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Fiscal Note

Fiscal Services Division

HF 2583 – Department of Revenue, Sales Tax (LSB5284HV)
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Fiscal Note Version – New

Description

House File 2583 makes technical and operational adjustments to Iowa Department of Revenue (IDR) tax programs and administrative functions. The Bill also relates to sales/use tax and bank franchise tax. Provisions of the Bill have various effective dates. **Table 3** at the end of this ***Fiscal Note*** summarizes the General Fund fiscal impacts of the various Bill divisions.

Background — Divisions with Minimal or No Projected Fiscal Impact

- **Division II —** Local Option Sales Tax (LOST) and Secure an Advanced Vision for Education (SAVE) distributions.
- **Division III —** Liability of sellers using certified service providers.
- **Division IV —** IDR authority to cancel various permits that are no longer in use.
- **Division V —** Iowa Economic Development Authority (IEDA) sales/use tax refund incentives through the High Quality Jobs Program deadline procedures.
- **Division VIII —** Motor fuel reporting requirement penalty.

Division I — Sales, Use, and Excise Tax — Returns Due

Description and Background

The Bill requires a combined sales and use tax permit to allow for combined filing of sales/use tax returns; requires electronic filing of these returns, with exceptions; and requires returns to be filed annually or monthly, eliminating the quarterly filing option and thresholds for those filings.

In addition, the Bill makes the following changes to the sales tax base:

- Eliminates the sales/use tax exemption on the sales price from the sale or rental of computers or computer peripherals by an insurance company, financial institution, or commercial enterprise.
- Exempts from sales tax the purchase of specified digital products (SDP), prewritten computer software, and related services sold to public utilities.

Assumptions/Fiscal Impact (Division I)

The portion of the Bill providing for changes to sales/use tax permits and filings is estimated to have no fiscal impact.

- The Department of Revenue estimates that sales/use tax revenue will increase 3.6% in FY 2023, 3.0% in FY 2024, 2.7% in FY 2025, 2.6% in FY 2026, 3.0% in FY 2027, and 3.0% in FY 2028. Those Department estimates are used for calculations of those fiscal years.

- SAVE refunds are 1.0% of sales/use tax collected. LOST distributions are estimated to be 0.97% of sales/use tax collected.

The fiscal impact of changes in Division I are shown in **Table 1** and include impacts to the SAVE Fund and LOST distributions.

Table 1 — Increase in Sales/Use Tax Collected
In Millions

	Professions and Occupations SDP Taxation	Public Utilities SDP Exemption	Net Increase to Sales/Use Tax Collected	Increase in SAVE Refunds	Increase in LOST Distributions
FY 2023	$ 1.4	$ -0.1	$ 1.3	$ 0.2	$ 0.2
FY 2024	3.0	-0.2	2.8	1.4	1.3
FY 2025	3.1	-0.2	2.9	1.5	1.4
FY 2026	3.2	-0.2	3.0	1.5	1.5
FY 2027	3.4	-0.3	3.1	1.6	1.5
FY 2028	3.6	-0.3	3.3	1.6	1.6

SDP = Specified digital products
The FY 2023 amount is for one-half of the fiscal year.
Totals may not add due to rounding.
An increase in SAVE refunds will have a negative impact on the General Fund.
An increase in LOST distributions will have no impact on the General Fund.

Division VI — Bank Franchise Tax

Description and Background

The Bill reduces Iowa's current bank franchise tax rate of 5.0% of net income over five tax years. The tax rate is first reduced to 4.7% for tax year (TY) 2023 and is reduced over the next four years until the rate is fixed at 3.5% for TY 2027 and after.

The Iowa franchise tax applies to the net income of financial institutions that is apportioned to Iowa. The term "financial institution" refers to banks but also includes several other corporate structures. The term does not include credit unions.

The fiscal impact for a change in the franchise tax consists of two parts:

- Calculating the reduction in the franchise tax.
- Calculating the reduction in the use of the individual income tax Bank Franchise Tax Credit that is the result of a decrease in the franchise tax rate. The Bank Franchise Tax Credit is a mechanism used to avoid the double taxation of financial institution profits. Double taxation occurs if the profits of an institution are taxed first at the entity (corporate) level, and the owners are then taxed on the profits as income. The credit adjusts an owner's income to account for the fact that franchise tax was paid on the profits at the entity level. The Bank Franchise Tax Credit is a nonrefundable credit.

Assumptions/Fiscal Impact (Division VI)

The Department uses a bank profit projection process for the franchise tax that:

- Begins with a projection of net income at the entity (national) level using data from returns filed for tax years 2018 through 2020.
- Apportions each entity's net income to Iowa.
- Applies the current 5.0% tax rate and the proposed tax rate reductions.
- Subtracts tax credits.
- Compares the projected tax liability results using the current tax rate to the results using the proposed tax rate.
- Applies the projected reduction percentages to current law projections for gross franchise tax collections based on the most recent Revenue Estimating Conference projections for FY 2023 and the Department's projections for future years.

Based on 2007 through 2021 historical averages of franchise tax payments and Bank Franchise Tax Credits, the Department estimates that for each $1.00 of reduced franchise tax, the corresponding reduction in Bank Franchise Tax Credit usage on Iowa individual income tax returns will increase individual income tax by $0.35.

The franchise tax rate reductions are projected to reduce bank franchise tax liability and decrease the use of the Bank Franchise Tax Credit. The annual amounts of the two fiscal impacts combine to produce the following projected net tax liability and State General Fund revenue reductions:

- FY 2023 — $1.4 million
- FY 2024 — $3.8 million
- FY 2025 — $6.4 million
- FY 2026 — $7.4 million
- FY 2027 — $9.6 million
- FY 2028 — $13.4 million

For years beyond FY 2028, the projected tax liability and State General Fund revenue reductions are expected to increase at the rate of net income growth for banks doing business in Iowa.

Division VII — Manufactured Food — Sales Tax Exemption

Description and Background

The Bill expands the exemption of items and services used by a manufacturer to produce marketable food products for human consumption to include an exemption for a manufacturer of food ingredients. The change is effective upon enactment and applies retroactively to January 1, 2019. Due to the retroactive applicability, the Bill requires refund claims to be filed prior to October 1, 2022, and total refund claims cannot exceed $100,000 for any calendar year.

Iowa Code section 423.3(49) provides an exemption for items or services purchased in the production of food. Those items and services are considered taxable if used in the production of food ingredients or other products that could be eaten as food but are not marketable food products for human consumption.

Items, services, equipment, materials, and facilities used in the production of food are often the same as those used in the production of food ingredients or other food products that are not marketable for human consumption. It can be difficult to distinguish an item or service that is used in the production of food products for human consumption from one that is used for some other purpose, which can complicate compliance with the provisions of current law. The difficulty to distinguish has been the source of a number of tax appeals in recent years.

Assumptions/Fiscal Impact (Division VII)

- The cost of items and services associated with the manufacture of both food and food ingredients is estimated to have been $445.1 million in 2020, and 80.0% of these costs will fall under the new exemption. Because of current noncompliance, the fiscal impact of the change will be 20.0% of the expanded exemption.
- Growth trends in future fiscal years are based on the consumer price index (CPI) and will increase 5.0% in 2021 and 2.0% annually thereafter through 2028.
- SAVE refunds are 1.0% of sales/use tax collected. LOST distributions are estimated to be 0.97% of sales/use tax collected.

- The full $100,000 of refund claims per year starting with FY 2019 and continuing through FY 2022 will be utilized, increasing the FY 2023 fiscal impact estimate by $400,000 to account for four years of refund claims being filed.

The tax decrease associated with the expanded exemption is shown in **Table 2** and includes impacts to the SAVE Fund and LOST distributions.

Table 2 — Decrease in Sales/Use Tax Collected From Exemption for Manufacturers of Food Ingredients
In Millions

	Decrease to Sales/Use Tax Collected	Decrease in SAVE Refunds	Decrease in LOST Distributions
FY 2023	$ -5.0	$ -0.8	$ -0.8
FY 2024	-4.7	-0.8	-0.8
FY 2025	-4.8	-0.8	-0.8
FY 2026	-4.9	-0.8	-0.8
FY 2027	-5.0	-0.8	-0.8
FY 2028	-5.1	-0.8	-0.8

A decrease in SAVE refunds will have a positive impact on the General Fund.
A decrease in LOST distributions will have no impact on the General Fund.

Summary of Fiscal Impact

State General Fund — Table 3 summarizes the Bill's projected General Fund fiscal impacts.

Table 3 — Projected Increase (Decrease) in Tax Liability and State General Fund Revenue
In Millions

Division	Item	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
I	Sales/Use Tax — Change to SDP Exemption	$ 1.4	$ 3.0	$ 3.1	$ 3.2	$ 3.4	$ 3.6
I	Sales/Use Tax — Public Utilities Exemption SDP	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3
I	Sales/Use Tax — SAVE Refunds	-0.2	-1.4	-1.5	-1.5	-1.6	-1.6
VI	Bank Franchise Tax Rate Reduction	-1.4	-3.8	-6.4	-7.4	-9.6	-13.4
VII	Sales/Use Tax — Manufactured Food	-5.0	-4.7	-4.8	-4.9	-5.0	-5.1
VII	Sales/Use Tax — SAVE Refunds	0.8	0.8	0.8	0.8	0.8	0.8
	Total Projected Change Compared to Current Law	$ -4.5	$ -6.3	$ -9.0	$ -10.0	$ -12.3	$ -16.0

SDP = Specified digital products

Sources

Department of Revenue
LSA Calculations

/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.