

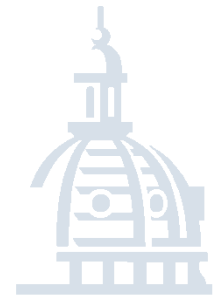


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HF 2359 – Supplier Income Tax Exemption (LSB 5279HV)

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Fiscal Note Version – New

Description

House File 2359 creates an income tax exemption for corporate income earned by S-Corporation and C-Corporation businesses that are, at least in part, suppliers to Iowa anchor manufacturers. The exclusion is equal to the Iowa apportioned income that is above the company's Iowa apportioned income in a base year. The base year calculation grows 5.0% per year with each additional year's exemption calculated from the base year income incremented by 5.0% per tax year. The exclusion is available for tax years beginning on or after January 1, 2012. The Economic Development Authority (EDA) may not issue new certificates after January 1, 2015.

In the Bill:

1. Certified Supplier means a business certified by the EDA. The EDA is required to certify all suppliers that:
 - Manufacture tangible personal property at one or more facilities in Iowa and derive more than 10.0% of gross sales of tangible personal property from one facility in Iowa through sales to one or more Iowa anchor manufacturers.
 - Provide a statement from one anchor manufacturer that the manufacturer meets the definition of an anchor manufacturer.
 - Have at least 10.0% of total payroll located in Iowa or the supplier employs at least 50 employees at a facility in Iowa.
2. Anchor Manufacturer is defined as a business that manufactures tangible personal property at a facility in Iowa and exports at least 50.0% of the tangible personal property produced at the anchor manufacturer's Iowa facility to markets outside of Iowa.

Each certified supplier will continue to benefit from the exclusion as long as the supplier has Iowa apportioned income in excess of the base year Iowa apportioned income, incremented by 5.0% each tax year. The Bill applies retroactively to tax years beginning on or after January 1, 2012. The EDA may not issue new certificates after January 1, 2015, so the Bill impacts only tax years 2012, 2013, and 2014.

Background

The net income of C-Corporations is taxed by Iowa at the business entity level, while S-Corporations are taxed through the individual income tax returns of the owners. The business structure for both entity types is defined through the federal Internal Revenue Code (IRC).

Many provisions of the Bill are difficult or impossible to estimate. The data necessary is not available. The Department of Revenue (DR) provided a fiscal impact estimate based on a portion of the universe of potential beneficiaries from this proposed tax change. Using the most recent three years of C-Corporation tax returns available, the DR provided an estimate based

on manufacturing C-Corporations with Iowa apportioned income growth sufficient to benefit from the proposal. The DR's estimate should be considered a maximum for the subset of companies, but the estimate does not include companies that are not categorized as manufacturers and it does not include S-Corporations.

The Bill has several broad definitions that make developing a reasonable estimate of the fiscal impact of the Bill problematic.

Manufacturing includes "combining of different materials" and "extracting and recovering natural resources." This definition could include biodiesel blending and production, ethanol blending and production, vehicle or heating fuel delivery, electricity production (including wind), and perhaps the delivery of natural gas.

An anchor manufacturer is defined as any business that exports at least 50.0% of what it produces at a facility in Iowa to out-of-state buyers.

- There is no requirement that an anchor manufacturer be of a specific employment or sales size. An anchor manufacturer could be a C-Corporation with 1,000 employees or it could be a sole proprietorship with one employee.
- There is no requirement that the tangible personal property purchased from a certified supplier be included by the anchor manufacturer as part of tangible personal property sold and exported out-of-state.

A qualifying supplier must supply at least 10.0% of the tangible personal property the supplier produces at an Iowa facility to an anchor manufacturer. This requirement also means that up to 90.0% of what that facility produces may be sold elsewhere in the State, and it means that anything else that qualified supplier produces at other facilities could be unrelated to supplying an anchor manufacturer. As long as the business meets the production requirements at one facility and also meets the employment thresholds, all Iowa-apportioned income growth that business experienced above the 5.0% growth requirement will be exempt from Iowa business income tax and this will be true even if the growth is not related to supplying an Iowa anchor manufacturer.

A certified supplier could also increase its Iowa-apportioned income simply by purchasing another Iowa-based supplier or by taking over the contracts of an existing Iowa supplier. Both of these situations would result in reduced General Fund revenue through the tax exemption, but would not result in any additional Iowa-based production.

Further adding to the uncertainty and potential cost of the proposal, is the fact that an anchor manufacturer could be a certified supplier to another anchor manufacturer.

Fiscal Impact

The DR calculates that the maximum impact of the Bill, for C-Corporations only, will result in a decrease of tax revenue to the state of \$44.5 million over the three tax years. The DR was unable to provide any type of dollar estimate for S-Corporations. The DR was able to provide statistics showing that the number of S-Corporation manufacturing firms in Iowa is approximately 63.0% of the number of C-Corporation manufacturing firms. Multiplying the DR's C-Corporation maximum estimate of \$44.5 million times 1.63, yields a three-year total of \$72.6 million.

The DR estimates that approximately 57.0% of identified C-Corporation and S-Corporation manufacturers meet at least one of the employment threshold requirements in the Bill. Applying 57.0% to the \$72.6 million yields \$41.2 million.

However, the above math assumes two things:

- All C-Corporations and S-Corporations categorized as manufacturers are certified suppliers to anchor manufacturers.
- Only businesses categorized as manufacturers will qualify as certified suppliers to anchor manufacturers.

In practical impact, neither number one nor two above will be true, but they will offset. Some percentage of Iowa manufacturers will not qualify as certified suppliers because they will not provide at least 10.0% of the tangible property they produce at a single facility to a qualified anchor manufacturer. But also, some businesses that are not categorized as manufacturers will in fact meet the 10.0% supplier threshold and their income subject to Iowa tax could be reduced.

The Bill applies only to tax years 2012, 2013, and 2014. After 2014, the EDA and the DR are required to consult with the Chairpersons of the Economic Growth and Rebuild Iowa Committees of the House and Senate.

The estimated reductions in General Fund revenue associated with the income tax exemption created in the Bill are:

- FY 2013 = \$ - 7.0 million
- FY 2014 = \$ -12.1 million
- FY 2015 = \$ -15.1 million
- FY 2016 = \$ - 7.1 million

In addition to decreasing State General Fund revenue, tax law changes that lower S-Corporation taxable income also reduces the amount of revenue raised by the local option income surtax for schools. Over the four impacted fiscal years, the reduction is projected to average \$125,000 per year.

Sources

Department of Revenue
Legislative Services Agency analysis

/s/ Holly M. Lyons

March 5, 2012

The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#) and the correctional and minority impact statements were prepared pursuant to Iowa Code [Section 2.56](#). Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.
