Senate Study Bill 1189

SENATE FILE ______
BY (PROPOSED COMMITTEE ON WAYS AND MEANS BILL BY CHAIRPERSON McKIBBEN)

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

A BILL FOR

An Act relating to state taxes by imposing a single rate tax, eliminating the deduction for federal income taxes paid, and eliminating the alternative minimum tax under the individual income tax; by increasing the sales and use tax rate; and by increasing the state cigarette and tobacco products tax rates; and including effective and applicability date provisions.
BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:
TLSB 3429SC 80
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DIVISION I
INDIVIDUAL INCOME TAX
SINGLE TAX RATE

Section 1. Section 422.4, subsections 1 and 2, Code 2003, are amended by striking the subsections.

Sec. 2. Section 422.4, subsection 16, Code 2003, is amended to read as follows:

16. ~~The words "taxable~~ <u>"Taxable</u> income" ~~mean~~ <u>means</u> the net income as defined in section 422.7 minus the deductions allowed by section 422.9, in the case of individuals~~; in~~<u>. In</u> the case of estates or trusts, ~~the words~~ "taxable income" ~~mean~~ <u>means</u> the taxable income<u>,</u> ~~(~~without a deduction for personal exemption~~)~~<u>,</u> 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 2003, 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 which tax shall be levied, collected, and paid annually upon and with respect to the entire taxable income at the rate of three and one=half 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 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 may 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 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 subparagraph also applies to individuals who

are residents of Iowa for less than the entire tax year.

c. (1) A bill containing among its provisions an increase in the tax rate under this section or the imposition upon individuals or estates or trusts of an income surtax or alternative minimum tax shall require the affirmative votes of at least three=fourths of the members elected to each house of the general assembly for passage.

(2) A lawsuit challenging the proper enactment of a bill pursuant to subparagraph (1) shall be filed no later than one year following the enactment. Failure to file such a lawsuit within the one=year time limit shall negate the three=fourths majority requirement as it applies to the bill.

(3) Each bill to which subparagraph (1) applies shall include a separate provision describing the requirements for enactment prescribed by subparagraphs (1) and (2).

Sec. 4. Section 422.5, subsection 2, Code 2003, is amended by striking the subsection and inserting in lieu thereof the following:

2. a. However, if the married persons' filing jointly, unmarried head of household's, or surviving spouse's net income exceeds fifteen thousand dollars or eleven thousand dollars in the case of all other persons, the regular tax imposed under this division shall be the lesser of the product of eight percent times the portion of the net income in excess of fifteen thousand dollars or eleven thousand dollars, as applicable, or the regular tax liability computed without regard to this paragraph.

b. Paragraph "a" does not apply to estates and trusts. Married taxpayers electing to file separately shall compute the alternate tax described in paragraph "a" using the total net income of the husband and wife. The alternate tax described in paragraph "a" does not apply if one spouse elects to carry back or carry forward the loss as provided in section 422.9, subsection 3. A person who is claimed as a dependent by another person as defined in section 422.12 shall not receive the benefit of paragraph "a" if the person claiming the dependent has net income exceeding fifteen thousand dollars or eleven thousand dollars as applicable or the person claiming the dependent and the person's spouse have combined net income exceeding fifteen thousand dollars or eleven thousand dollars as applicable.

Sec. 5. Section 422.5, subsections 5 and 7, Code 2003, are amended by striking the subsections.

Sec. 6. Section 422.7, Code 2003, is amended by striking the section and inserting in lieu thereof the following:

422.7 "NET INCOME" == HOW COMPUTED.

The term "net income" means the adjusted gross income before the net operating loss deduction as properly computed for federal income tax purposes under the Internal Revenue Code, with the following adjustments:

1. The adjusted gross income is adjusted by adding the sum of the following:

a. Add the amount of federal income tax refunds received in a tax year beginning on or after January 1, 2004, but before January 1, 2007, to the extent that the federal income tax was deducted on an Iowa individual income tax return for a tax year beginning prior to January 1, 2004.

b. Add interest and dividends from foreign securities and from securities of state and other political subdivisions exempt from federal income tax under the Internal Revenue Code.

c. Add interest and dividends from regulated investment companies exempt from federal income tax under the Internal Revenue Code.

d. Add, to the extent not already included, income from the sale of obligations of the state and its political subdivisions. Income from the sale of these obligations is exempt from the taxes imposed by this division only if the law authorizing these obligations specifically exempts the income from the sale from the state individual income tax.

e. Add the amount resulting from the cancellation of a participation agreement refunded to the taxpayer as a participant in the Iowa educational savings plan trust under chapter 12D to the extent previously deducted as a contribution to the trust.

2. The adjusted gross income is adjusted by subtracting the sum of the following:

a. Subtract the amount of federal income taxes paid or accrued, as the case may be, in a tax year beginning on or after January 1, 2004, but before January 1, 2007, to the extent the federal tax payment is for a tax year beginning prior to January 1, 2004.

b. Subtract interest and dividends from federal securities.

c. Subtract the loss on the sale or exchange of a share of a regulated investment company held for six months or less to the extent the loss was disallowed under section 852(b)(4)(B) of the Internal Revenue Code.

d. (1) Subtract, to the extent included, the amount of additional social security benefits taxable under the Internal Revenue Code for tax years beginning on or after January 1, 1994. The amount of social security benefits taxable as provided in section 86 of the Internal Revenue Code, as amended up to and including January 1, 1993, continues to apply for state income tax purposes for tax years beginning on or after January 1, 1994.

(2) Married taxpayers, who file a joint federal income tax return and who elect to file separate returns for state income tax purposes, shall allocate between the spouses the amount of benefits subtracted under subparagraph (1) from net income in the ratio of the social security benefits received by each spouse to the total of these benefits received by both spouses.

e. (1) For a person who is disabled, or is fifty=five years of age or older, or is the surviving spouse of an individual or a survivor having an insurable interest in an individual who would have qualified for the exemption under this paragraph for the tax year, subtract, to the extent included, the total amount of a governmental or other pension or retirement pay, including, but not limited to, defined benefit or defined contribution plans, annuities, individual retirement accounts, plans maintained or contributed to by an employer, or maintained or contributed to by a self=employed person as an employer, and deferred compensation plans or any earnings attributable to the deferred compensation plans, up to a maximum of six thousand dollars for a person, other than a husband or wife, who files a separate state income tax return and up to a maximum of twelve thousand dollars for a husband and wife who file a joint state income tax return.

(2) However, a surviving spouse who is not disabled or fifty=five years of age or older can only exclude the amount of pension or retirement pay received as a result of the death of the other spouse. A husband and wife filing separate state income tax returns are allowed a combined maximum exclusion under this paragraph "e" of up to the amount allowed for a husband and wife who file a joint state income tax return. The exclusion shall be allocated to the husband or wife in the proportion that each spouse's respective pension and retirement pay received bears to total combined pension and retirement pay received.

f. Notwithstanding the method for computing income from an installment sale under section 453 of the Internal Revenue Code, as defined in section 422.3, the method to be used in computing income from an installment sale shall be the method under section 453 of the Internal Revenue Code, as amended up to and including January 1, 2000. A taxpayer affected by this paragraph shall make adjustments in the adjusted gross income pursuant to rules adopted by the director.

The adjustment to net income provided in this paragraph is repealed for tax years beginning on or after January 1, 2002. However, to the extent that a taxpayer using the accrual method of accounting reported the entire capital gain from the sale or exchange of property on the Iowa return for the tax year beginning in the 2001 calendar year and the capital gain was reported on the installment method on the federal income tax return, any additional installment from the capital gain reported for federal income tax purposes is not to be included in net income in tax years beginning on or after January 1, 2002.

g. Subtract, if the taxpayer is the owner of an individual development account certified under chapter 541A at any time during the tax year, all of the following:

(1) Contributions made to the account by persons and entities, other than the taxpayer, as authorized in chapter 541A.

(2) The amount of any savings refund authorized under section 541A.3, subsection 1.

(3) Earnings from the account.

h. (1) Subtract the maximum contribution that may be deducted for income tax purposes as a participant in the Iowa educational savings plan trust pursuant to section 12D.3, subsection 1, paragraph "a".

(2) Subtract, to the extent included, income from interest and earnings received from the Iowa educational savings plan trust created in chapter 12D.

(3) Subtract, to the extent not deducted for federal income tax purposes, the amount of any gift, grant, or donation made to the Iowa educational savings plan trust for deposit in the endowment fund of that trust.

i. Subtract, to the extent included, active duty pay received by a person in the national guard or armed forces military reserve for services performed on or after August 2, 1990, pursuant to military orders related to the Persian Gulf Conflict.

j. Subtract, to the extent included, active duty pay received by a person in the national guard or armed forces military reserve for service performed on or after November 21, 1995, pursuant to military orders related to peacekeeping in Bosnia=Herzegovina.

k. Subtract, to the extent included, the following:

(1) Payments made to the taxpayer because of the taxpayer's status as a victim of persecution for racial, ethnic, or religious reasons by Nazi Germany or any other Axis regime or as an heir of such victim.

(2) Items of income attributable to, derived from, or in any way related to assets stolen from, hidden from, or otherwise lost to a victim of persecution for racial, ethnic, or religious reasons by Nazi Germany or any other Axis regime immediately prior to, during, and immediately after World War II, including, but not limited to, interest on the proceeds receivable as insurance under policies issued to a victim of persecution for racial, ethnic, or religious reasons by Nazi Germany or any other Axis regime by European insurance companies immediately prior to and during World War II. However, income from assets acquired with such assets or with the proceeds from the sale of such assets shall not be subtracted. This subparagraph shall only apply to a taxpayer who was the first recipient of such assets after recovery of the assets and who is a victim of persecution for racial, ethnic, or religious reasons by Nazi Germany or any other Axis regime or is an heir of such victim.

3. a. In determining the amount of federal income tax refunds or taxes paid or accrued under subsection 1 or subsection 2, for tax years beginning in the 2001 calendar year, the amount shall not be adjusted by the amount received during the tax year of the advanced refund of the rate reduction tax credit provided pursuant to the federal Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107=16, and the advanced refund of such credit shall not be subject to taxation under this division.

b. In determining the amount of federal income tax refunds or taxes paid or accrued under subsection 1 or subsection 2, for tax years beginning in the 2002 calendar year, the amount for the tax year shall not be adjusted by the amount of the rate reduction credit received in the tax year to the extent that the credit is attributable to the rate reduction credit provided pursuant to the federal Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107=16, and the amount of such credit shall not be taxable under this division.

Sec. 7. Section 422.8, subsection 2, paragraph a, Code 2003, is amended to read as follows:

a. Nonresident's net income allocated to Iowa is the net income, or portion of net income, which is derived from a business, trade, profession, or occupation carried on within this state or income from any property, trust, estate, or other source within Iowa. However, income derived from a business, trade, profession, or occupation carried on within this state and income from any property, trust, estate, or other source within Iowa shall not include distributions from pensions, including defined benefit or defined contribution plans, annuities, individual retirement accounts, and deferred compensation plans or any earnings attributable thereto so long as the distribution is directly related to an individual's documented retirement and received while the individual is a nonresident of this state. If a business, trade, profession, or occupation is carried on partly within and partly without the state, only the portion of the net income which is fairly and equitably attributable to that part of the business, trade, profession, or occupation carried on within the state is allocated to Iowa for purposes of section 422.5, subsection 1, paragraph ~~"j"~~ "b", and section 422.13 and income from any property, trust, estate, or other source partly within and partly without the state is allocated to Iowa in the same manner, except that annuities, interest on bank deposits and interest=bearing obligations, and dividends are allocated to Iowa only to the extent to which they are derived from a business, trade, profession, or occupation carried on within the state.

Sec. 8. Section 422.8, subsection 4, Code 2003, is amended by striking the subsection.

Sec. 9. Section 422.9, unnumbered paragraph 1 and subsections 1 and 2, Code 2003, are amended by striking the unnumbered paragraph and the subsections and inserting in lieu thereof the following:

In computing taxable income of individuals, there shall be deducted from net income the following:

1. A standard deduction equal to the following:

a. For a single individual, or a married person filing separately, two thousand dollars.

b. For a head of household, or a husband and wife filing a joint return, four thousand dollars.

c. For each dependent, an additional two thousand dollars. As used in this section, the term "dependent" has the same meaning as provided by the Internal Revenue Code.

2. In addition to the amount in subsection 1, the following:

a. For a single individual, husband, wife, or head of household, an additional exemption of one thousand dollars for each such individual who has attained the age of sixty=five years before the close of the tax year or on the first day following the end of the tax year.

b. For a single individual, husband, wife, or head of household, an additional exemption of one thousand dollars for each such individual who is blind at the close of the tax year. For the purposes of this paragraph, an individual is blind only if the individual's central visual acuity does not exceed twenty=two hundredths in the better eye with correcting lenses, or if the individual's visual acuity is greater than twenty=two hundredths but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than twenty degrees.

Sec. 10. Section 422.9, subsections 4 through 7, Code 2003, are amended by striking the subsections.

Sec. 11. Section 422.11B, subsection 1, Code 2003, is amended to read as follows:

1. There is allowed as a credit against the tax determined in section 422.5, subsection 1, paragraphs "a" through "j" for a tax year an amount equal to the minimum tax credit for that tax year.

The minimum tax credit for a tax year is the excess, if any, of the adjusted net minimum tax imposed for all prior tax years beginning on or after January 1, 1987, but before January 1, 2004, over the amount allowable as a credit under this section for those prior tax years.

If a minimum tax credit is available to a tax period beginning on or after January 1, 2004, the credit can be carried over to tax years beginning on or after January 1, 2004, but before January 1, 2007. The minimum tax credit is limited to the tax determined in section 422.5, subsection 1, paragraphs "a" and "b".

Sec. 12. Section 422.12, subsection 1, Code 2003, is amended by striking the subsection and inserting in lieu thereof the following:

1. A personal exemption credit in the following amounts:

a. If the net income of an estate or trust, a single individual, or a married person filing a separate return is no more than twenty=five thousand dollars, forty dollars.

b. If the net income of a head of household or a husband and wife filling a joint return is no more than fifty thousand dollars, eighty dollars.

c. For each dependent of a taxpayer described in paragraph "a" or "b", an additional forty dollars. As used in this section, "dependent" means the same as provided in the Internal Revenue Code.

Sec. 13. Section 422.12B, subsection 2, Code 2003, is amended to read as follows:

2. Married taxpayers electing to file separate returns ~~or filing separately on a combined return~~ may avail themselves of the earned income credit by allocating the earned income credit to each spouse in the proportion that each spouse's respective earned income bears to the total combined earned income. Taxpayers affected by the allocation provisions of section 422.8 shall be permitted a deduction for the credit

only in the amount fairly and equitably allocable to Iowa under rules prescribed by the director.

Sec. 14. Section 422.12C, subsection 3, Code 2003, is amended to read as follows:

3. Married taxpayers who have filed joint federal returns electing to file separate returns ~~or to file separately on a combined return form~~ must determine the child and dependent care credit under subsection 1 based upon their combined net income and allocate the total credit amount to each spouse in the proportion that each spouse's respective net income bears to the total combined net income. Nonresidents or part=year residents of Iowa must determine their Iowa child and dependent care credit in the ratio of their Iowa source net income to their all source net income. Nonresidents or part=year residents who are married and elect to file separate returns ~~or to file separately on a combined return form~~ must allocate the Iowa child and dependent care credit between the spouses in the ratio of each spouse's Iowa source net income to the combined Iowa source net income of the taxpayers.

Sec. 15. Section 422.13, subsection 1, paragraph c, and subsection 1A, Code 2003, are amended to read as follows:

c. However, if that part of the net income of a nonresident which is allocated to Iowa pursuant to section 422.8, subsection 2, is less than one thousand dollars the nonresident is not required to make and sign a return ~~except when the nonresident is subject to the state alternative minimum tax imposed pursuant to section 422.5, subsection 1, paragraph "k"~~.

1A. Notwithstanding any other provision in this section, a resident of this state is not required to make and file a return if the person's net income is equal to or less than ~~the appropriate dollar amount listed in section 422.5, subsection 2, upon which tax is not imposed~~ fifteen thousand dollars in the case of married persons filing jointly, unmarried heads of households, and surviving spouses, or is equal to or less than eleven thousand dollars in the case of all other persons. A nonresident of this state is not required to make and file a return if the person's total net income ~~in section 422.5, subsection 1, paragraph "j",~~ is equal to or less than ~~the appropriate dollar amount provided in section 422.5, subsection 2, upon which tax is not imposed~~ fifteen thousand dollars in the case of married persons filing jointly, unmarried heads of households, and surviving spouses, or is equal to or less than eleven thousand dollars in the case of all other persons. For purposes of this subsection, the amount of a lump sum distribution subject to separate federal tax shall be included in net income for purposes of determining if a resident is required to file a return and the portion of the lump sum distribution that is allocable to Iowa is included in total net income for purposes of determining if a nonresident is required to make and file a return.

Sec. 16. Section 422.21, unnumbered paragraphs 1 and 2, Code 2003, are amended to read as follows:

Returns shall be in the form the director prescribes, and shall be filed with the department on or before the last day of the fourth month after the expiration of the tax year. However, co=operative associations as defined in section 6072(d) of the Internal Revenue Code shall file their returns on or before the fifteenth day of the ninth month following the close of the taxable year and nonprofit corporations subject to the unrelated business income tax imposed by section 422.33, subsection 1A, shall file their returns on or before the fifteenth day of the fifth month following the close of the taxable year. If, under the Internal Revenue Code, a corporation is required to file a return covering a tax period of less than twelve months, the state return shall be for the same period and is due forty=five days after the due date of the federal tax return, excluding any extension of time to file. In case of sickness, absence, or other disability, or if good cause exists, the director may allow further time for filing returns. The director shall cause to be prepared blank forms for the returns and shall cause them to be distributed throughout the state and to be furnished upon application, but failure to receive or secure the form does not relieve the taxpayer from the obligation of making a return that is required. The department may as far as consistent with the Code draft income tax forms to conform to the income tax forms of the internal revenue department of the United States government. Each return by a taxpayer upon whom a tax is imposed by section 422.5 shall show the county of the residence of the taxpayer. For tax years beginning on or after January 1, 2004, the director shall not prescribe and no longer accept income tax returns of married persons filing separately on the combined return form.

An individual in the armed forces of the United States serving in an area designated by the president of the United States or the United States Congress as a combat zone or as a qualified hazardous duty area, or an individual serving in support of those forces, is allowed the same additional time period after leaving the combat zone or the qualified hazardous duty area, or after a period of continuous hospitalization, to file a state income tax return or perform other acts related to the department, as would constitute timely filing of the return or timely performance of other acts described in section 7508(a) of the Internal Revenue Code. For the purposes of this paragraph, "other acts related to the department" includes filing claims for refund for any tax administered by the department, making tax payments other than withholding payments, filing appeals on the tax matters, filing other tax returns, and performing other acts described in the department's rules. The additional time period allowed applies to the spouse of the individual described in this paragraph to the extent the spouse files jointly ~~or separately on the combined return form~~ with the individual or when the spouse is a party with the individual to any matter for which the additional time period is allowed.

Sec. 17. Section 422.21, unnumbered paragraph 5, Code 2003, is amended by striking the unnumbered paragraph.

Sec. 18. Section 422.21, unnumbered paragraph 7, Code 2003, is amended to read as follows:

If married taxpayers file a joint return ~~or file separately on a combined return~~ in accordance with rules prescribed by the director, both spouses are jointly and severally liable for the total tax due on the return, except when one spouse is considered to be an innocent spouse under criteria established pursuant to section 6015 of the Internal Revenue Code.

Sec. 19. Section 422.11B, Code 2003, is repealed.

COORDINATING AMENDMENTS

Sec. 20. Section 12D.9, subsection 2, Code 2003, is amended to read as follows:

2. State income tax treatment of the Iowa educational savings plan trust shall be as provided in section 422.7, ~~subsections 32, 33, and 34~~ subsection 1, paragraph "e", and subsection 2, paragraph "h", and section 422.35, subsection 14.

Sec. 21. Section 217.39, Code 2003, is amended to read as follows:

217.39 PERSECUTED VICTIMS OF WORLD WAR II == REPARATIONS == HEIRS.

Notwithstanding any other law of this state, payments paid to and income from lost property of a victim of persecution for racial, ethnic, or religious reasons by Nazi Germany or any other Axis regime or as an heir of such victim which is exempt from state income tax as provided in section 422.7, subsection ~~35~~ 2, paragraph "k", shall not be considered as income or an asset for determining the eligibility for state or local government benefit or entitlement programs. The proceeds are not subject to recoupment for the receipt of governmental benefits or entitlements, and liens, except liens for child support, are not enforceable against these sums for any reason.

Sec. 22. Section 422.120, subsection 1, paragraph b, subparagraph (3), Code 2003, is amended to read as follows:

(3) The annual index factor for the 1997 calendar year is one hundred percent. For ~~each subsequent~~ the 1998 through 2002 calendar ~~year~~ years, the annual index factor equals the annual inflation factor for that calendar year as computed in section 422.4 for purposes of the individual income tax. For the 2003 calendar year and each subsequent calendar year the annual index factor shall be determined by the department by October 15 of the calendar year preceding the calendar year for which the factor is determined, which reflects the purchasing power of the dollar as a result of inflation during the fiscal year ending in the calendar year preceding the calendar year for which the factor is determined. In determining the annual index factor, the department shall use the annual percent change, but not less than zero percent, in the gross domestic product price deflator computed for the second quarter of the calendar year by the bureau of economic analysis of the United States department of commerce and shall add all of that percent change to one hundred percent. The annual index factor and the cumulative index factor shall each

be expressed as a percentage rounded to the nearest one=tenth of one percent. The annual index factor shall not be less than one hundred percent.

Sec. 23. Section 425.23, subsection 4, paragraph b, Code 2003, is amended to read as follows:

b. The annual adjustment factor for the 1998 base year is one hundred percent. For ~~each subsequent~~ the 1999 through 2002 base ~~year~~ years, the annual adjustment factor equals the annual inflation factor for the calendar year, in which the base year begins, as computed in section 422.4 for purposes of the individual income tax. For the 2003 base year and each subsequent base year, the annual adjustment factor equals the annual index factor, in which the base year begins, as computed in section 422.120, subsection 1, for purposes of the livestock production tax credit.

Sec. 24. Section 450.4, subsection 8, Code 2003, is amended to read as follows:

8. On the value of that portion of any lump sum or installment payments which are received by a beneficiary under an annuity which was purchased under an employee's pension or retirement plan which was excluded from net income ~~as set forth in~~ under section 422.7~~, subsection 31~~.

Sec. 25. Section 541A.2, subsection 7, unnumbered paragraph 1, Code 2003, is amended to read as follows:

An individual development account closed in accordance with this subsection is not subject to the limitations and benefits provided by this chapter but is subject to state tax in accordance with the provisions of section 422.7, subsection ~~28~~ 2, paragraph "g", and section 450.4, subsection 6. An individual development account may be closed for any of the following reasons:

Sec. 26. Section 541A.3, subsection 2, Code 2003, is amended to read as follows:

2. Income earned by an individual development account is not subject to state tax, in accordance with the provisions of section 422.7, subsection ~~28~~ 2, paragraph "g".

EFFECTIVE AND APPLICABILITY DATE PROVISION

Sec. 27.

1. Except as provided in subsection 2, this division of this Act takes effect January 1, 2004, for tax years beginning on or after that date.

2. The section of this division of this Act repealing section 422.11B takes effect January 1, 2007, for tax years beginning on or after that date.

DIVISION II

SALES, USE, AND CIGARETTE TAXES

SALES AND USE TAXES

Sec. 28. Section 422.42, subsection 6, Code 2003, is amended by adding the following new paragraph:

NEW PARAGRAPH. c. That in transactions in which tangible personal property or services are taxable when sold at retail, any charges by the retailer for handling, delivery, or freight are included in the gross receipts.

Sec. 29. Section 422.43, subsections 1, 2, 4, 5, 6, 7, 10, and 12, Code 2003, are amended to read as follows:

1. There is imposed a tax of five and one=half percent upon the gross receipts from all sales of tangible personal property, consisting of goods, wares, or merchandise, except as otherwise provided in this division, sold at retail in the state to consumers or users; a like rate of tax upon the gross receipts from the sales, furnishing, or service of gas, electricity, water, heat, pay television service, and communication service, including the gross receipts from such sales by any municipal corporation or joint water utility furnishing gas, electricity, water, heat, pay television service, and communication service to the public in its proprietary capacity, except as otherwise provided in this division, when sold at retail in the state to consumers or users; a like rate of tax upon the gross receipts from all sales of tickets or admissions to places of amusement, fairs, and athletic events except those of elementary and secondary educational institutions; a like rate of tax on the gross receipts from an entry fee or like charge imposed solely for the privilege of participating in an activity at a place of amusement, fair, or athletic event unless the gross receipts from the sales of tickets or admissions charges for observing the same activity are taxable under this division; and a like rate of tax upon that part of private club membership fees or charges paid for the privilege of participating in any athletic sports provided club members.

2. There is imposed a tax of five and one=half percent

upon the gross receipts derived from the operation of all forms of amusement devices and games of skill, games of chance, raffles, and bingo games as defined in chapter 99B, operated or conducted within the state, the tax to be collected from the operator in the same manner as for the collection of taxes upon the gross receipts of tickets or admission as provided in this section. The tax shall also be imposed upon the gross receipts derived from the sale of lottery tickets or shares pursuant to chapter 99E. The tax on the lottery tickets or shares shall be included in the sales price and distributed to the general fund as provided in section 99E.10.

4. There is imposed a tax of five and one=half percent upon the gross receipts from the sales of engraving, photography, retouching, printing, and binding services. For the purpose of this division, the sales of engraving, photography, retouching, printing, and binding services are sales of tangible property.

5. There is imposed a tax of five and one=half percent upon the gross receipts from the sales of vulcanizing, recapping, and retreading services. For the purpose of this division, the sales of vulcanizing, recapping, and retreading services are sales of tangible property.

6. There is imposed a tax of five and one=half percent upon the gross receipts from the sales of optional service or warranty contracts, except residential service contracts regulated under chapter 523C, which provide for the furnishing of labor and materials and require the furnishing of any taxable service enumerated under this section. The gross receipts are subject to tax even if some of the services furnished are not enumerated under this section. For the purpose of this division, the sale of an optional service or warranty contract, other than a residential service contract regulated under chapter 523C, is a sale of tangible personal property. Additional sales, services, or use taxes shall not be levied on services, parts, or labor provided under optional service or warranty contracts which are subject to tax under this section.

If the optional service or warranty contract is a computer software maintenance or support service contract and there is no separately stated fee for the taxable personal property or for the nontaxable service, the tax of five and one=half percent imposed by this subsection shall be imposed on fifty percent of the gross receipts from the sale of such contract. If the contract provides for technical support services only, no tax shall be imposed under this subsection. The provisions of this subsection also apply to the tax imposed by chapter 423.

7. There is imposed a tax of five and one=half percent upon the gross receipts from the renting of rooms, apartments, or sleeping quarters in a hotel, motel, inn, public lodging house, rooming house, manufactured or mobile home which is tangible personal property, or tourist court, or in any place where sleeping accommodations are furnished to transient guests for rent, whether with or without meals. "Renting" and "rent" include any kind of direct or indirect charge for such rooms, apartments, or sleeping quarters, or their use. For the purposes of this division, such renting is regarded as a sale of tangible personal property at retail. However, this tax does not apply to the gross receipts from the renting of a room, apartment, or sleeping quarters while rented by the same person for a period of more than thirty=one consecutive days.

10. There is imposed a tax of five and one=half percent upon the gross receipts from the rendering, furnishing, or performing of services as defined in section 422.42.

12. A tax of five and one=half percent is imposed upon the gross receipts from the sales of prepaid telephone calling cards and prepaid authorization numbers. For the purpose of this division, the sales of prepaid telephone calling cards and prepaid authorization numbers are sales of tangible personal property.

Sec. 30. Section 422.43, subsection 13, paragraph a, unnumbered paragraph 1, Code 2003, is amended to read as follows:

A tax of five and one=half percent is imposed upon the gross receipts from the sales, furnishing, or service of solid waste collection and disposal service.

Sec. 31. Section 422.43, subsections 16 and 17, Code 2003, are amended to read as follows:

16. a. A tax of five and one=half percent is imposed upon the gross receipts from sales of bundled services contracts.

For purposes of this subsection, a "bundled services contract" means an agreement providing for a retailer's performance of services, one or more of which is a taxable service enumerated in this section and one or more of which is not, in return for a consumer's or user's single payment for the performance of the services, with no separate statement to the consumer or user of what portion of that payment is attributable to any one service which is a part of the contract.

b. For purposes of the administration of the tax on bundled services contracts, the director may enter into agreements of limited duration with individual retailers, groups of retailers, or organizations representing retailers of bundled services contracts. Such an agreement shall impose the tax rate only upon that portion of the gross receipts from a bundled services contract which is attributable to taxable services provided under the contract.

17. A tax of five and one=half percent is imposed upon the gross receipts from any mobile telecommunication service which this state is allowed to tax by the provisions of the federal Mobile Telecommunications Sourcing Act, Pub. L. No. 106=252, 4 U.S.C. } 116 et seq. For purposes of this subsection, taxes on mobile telecommunications service, as defined under the federal Mobile Telecommunications Sourcing Act, that are deemed to be provided by the customer's home service provider shall be paid to the taxing jurisdiction whose territorial limits encompass the customer's place of primary use, regardless of where the mobile telecommunication service originates, terminates, or passes through and shall in all other respects be taxed in conformity with the federal Mobile Telecommunications Sourcing Act. All other provisions of the federal Mobile Telecommunications Sourcing Act are adopted by the state of Iowa and incorporated into this subsection by reference. With respect to mobile telecommunications service under the federal Mobile Telecommunications Sourcing Act the director shall, if requested, enter into agreements consistent with the provisions of the federal Act.

Sec. 32. Section 422.45, subsection 61, Code 2003, is amended by striking the subsection and inserting in lieu thereof the following:

61. a. The gross receipts from the sale, furnishing, or service of metered gas, electricity, and fuel, including propane and heating oil to residential customers which is used to provide energy for residential dwellings and units of apartment and condominium complexes used for human occupancy shall be partially exempt as provided in paragraph "b".

b. If the date of the utility billing or meter reading cycle of the residential customer for the sale, furnishing, or service of metered gas and electricity is on or after January 1, 2003, or if the sale, furnishing, or service of fuel for purposes of residential energy and the delivery of the fuel occurs on or after January 1, 2003, the rate of tax is three percent of the gross receipts.

c. The partial exemption in this subsection does not apply to local option sales and services taxes imposed pursuant to chapters 422B and 422E.

Sec. 33. Section 422.47, Code 2003, is amended by adding the following new subsection:

NEW SUBSECTION. 2. Construction contractors may make application to the department for a refund of the additional one=half of one percent tax paid under this division by reason of the increase in the tax from five to five and one=half percent for taxes paid on goods, wares, or merchandise under the following conditions:

a. The goods, wares, or merchandise are incorporated into an improvement to real estate in fulfillment of a written contract fully executed prior to July 1, 2003. The refund shall not apply to equipment transferred in fulfillment of a mixed construction contract.

b. The contractor has paid to the department or to a retailer the full five and one=half percent tax.

c. The claim is filed on forms provided by the department and is filed within one year of the date the tax is paid.

A contractor who makes an erroneous application for refund shall be liable for payment of the excess refund paid plus interest at the rate in effect under section 421.7. In addition, a contractor who willfully makes a false application for refund is guilty of a simple misdemeanor and is liable for a penalty equal to fifty percent of the excess refund claimed. Excess refunds, penalties, and interest due under this subsection may be enforced and collected in the same manner as the tax imposed by this division.

Sec. 34. Section 422C.3, subsection 1, Code 2003, is amended to read as follows:

1. A tax of five and one=half percent is imposed upon the rental price of an automobile if the rental transaction is subject to the sales and services tax under chapter 422, division IV, or the use tax under chapter 423. The tax shall not be imposed on any rental transaction not taxable under the state sales and services tax, as provided in section 422.45, or the state use tax, as provided in section 423.4, on automobile rental receipts.

Sec. 35. Section 423.2, Code 2003, is amended to read as follows:

423.2 IMPOSITION OF TAX.

An excise tax is imposed on the use in this state of tangible personal property, including aircraft subject to registration under section 328.20, purchased for use in this state, at the rate of five and one=half percent of the purchase price of the property. An excise tax is imposed on the use of manufactured housing in this state at the rate of five and one=half percent of the purchase price if the manufactured housing is sold in the form of tangible personal property and at the rate of five and one=half percent of the installed purchase price if the manufactured housing is sold in the form of realty. An excise tax is imposed on the use of leased vehicles at the rate of five and one=half percent of the amount otherwise subject to tax as calculated pursuant to section 423.7A. The excise tax is imposed upon every person using the property within this state until the tax has been paid directly to the county treasurer or the state department of transportation, to a retailer, or to the department. An excise tax is imposed on the use in this state of services enumerated in section 422.43 at the rate of five and one=half percent. This tax is applicable where services are rendered, furnished, or performed in this state or where the product or result of the service is used in this state. This tax is imposed on every person using the services or the product of the services in this state until the user has paid the tax either to an Iowa use tax permit holder or to the department.

Sec. 36. APPLICABILITY. This section applies in regard to the increase in the state sales tax from five to five and one= half percent. The five and one=half percent rate applies to all sales of taxable personal property, consisting of goods, wares, or merchandise if delivery occurs on or after July 1, 2003. The five and one=half percent rate applies to the gross receipts from the sale, furnishing, or service of gas, electricity, water, heat, pay television service, and communication service if the date of billing the customer is on or after July 1, 2003. In the case of a service contract entered into prior to July 1, 2003, which contract calls for periodic payments, the five and one=half percent rate applies to those payments made or due on or after July 1, 2003. This periodic payment applies, but is not limited to, tickets or admissions, private club membership fees, sources of amusement, equipment rental, dry cleaning, reducing salons, dance schools, and all other services subject to tax, except the aforementioned utility services which are subject to a special transitional rule. Unlike periodic payments under service contracts, installment sales of goods, wares, and merchandise are subject to the full amount of sales or use tax when the sales contract is entered into.

CIGARETTE AND TOBACCO TAXES

Sec. 37. Section 453A.6, subsection 1, Code 2003, is amended to read as follows:

1. There is imposed, and shall be collected and paid to the department, the following taxes on all cigarettes used or otherwise disposed of in this state for any purpose whatsoever:

CLASS A. On cigarettes weighing not more than three pounds per thousand, ~~eighteen mills~~ three and five hundredths cents on each such cigarette.

CLASS B. On cigarettes weighing more than three pounds per thousand, ~~eighteen mills~~ three and five hundredths cents on each such cigarette.

Sec. 38. Section 453A.43, subsection 1, unnumbered paragraph 1, Code 2003, is amended to read as follows:

A tax is imposed upon all tobacco products in this state and upon any person engaged in business as a distributor of tobacco products, at the rate of ~~twenty=two~~ thirty=seven percent of the wholesale sales price of the tobacco products, except little cigars as defined in section 453A.42. Little cigars shall be subject to the same rate of tax imposed upon cigarettes in section 453A.6, payable at the time and in the manner provided in section 453A.6; and stamps shall be affixed as provided in division I of this chapter. The tax on tobacco products, excluding little cigars, shall be imposed at the time the distributor does any of the following:

Sec. 39. Section 453A.43, subsection 2, unnumbered paragraph 1, Code 2003, is amended to read as follows:

A tax is imposed upon the use or storage by consumers of tobacco products in this state, and upon the consumers, at the rate of ~~twenty=two~~ thirty=seven percent of the cost of the tobacco products.

STUDY COMMITTEES

Sec. 40. INDUSTRIAL PROCESSING EXEMPTION STUDY COMMITTEE. On or before July 1, 2003, the department of revenue and finance shall initiate and coordinate the establishment of an industrial processing exemption study committee and provide staffing assistance to the committee. It is the intent of the general assembly that the committee shall include representatives of the department of revenue and finance, department of management, industrial producers including manufacturers, fabricators, printers and publishers, and an association that specifically represents business tax issues, and other stakeholders.

The industrial processing exemption under the sales and use tax is a significant exemption for business. The committee shall study and make legislative and administrative recommendations relating to Iowa's processing exemption to ensure maximum utilization by Iowa's industries.

The committee shall study and make recommendations regarding all of the following:

1. The current sales and use tax industrial processing exemption.

2. The corresponding administrative rules, including a review and recommendation of an administrative rules process relating to the industrial processing exemption prior to filing with the administrative rules review committee.

3. Other states' industrial processing exemptions.

4. Recommendations for change for issues including effectiveness and competitiveness.

5. Development of additional publications to improve compliance.

The committee shall annually report to the general assembly by January 1 of each year through January 1, 2013.

Sec. 41. IOWA SALES, SERVICES, AND USE TAX STUDY COMMITTEE. On or before July 1, 2003, the department of revenue and finance shall initiate and coordinate the establishment of a state sales, services, and use tax study committee and provide staffing assistance to the committee. It is the intent of the general assembly that the committee shall include representatives of the department of revenue and finance, department of management, an association of Iowa farmers and other agricultural interests, retail associations, contractors, taxpayers, an association that specifically represents business tax issues and other stakeholders, two members of the general assembly, and a representative of the governor's office.

The committee shall study the current sales, services, and use tax law. Programs funded through special features of the tax code often escape regular review. It is intended that the study committee shall review the current sales, services, and use tax exemptions to improve government accountability.

The committee shall study and make recommendations regarding all of the following:

1. Retaining or eliminating current sales, services, and use tax exemptions or providing new exemptions. The decision shall be based at least partially on the issues of effectiveness and competitiveness and their impact on economic behavior.

2. Tax simplification and consistency issues in applying the tax, including recordkeeping burdens on retailers and application by the department of revenue and finance.

3. Streamline sales tax implementation in Iowa.

4. The tax rate.

5. Comparison of Iowa sales, services, and use tax structure with other states.

The committee shall report to the general assembly by January 1, 2004. The report shall provide rationale for each decision made by the study committee.

EXPLANATION

DIVISION I == Division I of this bill rewrites the state individual income tax by setting a flat rate of 3.5 percent of the taxable income. Most adjustments to federal adjusted gross income are eliminated. However, deductions for a portion of social security benefits and pensions received are maintained. In arriving at the taxable income, all of the itemized deductions allowed for federal tax purposes are eliminated. A standard deduction is provided which is equal to $2,000 for each personal exemption the taxpayer is allowed under the federal tax code. An additional $1,000 deduction is allowed if the individual or the individual's spouse is 65 or older or blind. The present personal credit is made contingent on the amount of net income. This amounts to a maximum income of $25,000 for single filers and $50,000 for joint filers and heads of households. The deduction for federal income taxes paid is eliminated. The alternative minimum tax is eliminated. The division also retains the present credits that are allowed except for the minimum tax credit which is eliminated beginning with the 2007 tax year. The ability of married persons to file separately on combined returns is eliminated. The division requires a three=fourths vote of members elected to each house to pass legislation that would increase the income tax rate or would impose an alternative minimum tax or individual income surtax. A person is not required to file a return if the person's net income is no more than $15,000 for joint filers, heads of households, and surviving spouses, or no more than $11,000 for single filers.

Division I of the bill takes effect January 1, 2004, for tax years beginning on or after that date.

DIVISION II == Division II of this bill increases the sales and use tax rates from 5 percent to 5.5 percent, sets the rate for providing gas, electricity, and fuel for residential dwellings at 3 percent (total exemption was to occur beginning January 1, 2006), and imposes the tax on the charges by retailers for delivery or transportation of taxable tangible personal property and services.

The division also increases the cigarette tax rate from 1.8 cents per cigarette, 36 cents a pack, to 3.05 cents per cigarette, 61 cents a pack, and increases the tobacco products tax from 22 percent of the wholesale price to 37 percent of the wholesale price.

The division requires the department of revenue and finance to establish two study committees. The first is to study the industrial processing exemption under the sales and use tax and report to the legislature annually through January 2013. The second is to study the entire sales and use tax law and report to the legislature with its recommendations by January 1, 2004. Both study committees would consist of representatives of organizations or businesses with interests in the issues.

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