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**SF 603** – Income Tax Exemption, Military Pay (LSB2166SV)  
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Fiscal Note Version – New

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**Description**

**Senate File 603** exempts pay for service performed pursuant to 32 U.S.C. section **502(f)** or **709(a)** and (b) from the State income tax. The Bill applies retroactively to January 1, 2021, for tax years beginning on or after that date.

**Background**

Under Iowa Code section **422.7(42A)**, pay received from the federal government while on active duty status in the armed forces, reserve, or National Guard is exempt from Iowa income tax.

**Assumptions**

- The Iowa National Guard reports that a total of \$78.0 million in wages that would be the subject of the proposed income tax exemption was paid to active duty-status military personnel in Iowa during tax year (TY) 2018.
- It is assumed that with the exception of annual wage increase, this amount of pay will remain at the TY 2018 level.
- The annual wage increase for each tax year is assumed to be 2.4%, calculated from the TY 2018 amount.
- The average income tax rate for TY 2021 through TY 2023 is assumed to be 4.0%.
- The **income tax system** that was put in place in 2018 Iowa Acts, chapter **1161**, and that is the subject of two State General Fund triggers is assumed to be activated starting TY 2024. At that point, the average income tax rate for the military wages that are the subject of this Bill is assumed to decrease by 10.0%, to 3.6%.
- The tax change is effective retroactively to January 1, 2021. The tax reduction associated with pay received from January 1, 2021, through June 30, 2021, is assumed to result in higher tax refunds and lower tax return payments during FY 2022. With the exception of this initial six-month period, the General Fund revenue reduction associated with each calendar year is assumed to fall 50.0% in the fiscal year that ends during the calendar year and 50.0% in the fiscal year that begins during the calendar year.
- The local option income surtax for schools statewide average rate is assumed to be 3.0% of tax liability.

**Fiscal Impact**

The tax reduction associated with the military pay exemption proposed in this Bill is projected to reduce net General Fund revenue by the following amounts:

- FY 2022 = \$5.0 million
- FY 2023 = \$3.5 million
- FY 2024 = \$3.4 million
- FY 2025 and after = \$3.3 million

The income tax reduction is projected to also reduce the statewide revenue raised by the local option income surtax for schools by \$0.1 million to \$0.2 million per year.

**Sources**

Iowa National Guard (TY 2018 wages)  
Militarybenefits.info ([military pay tables](#))  
TurboTax (average Iowa income tax rates)  
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.

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