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Fiscal Note

Fiscal Services Division

SF 552 – Income and Insurance Premium Tax Reduction (LSB1993SV)
Staff Contact: Jeff Robinson (515.281.4614) jeff.robinson@legis.iowa.gov
Fiscal Note Version – New

Description

Senate File 552 relates to individual and corporate income tax rates and the insurance premium tax. The Bill includes the following provisions:

- **Division I** — Decreases Iowa's individual income tax rate(s) for tax year (TY) 2025 through TY 2029. After TY 2028, the Bill establishes an annual calculation that uses the balance in the Taxpayer Relief Fund (TRF) (see Iowa Code section 8.57E) to reduce the Iowa income tax rate for the upcoming and future tax years. The annual calculation is performed until the Iowa individual income tax rate equals 0.00%.
- **Division II** — Decreases the corporate income tax net revenue threshold found in Iowa Code section 422.33(1)(b) from the current $700.0 million to $680.0 million. The threshold is used in current law to determine if sufficient corporate income tax net revenue was deposited to the State General Fund in the previous fiscal year to require a reduction in the top corporate income tax rate effective for the next tax year. The Bill also lowers the minimum corporate income tax rate allowed under this annual adjustment process from the current minimum of 5.50% to 4.75%.
- **Division III** — Decreases the current 1.00% insurance premium tax rate to 0.95% for calendar year 2025 and 0.90% for calendar year 2026 and after.
- **Division IV** — Amends Iowa Code section 422.7(43), which excludes the net capital gain on the sale of certain qualified stock. The section was originally enacted in 2022 Iowa Acts, chapter 1002 (State Taxation and Revenue Act).

Division IV is effective upon enactment and applies retroactively to January 1, 2023. The remainder of the Bill is effective July 1, 2023.

Division I — Individual Income Tax

Background

Under current law, Iowa will have two individual income tax rates for tax year (TY) 2025 (4.40% and 4.82%). For TY 2026 and after, Iowa will have a single tax rate of 3.90%. The Bill lowers the TY 2025 rates to 4.00% and 4.40% and lowers the single tax rate for TY 2026 through TY 2028 to the following percentages:

- TY 2026 = 3.55%
- TY 2027 = 2.95%
- TY 2028 = 2.50%

For TY 2029, the single rate will remain at 2.50%. After TY 2029, the rate will remain at 2.50% unless lowered through a provision of the Bill that requires any balance in the TRF to be used to reduce the income tax rate, beginning with TY 2030. The potential individual income tax rate reduction is accomplished through direction to the Department of Revenue (Department) to perform a calculation in November 2029, and each succeeding November, until the individual income tax rate is reduced to zero.

Assumptions

The projected fiscal impact was estimated by the Department through the use of an individual income tax model developed for the 2023 Legislative Session. The model is based on actual Iowa income tax returns filed for TY 2021, and those returns are used to project tax liability under current law and under the proposed law. For the projections, the following assumptions were used:

- TY 2021 tax return factors (income, dependents, exemptions, tax credits, etc.) are aged to reflect annual changes to each factor based on actual historical tax return information and Department projections of Iowa economic growth and population change.
- Federal tax provisions that are scheduled to expire without congressional action to extend them are assumed to expire as provided in current law.
- Iowa's future income tax rate reductions are assumed in the current-law model.
- The model produces estimated income tax liability changes on a tax year basis. The Department converts tax year impacts to fiscal year impacts using historical relationships in tax withholding, tax estimate payments, payments with tax returns, and tax refunds.
- Since the Bill reduces income tax rates, income tax withholding tables will be reduced to better match income tax withholding with actual income tax liability. Lowering income tax withholding also reduces the amount of income tax withheld from the paychecks of taxpayers who do not file individual income tax returns (referred to as "nonfilers"). Since the Department's model is based on actual income tax returns, nonfilers are not represented in the model and the withholding impact for nonfilers must be adjusted outside of the model.
- The Bill lowers income tax rates and income tax liability. The local option income surtax for schools equals a percentage of Iowa income tax liability. Therefore, a reduction in State income tax liability is assumed to reduce the amount of revenue raised through the surtax. The reduction is assumed to equal 2.5% of any projected change in State income tax liability.

Fiscal Impact

The Department projects that the reduction in income tax rates for TY 2025 through TY 2029 will reduce income taxes by the amounts listed in the top portion of **Figure 1**, while the bottom portion provides the projected reduction in State General Fund revenue by fiscal year.

Figure 1

Projected Individual Income Tax Change by Tax Year, in Millions

Tax Year Estimate	TY 2023	TY 2024	TY 2025	TY 2026	TY 2027	TY 2028	TY 2029
Resident Filers	$ 0.0	$ 0.0	$ -356.3	$ -300.5	$ -837.6	$ -1,263.9	$ -1,308.1
Nonresident Filers	0.0	0.0	-30.6	-25.8	-71.8	-108.4	-112.2
Nonfilers	0.0	0.0	-14.3	-15.8	-44.2	-67.0	-69.3
Total	$ 0.0	$ 0.0	$ -401.2	$ -342.1	$ -953.6	$ -1,439.3	$ -1,489.6

Projected State General Fund Revenue Change by Fiscal Year, in Millions

Fiscal Year Estimate	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Tax Change	$ 0.0	$ 0.0	$ -150.2	$ -405.2	$ -622.5	$ -1,177.1	$ -1,450.0

The Department does not have sufficient information to project the potential impact of the Bill's contingent tax rate reductions that will occur if the balance in the TRF is sufficient after FY 2029. The potential impact on Iowa individual income tax and State General Fund revenue is discussed in the Fiscal Impact Summary section at the end of this ***Fiscal Note***.

Division II — Corporate Income Tax

Background

Under current law, the top corporate income tax rate (8.40% for TY 2023) may be lowered if corporate income tax revenue, net of tax refunds issued, exceeds $700.0 million for a fiscal year. This annual potential tax rate reduction will occur until corporate income is subject to a single tax rate of 5.50%. The Bill lowers the annual dollar threshold to $680.0 million and lowers the minimum corporate income tax rate to 4.75%.

Assumptions

The projected fiscal impact was estimated by the Department through the use of a corporate income tax model developed for the 2023 Legislative Session. The model is based on actual Iowa corporate income tax returns filed for TY 1990 through TY 2021, and those returns are used to project tax liability under current law and under the proposed law. For the projections, the following assumptions were used:

- Tax return factors (income, expenses, exemptions, tax credits, etc.) are aged to reflect annual changes to each factor based on actual historical tax return information and Department projections of Iowa economic growth and population change.
- Iowa's existing contingent corporate income tax rate reduction process is assumed in the current-law model.
- The model produces projected income tax liability changes on a tax year basis. The Department converts tax year impacts to fiscal year impacts using historical relationships in corporate income tax estimate payments, payments with tax returns, and tax refunds.
- The Department's assumptions concerning future corporate income tax liability under existing law and under the proposal produce the projected corporate income tax rates shown in **Figure 2**.

Figure 2

Projected Iowa Corporate Income Tax Rates

	Current Law		Proposed Law	
Tax Year	Up to $100,000 in Taxed Income	More Than $100,000 in Taxed Income	Up to $100,000 in Taxed Income	More Than $100,000 in Taxed Income
2023	5.50%	8.40%	5.50%	8.40%
2024	5.50%	7.70%	5.50%	7.70%
2025	5.50%	6.00%	5.50%	5.80%
2026	5.50%	5.50%	4.75%	4.75%
2027	5.50%	5.50%	4.75%	4.75%
2028	5.50%	5.50%	4.75%	4.75%

Fiscal Impact

The Department projects that the reduction in corporate income tax rates will reduce taxes owed and State General Fund receipts by the amounts listed in **Figure 3**.

Figure 3

Corporate Income Tax Projections
and State General Fund Tax Revenue Change
In Millions

Fiscal Year Estimate	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Current Law	$ 858.4	$ 830.1	$ 810.6	$ 708.3	$ 686.1	$ 737.2	$ 750.0
Proposed Law	858.4	824.1	789.3	675.0	617.1	654.4	665.7
Tax Revenue Change	$ 0.0	$ -6.0	$ -21.3	$ -33.3	$ -69.0	$ -82.8	$ -84.3

Division III — Insurance Premium Tax

Background

Insurance companies do not pay Iowa corporate income tax on their insurance business, and insurance sales are not subject to the State sales tax. The taxation of insurance business is imposed through an insurance premium tax. Iowa's insurance premium tax rate is equal to 1.00% of premiums paid for Iowa domiciled companies and for companies not domiciled in Iowa but with a home state insurance premium tax rate of 1.00% or lower. Companies not domiciled in Iowa that have a home state tax rate higher than 1.00% pay an insurance premium tax rate equal to the rate of their home state.

The Bill lowers the insurance premium tax rate to 0.95% for calendar year 2025 insurance premiums and 0.90% for calendar years after 2025.

Insurance premiums for sales made in a calendar year are subject to two prepayments during the calendar year, each of which is equal to 50.0% of a company's insurance premium tax liability from the previous calendar year. A final payment, if necessary, is due when the annual insurance premium tax return is filed in March following the end of a calendar year.

Assumptions

The assumptions used to estimate the fiscal impact of the two-stage rate reduction are as follows:

- The March 2023 Revenue Estimating Conference estimate for insurance premium tax revenue for FY 2024 ($151.6 million) is assumed for that fiscal year. For future fiscal years, insurance premium tax receipts are assumed to increase 2.4% per year under current law.
- The annual total of insurance premium tax refunds is a minor amount and is ignored for the projection. If an annual tax return shows that a company's prepayments exceeded the tax liability for the year, the excess becomes part of the company's next prepayment.
- For the proposed law and based on historical insurance premium tax payment patterns, calendar year prepayment and final payments are assumed to occur 53.8% before July 1 and 46.2% after the start of the new fiscal year.

Fiscal Impact

Based on the assumptions, the Department's projections for fiscal year insurance premium tax receipts under current law and under the proposal, as well as the projected difference (fiscal impact), are presented in **Figure 4**.

Figure 4

Insurance Premium Tax Projections and State General Fund Tax Revenue Change
In Millions

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Current Law	$ 151.4	$ 151.6	$ 155.2	$ 158.9	$ 162.7	$ 166.6	$ 170.6
Proposed Law	151.4	151.6	152.0	146.7	145.9	149.4	152.8
Tax Revenue Change	$ 0.0	$ 0.0	$ -3.2	$ -12.2	$ -16.8	$ -17.2	$ -17.8

Division IV — Qualified Stock Capital Gains

Background

Current Iowa law provides for a tax exemption for capital gains realized through the sale of certain qualified stock. The exemption is phased in over a three-tax year period, with 33.3% of any gain exempted for TY 2023, 66.0% for TY 2024, and 100.0% for TY 2025 and after. To qualify, the stock must have been acquired by the taxpayer while the taxpayer was employed by a qualified corporation and on account of that same employment. The exemption is established in Iowa Code section 422.7(43). That section was originally enacted in 2022 Iowa Acts, chapter 1002 (State Taxation and Revenue Act).

The Bill expands the availability of the capital gains by changing three definitions. The changes are effective upon enactment and apply retroactively to tax years beginning on or after January 1, 2023. Specifically, the Bill:

- Modifies the definition of "employee-owner" to include employment at a qualified corporation rather than an individual who owns capital stock in a qualified corporation for at least 10 years while employed at and on account of employment with the corporation.
- Modifies the definition of "Iowa affiliated group" within the definition of "qualified corporation" to include an affiliated group that is eligible to make a valid election to file an Iowa consolidated income tax return rather than an affiliated group that has made a valid election to file an Iowa consolidated income tax return.
- Modifies the definition of "member" within the definition of "qualified corporation" to include any entity that is eligible to be included in a consolidated return rather than any entity that is actually included in the consolidated return.

Assumptions

The assumptions used to estimate the fiscal impact of the expansion of the capital gains exemption are as follows:

- The ***Fiscal Note*** for the 2022 legislation (HF 2317, State Taxation and Revenue Act) that created the current exemption was used as the basis for this Bill's expansion of the capital gains exemption. That ***Fiscal Note*** projected a $4.0 million State General Fund revenue reduction for FY 2024 that increased to $9.5 million for FY 2028.
- Employees who work for a single qualified company for at least 10 years qualify under the current exemption. The Bill expands the types of employment that may result in a potential capital gains exemption. The two additional potential groups include:
  - Group 1 — Employees who work for more than one qualified corporation within a group of corporations that file a consolidated Iowa corporate income tax return.

- Group 2 — Employees who work for one or more corporations where the corporations are eligible to file a consolidated Iowa corporate income tax return but the corporations chose not to do so.

- It is assumed that Group 1 will represent a small number of additional taxpayers qualifying for the capital gains exemption.
- It is assumed that Group 2 will represent a significant increase in the pool of taxpayers who are potentially eligible for the capital gains exemption.
- Information from Iowa corporate income tax returns filed for TY 2011 through TY 2020 was analyzed to estimate what percentage of Iowa corporate income tax is derived from three types of corporate income tax filers, with the percentages used to estimate how the capital gains exemption will increase if expanded to include the employees of additional corporations. The types and the corporate income tax percentages were determined as follows:
  - Type 1 — Corporations filing separate Iowa and separate federal income tax returns. Type 1 represents 15.0% of Iowa corporate income tax liability.
  - Type 2 — Corporations filing separate Iowa and consolidated federal income tax returns. Type 2 represents 44.0% of Iowa corporate income tax liability.
  - Type 3 — Corporations filing consolidated Iowa and consolidated federal income tax returns. Type 3 represents 41.0% of Iowa corporate income tax liability.
- Type 3 represents the employment situations that currently qualify for the capital gains exemption (41.0%). The remaining 59.0% of corporate income tax liability is represented by Types 1 and 2. The addition of 59.0% to the current assumed 41.0% represents an addition of 119.5% of the impact assumed in the 2022 ***Fiscal Note***.
- The Bill lowers income tax rates and income tax liability. The local option income surtax for schools equals a percentage of Iowa income tax liability. Therefore, a reduction in State income tax liability is assumed to reduce the amount of revenue raised through the surtax. The reduction is assumed to equal 2.5% of any projected change in State income tax liability.
- Tax year impacts on State General Fund revenue are assumed to occur after June 30 of the tax year.

Fiscal Impact

The projected individual income tax reduction associated with the expansion of the capital gains exemption is provided in the top portion of **Figure 5**, while the bottom portion provides the fiscal year impact on State General Fund revenue.

Figure 5

Projected Individual Income Tax Change by Tax Year, in Millions

	TY 2023	TY 2024	TY 2025	TY 2026	TY 2027	TY 2028	TY 2029
HF 2317 Fiscal Note	$ -4.0	$ -7.6	$ -10.3	$ -9.0	$ -9.5	$ -10.0	$ -10.5
% Increase Due to Bill	119.5%	119.5%	119.5%	119.5%	119.5%	119.5%	119.5%
Tax Year Impact of Bill	$ -4.8	$ -9.1	$ -12.3	$ -10.8	$ -11.4	$ -12.0	$ -12.5

Projected State General Fund Revenue Change by Fiscal Year, in Millions

	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Fiscal Year Impact	$ 0.0	$ -4.8	$ -9.1	$ -12.3	$ -10.8	$ -11.4	$ -12.0

Fiscal Impact Summary

The Bill is projected to reduce State General Fund revenue through reductions in individual income, corporate income, and insurance premium taxes. The projected reductions are presented in **Figure 6**.

Figure 6

Projected State General Fund Revenue Change
In Millions

Division	Provision	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
I	Individual Income Tax	$ 0.0	$ 0.0	$ -150.2	$ -405.2	$ -622.5	$ -1,177.1	$ -1,450.0
II	Corporate Income Tax	0.0	-6.0	-21.3	-33.3	-69.0	-82.8	-84.3
III	Insurance Premium Tax	0.0	0.0	-3.2	-12.2	-16.8	-17.2	-17.8
IV	Qualified Stock Capital Gains	0.0	-4.8	-9.1	-12.3	-10.8	-11.4	-12.0
	Total	$ 0.0	$ -10.8	$ -183.8	$ -463.0	$ -719.1	$ -1,288.5	$ -1,564.1

Divisions I and IV are projected to reduce individual income tax liability. Law changes that reduce individual income tax liability also reduce the amount of revenue raised through the individual income surtax for schools. The surtax reductions that result from the projected individual income tax liability reductions are as follows:

- FY 2024 = $0.1 million
- FY 2025 = $4.0 million
- FY 2026 = $10.4 million
- FY 2027 = $15.8 million
- FY 2028 = $29.7 million
- FY 2029 = $36.5 million

The State General Fund and income surtax for schools reductions are expected to continue in future fiscal years, increasing each year at the rate of growth in Iowa personal income.

Division I of the Bill requires the Department to perform an annual calculation to determine whether the balance in the TRF is sufficient to allow a reduction in the individual income tax rate of at least 0.10 percentage point. If the Department determines that the TRF balance is sufficient, the individual income tax is to be reduced for the upcoming tax year. The first time the Department is to perform this calculation is at the conclusion of FY 2029. The LSA estimates that without appropriations or transfers from the TRF initiated by the Legislature between now and the end of FY 2029, the balance in the TRF will exceed $4.000 billion at the conclusion of FY 2029, and that level should be sufficient to reduce the State individual income tax rate to 0.00% beginning with TY 2030. Under the provisions of the Bill, an amount equal to the net individual income tax revenue deposited to the State General Fund in FY 2029 will be transferred from the TRF to the State General Fund in FY 2030. The reduction in State General Fund revenue that is the result of the 0.00% State income tax rate is permanent.

Sources

Department of Revenue
Moody's Analytics
Regional Economic Models, Inc. (REMI)
Legislative Services Agency

/s/ Jennifer Acton

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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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