

Sukup, Ch
Hoversten
Winckler

HSB 501

WAYS AND MEANS
SUCCESS
SF/HF 2079

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

Passed House, Date _____ Passed Senate, Date _____
Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____
Approved _____

A BILL FOR

1 An Act establishing a new economy employment initiative by
2 providing for a partial deduction under the individual income
3 tax for the capital gain from the sale or exchange of capital
4 stock of a corporation which was acquired by an individual on
5 account of employment with the corporation, limiting the
6 fiscal impact of the partial deductions, and including an
7 effective and retroactive applicability date provision.

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

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960 0002

1 Section 1. Section 422.7, Code Supplement 2001, is amended
2 by adding the following new subsection:

3 NEW SUBSECTION. 38. a. For purposes of this subsection:

4 (1) "Capital stock" means voting and nonvoting common and
5 preferred stock and stock options issued pursuant to an
6 incentive stock option plan. "Capital stock" does not include
7 stock rights, stock warrants, or debt securities, and does not
8 include stock or stock options issued by a corporation which
9 does not offer incentive stock options to all full-time
10 employees. A corporation does not offer incentive stock
11 options to all full-time employees unless each of those
12 employees is issued at least a number of incentive stock
13 options equal to twenty percent of all issued outstanding
14 incentive stock options divided by the number of full-time
15 employees.

16 (2) "Corporation" means any of the following:

17 (a) A corporation which at the time of the first sale or
18 exchange for which an election is made under paragraph "c" has
19 been in existence and actively doing business for at least
20 three years and is not a personal holding company as defined
21 in section 542(a) of the Internal Revenue Code.

22 (b) A corporation which is a member of an affiliated
23 group, as defined in section 1504(a) of the Internal Revenue
24 Code, which group includes a corporation described in
25 subparagraph subdivision (a) and which group has been in
26 existence and actively doing business for at least three
27 years.

28 (c) A predecessor or successor corporation of a
29 corporation described in subparagraph subdivision (a). A
30 corporation is a predecessor or successor corporation if the
31 corporation was a party to a reorganization that was entirely
32 or substantially income tax free and that occurred during or
33 after the employment of the taxpayer making an election under
34 paragraph "c".

35 (3) "Incentive stock option" means the same as defined in

1 section 422(b) of the Internal Revenue Code.

2 b. For purposes of this subsection, the corporation
3 issuing capital stock for which an election under paragraph
4 "c" is made must, at the time of the first sale or exchange
5 for which the election is made, have at least five
6 shareholders and at least two shareholders or groups of
7 shareholders who are not related to each other and each of
8 which owns at least five percent of the capital stock.

9 For purposes of this paragraph "b", two persons shall be
10 considered to be related when, under section 318 of the
11 Internal Revenue Code, one is a person who owns, directly or
12 indirectly, capital stock that if directly owned would be
13 attributed to the other person or is the spouse, child,
14 parent, grandparent, brother, sister, aunt, uncle, cousin,
15 niece, or nephew of the other person who owns capital stock
16 either directly or indirectly.

17 c. (1) In the manner provided in paragraph "d", an
18 individual may elect to subtract one-half of the capital gain
19 from the sale or exchange of capital stock of a corporation
20 acquired by the individual on account of employment with that
21 corporation. However, for tax years beginning in the 2002
22 calendar year, the amount that may be subtracted is one-fourth
23 of such capital gain.

24 (2) (a) Each individual shall be entitled to two
25 elections under subparagraph (1) during the individual's
26 lifetime for the capital stock of two different corporations.

27 (b) The election applies only to the tax year for which
28 the election was made and applies to all sales and exchanges
29 in the tax year for which the election was made of capital
30 stock in the same corporation which was acquired as provided
31 in subparagraph (1).

32 (c) After the individual makes an election for the tax
33 year, the election shall also apply to the sale or exchange in
34 that tax year of capital stock of the corporation which had
35 been transferred by inter vivos gift from the individual to

1 the individual's spouse if the capital stock was acquired as
2 provided in subparagraph (1). This provision applies in the
3 case of the spouse, only if the spouse was married to such
4 individual on the date of sale or exchange or the date of
5 death of the individual and if the spouse and individual file
6 a joint Iowa income tax return on which the election is made.
7 If the individual dies without making an election, the
8 surviving spouse may make the election for capital stock that
9 would have qualified under this subparagraph subdivision.
10 However, if there is no surviving spouse, the oldest surviving
11 issue who owns capital stock that would have qualified under
12 this subparagraph subdivision may make the election.

13 d. An election under paragraph "c" shall be made by
14 including a written statement with the taxpayer's Iowa income
15 tax return for the tax year for which the election is made.
16 The written statement shall identify the corporation that
17 issued the capital stock, the grounds for the election under
18 this subsection, and that the taxpayer elects to have this
19 subsection apply to sales and exchanges in that tax year.

20 (1) In order for the taxpayer to claim the benefits of the
21 partial deduction of the capital gain under this subsection,
22 the taxpayer must completely fill out the tax return,
23 determine the taxpayer's income tax liability without the
24 benefit of this subsection, and pay the amount of tax owed.
25 The taxpayer shall recompute the taxpayer's income tax
26 liability, by applying the provisions of this subsection on a
27 special return. This special return shall be filed under
28 rules of the director and constitutes a claim for refund of
29 the difference between the amount of tax the taxpayer paid as
30 determined without the application of the provisions of this
31 subsection and the amount of tax determined with the
32 application of the provisions of this subsection.

33 (2) This subsection shall not affect the amount of the
34 taxpayer's checkoff to the Iowa election campaign fund under
35 section 56.18, the checkoff for the state fish and game

1 protection fund in section 456A.16, the credits from tax
2 provided in sections 422.10, 422.11A, and 422.12 and the
3 allocation of these credits between spouses if the taxpayers
4 filed separate returns or separately on combined returns.

5 (3) For any tax year, the aggregate amount of refund
6 claims that shall be paid pursuant to this subsection shall
7 not exceed three million dollars. If, for a tax year, the
8 aggregate amount of refund claims filed pursuant to this
9 subsection exceeds three million dollars, each claim for
10 refund shall be paid on a pro rata basis so that the aggregate
11 amount of refund claims paid does not exceed three million
12 dollars. In the case where refund claims are not paid in
13 full, the amount of the refund to which the taxpayer is
14 entitled under this subsection is the pro rata amount that was
15 paid and the taxpayer is not entitled to a refund of the
16 unpaid portion and is not entitled to carry that amount
17 forward or backward to another tax year. Taxpayers shall not
18 use refunds as estimated payments for the succeeding tax year.
19 Taxpayers whose tax years begin on January 1 must file their
20 refund claims by October 31 of the calendar year following the
21 end of their tax years to be eligible for refunds. Taxpayers
22 whose tax years begin on a date other than January 1 must file
23 their refund claims by the end of the tenth month following
24 the end of their tax years to be eligible. The department
25 shall determine on February 1 of the second succeeding
26 calendar year if the total amount of claims for refund exceeds
27 three million dollars for the tax year. Notwithstanding any
28 other provision, interest shall not be due on any refund
29 claims that are paid by the last day of February of the second
30 succeeding calendar year. If the claim is not payable on
31 February 1 of the second succeeding calendar year, because the
32 taxpayer is a fiscal year filer, the claim shall be considered
33 a claim for the following tax year.

34 e. The deduction under this subsection is in lieu of any
35 deduction allowable under section 1202 of the Internal Revenue

1 Code for the capital gain from the sale or exchange of the
2 same capital stock.

3 Sec. 2. EFFECTIVE AND RETROACTIVE APPLICABILITY DATE.

4 This Act, being deemed of immediate importance, takes effect
5 upon enactment and applies retroactively to January 1, 2002,
6 for tax years beginning on or after that date.

7 EXPLANATION

8 This bill provides a deduction under the individual income
9 tax of 50 percent (25 percent for the 2002 tax year) of the
10 capital gain from the sale or exchange of capital stock of a
11 corporation acquired by the taxpayer on account of employment
12 with the corporation. The taxpayer must make an election to
13 take the deduction and the election only applies for that tax
14 year. The election is made by a written statement filed with
15 the department. In addition, the benefits of the deduction
16 are realized by means of a refund claim. This involves the
17 taxpayer filing a return with tax liability determined without
18 deduction for the capital gain and a special return with tax
19 liability determined with the deduction for the capital gain.
20 The reduction in tax liability will be treated as a claim for
21 refund of the amount of the reduction. However, not more than
22 \$3 million in tax refunds may be allowed for any tax year. If
23 more refunds are claimed, then each refund claim is payable at
24 a pro rata amount, which is the final amount of the taxpayer's
25 actual refund. A taxpayer may make two elections for two
26 different corporations during the taxpayer's lifetime. The
27 election would also apply to stock sold during that tax year
28 which was previously granted to a spouse of the taxpayer but
29 only if they file a joint Iowa income tax return. The
30 election would not apply to capital gains from stock or stock
31 options unless the corporation issuing the options offered
32 them to all full-time employees.

33 The deduction is in lieu of the deduction that may be
34 allowable under the Internal Revenue Code for sale or exchange
35 of stock in a small business held for five years.

501

S.F. _____ H.F. _____

1 The bill takes effect upon enactment and applies
2 retroactively to January 1, 2002, for tax years beginning on
3 or after that date.

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JAN 17 2002
WAYS & MEANS CALENDAR

HOUSE FILE 2079
BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO HSB 501)

Passed House, Date _____ Passed Senate, Date _____
Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____
Approved _____

A BILL FOR

1 An Act establishing a new economy employment initiative by
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HF 2079

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15 employees. A corporation does not offer incentive stock
16 options to all full-time employees unless any restrictions on
17 the exercise or sale of the stock options apply to all these
18 employees under the same terms.

19 (2) "Corporation" means any of the following:

20 (a) A corporation which at the time of the first sale or
21 exchange for which an election is made under paragraph "c" has
22 been in existence and actively doing business for at least
23 three years and is not a personal holding company as defined
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26 group, as defined in section 1504(a) of the Internal Revenue
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32 corporation described in subparagraph subdivision (a). A
33 corporation is a predecessor or successor corporation if the
34 corporation was a party to a reorganization that was entirely
35 or substantially income tax free and that occurred during or

1 after the employment of the taxpayer making an election under
2 paragraph "c".

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4 section 422(b) of the Internal Revenue Code.

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13 considered to be related when, under section 318 of the
14 Internal Revenue Code, one is a person who owns, directly or
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21 individual may elect to subtract one-half of the capital gain
22 from the sale or exchange of capital stock of a corporation
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28 elections under subparagraph (1) during the individual's
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1 year, the election shall also apply to the sale or exchange in
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3 been transferred by inter vivos gift from the individual to
4 the individual's spouse if the capital stock was acquired as
5 provided in subparagraph (1). This provision applies in the
6 case of the spouse, only if the spouse was married to such
7 individual on the date of sale or exchange or the date of
8 death of the individual and if the spouse and individual file
9 a joint Iowa income tax return on which the election is made.

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23 (1) In order for the taxpayer to claim the benefits of the
24 partial deduction of the capital gain under this subsection,
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27 benefit of this subsection, and pay the amount of tax owed.
28 The taxpayer shall recompute the taxpayer's income tax
29 liability, by applying the provisions of this subsection on a
30 special return. This special return shall be filed under
31 rules of the director and constitutes a claim for refund of
32 the difference between the amount of tax the taxpayer paid as
33 determined without the application of the provisions of this
34 subsection and the amount of tax determined with the
35 application of the provisions of this subsection.

1 (2) This subsection shall not affect the amount of the
2 taxpayer's checkoff to the Iowa election campaign fund under
3 section 56.18, the checkoff for the state fish and game
4 protection fund in section 456A.16, the credits from tax
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17 entitled under this subsection is the pro rata amount that was
18 paid and the taxpayer is not entitled to a refund of the
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27 the end of their tax years to be eligible. The department
28 shall determine on February 1 of the second succeeding
29 calendar year if the total amount of claims for refund exceeds
30 three million dollars for the tax year. Notwithstanding any
31 other provision, interest shall not be due on any refund
32 claims that are paid by the last day of February of the second
33 succeeding calendar year. If the claim is not payable on
34 February 1 of the second succeeding calendar year, because the
35 taxpayer is a fiscal year filer, the claim shall be considered

1 a claim for the following tax year.

2 e. The deduction under this subsection is in lieu of any
3 deduction allowable under section 1202 of the Internal Revenue
4 Code for the capital gain from the sale or exchange of the
5 same capital stock.

6 Sec. 2. EFFECTIVE AND RETROACTIVE APPLICABILITY DATE.

7 This Act, being deemed of immediate importance, takes effect
8 upon enactment and applies retroactively to January 1, 2002,
9 for tax years beginning on or after that date.

10 EXPLANATION

11 This bill provides a deduction under the individual income
12 tax of 50 percent (25 percent for the 2002 tax year) of the
13 capital gain from the sale or exchange of capital stock of a
14 corporation acquired by the taxpayer on account of employment
15 with the corporation. The taxpayer must make an election to
16 take the deduction and the election only applies for that tax
17 year. The election is made by a written statement filed with
18 the department. In addition, the benefits of the deduction
19 are realized by means of a refund claim. This involves the
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21 deduction for the capital gain and a special return with tax
22 liability determined with the deduction for the capital gain.
23 The reduction in tax liability will be treated as a claim for
24 refund of the amount of the reduction. However, not more than
25 \$3 million in tax refunds may be allowed for any tax year. If
26 more refunds are claimed, then each refund claim is payable at
27 a pro rata amount, which is the final amount of the taxpayer's
28 actual refund. A taxpayer may make two elections for two
29 different corporations during the taxpayer's lifetime. The
30 election would also apply to stock sold during that tax year
31 which was previously granted to a spouse of the taxpayer but
32 only if they file a joint Iowa income tax return. The
33 election would not apply to capital gains from stock or stock
34 options unless the corporation issuing the options offered
35 them to all full-time employees.

1 The deduction is in lieu of the deduction that may be
2 allowable under the Internal Revenue Code for sale or exchange
3 of stock in a small business held for five years.

4 The bill takes effect upon enactment and applies
5 retroactively to January 1, 2002, for tax years beginning on
6 or after that date.

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HOUSE FILE 2079

H-8018

1 Amend House File 2079 as follows:

2 1. By striking everything after the enacting
3 clause and inserting the following:

4 "Section 1. Section 404A.4, subsection 4, Code
5 2001, is amended to read as follows:

6 4. The total amount of tax credits that may be
7 approved for a fiscal year under this chapter shall
8 not exceed ~~two~~ four million four hundred thousand
9 dollars. Tax credit certificates shall be issued on
10 the basis of the earliest awarding of certifications
11 of completion as provided in subsection 1. The
12 departments of economic development and revenue and
13 finance shall each adopt rules to jointly administer
14 this subsection and shall provide by rule for the
15 method to be used to determine for which fiscal year
16 the tax credits are approved."

17 2. Title page, by striking lines 1 through 7 and
18 inserting the following: "An Act increasing the
19 amount of tax credits that may be granted in a fiscal
20 year for historical preservation projects."

By WARNSTADT of Woodbury

H-8018 FILED JANUARY 30, 2002

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HOUSE FILE 2079

H-8022

1 Amend House File 2079 as follows:

2 1. By striking everything after the enacting
3 clause and inserting the following:

4 "Section 1. Section 404A.4, subsection 4, Code
5 2001, is amended to read as follows:

6 4. The total amount of tax credits that may be
7 approved for a fiscal year under this chapter shall
8 not exceed ~~two~~ five million four hundred thousand
9 dollars. Tax credit certificates shall be issued on
10 the basis of the earliest awarding of certifications
11 of completion as provided in subsection 1. The
12 departments of economic development and revenue and
13 finance shall each adopt rules to jointly administer
14 this subsection and shall provide by rule for the
15 method to be used to determine for which fiscal year
16 the tax credits are approved."

17 2. Title page, by striking lines 1 through 7 and
18 inserting the following: "An Act increasing the
19 amount of tax credits that may be granted in a fiscal
20 year for historical preservation projects."

By WARNSTADT of Woodbury

H-8022 FILED FEBRUARY 4, 2002

Legislative Fiscal Bureau Fiscal Note

HF 2079 - New Economy Employment Initiative (LSB 5319 HV)

Analyst: Jeff Robinson (Phone: (515) 281-6767) (Jeff.Robinson@legis.state.ia.us)

Fiscal Note Version - New

Description

House File 2079 provides for a 50.0% (25.0% in tax year 2002) deduction from taxable income of the capital gain from the sale or exchange of stock of a corporation when the stock was acquired on account of employment with the corporation. A taxpayer is limited to two deductions for the stock of two corporations during the taxpayers lifetime. The total State cost for all such deductions is limited to \$3.0 million per year. If the claims exceed \$3.0 million, the tax benefits are prorated. The Bill takes effect upon enactment and applies to 2002 and subsequent tax years. The Department of Revenue and Finance is directed to determine by February 1 the total value of all refund claims from returns filed in the previous calendar year. Therefore, refunds for tax year 2002 will be paid after February 1 of calendar year 2004 (FY 2004).

Background

The income deduction in House File 2079 would be available for stock acquired by employees and owners of companies when the stock was acquired through a qualified employee stock option plan and also for stock acquired by company owners when the corporation was created (founder's shares).

The capital gain on stock acquired through an employee stock option plan would be equal to the difference between the price of the stock when sold and the price of the stock when the option was granted. For example, if an employee is granted 1,000 stock option shares when the share value of the company is \$15 and then exercises the option when the value is \$50 per share, the person would have a capital gain equal to \$35,000 (\$50 received minus \$15 paid times 1,000 shares). The Bill would reduce the taxpayer's Iowa income tax by approximately \$1,200 to \$1,600, depending on the employee's marginal tax rate.

The capital gain on stock received as founder's shares would, in most instances, be equal to the price received when the stock is sold or exchanged. This is because stock issued at a company's founding has no market-determined value. If 1,000 shares of stock are sold at \$50 per share, the capital gain would be \$50,000 (\$50 received times 1,000 shares). The Bill would reduce the taxpayer's Iowa income tax by \$2,250 at the maximum 8.98% marginal tax rate.

The above numbers are examples for illustrative purposes only. The benefit to individual taxpayer's would be determined by the number of shares received, the price paid per share for the option, and the price received when the option share is sold

Fiscal Impact

House File 2079 has no fiscal impact in FY 2003 due to refunds being paid before February 1, 2004. As a result of the Bill becoming effective more than one-third of the way through tax year 2002 and the benefit for tax year 2002 is only one-half the benefit in future fiscal years, the value of tax refunds paid in FY 2004 will be \$1.0 million of the \$3.0 million available. The fiscal impact in FY 2005 and beyond is estimated to be \$3.0 million per year.

Sources

Legislative Fiscal Bureau analysis
Department of Revenue and Finance analysis

_____/s/ Dennis C Prouty_____

January 30, 2002

The fiscal note and correction impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Legislative Fiscal Bureau to members of the Legislature upon request.
