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[HF 779](#) – Tax Code Changes (LSB2786HV.1)  
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Fiscal Note Version – As passed by the House

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**Description**

[House File 779](#) as passed by the House makes changes to the application and administration of Iowa sales, property, and income (individual, corporate, bank franchise, and credit union) tax provisions. The Bill has various applicability dates including retroactive applicability dates.

**Explanation and Assumptions**

Provisions with Estimated Fiscal Impacts

Refer to page 8 for the table of projected General Fund revenue change by the provisions outlined below.

**Division I, Sections 9 and 12:** Requires nonresident taxpayers claiming the Early Childhood Development (ECD) Tax Credit to prorate the ECD claims based on the ratio of Iowa-source income to income from all income reported on their tax return. The change is effective beginning tax year (TY) 2019. The change is projected to increase net General Fund revenue. Assumptions used in developing the estimate include:

- The Department of Revenue (DOR) estimated the impact on nonresident taxpayers using the DOR model of all Iowa income tax returns. The model results estimate that the change will increase total tax liability by \$38,000 per tax year, beginning TY 2019.
- Of the \$38,000 estimated revenue increase for TY 2019, the Legislative Services Agency (LSA) estimates that 5.0% will impact FY 2019 through increased withholding and estimate payments, and 95.0% will impact FY 2020.
- Of the \$38,000 estimated increase in TY 2020 and after, the LSA estimates that 17.0% will impact the fiscal year in which the tax year begins, and 83.0% will impact the next fiscal year.

**Division I, Section 11:** Extends the tax benefits of like-kind exchanges for Iowa corporate income and bank franchise tax purposes to include the exchange of all property, not just real property, for TY 2019. The change is projected to reduce net General Fund revenue by \$0.9 million over two fiscal years. The DOR developed the estimate from an [analysis](#) prepared by the federal Joint Committee on Taxation.

**Division III, Section 21:** Specifies that both carpentry repair and carpentry installation are taxable services subject to Iowa sales tax.<sup>1</sup> Current law lists the term “carpentry” as a service subject to Iowa sales tax. The change is effective July 1, 2019. The change is projected to increase sales tax revenue. The following assumptions were used to estimate the revenue increase:

- A total of \$16.9 million in carpentry services will become newly subject to sales tax in FY 2019, and the total will increase 2.3% each fiscal year.

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<sup>1</sup> In this document, the term “sales tax” includes use tax where applicable.

- The State sales tax rate is 5.0%, the State sales tax rate for school infrastructure is 1.0%, and the average local option sales tax rate is 0.9%.

**Division III, Section 22:** Exempts grain bins and the materials used to build and repair grain bins from the sales tax. The change is effective retroactive to July 1, 2019. The following data source and assumptions were used to estimate the revenue increase:

- Iowa on-farm grain storage capacity statistics from the National Agricultural Statistics Service were used to estimate Iowa grain storage capacity, replacement rate, and replacement costs.
- Grain storage capacity in Iowa equals 2.12 billion bushels.
- New and replacement capacity equals 2.4% of each year's existing capacity.
- The cost of new and replacement capacity is assumed to equal \$2.00 per bushel of capacity, and that cost is assumed to increase 2.3% per year.
- No additional cost is assumed for maintenance and repair costs.
- The State sales tax rate is 5.0%, the State sales tax rate for school infrastructure is 1.0%, and the average local option sales tax rate is 0.9%.

**Division III, Section 23:** Adds supplies and replacement parts purchased for use at property that is centrally assessed to the exclusions from the existing machinery and equipment sales tax exemption. The change is retroactive to January 1, 2016. The following data sources and assumptions were used to estimate the revenue increase:

- Department of Revenue use tax returns from businesses assumed to be centrally assessed companies.
- Modern Materials Handling Magazine surveys.
- In FY 2018, centrally assessed business purchases subject to use tax totaled an estimated \$352.8 million. An amount equal to 3.0% of those purchases (\$10.58 million) is assumed to be impacted by the Bill.
- The value of purchases made by centrally assessed businesses and impacted by the change will increase 5.0% per year.
- Without the retroactive change, an estimated \$0.9 million in sales tax refunds related to this issue is expected to be paid in FY 2020.
- The State sales tax rate is 5.0%, the State sales tax rate for school infrastructure is 1.0%, and the average local option sales tax rate is 0.9%.

**Division III, Sections 25 Through 27:** Removes the 200-sale threshold for remote sellers, marketplace facilitators, and referrers. Iowa law currently requires these types of entities, if they do not have traditional sales tax nexus in Iowa, to collect and remit sales tax if they complete at least 200 sales to Iowa customers in a year or have taxable sales to Iowa customers of at least \$100,000 in a year. With this change, remote sellers will only be subject to the \$100,000 threshold. The change is effective July 1, 2019. The following assumptions were used to estimate the revenue decrease:

- The DOR estimates that for FY 2020, 956 out-of-state retailers will have at least 200 Iowa transactions in a year but less than \$100,000 in Iowa sales. The Department expects that number to increase by 10.0% per year for the next five years.
- The average yearly Iowa sales amount for the impacted retailers is assumed to be \$18,600 in FY 2020, and that amount is assumed to increase 2.3% each year.
- The businesses impacted by the change are assumed to stop collecting and remitting tax to Iowa as a result of the change.
- The State sales tax rate is 5.0%, the State sales tax rate for school infrastructure is 1.0%, and the average local option sales tax rate is 0.9%.

**Division V:** Allows qualified property of competitive long-distance telephone companies to be centrally assessed by the DOR and taxed in the same manner as commercial property. The change is retroactive to July 1, 2018. Compared to the situation under current law, enactment of the changes will reduce the property tax owed by the companies for FY 2021 through FY 2023. The property tax reduction will result in decreased local government property tax revenue and an increase in the General Fund appropriation for school aid. The following assumptions were used to estimate the property tax revenue decrease and appropriation increase:

- The DOR estimates that Division V will decrease the taxed valuation of competitive long distance telephone companies by \$55.53 million in assessment year 2019 (FY 2021). The value is assumed to increase 2.3% each fiscal year.
- The FY 2019 statewide average property tax rate for utility property was \$27.73 per \$1,000 of taxed valuation. This rate is assumed to remain constant in future fiscal years. Of the \$27.73, the school basic levy component equals \$5.40.
- By action of the State school aid formula, property tax exemptions increase the General Fund appropriation to schools by \$5.40 per \$1,000 of exempted valuation. This causes the revenue reduction of a \$27.73 property tax rate to reduce local government revenue by \$22.33, as schools are reimbursed by the State General Fund for the remaining \$5.40.

**Division VI:** Extends the Targeted Jobs Withholding Credit Pilot Project, set to expire June 30, 2019, to June 30, 2021. The program offers a withholding tax credit to businesses that are located in or expand into one of the pilot project cities:

- Sioux City
- Council Bluffs
- Burlington
- Keokuk
- Fort Madison

Qualified businesses sign an agreement with the city and the Iowa Economic Development Authority. The tax credit equals 3.0% of gross wages paid to each employee covered by the agreement. The following assumptions were made to estimate the fiscal impact of this change:

- An average year's agreements under the existing program has equaled \$5.0 million in withholding credits. That level of awards is assumed for each of the four extended years.
- One-half of the annual award amount will be five-year awards, and one-half will be 10-year awards. For five-year awards, the annual tax credit will equal 16.0% of the award amount each year for five years, and 20.0% of the award will expire unused. For 10-year awards, the annual tax credit will equal 8.0% of the award amount each year for 10 years, and 20.0% of the award will expire unused.
- The impact of the extended tax credit will begin in FY 2020 and extend to FY 2032.

**Division VII:** Increases the annual aggregate award cap for the [School Tuition Organization \(STO\) Tax Credit](#) from the current \$13.0 million to \$15.0 million, effective beginning CY 2020.

The following facts, assumptions, and sources were used in developing the fiscal impact estimate for this provision:

- The tax credit is equal to 65.0% of a qualified contribution to an STO. Therefore, an increase in the STO cap of \$4.0 million translates to \$6.15 million in increased STO contributions.
- Contributions to STOs that earn the taxpayer a 65.0% tax credit are not allowed to also be used as an itemized deduction for Iowa tax purposes. Some taxpayers making qualified contributions to STOs may make that contribution instead of a contribution to another charity or organization that would earn the taxpayer an itemized deduction. It is assumed that

50.0% of the additional \$6.15 million displaces contributions that would earn the taxpayer a usable itemized deduction. The average marginal State income tax rate for taxpayers utilizing itemized deductions is assumed to be 6.9% through TY 2022 and 6.5% for TY 2023 and after. This calculation will offset the annual tax credit cost by \$0.2 million.

- School Tuition Organization Tax Credits are not refundable or transferable, but unused credits may be carried forward for up to five additional tax years. Based on historical STO Tax Credit claims, 94.0% of awarded credits are redeemed and 6.0% expire unredeemed. The assumed redemption pattern is:
  - Year 1 = 60.0% of the amount awarded
  - Year 2 = 20.0%
  - Year 3 = 8.0%
  - Years 4 through 6 = 2.0% per year
- The STO credit is not refundable, so it impacts the calculation of the local option income surtax for schools. The impact on the surtax is assumed to be an amount equal to 2.9% of the General Fund impact.
- The LSA estimates that 10.0% of each tax year's tax reduction will impact the fiscal year in which the tax year begins, and 90.0% will impact the next fiscal year.

**Division VIII:** Reestablishes the individual income tax checkoffs for the Iowa State Fair Foundation Fund and the joint Veterans Trust Fund and Volunteer Fire Fighter Preparedness Fund. The changes are effective for tax years (TY) 2019 and 2020.

A checkoff allows a taxpayer who files an Iowa individual income tax return to designate a dollar amount to be contributed to a specific fund.

For TY 2018, the following four checkoffs were included on the form:

- Iowa State Fair Foundation Fund
- Fish and Game Protection Fund
- Child Abuse Prevention Program Fund
- Joint Veterans Trust Fund and Volunteer Fire Fighter Preparedness Fund

Iowa Code section [422.12E](#) provides that when the same four income tax checkoffs have been on the tax return for two consecutive tax years, the two checkoffs with the least amount of contributions over a specified time period are repealed. The Iowa State Fair Foundation Fund and the joint Veterans Trust Fund and Volunteer Fire Fighter Preparedness Fund received the lowest contributed amounts over the latest specified period, so both were repealed by operation of law. The following table shows the average annual tax checkoff contribution amounts for the last 10 tax years (TY 2008 through TY 2017) and the last two tax years.

Checkoff	Tax Years	
	Last 10 Tax Years	2016 & 2017 Only
Fish and Wildlife	\$131,872	\$148,354
State Fair	65,944	64,167
Veterans/Fire Fighter	62,543	72,098
Child Abuse	66,690	79,472
<b>Total</b>	<b>\$327,049</b>	<b>\$364,091</b>

The tax checkoffs available on an Iowa individual income tax return are voluntary contributions, and any contribution made represents money donated by the taxpayer and not money diverted from the State General Fund. Reestablishing the two repealed checkoffs will give Iowa taxpayers the opportunity to donate to the two programs through the tax return process for TY 2019 and TY 2020. Annual contributions to the two checkoffs average about \$65,000 each.

**Division X:** Expands the existing sales tax exemption for manufacturers by adding the word “primarily” to the definition of “manufacturer.” This change will allow companies that are primarily manufacturers, but also engage in activities that are not manufacturing, to benefit from the sales tax exemption for manufacturers. The change is effective retroactive to May 30, 2018.

Changes that narrowed the definition of “manufacturer” for the purpose of the sales/use tax exemption have been in place for less than one year, so insufficient information exists to measure the impact of the changes on differing manufacturing business situations. It is likely that the narrowing of the definition to exclude companies that engage in manufacturing and also engage in nonmanufacturing activities has impacted the sales tax exemption for some businesses. This assumed likelihood means that the fiscal impact of the Bill language is not zero. Assumptions used to estimate the fiscal impact of the provision include:

- The March Revenue Estimating Conference estimate for FY 2020 State General Fund sales tax net revenue (gross tax receipts minus tax refunds and the transfer to school infrastructure finance) is \$2.497 billion. This amount is assumed to increase 2.3% per year.
- The Bill will result in an assumed annual reduction in sales tax net revenue of 0.007%.

**Division XIV:** Eliminates the Iowa bank franchise alternative minimum tax. The change is effective January 1, 2021 (TY 2021). A related credit for alternative minimum taxes paid is eliminated for TY 2022 and after. Assumptions used to estimate the fiscal impact of the provision include:

- Financial institution tax return information is based on TY 2016 and TY 2017 (the two most recent available tax years). For both years, approximately 2.0% of financial institutions paid the bank franchise alternative minimum tax. Based on the average of the two years, the DOR estimates that eliminating the bank franchise alternative minimum tax will reduce tax liability by 4.6% for TY 2021 and by 2.1% for TY 2022 and each year thereafter.
- The tax liability reduction estimates are applied to the March 2019 Revenue Estimating Conference estimates for bank franchise tax revenue (\$41.3 million for FY 2019 and \$50.1 million for FY 2020, with revenue levels beyond FY 2020 assumed to increase 2.6% per year).
- Shareholders of financial institutions organized as S corporations or LLCs are allowed to claim an income tax credit for Iowa franchise taxes paid. Based on historical tax return data for financial institution shareholders, it is assumed that 50.0% of the decreased tax liability will result in decreased income tax credits for franchise taxes paid.
- Banks are required to remit bank franchise tax as quarterly estimate payments. The LSA estimates that 50.0% of each tax year’s tax reduction will impact the fiscal year in which the tax year begins, and 50.0% will impact the next fiscal year.

**Division XV:** Reenacts the Geothermal Heat Pump Tax Credit. This credit was repealed in [SF 2417](#) (2018 Tax Modifications Act). The credit is equal to 20.0% of a similar federal tax credit. That federal tax credit is currently equal to 30.0% of installation costs, so that makes the Iowa credit equal to 6.0% of installation costs. The federal tax credit is repealed December 31, 2021. With the impending federal repeal, the reenacted tax credit will allow Iowa installations to earn a credit for three years (CY 2019 through CY 2021). The Bill places a maximum annual

cumulative tax credit claim limit for the Iowa credit of \$1.0 million. Any claims in excess of that amount for a calendar year are waitlisted and eligible to claim credits in the next year.

- Based on credit demand for the previous Iowa credit, it is assumed that installation costs will total \$35.0 million per year for the three years. Upcoming reductions in the federal tax credit rate to 26.0% for CY 2020 and 22.0% for CY 2021 mean that the Iowa rate will be 5.2% in CY 2020 and 4.4% in CY 2021. Based on the assumed value of installations and the Iowa tax credit percentage, the amount of annual credits earned from Iowa installations will equal:
  - CY 2019 = \$2.10 million
  - CY 2020 = \$1.82 million
  - CY 2021 = \$1.54 million
- The Bill limits annual credit claims to \$1.0 million. The assumed level of credits earned is \$5.46 million. This means that a waitlist will develop, and tax credit redemption will occur over at least six tax years (TY 2019 through TY 2024).

#### Provisions with Minor or No Estimated Fiscal Impact

**Division I, Sections 1 Through 3:** Clarifies Iowa tax provisions related to the Qualified Business Income (QBI) deduction for TY 2019. The changes will allow for easier administration of the QBI income tax provisions.

**Division I, Section 4:** Specifies that the membership of a board of directors of an STO may exceed seven in number.

**Division I, Sections 5 Through 8 and 13:** Clarifies that the STO Tax Credit annual limit is a calendar year limit.

**Division I, Section 10:** Updates Internal Revenue Code reference language related to the bank franchise alternative minimum tax.

**Division II:** Allows simplified disclosure of tax information to a person authorized by the taxpayer to receive the taxpayer's information.

**Division III, Section 19:** Changes the term "entity" to "person" as it relates to the term "affiliate" as it applies to the duty to collect and remit sales tax. The DOR reports that this change is for clarity and the language will aid in tax administration and enforcement.

**Division III, Sections 20 and 24:** Makes the entire purchase price of a software maintenance service or warranty contract subject to sales/use tax if the service portion of the contract price is not separately listed. Under current law, this situation would result in one-half of the contract price being subject to sales tax. The change also makes the purchase exempt from sales tax if the purchaser is a commercial enterprise. Together, the changes mean that only purchases made by entities that do not qualify as a commercial enterprise will be subject to tax. The DOR indicates that the overall impact of the changes will be slightly positive.

**Division III, Sections 28 and 29:** Allows certain sales/use tax reports required of a referrer (online sales) to be filed on an annual, rather than monthly, basis, and requires the DOR to implement certain sales/use tax referrer requirements by administrative rule.

**Division III, Section 30:** Strikes a provision that automatically registers with Iowa any retailer that registers in any state that is part of the Streamlined Sales Tax Agreement.

**Division III, Section 31:** Establishes a Taxation and Exemption of Computers Task Force to review the definition of “computer” as it relates to the existing sales tax exemption for computers. The DOR is directed to provide any recommendations of the Task Force to the General Assembly by January 1, 2020. The only fiscal impact of the provision would be the administrative costs to the DOR.

**Division IV:** Clarifies the application and collection of the automobile rental excise tax.

**Division IX:** Adds the examination and audit of all taxes collected or administered by the DOR to the powers and duties of the Director of the DOR.

**Division XI:** Expands the list of industries eligible to claim the Research Activities Credit (RAC) to include agriscience. The change is effective retroactive to January 1, 2017 (TY 2017). Under current law, and effective TY 2017, eligible industries must meet the following two requirements to be eligible for the Iowa RAC:

- Claim and be allowed the Federal Research Credit for the Iowa research claimed.
- Be engaged in one of the following industries:
  - Manufacturing
  - Life sciences
  - Software engineering
  - Aviation and aerospace

Agriscience is interpreted by the DOR to be a life science industry and currently eligible for the RAC under existing law. Therefore, the change is considered a clarification and does not have a fiscal impact.

**Division XII:** Allows a qualified taxpayer to claim the entirety of the Adoption Tax Credit in the tax year when the adoption is finalized. Under current law, the eligible taxpayer must file an amended return for expenses incurred during tax years prior to the finalization of the adoption. The change applies retroactively to TY 2019. While the change may have a small General Fund revenue impact between fiscal years, it is not expected to decrease tax revenue across multiple fiscal years.

**Division XIII:** Extends the current sunset date for the [Utility Replacement Tax Task Force](#) for five years, to January 1, 2024. The Task Force studies the effect of electric, natural gas, and water utility replacement taxes (a local tax that replaces property tax) on local taxing authorities.

**Division XVI:** Administrative change to the imposition of the moneys and credits tax (the income tax paid by credit unions). No changes are made to the tax itself.

### **Fiscal Impact**

The projected fiscal impact of the various provisions of the Bill is summarized in the following table.

**Projected State General Fund Revenue Change by Provision**

In Millions

<u>Division/Section</u>	<u>Provision</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Div. I, Sec. 9	ECD Nonresident	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0
Div. I, Sec. 11	Like-Kind Exchanges	-0.2	-0.7	0.0	0.0	0.0	0.0
Div. III, Sec. 21	Carpentry	0.0	0.8	-0.9	-0.9	-0.9	-0.9
Div. III, Sec. 22	Grain Bins	0.0	-5.2	-5.3	-5.5	-5.6	-5.8
Div. III, Sec. 23	M & E Exemption	0.6	1.5	0.6	0.6	0.7	0.7
Div. III, Sec. 25-27	Seller 200 Nexus	0.0	-0.9	-1.0	-1.1	-1.3	-1.4
Div. VI	Targeted Jobs	0.0	-0.6	-1.2	-1.2	-1.2	-1.2
Div. VII	STO Tax Credit	0.0	-0.1	-1.1	-1.5	-1.7	-1.7
Div. X	Manufacturer Def.	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
Div. XIV	Franchise Tax AMT	0.0	0.0	-0.6	-0.9	-0.6	-0.6
Div. XV	Geothermal Tax Credit	0.0	-1.0	-1.0	-1.0	-1.0	-1.0
	<b>Total</b>	<b>\$ 0.4</b>	<b>\$ -6.4</b>	<b>\$ -8.9</b>	<b>\$ -9.9</b>	<b>\$ -10.0</b>	<b>\$ -10.3</b>

**Projected State General Fund Appropriation Change by Provision**

In Millions

<u>Division/Section</u>	<u>Provision</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Div. V	School Aid Approp.	\$ 0.0	\$ 0.0	\$ 0.3	\$ 0.3	\$ 0.3	\$ 0.3

**Projected Local Revenue Change by Revenue Type**

In Millions

<u>Local Revenue Type</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
School Infrastructure	\$ 0.1	\$ -0.9	\$ -1.0	\$ -1.0	\$ -1.1	\$ -1.2
Local Option Sales Tax	0.1	-0.9	-0.8	-0.9	-0.9	-0.9
School Income Surtax	0.0	0.0	0.0	0.0	0.0	0.0
Property Tax	0.0	0.0	-1.2	-1.3	-1.3	-1.3
<b>Total</b>	<b>\$ 0.2</b>	<b>\$ -1.8</b>	<b>\$ -3.0</b>	<b>\$ -3.2</b>	<b>\$ -3.3</b>	<b>\$ -3.4</b>

ECD = Early Childhood Development Tax Credit  
 CDC = Child and Dependent Care Tax Credit  
 M & E = Machinery and Equipment

STO = School Tuition Organization  
 AMT = Alternative Minimum Tax  
 RAC = Research Activities Credit

**Sources**

Department of Revenue  
 Joint Committee on Taxation (U.S. Congress)  
 National Agricultural Statistics Service  
 Iowa Department of Commerce  
 Legislative Services Agency analysis

/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.