



Bill Summary

SF 2123 Internal Revenue Code (IRC) Update Bill

Status of Bill: House Calendar
Committee: Ways & Means (20-0)
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Background

- Iowa income tax laws generally conform to federal definitions of income, deductions, expenses, etc. Although some states allow for the automatic adoption of federal tax changes, Iowa does not. So each year we must pass an IRC Update bill to “couple” with federal tax law changes.
- Failure to “couple” complicates the tax system by forcing taxpayers to use different calculations for their federal and state taxes – a particular burden to small businesses trying to keep two sets of books – one for the federal tax collector and one for the state tax collector.
- In the past twenty years or so, Iowa has chosen to decouple from federal tax law twice:
 - In 1994 / Social Security: Congress increased the maximum amount of Social Security benefits subject to income taxes from 50% to 85%, but Iowa did not couple with this change – but still refers to the 1993 IRC which allows taxing a maximum of only 50% of these benefits.
 - In 2003 – Economic Stimulus: Congress adopted a 30% bonus depreciation for equipment bought from 9-11-02 to 5-5-03, and a 50% bonus depreciation for equipment bought after 5-6-03 but before 1-1-05. Iowa, during the 2003 session, Iowa did not couple. However, during a Special Session held in September of 2004, Iowa coupled with the 50% depreciation for equipment bought after 5-5-05, but before 1-1-05, but Iowa never did couple with the 30% bonus depreciation for equipment bought before 5-6-03 .

Summary of SF 2123

SF 2123 couples with changes to federal tax law passed by Congress in 2007, including (1) the Small Business and Work Opportunity Tax Act of 2007, (2) the Mortgage Forgiveness Debt Relief Act of 2007, and (3) the Tax Increase Prevention Act of 2007. The bill adopts all 2007 federal changes regarding computation of Iowa net income for individuals, corporations and financial institutions, and definitional changes to the research activities credit. In addition, there were four provisions that had a measurable impact on Iowa revenue:

1. Home Mortgage Debt Discharge Income Exclusion: A lender may renegotiate terms of a mortgage in order to avoid foreclosure – which may include discharging a portion of the debt. Forgiven debt is considered reportable income. In December, Congress adopted an exclusion from income for home mortgage debt discharged on or after January 1, 2007, and before January 1, 2010.
2. Extending the Mortgage Insurance Premium Deduction: If a mortgage loan is for more than 80% of a home’s value, the lender typically requires the homebuyer to purchase a single premium insurance policy against default on the mortgage. The provision allowing an itemized deduction for the mortgage insurance premium was about to expire, but was extended by Congress.
3. Volunteer EMR and Firefighters Income Exclusion: Excludes from income up to \$360 in payments received by volunteer Emergency Medical Responders and firefighters for 2008 through 2010.
4. Section 179 depreciation expensing for businesses: The amount of assets a business may expense in the first year was increased several years ago from \$25,000 to \$100,000, with annual inflation adjustments (\$128,000 for 2008). This was due to expire, so Congress extended it through 2010.

Fiscal Impact:

SF 2123 will reduce revenues by \$300,000 in FY 08, \$1.1 million in FY 09, and will not affect FY 10.

Effective Date:

Since these changes affect the 2007 tax year, for which Iowans are in the process of filing their tax returns, the bill takes effect upon enactment and is retroactive to January 1, 2007.

Amendment summary

[LOST 47-53]

H-8039 by Rants (R-Woodbury) –Includes Economic Stimulus Act: The amendment couples with federal tax changes through February 14, 2008, rather than January 1, 2008. February 14, 2008 is the date President Bush signed U.S. House Resolution 5140 – the Recovery Rebates and Economic Stimulus for the American People Act of 2008, which does the following:

1. **Tax Rebates:** Grants tax rebates of \$600, or tax liability whichever is less, to individual taxpayers (\$1,200 for married taxpayers filing joint returns), plus an additional \$300 for each child.
 - There is a minimum rebate of \$300 (\$600 joint returns) with earned income of at least \$3,000, including social security benefits and compensation and pensions paid to disabled veterans.
 - Rebates are cut by 5% of the amount adjusted gross income exceeds \$75,000 (\$150,000 joint returns).
 - Provides that rebates shall not be considered income for purposes of determining eligibility for federal and federally-assisted state benefit programs.
2. **Business Incentives - Just for Tax Year 2008:**
 - The Section 179 expensing allowance for depreciable business assets increases from \$128,000 to \$250,000, and the maximum investment limitation increases from \$510,000 to \$800,000.
 - The bonus depreciation - the amount of the adjusted basis of certain depreciable property (e.g., equipment and computer software) that may be claimed as a deductible expense in 2008 increases from 30% to 50%.
3. **Mortgage Programs:**
 - Raises the ceiling on the maximum original principal of a mortgage originated between July 1, 2007, and December 31, 2008, that may be purchased by either the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac).
 - Congress's intent is that Fannie Mae and Freddie Mac securitize mortgages under the increased loan limits of this Act unless it adds to mortgage costs or interferes with liquidity to the market.
 - Establishes a temporary loan limit increase for FHA-insured mortgages in specified high-cost areas for which a borrower received credit approval by December 31, 2008.
 - Grants the Secretary of Housing and Urban Development (HUD) discretionary authority to increase loan limits in 2008 based upon the size and location of residences in particular areas, and directs the Secretary to publish the median house prices and mortgage principal obligation limits as revised by this Act not later than 30 days after its enactment.
4. **Fiscal Impact - Only the Business Incentives in Item 3 Cause a Revenue Loss:**
 - Over the long term – this is theoretically a wash. The federal stimulus bill “frontloads” tax deductions that a business would otherwise take in later years – over the life of the depreciation schedule used – but the Department of Revenue (IDR) analysis shows a \$14.59 million loss over ten years.
 - Revenues decline by \$60.84 million over three years: by \$15.87million in FY 09; by \$40.41 million in FY 10, and by \$4.56 million in FY 11.
 - Revenues then increase by only \$47.25 million over the next seven years: by \$12.35 million in FY 12; by \$10.63 million in FY 13; by \$8.96 million in FY 14; by \$6.72 million in FY 15; by \$4.34 million in FY 16, by \$2.64 million in FY 17; and by \$1.6 million in FY 18.

WHAT WILL OTHER STATES DO?

1. This type of federal action is difficult for many states to deal with, as it occurs well into their budget development process and during economic downturns when revenue growth is soft or nonexistent.
2. In 2003 – when Iowa failed to couple with similar provisions - the Federation of Tax Administrators reported that 13 states (including Iowa) without automatic coupling did not couple, 15 states (including Missouri, Illinois, and Wisconsin) with automatic coupling passed legislation to decouple, 4 states (including Nebraska,

and Minnesota) required businesses to fully or partially add-back the value of these incentives, and Kansas increased its corporate franchise tax and some fees to offset revenue lost due to these incentives.

3. Today: The Federation of Tax Administrators has been polling other state's activity and of the 19 states that had responded as of February 26, 2008:

- Bonus Depreciation:
 - 5 states (Nebraska, Louisiana, Michigan, Utah, & West Virginia) said they probably will couple.
 - 6 states (California, Kansas, New Jersey, North Carolina, Oklahoma, & Oregon) were undecided.
 - 6 states (Arizona, Illinois, Maine, Minnesota, Ohio, & Vermont) said they probably will not couple.
 - 2 states (Massachusetts and New York) said they definitely will not couple.
- Section 179 Expensing:
 - 6 states (Nebraska, Louisiana, Michigan, Utah, West Virginia, & Vermont) said they probably will couple.
 - 7 states (California, Kansas, New Jersey, New York North Carolina, Oklahoma, & Oregon) were undecided.
 - 5 states (Arizona, Illinois, Minnesota, Ohio, & Pennsylvania) said they probably will not couple.
 - 1 state (Maine) said it definitely will not couple.
- Bonus Depreciation: Just as in 2003 – when all is said and done, its likely lots of state will not couple or will only partially couple with these provisions.

[ADOPTED 100-0]

H-8048 by Shomshor (D-Pottawattamie) –Section 179 Expensing from Economic Stimulus Act: The amendment couples with just the Section 179 expensing provision from the U.S. House Resolution 5140 – the Recovery Rebates and Economic Stimulus for the American People Act of 2008, which does the following:

1. Section 179 allows a business to elect to deduct all or part of the cost of certain qualifying property in the year it is placed in service. This is in lieu of recovering the cost by taking depreciation deductions over a scheduled recovery period. If the business elects to use section 179, then the basis of the asset must be reduced by the amount expensed before calculating depreciation deductions.
 - This incentive is specifically for small businesses, so it includes a maximum investment limitation that reduces the value of the incentive as the size of the investment increases, so there is no value to large corporations buying very expensive equipment. Currently, the maximum investment limitation is \$510,000, and for every dollar an investment exceeds this amount, the maximum expensing allowance is decreased by one dollar.
 - Example #1: A business invests \$450,000. This does not exceed the \$510,000 investment limit, so the business may claim the maximum expensing allowance which is \$128,000.
 - Example #2: A business invests \$600,000. This exceeds the \$510,000 investment limit by \$72,000, so \$72,000 must be deducted from the \$128,000 maximum expensing allowance. \$128,000 minus \$72,000 equals \$56,000, so the business is only allowed to take a \$56,000 expensing allowance.
2. Qualified Section 179 property includes:
 - Tangible personal property, including machinery and equipment; property contained in or attached to a building (other than structural components), such as refrigerators, grocery store counters, office equipment, printing presses, testing equipment, and signs; gasoline storage tanks and pumps at retail service stations; livestock, including horses, cattle, hogs, sheep, goats, and mink and other furbearing animals.
 - Other tangible property (except buildings and structural components) used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services, a research facility used in connection with any of the above activities, or a facility used in connection with any of the above activities for the bulk storage of fungible commodities.
 - Single purpose agricultural (livestock) or horticultural structures.
 - Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.
 - Off-the-shelf computer software.

- It does not include income producing investment property, rental property (unless renting property is your business), and property that produces royalties.
3. Regarding Section 179 - the federal stimulus bill increases the expensing allowance for depreciable business assets from \$128,000 to \$250,000, and increases the investment limitation from \$510,000 to \$800,000.
 4. Fiscal Impact: A revenue loss of \$901,000 in FY 09 and \$600,000 in FY 10.
 - Revenue declines by \$1.5 million over two years: by \$901,000 in FY 09 and \$600,000 in FY 10.
 - Revenue increases by \$1.4 million over the next six years: by \$500,000 in FY 11; by \$300,000 in FY 12; by \$200,000 in FY 13; by \$200,000 in FY 14; by \$100,000 in FY 15; and by \$100,000 in FY 15.

[NOT GERMANE – RULE SUSPENSION LOST 48-52]

H-8043 by Rants (R-Woodbury) – Amends the Microsoft Incentive Bill: This amendment amends HF 2233 (the Microsoft bill), which has been sent to the Governor for his signature. The amendment makes “data centers”, as well as web portals eligible businesses for the sales and property tax exemptions on certain equipment and computers. A data center is defined as a facility, or portion of a facility, that is predominately used for the housing and operation of computer data processing hardware and associated equipment directly in support thereof. The amendment requires the data center to make a minimum \$1 million investment in an Iowa location within the first six years of operation in Iowa beginning with the date the data center initiates site preparation activities. The minimum investment includes the initial investment, including land and subsequent acquisition of additional adjacent land and subsequent investment at the Iowa location.