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Fiscal Note

Fiscal Services Division

HF 2129 – Capital Gains Exclusion (LSB 5083HV)
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Fiscal Note Version – New

Description

House File 2129 expands Iowa's special capital gains income tax exclusion for the sale of a business. Under current law (**Iowa Code section 422.7(21)**), Iowa excludes from State income tax any capital gains realized from the sale of all or substantially all of the tangible personal property of a business. This Bill will expand the sale definition to include all or substantially all of the stock or equity interest in a business. Under current law and under the proposed expansion, the seller is required to have "materially participated" in the business for at least 10 years in order to qualify for the income tax exclusion. The 10-year material participation requirement does not apply in instances of sales to lineal descendants. This Bill is retroactive to January 1, 2014.

Background

Iowa's current capital gains exclusion for the sale of the tangible personal property of a business has been in place as a 100.0% exclusion since tax year 1998 (HF 2513, Miscellaneous Tax Act of 1998). Prior to tax year 1998, the exclusion was limited.

Subject to requirements and limitations, Iowa also has capital gains exclusions for the sale of horses, cattle, and other breeding livestock, the sale of timber, and for Employee Stock Ownership Plans (ESOP).

According to Department of Revenue income tax statistics, the capital gains income tax exclusions provided in Iowa Code section 422.7(21) were utilized on 10,391 tax returns filed for tax year 2012 and the exclusion resulted in a tax savings of $80.7 million for the benefiting taxpayers.

Assumptions

- Using State and federal tax returns of Iowa taxpayers, the Department of Revenue identified 369 tax returns reporting a capital gain for tax year 2012 where the taxpayer had participated in the business for a minimum of 10 years.
- The total capital gain identified on those 369 returns that would be eligible under the capital gains exclusion expansion proposed in HF 2129 is $28.0 million.
- The assumed average marginal tax rate is 8.90%.
- The future growth in capital gains is assumed to equal the S & P 500 growth projections provided by Moody's Analytics (February 2014 projection).
- Exclusions from State income tax reduce the statewide yield on the local option income tax for schools by 3.5% of the net General Fund impact.

Fiscal Impact

The capital gains income tax exclusion contained in this Bill is projected to reduce net General Fund revenue by the following amounts:

- FY 2015 = $3.7 million
- FY 2016 = $3.3 million
- FY 2017 = $3.4 million
- FY 2018 = $3.4 million

The projected impact will continue beyond FY 2018. In addition to the State General Fund impact, the capital gains exclusion will also reduce local option income tax for schools revenue by $116,000 per year, beginning in FY 2015.

Sources

Department of Revenue
Moody's Analytics

/s/ Holly M. Lyons

March 3, 2014

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.