



SF 2383 – Tax System Modification (LSB5452SV.1)
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Fiscal Note Version – As amended and passed by the Senate

Description

Senate File 2383 as amended and passed by the Senate relates to State and local taxation. The Bill makes changes to Iowa's State individual and corporate income, sales/use, and financial institution taxes. The Bill also makes changes to the local option sales tax, hotel and motel tax, and automobile rental excise tax.

Individual Income Tax Changes for Tax Year (TY) 2018 (Division I) – These changes couple Iowa tax laws with several recent federal changes. The tax coupling relates to the federal Earned Income Tax Credit, teacher expenses, certain business accounting method modifications, and recharacterization of Roth individual retirement account conversions.

Individual Income Tax Changes (Division II) – The following changes are generally effective for tax years beginning on or after January 1, 2019 (TY 2019):

- Changes the starting point for Iowa individual income tax to line 43 of the federal 1040 tax return [form](#) (federal taxable income). This change couples Iowa tax law with federal definitions of income, adjustments, exemptions, and deductions.
- Eliminates the Iowa filing status of married filing jointly on a combined return.
- Eliminates the deduction for federal income taxes paid. A one-year transition calculation is provided.
- Repeals the Iowa alternative minimum tax. A one-year transition calculation is provided.
- Retains the current deductions for military pension income and military active duty pay.
- Retains and raises the general pension exclusion to \$10,000 (single) and \$20,000 (married).
- Retains the current 100.0% exclusion for Social Security income.
- Retains current deductions for contributions to College Savings Iowa educational savings plans ([529 Plans](#)), [Iowa Achieving a Better Life Experience \(ABLE\) Plans](#), [First-Time Homebuyer Savings Accounts](#), and several other less common deductions.
- Creates a new deduction for any income that results from an employer paying a qualified student loan on behalf of an employee.
- Creates a new deduction for interest and earnings income received from a Burial Trust Fund as defined in Iowa Code section [523A.102](#).
- Decouples Iowa tax law from a federal tax benefit known as bonus depreciation. Iowa taxpayers will need to add back to income any bonus depreciation claimed on their federal tax return. Taxpayers will still be able to depreciate qualified property without the additional benefit of bonus depreciation.
- Reduces the number of Iowa individual income tax brackets from nine brackets to five.
- Establishes five income tax rates ranging from 5.0% to 6.6% for TY 2019. Iowa's current nine tax rates range from 0.36% to 8.98%.
- Reduces the top tax rate to 6.5% for TY 2020, 6.4% for TY 2021, and 6.3% for TY 2022.
- Indexes (reduces) the five income tax rates annually based on inflation, beginning TY 2023.
- Automatically couples with most future federal tax changes.

Corporate Income Tax (Division II) – The following changes are effective for tax years beginning on or after January 1, 2019 (TY 2019):

- Repeals the alternative minimum tax. A one-year transition calculation is provided.
- Eliminates the deduction for federal income taxes paid. A one-year transition calculation is provided.
- Decouples Iowa tax law from a federal tax benefit known as bonus depreciation. Iowa taxpayers will need to add back to income any bonus depreciation claimed on their federal tax return. Taxpayers will still be able to depreciate qualified property without the additional benefit of bonus depreciation.
- Reduces the number of Iowa corporate income tax brackets from four brackets to two. The change takes effect for TY 2021.
- Lowers corporate income tax rates over several tax years, from the current range of 6.0% to 12.0%, to 5.5% (up to \$250,000) and 7.0% (\$250,000 and above).
- Automatically couples with most future federal tax changes.

Taxation of Financial Institutions (Division IV) – The following changes are effective January 1, 2019 (TY 2019):

- Repeals the State moneys and credits tax. The moneys and credits tax is imposed on State credit unions at a rate that equals 0.5% of “legal and special reserves.” Under current law, moneys and credits tax revenue is split 50.0%/50.0% between the State and local governments (cities and counties).
- Modifies the State franchise tax rate, currently equal to 5.0% of net income, to instead equal 2.0% of the first \$7.5 million of net income and 4.0% of any income above \$7.5 million.
- Applies the modified franchise tax to banks, in-state credit unions, out-of-state credit unions, and agricultural associations that are members of the federal Farm Credit System. Under current law, the franchise tax applies only to banks.

Sales and Use Tax (Division VI) – This Division is effective January 1, 2019; however, changes to definitions are effective July 1, 2018. The effective changes are as follows:

- Changes photography and retouching from a sale of tangible personal property to an enumerated service.
- Adds taxis, driver services, ride-sharing services, and rides for hire as taxable personal transportation services subject to the sales/use tax.
- Eliminates current sales/use tax exemptions for online computer services and retail sales delivered electronically.
- Exempts the sale of grain bins, and materials used to construct grain bins, from the sales/use tax.
- Expands sales tax exemptions for farm businesses by replacing 25 sales/use tax exemptions for expenses related to agricultural production with a general sales/use tax exemption for the purchase of tangible personal property that is properly claimed as a business deduction for Iowa income tax purposes and that is used on land eligible for the Agricultural Land Property Tax Credit.
- Amends the definition of the term “manufacturer” for purposes of the manufacturing and equipment sales/use tax exemption to require that a business be primarily engaged in manufacturing in order to qualify for the sales/use tax exemption.
- Amends the sale-for-resale exemption for construction equipment dealers when purchasing construction equipment for lease or rental as long as the purchaser is a party to a qualified dealer agreement.
- Modifies and clarifies requirements for persons to collect and remit State sales/use tax and local option sales tax. Expansion of the definition of “Iowa sales” includes any retailer

selling more than \$100,000 worth of products or making more than 200 separate sales into the State, as well as including any “marketplace provider” that facilitates sales in the State.

Tax Credits (Division III) – These changes have a variety of effective dates, specified below:

- Increases the annual maximum allocation of tax credits to the Angel Investor Tax Credit Program from the current \$2.0 million to \$4.0 million. The change is effective July 1, 2018.
- Reduces the maximum amount of tax credits allowed in a year under the Innovation Fund Investment Tax Credit Program by an amount equal to the amount by which the Angel Investor Tax Credit Program exceeds \$2.0 million in that same year. The change is effective July 1, 2018.
- Increases the annual maximum allocation of tax credits to the Workforce Housing Tax Incentive Program from the current \$20.0 million to \$22.0 million, and dedicates the \$2.0 million annual increase to small cities. The change is effective July 1, 2018.
- Establishes an annual \$80.0 million maximum tax credit allocation to the High Quality Jobs Program. The change is effective July 1, 2018.
- Establishes additional restrictions on the types of businesses eligible for participation under the High Quality Jobs Program. The change is effective July 1, 2018.
- Repeals the refundability of the Supplemental Research Activities Tax Credit available under the High Quality Jobs Program. The change is effective for contracts signed on or after July 1, 2018.
- Repeals the High Quality Jobs Program, effective July 1, 2025.
- Increases by two percentage points, to 7.0% and 17.0%, two tax credit rates associated with the Agricultural Assets Transfer Tax Credit Program. The change is effective January 1, 2019.
- Increases the annual maximum amount of tax credits awarded under the Agricultural Assets Transfer Tax Credit Program from the current \$6.0 million to \$8.0 million. The change is effective July 1, 2018.
- Repeals the Accelerated Career Education Program, effective July 1, 2025.
- Extends the Targeted Jobs Withholding Tax Credit Pilot Project one year, to June 30, 2019. The change is effective July 1, 2018.
- Reduces the maximum amount allowed in a year under the Historic Preservation and Cultural and Entertainment District Tax Credit Program from the current level of \$45.0 million to \$40.0 million. The tax credit is repealed effective July 1, 2025.
- Limits the availability of the existing Research Activities Tax Credit Program to businesses engaged in manufacturing, life sciences, software engineering, or the aviation and aerospace industry. The change is effective January 1, 2018.
- Modifies the calculation of the base amount of research expenditures used in calculating the Research Activities Tax Credit. The change is effective retroactively to January 1, 2010.
- Increases the maximum amount allowed in a year under the School Tuition Organization Tax Credit Program from the current level of \$12.0 million to \$13.0 million, and increases the household income limit at which a student is considered eligible for assistance under the Program from the current level of three times, to four times the federal poverty level. The changes are effective January 1, 2019.
- Repeals the Tuition and Textbook Tax Credit, the Volunteer Firefighter and Emergency Medical Services Personnel Tax Credit, and the Reserve Peace Officer Tax Credit, effective January 1, 2022 (TY 2022).
- Repeals the Geothermal Tax Credit, the Geothermal Heat Pump Tax Credit, the Farm to Food Donation Tax Credit, and the Ethanol Promotion Tax Credit, effective January 1, 2019 (TY 2019).
- Repeals the Solar Energy System Tax Credit on July 1, 2018, for installations occurring on or after that date.

- Repeals the Taxpayers Trust Fund Tax Credit, effective FY 2021.

Miscellaneous Provisions

- Requires the Legislative Tax Expenditure Committee to study all available tax credits during the 2018 interim and to submit findings and recommendations to the General Assembly for consideration during the 2019 Legislative Session.
- Confirms the existing Iowa Educational Savings Plan Trust (Iowa 529 Plan) and Iowa ABLE Plan to recent federal changes, including provisions allowing withdrawals from an Iowa 529 Plan for eligible elementary or secondary tuition expenses, and provisions related to the transfer of Iowa 529 Plan assets to an Iowa ABLE Plan. The changes are effective January 1, 2018 (TY 2018).
- Expands the types of persons who must collect and remit the hotel and motel tax.
- Expands the types of persons who must collect and remit the automobile rental tax.
- Repeals an existing exemption from the hotel and motel tax for rooms rented in a memorial union of an Iowa college or university.
- Expands an existing exemption for the rental of rooms at certain religious institutions so that the exemption applies not only to the local option hotel and motel tax, but also to the State hotel and motel tax (5.0% tax rate).
- Modifies and clarifies the term “lodging” for the purposes of the hotel and motel tax to include a cabin, apartment, or residential property within the definition of lodging.
- Restricts class action rights and implied rights of action that may arise under Iowa Code chapter [421](#). Provides immunity from any private cause of action arising from or related to the overpayment of taxes that are collected and remitted to the Department of Revenue. The changes are effective upon enactment.

Fiscal Impact Assumptions

Individual Income Tax – Projections are made through the use of the Department of Revenue’s individual income tax micromodel. The micromodel is based on actual Iowa tax returns filed for TY 2016, with data inputs aged for demographic and inflation factors to simulate the projected tax years. The impact of recent changes to the federal tax code has been incorporated into the baseline assumptions of the micromodel. Tax year revenue changes are converted to fiscal years using historical tax payment and tax refund patterns. The following table presents Department of Revenue micromodel estimates of the tax reduction projected for TY 2019 and TY 2023.

Individual Income Tax Revenue Calculation		
(Dollars in Millions)		
	<u>TY 2019</u>	<u>TY 2023</u>
Current Law	\$ 4,071.5	\$ 4,545.2
Proposed Law	\$ 3,375.0	\$ 3,497.3
\$ Difference	\$ -696.5	\$ -1,047.9
% Difference	-17.1%	-23.1%

Separate from the Department of Revenue assumptions and micromodel results, the Legislative Services Agency estimates that conforming Iowa's College Savings 529 Plan to recent federal changes will reduce State General Fund revenue by \$0.6 million in FY 2018. This negative fiscal impact is the result of taxpayers contributing additional money to existing College Savings Iowa accounts, and/or creating new accounts, in order to take advantage of the tax deduction allowed when filing tax returns for TY 2017. Iowa law allows contributions made through the filing date of the tax return to be deducted from that year's taxable income. Federal law changes enacted December 22, 2017, expanded the definition of qualified education expenses under 529 education savings plans. The expansion allows withdrawals for the purpose of paying elementary and secondary school tuition expenses. The projected fiscal impact is based on an assumed \$8.1 million in additional contributions made prior to the TY 2017 filing deadline by taxpayers taking advantage of the additional tax deduction allowed in Division I of this Bill. The fiscal impacts of the provision beyond FY 2018 are assumed to be included within the Department of Revenue's micromodel results for the future fiscal years.

Corporate Income Tax – Projections are made through the use of the Department of Revenue's corporation income tax micromodel. The micromodel is based on tax returns filed for tax years 1990 through 2015, with data inputs aged for demographic and inflation factors to simulate the projected tax years. The impact of recent changes to the federal tax code has been incorporated into the baseline assumptions of the micromodel. Tax year revenue changes are converted to fiscal years using historical tax payment and tax refund patterns. The following table presents Department of Revenue micromodel estimates of the tax reduction projected for TY 2019 and TY 2023.

Corporate Income Tax Revenue Calculation		
(Dollars in Millions)		
	<u>TY 2019</u>	<u>TY 2023</u>
Current Law	\$ 478.7	\$ 514.8
Proposed Law	\$ 422.4	\$ 247.4
\$ Difference	\$ -56.3	\$ -267.4
% Difference	-11.8%	-51.9%

Franchise Tax – The Department used Iowa franchise tax returns filed for TY 2016 to form projections. Iowa law allows financial institutions organized as S corporations or LLCs to utilize tax credits equal to the franchise tax paid at the bank level when filing individual income tax returns that include the bank profits. This credit is known as the Iowa Franchise Tax Credit. Based on historical usage of this tax credit, the Department assumes that any reduction in Iowa franchise tax paid by banks will be offset by an amount equal to 48.5% of the tax reduction, through a reduction in the amount of the Iowa Franchise Tax Credit.

For financial institutions currently subject to the moneys and credits tax (credit unions), the Department used actual moneys and credits tax receipts deposited to the State General Fund

(\$736,000 for FY 2017) to form projections. This amount is assumed to represent 50.0% of all moneys and credits tax paid, after tax credits. An amount equal to the State General Fund deposits is also assumed to equal FY 2017 revenue for local governments from the moneys and credits tax. To form a projection of the amount credit unions will pay as franchise tax under the changes in the Bill, the Department used calendar year 2016 credit union annual net income data reported to the Iowa Division of Credit Unions and published by the Division.

Sales/Use Tax – Projections are made using information from the Department of Revenue’s [2015 Tax Expenditure Study](#), Census Bureau data, industry specific revenue and sales reports, and remittance reports from Iowa businesses. Fiscal estimates by major provision are summarized in the following table.

Fiscal Impact of Changes to the Sales/Use Tax Base					
Projected General Fund Revenue Change Compared to Current Law					
(In Millions)					
	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Ride Sharing	\$ 3.5	\$ 10.8	\$ 13.4	\$ 15.5	\$ 17.8
Online Sellers	10.2	26.4	27.6	28.5	29.5
Online Marketplaces	11.1	24.2	25.2	26.1	27.0
Agriculture Exemptions	-25.4	-52.6	-54.5	-56.5	-58.5
Grain Bins Exemption	-1.1	-2.2	-2.3	-2.4	-2.5
Construction Equipment Dealers	-4.9	-5.1	-5.3	-5.4	-5.6
Manufacturing Definition	7.1	14.8	15.3	15.8	16.4
Online Travel Companies	0.6	1.4	1.4	1.5	1.6
Total Sales/Use Tax at 6.0%	\$ 1.1	\$ 17.7	\$ 20.8	\$ 23.1	\$ 25.7
Transfer to SAVE Fund	\$ -0.1	\$ -2.7	\$ -3.2	\$ -3.6	\$ -4.0
State General Fund Impact	\$ 1.0	\$ 15.0	\$ 17.6	\$ 19.5	\$ 21.7

Tax Credit Changes – Changes to various tax credit programs have implications for individual income, corporate income, franchise, moneys and credits, insurance premium, and sales/use taxes. The projected impacts of changes in a few of the credits are included within the micromodel results cited above. The revenue impacts of changes to the tax credits listed in the following table were estimated by the Department of Revenue outside of the micromodel process and are therefore considered additional fiscal impacts.

Fiscal Impact of Tax Credit Changes on General Fund Revenue

Projected General Fund Revenue Change Compared to Current Law
(In Millions)

Tax Credit Program	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Accelerated Career Education Tax Credit	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Agricultural Assets Transfer Tax Credit	0.00	0.00	-0.56	-0.87	-1.02	-1.15
Ethanol Promotion Tax Credit	0.00	0.00	0.31	1.37	1.04	0.07
Farm-to-Food Donation Tax Credit	0.00	0.00	0.01	0.01	0.02	0.02
Geothermal Heat Pump Tax Credit	0.00	0.00	0.00	0.00	0.00	0.00
Geothermal Tax Credit	0.00	0.00	1.62	2.17	2.41	2.52
High Quality Jobs Program	0.00	0.00	0.25	1.42	2.25	3.80
Historic Preservation Tax Credit	0.00	0.00	0.31	1.45	2.73	4.01
Innovation Fund Tax Credit	0.00	0.00	0.00	0.00	0.00	0.00
Qualifying Business Tax Credit	0.00	-1.00	-2.00	-2.00	-2.00	-2.00
Research Activities Tax Credit	1.19	4.63	6.98	7.27	7.54	7.82
Research Activities Tax Credit (Supplemental)	0.00	0.02	1.06	3.48	5.25	6.84
School Tuition Organization Tax Credit	0.00	0.00	-0.71	-0.89	-0.93	-0.94
Solar Energy System Tax Credit	0.00	0.01	1.95	3.12	3.52	1.32
Targeted Jobs Tax Credit	0.00	-0.03	-0.24	-0.24	-0.24	-0.24
Workforce Housing Tax Credit	0.00	-0.87	-1.59	-1.68	-1.73	-1.75
Total	\$ 1.19	\$ 2.76	\$ 7.39	\$ 14.61	\$ 18.84	\$ 20.32

Fiscal Impact Summary

The various impacts of the provisions of the Bill as amended are summarized in the top portion of the following table. With the exception of a small positive impact on FY 2018 revenue, the combined revenue impact is negative for fiscal years through FY 2023, and is expected to remain so for future fiscal years. Several provisions are not fully implemented in FY 2023. The provisions include:

- Elimination of the High Quality Jobs Program and associated tax credits July 1, 2025.
- Elimination of the Accelerated Career Education Program July 1, 2025.
- Elimination of the Historic Preservation and Cultural and Entertainment District Tax Credit July 1, 2025.
- Indexation of individual income tax rates (as opposed to tax brackets) beyond TY 2023.

Compared to current law, elimination of the three tax credit programs will increase State General Fund revenue in years beyond FY 2023, while indexing the tax rates will produce less individual income tax revenue than the current system of indexing tax brackets.

The projected impact on local government tax revenue is summarized in the bottom portion of the table. The first two items are revenue sources for local school districts, while the third and fourth items are revenues of cities and counties.

State and Local Revenue Impact
 Projected Change Compared to Current Law
 (In Millions)

State General Fund Revenue Impact

Item	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Individual Income Tax	\$ -0.6	\$ -209.7	\$ -770.8	\$ -901.6	\$ -943.3	\$ -995.7
Burial Trust Fund Exemption	0.0	0.0	-0.3	-0.3	-0.3	-0.4
Corporate Income Tax	0.0	-14.1	-56.3	-103.8	-206.1	-267.4
Franchise Tax (Banks)	0.0	-10.8	-31.3	-32.5	-33.6	-34.8
Franchise Tax Credit Reduction	0.0	5.2	15.2	15.7	16.3	16.9
Franchise Tax (Credit Unions)	0.0	0.0	4.4	4.6	4.8	4.9
Moneys and Credits Tax	0.0	0.0	-0.8	-0.8	-0.9	-0.9
Sales/Use Tax	0.0	1.0	15.0	17.6	19.5	21.7
Tax Credit Changes	1.2	2.8	7.4	14.6	18.8	20.3
General Fund Revenue Impact	\$ 0.6	\$ -225.6	\$ -817.5	\$ -986.5	\$ -1,124.8	\$ -1,235.4

Local Government Revenue Impact

Item	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
School Income Surtax	\$ 0.0	\$ 0.0	\$ -24.7	\$ -31.1	\$ -32.2	\$ -33.2
School Infrastructure (SAVE) Fund	0.0	0.1	2.7	3.2	3.6	4.0
Local Option Sales Tax	0.0	0.1	2.1	2.6	2.8	3.2
Moneys and Credits Tax	0.0	0.0	-0.8	-0.8	-0.9	-0.9
Local Government Revenue Impact	\$ 0.0	\$ 0.2	\$ -20.7	\$ -26.1	\$ -26.7	\$ -26.9

Sources

Census Bureau data
 Iowa Department of Revenue
 Iowa Division of Credit Unions
 Iowa Division of Insurance
 Legislative Services Agency analysis

/s/ Holly M. Lyons

March 20, 2018

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.
