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INCOME TAX JOINT SUBCOMMITTEE

OF THE

SENATE AND HOUE STANDING COMMITTEES ON WAYS AND MEANS

Submitted to the General Assembly

January, 1980

FINAL REPORT

INCOME TAX JOINT SUBCOMMITTEE

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Senate File 494 passed by the General Assembly in 1979 called for the Legislative Council to establish a Joint Subcommittee of the Standing Committees on Ways and Means for consideration of the state income tax structure which should include indexing and its effects on state revenues and existing state programs. The Legislative Council authorized two meeting days and appointed the following members of the Joint Subcommittee:

Senator David M. Readinger, Co-chairperson
Representative Walter Conlon, Co-chairperson
Senator Richard F. Drake
Senator Edgar H. Holden
Senator C. W. Hutchins
Senator Bob Rush
Representative Michael W. Connolly
Representative Mick Lura
Representative Emil S. Pavich
Representative Doug Shull

At the two meetings, the Subcommittee received information from the Department of Revenue involving the effects that the income tax changes made by Senate File 494 would have on state revenues, the issues involved with legislation to allow for income averaging and averaging of lump-sum distributions, the revenue effects on amending the franchise tax and changing the deduction for federal income taxes to an accrual basis. The Subcommittee also discussed with the State Comptroller the meaning and make up of the "unobligated general fund balance" as used in Senate File 494.

The handouts received by the Subcommittee from the Department of Revenue which are on file with the Legislative Service Bureau are entitled as follows:

1. Senate File 494--Outline of Changes--Individual Income Tax Law--Tax Year 1979.

2. Accrual Versus Cash Federal Tax Deduction.

3. Franchise Tax.

4. Income Averaging.

5. A Report on the Issues Related to Income Averaging.

6. Lump-Sum Distributions.

7. A Report on the Issues Related to Lump-Sum Distribution Averaging.

Also on file with the Legislative Service Bureau are all drafts on income averaging and lump-sum distribution averaging and a draft from the Advisory Commission on Intergovernmental Relations entitled "Inflation and Income Taxes: A Primer".

The Joint Subcommittee recommended that the following study bills be drafted:

1. A bill authorizing individual taxpayers to income average in determining their income tax liability with the bill based upon the federal law and with a five-year residency requirement.

2. A bill authorizing the averaging of a lump-sum distribution from an employee's pension, retirement or annuity plan in computing the individual's income tax with the bill based on the federal law.

3. A bill providing for the deduction of the federal income on an accrual basis in determining the individual or corporate income tax with the transition year being 1980.

4. A bill to make the indexing provisions of Senate File 494 permanent and lowering the amount required in the general fund to forty million dollars.

The Subcommittee also recommended that further study be given to the amending of the franchise tax and to its impact.

PROPOSED HOUSE/SENATE FILE ________

By (PROPOSED COMMITTEE ON WAYS AND MEANS BILL RECOMMENDED BY THE INCOME TAX SUBCOMMITTEE)

Passed House, Date____________ Passed Senate, Date____________
Vote: Ayes________ Nays________ Vote: Ayes________ Nays________

Approved______________________________

A BILL FOR

An Act relating to the indexing of the state individual income tax.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Acts of the Sixty-eighth General Assembly, 1979 Session, chapter ninety-three (93), section one (1), amending section four hundred twenty-two point four (422.4), Code 1979, is amended to read as follows:

SECTION 1. Section four hundred twenty-two point four (422.4), Code 1979, is amended by adding the following new subsection:

NEW SUBSECTION.

a. "Annual inflation factor" means an index, expressed as a percentage, determined by the department each year to reflect the purchasing power of the dollar as a result of inflation or deflation during the preceding calendar year. In determining the annual inflation factor, the department shall use the annual percent change in the consumer price index produced by the bureau of labor statistics of the United States department of labor and shall add one-fourth for the 1979 calendar year, ~~and~~ two-fourths for the 1980 calendar year, three-fourths for the 1981 calendar year and the total amount for subsequent calendar years of that percent change to one hundred percent, except that the amount of the percent change added to the one hundred percent shall not exceed the greater of zero or the difference between the percent change and three percent. The annual inflation factor and the cumulative inflation factor shall each be expressed as a percentage rounded to the nearest one-tenth of one percent.

b. "Cumulative inflation factor" means the product of the annual inflation factor for the 1978 calendar year and all annual inflation factors for subsequent calendar years as determined pursuant to this subsection. The cumulative inflation factor shall apply to all tax years beginning on or after January first of the calendar year in which the latest annual inflation factor has been determined.

c. The annual inflation factor for the 1978 calendar year is one hundred percent.

~~d.--The-annual-inflation-factor-and-the-cumulative-inflation~~

~~factor-shall-only-be-computed-for-the-1979-and-1980-calendar years.~~

~~c~~ d. Notwithstanding the computation of the annual inflation factor under paragraph a of this subsection, the annual inflation factor is one hundred percent for any calendar year in which the unobligated state general fund balance on June thirtieth as certified by the state comptroller by September tenth of the fiscal year beginning in that calendar year is less than ~~sixty~~ forty million dollars.

Sec. 2. Acts of the Sixty-eighth General Assembly, 1979 Session, chapter ninety-three (93), section four (4), amending section four hundred twenty-two point five (422.5), Code 1979, is amended to read as follows:

SEC. 4. Section four hundred twenty-two point five (422.5), Code 1979, is amended by adding the following new unnumbered paragraph:

NEW UNNUMBERED PARAGRAPH. Upon determination of the latest cumulative inflation factor, the director of revenue shall multiply each dollar amount set forth in subsections 1 through 13 of this section and each dollar amount specified in unnumbered paragraph 6 of this section as the maximum amount of annuities received which may be excluded in determining final taxable income by this cumulative inflation factor, shall round off the resulting product to the nearest one dollar and incorporate the result into the income tax forms and instructions for each tax year. ~~The-director-shall-not alter-the-dollar-amounts-specified-in-subsections-1-through 13-of-this-section-for-any-tax-year-beginning-on-or-after January-1,-1981.~~ However, the resulting product shall not reduce the dollar amounts set forth in subsections 1 through 13 and unnumbered paragraph 6 of section 422.5 below those specified on January 1, 1979.

Sec. 3. Acts of the Sixty-eighth General Assembly, 1979 Session, chapter ninety-three (93), section eight (8), amending section four hundred twenty-two point twenty-one (422.21), Code 1979, is amended to read as follows:

SEC. 8. Section four hundred twenty-two point twenty-one (422.21), Code 1979, is amended by adding the following new unnumbered paragraph:

NEW UNNUMBERED PARAGRAPH. The director shall determine for the 1979 and ~~1980~~ subsequent calendar years the annual and cumulative inflation factors for those calendar years to be applied to tax years beginning on or after January first of that calendar year. The director shall compute the new dollar amounts as specified therein to be adjusted in section 422.5 by the latest cumulative inflation factor and round off the result to the nearest one dollar. ~~The-director-shall not-compute-new-dollar-amounts-specified-in-subsections-1 through-13-of-section-422.5-for-any-tax-year-beginning-on or-after-January-1,-1981.~~ The annual and cumulative inflation factors determined by the director are not rules as defined in section 17A.2, subsection 7.

Sec. 4. This Act is retroactive to January 1, 1980 for tax years beginning on or after January 1, 1980 and to this extent is retroactive.

Sec. 5. This Act, being deemed of immediate importance, shall take effect from and after its publication in ______ ______, a newspaper published in ______, Iowa, and in ______, a newspaper published in ______, Iowa.

EXPLANATION

The bill makes permanent the indexing of the individual income tax rate brackets and the maximum amount of annuities received from the United States government which may be excluded in determining taxable income. The bill also lowers from $60,000,000 to $40,000,000 the amount of unobligated general fund balance which must be available before indexing may occur for a tax year beginning in the calendar year in which the balance is certified.

PROPOSED HOUSE/SENATE FILE ________

By (PROPOSED COMMITTEE ON WAYS AND MEANS BILL RECOMMENDED BY THE INCOME TAX SUBCOMMITTEE)

Passed House, Date ____________ Passed Senate, Date ____________

Vote: Ayes ________ Nays ________ Vote: Ayes ________ Nays ________

Approved ______________________________

A BILL FOR

An Act providing for the deduction of the federal income tax accrued for the tax year in computing the state individual and corporate income tax for that year.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Section four hundred twenty-two point nine (422.9), subsection two (2), paragraph b, Code 1979, as that section is amended by Acts of the Sixty-eighth General Assembly, 1979 Session, chapter ninety-three (93), section five (5), is amended to read as follows:

b. Add the amount of federal income taxes ~~paid-or~~ accrued ~~as-the-case-may-be,~~ during the tax year, adjusted by any federal income tax refunds to the extent such refunds result from a carry-back of a federal loss or tax credit to a prior tax year. ~~Provided,-however,-that-where~~ If married persons~~,~~ who have filed a joint federal income tax return, file separately, ~~such~~ the total shall be divided between them according to the portion ~~therefore-paid-or~~ accrued~~,-as-the case-may-be,~~ by each.

In addition to the amount otherwise computed under paragraph b of this subsection, taxpayers who deducted federal income taxes on a cash basis for tax years beginning prior to January 1, 1980 shall add any additional federal income taxes paid for tax years beginning prior to January 1, 1980 in the tax year of payment and shall subtract any refunds or credits of federal income taxes paid for tax years beginning prior to January 1, 1980 in the tax year the refund or credit is received.

Sec. 2. Section four hundred twenty-two point thirty-five (422.35), subsection four (4), Code 1979, is amended to read as follows:

4. Subtract fifty percent of the federal income taxes ~~paid-or~~ accrued~~,-as-the-case-may-be,~~ during the tax year, adjusted by any federal income tax refunds to the extent such refunds result from a carry-back of a federal loss or tax credit to a prior tax year; and add the Iowa income tax deducted in computing said taxable income.

In addition to the amount otherwise computed under this subsection, taxpayers that deducted federal income taxes on a cash basis for tax years beginning prior to January 1, 1980 shall subtract fifty percent of any additional federal income taxes paid for tax years beginning prior to January 1, 1980 in the tax year of payment and shall add to Iowa income fifty percent of any refunds or credits of federal income taxes paid for tax years beginning prior to January 1, 1980 in the tax year the refund or credit is received.

Sec. 3. This Act is retroactive to January 1, 1980 for tax years beginning on or after that date.

Sec. 4. This Act, being deemed of immediate importance, shall take effect from and after its publication in ______ __________, a newpaper published in ______________, Iowa, and in __________________________, a newspaper published in ______________, Iowa.

EXPLANATION

The bill provides that beginning with tax years beginning on January 1, 1980 deduction will be allowed for the individual's or corporation's federal tax liability for the tax year for which the state return is being filed. This deduction will be adjusted by refunds which result from a carryback of a federal loss or tax credit to a prior tax year. Provision is made for the transitional period to allow individuals and corporations who had refunds or paid additional taxes for tax years beginning before the effective date of this Act to adjust their federal tax liability by such refunds or tax payments.

PROPOSED HOUSE/SENATE FILE ________

By (PROPOSED COMMITTEE ON WAYS AND MEANS BILL RECOMMENDED BY THE INCOME TAX SUBCOMMITTEE)

Passed House, Date ____________ Passed Senate, Date ____________

Vote: Ayes ________ Nays ________ Vote: Ayes ________ Nays ________

Approved ________________________

A BILL FOR

An Act allowing special income tax treatment for the receipt of a lump sum distribution from an employees' pension, retirement or annuity plan.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Chapter four hundred twenty-two (422), Code 1979, is amended by adding sections two (2) through four (4) of this Act as a new division.

Sec. 2. NEW SECTION. DEFINITIONS. For purposes of this division unless otherwise required by the context:

1. "Internal Revenue Code of 1954" means the Internal Revenue Code of 1954 as amended to and including January 1, 1979.

2. "Tax year", "resident" and "individual" mean the same as defined in section four hundred twenty-two point four (422.4) of the Code.

3. "Taxpayer" means an individual, estate or trust for which the receipt of a lump sum distribution in the tax year would be Iowa taxable income as determined under the provisions of division two (II) of this chapter without regard for the provisions of this division or an election made for federal income tax purposes to receive the benefits of section 402 (e) of the Internal Revenue Code of 1954.

Sec. 3. NEW SECTION. TAX ON LUMP SUM DISTRIBUTIONS.

1. A tax is imposed on the ordinary income portion of a lump sum distribution received by a taxpayer in a tax year, in the amount determined as follows:

a. The amount of tax imposed for the tax year is an amount equal to the amount of the initial separate tax for the tax year multiplied by the ratio that the ordinary income portion of the lump sum distribution for the tax year bears to the total taxable amount of that distribution for the tax year.

b. The initial separate tax for the tax year is an amount equal to ten times the tax which would be imposed under subsections one (1) through thirteen (13) of section four hundred twenty-two point five (422.5) of the Code if the taxable income were an amount equal to one-tenth of the excess of the total taxable amount of the lump sum distribution for the tax year over the minimum distribution allowance.

c. The minimum distribution allowance for the tax year is an amount equal to one-half of the first twenty thousand dollars of the total taxable amount of the lump sum distribution for the tax year reduced, but not below zero, by one-fifth of the amount by which that total taxable amount exceeds twenty thousand dollars.

2. In the case of a taxpayer receiving a lump sum distribution for the tax year who during the six-tax-year period ending on the last day of the tax year has received one or more other lump sum distributions after December 31, 1979, or if a part or all of the distribution is an annuity contract, in computing the tax imposed by subsection one (1) of this section the total taxable amounts of all these distributions during that six-tax-year period shall be aggregated. However the amount of the tax computed shall be reduced, but not below zero, by the sum of the tax imposed by subsection one (1) of this section with respect to those other lump sum distributions and that portion of the tax on the aggregated total taxable amounts which is attributable to annuity contracts. For purposes of this subsection:

a. A beneficiary of a trust to which a lump sum distribution is made shall be treated as the recipient of the distribution if the beneficiary is an employee, including an employee within the meaning of section 401 (c) (1) of the Internal Revenue Code of 1954, with respect to the plan under which the distribution is made or is treated as the owner of the trust for purposes of sections 671 through 679 of the Internal Revenue Code of 1954.

b. In the case of the distribution of an annuity contract, the taxable amount of that distribution is the current acturial value of the contract as determined on the date of the distribution.

c. In the case of a lump sum distribution with respect to any individual which is made only to two or more trusts, the tax imposed by subsection one (1) of this section shall be computed as if the distribution was made to a single trust, but the liability for the tax shall be apportioned among the trusts according to the relative amounts received by each.

3. The ordinary income portion of a lump sum distribution for the tax year shall be allowed as a deduction for the tax year in computing Iowa net income under section four hundred twenty-two point seven (422.7) of the Code to the extent that portion is included in the adjusted gross income as properly computed for federal income tax purposes under the Internal Revenue Code of 1954.

4. The definitions of and special rules, including the rules on taxpayer elections, for a lump sum distribution, the total taxable amount of a lump sum distribution and the ordinary income portion of a lump sum distribution shall be as specified in section 402 (e) (4) of the Internal Revenue Code of 1954 except that rules shall be prescribed by the director in lieu of the regulations promulgated by the secretary of the treasury. A taxpayer who has made an election under section 402 (e) (4) (B) or section 402 (e) (4) (L) of the Internal Revenue Code of 1954 for ferderal income tax purposes shall be bound by that election in determining the taxpayer's Iowa income tax liability for that tax year.

Sec. 4. <u>NEW SECTION</u>. ELIGIBLE TAXPAYERS. The provisions of this division shall apply only to taxpayers who have elected in determining their federal income tax liability for the tax year to receive the benefits of section 402 (e) of the Internal Revenue Code of 1954.

Sec. 5. Section four hundred twenty-two point five (422.5) unnumbered paragraph two (2), Code 1979, as amended by Acts of the Sixty-eighth General Assembly, 1979 Session, chapter ninety-three (93), section two (2), is amended to read as follows:

However, no tax shall be imposed on any resident or non-resident whose net income, as defined in section 422.7, is five thousand dollars or less; but in the event that the payment of tax under this division would reduce the net income to less than five thousand dollars, then the tax shall be reduced to that amount which would result in allowing the taxpayer to retain a net income of five thousand dollars. The preceding sentence does not apply to estates or trusts. For the purpose of this paragraph, the entire net income, including any part thereof not allocated to Iowa, shall be taken into account and the amount of the ordinary income portion of a lump sum distribution deducted under the Internal Revenue Code of 1954 shall be included in net income. If the combined net income of a husband and wife exceeds five thousand dollars, neither of them shall receive the benefit of this paragraph, and it is immaterial whether they file a joint return or separate returns. A person who is claimed as a dependent by another person as defined in section 422.12 shall not receive the benefit of this paragraph if the person claiming the dependent has net income exceeding five thousand dollars or the person claiming the dependent and the person's spouse have combined net income exceeding five thousand dollars.

Sec. 6. Section four hundred twenty-two point seven (422.7), Code 1979, is amended by adding the following new subsection:

NEW SUBSECTION. Subtract the deduction allowed by subsection three (3) of section three (3) of this Act.

Sec. 7. This Act is retroactive to January 1, 1980 for lump sum distributions received in tax years beginning on or after January 1, 1980.

Sec. 8. This Act, being deemed of immediate importance, shall take effect from and after its publication in ______________________, a newspaper published in ________________, Iowa, and in ____________________________, a newspaper published in ____________________, Iowa.

EXPLANATION

This bill provides that taxpayers subject to the Iowa individual income tax can receive benefits similar to the federal law with regard to the receipt in a tax year of a lump sum distribution from an employees' pension, retirement or annuity plan. Presently such a distribution is completely taxed in the tax year received thus resulting in the taxpayer being place in a high tax bracket if the distribution is large. The bill would determine the tax on 10% of the distribution and multiply this by 10 to determine the total tax. The bill would also provide that the tax on the distribution be determined without adding other income received in the tax year. Presently other income is included with the distribution in determining the tax. This bill would apply to those taxpayers who elect the benefits of the federal law in determining their federal income tax.

PROPOSED HOUSE/SENATE FILE ______

By (PROPOSED COMMITTEE ON WAYS AND MEANS BILL RECOMMENDED BY THE INCOME TAX SUBCOMMITTEE)

Passed House, Date____________ Passed Senate, Date____________

Vote: Ayes________ Nays________ Vote: Ayes________ Nays________

Approved______________________________

A BILL FOR

An Act authorizing a taxpayer to income average in determining the taxpayer's individual income tax liability for the tax year.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Chapter four hundred twenty-two (422), Code 1979, is amended by adding sections two (2) through six (6) of this Act as a new division:

Sec. 2. NEW SECTION. LIMITATION ON TAX. Notwithstanding the amount of tax determined in accordance with section four hundred twenty-two point five (422.5) of the Code, if an eligible individual has averagable income exceeding three thousand dollars for the computation year, then the tax imposed by section four hundred twenty-two point five (422.5) of the Code for the computation year which is attributable to averagable income shall be five times the increase in tax under that section between the tax on the sum of twenty percent of the averagable income plus one hundred twenty percent of the average base period income and the tax on one hundred twenty percent of the average base period income.

Sec. 3. NEW SECTION. DEFINITIONS. For the purposes of this division:

1. "Averagable income" means the amount by which Iowa taxable income for the computation year exceeds one hundred twenty percent of average base period income. In computing averagable income, taxable income for the computation year shall be reduced, to the extent included in taxable income, by the amount to which section 72(m) (5) of the Internal Revenue Code of 1954 applies and the amounts included in the income of a beneficiary of a trust under section 667(a) of the Internal Revenue Code of 1954.

2. "Average base period income" means one-fourth of the sum of the base period incomes for the base period.

3. "Base period income" for a tax year means the Iowa taxable income for that year increased, to the extent the amount would have been included in taxable income, by an amount equal to the excess of the amount excluded from federal gross income under section 911 and subpart D of part III of subchapter N of the Internal Revenue Code of 1954, over the deductions which would have been properly allocable to or

chargeable against that amount but for the exclusion of that amount from federal gross income; and decreased, to the extent included in taxable income, by the amounts included in the income of a beneficiary of a trust under section 667(a) of the Internal Revenue Code of 1954.

4. "Computation year" means the tax year for which the taxpayer chooses the benefits of this division.

5. "Base period" means the four tax years immediately preceding the computation year.

6. "Base period year" means any of the four tax years immediately preceding the computation year.

7. Except as otherwise provided in this subsection, "eligible individual" means an individual who was a resident of this state throughout the computation year and throughout every base period year and who is subject to the tax imposed by division one (I) of this chapter for the computation year. An individual is not an eligible individual for the computation year if, for any base period year, the individual and the individual's spouse furnished less than one-half of the individual's support except that the individual who meets the residency requirements is an eligible individual in any of the following cases:

a. If the computation year ends after the individual attained age twenty-five and, during at least four of the individual's tax years beginning after the individual attained age twenty-one and ending with the computation year, the individual was not a full-time student.

b. If more than one-half of the individual's Iowa taxable income for the computation year is attributable to work performed by the individual in substantial part during two or more of the base period years, or

c. If the individual computes his or her tax on the basis of joint income of husband and wife for the computation year and not more than twenty-five percent of the aggregate Iowa net income of the individual and the individual's spouse for the computation year is attributable to the individual.

8. "Student" means, with respect to a tax year, an individual who during each of five calendar months during the tax year was a full-time student at an educational organization described in section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954, or was pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of such an educational organization or of a state or a political subdivision of a state.

9. "Net income", "taxable income", "tax year" and "Internal Revenue Code of 1954" have the same meaning as defined in section four hundred twenty-two point four (422.4) of the Code.

Sec. 4. NEW SECTION. ELECTION. This division applies to a tax year only at the taxpayer's election. The election may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by division one (I) of this chapter for the tax year.

Sec. 5. NEW SECTION. MARRIED TAXPAYERS.

1. For purposes of this division, the base period income of an individual for any base period year shall not be less than fifty percent of the base period income which would result from combining his or her income and deductions for that year with the greater of the income and deductions for that year of the individual who is his or her spouse for the computation year or with the income and deductions for that year of the individual who was his or her spouse for that base period year. However, this subsection does not apply for a base period year if, for the computation year, the individual files with his or her spouse a joint return for Iowa income tax purposes or files a federal return as a surviving spouse; and the individual was not married to any other spouse for that base period year.

2. In the case of a joint return for Iowa income tax

purposes, the three thousand dollar figure specified in section two (2) of this Act shall be applied to the aggregate averagable income.

3. For purposes of this division, section 143(a) of the Internal Revenue Code of 1954 applies in determining whether an individual is married for any tax year.

Sec. 6. NEW SECTION. RETURN NOT MADE IN BASE YEAR. This division shall apply to the tax year even though the taxpayer electing the benefits of this division was not required to make and sign an Iowa income tax return for one or more tax years during the base period. The average base period income for that taxpayer shall be determined as if that taxpayer had been required to make and sign an Iowa income tax return for the tax years in the base period.

Sec. 7. Section four hundred twenty-two point seven (422.7), Code 1979, is amended by adding the following new subsection:

NEW SUBSECTION. If the taxpayer elects to receive the benefits of sections two (2) through six (6) of this Act, add the amount equal to the excess of the amount excluded from federal gross income under section 911 and subpart D of part III of subchapter N of the Internal Revenue Code of 1954 over the deductions which would have been properly allowable to or chargeable against such amount but for the exclusion of that amount from federal gross income.

Sec. 8. This Act is efective January 1, 1981 for computation years beginning on or after that date and for base period years beginning on or after January 1, 1977.

EXPLANATION

This bill authorizes Iowa individual taxpayers to average their taxable income for a tax year over a five-year period if the taxpayer was a resident throughout that five-year period. This will result in most cases in less taxes due the state. The provisions in the bill for income tax averaging are based upon the federal income tax averaging provisions with the only changes made being those needed to make the provisions applicable to Iowa. The bill provides that a taxpayer can income average for a tax year beginning on or after January 1, 1981.