



HF 2433 – IRC Update and Manufacturing Consumables (LSB6046HV)
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Fiscal Note Version – New

Description

House File 2433 has three functions. The bill:

- Generally conforms Iowa's tax laws with changes to the federal Internal Revenue Code (IRC) made since January 1, 2015. The coupling is temporary and applies only to tax year 2015. The bill does not couple with the federal tax provision known as "bonus depreciation." The change is effective on enactment and applies retroactively to January 1, 2015.
- Rescinds administrative rules promulgated by the Iowa Department of Revenue in 2015 and scheduled to take effect July 1, 2016. The rules relate to the application of the state sales/use tax to manufacturing inputs (generally supplies and replacement parts) and to the application of the state sales/use tax to certain tangible personal property that becomes part of real property (land and buildings). This action is effective on enactment.
- Provides a sales/use tax exemption for the purchase of items used in certain manufacturing, research and development, data processing or storage, or recycling activities. The exemption generally relates to manufacturing supplies and replacement parts. This change applies to purchases made on or after July 1, 2016.

Background — IRC Update

Since January 1, 2015, the only significant federal tax changes were enacted as part of **H.R. 2029** (Consolidated Appropriations Act, 2016). This federal Act became law December 18, 2015. While many of the provisions were made a permanent part of the federal IRC, some tax provisions were extended through 2016 and others through tax year 2019. The extended provisions will require future federal action if they are to continue beyond the new expiration date.

Of the newly-permanent federal tax provisions, the most significant from a fiscal impact perspective is the extension and enhancement of favorable depreciation accounting known as "section 179 expensing." This provision allows business taxpayers (including corporate taxpayers and business entities taxed through the individual income tax) to write off additional depreciation in the year a qualified depreciable asset is placed in service. Since the provision accelerates the claiming of depreciation, the provision reduces taxes owed in the first year, but increases taxes owed in later years.

The one federal change that the bill does not conform with is known as "bonus depreciation." Bonus depreciation provides a similar benefit for more expensive depreciable assets. Iowa has not coupled with federal bonus depreciation provisions in the past.

The IRC conformity impact estimates were calculated by the Iowa Department of Revenue using national estimates available from the Joint Committee on Taxation and information available from the Department's database of Iowa income tax returns and from the Department's microsimulation tax model. The estimated impact of the coupling provisions of this bill are provided in **Table 1**.

Table 1
Impact on General Fund Revenue
IRC Coupling Provisions - In Millions

	Section 179 Expensing	Other Provisions	Total Net Revenue Increase (Decrease)
FY 2016	\$ -77.8	\$ -19.8	\$ -97.6
FY 2017	18.5	-8.4	10.1
FY 2018	15.9	0.3	16.2
FY 2019	11.7	0.0	11.7
FY 2020	9.5	0.0	9.5
FY 2021	8.2	0.0	8.2
FY 2022	6.7	0.0	6.7
FY 2023	1.2	0.0	1.2

Background — Manufacturing Consumables

Division II of the bill rescinds Department of Revenue administrative rules scheduled to take effect July 1, 2016. Those rules relate to definitions and qualifications for existing sales/use tax exemptions. The rules have a negative fiscal impact on State General Fund revenue. That impact was considered by the December Revenue Estimating Conference (REC) and incorporated into the General Fund estimate for FY 2017. The rules also have a negative fiscal impact on school district, city, and county revenue. The state and local revenue reductions associated with the Department of Revenue rule change and estimated by the REC are presented in **Table 2**. This bill negates the negative revenue impacts associated with the administrative rules and displayed in **Table 2**.

Table 2
Impact on State and Local Revenue
Department of Revenue Rules - In Millions of Dollars

	State General Fund	School Infrastructure	Local Option Taxes	Total Tax Reduction, State and Local Taxes Combined
FY 2016	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0
FY 2017	-34.8	-7.0	-6.1	-47.9
FY 2018	-35.9	-7.2	-6.3	-49.4
FY 2019	-37.1	-7.4	-6.5	-51.0
FY 2020	-38.3	-7.7	-6.7	-52.7
FY 2021	-39.6	-7.9	-6.9	-54.4

In addition, Division II replaces the rescinded administrative rules with sales/use tax exemption language dealing with the same subject, but with a more limited effect. The bill expands a current tax exemption to include some items considered supplies and replacement parts (manufacturing consumables). The bill does not change any tax exemption related to tangible

personal property that becomes part of real property. The Department of Revenue estimates that the expansion of the current sales/use tax exemption for manufacturing consumables will reduce state and local revenue by the amounts listed in **Table 3**:

	State General Fund	School Infrastructure	Local Option Taxes	Total Tax Reduction, State and Local Taxes Combined
FY 2016	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0
FY 2017	-21.3	-4.3	-3.6	-29.2
FY 2018	-22.4	-4.5	-3.8	-30.7
FY 2019	-23.5	-4.7	-4.0	-32.2
FY 2020	-24.5	-4.9	-4.1	-33.5
FY 2021	-25.4	-5.1	-4.3	-34.8

Fiscal Impacts

State General Fund — The impact of the bill on State General Fund net revenue is the combination of **Tables 1, 2, and 3** above, with the IRC changes and the enactment of the sales tax exemption acting to reduce projected General Fund revenue and the administrative rules rescission acting to increase revenue. The estimated General Fund revenue impact of each provision is summarized in **Table 4**.

	IRC Coupling	Administrative Rules Rescinded	Manufacturing Consumables Sales Tax Exemption	Total General Fund Impact
FY 2016	\$ -97.6	\$ 0.0	\$ 0.0	\$ -97.6
FY 2017	10.1	34.8	-21.3	23.6
FY 2018	16.2	35.9	-22.4	29.7
FY 2019	11.7	37.1	-23.5	25.3
FY 2020	9.5	38.3	-24.5	23.3
FY 2021	8.2	39.6	-25.4	22.4
FY 2022	6.7	40.9	-26.2	21.4
FY 2023	1.2	42.2	-27.1	16.3

Iowa tax law allows taxpayers to subtract federal income taxes paid from their Iowa income (federal deductibility). Therefore, when Congress enacts legislation that reduces federal taxes, the income is subject to Iowa income tax increases. This General Fund revenue impact is automatic and does not require legislative action. The estimated positive impacts on State General Fund revenue are provided below. The amounts are provided for reference purposes and do not represent an additional fiscal impact of this bill. The amounts have been added to the General Fund balance sheet and will be incorporated into the next REC estimate.

- FY 2016 = \$2.0 million
- FY 2017 = \$76.4 million
- FY 2018 = \$42.4 million
- FY 2019 = \$28.6 million
- FY 2020 and after = approximately \$30.8 million per year

Local Option Income Surtax Revenue — Reducing Iowa individual income taxes also reduces the yield from the local option income surtax for schools. Statewide, that surtax produces an amount equal to approximately 3.0% of the state individual income tax revenue. The IRC coupling provisions of this bill will reduce the statewide surtax yield by \$2.6 million in FY 2016 and increase the yield by \$350,000 per year from FY 2017 through FY 2023.

Local Government Sales Tax Revenue — Rescinding the administrative rules and enacting the sales tax exemption provisions also increases the amount of money raised by the state sales tax that is in turn transferred to school districts for school infrastructure purposes and it also increases local option sales tax revenue collected by local governments. The combination of the rules rescission and the enacted sales tax exemption will increase annual school infrastructure revenue \$2.7 million and increase annual local option sales tax collections \$2.5 million each fiscal year. Both impacts begin with FY 2017.

Sources

Iowa Department of Revenue
United States Congress Joint Committee on Taxation
Revenue Estimating Conference

/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.
