



HF 597 – Sales Tax and Other Tax Modifications (LSB2350YH)
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Fiscal Note Version – New

Description

House File 597 makes the following changes by division:

- Division I: Increases the sales and use tax rates by a total of 0.375% over three years.
- Division II: Reduces individual income tax rates by the amount generated by the sales and use tax rate increases.
- Division III: Exempts the sale of water by utilities from sales tax and creates a Water Service Excise Tax on metered water. Moneys from the excise tax will be deposited in the General Fund and are then transferred incrementally to the Wastewater and Drinking Water Treatment Financial Assistance Fund. One-sixth of the moneys will be transferred to the Secure an Advanced Vision for Education (SAVE) Fund, and then one-sixth from the General Fund in FY 2018. The amount transferred will increase by one-sixth each year until the full amount of the tax is transferred in FY 2023 and after. The tax is repealed on January 1, 2031. The Department of Revenue will administer the collection and transfer of the Water Service Excise Tax. More program information is listed in Division III of the Fiscal Impact.
- Division IV: Makes changes to the Natural Resources and Outdoor Recreation Trust Fund in Iowa Code chapter [461](#).

Background

Division I. An amendment to the Iowa Constitution ratified on November 2, 2010, created the Natural Resources and Outdoor Recreation (NROR) Trust Fund and the amount credited to the Fund will be equal to the amount generated by an increase in the State sales tax rate not to exceed 0.375%. The State sales tax rate has not been increased since the enactment.

Division III. Currently, the sale of water by utilities to residential and nonresidential customers is subject to sales tax, as well as to any local option sales tax (LOST). Nonresidential sewage utilities are also subject to sales tax, while residential sewage utilities are not. The State sales tax includes a portion, commonly referred to as the “sixth cent,” that is directed to the Secure an Advanced Vision for Education (SAVE) Program. The Wastewater Treatment Financial Assistance Program, created in Iowa Code section [16.134](#), was established for communities, with priority given to disadvantaged communities, seeking to install or upgrade wastewater treatment facilities due to regulatory activity by the DNR. Grant awards are capped at \$500,000. The Program received appropriations from the Rebuild Iowa Infrastructure Fund (RIIF) for the period of FY 2006 to FY 2008 for a total of \$11.0 million.

Assumptions

Division I

- The first sales and use tax increase of 0.125% takes place on January 1, 2018, followed by increases of 0.125% annually for two more years.
- Sales and use tax receipts are collected 51.3% from July to December and 48.7% from January to June.
- The Constitutional Amendment applies only to sales tax, not use tax.
- Sales tax represents 83.25% of the combined receipts and use tax represents 16.75%.

Division II

- Additional sales and use tax revenues certified in FY 2018, for example, would be used to calculate the income tax rate reductions for Tax Year (TY) 2018, implemented on tax returns filed during 2019. This would then move forward annually. Withholding tables would not be adjusted by the Department of Revenue until TY 2022.
- Decreasing income tax rates will also impact the income surtax for school districts and county governments.

Division III

- The annual sales tax attributable to metered water sales in FY 2015 was \$20.3 million. This number was then increased using Moody's projections of the Consumer Price Index (CPI) inflation index and population estimates from the REMI forecast.
- Items or services exempt from the State sales tax are also exempt from any LOST. The Bill does not provide for a LOST on water services.
- The Bill makes the tax subject to the SAVE transfer.
- The section of the Bill related to the tax becomes effective July 1, 2017 (FY 2018), and the tax is repealed July 1, 2029.
- The Department of Revenue will experience administrative costs related to establishing the collection of the Water Service Excise Tax.

Division IV

- The requirement that 60.0% of funding is allocated to support research-based water quality initiatives can be met under the current account allocations found in the Iowa Code.

Fiscal Impact

Division I

Raising the sales and use taxes will increase revenues by the following estimated amounts.

	Estimated Impact of Sales/Use Tax Increase		
	Dollars in Millions		
	New Revenue	NROR Trust	
		Fund	General Fund
FY 2018	\$ 30.4	\$ 25.3	\$ 5.1
FY 2019	95.5	79.5	16.0
FY 2020	164.3	136.8	27.5
FY 2021	203.8	169.6	34.1
FY 2022	209.6	174.5	35.1

The NROR Trust Fund will be allocated as follows.

Natural Resources and Outdoor Recreation Trust Fund Accounts

Dollars in Millions

	Natural Resources		Soil Conservation and Water Protection		Watershed Protection		Iowa Resource Enhancement and Protection Fund		Local Conservation Partnership		Trails		Lake Restoration	
FY 2018	\$	5.8	\$	5.1	\$	3.5	\$	3.3	\$	3.3	\$	2.5	\$	1.8
FY 2019		18.3		15.9		11.1		10.3		10.3		8.0		5.6
FY 2020		31.5		27.4		19.1		17.8		17.8		13.7		9.6
FY 2021		39.0		33.9		23.8		22.1		22.1		17.0		11.9
FY 2022		40.1		34.9		24.4		22.7		22.7		17.4		12.2

Division II

The impact on individual taxable income rates is as follows.

Current Law Income Tax Rates				HF 597					
	Over	But Not Over	Rate	TY 2018	TY 2019	TY 2020	TY 2021	TY 2022	TY 2023
1	\$ 0	\$ 1,600	0.36%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2	1,600	3,200	0.72%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
3	3,200	6,400	2.43%	2.35%	1.05%	0.00%	0.00%	0.00%	0.00%
4	6,400	14,400	4.50%	4.50%	4.50%	4.38%	4.09%	4.08%	4.08%
5	14,400	24,000	6.12%	6.12%	6.12%	6.12%	6.12%	6.12%	6.12%
6	24,000	32,000	6.48%	6.48%	6.48%	6.48%	6.48%	6.48%	6.48%
7	32,000	48,000	6.80%	6.80%	6.80%	6.80%	6.80%	6.80%	6.80%
8	48,000	72,000	7.92%	7.92%	7.92%	7.92%	7.92%	7.92%	7.92%
9	72,000	or more	8.98%	8.98%	8.98%	8.98%	8.98%	8.98%	8.98%

NOTE: Shaded areas denote new tax rates.

Other impacts associated with the Bill related to individual income taxes include:

- There will be some incidental payment timing changes for taxpayers. Generally, income tax rates for a tax year are released in February. However, certified sales and use tax collections for the completed fiscal year will not be available until September of that tax year, necessitating an income tax rate revision. This will likely cause estimated income tax payers to overpay their liability in the tax year and receive a refund in the following processing year. Wage withholding tables will also not be adjusted until after the phase-in of the sales and use tax increases.
- There are some taxpayers who would experience higher tax liability, which reflects the increase in their Iowa Alternative Minimum Tax.
- The amount of revenue generated for school district and local income surtaxes will decrease due to the lower amounts of income tax liability. These estimates are presented in the last table. Most income surtaxes are used in combination with property taxes to fund the instructional support program, the educational improvement program, and the voter-approved physical plant and equipment levy.

Division III

The estimated impact of the Water Service Tax is outlined in the following table.

Current Law vs. Proposed Law (HF 597)

Dollars in Millions

	Current Law			HF 597			
	General Fund	SAVE Fund	Local Option Sales Tax	General Fund	SAVE Fund	Local Option Sales Tax	Assistance Fund
FY 2018	\$ 18.5	\$ 3.7	\$ 3.1	\$ 17.0	\$ 3.7	\$ 0.0	\$ 1.5
FY 2019	19.2	3.8	3.2	14.4	3.8	0.0	4.8
FY 2020	19.8	4.0	3.3	11.6	4.0	0.0	8.3
FY 2021	20.4	4.1	3.4	8.5	4.1	0.0	11.9
FY 2022	21.0	4.2	3.5	5.3	4.2	0.0	15.8

Estimated Impact of Metered Water Tax

Dollars in Millions

General Fund	SAVE Fund	Local Option Sales Tax	Assistance Fund
\$ -1.5	\$ 0.0	\$ -3.1	\$ 1.5
-4.8	0.0	-3.2	4.8
-8.3	0.0	-3.3	8.3
-11.9	0.0	-3.4	11.9
-15.8	0.0	-3.5	15.8

Revenue will be transferred to the Wastewater and Drinking Water Treatment Financial Assistance Fund administered by the IFA. Funds will be used to award grants to communities or eligible entities that seek to upgrade eligible facilities.

Grants will not exceed \$500,000 per recipient. By October 1 of every year, the IFA will submit a report to the Governor and General Assembly itemizing all expenditures made in the previous year. Beginning September 1, 2026, and every 10 years after, a Program Review Committee will be created to review the Wastewater and Drinking Water Treatment Financial Assistance Program. The Committee will submit a report to the Governor and General Assembly by December 1 of the same year to summarize the effectiveness of the Program over the past 10 years.

The Department of Revenue estimates expenditures for implementing the Water Service Excise Tax at \$1.1 million for FY 2018. This estimate includes the following:

- \$800,000 for services from the Office of the Chief Information Officer.
- \$200,000 for services from First Data Government Solutions.
- \$58,000 for indirect expenditures by the Department of Revenue.

Division IV

No fiscal impact.

Summary of Fiscal Impact of the Bill

The impact to the General Fund for all changes in HF 597 is outlined in the following table.

Estimated Impact of All General Fund Changes

Dollars in Millions

	Use Tax Increase	Metered Water Tax Removal	Personal Income Tax Decrease	Net Impact
FY 2018	\$ 5.1	\$ -1.5	\$ -0.1	\$ 3.4
FY 2019	16.0	-4.8	-33.6	-22.4
FY 2020	27.5	-8.3	-97.7	-78.5
FY 2021	34.1	-11.9	-165.6	-143.4
FY 2022	35.1	-15.8	-203.4	-184.1

The impact on all revenues, funds, and transfers in total is as follows.

House File 597 Total Estimated Impact

Dollars in Millions

	General Fund	Natural Resources and Outdoor Recreation Trust Fund	Wastewater and Drinking Water Treatment Financial Assistance Program	Local Option Sales Tax	Local Income Surtax
FY 2018	\$ 3.4	\$ 25.3	\$ 1.5	\$ -3.1	\$ -1.0
FY 2019	-22.4	79.5	4.8	-3.2	-3.3
FY 2020	-78.5	136.8	8.3	-3.3	-5.6
FY 2021	-143.4	169.6	11.9	-3.4	-6.9
FY 2022	-184.1	174.5	15.8	-3.5	-7.1

As previously mentioned, there will be estimated costs associated with implementing a new metered water tax (\$1.1 million), as well as costs to reprogram the Department of Revenue's existing audit system to adjust the sales and use tax rates three times, and income tax rates up to 12 times, the cost of which is not estimable at this time.

Sources

Department of Revenue
Iowa Finance Authority
Department of Natural Resources
LSA Analysis and Calculations

/s/ Holly M. Lyons

April 4, 2017

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.