**Department of Revenue**

**2022 Sales Tax Legislative Proposals**

**Overview**

The Iowa Department of Revenue has just completed the first phase of upgrades to its tax administration systems. This first wave of changes touched sales and use tax, motor fuel and other excise taxes, and income tax withholding. This new system will provide an immensely improved process for taxpayers to file returns and remit taxes due to the Department. The Department proposes additional changes to the process of obtaining permits and filing returns for sales and use tax to take effect July 1, 2022, once taxpayers and the Department have adjusted to the new system.

This bill will require returns be filed on a monthly basis instead of quarterly (except for annual filers). The bill allows taxpayers to file one combined return for sales and use taxes as well as one permit for both tax types, rather than separate permits and returns for each. There will no longer be semimonthly deposits of sales tax collected. The annual filer threshold will be raised from $120 to $1,200 of tax collected annually. Monthly filers will be required to file electronically, unless they request permission from the Director otherwise, to allow for taxpayers who cannot use computers or have other factors prohibiting electronic filing.

Additionally, with nearly all tax collections being remitted on a monthly basis, this bill allows Department to distribute local option sales tax and secure an advanced vision for education funds to local governments and school districts based on actual tax remitted rather than estimates. This will eliminate the need to make end-of-year adjustments after calculating actual remittances, improving the accuracy of distributions for these jurisdictions and greatly improving the administrative work by the Department.

Additional background on the shift to a combined monthly sales and use tax return are below.

This bill also includes these additional administrative changes:

* It creates the permanent authority to cancel fuel, sales, and withholding permits no longer in use, similar to language enacted in 2021 Senate File 608 which provided temporary authority.
* The bill updates statutory "temporary" permit language to seasonal to reflect current practice.
* The bill adjusts the Department’s ability to notify “certified service providers” and sellers registered under the Streamlined Sales and Use Tax Agreement simultaneously if a payment or filing issue occurs.
* The bill creates a $100 penalty for failure to file the retailer’s annual report for motor fuel. A $100 penalty is identical to other late-filing penalties for motor fuel. The retailer’s annual report is used to calculate tax rates for various fuel types each year.
* The bill replaces the term “license” with “permit” throughout the motor fuel tax chapter.
* Lastly, the bill clarifies the “project completion” deadline for businesses seeking to apply for a sales tax refund through the High Quality Jobs Program. The Department worked with the Economic Development Authority to improve the existing provision.

**Combined Sales and Use Tax Return**

Today, a business may need to obtain a separate permit and file separate returns for sales tax, retailer’s use tax, and consumer’s use tax. Retailer’s use tax is a voluntary collection and remittance by sellers who make sales on goods and services they know will be used in Iowa. Because of changes to the law effective 2019, most taxpayers that previously collected retailer’s use tax are now required to collect sales tax. Consumer’s use tax is typically owed by taxpayers for tangible personal property or services they acquire without paying the sales tax and which they “consume” during the course of their business. The Department has historically advised taxpayers that if they “regularly” make purchases subject to use tax, they should obtain a consumer’s use tax permit and file a consumer’s use tax return. The Department has also instructed taxpayers who only occasionally incur use tax to report such purchases on the Goods Consumed line of today’s sales tax return, which leads to confusion for taxpayers and Department staff alike.

Starting July 1, 2022, the Department will allow businesses to register for one permit to cover all of these tax types. Taxpayers will be able to report all tax due for each of these tax types on the same return. Putting sales tax and use tax on the same return will likely improve the accuracy of reporting by taxpayers of these distinct tax types.

**Return Filing, Payment Frequency, and Electronic Filing**

Today, most sales tax permit holders file returns once per calendar quarter. In addition, the Department requires taxpayers to remit taxes on a frequency based on how much money they collect, as prescribed by administrative rule. Payments may be required on a quarterly, monthly, or semimonthly basis. Taxpayers remitting collected tax more frequently than they file returns are allowed to remit either actual tax collected or one of two options for estimated payment based on prior collections. Taxpayers that collect less than $120 of sales tax per calendar year are only required to file a return and remit tax annually.

Challenges with the current process include the following:

* Taxpayers that fail to make semimonthly or monthly payment deposits are assumed to have zero liability, which rewards non-filing.
* Taxpayers do not have the ability to correct the tax remitted on a payment deposit resulting in overpaid or underpaid penalty and interest.
* Only state sales tax and local option sales tax are required to be paid on the monthly or semimonthly deposit, which is confusing for taxpayers with other excise tax (for example, hotel and motel or water service) obligations.
* Billings, refunds, and assessments are all deferred until the quarterly return.
* Some taxpayers confuse monthly and semimonthly payments with filing returns, resulting in only reporting month three tax on the quarterly return.
* Underpaid deposits are not billed the correct penalty and interest.
* Interest on a late payment from a semimonthly filer is under-assessed.

Requiring monthly returns will resolve the current challenges of administering a system of misaligned return filings and payments. Eliminating the semimonthly remittance will put all taxpayers (except annual filers) on the same schedule for filing returns and making payments. This change will ensure taxpayers remit actual sales taxes collected, which is required for income tax withholding and is common in other states. Requiring actual taxes collected to be paid and reported on a monthly basis will greatly simplify the assessment and calculation of penalty and interest for late or non-filed returns or payments.

The Department proposes to raise the threshold for determining whether a taxpayer only needs to file an annual return. As noted above, that threshold is currently $120 of tax collected per year. To mitigate the burden on truly small businesses of more frequent filing and remittance frequency, the Department proposes to raise this threshold to $1,200 of tax collected per year. Using 2021 permit and return data, this will move an additional approximate 45,000 taxpayers to an annual filing and payment status for a total of 77,000 annual filers out of 132,000 total permit holders, but will have a negligible impact to total tax collections: these 77,000 annual filers will remit $13 million, while monthly filers will remit $3.4 billion.

Additionally, and especially in conjunction with an increase in the annual filer threshold, it is reasonable to expect businesses in 2022 to file tax returns electronically. Electronic filing and payment is common in other states and for various tax types. The new tax system will be boundlessly easier for taxpayers to use, making these changes much more manageable than if the Department implemented them using its prior filing and payment processes.