House Study Bill 626 - Introduced

HOUSE FILE _____
BY (PROPOSED COMMITTEE ON WAYS AND MEANS BILL BY CHAIRPERSON HEIN)

A BILL FOR

An Act relating to state revenue and finance by modifying the individual income tax, making appropriations, and including effective date and applicability provisions.

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

DIVISION I

SALE OF CERTAIN QUALIFIED STOCK —— NET CAPITAL GAIN EXCLUSION

Section 1. Section 422.7, Code 2022, is amended by adding the following new subsection:

NEW SUBSECTION. 63. *a.* Subtract the following percentage of the net capital gain from the sale or exchange of capital stock of a qualified corporation for which an election is made by an employee-owner:

(1) For the tax year beginning in the 2023 calendar year, thirty-three percent.

(2) For the tax year beginning in the 2024 calendar year, sixty-six percent.

(3) For tax years beginning on or after January 1, 2025, one hundred percent.

b. (1) An employee-owner is entitled to make one irrevocable lifetime election to exclude the net capital gain from the sale or exchange of capital stock of one qualified corporation which capital stock was acquired by the employee-owner while employed and on account of employment by such qualified corporation.

(2) The election shall apply to all subsequent sales or exchanges of qualifying capital stock of the elected corporation within fifteen years of the date of the election, provided that the subsequent sales or exchanges were of capital stock in the same qualified corporation and were acquired by the employee-owner while employed and on account of employment by such qualified corporation.

(3) The election shall apply to qualifying capital stock that has been transferred by inter vivos gift from the employee-owner to the employee-owner's spouse or to a trust for the benefit of the employee-owner's spouse following the transfer. This subparagraph (3) shall apply to a spouse only if the spouse was married to the employee-owner on the date of the sale or exchange or the date of death of the employee-owner.

(4) If the employee-owner dies after having sold or exchanged qualifying capital stock without having made an election under this subsection, the surviving spouse or, if there is no surviving spouse, the personal representative of the employee-owner's estate, may make the election that would have qualified under this subsection.

(5) The election shall be made in the manner and form prescribed by the department and shall be included with the taxpayer's state income tax return for the taxable year in which the election is made.

c. For purposes of this subsection:

(1) *"Capital stock"* means common or preferred stock, either voting or nonvoting. *"Capital stock"* does not include stock rights, stock warrants, stock options, or debt securities.

(2) *"Employee-owner"* means an individual who owns capital stock in a qualified corporation for at least ten years, which capital stock was acquired by the individual while employed and on account of employment by such corporation for at least ten cumulative years.

(3) *"Personal representative"* means the same as defined in section 633.3, or if there is no such personal representative appointed, then the person legally authorized to perform substantially the same functions.

(4) (a) *"Qualified corporation"* means, with respect to an employee-owner, a corporation which, at the time of the first sale or exchange for which an election is made by the employee-owner under this subsection, meets all of the following conditions:

(i) The corporation employed individuals in this state for at least ten years.

(ii) The corporation has had at least five shareholders for the ten years prior to the first sale or exchange under this subsection.

(iii) The corporation has had at least two shareholders or groups of shareholders who are not related for the ten years prior to the first sale or exchange under this subsection. Two persons are considered related when, under section 318 of the Internal Revenue Code, one is a person who owns, directly or indirectly, capital stock that if directly owned would be attributed to the other person, or is the brother, sister, aunt, uncle, cousin, niece, or nephew of the other person who owns capital stock either directly or indirectly.

(b) "*Qualified corporation*" includes any member of an Iowa affiliated group if the Iowa affiliated group includes a member that has employed individuals in this state for at least ten years. For purposes of this subparagraph division, "*Iowa affiliated group*" means an affiliated group that has made a valid election to file an Iowa consolidated income tax return under section 422.37 in the year in which the deduction under this subsection is claimed. "*Member*" includes any entity included in the consolidated return under section 422.37, subsection 2, for the tax year in which the deduction is claimed.

(c) "*Qualified corporation*" also includes any corporation that was a party to a reorganization that was entirely or substantially tax free if such reorganization occurred during or after the employment of the employee-owner.

Sec. 2. EFFECTIVE DATE. This division of this Act takes effect January 1, 2023.

Sec. 3. APPLICABILITY. This division of this Act applies to tax years beginning on or after January 1, 2023.

DIVISION II

RETIRED FARMER LEASE INCOME EXCLUSION

Sec. 4. Section 422.7, Code 2022, is amended by adding the following new subsection:

NEW SUBSECTION. 21A. *a.* Subtract, to the extent included, net income received by an eligible individual pursuant to a farm tenancy agreement covering real property held by the eligible individual for ten or more years, if the eligible individual materially participated in a farming business for ten or more years.

b. An individual who elects to exclude income received pursuant to a farm tenancy agreement under this subsection shall not claim any of the following in the tax year in which the election is made or in any succeeding year:

(1) The capital gain exclusion under section 422.7, subsection 21.

(2) The beginning farmer tax credit under section 422.11E.

c. Married individuals who file separate state income tax returns shall allocate their combined annual exclusion limit to each spouse in the proportion that each spouse's respective net income from a farm tenancy agreement bears to the total net income from a farm tenancy agreement.

d. The department shall establish criteria, by rule, relating to whether and how a surviving spouse may claim the income exclusion for which a deceased eligible individual would have been eligible under this subsection.

e. Net income from a farm tenancy agreement earned, received, or reported by an entity taxed as a partnership for federal tax purposes, an S corporation, or a trust or estate is not eligible for the election and deduction in this subsection, even if such net income ultimately passes through to an eligible individual.

f. For purposes of this subsection:

(1) "*Eligible individual*" means an individual who is disabled or who is fifty-five years of age or older at the time the election is made, who no longer materially participates in a farming business at the time the election is made, and who, as an owner-lessor, is party to a farm tenancy agreement.

(2) "*Farm tenancy agreement*" means a written agreement outlining the rights and obligations of an owner-lessor and a tenant-lessee where the tenant-lessee has a farm tenancy as defined in section 562.1A. A "*farm tenancy agreement*" includes cash leases, crop share leases, or livestock share leases.

(3) "*Farming business*" means the production, care, growing,

harvesting, preservation, handling, or storage of crops or forest or fruit trees; the production, care, feeding, management, and housing of livestock; or horticulture, all intended for profit.

(4) *"Livestock"* means the same as defined in section 717.1.

(5) *"Materially participated"* means the same as *"material participation"* in section 469(h) of the Internal Revenue Code.

Sec. 5. EFFECTIVE DATE. This division of this Act takes effect January 1, 2023.

Sec. 6. APPLICABILITY. This division of this Act applies to tax years beginning on or after January 1, 2023.

DIVISION III

RETIRED FARMER CAPITAL GAIN EXCLUSION

Sec. 7. Section 422.7, subsection 21, Code 2022, is amended by striking the subsection and inserting in lieu thereof the following:

21. *a.* For purposes of this subsection:

(1) *"Farming business"* means the production, care, growing, harvesting, preservation, handling, or storage of crops or forest or fruit trees; the production, care, feeding, management, and housing of livestock; or horticulture, all for intended profit.

(2) *"Held"* shall be determined with reference to the holding period provisions of section 1223 of the Internal Revenue Code and the federal regulations pursuant thereto.

(3) *"Livestock"* means the same as defined in section 717.1.

(4) *"Materially participated"* means the same as *"material participation"* in section 469(h) of the Internal Revenue Code.

(5) (a) *"Real property used in a farming business"* means all tracts of land and the improvements and structures located on such tracts which are in good faith used primarily for a farming business. Buildings which are primarily used or intended for human habitation are deemed to be used in a farming business when the building is located on or adjacent to the parcel used in the farming business. Land and the

nonresidential improvements and structures located on such land that shall be considered to be used primarily in a farming business include but are not limited to land, improvements or structures used for the storage or maintenance of farm machinery or equipment, for the drying, storage, handling, or preservation of agricultural crops, or for the storage of farm inputs, feed, or manure. Real property used in a farming business shall also include woodland, wasteland, pastureland, and idled land used for the conservation of natural resources including soil and water.

(b) Real property classified as agricultural property for Iowa property tax purposes, except real property described in section 441.21, subsection 12, paragraph *"a"* or *"b"*, shall be presumed to be real property used in a farming business. This presumption is rebuttable by the department by a preponderance of evidence that the real property did not meet the requirements of subparagraph division (a).

(6) *"Relative"* means a person that satisfies one or more of the following conditions:

(a) The individual is related to the taxpayer by consanguinity or affinity within the second degree as determined by common law.

(b) The individual is a lineal descendent of the taxpayer. For purposes of this subparagraph division, *"lineal descendent"* means children of the taxpayer, including legally adopted children and biological children, stepchildren, grandchildren, great-grandchildren, and any other lineal descendent of the taxpayer.

(c) An entity in which an individual who satisfies the conditions of either subparagraph division (a) or (b) has a legal or equitable interest as an owner, member, partner, or beneficiary.

(7) *"Retired farmer"* means an individual who is disabled or who is fifty-five years of age or older and who no longer materially participates in a farming business when an exclusion

and deduction is claimed under this subsection.

b. Subtract the net capital gain from the sale of real property used in a farming business if one of the following conditions are satisfied:

(1) The taxpayer has materially participated in a farming business for a minimum of ten years and has held the real property used in a farming business for a minimum of ten years. If the taxpayer is a retired farmer, the taxpayer is considered to meet the material participation requirement if the taxpayer materially participated in a farming business for ten years or more in the aggregate, prior to making an election under this subsection.

(2) The taxpayer has held the real property used in a farming business which is sold to a relative of the taxpayer.

c. For a taxpayer who is a retired farmer, subtract the net capital gain from the sale of cattle or horses held by the taxpayer for breeding, draft, dairy, or sporting purposes for a period of twenty-four months or more from the date of acquisition; but only if the taxpayer materially participated in the farming business for five of the eight years preceding the farmer's retirement or disability and who has sold all or substantially all of the taxpayer's interest in the farming business by the time the election under this paragraph is made.

d. For a taxpayer who is a retired farmer, subtract the net capital gain from the sale of breeding livestock, other than cattle and horses, if the livestock is held by the taxpayer for a period of twelve months or more from the date of acquisition; but only if the taxpayer materially participated in the farming business for five of the eight years preceding the farmer's retirement or disability and who has sold all or substantially all of the taxpayer's interest in the farming business by the time the election under this paragraph is made.

e. A taxpayer who is a retired farmer may make, subject to the limitations described in paragraphs "*f*" and "*g*", a single, lifetime election to exclude all qualifying capital gains under paragraphs *"b"*, *"c"*, and *"d"*.

f. A taxpayer who is a retired farmer who elects to exclude capital gains under paragraph *"b"*, *"c"*, or *"d"* shall not claim the beginning farmer tax credit under section 422.11E or the exclusion for net income received pursuant to a farm tenancy agreement in section 422.7, subsection 21A, in the tax year in which this election is made or in any subsequent year.

g. A taxpayer who is a retired farmer who claims the beginning farmer tax credit under section 422.11E shall not, in the same year, make an election under this subsection. A taxpayer who is a retired farmer and who elects to exclude the net income received from a farm tenancy agreement under section 422.7, subsection 21A, shall not, in the same tax year or in any subsequent tax year, make the election under this subsection.

h. Married individuals who file separate state income tax returns shall allocate their combined annual net capital gain exclusion under paragraphs *"b"*, *"c"*, and *"d"* to each spouse in the proportion that each spouse's respective net capital gain bears to the total net capital gain.

i. The department shall establish criteria, by rule, relating to whether and how a surviving spouse may claim the income exclusion for which a deceased retired farmer would have been eligible under this subsection.

Sec. 8. REPEAL. 2018 Iowa Acts, chapter 1161, section 113, is repealed.

Sec. 9. REPEAL. 2019 Iowa Acts, chapter 162, section 1, is repealed.

Sec. 10. EFFECTIVE DATE. This division of this Act takes effect January 1, 2023.

Sec. 11. APPLICABILITY.

1. This division of this Act applies to tax years beginning on or after January 1, 2023.

2. This division of this Act applies to sales consummated on or after the effective date of this division of this Act, and

sales consummated prior to the effective date of this division of this Act shall be governed by the law as it existed prior to the effective date of this division of this Act.

DIVISION IV

INDIVIDUAL INCOME TAX RATES —— TAX YEARS 2023-2025

Sec. 12. Section 422.5, subsection 3, paragraph b, Code 2022, is amended to read as follows:

b. (1) In lieu of the computation in subsection 1 or 2, or in paragraph *"a"* of this subsection, if the married persons', filing jointly ~~or filing separately on a combined return~~, head of household's, or surviving spouse's net income exceeds thirteen thousand five hundred dollars, the regular tax imposed under this subchapter shall be the lesser of the ~~maximum~~ alternate state individual income tax rate specified in subparagraph (2) times the portion of the net income in excess of thirteen thousand five hundred dollars or the regular tax liability computed without regard to this sentence. Taxpayers electing to file separately shall compute the alternate tax described in this paragraph using the total net income of the ~~husband and wife~~ spouses. The alternate tax described in this paragraph does not apply if one spouse elects to carry back or carry forward the loss as provided in section 422.9, subsection 3.

(2) (a) (i) (A) For the tax year beginning on or after January 1, 2023, but before January 1, 2024, the alternate tax rate is 6.00 percent.

(B) For the tax year beginning on or after January 1, 2024, but before January 1, 2025, the alternate tax rate is 5.70 percent.

(C) For the tax year beginning on or after January 1, 2025, but before January 1, 2026, the alternate tax rate is 5.20 percent.

(ii) This subparagraph division (a) is repealed January 1, 2026.

(b) For tax years beginning on or after January 1, 2026, the alternate tax rate is 4.50 percent.

Sec. 13. Section 422.5, subsection 3B, paragraph b, Code 2022, is amended to read as follows:

b. (1) In lieu of the computation in subsection 1, 2, or 3, if the married persons', filing jointly ~~or filing separately on a combined return~~, head of household's, or surviving spouse's net income exceeds thirty-two thousand dollars, the regular tax imposed under this subchapter shall be the lesser of the ~~maximum~~ alternate state individual income tax rate specified in subparagraph (2) times the portion of the net income in excess of thirty-two thousand dollars or the regular tax liability computed without regard to this sentence. Taxpayers electing to file separately shall compute the alternate tax described in this paragraph using the total net income of the ~~husband and wife~~ spouses. The alternate tax described in this paragraph does not apply if one spouse elects to carry back or carry forward the loss as provided in section 422.9, subsection 3.

(2) (a) (i) (A) For the tax year beginning on or after January 1, 2023, but before January 1, 2024, the alternate tax rate is 6.00 percent.

(B) For the tax year beginning on or after January 1, 2024, but before January 1, 2025, the alternate tax rate is 5.70 percent.

(C) For the tax year beginning on or after January 1, 2025, but before January 1, 2026, the alternate tax rate is 5.20 percent.

(ii) This subparagraph division (a) is repealed January 1, 2026.

(b) For tax years beginning on or after January 1, 2026, the alternate tax rate is 4.50 percent.

Sec. 14. Section 422.5, subsection 6, Code 2022, is amended to read as follows:

6. *a.* Upon determination of the latest cumulative inflation factor, the director shall multiply each dollar amount set forth in section 422.5A by this cumulative inflation factor,

shall round off the resulting product to the nearest one dollar, and shall incorporate the result into the income tax forms and instructions for each tax year.

b. This subsection is repealed on January 1, 2026.

Sec. 15. Section 422.5A, Code 2022, is amended by striking the section and inserting in lieu thereof the following:

422.5A Tax rates.

1. *a.* The tax imposed in section 422.5 shall be calculated using the following rates in the following tax years in the case of married persons filing jointly:

(1) For the tax year beginning on or after January 1, 2023, but before January 1, 2024:

(a) On taxable income from 0 through $12,000, the rate of 4.40 percent.

(b) On taxable income exceeding $12,000 but not exceeding $60,000, the rate of 4.82 percent.

(c) On taxable income exceeding $60,000 but not exceeding $150,000, the rate of 5.70 percent.

(d) On taxable income exceeding $150,000, the rate of 6.00 percent.

(2) For the tax year beginning on or after January 1, 2024, but before January 1, 2025:

(a) On taxable income from 0 through $12,000, the rate of 4.40 percent.

(b) On taxable income exceeding $12,000 but not exceeding $60,000, the rate of 4.82 percent.

(c) On taxable income exceeding $60,000, the rate of 5.70 percent.

(3) For the tax year beginning on or after January 1, 2025, but before January 1, 2026:

(a) On taxable income from 0 through $12,000, the rate of 4.40 percent.

(b) On taxable income exceeding $12,000, the rate of 4.82 percent.

b. The tax imposed in section 422.5 shall be calculated using the following rates in the following tax years in the case of any other taxpayer other than married persons filing jointly:

(1) For the tax year beginning on or after January 1, 2023, but before January 1, 2024:

(a) On taxable income from 0 through $6,000, the rate of 4.40 percent.

(b) On taxable income exceeding $6,000 but not exceeding $30,000, the rate of 4.82 percent.

(c) On taxable income exceeding $30,000 but not exceeding $75,000, the rate of 5.70 percent.

(d) On taxable income exceeding $75,000, the rate of 6.00 percent.

(2) For the tax year beginning on or after January 1, 2024, but before January 1, 2025:

(a) On taxable income from 0 through $6,000, the rate of 4.40 percent.

(b) On taxable income exceeding $6,000 but not exceeding $30,000, the rate of 4.82 percent.

(c) On taxable income exceeding $30,000, the rate of 5.70 percent.

(3) For the tax year beginning on or after January 1, 2025, but before January 1, 2026:

(a) On taxable income from 0 through $6,000, the rate of 4.40 percent.

(b) On taxable income exceeding $6,000, the rate of 4.82 percent.

2. This section is repealed January 1, 2026.

Sec. 16. REPEAL. 2018 Iowa Acts, chapter 1161, section 107, is repealed.

Sec. 17. EFFECTIVE DATE. This division of this Act takes effect January 1, 2023.

Sec. 18. APPLICABILITY. This division of this Act applies to tax years beginning on or after January 1, 2023.

DIVISION V

INDIVIDUAL INCOME TAX —— FLAT RATE

Sec. 19. Section 421.27, subsection 9, paragraph a, subparagraph (3), Code 2022, is amended to read as follows:

(3) In the case of all other entities, including corporations described in section 422.36, subsection 5, and all other entities required to file an information return under section 422.15, subsection 2, the entity's Iowa net income after the application of the Iowa business activity ratio, if applicable, multiplied by the ~~top~~ income tax rate imposed under section ~~422.5A~~ 422.5 for the tax year, less any Iowa tax credits available to the entity.

Sec. 20. Section 422.5, subsection 1, paragraph a, Code 2022, is amended to read as follows:

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 as defined in this subchapter at ~~rates as provided in section 422.5A~~ a rate of four percent.

Sec. 21. Section 422.16B, subsection 2, paragraph a, Code 2022, is amended to read as follows:

a. (1) A pass-through entity shall file a composite return on behalf of all nonresident members and shall report and pay the income or franchise tax imposed under this chapter at the maximum state income or franchise tax rate applicable to the member under section ~~422.5A~~ 422.5, 422.33, or 422.63 on the nonresident members' distributive shares of the income from the pass-through entity.

(2) The tax rate applicable to a tiered pass-through entity shall be the ~~maximum~~ state income tax rate under section ~~422.5A~~ 422.5.

Sec. 22. Section 422.25A, subsection 5, paragraph c, subparagraphs (3), (4), and (5), Code 2022, are amended to read as follows:

(3) Determine the total distributive share of all final federal partnership adjustments and positive reallocation

adjustments as modified by this title that are reported to nonresident individual partners and nonresident fiduciary partners and allocate and apportion such adjustments as provided in section 422.33 at the partnership or tiered partner level, and multiply the resulting amount by the ~~maximum~~ individual income tax rate pursuant to section ~~422.5A~~ 422.5 for the reviewed year.

(4) For the total distributive share of all final federal partnership adjustments and positive reallocation adjustments as modified by this title that are reported to tiered partners:

(a) Determine the amount of such adjustments which are of a type that would be subject to sourcing to Iowa under section 422.8, subsection 2, paragraph *"a"*, as a nonresident, and then determine the portion of this amount that would be sourced to Iowa under those provisions as if the tiered partner were a nonresident.

(b) Determine the amount of such adjustments which are of a type that would not be subject to sourcing to Iowa under section 422.8, subsection 2, paragraph *"a"*, as a nonresident.

(c) Determine the portion of the amount in subparagraph division (b) that can be established, as prescribed by the department by rule, to be properly allocable to indirect partners that are nonresident partners or other partners not subject to tax on the adjustments.

(d) Multiply the total of the amounts determined in subparagraph divisions (a) and (b), reduced by any amount determined in subparagraph division (c), by the ~~highest~~ individual income tax rate pursuant to section ~~422.5A~~ 422.5 for the reviewed year.

(5) For the total distributive share of all final federal partnership adjustments and positive reallocation adjustments as modified by this title that are reported to resident individual partners and resident fiduciary partners, multiply that amount by the ~~highest~~ individual income tax rate pursuant to section ~~422.5A~~ 422.5 for the reviewed year.

Sec. 23. EFFECTIVE DATE. This division of this Act takes effect January 1, 2026.

Sec. 24. APPLICABILITY. This division of this Act applies to tax years beginning on or after January 1, 2026.

DIVISION VI

RETIREMENT INCOME

Sec. 25. Section 8.57E, subsection 2, Code 2022, is amended to read as follows:

2. Moneys in the taxpayer relief fund shall only be used pursuant to appropriations or transfers made by the general assembly for tax relief~~, including but not limited to increases in the general retirement income exclusion under section 422.7, subsection 31,~~ or reductions in income tax rates.

Sec. 26. Section 422.5, subsection 3, paragraph a, Code 2022, is amended to read as follows:

a. The tax shall not be imposed on a resident or nonresident whose net income, as defined in section 422.7, is thirteen thousand five hundred dollars or less in the case of married persons filing jointly or filing separately on a combined return, heads of household, and surviving spouses or nine thousand dollars or less in the case of all other persons; but in the event that the payment of tax under this subchapter would reduce the net income to less than thirteen thousand five hundred dollars or nine thousand dollars as applicable, then the tax shall be reduced to that amount which would result in allowing the taxpayer to retain a net income of thirteen thousand five hundred dollars or nine thousand dollars as applicable. The preceding sentence does not apply to estates or trusts. For the purpose of this subsection, the entire net income, including any part of the net income not allocated to Iowa, shall be taken into account. ~~For purposes of this subsection, net income includes all amounts of pensions or other retirement income, except for military retirement pay excluded under section 422.7, subsection 31A, paragraph "a", or section 422.7, subsection 31B, paragraph "a", received from any~~

~~source which is not taxable under this subchapter as a result of the government pension exclusions in section 422.7, or any other state law.~~ If the combined net income of a husband and wife exceeds thirteen thousand five hundred dollars, neither of them shall receive the benefit of this subsection, and it is immaterial whether they file a joint return or separate returns. However, if a husband and wife file separate returns and have a combined net income of thirteen thousand five hundred dollars or less, neither spouse shall receive the benefit of this paragraph, if one spouse has a net operating loss and 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 this subsection if the person claiming the dependent has net income exceeding thirteen thousand five hundred dollars or nine thousand dollars as applicable or the person claiming the dependent and the person's spouse have combined net income exceeding thirteen thousand five hundred dollars or nine thousand dollars as applicable.

Sec. 27. Section 422.5, subsection 3B, paragraph a, Code 2022, is amended to read as follows:

a. The tax shall not be imposed on a resident or nonresident who is at least sixty-five years old on December 31 of the tax year and whose net income, as defined in section 422.7, is thirty-two thousand dollars or less in the case of married persons filing jointly or filing separately on a combined return, heads of household, and surviving spouses or twenty-four thousand dollars or less in the case of all other persons; but in the event that the payment of tax under this subchapter would reduce the net income to less than thirty-two thousand dollars or twenty-four thousand dollars as applicable, then the tax shall be reduced to that amount which would result in allowing the taxpayer to retain a net income of thirty-two thousand dollars or twenty-four thousand dollars as applicable.

The preceding sentence does not apply to estates or trusts. For the purpose of this subsection, the entire net income, including any part of the net income not allocated to Iowa, shall be taken into account. ~~For purposes of this subsection, net income includes all amounts of pensions or other retirement income, except for military retirement pay excluded under section 422.7, subsection 31A, paragraph "a", or section 422.7, subsection 31B, paragraph "a", received from any source which is not taxable under this subchapter as a result of the government pension exclusions in section 422.7, or any other state law.~~ If the combined net income of a husband and wife exceeds thirty-two thousand dollars, neither of them shall receive the benefit of this subsection, and it is immaterial whether they file a joint return or separate returns. However, if a husband and wife file separate returns and have a combined net income of thirty-two thousand dollars or less, neither spouse shall receive the benefit of this paragraph, if one spouse has a net operating loss and 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 this subsection if the person claiming the dependent has net income exceeding thirty-two thousand dollars or twenty-four thousand dollars as applicable or the person claiming the dependent and the person's spouse have combined net income exceeding thirty-two thousand dollars or twenty-four thousand dollars as applicable.

Sec. 28. Section 422.7, subsection 31, Code 2022, is amended to read as follows:

31. *a.* ~~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 subsection for the tax year, subtract~~ Subtract, to the extent included, the total amount ~~of~~ received from a governmental or other pension or retirement ~~pay~~ plan, 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. 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 or separately on a combined state return are allowed a combined maximum exclusion under this subsection of up to twelve thousand dollars. The twelve thousand dollar 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~~ received by a person who is disabled, or is fifty-five years of age or older, or is the surviving spouse of an individual or is a survivor having an insurable interest in an individual who would have qualified for the exemption under this subsection for the tax year.

b. Married taxpayers who file separate state income tax returns shall allocate their combined annual exclusion amount to each spouse in the proportion that each spouse's respective income received from a pension or retirement plan bears to the total combined pension or retirement pay received.

c. A taxpayer who is not disabled or fifty-five years of age or older and who receives pension or retirement pay as a surviving spouse or as a survivor with an insurable interest in an individual who would have qualified for the exemption for the tax year may only exclude the amount received from a pension or retirement plan in the tax year as a result of the

<u>death of the decedent.</u>

Sec. 29. EFFECTIVE DATE. This division of this Act takes effect January 1, 2023.

Sec. 30. APPLICABILITY. This division of this Act applies to tax years beginning on or after January 1, 2023.

DIVISION VII

TAXPAYER RELIEF FUND

Sec. 31. Section 8.57E, Code 2022, is amended by adding the following new subsection:

<u>NEW SUBSECTION</u>. 5. *a.* For the purposes of tax relief provided in this Act, the following amounts shall be transferred from the taxpayer relief fund to the general fund of the state for the following fiscal years:

(1) For the fiscal year beginning July 1, 2022, and ending June 30, 2023, one hundred thirteen million dollars.

(2) For the fiscal year beginning July 1, 2023, and ending June 30, 2024, one hundred fifty-nine million one hundred thousand dollars.

(3) For the fiscal year beginning July 1, 2024, and ending June 30, 2025, ninety-two million three hundred thousand dollars.

(4) For the fiscal year beginning July 1, 2025, and ending June 30, 2026, two hundred fifty-nine million four hundred thousand dollars.

(5) For the fiscal year beginning July 1, 2026, and ending June 30, 2027, one hundred ninety-five million six hundred thousand dollars.

(6) For the fiscal year beginning July 1, 2027, and ending June 30, 2028, nine million six hundred thousand dollars.

b. This subsection is repealed July 1, 2028.

EXPLANATION

The inclusion of this explanation does not constitute agreement with the explanation's substance by the members of the general assembly.

This bill relates to state revenue and finance by modifying the individual income tax and making appropriations.

DIVISION I —— SALE OF CERTAIN QUALIFIED STOCK —— NET CAPITAL GAIN EXCLUSION. The bill grants an employee-owner one irrevocable lifetime election to exclude from state individual income tax the net capital gain from the state of the capital stock on one qualified corporation. The election applies to all subsequent sales or exchanges of capital stock.

The bill phases in over a three-year period the complete exclusion from the individual income tax the net capital gain from the sale of capital stock on one qualified corporation. The percentage of the capital gain that is excluded for tax years beginning in 2023, 2024, and 2025 and beyond is 33 percent, 66 percent, and 100 percent, respectively. Several requirements must be met for the capital stock to qualify as capital stock of a qualified corporation. The qualified corporation must have employed individuals in this state for at least 10 years. The qualified corporation must have had at least five shareholders for the 10 years prior to the first sale or exchange pursuant to the bill, and the corporation must have had at least two shareholders or groups of shareholders who are not related for the 10 years prior to the sale or exchange. The bill requires the capital stock to be common or preferred stock, and may be either voting or nonvoting, but does not include warrants, stock options, or debt securities.

The bill provides that the election applies to transfers of the capital stock by inter vivos gift from the employee-owner to a spouse, or to a trust for the benefit of the employee-owner´s spouse. The election will apply to a spouse only if the spouse was married to the employee-owner on the date of the sale or the date of the employee-owner´s death.

If, after making a valid inter vivos gift of stock that meets all the requirements for an election, an employee-owner dies without making an election, the surviving spouse, or if there is no surviving spouse, the personal representative of the employee-owner´s estate, may make the election.

An election under the bill is made on a form prescribed by the department of revenue and included with the taxpayer's state income tax return for the taxable year in which the election is made.

The division takes effect January 1, 2023, and applies to tax years beginning on or after that date.

DIVISION II —— RETIRED FARMER LEASE INCOME EXCLUSION. Commencing with tax years beginning on or after January 1, 2023, the bill excludes from the individual income tax a retired farmer's total net income received pursuant to a farm tenancy agreement covering real property held by the retired farmer for 10 or more years, if the farmer materially participated in a farming business for 10 or more years.

Net income from a farm tenancy agreement earned by an entity taxed as a partnership for federal tax purposes, an S corporation, or a trust or estate is not eligible for the lease income exclusion, even if the net income passes through to a retired farmer.

A retired farmer is not eligible for the lease income exclusion unless the farmer is at least 55 years of age and no longer materially participating in farming.

A retired farmer who elects to claim the lease income exclusion is not eligible, in the tax year the election is made or in succeeding tax years, to claim the capital gain exclusion under Code section 422.7(21), as amended by another division of the bill, or the beginning farmer tax credit.

The division takes effect January 1, 2023, and applies to tax years beginning on or after that date.

DIVISION III —— RETIRED FARMER CAPITAL GAIN EXCLUSION. The bill modifies the individual income tax capital gain exclusion for the sale of real property used in a farming business which otherwise would have gone into effect in tax year 2023, which was enacted in 2018 Iowa Acts, chapter 1161, section 113, and later modified in 2019 Iowa Acts, chapter 162. The bill repeals both 2018 Iowa Acts, chapter 1161, section 113, and 2019 Iowa Acts, chapter 162, and creates a new capital gain exclusion provision based upon the 2019 Iowa Acts, chapter 162 provisions, effective for tax years beginning on or after January 1, 2023.

Under the provisions in 2019 Iowa Acts, chapter 162, section 1, which otherwise would have gone into effect during the 2023 tax year, a taxpayer who materially participates in a farming business for at least 10 years and held real property used in such a business for at least 10 years, may make a single lifetime exclusion election from the individual income tax of the capital gain of the sale of such property.

The bill modifies the term "materially participated" in a farming business to include a retired farmer if the retired farmer materially participated in a farming business for 10 years or more, in the aggregate, prior to making the election to exclude the capital gain of the sale of real property used in a farming business.

In addition to a single lifetime exclusion of the capital gain from the sale of real property used in a farming business, the bill also allows a retired farmer to make a single lifetime exclusion of the net capital gain from the sale of cattle or horses if held by the retired farmer for breeding, draft, dairy, or sporting purposes for more than 24 months, and only if the retired farmer materially participated in the farming business for five of the eight years preceding the retired farmer's retirement or disability, and who sold all or substantially all of the retired farmer's interest in the farming business by the time the election to exclude capital gain of the sale of livestock from the individual income tax is made.

Additionally, the bill allows a retired farmer to make a single lifetime exclusion of the net capital gain from the sale of breeding livestock, other than cattle and horses, if the livestock is held by the retired farmer for more than 12 months, and only if the retired farmer materially participated in the farming business for five of the eight years preceding the retired farmer's retirement or disability, and who sold all or substantially all of the retired farmer's interest in the farming business by the time the election to exclude capital gain of the sale of livestock from the individual income tax is made.

Under the bill, a retired farmer is not eligible for the capital gain exclusion if the retired farmer claims the beginning farmer tax credit in the same tax year. A retired farmer electing the capital gain exclusion is not eligible to elect to exclude retired farmer lease income in the same tax year or any succeeding tax year.

The division takes effect January 1, 2023, and applies to sales consummated on or after that date.

For sales consummated prior to January 1, 2023, the existing law in Code section 422.7(21) shall govern.

DIVISION IV —— INDIVIDUAL INCOME TAX —— TAX YEARS 2023-2025. The bill repeals the individual income tax rates and brackets described in 2018 Iowa Acts, chapter 1161, section 107, which otherwise would have gone into effect January 1, 2023, and strikes and replaces the individual income tax rates and brackets for the tax year beginning January 1, 2023, in Code section 422.5A. The bill reduces individual income tax rates beginning with the 2023 tax year, and reduces the number of individual income tax brackets beginning with the 2024 tax year. The modified individual income tax rates and brackets are as follows:

For the 2023 tax year:

Married filing jointly

Income over:	But not over:	Tax Rate:
1) $0	$12,000	4.40%
2) $12,000	$60,000	4.82%
3) $60,000	$150,000	5.70%
4) $150,000		6.00%

All other filers other than married filing jointly

Income over:	But not over:	Tax Rate:

1) $0	$6,000	4.40%
2) $6,000	$30,000	4.82%
3) $30,000	$75,000	5.70%
4) $75,000		6.00%

For the 2024 tax year:

<u>Married filing jointly</u>

Income over:	But not over:	Tax Rate:
1) $0	$12,000	4.40%
2) $12,000	$60,000	4.82%
3) $60,000		5.70%

<u>All other filers other than married filing jointly</u>

Income over:	But not over:	Tax Rate:
1) $0	$6,000	4.40%
2) $6,000	$30,000	4.82%
3) $30,000		5.70%

For the 2025 tax year:

<u>Married filing jointly</u>

Income over:	But not over:	Tax Rate:
1) $0	$12,000	4.40%
2) $12,000		4.82%

<u>All other filers other than married filing jointly</u>

Income over:	But not over:	Tax Rate:
1) $0	$6,000	4.40%
2) $6,000		4.82%

Currently, an alternate income tax calculation exists in Code section 422.5. The alternate income tax is an alternate method of calculating income tax liability in lieu of the regular income tax calculation. The alternate method multiplies the taxpayer´s taxable income above the income tax filing thresholds in Code section 422.5(3)(b) or 422.5(3B)(b) by the highest existing individual income tax rate until the taxpayer´s tax liability is equal to the tax liability that would have been calculated under the regular income tax calculation method, then after such point the regular income tax calculation with the regular income tax rates are used.

The bill phases in changes to the alternate tax rate until the rate is set at 4.50 percent commencing with tax years beginning on or after January 1, 2026.

The division takes effect January 1, 2023, and applies to tax years beginning on or after that date.

DIVISION V —— INDIVIDUAL INCOME TAX —— FLAT RATE. Commencing with tax years beginning on or after January 1, 2026, the bill establishes a flat 4.00 percent individual income tax rate on all taxable income and moves the individual income tax rate from Code section 422.5A to Code section 422.5. The division takes effect January 1, 2026, and applies to tax years beginning on or after that date.

DIVISION VI —— RETIREMENT INCOME EXCLUSION. Under current law, a taxpayer who is disabled, who is at least 55 years of age, or who is the surviving spouse or other specified survivor of that qualifying taxpayer, may exclude a maximum of $6,000 of other retirement income ($12,000 for married persons).

Commencing with tax years beginning January 1, 2023, the bill excludes retirement income from the computation of net income for purposes of the individual income tax. In order to be eligible for the retirement income exclusion, a person must be disabled, at least 55 years of age, or be the surviving spouse of an individual or be a survivor having an insurable interest in an individual who would have qualified for the retirement income exclusion.

The bill does not change current law allowing a taxpayer to exclude all retirement pay, including certain survivor benefits, received from the federal government for military service performed in the armed forces, the armed forces military reserve, or national guard.

The bill strikes a provision permitting moneys in the taxpayer relief fund to be used for increases in the general retirement income exclusions in Code section 422.7(31) because the bill provides for the complete exclusion of such retirement income.

The bill also excludes this retirement income from the calculation of net income for purposes of determining whether or not a taxpayer's net income exceeds the amount at which the individual income tax will not be imposed pursuant to Code section 422.5(3) or 422.5(3B), and for which an individual income tax return is not required to be filed, and for purposes of calculating the alternate tax in Code section 422.5, and further provides that any retirement income excluded from the individual income tax will not be added back to these calculations for tax years beginning in 2023 or later.

The division takes effect January 1, 2023, and applies to tax years beginning on or after that date.

DIVISION VII —— TAXPAYER RELIEF FUND. For each of the next six fiscal years, the bill transfers from the taxpayer relief fund to the general fund of the state the following amounts: for FY 2022-2023, $113 million; for FY 2023-2024, $159.1 million; for FY 2024-2025, $92.3 million; for FY 2025-2026, $259.4 million; for FY 2026-2027, $195.6 million; for FY 2027-2028, $9.6 million.