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**SF 603** – Income Tax Exemption, Military Pay (LSB2166SV.1)  
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Fiscal Note Version – REVISED Fiscal Impact

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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 \$209.2 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) 2020.
- It is assumed that with the exception of annual wage increases, this amount of pay will remain at the TY 2020 level.
- The annual wage increase for each tax year is assumed to be 2.4%, calculated from the TY 2020 amount.
- The average income tax rate for TY 2021 through TY 2022 is assumed to be 3.9%.
- The **income tax system** that was put in place in 2018 Iowa Acts, chapter **1161**, is assumed to become effective starting TY 2023. At that time, the average income tax rate for the military wages that are the subject of this Bill is assumed to decrease to 3.5%.
- The tax exemption 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 = \$12.6 million
- FY 2023 and after = \$8.2 million

The income tax reduction is projected to also reduce the statewide revenue raised by the local option income surtax for schools by \$0.3 million per year.

**Sources**

Iowa National Guard (TY 2020 wages)  
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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