

Iowa Legislative Fiscal Bureau



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Proposed Administrative Rules to Recover Costs Associated with the Administration of the Local Option Sales and Service Taxes

ISSUE

The Department of Revenue and Finance has passed a rule that would allow the Department to charge all jurisdictions imposing Local Option Sales and Service Taxes an administrative fee effective July 1, 2000.

The *Issue Review* also addresses interest earned on funds collected for Local Option Taxes prior to distribution to local jurisdictions.

AFFECTED AGENCIES

Department of Revenue and Finance
Local Jurisdictions that impose Local Option Sales and Service Taxes

CODE AUTHORITY

Chapter 422B, Code of Iowa

BACKGROUND

During the 2000 Legislative Session HF 2545 (Administration and Regulation Appropriations Act) was passed. That Act included language, in Section 28, that permits the Director of the Department of Revenue and Finance to charge a fee to recover the direct costs of administration related to the collection and distribution of Local Sales and Service Taxes.

How fees would be determined: The administrative fee to be imposed on Local Option Sales and Service Tax jurisdictions would be for recovery of direct costs incurred by the Department in the collection and distribution of the Tax. "Direct costs" would include, but are not limited to, costs related to taxpayer contacts and presentations, return processing, additional data entry, increased error processing, estimation, audits, and distribution of revenues. Fees would not include such indirect costs as policy and systems development, general agency administrative costs and collection costs.

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The fee would be based on the number of times the county occurs on the returns processed by the Department during a fiscal year. The Department would divide the cost to be recovered into four quarterly amounts. Each city or unincorporated area of a county would be charged the same proportionate share of the cost as the jurisdiction receives as its share of revenues.

History of the Local Option Sales and Services Tax: The Regular Local Option Sales and Services Tax was established during the 1985 Legislative Session. During FY 1986, two jurisdictions imposed the Tax and \$11,941 was collected. The number of jurisdictions imposing the Tax has increased each year. For FY 2001, 645 jurisdictions have implemented the Tax and an estimated \$151.3 million will be collected in regular Local Option Taxes.

The School Infrastructure Local Option Sales and Services Tax was established during the 1998 Legislative Session. During FY 1999, ten school districts imposed the Tax and \$9.8 million was collected. For FY 2001, the number of school districts imposing the tax will increase to 106 and estimated collections will total \$120.5 million.

Local Option Tax Program Administration: The Department of Revenue and Finance is responsible for administering the collection and distribution of Local Option Sales and Service Tax.

Prior to local government officials holding an election on the question of imposing a Local Option Tax, the Department is requested to provide an estimate of the amount of revenue that would be raised. In addition, the Department provides local officials with advice on the wording of the ballot and the election procedure, and if requested, field staff hold local forums on the mechanics of the Local Option Tax.

When a new jurisdiction approves a Local Option Tax, the Department updates information and processing systems to reflect the change. In addition, the Department publicizes the change and a mailing is made to all sales tax permit holders in the affected jurisdictions notifying them of the tax rate change and how to record Local Option Tax collections on quarterly or annual tax returns. During the first two quarters following imposition of the tax, the Department resolves problems associated with underpayment of the tax and mistakes in completing tax returns. Also, the Department's Taxpayer Services Section provides educational services within the affected jurisdictions.

For jurisdictions with existing Local Option Taxes, the Department prepares fiscal year estimates of the amount of tax that will be collected and distributed. A letter is then sent to each jurisdiction by July 15 notifying local government officials of the amount of Local Option Tax that will be distributed each month of the year.

Beyond collecting and depositing tax payments, and distributing the tax proceeds to local governments and school districts, administration within the Department involves:

- Entering return information in the Department's computer system
- Checking returns for completeness and accuracy
- Working with taxpayers to correct return errors
- Auditing returns
- Collecting unpaid taxes
- Providing ongoing assistance and information to businesses and local government officials

Distribution of tax collections: Since businesses report Local Option Tax collections by county, the Department is required to determine the amount of tax that should be distributed to each local jurisdiction within a county and each school district. For the regular Local Option Tax, distribution amounts to the local jurisdictions within a county are computed using a formula based on population. For the school infrastructure Local Option Tax, school district distribution amounts are determined based on the prior year's enrollment. Funds are distributed to local jurisdictions monthly and payments are based on estimates of the amount of tax that will be remitted to the Department and certified as correct during the fiscal year. The twelve monthly payments are set at a level equal to 95.0% of the fiscal year estimated amount. Generally, after the first three quarters of the fiscal year, distributions and the amount of collections certified for the period are compared, adjustments are made to the final three monthly distributions if necessary. During November, following the close of the fiscal year, reconciliation payments are made to those local government jurisdictions and school districts that have received less than 100.0% of their pro-rated share of certified county collections in the 12 monthly payments. For jurisdictions that received more than 100.0% of their share of county Local Option Tax collections, the Department recovers overpayment amounts by reducing the next fiscal year's monthly payments beginning with the November payment.

Timing of tax collections: The frequency that taxpayers are required to remit sales tax receipts to the Department depends on the amount of State tax collected. Taxpayers that collect more than \$8,000 in State sales tax per month are required to remit the tax twice per month. Taxpayers that collect more than \$50 per month but less than \$8,000 per month in State sales tax are required to remit the tax once a month. Taxpayers that collect \$50 or less per month but more than \$120 per year in State sales tax are required to remit the tax quarterly. Taxpayers that collect \$120 or less per year in State sales tax are required to remit the tax annually. Local Option Tax collections are to be remitted with the same frequency as determined by State sales tax collections. In addition, semi-monthly, monthly, and quarterly taxpayers are required to file quarterly sales tax returns to identify the amount of regular Local Option Tax and School Local Option Tax collected by county. Annual filers are required to provide similar information on their returns. Semi-monthly taxpayers account for approximately 55.0% of Local Option Tax collections; monthly filers, 38.0%; quarterly filers, 6.0%; and annual filers, less than 1.0%.

CURRENT SITUATION

Cost of Program Administration: The Department of Revenue and Finance has estimated the cost of administering the Local Option Sales and Service Tax programs will be \$396,000 during FY 2001. The cost estimate includes no overhead factor to cover such items as:

- A share of the salary and benefits of top management
- A share of the salary and benefits of clerical support staff
- Utility charges
- Computer equipment depreciation
- Supplies
- Some direct costs that are not presently segregated by program:
 - Long-distance telephone charges
 - Information Technology Department mainframe computer time charges

The charges proposed by the Department represent about 0.2% of the estimated FY 2001 Local Option Tax collections. In comparison, about half of the 33 states that administer local option programs charge fees ranging from 1.0% to 3.0% of collections. Another nine states charge fees based on the cost of administering their program with four of these charging 1.0% or more of collections. Six states, including Iowa, collect no fees at the present time. **(Attachment A)**

Interest going to the State General Fund: The Department of Revenue and Finance estimates that during FY 2001, \$375,000 of interest will be earned on the funds resulting from the collection of Local Option Taxes before the final distribution is made in November 2001. This is based upon an assumed interest rate of 6.25%. **(Attachment B)**

The Department of Revenue and Finance calculated that interest earned on the collection of Local Option Taxes in FY 1999 was \$174,000. This is based upon an assumed compounded interest rate of 5.50%. It should be noted that the Department distributed approximately \$5.3 million more than was collected in Local Option Taxes during FY 1999. The overpayment reduces the amount of interest earned. The overpayment was recouped by reducing payments during FY 2000. **(Attachment C)**

Proposed rules: The rules will take effect October 25, 2000, if the Administrative Rules Review Committee does not take any action. The rules will be on the October 9, 2000, agenda of the Committee.

ALTERNATIVES

- The Administrative Rules Review Committee may take no action and the rules will be effective October 25, 2000. If the rules take effect on October 25, 2000, the General Assembly may want to address the issue of whether or not the administrative fee should be continued beyond FY 2001.
- The Committee may delay the effective date of the rules until the close of the 2001 Legislative Session. The motion can be made by any of the ten members of the Committee. The motion does not require a second and the motion would be adopted if six votes are cast in favor of the motion. The Committee does not have to provide a reason for delaying the effective date. This would allow the General Assembly to address the rules during the 2001 Legislative Session and if no action is taken by the General Assembly, the rules would become effective at the close of the Legislative Session.
- The General Assembly may also wish to address interest earned by the State General Fund on the collection of Local Option Taxes. The General Assembly could:
 - Take no action.
 - Establish a separate fund for tax collections and require the interest earned to be distributed with funds distributed to the locals. This would eliminate the interest going to the State General Fund. The State would then only be collecting the administrative fee that covers the direct costs attributed to the administration of the taxes. The interest earned would be going to the locals and could help off-set the cost of the administrative fee.

- Require the Department of Revenue and Finance to distribute estimated payments at a rate greater than 95.0%, or distribute the funds before the 28th of each month. This could eliminate interest going to the State General Fund and place the funds in the hands of the locals.

BUDGET IMPACT

Funds generated by the proposed fee: It is estimated that the proposed fee would generate \$396,000 during FY 2001.

STAFF CONTACT: Ron Robinson (Ext. 16256)

Local Option Sales Tax Survey of State Administrative Charges

	State	Basis	Rate	Notes
1	Arkansas	Fixed Rate	3.00%	
2	Nebraska	Fixed Rate	3.00%	
3	Illinois	Fixed Rate	2.00%	
4	Texas	Fixed Rate	2.00%	
5	Wisconsin	Fixed Rate	1.50%	
6	Utah	Fixed Rate	1.50%	
7	Georgia	Fixed Rate	1.00%	
8	Missouri	Fixed Rate	1.00%	
9	Ohio	Fixed Rate	1.00%	
10	Pennsylvania	Fixed Rate	1.00%	
11	Wyoming	Fixed Rate	1.00%	
12	California	Fixed Rate	0.82%	
13	Oklahoma	Fixed Rate	Varies	
14	New Mexico	Fixed Rate	< 3.00%	
15	Washington	Fixed Rate	< 2.00%	
16	Alabama	Cost Formula	< 2.00%	Plus \$8,000 - \$10,000 for startup
17	Minnesota	Cost Contract		
18	Florida	Cost		
19	New York	Cost	1.30%	Estimated effective rate
20	North Carolina	Cost	0.50%	Estimated effective rate
21	South Carolina	Cost		
22	South Dakota	Cost		
23	Tennessee	Cost	1.10%	Estimated effective rate
24	North Dakota	Contract	1.30%	Lessor or 3.00% or \$35 per permit annually
25	Arizona	No Charge		
26	Colorado	No Charge		
27	Iowa	No Charge		
28	Kansas	No Charge		
29	Mississippi	No Charge		
30	Virginia	No Charge		
31	Alaska	Unknown		
32	Idaho	Unknown		
33	Louisiana	Unknown		

Local Option Sales Tax Estimated Interest Earned, FY 2001 (Simple Interest)

Month	Local Option Tax Receipts					Distributions	Ending Balance	Net Interest
	Semi-Monthly	Monthly	Quarterly	Annual	Total			
Jul-00	4,155,776	0	0	0	4,155,776	0	4,155,776	3,607
Aug-00	8,311,552	4,894,304	0	0	13,205,856	21,422,885	-4,061,253	36,485
Sep-00	8,311,552	4,894,304	0	0	13,205,856	21,422,885	-12,278,282	-2,693
Oct-00	4,273,705	7,688,822	2,063,362	0	14,025,889	21,422,885	-19,675,278	-68,046
Nov-00	25,087,144	13,082,986	2,063,362	0	40,233,492	23,247,111	-2,688,897	34,380
Dec-00	8,547,410	5,394,164	0	0	13,941,574	23,247,111	-11,994,434	7,143
Jan-01	4,022,834	4,956,273	1,321,415	22,024	10,322,545	23,247,111	-24,919,000	-72,163
Feb-01	28,301,707	16,332,986	3,083,301	51,388	47,769,382	20,434,923	2,415,460	53,257
Mar-01	8,045,668	4,768,350	0	0	12,814,018	20,434,923	-5,205,445	34,519
Apr-01	21,691,526	4,340,687	1,180,923	0	27,213,136	20,434,923	1,572,768	-25,541
May-01	10,432,856	14,592,034	2,755,488	0	27,780,378	22,240,957	7,112,189	89,410
Jun-01	10,432,856	4,463,764	0	0	14,896,620	22,240,957	-232,147	61,599
Jul-01	0	5,159,923	1,285,293	0	6,445,216	22,240,957	-16,027,888	-10,222
Aug-01	14,780,504	12,039,819	2,999,018	0	29,819,341	0	13,791,453	65,691
Sep-01	0	0	0	0	0	0	13,791,453	71,830
Oct-01	0	0	0	0	0	0	13,791,453	74,225
Nov-01	0	0	0	0	0	13,791,454	-1	21,549
FY 2001	156,395,090	102,608,416	16,752,162	73,412	275,829,080	275,829,082	-1	375,030

Notes:

1. The estimated interest payments assume no compounding (simple interest) at a rate of 6.25% per year.
2. For jurisdictions that receive less than the total amount due for the fiscal year a reconciliation payment is made in the November following the close of the fiscal year. For jurisdictions that receive more than the total amount due for the fiscal year, the amount of overpayment is deducted from the next fiscal year's monthly payments beginning with the November payment.

Local Opt Sales Tax Estimated Interest Earned, FY 1999

Month	Local Option Tax Receipts					Distributions	Ending Balance	Net Interest
	Semi-Monthly	Monthly	Quarterly	Annual	Total			
Jul-98	2,661,722	0	0	0	2,661,722	0	2,663,349	2,034
Aug-98	5,323,444	3,067,871	0	0	8,391,315	9,765,428	1,312,382	22,940
Sep-98	5,323,444	3,067,871	0	0	8,391,315	9,765,428	-43,968	17,556
Oct-98	3,094,325	2,631,889	1,069,361	0	6,795,575	9,765,428	-3,013,631	-264
Nov-98	10,411,420	6,479,081	1,069,361	0	17,959,862	11,008,561	3,966,467	29,863
Dec-98	6,188,650	3,847,192	0	0	10,035,842	11,008,561	3,028,197	34,306
Jan-99	2,525,468	1,481,876	662,683	54,763	4,724,790	11,008,561	-3,243,146	11,470
Feb-99	10,395,573	7,562,151	1,546,259	127,780	19,631,763	11,911,674	4,511,809	36,050
Mar-99	5,050,936	4,104,440	0	0	9,155,376	11,911,674	1,791,249	35,323
Apr-99	8,220,151	1,105,584	534,605	0	9,860,340	11,911,674	-251,844	7,929
May-99	5,724,526	5,953,123	1,247,412	0	12,925,061	13,030,422	-332,001	25,191
Jun-99	5,724,526	3,373,428	0	0	9,097,954	13,030,422	-4,252,346	11,524
Jul-99	0	2,359,151	670,335	0	3,029,486	13,030,422	-14,276,833	-25,082
Aug-99	6,271,431	5,504,687	1,564,115	0	13,340,233	0	-946,535	-7,898
Sep-99	0	0	0	0	0	0	-950,883	-4,349
Oct-99	0	0	0	0	0	0	-955,397	-4,515
Nov-99	0	0	0	0	0	4,349,905	-5,323,001	-18,367
FY 1999	76,915,616	50,538,344	8,364,131	182,543	136,000,634	141,498,160	-5,323,001	173,711
Over Pmt								<u>-5,323,001</u>
Net Interest								-5,149,290

Notes:

1. The estimated interest payments assumes compounding.
2. For jurisdictions that receive less than the total amount due for the fiscal year a reconciliation payment is made in the November following the close of the fiscal year. For jurisdictions that receive more than the total amount due for the fiscal year, the amount of overpayment is deducted from the next fiscal year's monthly payments beginning with the November payment.