Fiscal Note

Fiscal Services Division

SF 214 – Income Tax Exemption, Pandemic Payments (LSB1862XS)
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Fiscal Note Version – New

Description

Senate File 214 excludes unemployment insurance (UI) payments received through several recent federal programs from Iowa taxable income when computing income tax liability. The changes are retroactive to January 1, 2020, and apply to tax years (TY) 2020 and 2021. The federal programs included in the exemption are:

- Pandemic Unemployment Assistance (PUA).
- Pandemic Emergency Unemployment Compensation (PEUC).
- Unemployment compensation approved by Presidential declaration and known as Lost Wages Assistance (LWA).
- The extension of PUA and PEUC approved by Congress in December 2020.

Background

The distribution of UI payments is a function of the Iowa Department of Workforce Development. Payments to qualified individuals are made weekly. The large increase in weekly UI payments began in mid-March 2020, when Congress enacted the federally funded emergency programs. With the recent extensions approved by Congress in December 2020, the emergency programs are available to qualified individuals through mid-March 2021.

Unemployment insurance recipients may choose to have federal and State income tax withheld from the payments they receive. If a recipient chooses Iowa withholding, the amount withheld is equal to 5.0% of the payment. If the recipient chooses to not have income tax withheld, any tax due on the UI income is resolved when the tax return for the year is filed.

Assumptions

- The taxpayer benefit from this exemption will be realized through lower individual income tax liability when filing TY 2020 and TY 2021 income tax returns. For some taxpayers, an amended TY 2020 filing will be necessary.
- The average marginal income tax rate for persons receiving UI payments is projected by the Department of Revenue to equal 5.25%.
- The reduction in State income tax liability will result in a reduction in the amount owed for any local option income surtax for schools. The statewide average surtax rate is 3.0% of State income tax liability.
- The total amount of UI payments subject to the proposed income tax exemption is calculated to be $966.4 million.

Unemployment Insurance Income
Impacted by the Proposed Tax Exemption
In Millions

	PUA	PEUC	LWA	Total
TY 2020	$ 173.9	$ 185.9	$ 156.9	$ 516.7
TY 2021	$ 216.3	$ 231.7	$ 1.7	$ 449.7
Total	$ 390.2	$ 417.6	$ 158.6	$ 966.4

Fiscal Impact

Exempting federal emergency UI payments from the State income tax is projected to reduce General Fund revenue by the following amounts:

- FY 2021 = $27.1 million
- FY 2022 = $23.6 million

There is no projected impact beyond FY 2022. The statewide yield from the local option income surtax for schools will be reduced by a projected $1.5 million across the two fiscal years.

Tax returns for TY 2020 filing season begins in mid-February 2021. Exempting the UI income from income tax for TY 2020 will require changes to tax forms, instructions, and programs. It is likely that this change will result in a significant number of TY 2020 amended returns and that will increase the administration costs of the Department of Revenue.

Additional Potential Fiscal Impact

Existing Iowa law provides for a significant change to Iowa's individual income tax system once two General Fund revenue triggers are met. The first year that the triggers may be met is at the conclusion of FY 2022. Once implemented, this contingent income tax system is projected to reduce Iowa individual income tax by roughly $300.0 million per tax year. Since this Bill is projected to reduce General Fund revenue in FY 2022, the Bill's changes will reduce the probability of achieving both revenue triggers; as a consequence, the Bill could result in delayed implementation of the income tax reduction by one tax year.

Sources

Department of Workforce Development
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.