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**SF 192** – Farming Capital Gains Tax Exemption (LSB1794XS)  
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Fiscal Note Version – New

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**Description**

**Senate File 192** modifies the income tax exemption for a qualified capital gain realized through the sale of real property used in a farming business. The change is effective once the contingent individual income tax system established in **SF 2417** (2018 Tax Modifications Act) becomes effective. The earliest possible effective tax year (TY) for the contingent system is TY 2023.

The contingent tax system allows a capital gains exemption for the sale of farming business real property if certain sale conditions are met. The current capital gains exemption under the contingent tax system requires all of the following:

- That the taxpayer realizing the capital gain must have materially participated in the farming business for at least 10 years and must have owned the real property for at least 10 years.
- That the sale that produced the capital gain was to a qualified relative, where:
  - The relationship to the purchaser was the result of a common ancestor (consanguinity, or blood relative).
  - The sale is to a lineal descendant (including adopted children).

Current law disallows the exemption if the property is sold by the purchasing relative within five years to a nonqualifying person. The deduction is also disallowed where a net operating loss is deducted on the taxpayer's tax return for that tax year. Also, all buildings which are primarily used or intended for use as human habitation are excluded from the exemption.

The changes in the Bill expand the availability of the capital gains exemption to include additional capital gains situations. Expansions include:

- All sales to relatives, as defined in the Bill, result in a capital gain exemption for the seller, without regard to whether the owner materially participated in the farm operation or to the length of time the real property was owned by the taxpayer.
- The disallowance of the exemption upon sale within five years to a nonqualifying person is removed.
- The disallowance for tax years where a net operating loss is deducted is removed.
- A sale to an entity (LLC, corporation, etc.) in which a qualifying purchaser has an interest at the time of the sale qualifies for the exemption.
- Sales to affinity (i.e., by marriage) relatives as well as blood relatives qualify for the exemption.
- The sale of a building primarily used for human habitation is included in the exemption if the building is located on or adjacent to the farming business property.

### **Assumptions**

- Using Iowa income tax returns filed for TY 2017, the Department of Revenue estimates that the changes in the Bill will increase the annual aggregate amount of capital gains exempted from Iowa income tax by \$148.0 million.
- The contingent income tax system is assumed to be effective the first tax year possible, TY 2023.
- The average marginal income tax rate for the impacted tax returns will equal 5.3% in TY 2023 and after.
- Qualified farm taxpayers are not required to make estimate payments, and farm income is not subject to withholding. Therefore, TY 2023 fiscal impacts will occur when TY 2023 tax returns are filed in spring 2024 (FY 2024).
- The average local option income surtax rate for schools will equal 2.9% of State income tax liability.

### **Fiscal Impact**

The expansion of the farming business capital gains exemption currently allowed under the contingent income tax system is projected to decrease net General Fund revenue by \$7.8 million per fiscal year. In addition, revenue raised by the local option income surtax for schools will be reduced by \$227,000 per year. Both revenue reductions will begin FY 2024.

### **Source**

Department of Revenue

/s/ Holly M. Lyons

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

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