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HF 2529
3/30/98
(P. 1067)

3/19/98 Renowned from W. & Means Calendar & Moved to
Unfunded Business

FILED FEB 20 1998

SENATE FILE 2357

BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO SSB 2081)

Passed Senate, Date 3/23/98 (p. 826) Passed House, Date 3/30/98
Vote: Ayes 47 Nays 0 Vote: Ayes 96 Nays 0
Approved April 10, 1998

A BILL FOR

1 An Act updating the Iowa Code references to the Internal Revenue
2 Code, exempting certain preneed funeral trust income from
3 taxation, revising the carryback and carryover periods for
4 certain net operating losses, providing refunds, and providing
5 an effective date and retroactive applicability dates.

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

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S.F. 2357

1 Section 1. Section 15.335, unnumbered paragraph 1, Code
2 Supplement 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, 1997 1998.

27 Sec. 2. Section 15A.9, subsection 8, unnumbered paragraph
28 2, Code Supplement 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, 1997
34 1998. 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 Supplement 1997,
2 is amended 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 January 1, ~~1997~~ 1998, whichever is applicable.

8 Sec. 4. Section 422.6, unnumbered paragraph 1, Code
9 Supplement 1997, is amended to read as follows:

10 The tax imposed by section 422.5 less the credits allowed
11 under sections 422.10, 422.11A, and 422.11B, and the personal
12 exemption credit allowed under section 422.12 apply to and are
13 a charge against estates and trusts with respect to their
14 taxable income, and the rates are the same as those applicable
15 to individuals. The fiduciary shall make the return of income
16 for the estate or trust for which the fiduciary acts, whether
17 the income is taxable to the estate or trust or to the
18 beneficiaries. However, for tax years ending after August 5,
19 1997, if the trust is a qualified preneed funeral trust as set
20 forth in section 685 of the Internal Revenue Code and the
21 trustee has elected the special tax treatment under section
22 685 of the Internal Revenue Code, neither the trust nor the
23 beneficiary is subject to Iowa income tax on income accruing
24 to the trust.

25 Sec. 5. Section 422.9, subsection 3, paragraphs a, b, and
26 c, Code Supplement 1997, are amended to read as follows:

27 a. The Iowa net operating loss shall be carried back three
28 taxable years for an individual taxpayer with a casualty or
29 theft property loss or for a net operating loss in a
30 presidentially declared disaster area incurred by a taxpayer
31 engaged in a small business or in the trade or business of
32 farming. For all other Iowa net operating losses, the net
33 operating loss shall be carried back two taxable years or to
34 the taxable year in which the individual taxpayer first earned
35 income in Iowa whichever year is the later.

1 b. The Iowa net operating loss remaining after being
2 carried back as required in paragraph "a" of this subsection
3 or if not required to be carried back shall be carried forward
4 ~~fifteen~~ twenty taxable years.

5 c. If the election under section 172(b)(3) of the Internal
6 Revenue Code is made, the Iowa net operating loss shall be
7 carried forward ~~fifteen~~ twenty taxable years.

8 Sec. 6. Section 422.10, unnumbered paragraph 1, Code
9 Supplement 1997, is amended to read as follows:

10 The taxes imposed under this division shall be reduced by a
11 state tax credit for increasing research activities in this
12 state. For individuals, the credit equals six and one-half
13 percent of the state's apportioned share of the qualifying
14 expenditures for increasing research activities. The state's
15 apportioned share of the qualifying expenditures for
16 increasing research activities is a percent equal to the ratio
17 of qualified research expenditures in this state to total
18 qualified research expenditures. For purposes of this
19 section, an individual may claim a research credit for
20 qualifying research expenditures incurred by a partnership,
21 subchapter S corporation, estate, or trust electing to have
22 the income taxed directly to the individual. The amount
23 claimed by the individual shall be based upon the pro rata
24 share of the individual's earnings of a partnership,
25 subchapter S corporation, estate, or trust. For purposes of
26 this section, "qualifying expenditures for increasing research
27 activities" means the qualifying expenditures as defined for
28 the federal credit for increasing research activities which
29 would be allowable under section 41 of the Internal Revenue
30 Code in effect on January 1, ~~1997~~ 1998.

31 Sec. 7. Section 422.33, subsection 5, unnumbered paragraph
32 1, Code Supplement 1997, is amended to read as follows:

33 The taxes imposed under this division shall be reduced by a
34 state tax credit for increasing research activities in this
35 state equal to six and one-half percent of the state's

1 apportioned share of the qualifying expenditures for
2 increasing research activities. The state's apportioned share
3 of the qualifying expenditures for increasing research
4 activities is a percent equal to the ratio of qualified
5 research expenditures in this state to the total qualified
6 research expenditures. For purposes of this subsection,
7 "qualifying expenditures for increasing research activities"
8 means the qualifying expenditures as defined for the federal
9 credit for increasing research activities which would be
10 allowable under section 41 of the Internal Revenue Code in
11 effect on January 1, ~~1997~~ 1998.

12 Sec. 8. Section 422.35, subsection 11, paragraphs a, b,
13 and c, Code Supplement 1997, are amended to read as follows:

14 a. The Iowa net operating loss shall be carried back three
15 taxable years for a net operating loss incurred in a
16 presidentially declared disaster area by a taxpayer engaged in
17 a small business or in the trade or business of farming. For
18 all other Iowa net operating losses, the net operating loss
19 shall be carried back two taxable years or to the taxable year
20 in which the corporation first commenced doing business in
21 this state, whichever is later.

22 b. The Iowa net operating loss remaining after being
23 carried back as required in paragraph "a" of this subsection
24 or if not required to be carried back shall be carried forward
25 fifteen twenty taxable years.

26 c. If the election under section 172(b)(3) of the Internal
27 Revenue Code is made, the Iowa net operating loss shall be
28 carried forward fifteen twenty taxable years.

29 Sec. 9. Section 422.73, Code 1997, is amended by adding
30 the following new subsection:

31 NEW SUBSECTION. 3. Notwithstanding subsection 2, a claim
32 for credit or refund of the income tax paid is considered
33 timely if the claim is filed with the department on or before
34 June 30, 1999, if the taxpayer's federal income tax was
35 refunded due to a provision in the federal Taxpayer Relief Act

1 of 1997, Pub. L. No. 105-34, which affected the federal
2 adjusted gross incomes of individuals or estates and trusts,
3 or affected the taxable incomes of corporate taxpayers.

4 Sec. 10. Sections 1, 2, 3, 6, and 7 of this Act apply
5 retroactively to January 1, 1997, for tax years beginning on
6 or after that date.

7 Sec. 11. Section 4 of this Act applies retroactively to
8 tax years ending after August 5, 1997.

9 Sec. 12. Sections 5 and 8 of this Act apply retroactively
10 to net operating losses and casualty losses arising in taxable
11 years beginning after August 5, 1997.

12 Sec. 13. Section 9 of this Act applies retroactively to
13 January 1, 1977, for tax years beginning on or after that
14 date.

15 Sec. 14. This Act, being deemed of immediate importance,
16 takes effect upon enactment.

17 EXPLANATION

18 This bill updates the references to the Internal Revenue
19 Code to make the federal income tax revisions enacted by
20 Congress in 1997 applicable for Iowa income tax purposes and
21 makes other changes related to Iowa income tax. Iowa Code
22 sections 15.335, 15A.9, 422.10, and 422.33 are amended to
23 update the Iowa Code references to the state research
24 activities credit for individuals, corporations, corporations
25 in economic development areas, and corporations in quality
26 jobs enterprise zones to include the 1997 changes to the
27 federal research activities credits.

28 Iowa Code section 422.3 is amended to update the reference
29 in the Iowa Code to the Internal Revenue Code to January 1,
30 1998, to include the federal income tax revisions made by
31 Congress in the 1997 calendar year, making those revisions
32 applicable for Iowa income tax purposes.

33 Iowa Code section 422.6 is amended to exempt preneed
34 funeral trusts electing special tax treatment, and
35 beneficiaries of such trusts, from Iowa income tax on the

1 income accruing to such trusts.

2 Iowa Code sections 422.9 and 422.35 are amended to revise
3 the carryback and carryover periods for net operating losses
4 and casualty losses to conform with the federal changes in the
5 carryback and carryforward periods for these losses in the
6 federal Taxpayer Relief Act of 1997.

7 Iowa Code section 422.73 is amended to authorize refunds
8 beyond the state's three-year statute of limitations for
9 refund if a taxpayer qualifies for refund for federal tax
10 purposes as a result of retroactive application of some
11 provisions of the federal Taxpayer Relief Act of 1997.

12 Amendments to Iowa Code sections 15.335, 15A.9, 422.3,
13 422.10, and 422.33 apply retroactively to January 1, 1997, for
14 tax years beginning on or after that date.

15 The amendment to Iowa Code section 422.6 applies
16 retroactively to tax years ending after August 5, 1997.

17 Amendments to Iowa Code sections 422.9 and 422.35 apply
18 retroactively to losses arising in taxable years beginning
19 after August 5, 1997.

20 The amendment to Iowa Code section 422.73 applies
21 retroactively to January 1, 1977, for tax years beginning on
22 or after that date.

23 The bill takes effect upon enactment.

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**SENATE FILE 2357
FISCAL NOTE**

A fiscal note for Senate File 2357 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.

Senate File 2357 updates the references to the Internal Revenue Code to make the federal income tax revisions enacted by Congress in 1997 applicable for Iowa income tax purposes. The Bill is effective upon enactment.

There were ten 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 1998, FY 1999, and FY 2000 fiscal impact, expressed as (FY 1998 impact, FY 1999 impact, FY 2000 impact). Several provisions of the federal Taxpayer Relief Act of 1997 required no legislative action, but resulted in a net increase in revenues to the General Fund (e.g., federal capital gains rate reduction). The revenue increase from the provisions requiring no legislative action has been included in the November estimate of the Revenue Estimating Conference.

1. Student Loan Interest Deduction - Permits a deduction from income for student loan interest paid. (\$0.0 million, \$-0.2 million, \$-0.3 million)
2. Penalty-free Individual Retirement Account (IRA) Withdrawals - Permits withdrawals from an IRA for educational purposes without imposing a penalty. (\$-0.1 million, \$-0.5 million, \$-0.4 million)
3. Education IRA - Permits the contribution of up to \$500 per child to an Education IRA. Contributions are after-tax, but distributions are tax-exempt. (\$-0.2 million, \$-1.5 million, \$-2.0 million)
4. Other Education Provisions - These include the extension of the exclusion for employer-provided educational assistance. Expenses paid by an employer for courses beginning before June 1, 2000, are excludable from the employee's income. Also included is the expansion of the forgiveness of loan income exclusion which has been expanded to include student loans sponsored by tax-exempt charitable organizations. (\$-0.1 million, \$-1.5 million, \$-1.2 million)
5. Increased IRA Income Limits - Raises the income limits on pre-tax contributions to an IRA. The new income limits for full exemption are \$30,000 for single filers and \$50,000 for joint filers, increased by \$5,000 and \$10,000, respectively. (\$-0.8 million, \$-1.5 million, \$0.2 million)
6. Capital Gains - The effect is primarily due to the federal change in the sale of a principal residence. Under federal law, up to a \$250,000 gain from the sale of a principal residence is excludable from income if the individual owned and occupied the residence for at least two years prior

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to the sale. (\$-0.8 million, \$-1.5 million, \$-1.1 million)

7. Small Corporation Alternative Minimum Tax (AMT) Exemption - A corporation that meets certain gross receipts tests is considered to be a "small corporation" and, as a result, will not be liable for the AMT tax as long as it remains a small corporation. Once recognized as a small corporation, it is exempt from AMT so long as its average annual gross receipts do not exceed \$7.5 million. (\$-0.1 million, \$-0.2 million, \$-0.3 million)
8. Conform AMT Depreciation to Federal Definition - The AMT adjustment is eliminated for property depreciated under straight line method and recovery periods are conformed for other property. (\$0.0 million, \$-0.5 million, \$-1.8 million)
9. Farm Installment Sales - Under prior law, cash-basis farmers could not use installment method for sales of property for computing AMT. Federal law was changed to permit use of the installment method. (\$-0.7 million, \$-1.2 million, \$-1.0 million)
10. Safe Harbor Provision - Reduces the amount of the preceding year's tax which must be paid to avoid a penalty from 110.0% to 105.0%. (\$0.0 million, \$-3.1 million, \$0.9 million)

FISCAL IMPACT

Senate File 2357 is expected to result in a decrease in General Fund revenue of approximately \$2.8 million in FY 1998, \$11.7 million in FY 1999, and \$7.0 million in FY 2000.

SOURCES

Department of Revenue and Finance
Legislative Tax Model
Federation of Tax Administrators

(LSB 3231SV, LCS)

FILED MARCH 4, 1998

BY DENNIS PROUTY, FISCAL DIRECTOR

Borleng
Freeman
Palmer

SSB 2081

Ways & Means
Succeeded By

SENATE/HOUSE FILE SF/HF 2357
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
2 Code, exempting certain preneed funeral trust income from
3 taxation, revising the carryback and carryover periods for
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1 Section 1. Section 15.335, unnumbered paragraph 1, Code
2 Supplement 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, ~~1997~~ 1998.

27 Sec. 2. Section 15A.9, subsection 8, unnumbered paragraph
28 2, Code Supplement 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, ~~1997~~
34 1998. 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 Supplement 1997,
2 is amended 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 January 1, ~~1997~~ 1998, whichever is applicable.

8 Sec. 4. Section 422.6, unnumbered paragraph 1, Code
9 Supplement 1997, is amended to read as follows:

10 The tax imposed by section 422.5 less the credits allowed
11 under sections 422.10, 422.11A, and 422.11B, and the personal
12 exemption credit allowed under section 422.12 apply to and are
13 a charge against estates and trusts with respect to their
14 taxable income, and the rates are the same as those applicable
15 to individuals. The fiduciary shall make the return of income
16 for the estate or trust for which the fiduciary acts, whether
17 the income is taxable to the estate or trust or to the
18 beneficiaries. However, for tax years ending after August 5,
19 1997, if the trust is a qualified preneed funeral trust as set
20 forth in section 685 of the Internal Revenue Code and the
21 trustee has elected the special tax treatment under section
22 685 of the Internal Revenue Code, neither the trust nor the
23 beneficiary is subject to Iowa income tax on income accruing
24 to the trust.

25 Sec. 5. Section 422.9, subsection 3, paragraphs a, b, and
26 c, Code Supplement 1997, are amended to read as follows:

27 a. The Iowa net operating loss shall be carried back three
28 taxable years for an individual taxpayer with a casualty or
29 theft property loss or for a net operating loss in a
30 presidentially declared disaster area incurred by a taxpayer
31 engaged in a small business or in the trade or business of
32 farming. For all other Iowa net operating losses, the net
33 operating loss shall be carried back two taxable years or to
34 the taxable year in which the individual taxpayer first earned
35 income in Iowa whichever year is the later.

1 b. The Iowa net operating loss remaining after being
2 carried back as required in paragraph "a" of this subsection
3 or if not required to be carried back shall be carried forward
4 ~~fifteen~~ twenty taxable years.

5 c. If the election under section 172(b)(3) of the Internal
6 Revenue Code is made, the Iowa net operating loss shall be
7 carried forward ~~fifteen~~ twenty taxable years.

8 Sec. 6. Section 422.10, unnumbered paragraph 1, Code
9 Supplement 1997, is amended to read as follows:

10 The taxes imposed under this division shall be reduced by a
11 state tax credit for increasing research activities in this
12 state. For individuals, the credit equals six and one-half
13 percent of the state's apportioned share of the qualifying
14 expenditures for increasing research activities. The state's
15 apportioned share of the qualifying expenditures for
16 increasing research activities is a percent equal to the ratio
17 of qualified research expenditures in this state to total
18 qualified research expenditures. For purposes of this
19 section, an individual may claim a research credit for
20 qualifying research expenditures incurred by a partnership,
21 subchapter S corporation, estate, or trust electing to have
22 the income taxed directly to the individual. The amount
23 claimed by the individual shall be based upon the pro rata
24 share of the individual's earnings of a partnership,
25 subchapter S corporation, estate, or trust. For purposes of
26 this section, "qualifying expenditures for increasing research
27 activities" means the qualifying expenditures as defined for
28 the federal credit for increasing research activities which
29 would be allowable under section 41 of the Internal Revenue
30 Code in effect on January 1, ~~1997~~ 1998.

31 Sec. 7. Section 422.33, subsection 5, unnumbered paragraph
32 1, Code Supplement 1997, is amended to read as follows:

33 The taxes imposed under this division shall be reduced by a
34 state tax credit for increasing research activities in this
35 state equal to six and one-half percent of the state's

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1 apportioned share of the qualifying expenditures for
2 increasing research activities. The state's apportioned share
3 of the qualifying expenditures for increasing research
4 activities is a percent equal to the ratio of qualified
5 research expenditures in this state to the total qualified
6 research expenditures. For purposes of this subsection,
7 "qualifying expenditures for increasing research activities"
8 means the qualifying expenditures as defined for the federal
9 credit for increasing research activities which would be
10 allowable under section 41 of the Internal Revenue Code in
11 effect on January 1, ~~1997~~ 1998.

12 Sec. 8. Section 422.35, subsection 11, paragraphs a, b,
13 and c, Code Supplement 1997, are amended to read as follows:

14 a. The Iowa net operating loss shall be carried back three
15 taxable years for a net operating loss incurred in a
16 presidentially declared disaster area by a taxpayer engaged in
17 a small business or in the trade or business of farming. For
18 all other Iowa net operating losses, the net operating loss
19 shall be carried back two taxable years or to the taxable year
20 in which the corporation first commenced doing business in
21 this state, whichever is later.

22 b. The Iowa net operating loss remaining after being
23 carried back as required in paragraph "a" of this subsection
24 or if not required to be carried back shall be carried forward
25 fifteen twenty taxable years.

26 c. If the election under section 172(b)(3) of the Internal
27 Revenue Code is made, the Iowa net operating loss shall be
28 carried forward fifteen twenty taxable years.

29 Sec. 9. Section 422.73, Code 1997, is amended by adding
30 the following new subsection:

31 NEW SUBSECTION. 3. Notwithstanding subsection 2, a claim
32 for credit or refund of the income tax paid is considered
33 timely if the claim is filed with the department on or before
34 June 30, 1999, if the taxpayer's federal income tax was
35 refunded due to a provision in the federal Taxpayer Relief Act

1 of 1997, Pub. L. No. 105-34, which affected the federal
2 adjusted gross incomes of individuals or estates and trusts,
3 or affected the taxable incomes of corporate taxpayers.

4 Sec. 10. Sections 1, 2, 3, 6, and 7 of this Act apply
5 retroactively to January 1, 1997, for tax years beginning on
6 or after that date.

7 Sec. 11. Section 4 of this Act applies retroactively to
8 tax years ending after August 5, 1997.

9 Sec. 12. Sections 5 and 8 of this Act apply retroactively
10 to net operating losses and casualty losses arising in taxable
11 years beginning after August 5, 1997.

12 Sec. 13. Section 9 of this Act applies retroactively to
13 January 1, 1977, for tax years beginning on or after that
14 date.

15 Sec. 14. This Act, being deemed of immediate importance,
16 takes effect upon enactment.

17

EXPLANATION

18 This bill updates the references to the Internal Revenue
19 Code to make the federal income tax revisions enacted by
20 Congress in 1997 applicable for Iowa income tax purposes and
21 makes other changes related to Iowa income tax. Iowa Code
22 sections 15.335, 15A.9, 422.10, and 422.33 are amended to
23 update the Iowa Code references to the state research
24 activities credit for individuals, corporations, corporations
25 in economic development areas, and corporations in quality
26 jobs enterprise zones to include the 1997 changes to the
27 federal research activities credits.

28 Iowa Code section 422.3 is amended to update the reference
29 in the Iowa Code to the Internal Revenue Code to January 1,
30 1998, to include the federal income tax revisions made by
31 Congress in the 1997 calendar year, making those revisions
32 applicable for Iowa income tax purposes.

33 Iowa Code section 422.6 is amended to exempt preneed
34 funeral trusts electing special tax treatment, and
35 beneficiaries of such trusts, from Iowa income tax on the

1 income accruing to such trusts.

2 Iowa Code sections 422.9 and 422.35 are amended to revise
3 the carryback and carryover periods for net operating losses
4 and casualty losses to conform with the federal changes in the
5 carryback and carryforward periods for these losses in the
6 federal Taxpayer Relief Act of 1997.

7 Iowa Code section 422.73 is amended to authorize refunds
8 beyond the state's three-year statute of limitations for
9 refund if a taxpayer qualifies for refund for federal tax
10 purposes as a result of retroactive application of some
11 provisions of the federal Taxpayer Relief Act of 1997.

12 Amendments to Iowa Code sections 15.335, 15A.9, 422.3,
13 422.10, and 422.33 apply retroactively to January 1, 1997, for
14 tax years beginning on or after that date.

15 The amendment to Iowa Code section 422.6 applies
16 retroactively to tax years ending after August 5, 1997.

17 Amendments to Iowa Code sections 422.9 and 422.35 apply
18 retroactively to losses arising in taxable years beginning
19 after August 5, 1997.

20 The amendment to Iowa Code section 422.73 applies
21 retroactively to January 1, 1977, for tax years beginning on
22 or after that date.

23 The bill takes effect upon enactment.

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MEMORANDUM

TO: MEMBERS OF THE 1998 GENERAL ASSEMBLY

FROM: THE IOWA DEPARTMENT OF REVENUE AND FINANCE

DATE: NOVEMBER 18, 1997

RE: THE BILL RELATING TO UPDATING THE IOWA CODE TO INCLUDE THE FEDERAL INCOME TAX CHANGES MADE IN 1997 AND PROVIDING EFFECTIVE AND RETROACTIVE APPLICABILITY DATES FOR THE PROVISIONS

This is the annual bill proposed by the Department of Revenue and Finance to include into Iowa income tax law, the federal income tax changes enacted by Congress in 1997. The bill updates the Iowa research activities credit to include revisions in the federal research credit, which is the basis for the Iowa research activities credits. The Iowa code section which defines the Internal Revenue Code for Iowa income tax purposes is also updated so that all the federal changes which affect the computation of Iowa net income for individual taxpayers and the federal changes which affect the computation of taxable income for corporate taxpayers are adopted.

One major tax bill was enacted by Congress in 1997. This bill was the Taxpayer Relief Act of 1997 which was signed into law by the president on August 5, 1997. The Taxpayer Relief Act of 1997 includes over 800 amendments to the Internal Revenue Code and nearly 300 new provisions. Some of the changes in what will be referred to as the "Act" involved changing the periods for carrying back and carrying forward net operating losses and capital losses. Historically, the General Assembly has adopted the federal net operating carryback and carryforward periods for Iowa income tax purposes. Therefore, the provisions in sections 5 and 8 of the update bill are proposed to conform to the new federal net operating loss carryover/carryback periods.

The "Act" includes some forty provisions which are retroactively effective beyond the three-year statute of limitations for refund in Iowa Code subsection 422.73(2). We believe that some of these retroactive provisions are merely technical corrections and will not have a wide-spread relevance. A number of these provisions are retroactive to some date or period in the 80's as well as one provision retroactive for leases entered into after December 31, 1976. The statute of limitations for refund has been amended

in section eight of the bill to provide refunds to taxpayers who are affected by one of the retroactive provisions so the taxpayers can get refunds on their Iowa returns if they qualified for refunds for federal tax purposes.

There were many federal provisions in the "Act" other than those previously mentioned that are considered to have been adopted if this bill is enacted. Descriptions of many of these provisions follow.

There is a new deduction for interest paid on certain qualified education loans for tuition and related expenses. The exclusion from gross income for employer-provided educational assistance benefits for undergraduate courses which had previously expired 7 is extended to May 31, 2000. The bill allows a charitable deduction to C corporations for donations of computer technology and equipment to grades K-12.

There are numerous provisions in the "ACT" related to individual retirement arrangements (IRAs). All these provisions will deemed to be adopted for Iowa income tax purposes, including provisions related to the Roth IRA, which is a new type of IRA.

Effective May 7, 1997, there is a \$250,000 exclusion for the sale of a personal residence (500,000 in the case of a joint return). For purpose of the home office deduction, the definition of "principle place of business" is expanded in 1998 to include a home office used by a taxpayer to conduct business, administrative or management activities.

Starting in 1998, the percentage of the health insurance premiums that are deductible for self-employed individuals is increased over a ten-year period until the premiums are fully deductible starting in the year 2007. Note that 100% of the health insurance premiums have been deductible on the Iowa income tax return since 1996.

There are many provisions in the Taxpayer Relief Act of 1997 which will not be adopted if the Internal Revenue Code Update bill is enacted. Some major provisions that will not be adopted without specific language are mentioned below.

The "ACT" establishes a child tax credit of \$500(\$400 in 1998), for each qualifying child under age 17. Individuals may claim a Hope tax credit of up to \$1,500 per student per year for qualified tuition and fees for a student (taxpayer, spouse or dependent) who meet certain conditions.

Another education-related credit is the Lifetime Learning tax credit. This credit is for 20% of qualified tuition and fees paid per year for a student (taxpayer, spouse or dependent). The unified credit for federal estate tax is increased gradually over a nine-year period to \$1 million in the year 2006. An executor may elect to exclude for

purposes of estate tax the value of certain qualified "family-owned business interests" if certain requirements are met.

Effective for transactions after May 7, 1997, the federal tax rates for most types of capital gains are reduced.

Additional information about provisions in the Taxpayers Relief Act of 1997 is included in a write-up of this Act that was produced by members of the Policy Section of the Department. This write-up is available by calling 281-4250.

SENATE FILE 2357

AN ACT

UPDATING THE IOWA CODE REFERENCES TO THE INTERNAL REVENUE CODE,
EXEMPTING CERTAIN PRENEED FUNERAL TRUST INCOME FROM TAXATION,
REVISING THE CARRYBACK AND CARRYOVER PERIODS FOR CERTAIN NET
OPERATING LOSSES, PROVIDING REFUNDS, AND PROVIDING AN
EFFECTIVE DATE AND RETROACTIVE APPLICABILITY DATES.

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

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

An eligible business may claim a corporate tax credit for increasing research activities in this state during the period the eligible business is participating in the program. The credit equals six and one-half percent of the state's apportioned share of the qualifying expenditures for increasing research activities. The state's apportioned share of the qualifying expenditures for increasing research activities is a percent equal to the ratio of qualified

research expenditures in this state to total qualified research expenditures. The credit allowed in this section is in addition to the credit authorized in section 422.33, subsection 5. If the eligible business is a partnership, subchapter S corporation, limited liability company, or estate or trust electing to have the income taxed directly to the individual, an individual may claim the tax credit allowed. The amount claimed by the individual shall be based upon the pro rata share of the individual's earnings of the partnership, subchapter S corporation, limited liability company, or estate or trust. For purposes of this section, "qualifying expenditures for increasing research activities" means the qualifying expenditures as defined for the federal credit for increasing research activities which would be allowable under section 41 of the Internal Revenue Code in effect on January 1, ~~1997~~ 1998.

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

For the purposes of this section, "qualifying expenditures for increasing research activities" means the qualifying expenditures as defined for the federal credit for increasing research activities which would be allowable under section 41 of the Internal Revenue Code in effect on January 1, ~~1997~~ 1998. The credit authorized in this subsection is in lieu of the credit authorized in section 422.33, subsection 5.

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

4. "Internal Revenue Code" means the Internal Revenue Code of 1954, prior to the date of its redesignation as the Internal Revenue Code of 1986 by the Tax Reform Act of 1986, or means the Internal Revenue Code of 1986 as amended to and including January 1, ~~1997~~ 1998, whichever is applicable.

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

The tax imposed by section 422.5 less the credits allowed under sections 422.10, 422.11A, and 422.11B, and the personal

exemption credit allowed under section 422.12 apply to and are a charge against estates and trusts with respect to their taxable income, and the rates are the same as those applicable to individuals. The fiduciary shall make the return of income for the estate or trust for which the fiduciary acts, whether the income is taxable to the estate or trust or to the beneficiaries. However, for tax years ending after August 5, 1997, if the trust is a qualified preneed funeral trust as set forth in section 685 of the Internal Revenue Code and the trustee has elected the special tax treatment under section 685 of the Internal Revenue Code, neither the trust nor the beneficiary is subject to Iowa income tax on income accruing to the trust.

Sec. 5. Section 422.9, subsection 3, paragraphs a, b, and c, Code Supplement 1997, are amended to read as follows:

a. The Iowa net operating loss shall be carried back three taxable years for an individual taxpayer with a casualty or theft property loss or for a net operating loss in a presidentially declared disaster area incurred by a taxpayer engaged in a small business or in the trade or business of farming. For all other Iowa net operating losses, the net operating loss shall be carried back two taxable years or to the taxable year in which the individual taxpayer first earned income in Iowa whichever year is the later.

b. The Iowa net operating loss remaining after being carried back as required in paragraph "a" of this subsection or if not required to be carried back shall be carried forward fifteen twenty taxable years.

c. If the election under section 172(b)(3) of the Internal Revenue Code is made, the Iowa net operating loss shall be carried forward fifteen twenty taxable years.

Sec. 6. Section 422.10, unnumbered paragraph 1, Code Supplement 1997, is amended to read as follows:

The taxes imposed under this division shall be reduced by a state tax credit for increasing research activities in this state. For individuals, the credit equals six and one-half

percent of the state's apportioned share of the qualifying expenditures for increasing research activities. The state's apportioned share of the qualifying expenditures for increasing research activities is a percent equal to the ratio of qualified research expenditures in this state to total qualified research expenditures. For purposes of this section, an individual may claim a research credit for qualifying research expenditures incurred by a partnership, subchapter S corporation, estate, or trust electing to have the income taxed directly to the individual. The amount claimed by the individual shall be based upon the pro rata share of the individual's earnings of a partnership, subchapter S corporation, estate, or trust. For purposes of this section, "qualifying expenditures for increasing research activities" means the qualifying expenditures as defined for the federal credit for increasing research activities which would be allowable under section 41 of the Internal Revenue Code in effect on January 1, ~~1997~~ 1998.

Sec. 7. Section 422.33, subsection 5, unnumbered paragraph 1, Code Supplement 1997, is amended to read as follows:

The taxes imposed under this division shall be reduced by a state tax credit for increasing research activities in this state equal to six and one-half percent of the state's apportioned share of the qualifying expenditures for increasing research activities. The state's apportioned share of the qualifying expenditures for increasing research activities is a percent equal to the ratio of qualified research expenditures in this state to the total qualified research expenditures. For purposes of this subsection, "qualifying expenditures for increasing research activities" means the qualifying expenditures as defined for the federal credit for increasing research activities which would be allowable under section 41 of the Internal Revenue Code in effect on January 1, ~~1997~~ 1998.

Sec. 8. Section 422.35, subsection 11, paragraphs a, b, and c, Code Supplement 1997, are amended to read as follows:

a. The Iowa net operating loss shall be carried back three taxable years for a net operating loss incurred in a presidentially declared disaster area by a taxpayer engaged in a small business or in the trade or business of farming. For all other Iowa net operating losses, the net operating loss shall be carried back two taxable years or to the taxable year in which the corporation first commenced doing business in this state, whichever is later.

b. The Iowa net operating loss remaining after being carried back as required in paragraph "a" of this subsection or if not required to be carried back shall be carried forward twenty taxable years.

c. If the election under section 172(b)(3) of the Internal Revenue Code is made, the Iowa net operating loss shall be carried forward fifteen twenty taxable years.

Sec. 9. Section 422.73, Code 1997, is amended by adding the following new subsection:

NEW SUBSECTION. 3. Notwithstanding subsection 2, a claim for credit or refund of the income tax paid is considered timely if the claim is filed with the department on or before June 30, 1999, if the taxpayer's federal income tax was refunded due to a provision in the federal Taxpayer Relief Act of 1997, Pub. L. No. 105-34, which affected the federal adjusted gross incomes of individuals or estates and trusts, or affected the taxable incomes of corporate taxpayers.

Sec. 10. Sections 1, 2, 3, 6, and 7 of this Act apply retroactively to January 1, 1997, for tax years beginning on or after that date.

Sec. 11. Section 4 of this Act applies retroactively to tax years ending after August 5, 1997.

Sec. 12. Sections 5 and 8 of this Act apply retroactively to net operating losses and casualty losses arising in taxable years beginning after August 5, 1997.

Sec. 13. Section 9 of this Act applies retroactively to January 1, 1977, for tax years beginning on or after that date.

Sec. 14. This Act, being deemed of immediate importance, takes effect upon enactment.

MARY E. KRAMER
President of the Senate

RON J. CORBETT
Speaker of the House

I hereby certify that this bill originated in the Senate and is known as Senate File 2357, Seventy-seventh General Assembly.

MARY PAT GUNDERSON
Secretary of the Senate

Approved *April 10*, 1998

TERRY E. BRANSTAD
Governor