HSB 25

WAYS AND MEANS

Hoffman (chair)
Holmes
Weigel

SENATE/HOUSE FILE SF 516
BY (PROPOSED DEPARTMENT OF
REVENUE AND FINANCE BILL)

Passed Senate, Date ____________ Passed House, Date ____________
Vote: Ayes ______ Nays ________ Vote: Ayes ______ Nays ________
Approved ______________________________

A BILL FOR

An Act updating the Iowa Code references to the Internal Revenue Code, extending the loss carryback period for farm net operating losses, providing certain tax credits to estates and trusts, and providing an effective date and a retroactive applicability date.

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

TLSB 1153DP 78
sc/jw/5

S.F. ________ H.F. ________

Section 1. Section 15.335, unnumbered paragraph 1, Code 1999, 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, ~~1998~~ 1999.

Sec. 2. Section 15A.9, subsection 8, unnumbered paragraph 2, Code 1999, 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, ~~1998~~ 1999. The credit authorized in this subsection is in lieu of the credit authorized in section 422.33, subsection 5.

S.F. ______ H.F. ______

Sec. 3. Section 422.3, subsection 4, Code 1999, 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, ~~1998~~ 1999, whichever is applicable.

Sec. 4. Section 422.6, unnumbered paragraph 1, Code 1999, is amended to read as follows:

The tax imposed by section 422.5 less the credits allowed under sections 15.333, 15.335, 15E.193A, 422.10, 422.11, 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, paragraph b, Code 1999, is amended to read as follow:

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

Sec. 6. Section 422.9, subsection 3, Code 1999, is amended by adding the following new paragraph:

NEW PARAGRAPH. d. Notwithstanding paragraph "a", for a taxpayer who is engaged in the trade or business of farming as defined in section 263A(e)(4) of the Internal Revenue Code and

STATE OF IOWA

DEPARTMENT OF REVENUE AND FINANCE
GERALD D. BAIR, DIRECTOR

TO: MEMBERS OF THE 1999 GENERAL ASSEMBLY

FROM: IOWA DEPARTMENT OF REVENUE & FINANCE

DATE: DECEMBER 1, 1998

SUBJECT: THE BILL RELATING TO UPDATING THE IOWA CODE TO INCLUDE THE FEDERAL INCOME TAX CHANGES MADE IN 1998, TAXATION OF ESTATES AND TRUSTS, 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 1998. The bill updates the provisions for 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 1998 federal changes which affect the computation of Iowa net income for individual taxpayers and the computation of taxable income for corporate taxpayers are adopted.

Two tax bills were enacted by Congress in 1998. The first bill is the Internal Revenue Service Restructuring and Reform Bill of 1998 which was signed into law by the President on July 22, 1998. This Act revamps the governance and structure of the IRS.

In addition, this Act provides that states may participate in the IRS refund offset program for specified past-due, legally enforceable state income tax debts provided the person with the federal tax overpayment has shown on the federal return for the taxable year of the overpayment an address in the state seeking the tax offset.

The Act includes numerous technical corrections and clarifications to provisions in the Taxpayer Relief Act of 1997 and in prior federal tax legislation. The Act has a number of provisions which pertain to Roth IRAs and the conversion of other IRAs to Roth IRAs.

A second federal tax bill, the Tax Relief Extension Bill, was passed and signed by the President on October 21, 1998. This bill extends several tax benefits on a retroactive basis that had expired, and accelerates the implementation dates for several other tax benefits. Among the tax benefits that were extended on a retroactive basis are the research activities credit, the work opportunity credit, and the deduction for gifts of appreciated stock to private foundations.

The Tax and Trade Relief Extension Act of 1998 includes three provisions which are provided to assist taxpayers who are in the trade or business of farming. One provision enables taxpayers other than estates or trusts to average taxable income attributable to farming over three years.

A second provision changes the timing of when payments made under the Federal Agricultural Improvement and Reform Act of 1996 are included in a taxpayer's income. This income is taxed when actually received and not at the time of constructive receipt when options for payment are selected.

A final provision extends the net operating loss carryback period to five years for net operating losses from farming businesses regardless of whether the loss is incurred in a Presidentially declared disaster area for farm net operating losses arising in taxable years beginning after December 31, 1997. Similar provisions for a five-year carryback of Iowa farm net operating losses are included in sections four, five, eight and nine of the bill.

Additional information about provisions in the Internal Revenue Service Restructuring and Reform Bill of 1998 and the Tax and Trade Relief Extension Act of 1998 are available in write-ups produced by members of the Policy Section of the Department. The write-ups may be obtained by calling 281-4250.

In addition to the sections of Code amended to reflect changes necessary to adopt the provisions of the Internal Revenue Service Restructuring and Reform Bill of 1998, and the Tax and Trade Relief Extension Act of 1998 this Act amends Iowa Code section 422.6 to allow estates or trusts to take the same credits against computed tax as individuals. The reason this is necessary is that an electing small business trust can be a shareholder in an S corporation and as such it is taxable on its distributive share on the S corporation's income and would be entitled to use the tax credits that flow through the S corporation to the shareholder. Also in rare instances an estate in winding up the business affairs of a decedent may be subject to tax on income earned during the probate process.

Substituted for S.F. 230 4/7/99

MAR 8 1999 (p. 1111)

WAYS & MEANS CALENDAR

HOUSE FILE 516

BY COMMITTEE ON WAYS AND MEANS

WITHDRAWN 4-7-99

(SUCCESSOR TO HSB 25)

(COMPANION TO SF 230)

Passed House, Date ____________ Passed Senate, Date ____________

Vote: Ayes _______ Nays ________ Vote: Ayes _______ Nays _________

Approved ____________________________

A BILL FOR

An Act updating the Iowa Code references to the Internal Revenue Code, extending the loss carryback period for farm net operating losses, providing certain tax credits to estates and trusts, and providing an effective date and a retroactive applicability date.

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

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HF 516

S.F. ________ H.F. 516

Section 1. Section 15.335, unnumbered paragraph 1, Code 1999, 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, ~~1998~~ 1999.

Sec. 2. Section 15A.9, subsection 8, unnumbered paragraph 2, Code 1999, 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, ~~1998~~ 1999. 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 1999, 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, ~~1998~~ 1999, whichever is applicable.

Sec. 4. Section 422.6, unnumbered paragraph 1, Code 1999, is amended to read as follows:

The tax imposed by section 422.5 less the credits allowed under sections 15.333, 15.335, 15E.193A, 422.10, 422.11, 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, paragraph b, Code 1999, is amended to read as follow:

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

Sec. 6. Section 422.9, subsection 3, Code 1999, is amended by adding the following new paragraph:

NEW PARAGRAPH. d. Notwithstanding paragraph "a", for a taxpayer who is engaged in the trade or business of farming as defined in section 263A(e)(4) of the Internal Revenue Code and has a loss from farming as defined in section 172(b)(1)(F) of the Internal Revenue Code including modifications prescribed by rule by the director, the Iowa loss from the trade or business of farming is a net operating loss which may be carried back five taxable years prior to the taxable year of the loss.

Sec. 7. Section 422.10, unnumbered paragraph 1, Code 1999, 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, ~~1998~~ 1999.

Sec. 8. Section 422.33, subsection 5, unnumbered paragraph 1, Code 1999, 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, ~~1998~~ <u>1999</u>.

Sec. 9. Section 422.35, subsection 11, paragraph b, Code 1999, is amended to read as follows:

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

Sec. 10. Section 422.35, subsection 11, Code 1999, is amended by adding the following new paragraph:

<u>NEW PARAGRAPH</u>. f. Notwithstanding paragraph "a", for a taxpayer who is engaged in the trade or business of farming as defined in section 263A(e)(4) of the Internal Revenue Code and has a loss from farming as defined in section 172(b)(1)(F) of the Internal Revenue Code including modifications prescribed by rule by the director, the Iowa loss from the trade or business of farming is a net operating loss which may be carried back five taxable years prior to the taxable year of the loss.

Sec. 11. This Act applies retroactively to January 1, 1998, for tax years beginning on or after that date.

Sec. 12. This Act, being deemed of immediate importance, takes effect upon enactment.

EXPLANATION

This bill updates the references to the Internal Revenue Code to make the federal income tax revisions enacted by Congress in 1998 applicable for Iowa income tax purposes.

Iowa Code sections 15.335, 15A.9, 422.10, and 422.33 are amended to update the Iowa Code references to the state research activities credit for individuals, corporations, corporations in economic development areas, and corporations in quality jobs enterprise zones to include the 1998 changes to the federal research activities credit.

Iowa Code section 422.3 is amended to update the reference in the Iowa Code to January 1, 1999, to include the federal income tax revisions made by Congress in the 1998 calendar year, making those revisions applicable for Iowa income tax purposes.

Iowa Code section 422.6 is amended to allow estates and trusts to take the same credits against computed tax as individuals.

Iowa Code sections 422.9 and 422.35 are amended to extend the net operating loss carryback period to five years for net operating losses from farming businesses arising in taxable years beginning after December 31, 1997.

The bill applies retroactively to January 1, 1998, for tax years beginning on or after that date.

The bill takes effect upon enactment.

HOUSE FILE 516
FISCAL NOTE

A fiscal note for **House File 516** 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.

House File 516 updates the references to the Internal Revenue Code to make the federal income tax revisions enacted by Congress in 1998 applicable for Iowa income tax purposes. The Bill is effective upon enactment.

There were two provisions enacted by the federal government that have been identified as likely to affect State revenues. Several provisions of the federal IRS Restructuring Bill and Omnibus Appropriations Bill required no legislative action, but resulted in a net increase in revenues to the General Fund (e.g., federal capital gains holding period reduction). The revenue increase from the provisions requiring no legislative action has been included in the December estimate of the Revenue Estimating Conference.

FISCAL EFFECT

The General Fund fiscal impact of HF 516 is expected to be an increase in revenue of approximately $300,000 in FY 2000. The total impact is allocated as follows:

1. Prior year estimated "safe harbor." The safe harbor provision states that an individual who pays 105.0% of the prior year's tax liability is not subject to penalty. The Congress changed the 105.0% provision to 106.0% for individuals with adjusted gross income in excess of $150,000. The estimated General Fund fiscal impact from this provision is an acceleration of estimate payments of approximately $400,000 in FY 2000.

2. Appreciated stock to private foundations. The provision was changed on the federal level to allow a fair market value for bequeathing stock to private foundations, which reduces the tax liability of the individual. This provision expired June 30, 1998. Congress extended permanently the deduction at fair market value of stock value bequeathed to private foundations. The estimated General Fund fiscal impact from this provision is a decrease in General Fund revenues of approximately $100,000 in FY 2000 and succeeding fiscal years.

SOURCES

Iowa Department of Revenue and Finance
Legislative Tax Model

(LSB 1153hv, LCS)

FILED MARCH 9, 1999 BY DENNIS PROUTY, FISCAL DIRECTOR