



[HF 2489](#) – Income and Sales Tax Modification (LSB5613HV)
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Fiscal Note Version – New

Description

[House File 2489](#) relates to State and local taxation. The Bill makes changes to Iowa's State individual income tax and sales/use tax. Changes to the State individual income tax affect the amount of revenue raised by the local option income surtax for schools. 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) — The changes in Division I conform (couple) Iowa tax laws with several recent federal changes. The tax coupling relates to the federal Earned Income Tax Credit, teacher expenses, business accounting and retirement savings modifications, and the ability to deduct sales/use taxes in lieu of State and local income taxes. The changes apply retroactively to January 1, 2018, and apply to tax years beginning on or after that date, but before January 1, 2019.

Division I also makes changes to Iowa's existing individual income tax \$25,000 deduction limit on Internal Revenue Code (IRC) [section 179](#) expensing. The Bill increases the annual limit to \$100,000 for TY 2018 and TY 2019, and \$250,000 for TY 2020 and after. Associated investment limits are also established at \$400,000 for TY 2018 and TY 2019, and \$1.0 million for TY 2020 and after. The section 179 changes apply retroactively to January 1, 2018, for tax years beginning on or after that date.

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

- Generally couples Iowa's individual income tax laws with the federal IRC as amended through January 1, 2018. Specific exceptions to the general conformity include:
 - Solar Energy System Tax Credit (coupled separately under current Iowa law).
 - State Research Activities Tax Credit (coupled separately under current Iowa law).
 - Like-kind exchanges (Iowa law will continue to allow like-kind exchanges of personal property).
 - Qualified Business Income (QBI) (the deduction is set at 25.0% of the amount allowed for federal tax purposes).
 - Bonus depreciation (not allowed for Iowa tax purposes). Taxpayers will still be able to depreciate qualified property without the additional benefit of bonus depreciation.
 - Section 179 expensing (allowed, but limited to the amounts provided in Division I).
- Increases the Iowa standard deduction to \$3,000 (single and married filing separately) and \$7,500 (married filing combined). Under current law, the standard deduction amounts are projected to be \$2,070/\$5,090 for tax year 2019.
- Decreases the income tax rates associated with Iowa's nine income tax brackets. The rates are reduced for TY 2019, and reduced further for TY 2020 and after. Current and proposed tax rates are provided in **Table 1**.

Table 1 – Current and Proposed Income Tax Brackets

Estimated Tax Year (TY) 2019 Tax Brackets*		Tax Rate		
Taxed Income Over	But Not Over	Current Law	TY 2019	After TY 2019
\$ -	\$ 1,628	0.36%	0.34%	0.32%
\$ 1,628	\$ 3,256	0.72%	0.68%	0.65%
\$ 3,256	\$ 6,512	2.43%	2.31%	2.20%
\$ 6,512	\$ 14,652	4.50%	4.28%	4.10%
\$ 14,652	\$ 24,420	6.12%	5.94%	5.60%
\$ 24,420	\$ 32,560	6.48%	6.29%	6.10%
\$ 32,560	\$ 48,840	6.80%	6.60%	6.58%
\$ 48,840	\$ 73,260	7.92%	7.84%	7.82%
\$ 73,260	And Over	8.98%	8.89%	8.89%

*Estimated TY 2019 brackets. Iowa tax brackets are indexed annually for inflation.

Iowa Educational Savings Plan Trust and Iowa ABLE Savings Plan Trust (Division III) — Confirms the existing Iowa Educational Savings Plan Trust ([Iowa 529 Plan](#)) and Disabilities Expenses Savings Plan Trust ([Iowa ABLE Plan](#)) to recent federal changes, including provisions allowing withdrawals from the 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 retroactively to January 1, 2018 (TY 2018).

Sales and Use Tax (Division IV) — This Division is effective January 1, 2019; however, some changes to definitions are effective July 1, 2018.

- **Digital Goods** — Imposes the 6.0% State sales/use tax on specified digital products, which include electronically transferred digital audio-video products, digital audio works, digital books, and other digital products. The tax applies whether the granted use of the product is permanent or temporary. The tax also applies if the specified digital product is sold as part of a subscription service. Corresponding changes related to specified digital products are made to existing sales/use tax exemptions.
- **Ride Sharing** — Adds taxis, driver services, ride-sharing services, and rides for hire as taxable personal transportation services subject to the sales/use tax.
- **Subscription Services** – Amends the existing definition of “pay television” under taxable services to include streaming video, video-on-demand, and pay-per-view (subscription services).
- **Online Sellers** — Expands the definition of sales tax nexus to include any retailer making more than \$100,000 in annual sales or making more than 200 separate sales within the State.
- **Online Marketplaces** — Expands and clarifies the sales tax collection obligations of online marketplace providers that facilitate sales into the State.
- **Travel Companies** — Clarifies auto rental and hotel and motel tax collection obligations among lessors, lodging facilitators, rental facilitators, and online travel companies.

Hotel and Motel and Automobile Rental Excise Taxes (Division V) — This Division is generally effective January 1, 2019; however, some definition changes are effective July 1, 2018. The Division:

- Expands the types of persons who must collect and remit the hotel and motel tax and the automobile rental tax.
- Modifies the definition of the term “sales price” as it applies to the hotel and motel tax and 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.

Fiscal Impact Assumptions

Individual Income Tax — Projections for most individual income tax provisions of the Bill 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 year revenue changes using historical tax payment and tax refund patterns. **Table 2** presents Department of Revenue micromodel estimates of the tax reduction projected for TY 2019 and TY 2023.

	TY 2018	TY 2019	TY 2020	TY 2023
Current Law	\$ 3,914.1	\$ 4,071.1	\$ 4,193.5	\$ 4,546.7
Proposed Law*	\$ 3,861.8	\$ 3,812.6	\$ 3,820.6	\$ 4,164.0
\$ Reduction	\$ 52.3	\$ 258.5	\$ 372.9	\$ 382.7
% Reduction	1.3%	6.3%	8.9%	8.4%
* Excludes impacts calculated outside of the Department's micromodel.				

Separate from the Department of Revenue assumptions and micromodel results, the impacts of several coupling provisions are estimated outside of the micromodel and represent additions to the fiscal impact produced by the micromodel.

As described above, the Bill has two major individual income tax functions: it generally couples Iowa tax law with federal tax changes that Iowa tax law is not currently coupled with, and it lowers tax rates while increasing the standard deduction. Roughly one-third of the income tax reduction is due to the coupling provisions, while two-thirds is the result of reduced rates and the increased standard deduction. The overall estimated income tax reduction, divided into those two major provisions, is detailed in **Table 3**, by tax year.

Table 3 – Estimated Individual Income Tax Reduction

Major Provision	In Millions					
	TY 2018	TY 2019	TY 2020	TY 2021	TY 2022	TY 2023
Coupling Only	\$ 52.3	\$ 92.6	\$ 118.3	\$ 113.0	\$ 108.6	\$ 107.8
Rates and Standard Deduction Only	0.0	167.0	255.9	262.5	268.8	276.1
Rate Interaction Adjustment	0.0	-1.1	-1.3	-1.3	-1.2	-1.2
Total Income Tax Reduction	\$ 52.3	\$ 258.5	\$ 372.9	\$ 374.2	\$ 376.2	\$ 382.7

Sales/Use Tax — Projections were produced by the Department of Revenue using information from the Department's [2015 Tax Expenditure Study](#), Census Bureau data, industry specific revenue and sales reports, and remittance reports from Iowa businesses. Fiscal year estimates by major provision are summarized in **Table 4**. As provided in current law, one-sixth of the State sales tax rate of 6.0% is diverted to the Secure an Advanced Vision for Education (SAVE) Fund. Money in the SAVE Fund is distributed to local school districts.

Table 4 – 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
Digital Goods	\$ 11.8	\$ 26.2	\$ 28.8	\$ 31.1	\$ 33.6
Ride Sharing	3.5	10.8	13.4	15.5	17.8
Subscription Services	9.5	21.8	24.0	25.9	27.9
Online Sellers	10.2	24.2	25.2	26.1	27.0
Online Marketplaces	17.4	42.2	44.1	45.6	47.2
Online Travel Companies	0.6	1.4	1.4	1.5	1.6
Total Sales/Use Tax at 6.0%	\$ 53.0	\$ 126.6	\$ 136.9	\$ 145.7	\$ 155.1
Transfer to SAVE Fund	\$ -8.7	\$ -20.8	\$ -22.6	\$ -24.0	\$ -25.6
State General Fund Impact	\$ 44.3	\$ 105.8	\$ 114.3	\$ 121.7	\$ 129.5

Fiscal Impact Summary

The various impacts of the provisions of the Bill are summarized in the top portion of **Table 5**. The first line of the top portion shows the micromodel results for the majority of the individual income tax provisions of the Bill. The second line provides the projected income tax impact for items estimated outside of the micromodel. The third line provides the estimated State General Fund impact of the changes to the sales/use tax base, with the amount transferred to the SAVE Fund excluded.

The projected impact on local government tax revenue is summarized in the bottom portion of **Table 5**. The first two items are revenue sources for local school districts, while the third item is city and county revenue.

Table 5 – State and Local Revenue Impact

Projected Change Compared to Current Law
(In Millions)

State General Fund Revenue Impact

<u>Item</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
Individual Income Tax	\$ -0.8	\$ -139.4	\$ -298.1	\$ -374.3	\$ -376.4	\$ -379.3
Ind. Income Other Coupling	-0.8	-3.6	-4.4	-8.8	-9.4	-9.9
<u>Sales/Use Tax</u>	<u>0.0</u>	<u>44.3</u>	<u>105.8</u>	<u>114.3</u>	<u>121.7</u>	<u>129.5</u>
General Fund Revenue Impact	\$ -1.6	\$ -98.7	\$ -196.7	\$ -268.8	\$ -264.1	\$ -259.7

Local Government Revenue Impact

<u>Item</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
School Income Surtax	\$ 0.0	\$ 1.8	\$ -2.7	\$ -6.4	\$ -6.2	\$ -6.1
School Infrastructure (SAVE) Fund	0.0	8.7	20.8	22.6	24.0	25.6
<u>Local Option Sales Tax</u>	<u>0.0</u>	<u>5.9</u>	<u>14.1</u>	<u>15.3</u>	<u>16.3</u>	<u>17.4</u>
Local Government Revenue Impact	\$ 0.0	\$ 16.4	\$ 32.2	\$ 31.5	\$ 34.1	\$ 36.9

The Department of Revenue indicates that the Bill will produce administrative costs and savings for the Department. However, no single cost or savings is significant and the net impact is not significant.

Sources

Iowa Department of Revenue
Legislative Services Agency analysis

/s/ Holly M. Lyons

April 19, 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.
