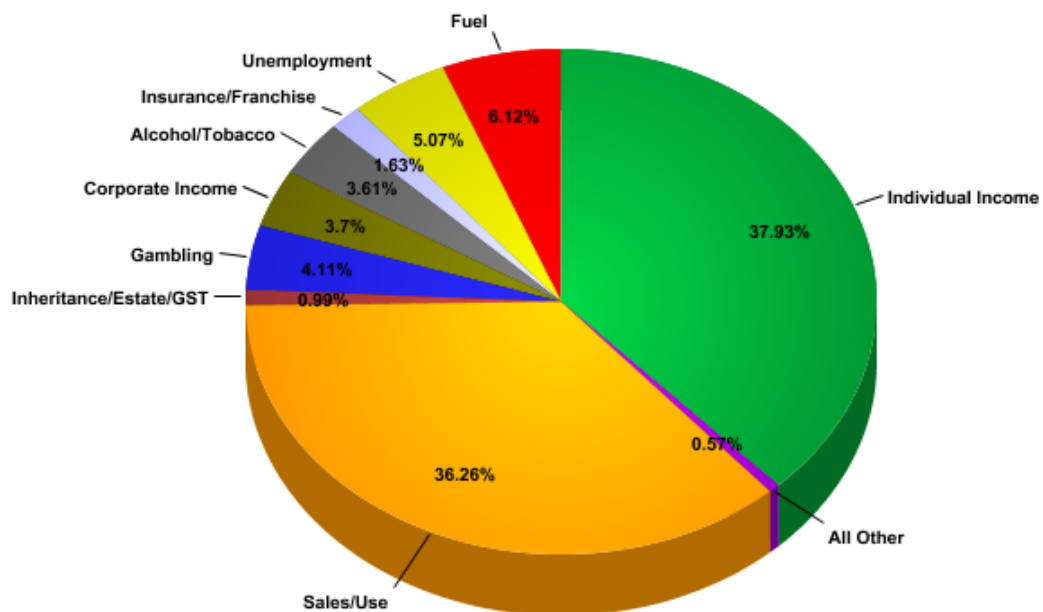
State Taxation in Iowa: An Overview



1. FY 2009 Tax Revenues

Tax Type	FY 2009 Net Revenues
Individual Income	\$2,709,777,092
Sales, Use, Hotel, New Vehicle Registration	\$2,590,327,962
Motor Fuel	\$437,210,512
Unemployment Compensation	\$362,439,658
Gambling	\$293,645,712
Corporate Income	\$264,365,192
Tobacco	\$237,607,000
Insurance	\$88,419,168
Inheritance, Estate, and Generation Skipping Transfer	\$70,748,554
Franchise	\$28,067,596
Environmental Protection Charge	\$20,608,144
Alcohol	\$20,564,216
Real Estate Transfer	\$15,924,558
Automobile Rental	\$3,693,035
Brucellosis and Tuberculosis Eradication	\$441,151
Drug Stamp	\$230,796

Proportional Tax Revenue (FY 2009)



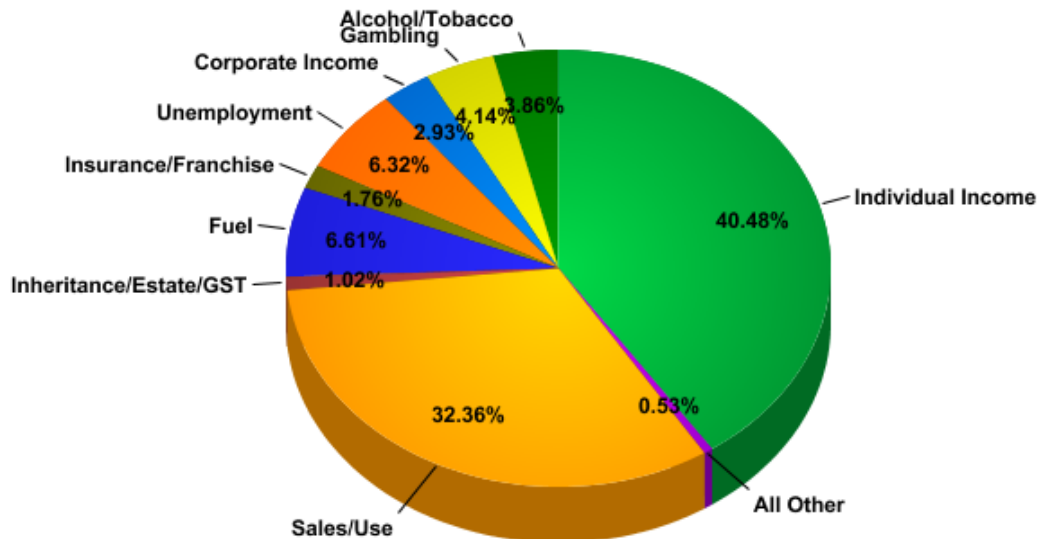


State Taxation in Iowa: An Overview

2. FY 2010 Tax Revenues

Tax Type	FY 2010 Net Revenues
Individual Income	\$2,658,000,000
Sales, Use, Hotel, New Vehicle Registration	\$2,125,000,000
Motor Fuel	\$433,900,000
Unemployment Compensation	\$415,300,000
Gambling	\$271,800,000
Tobacco	\$232,000,000
Corporate Income	\$192,100,000
Insurance	\$88,500,000
Inheritance, Estate, and Generation Skipping Transfer	\$66,800,000
Franchise Tax	\$27,300,000
Environmental Protection Charge	\$20,300,000
Alcohol	\$21,200,000
Real Estate Transfer	\$11,800,000
Automobile Rental	\$2,400,000
Brucellosis and Tuberculosis Eradication	\$400,000
Drug Stamp	\$100,000

Proportional Tax Revenue (FY 2010)



State Taxation in Iowa: An Overview



B. Local Tax Revenues

The following graph represents the amount of revenues from certain locally imposed taxes collected and administered by the state. The graph reports total, statewide revenue figures for these taxes and groups them in three primary categories: local option sales taxes, local income surtaxes, and local option hotel/motel taxes.

