



HF 2489 – Income and Sales Tax Modification (LSB5613HV.1)
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Fiscal Note Version – As amended by H-8476, a strike after amendment

Description

House File 2489 as amended by H-8476, which strikes everything after the enacting clause, relates to State and local taxation. The Bill as amended:

- Conforms (couples) Iowa's tax year (TY) 2018 individual income tax laws with several recent changes to the federal tax code.
- Generally conforms Iowa's individual income tax laws to the federal tax code, beginning with TY 2019.
- Reduces Iowa individual income tax rates, beginning TY 2019.
- Modifies Iowa's individual income tax system by reducing the number of tax brackets, reducing tax rates, and changing the basis of income taxation. The changes are effective only if two revenue targets are met. The earliest the changes may be effective is TY 2023. The two revenue targets that must be met are:
 - Actual net General Fund revenue must total at least \$8.3146 billion in the previous fiscal year.
 - Actual net General Fund revenue for the previous fiscal year must exceed the actual net General Fund revenue level for the fiscal year immediately prior to the previous year by at least 4.0%.
- Expands the sales/use tax base to include additional types of items and services. The expansion is effective January 1, 2019. The types of items include: digital goods, ride sharing, subscription services, online sellers, online marketplaces, manufacturing definition, and online travel company websites.
- Generally conforms Iowa's corporate income tax laws to the federal tax code, beginning with TY 2019.
- Reduces Iowa's corporate income tax rates beginning TY 2021. Iowa's alternative minimum tax and the ability of corporations to deduct federal income taxes paid are eliminated.
- Makes the following changes to several existing programs financed through tax credits:
 - Extends the Innovation Fund Tax Credit, set to expire June 30, 2018, to June 30, 2023.
 - Extends the Targeted Jobs Pilot Project and associated Targeted Jobs Withholding Tax Credit, set to expire June 30, 2018, to June 30, 2019.
 - Increases the annual cap for the School Tuition Organization Tax Credit by \$1.0 million, to \$13.0 million. The income threshold for grant eligibility is increased from 300 percent to 400 percent of federal poverty.
 - Eliminates the Solar Energy System Tax Credit effective July 1, 2018.
 - Eliminates two tax credits for geothermal energy systems effective January 1, 2019.
 - Makes changes to the Research Activities Tax Credit. The changes restrict the types of industries eligible for the credit and require that the taxpayer also claim a federal research tax credit for the same research and the same tax year. The changes are retroactive and apply to TY 2017 and after.
 - Eliminates the Taxpayer Trust Fund Tax Credit beginning TY 2018. The Taxpayer Trust Fund is renamed the Taxpayer Relief Fund.

- Makes technical corrections to the administration of tax law by the Department of Revenue.
- Makes changes to the local option sales tax, hotel and motel tax, and automobile rental excise tax.

By operation of law, changes to the State individual income tax affect the amount of revenue raised by the local option income surtax for schools, and changes to the State sales/use tax base affect the amount of revenue raised by the local option sales tax and revenue deposited to the Secure an Advanced Vision for Education (SAVE) Fund.

The individual income tax rates effective beginning TY 2019 are shown in **Table 1**.

Taxed Income Brackets*		Current Law Tax Rates	TY 2019 Rates
Lower Limit	Upper Limit		
\$ 0	\$ 1,628	0.36%	0.33%
\$ 1,629	\$ 3,256	0.72%	0.67%
\$ 3,257	\$ 6,512	2.43%	2.25%
\$ 6,513	\$ 14,652	4.50%	4.14%
\$ 14,653	\$ 24,420	6.12%	5.63%
\$ 24,421	\$ 32,560	6.48%	5.96%
\$ 32,561	\$ 48,840	6.80%	6.25%
\$ 48,841	\$ 73,260	7.92%	7.44%
\$ 73,261	And Over	8.98%	8.53%

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

The individual income tax rates and income brackets, contingent upon meeting the two aforementioned revenue targets and effective for TY 2023 at the earliest, are shown in **Table 2**.

Taxed Income Brackets		Contingent Rates TY 2023
Lower Limit	Upper Limit	
\$ 0	\$ 6,000	4.40%
\$ 6,001	\$ 30,000	4.82%
\$ 30,001	\$ 75,000	5.70%
\$ 75,001	And Over	6.50%

The corporate income tax rates effective beginning TY 2021 are shown in **Table 3**.

Table 3 – Corporate Income Tax Rates

Taxed Income Brackets		Current Law Tax Rates	TY 2021 Rates
Lower Limit	Upper Limit		
\$ 0	\$ 25,000	6.0%	5.5%
\$ 25,001	\$ 100,000	8.0%	5.5%
\$ 100,001	\$ 250,000	10.0%	9.0%
\$ 250,001	And Over	12.0%	9.8%

Fiscal Impact Assumptions

Individual Income Tax — Projections for most individual income tax provisions 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. 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.

Tax year revenue changes are converted to fiscal year revenue changes using historical tax payment and tax refund patterns. **Table 4** presents Department of Revenue micromodel estimates of the tax reduction projected for TY 2018, TY 2019, TY 2021, TY 2023, and TY 2024. Results for TY 2023 and TY 2024 assume both revenue targets are met at the conclusion of FY 2022. For **Table 4**, the coupling provisions estimated outside of the micromodel have been incorporated into the dollar amounts.

Table 4 – Estimated Individual Income Tax Revenue Change

(Dollars in Millions)

	TY 2018	TY 2019	TY 2021	TY 2023	TY 2024
Current Law	\$ 3,914.1	\$ 4,071.1	\$ 4,311.6	\$ 4,546.3	\$ 4,690.8
Proposed Law	\$ 3,867.2	\$ 3,669.1	\$ 3,825.1	\$ 3,907.2	\$ 3,724.8
\$ Reduction	\$ -46.9	\$ -402.0	\$ -486.5	\$ -639.1	\$ -966.0
% Reduction	-1.2%	-9.9%	-11.3%	-14.1%	-20.6%

Amendment H-8476 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 income tax rates. Approximately 35.5% of the total income tax reduction from TY 2018 through TY 2022 is due to the coupling provisions, while the remainder is the result of reduced tax rates. The overall estimated income tax reduction, divided into those two major provisions, is detailed by tax year in **Table 5**.

Table 5 – Estimated Individual Income Tax Impact

(In Millions)					
Major Provision	TY 2018	TY 2019	TY 2020	TY 2021	TY 2022
Coupling Only (micromodel)	\$ -44.0	\$ -100.4	\$ -153.4	\$ -168.4	\$ -185.8
Additional Coupling Provisions	-2.9	-3.2	-6.0	-7.0	-7.1
Rates Reduction Only (micromodel)	0.0	-303.0	-311.6	-319.7	-327.1
Rate Interaction Adjustment	0.0	4.6	7.8	8.6	9.7
Total Income Tax Reduction	\$ -46.9	\$ -402.0	\$ -463.2	\$ -486.5	\$ -510.3

Corporate Income Tax — The fiscal impact of provisions related to corporate tax rates, elimination of the corporate alternative minimum tax, and elimination of the ability to deduct federal taxes paid from corporate taxed income was estimated by the Department of Revenue using a corporate income tax model that is based on actual tax returns filed for tax years 1990 through 2015. Data inputs to the model were 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 model.

Separate from the Department of Revenue assumptions and model results, the impacts of several coupling provisions are estimated outside of the model and represent additions to the fiscal impact produced by the model. Tax year revenue changes are converted to fiscal year revenue changes using historical tax payment and tax refund patterns. **Table 6** presents Department of Revenue estimates of the corporate tax revenue changes for TY 2019 through TY 2024.

Table 6 – Corporate Income Tax Revenue Change Calculation

(Dollars in Millions)						
	TY 2019	TY 2020	TY 2021	TY 2022	TY 2023	TY 2024
Current Law Revenue	\$ 444.7	\$ 468.7	\$ 481.9	\$ 489.3	\$ 505.0	\$ 517.7
Tax Base and Rate Changes	0.0	0.0	-74.5	-75.1	-77.3	-79.1
Coupling	22.2	21.2	26.4	30.2	35.7	38.7
Total Revenue Change	\$ 22.2	\$ 21.2	\$ -48.1	\$ -44.9	\$ -41.6	\$ -40.4
Proposed Law Revenue	\$ 466.9	\$ 489.9	\$ 433.8	\$ 444.4	\$ 463.4	\$ 477.3
% Revenue Difference	5.0%	4.5%	-10.0%	-9.2%	-8.2%	-7.8%

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 7**. As provided in current law, one-sixth of the State sales tax rate of 6.0% is diverted to the SAVE Fund. Money in the SAVE Fund is distributed to local school districts.

Table 7 – 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	FY 2024
Digital Goods	\$ 11.8	\$ 26.2	\$ 28.8	\$ 31.1	\$ 33.6	\$ 35.6
Ride Sharing	3.5	10.8	13.4	15.5	17.8	18.7
Subscription Services	9.5	21.8	24.0	25.9	27.9	29.3
Online Sellers	10.2	24.2	25.2	26.1	27.0	27.9
Online Marketplaces	17.4	42.2	44.1	45.6	47.2	48.6
Manufacturing Definition	13.8	13.9	14.4	14.9	15.5	16.1
Online Travel Companies	0.6	1.4	1.4	1.5	1.6	1.7
Total Sales/Use Tax at 6.0%	\$ 66.8	\$ 140.5	\$ 151.3	\$ 160.6	\$ 170.6	\$ 177.9
Transfer to SAVE Fund	\$ -11.0	\$ -23.2	\$ -25.0	\$ -26.5	\$ -28.2	\$ -29.4
State General Fund Impact	\$ 55.8	\$ 117.3	\$ 126.3	\$ 134.1	\$ 142.4	\$ 148.5

Tax Credit Changes — Fiscal impact projections for changes to existing tax credit programs were produced by the Department of Revenue using tax credit claim and redemption patterns observed from actual tax credit applications and tax returns. **Table 8** provides the projected General Fund fiscal impact by tax credit.

Table 8 – Fiscal Impact of Tax Credit Changes

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	FY 2024
Innovation Fund	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ -1.0	\$ -1.7	\$ -2.2
Geothermal	0.0	0.0	1.6	2.2	2.4	2.5	2.5
Research Activities	0.6	4.5	7.2	7.5	7.8	8.1	8.4
School Tuition Organization	0.0	0.0	-0.7	-0.9	-1.0	-1.0	-1.0
Solar Energy System	0.0	0.0	1.3	2.9	3.5	1.4	0.5
Targeted Jobs Pilot Project	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
Taxpayer Trust Fund Tax Credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	\$ 0.6	\$ 4.5	\$ 9.2	\$ 11.5	\$ 11.5	\$ 9.1	\$ 8.0

Fiscal Impact Summary

The various State General Fund fiscal year impacts of the provisions of Amendment H-8476 are summarized in the top portion of **Table 9**. For **Table 9**, it is assumed both revenue targets are met at the end of FY 2022 and the new individual income tax system begins with TY 2023. The first line of the top portion shows the micromodel results for the individual income tax provisions, modified by some changes incorporated outside of the micromodel. The second line provides the projected impact of coupling Iowa's corporate tax laws with federal corporate income tax changes (including provisions estimated outside of the corporate income tax model), and the enactment of lower corporate income tax rates beginning TY 2021. 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 fourth line provides the net impact of changes to tax credit programs.

The projected impact on local government tax revenue is summarized in the bottom portion of **Table 9**. The first two items are revenue sources for local school districts, while the third item is city and county revenue.

Table 9 – 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	FY 2024
Individual Income Tax	\$ -0.8	\$ -186.0	\$ -408.9	\$ -471.5	\$ -494.8	\$ -540.7	\$ -753.3
Corporate Income Tax	0.0	25.6	20.8	5.2	-41.4	-48.3	-44.9
Sales/Use Tax	0.0	55.8	117.3	126.3	134.1	142.4	148.5
Tax Credits	0.6	4.5	9.2	11.5	11.5	9.1	8.0
General Fund Revenue Impact	\$ -0.2	\$ -100.1	\$ -261.6	\$ -328.5	\$ -390.6	\$ -437.5	\$ -641.7
Local Government Revenue Impact							
Item	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2023
School Income Surtax	\$ 0.0	\$ -1.8	\$ -11.8	\$ -13.7	\$ -14.3	\$ -14.8	\$ -21.7
School Infrastructure (SAVE) Fund	0.0	11.0	23.2	25.0	26.5	28.2	29.4
Local Option Sales Tax	0.0	8.7	18.3	19.7	20.9	22.3	23.2
Local Government Revenue Impact	\$ 0.0	\$ 17.9	\$ 29.7	\$ 31.0	\$ 33.1	\$ 35.7	\$ 30.9

The Department of Revenue indicates that Amendment H-8476 will produce both administrative costs and savings for the Department. However, with the exception of the administrative effort needed to audit and enforce the taxation of federal income tax refunds, estimated at \$0.5 million of Department administrative costs each year and no longer necessary should the revised tax system be triggered for TY 2023 or after, no single cost or savings is significant and the net impact to the Department is not significant.

Source

Iowa Department of Revenue

/s/ Holly M. Lyons

May 4, 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.
