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SENATE FILE 105
BY RIFE

Passed Senate, Date _____ Passed House, Date _____
Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____
Approved _____

A BILL FOR

1 An Act relating to the state individual income tax by imposing a
2 flat rate tax and including a retroactive effective and
3 applicability date provision.

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

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S.F. 105

FLAT TAX RATE

Section 1. Section 422.4, subsections 1 and 2, Code 1997, are amended by striking the subsections.

Sec. 2. Section 422.4, subsection 16, Code 1997, is amended to read as follows:

16. The words "taxable income" mean the net income as defined in section 422.7 minus the deductions allowed by section 422.9, in the case of individuals; ~~in.~~ In the case of estates or trusts, the words "taxable income" mean means the taxable income, ~~(without a deduction for personal exemption),~~ as computed for federal income tax purposes under the Internal Revenue Code, but with the adjustments specified in section 422.7 ~~plus the Iowa income tax deducted in computing the federal taxable income and minus federal income taxes as provided in section 422.9.~~

Sec. 3. Section 422.5, subsection 1, Code 1997, is amended by striking the subsection and inserting in lieu thereof the following:

1. a. A tax is imposed upon every resident and nonresident of the state or estate and trust which tax is levied, collected, and paid annually upon and with respect to the taxable income at the rate of three and eight-tenths percent.

b. (1) The tax imposed upon the taxable income of a nonresident shall be computed by reducing the amount determined pursuant to paragraph "a" by the amounts of nonrefundable credits under this division and by multiplying this resulting amount by a fraction of which the nonresident's net income allocated to Iowa, as determined in section 422.8, subsection 2, paragraph "a", is the numerator and the nonresident's total net income computed under section 422.7 is the denominator. This provision also applies to individuals who are residents of Iowa for less than the entire tax year.

(2) The tax imposed upon the taxable income of a resident shareholder in a value-added corporation which has in effect

1 for the tax year an election under subchapter S of the
2 Internal Revenue Code and carries on business within and
3 without the state may be computed by reducing the amount
4 determined pursuant to paragraph "a" by the amounts of
5 nonrefundable credits under this division and by multiplying
6 this resulting amount by a fraction of which the resident's
7 net income allocated to Iowa, as determined in section 422.8,
8 subsection 2, paragraph "b", is the numerator and the
9 resident's total net income computed under section 422.7 is
10 the denominator. If a resident shareholder has elected to
11 take advantage of this subparagraph, and for the next tax year
12 elects not to take advantage of this subparagraph, the
13 resident shareholder shall not reelect to take advantage of
14 this subparagraph for the three tax years immediately
15 following the first tax year for which the shareholder elected
16 not to take advantage of this subparagraph, unless the
17 director consents to the reelection. This subparagraph also
18 applies to individuals who are residents of Iowa for less than
19 the entire tax year.

20 (a) In order for a resident shareholder in a value-added
21 corporation which has in effect for the tax year an election
22 under subchapter S of the Internal Revenue Code and carries on
23 business within and without the state, to claim the benefits
24 of apportionment of income of the value-added corporation, the
25 taxpayer must completely fill out the return, determine the
26 taxpayer's income tax liability without the benefit of
27 apportionment of the value-added corporation's income, and pay
28 the amount of tax owed. The taxpayer shall recompute the
29 taxpayer's income tax liability, by applying the provisions of
30 this subparagraph on a special return. This special return
31 shall be filed under rules of the director and constitutes a
32 claim for refund of the difference between the amount of tax
33 the taxpayer paid as determined without the provisions of this
34 subparagraph and the amount of tax determined with the
35 provisions of this subparagraph.

1 (b) This subparagraph shall not affect the amount of the
2 taxpayer's checkoff to the Iowa election campaign fund under
3 section 56.18, the checkoff for the fish and game fund in
4 section 456A.16, the credits from tax provided in sections
5 422.10, 422.11A, and 422.12 and the allocation of these
6 credits between spouses if the taxpayers filed separate
7 returns or separately on combined returns.

8 (c) For any tax year, the aggregate amount of refund
9 claims that shall be paid pursuant to this subparagraph shall
10 not exceed five million dollars. If, for a tax year, the
11 aggregate amount of refund claims filed pursuant to this
12 subparagraph exceeds five million dollars, each claim for
13 refund shall be paid on a pro rata basis so that the aggregate
14 amount of refund claims does not exceed five million dollars.
15 In the case where refund claims are not paid in full, the
16 amount of the refund to which the taxpayer is entitled under
17 this subparagraph is the pro rata amount that was paid and the
18 taxpayer is not entitled to a refund of the unpaid portion and
19 is not entitled to carry that amount forward or backward to
20 another tax year. Taxpayers shall not use refunds as
21 estimated payments for the succeeding tax year. Taxpayers
22 whose tax years begin on January 1 must file their refund
23 claims by October 31 of the calendar year following the end of
24 their tax year to be eligible for refunds. Taxpayers whose
25 tax years begin on a date other than January 1 must file their
26 refund claims by the end of the tenth month following the end
27 of their tax years to be eligible. The department shall
28 determine on February 1 of the second succeeding calendar year
29 if the total amount of claims for refund exceeds five million
30 dollars for the tax year. Notwithstanding any other
31 provision, interest shall not be due on any refund claims that
32 are paid by the last day of February of the second succeeding
33 calendar year. If the claim is not payable on February 1 of
34 the second succeeding calendar year, because the taxpayer is a
35 fiscal year filer, then the amount of the claim allowed shall

1 be in the same ratio as the refund claims available on
2 February 1 of the second succeeding calendar year. These
3 claims shall be funded by moneys appropriated for payment of
4 individual income tax refunds.

5 Sec. 4. Section 422.5, subsection 6, Code 1997, is amended
6 by striking the subsection.

7 Sec. 5. Section 422.7, Code 1997, is amended by striking
8 the section and inserting in lieu thereof the following:

9 422.7 "NET INCOME" -- HOW COMPUTED.

10 1. For individuals, "net income" means the adjusted gross
11 income as properly computed for federal income tax purposes
12 under the Internal Revenue Code with the adjustments made in
13 paragraphs "a" and "b".

14 a. The adjusted gross income is adjusted by adding the sum
15 of the following:

16 (1) The amounts paid or accrued to the taxpayer as
17 interest or dividends during the tax year to the extent
18 excluded.

19 (2) The amount of tax imposed under this division to the
20 extent deducted for the tax year.

21 b. The adjusted gross income is adjusted by subtracting
22 the sum of the following:

23 (1) The amounts included pursuant to sections 402(a),
24 402(c), 403(a), 403(b), 406(a), 407(a), and 408 of the
25 Internal Revenue Code, or included as distributions under any
26 retirement or disability plan for employees of a governmental
27 agency or unit, or retirement payments to retired partners
28 which payments are excluded in computing net earnings from
29 self employment by section 1402 of the Internal Revenue Code
30 and regulations adopted pursuant thereto.

31 (2) The amount of tax imposed under this division which
32 was refunded to the extent included for the tax year.

33 (3) The amount included pursuant to section 111 of the
34 Internal Revenue Code as a recovery of items previously
35 deducted from adjusted gross income in computing taxable

1 income.

2 (4) The amount of social security benefits and railroad
3 retirement benefits, included pursuant to sections 72(r) and
4 86 of the Internal Revenue Code.

5 (5) The sum of the amounts disallowed as deductions by
6 sections 171(a)(2) and 265(a)(2) of the Internal Revenue Code
7 and the amounts of expenses allocable to interest and
8 disallowed as deductions by section 265(a)(1) of the Internal
9 Revenue Code.

10 2. For estates and trusts, "net income" means the taxable
11 income as properly computed for federal income tax purposes
12 under the Internal Revenue Code with the adjustments made in
13 paragraphs "a" and "b".

14 a. The taxable income is adjusted by adding the sum of the
15 following:

16 (1) The amounts paid or accrued to the taxpayer as
17 interest or dividends during the tax year to the extent
18 excluded.

19 (2) Six hundred dollars for an estate, three hundred
20 dollars for a trust which under its governing instrument is
21 required to distribute all of its income currently, or one
22 hundred dollars for all other trusts. However, the amount
23 added is only to the extent deducted.

24 (3) The amount of tax imposed under this division to the
25 extent deducted for the tax year.

26 b. The taxable income is adjusted by subtracting the sum
27 of the following:

28 (1) The amounts included pursuant to sections 402(a),
29 402(c), 403(a), 403(b), 406(a), 407(a), and 408 of the
30 Internal Revenue Code, or included as distributions under any
31 retirement or disability plan for employees of a governmental
32 agency or unit, or retirement payments to retired partners
33 which payments are excluded in computing net earnings from
34 self employment by section 1402 of the Internal Revenue Code
35 and regulations adopted pursuant thereto.

1 (2) The amount of tax imposed under this division which
2 was refunded to the taxpayer to the extent included for the
3 tax year.

4 (3) The amounts included in taxable income as adjusted by
5 paragraph "a" which are exempt from taxation by this state
6 either by reason of its constitution or by reason of the
7 constitution, treaties, or statutes of the United States.

8 (4) The amounts disallowed as deductions by sections
9 171(a)(2) and 265(a)(2) of the Internal Revenue Code and the
10 amounts of expenses allocable to interest and disallowed as
11 deductions by section 265(a)(1) of the Internal Revenue Code.

12 Sec. 6. Section 422.8, subsection 2, paragraph a, Code
13 1997, is amended to read as follows:

14 a. Nonresident's net income allocated to Iowa is the net
15 income, or portion of net income, which is derived from a
16 business, trade, profession, or occupation carried on within
17 this state or income from any property, trust, estate, or
18 other source within Iowa. However, income derived from a
19 business, trade, profession, or occupation carried on within
20 this state and income from any property, trust, estate, or
21 other source within Iowa shall not include distributions from
22 pensions, including defined benefit or defined contribution
23 plans, annuities, individual retirement accounts, and deferred
24 compensation plans or any earnings attributable thereto so
25 long as the distribution is directly related to an
26 individual's documented retirement and received while the
27 individual is a nonresident of this state. If a business,
28 trade, profession, or occupation is carried on partly within
29 and partly without the state, only the portion of the net
30 income which is fairly and equitably attributable to that part
31 of the business, trade, profession, or occupation carried on
32 within the state is allocated to Iowa for purposes of section
33 422.5, subsection 1, paragraph "j" "b", and section 422.13 and
34 income from any property, trust, estate, or other source
35 partly within and partly without the state is allocated to

1 Iowa in the same manner, except that annuities, interest on
2 bank deposits and interest-bearing obligations, and dividends
3 are allocated to Iowa only to the extent to which they are
4 derived from a business, trade, profession, or occupation
5 carried on within the state.

6 Sec. 7. Section 422.8, subsection 4, Code 1997, is amended
7 by striking the subsection.

8 Sec. 8. Section 422.9, subsections 1 and 2, Code 1997, are
9 amended by striking the subsections and inserting in lieu
10 thereof the following:

11 1. In computing taxable income of an individual, there is
12 deducted from net income the standard deduction as determined
13 under subsection 2.

14 2. The standard deduction is equal to the product of one
15 thousand dollars times the number of exemptions allowable to
16 the taxpayer for the tax year under section 151 of the
17 Internal Revenue Code.

18 Sec. 9. Section 422.9, subsections 4 and 5, Code 1997, are
19 amended by striking the subsections.

20 Sec. 10. Section 422.21, unnumbered paragraph 5, Code
21 1997, is amended by striking the unnumbered paragraph.

22 Sec. 11. Section 422.11B, Code 1997, is repealed.

23 COORDINATING AMENDMENTS

24 Sec. 12. Section 257.21, unnumbered paragraph 2, Code
25 1997, is amended to read as follows:

26 The instructional support income surtax shall be imposed on
27 the state individual income tax for the calendar year during
28 which the school's budget year begins, or for a taxpayer's
29 fiscal year ending during the second half of that calendar
30 year and after the date the board adopts a resolution to
31 participate in the program or the first half of the succeeding
32 calendar year, and shall be imposed on all individuals
33 residing in the school district on the last day of the
34 applicable tax year. As used in this section, "state
35 individual income tax" means the taxes computed under section

1 422.5, less the credits allowed in sections 422.11A, ~~422.11B,~~
2 422.11C, 422.12, and 422.12B.

3 Sec. 13. Section 422.6, unnumbered paragraph 1, Code 1997,
4 is amended to read as follows:

5 The tax imposed by section 422.5 less the credits allowed
6 under sections 422.10, 422.11A, ~~422.11B,~~ and 422.11C, and the
7 personal exemption credit allowed under section 422.12 apply
8 to and are a charge against estates and trusts with respect to
9 their taxable income, and the rates are the same as those
10 applicable to individuals. The fiduciary shall make the
11 return of income for the estate or trust for which the
12 fiduciary acts, whether the income is taxable to the estate or
13 trust or to the beneficiaries.

14 Sec. 14. Section 422.12C, subsection 1, unnumbered
15 paragraph 1, Code 1997, is amended to read as follows:

16 The taxes imposed under this division, less the credits
17 allowed under sections 422.11A, ~~422.11B,~~ 422.11C, 422.12, and
18 422.12B shall be reduced by a child and dependent care credit
19 equal to the following percentages of the federal child and
20 dependent care credit provided in section 21 of the Internal
21 Revenue Code:

22 Sec. 15. Section 422.13, subsection 1A, Code 1997, is
23 amended to read as follows:

24 1A. Notwithstanding any other provision in this section, a
25 resident of this state is not required to make and file a
26 return if the person's net income is equal to or less than the
27 appropriate dollar amount listed in section 422.5, subsection
28 2, upon which tax is not imposed. A nonresident of this state
29 is not required to make and file a return if the person's
30 total net income allocated to Iowa in section ~~422.5~~ 422.8,
31 subsection ~~17-paragraph-"j"~~ 2, is equal to or less than the
32 appropriate dollar amount provided in section 422.5,
33 subsection 2, upon which tax is not imposed. For purposes of
34 this subsection, the amount of a lump sum distribution subject
35 to separate federal tax shall be included in net income for

1 purposes of determining if a resident is required to file a
2 return and the portion of the lump sum distribution that is
3 allocable to Iowa is included in total net income for purposes
4 of determining if a nonresident is required to make and file a
5 return.

6 Sec. 16. Section 422D.2, Code 1997, is amended to read as
7 follows:

8 422D.2 LOCAL INCOME SURTAX.

9 A county may impose by ordinance a local income surtax as
10 provided in section 422D.1 at the rate set by the board of
11 supervisors, of up to one percent, on the state individual
12 income tax of each individual residing in the county at the
13 end of the individual's applicable tax year. However, the
14 cumulative total of the percents of income surtax imposed on
15 any taxpayer in the county shall not exceed twenty percent.
16 The reason for imposing the surtax and the amount needed shall
17 be set out in the ordinance. The surtax rate shall be set to
18 raise only the amount needed. For purposes of this section,
19 "state individual income tax" means the tax computed under
20 section 422.5, less the credits allowed in sections 422.11A,
21 ~~422.11B~~, 422.11C, 422.12, and 422.12B.

22 Sec. 17. EFFECTIVE AND RETROACTIVE APPLICABILITY DATE.

23 This Act applies retroactively to January 1, 1997, for tax
24 years beginning on or after that date.

25 EXPLANATION

26 The bill rewrites the state individual income tax by
27 setting a flat rate of three and eight-tenths percent of the
28 taxable income. In arriving at the taxable income, all of the
29 itemized deductions allowed for federal tax purposes are
30 eliminated. A standard deduction is provided which is equal
31 to \$1,000 for each personal exemption the taxpayer is allowed
32 under the federal tax code. The alternative minimum tax is
33 eliminated. The bill also retains the present credits that
34 are allowed except for the minimum tax credit.

35 The bill applies retroactively to January 1, 1997, for tax

1 years beginning on or after that date.

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