

FEB 20 1997

WAYS & MEANS CALENDAR

*Substituted by  
SF 129 3-11-97  
(P. 568)*

HOUSE FILE

**305**

BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO HSB 26)

(COMPANION TO SF 129)

**WITHDRAWN  
3-11-97 (P. 570)**

Passed House, Date \_\_\_\_\_ Passed Senate, Date \_\_\_\_\_

Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_ Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_

Approved \_\_\_\_\_

**A BILL FOR**

1 An Act updating the Iowa Code references to the Internal Revenue  
2 Code and providing a retroactive applicability date and an  
3 effective date.

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

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**WITHDRAWN**

**HF 305**

1 Section 1. Section 15.335, unnumbered paragraph 1, Code  
2 1997, is amended to read as follows:

3 An eligible business may claim a corporate tax credit for  
4 increasing research activities in this state during the period  
5 the eligible business is participating in the program. The  
6 credit equals six and one-half percent of the state's  
7 apportioned share of the qualifying expenditures for  
8 increasing research activities. The state's apportioned share  
9 of the qualifying expenditures for increasing research  
10 activities is a percent equal to the ratio of qualified  
11 research expenditures in this state to total qualified  
12 research expenditures. The credit allowed in this section is  
13 in addition to the credit authorized in section 422.33,  
14 subsection 5. If the eligible business is a partnership,  
15 subchapter S corporation, limited liability company, or estate  
16 or trust electing to have the income taxed directly to the  
17 individual, an individual may claim the tax credit allowed.  
18 The amount claimed by the individual shall be based upon the  
19 pro rata share of the individual's earnings of the  
20 partnership, subchapter S corporation, limited liability  
21 company, or estate or trust. For purposes of this section,  
22 "qualifying expenditures for increasing research activities"  
23 means the qualifying expenditures as defined for the federal  
24 credit for increasing research activities which would be  
25 allowable under section 41 of the Internal Revenue Code in  
26 effect on January 1, ~~1994~~ 1997.

27 Sec. 2. Section 15A.9, subsection 8, unnumbered paragraph  
28 2, Code 1997, is amended to read as follows:

29 For the purposes of this section, "qualifying expenditures  
30 for increasing research activities" means the qualifying  
31 expenditures as defined for the federal credit for increasing  
32 research activities which would be allowable under section 41  
33 of the Internal Revenue Code in effect on January 1, ~~1996~~  
34 1997. The credit authorized in this subsection is in lieu of  
35 the credit authorized in section 422.33, subsection 5.

1     Sec. 3. Section 422.3, subsection 4, Code 1997, is amended  
2 to read as follows:

3     4. "Internal Revenue Code" means the Internal Revenue Code  
4 of 1954, prior to the date of its redesignation as the  
5 Internal Revenue Code of 1986 by the Tax Reform Act of 1986,  
6 or means the Internal Revenue Code of 1986 as amended to and  
7 including ~~March-207-1996~~ January 1, 1997, whichever is  
8 applicable.

9     Sec. 4. Section 422.7, subsection 8, Code 1997, is amended  
10 to read as follows:

11     8. Subtract the amount of the ~~jobs~~ work opportunity tax  
12 credit allowable for the tax year under section 51 of the  
13 Internal Revenue Code to the extent that the credit increased  
14 federal adjusted gross income.

15     Sec. 5. Section 422.10, unnumbered paragraph 1, Code 1997,  
16 is amended to read as follows:

17     The taxes imposed under this division shall be reduced by a  
18 state tax credit for increasing research activities in this  
19 state. For individuals, the credit equals six and one-half  
20 percent of the state's apportioned share of the qualifying  
21 expenditures for increasing research activities. The state's  
22 apportioned share of the qualifying expenditures for  
23 increasing research activities is a percent equal to the ratio  
24 of qualified research expenditures in this state to total  
25 qualified research expenditures. For purposes of this  
26 section, an individual may claim a research credit for  
27 qualifying research expenditures incurred by a partnership,  
28 subchapter S corporation, estate, or trust electing to have  
29 the income taxed directly to the individual. The amount  
30 claimed by the individual shall be based upon the pro rata  
31 share of the individual's earnings of a partnership,  
32 subchapter S corporation, estate, or trust. For purposes of  
33 this section, "qualifying expenditures for increasing research  
34 activities" means the qualifying expenditures as defined for  
35 the federal credit for increasing research activities which

1 would be allowable under section 41 of the Internal Revenue  
2 Code in effect on January 1, ~~1995~~ 1997.

3 Sec. 6. Section 422.33, subsection 5, unnumbered paragraph  
4 1, Code 1997, is amended to read as follows:

5 The taxes imposed under this division shall be reduced by a  
6 state tax credit for increasing research activities in this  
7 state equal to six and one-half percent of the state's  
8 apportioned share of the qualifying expenditures for  
9 increasing research activities. The state's apportioned share  
10 of the qualifying expenditures for increasing research  
11 activities is a percent equal to the ratio of qualified  
12 research expenditures in this state to the total qualified  
13 research expenditures. For purposes of this subsection,  
14 "qualifying expenditures for increasing research activities"  
15 means the qualifying expenditures as defined for the federal  
16 credit for increasing research activities which would be  
17 allowable under section 41 of the Internal Revenue Code in  
18 effect on January 1, ~~1995~~ 1997.

19 Sec. 7. Section 422.35, subsection 5, Code 1997, is  
20 amended to read as follows:

21 5. Subtract the amount of the jobs work opportunity tax  
22 credit allowable for the tax year under section 51 of the  
23 Internal Revenue Code to the extent that the credit increased  
24 federal taxable income.

25 Sec. 8. This Act applies retroactively to January 1, 1996,  
26 for tax years beginning on or after that date.

27 Sec. 9. This Act, being deemed of immediate importance,  
28 takes effect upon enactment.

29 EXPLANATION

30 This bill updates the references to the Internal Revenue  
31 Code to make the federal income tax revisions enacted by  
32 Congress in 1996 applicable for Iowa income tax purposes. The  
33 bill reflects the change in nomenclature of the federal jobs  
34 tax credit to work opportunity tax credit. The bill updates  
35 the Iowa Code references to the state research activities

1 credit for individuals, corporations, and corporations in  
2 quality jobs enterprise zones to include the 1996 changes to  
3 the federal research activities credits. The research  
4 activities credit offered under the new jobs and income Act is  
5 also updated.

6 The bill takes effect immediately upon enactment and  
7 applies retroactively to tax years beginning on or after  
8 January 1, 1996.

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**HOUSE FILE 305  
FISCAL NOTE**

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A fiscal note for **House File 305** is hereby submitted pursuant to Joint Rule 17. Data used in developing this fiscal note is available from the Legislative Fiscal Bureau to members of the Legislature upon request.

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House File 305 updates the references to the Internal Revenue Code to make the federal income tax revisions enacted by Congress in 1996 applicable for Iowa income tax purposes. The Bill is retroactive to January 1, 1997.

There were eight provisions enacted by the federal government that have been identified as likely to affect State revenues. The following is a list of the provisions, including the FY 1997 and FY 1998 fiscal impact, expressed as (FY 1997 impact, FY 1998 impact).

1. Spousal IRAs - Non-working spouses under prior law could contribute \$250 to an IRA. This provision increases the contribution limit to \$2,000. (\$-0.1 million, \$-0.4 million)
2. Taxable Punitive Damages - Under prior law, many damage recoveries were non-taxable. (\$0.1 million, \$0.1 million)
3. Subchapter S Corporation Limits - Raised maximum number of shareholders from 35 to 75. (Insignificant impact, though it may have fiscal implications on the maximum State exposure resulting from pending Subchapter S corporation legislation at the State level).
4. Employer Education Exclusion - Expired provision, allows \$5,250 exclusion for assistance provided through employer education plan. (\$-2.3 million, \$-0.3 million)
5. Medical Savings Accounts - Pilot project for limited number of small businesses and self-employed persons. (\$-0.3 million, \$-0.6 million)
6. Long-Term Care Insurance - Long-term health insurance becomes eligible medical expense, which has implications for Iowa's 100% health insurance deduction. (Insignificant impact)
7. Nursing Home Deduction - Custodial nursing home expenses allowed as deduction, subject to limitations. (Insignificant impact)
8. Small Business Expense Deduction - Increased expense deduction from \$17,500 to \$25,000 over seven years. (\$-0.2 million, \$-0.5 million)

**FISCAL IMPACT**

House File 305 is expected to result in a decrease in revenues to the General Fund of approximately \$2.8 million in FY 1997, and approximately \$1.7 million in FY 1998.

**SOURCES**

Federation of Tax Administrators

(LSB 1113hv, JAM)

FILED MARCH 4, 1997

BY DENNIS PROUTY, FISCAL DIRECTOR

Jenkins, Chair  
Drake  
Weigel

HSB 26

WAYS AND MEANS

Succeeded By

SE/HF 305

SENATE/HOUSE FILE

BY (PROPOSED DEPARTMENT OF  
REVENUE AND FINANCE BILL)

Passed Senate, Date \_\_\_\_\_ Passed House, Date \_\_\_\_\_

Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_ Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_

Approved \_\_\_\_\_

A BILL FOR

1 An Act updating the Iowa Code references to the Internal Revenue  
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1 Section 1. Section 15A.9, subsection 8, unnumbered  
2 paragraph 2, Code 1997, is amended to read as follows:

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6 research activities which would be allowable under section 41  
7 of the Internal Revenue Code in effect on January 1, ~~1996~~  
8 1997. The credit authorized in this subsection is in lieu of  
9 the credit authorized in section 422.33, subsection 5.

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11 to read as follows:

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13 of 1954, prior to the date of its redesignation as the  
14 Internal Revenue Code of 1986 by the Tax Reform Act of 1986,  
15 or means the Internal Revenue Code of 1986 as amended to and  
16 including ~~March-20-1996~~ January 1, 1997, whichever is  
17 applicable.

18 Sec. 3. Section 422.7, subsection 8, Code 1997, is amended  
19 to read as follows:

20 8. Subtract the amount of the jobs work opportunity tax  
21 credit allowable for the tax year under section 51 of the  
22 Internal Revenue Code to the extent that the credit increased  
23 federal adjusted gross income.

24 Sec. 4. Section 422.10, unnumbered paragraph 1, Code 1997,  
25 is amended to read as follows:

26 The taxes imposed under this division shall be reduced by a  
27 state tax credit for increasing research activities in this  
28 state. For individuals, the credit equals six and one-half  
29 percent of the state's apportioned share of the qualifying  
30 expenditures for increasing research activities. The state's  
31 apportioned share of the qualifying expenditures for  
32 increasing research activities is a percent equal to the ratio  
33 of qualified research expenditures in this state to total  
34 qualified research expenditures. For purposes of this  
35 section, an individual may claim a research credit for

1 qualifying research expenditures incurred by a partnership,  
2 subchapter S corporation, estate, or trust electing to have  
3 the income taxed directly to the individual. The amount  
4 claimed by the individual shall be based upon the pro rata  
5 share of the individual's earnings of a partnership,  
6 subchapter S corporation, estate, or trust. For purposes of  
7 this section, "qualifying expenditures for increasing research  
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10 would be allowable under section 41 of the Internal Revenue  
11 Code in effect on January 1, ~~1995~~ 1997.

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13 1, Code 1997, is amended to read as follows:

14 The taxes imposed under this division shall be reduced by a  
15 state tax credit for increasing research activities in this  
16 state equal to six and one-half percent of the state's  
17 apportioned share of the qualifying expenditures for  
18 increasing research activities. The state's apportioned share  
19 of the qualifying expenditures for increasing research  
20 activities is a percent equal to the ratio of qualified  
21 research expenditures in this state to the total qualified  
22 research expenditures. For purposes of this subsection,  
23 "qualifying expenditures for increasing research activities"  
24 means the qualifying expenditures as defined for the federal  
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26 allowable under section 41 of the Internal Revenue Code in  
27 effect on January 1, ~~1995~~ 1997.

28 Sec. 6. Section 422.35, subsection 5, Code 1997, is  
29 amended to read as follows:

30 5. Subtract the amount of the jobs work opportunity tax  
31 credit allowable for the tax year under section 51 of the  
32 Internal Revenue Code to the extent that the credit increased  
33 federal taxable income.

34 Sec. 7. This Act applies retroactively to January 1, 1996,  
35 for tax years beginning on or after that date.

1 Sec. 8. This Act, being deemed of immediate importance,  
2 takes effect upon enactment.

3 EXPLANATION

4 This bill updates the references to the Internal Revenue  
5 Code to make the federal income tax revisions enacted by  
6 Congress in 1996 applicable for Iowa income tax purposes. The  
7 bill reflects the change in nomenclature of the federal jobs  
8 tax credit to work opportunity tax credit. The bill updates  
9 the Iowa Code references to the state research activities  
10 credit for individuals, corporations, and corporations in  
11 quality jobs enterprise zones to include the 1996 changes to  
12 the federal research activities credits.

13 The bill takes effect immediately upon enactment and  
14 applies retroactively to tax years beginning on or after  
15 January 1, 1996.

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## MEMORANDUM

TO: Members of the 1997 General Assembly

FROM: The Iowa Department of Revenue and Finance

DATE: December 4, 1996

RE: The Bill Relating to Updating the Iowa Code to Include the Federal Income Tax Changes Made in 1996 and Providing Effective and Retroactive Applicability Dates for the Provision.

This is the annual bill proposed by the Department to include into Iowa income tax law, the federal income tax changes enacted by Congress in 1996 after March 20, 1996. The bill updates the three statutes for the Iowa research activities credits to include revisions in the federal research activities credit which is a basis for the Iowa credits. The Iowa statute which defines the Internal Revenue Code for Iowa income tax is also updated so the all the 1996 federal changes which affect the computation of Iowa net income are adopted. The two Iowa statutes for the federal jobs tax credit are revised to reflect the fact that the jobs tax credit has been replaced by the work opportunity tax credit. The changes in the bill are made retroactive to January 1, 1996, for tax years beginning on or after that date. The Act is made effective upon enactment.

Three income tax bills were enacted by Congress in August of 1996 and were signed by the president. These bills are the Small Business Job Protection Act of 1996, the Health Insurance Portability and Accountability Act of 1996 and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. Most of the provisions in the three acts are applicable for tax years beginning after 1996. However, there are a few provisions that apply for 1996 and a few more provisions that are applicable retroactively prior to 1996. In the following paragraphs we summarize those major provisions from the three federal acts which will impact Iowa income tax. Some of these provisions will effect income tax revenues. We will note the effective dates of only those provisions which are applicable other than for tax periods beginning on or after January 1, 1997.

The Small Business Job Protection Act includes a number of provisions that extend expiring tax benefits, simplify provisions for setting up pension plans and assist small businesses. For small businesses the amount of annual capital investment which may be expensed under section 179 of the Internal Revenue Code is increased in seven steps from the current \$17,500 per year in 1996 to \$25,000 in 2003 and years after 2003. The Act includes a number of provisions which relate to qualifications for business entities to become S corporations and increases the maximum number of eligible shareholders in an S corporation from 35 to 75. One S corporation revision

allows banks to become S corporations under some conditions. This change may effect the Iowa Franchise tax, since S corporations' earnings are taxed to the shareholders and not the business entity or the bank. This issue is addressed in the Department's annual administration bill.

This Act includes a number of provisions which simplify setting up pension plans for some small businesses. Deductible contributions of up to \$2000 may be made to individual retirement accounts for each spouse, if the combined compensation of both spouses is equal to the contributed amount. Under 1996 law the maximum amount that could be contributed to an IRA for a non-working spouse was \$250. Damage recoveries for non-physical injuries or illness are taxable if received in tax years ending after August 20, 1996. Under prior law many damage recoveries were non-taxable. The \$7,500 limit on contributions to deferred compensation plans of state and local governments and tax exempt organizations is increased in \$500 increments on the basis of inflation.

The Act provides tax credits to taxpayers that adopt children. Note that current Iowa law provides an additional itemized deduction for adoption expenses to the extent the expenses exceed 3% of the taxpayer's federal adjusted gross income. Since Iowa does not have an adoption tax credit, this provision has no impact on the Iowa tax structure.

The new work opportunity tax credit mentioned previously is a scaled-down version of the targeted jobs credit. The new credit is effective for first-year wages paid to employees who begin work after September 30, 1996 and before October 1, 1997. The exclusion for up to \$5,250 per year of assistance provided through an employer's education plan, which expired after 1994, is retroactively reinstated for tax years beginning after 1994. This exclusion is set to expire for assistance for courses beginning after May 31, 1997. The federal research activities credit for 20% of increased research expenses which expired June 30, 1995 is revived, but only for expenses paid or incurred during the period from July 1, 1996 through May 31, 1997. Note that although the Iowa research activities credit is based on the criteria for the federal credit, the Iowa credit also applies in situations where the federal credit was not effective.

The Health Insurance Portability and Accountability Act of 1996 includes a number of provisions that will give taxpayers tax benefits for health-related expenses. Under the Act, self-employed taxpayers are allowed increased percentage deductions for health insurance premiums for themselves, their spouses and their dependents. The percentage of health insurance premiums allowed as a deduction increase from the current 30% in 1996 to 40% in 1997 with a final increase to 80% in 2006 and later tax years. Under the act, insurance premiums for long-term care such as nursing home care are treated as medical expenses for tax years after 1996. Thus, for 1997 federal returns, long-term health insurance premiums will be allowed as itemized deduction for medical expenses, subject to the federal limitations. These insurance premiums will be allowed for purposes of the Iowa health insurance deduction on 1997 Iowa returns. The Act also allows a deduction for custodial nursing home expenses, subject to federal limitations on 1997 Iowa and federal returns. Long-term care insurance benefits are tax-free subject to a \$175 per day cap.

Medical Saving Accounts are authorized starting in 1997 under a four-year test plan. These accounts are available only to employees covered under an employer sponsored high-deductible plan of a "small" employer. To qualify as a "high deductible plan" a health insurance policy must have a deductible of from \$1,500 to \$2,250 for single coverage and a deductible of between \$3,000 to \$4,500 for family coverage. A "small" employer is one that employed on average no more than 50 employees in either of the two preceding years. A qualified employee may deduct from income subject to tax for the year an amount equal to the aggregate amount, generally not to exceed compensation paid in cash during the tax year by the individual to a Medical Savings Account (MSA). In general, the amount of annual contribution to an account that may be deducted on the income tax return is limited to 65% of the deductible amount for individuals and 75% of the deductible amount for family coverage. Accumulated earnings in MSA accounts are not taxed. Withdrawals from the accounts which are used to pay medical expenses are not taxable. However, withdrawals from the accounts not used for medical expenses are taxable and are subject to an additional 15% tax on the federal return. If the IRC Update bill is passed, contributions to Medical Savings Accounts will be deducted on the Iowa return to the extent the contributions were deductible on the federal return. Withdrawals from the MSA accounts will be taxable on the Iowa return to the same extent as the withdrawals were taxable on the federal return. However, unwarranted withdrawals from the accounts will not be subject to an additional 15% tax on the Iowa return unless such tax is authorized by the Iowa General Assembly.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 includes a number of provisions designed to promote child support recovery by the various states. This Act also has a number of provisions related to computation of the federal earned income credit which is the basis for the Iowa earned income credit of 6.5% of the federal credit. The earned income credit provisions are applicable for 1996 federal returns.

## HOUSE FILE 306

## AN ACT

RELATING TO THE INDIVIDUAL INCOME TAX BY EXTENDING THE SPECIAL METHOD OF COMPUTATION OF TAX FOR VALUE-ADDED S CORPORATION SHAREHOLDERS TO ALL S CORPORATION SHAREHOLDERS AND ELIMINATING THE REFUND LIMITATION AND INCLUDING EFFECTIVE AND RETROACTIVE APPLICABILITY DATE PROVISIONS.

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

Section 1. Section 422.4, subsection 18, Code 1997, is amended by striking the subsection.

Sec. 2. Section 422.5, subsection 1, paragraph j, subparagraph (2), subparagraph subdivisions (a) and (c), Code 1997, are amended by striking the subparagraph subdivisions.

Sec. 3. Section 422.5, subsection 1, paragraph j, subparagraph (2), Code 1997, is amended to read as follows:

(2) The tax imposed upon the taxable income of a resident shareholder in a value-added S corporation which has in effect for the tax year an election under subchapter S of the Internal Revenue Code and carries on business within and without the state may be computed by reducing the amount determined pursuant to paragraphs "a" through "i" by the amounts of nonrefundable credits under this division and by multiplying this resulting amount by a fraction of which the resident's net income allocated to Iowa, as determined in section 422.8, subsection 2, paragraph "b", is the numerator and the resident's total net income computed under section 422.7 is the denominator. If a resident shareholder has elected to take advantage of this subparagraph, and for the next tax year elects not to take advantage of this subparagraph, the resident shareholder shall not reelect to take advantage of this subparagraph for the three tax years

immediately following the first tax year for which the shareholder elected not to take advantage of this subparagraph, unless the director consents to the reelection. This paragraph subparagraph also applies to individuals who are residents of Iowa for less than the entire tax year.

~~{a}--In order for a resident shareholder in a value-added corporation which has in effect for the tax year an election under subchapter S of the Internal Revenue Code and carries on business within and without the state, to claim the benefits of apportionment of income of the value-added S corporation, the taxpayer must completely fill out the return, determine the taxpayer's income tax liability without the benefit of apportionment of the value-added corporation's income, and pay the amount of tax owed. The taxpayer shall recompute the taxpayer's income tax liability, by applying the provisions of this subparagraph on a special return. This special return shall be filed under rules of the director and constitutes a claim for refund of the difference between the amount of tax the taxpayer paid as determined without the provisions of this subparagraph and the amount of tax determined with the provisions of this subparagraph.~~

{b} This subparagraph shall not affect the amount of the taxpayer's checkoff to the Iowa election campaign fund under section 56.18, the checkoff for the fish and game fund in section 456A.16, the credits from tax provided in sections 422.10, 422.11A, and 422.12 and the allocation of these credits between spouses if the taxpayers filed separate returns or separately on combined returns.

~~{c}--For any tax year, the aggregate amount of refund claims that shall be paid pursuant to this subparagraph shall not exceed five million dollars. If, for a tax year, the aggregate amount of refund claims filed pursuant to this subparagraph exceeds five million dollars, each claim for refund shall be paid on a pro-rata basis so that the aggregate amount of refund claims does not exceed five million dollars. In the case where refund claims are not paid in full, the amount of the refund to which the taxpayer is entitled under~~

~~this subparagraph is the pro-rata amount that was paid and the taxpayer is not entitled to a refund of the unpaid portion and is not entitled to carry that amount forward or backward to another tax year. Taxpayers shall not use refunds as estimated payments for the succeeding tax year. Taxpayers whose tax years begin on January 1 must file their refund claims by October 31 of the calendar year following the end of their tax year to be eligible for refunds. Taxpayers whose tax years begin on a date other than January 1 must file their refund claims by the end of the tenth month following the end of their tax years to be eligible. The department shall determine on February 1 of the second succeeding calendar year if the total amount of claims for refund exceeds five million dollars for the tax year. Notwithstanding any other provision, interest shall not be due on any refund claims that are paid by the last day of February of the second succeeding calendar year. If the claim is not payable on February 1 of the second succeeding calendar year, because the taxpayer is a fiscal year filer, then the amount of the claim allowed shall be in the same ratio as the refund claims available on February 1 of the second succeeding calendar year. These claims shall be funded by moneys appropriated for payment of individual income tax refunds.~~

Sec. 4. Section 422.5, subsection 1, paragraph k, unnumbered paragraph 4, Code 1997, is amended to read as follows:

In the case of a resident, including a resident estate or trust, the state's apportioned share of the state alternative minimum tax is one hundred percent of the state alternative minimum tax computed in this subsection. In the case of a resident or part-year resident shareholder in a value-added an S corporation which has in effect for the tax year an election under subchapter S of the Internal Revenue Code and carries on business within and without the state, a nonresident, including a nonresident estate or trust, or an individual, estate, or trust that is domiciled in the state for less than the entire tax year, the state's apportioned share of the

state alternative minimum tax is the amount of tax computed under this subsection, reduced by the applicable credits in sections 422.10 through 422.12 and this result multiplied by a fraction with a numerator of the sum of state net income allocated to Iowa as determined in section 422.8, subsection 2, paragraph "a" or "b" as applicable, plus tax preference items, adjustments, and losses under subparagraph (1) attributable to Iowa and with a denominator of the sum of total net income computed under section 422.7 plus all tax preference items, adjustments, and losses under subparagraph (1). In computing this fraction, those items excludable under subparagraph (1) shall not be used in computing the tax preference items. Married taxpayers electing to file separate returns or separately on a combined return must allocate the minimum tax computed in this subsection in the proportion that each spouse's respective preference items, adjustments, and losses under subparagraph (1) bear to the combined preference items, adjustments, and losses under subparagraph (1) of both spouses.

Sec. 5. Section 422.8, subsection 2, paragraph b, unnumbered paragraph 1, Code 1997, is amended to read as follows:

A resident's income allocable to Iowa is the income determined under section 422.7 reduced by items of income and expenses from a subchapter an S corporation which is a value-added corporation that carries on business within and without the state when those items of income and expenses pass directly to the shareholders under provisions of the Internal Revenue Code. These items of income and expenses are increased by the greater of the following:

Sec. 6. Section 422.8, subsection 6, Code 1997, is amended to read as follows:

6. If the resident or part-year resident is a shareholder of a value-added an S corporation which has in effect an election under subchapter S of the Internal Revenue Code, subsections 1 and 3 do not apply to any income taxes paid to another state or foreign country on the income from the value-

added corporation which has in effect an election under subchapter S of the Internal Revenue Code.

Sec. 7. Section 2 of this Act applies retroactively to January 1, 1997, for tax years beginning on or after that date.

Sec. 8. This Act, except for section 2 of this Act, is effective January 1, 1998, and applies to tax years beginning on or after that date.

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RON J. CORBETT  
Speaker of the House

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MARY E. KRAMER  
President of the Senate

I hereby certify that this bill originated in the House and is known as House File 306, Seventy-seventh General Assembly.

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ELIZABETH ISAACSON  
Chief Clerk of the House

Approved May 2, 1997

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TERRY E. BRANSTAD  
Governor

**HF 306**