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Fiscal Note

Fiscal Services Division

HF 336 – Capital Gains Tax Exemption (LSB 2096HH)
Analyst: Jeff Robinson (Phone: (515) 281-4614) (jeff.robinson@legis.iowa.gov)
Fiscal Note Version – New

Description

House File 336 creates a new individual income tax exemption for the net capital gains received from the sale or exchange of qualified capital stock. Qualified capital stock is defined as stock received "on account of employment" with a company and while employed by the company.

Each taxpayer is allowed to apply the exemption to one company in their life, and the exemption extends to the stock of affiliate companies of the employer. The exemption extends to gifts and trusts. Qualified heirs are allowed to make the designation in instances where the person dies without making a designation.

This Bill is effective on enactment and applies retroactively to tax year 2013 and after.

Background

The state of Nebraska has had a similar capital stock income tax exemption in place since 1987. The Nebraska law includes stock of the employer purchased while employed by the company, so it is not limited to just stock received as compensation. The Nebraska law also applies to extraordinary dividends (dividends in excess of 20.0% of the stock's market value) received by the employee through ownership of qualified capital stock.

Nebraska publishes estimates of the revenue impacts of their income tax preferences every two years. Over the course of the past five reports, the Nebraska estimate of the annual impact of this exemption averaged $30.3 million.

Assumptions

- The Nebraska Department of Revenue reports that approximately 20.0% of the income exempted from Nebraska income tax through this capital stock exemption is due to the dividend exemption and 80.0% is due to the capital gains exemption.
- In tax years 2009 and 2010, Nebraska taxpayers excluded an average of $375.5 million through the Nebraska capital stock exemption. Applying the 80.0% factor from number 1 above provides a Nebraska capital gains exemption of $300.4 million each year.
- Nebraska taxpayers reported an average of $1,623.9 million in capital gains on their tax year 2009 and 2010 federal tax returns, making the $300.4 million exemption equal to 18.5% of all Nebraska capital gains reported.
- Iowa taxpayers reported an average of $1,784.9 million in capital gains for tax years 2009 and 2010. Applying the 18.5% experience of Nebraska, Iowa taxpayers would expect the exclusion to equal $330.2 million each year.

- Nebraska law applies not only to stock received as compensation, but also to stock of the employer that is purchased by the employee while employed by the company. House File 336 does not extend the benefit to stock that is simply purchased by the employee, so the Iowa impact is expected to be less. To account for this difference, the estimated capital gains exemption is limited to 80.0%, or $264.2 million per year.
- Tax years 2009 and 2010 were significantly impacted by the recession, so capital gains were depressed. To adjust for the improvements in capital markets since tax year 2010, the $264.2 million impact is multiplied by 127.4%, providing a tax year 2013 estimate of $336.6 million. The tax year 2013 amount is also assumed for future tax years in the estimate.
- The average Iowa marginal tax rate is assumed to be 7.5%. This results in a projected annual General Fund revenue reduction of $25.2 million.
- Although the exemption is retroactive to January 1, 2013, no FY 2013 impact is assumed. The impact of tax year 2013 capital gains events will all accrue to FY 2014.
- With the exception of refundable tax credits, tax changes that impact Iowa individual income tax owed also impacts the revenue raised by the local option income surtax for schools. For the 12 months ending December 2012, the statewide yield from the surtax equaled 2.7% of net State income tax receipts.

Fiscal Impact

The new capital stock income tax exemption created in the Bill is projected to reduce net General Fund revenue by $25.2 million per fiscal year, beginning in FY 2014.

The impact on revenue generated by the local option income surtax for schools is projected to be 2.7% of the State General Fund impact, or $680,000 per year.

According to Nebraska tax statistics, this tax exemption is claimed by less than 0.1% of all Nebraska taxpayers. Due to the very small percentage of taxpayers involved, the actual impact in Iowa could be significantly different if the distribution and income sources of Iowa taxpayers within the impacted groups are significantly different than Nebraska taxpayers.

Sources

Nebraska Department of Revenue
Nebraska Tax Expenditure studies
Legislative Services Agency analysis
Iowa Department of Revenue

/s/ Holly M. Lyons

April 8, 2013

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.