

Eichhorn, Ch.
Shey
Richardson

HSB 502

WAYS AND MEANS
Succ
SF / HF 211

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 small business growth initiative by
2 adjusting the allocation to Iowa of income earned by an S
3 corporation for purposes of the state individual income tax
4 and including a retroactive applicability date provision.

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

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1 Section 1. Section 422.8, subsection 2, paragraph b,
2 subparagraph (2), Code 2001, is amended to read as follows:

3 (2) Any cash or the value of property distributions which
4 are made only to the extent that they are paid from income
5 upon which Iowa income tax has not been paid, as determined
6 under rules of the director, reduced by ~~fifty-percent-of~~ the
7 amount of any of these distributions that are made to enable
8 the shareholder to pay federal income tax on items of income,
9 loss, and expenses from the corporation.

10 Sec. 2. APPLICABILITY PROVISION. This Act applies
11 retroactively to January 1, 2002, for tax years beginning on
12 or after that date.

13 EXPLANATION

14 Under the state individual income tax, resident
15 shareholders of S corporations doing business within and
16 without the state are allowed to allocate income between Iowa
17 and other states in determining their state income tax. As
18 part of the allocation procedure, under current law, 50
19 percent of the amount of an S corporation distribution
20 received by a shareholder, which is used to pay federal income
21 tax, is not allocated to Iowa. The bill increases this
22 percentage to 100 percent.

23 The bill applies retroactively to January 1, 2002, for tax
24 years beginning on or after that date.

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JAN 17 2002

WAYS & MEANS CALENDAR

HOUSE FILE 2081

BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO HSB 502)

Passed House, Date _____ Passed Senate, Date _____

Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____

Approved _____

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HF 2081

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22 percentage to 100 percent.

23 The bill applies retroactively to January 1, 2002, for tax
24 years beginning on or after that date.

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27 H-8003

HOUSE FILE 2081

- 28 1 Amend House File 2081 as follows:
- 29 2 1. Page 1, by striking lines 11 and 12 and
- 30 3 inserting the following: "to tax years beginning on
- 4 or after January 1, 2003."
- 31 5 2. Title page, line 4, by striking the words "a
- 32 6 retroactive" and inserting the following: "an".

33 H-8003 FILED JANUARY 22, 2002 By RICHARDSON of Warren

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3.

HOUSE FILE 2081

H-8007

1 Amend House File 2081 as follows:

2 1. Page 1, by striking lines 1 through 9 and
3 inserting the following:

4 "Section 1. Section 422.5, subsection 1, paragraph
5 j, subparagraph (2), unnumbered paragraph 1, Code
6 2001, is amended to read as follows:

7 The tax imposed upon the taxable income of a
8 resident shareholder in an S corporation which has in
9 effect for the tax year an election under subchapter S
10 of the Internal Revenue Code or of a resident member
11 of a limited liability company which has elected to
12 have its income taxed directly to the member and
13 carries on business within and without the state may
14 be computed by reducing the amount determined pursuant
15 to paragraphs "a" through "i" by the amounts of
16 nonrefundable credits under this division and by
17 multiplying this resulting amount by a fraction of
18 which the resident's net income allocated to Iowa, as
19 determined in section 422.8, subsection 2, paragraph
20 "b", is the numerator and the resident's total net
21 income computed under section 422.7 is the
22 denominator. If a resident shareholder or resident
23 member has elected to take advantage of this
24 subparagraph, and for the next tax year elects not to
25 take advantage of this subparagraph, the resident
26 shareholder or resident member shall not reelect to
27 take advantage of this subparagraph for the three tax
28 years immediately following the first tax year for
29 which the shareholder or member elected not to take
30 advantage of this subparagraph, unless the director
31 consents to the reelection. This subparagraph also
32 applies to individuals who are residents of Iowa for
33 less than the entire tax year.

34 Sec. 2. Section 422.5, subsection 1, paragraph k,
35 unnumbered paragraph 4, Code 2001, is amended to read
36 as follows:

37 In the case of a resident, including a resident
38 estate or trust, the state's apportioned share of the
39 state alternative minimum tax is one hundred percent
40 of the state alternative minimum tax computed in this
41 subsection. In the case of a resident or part-year
42 resident shareholder in an S corporation which has in
43 effect for the tax year an election under subchapter S
44 of the Internal Revenue Code or of a resident or part-
45 year resident member of a limited liability company
46 which has elected to have its income taxed directly to
47 the member and carries on business within and without
48 the state, a nonresident, including a nonresident
49 estate or trust, or an individual, estate, or trust
50 that is domiciled in the state for less than the

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Page 2

1 entire tax year, the state's apportioned share of the
2 state alternative minimum tax is the amount of tax
3 computed under this subsection, reduced by the
4 applicable credits in sections 422.10 through 422.12
5 and this result multiplied by a fraction with a
6 numerator of the sum of state net income allocated to
7 Iowa as determined in section 422.8, subsection 2,
8 paragraph "a" or "b" as applicable, plus tax
9 preference items, adjustments, and losses under
10 subparagraph (1) attributable to Iowa and with a
11 denominator of the sum of total net income computed
12 under section 422.7 plus all tax preference items,
13 adjustments, and losses under subparagraph (1). In
14 computing this fraction, those items excludable under
15 subparagraph (1) shall not be used in computing the
16 tax preference items. Married taxpayers electing to
17 file separate returns or separately on a combined
18 return must allocate the minimum tax computed in this
19 subsection in the proportion that each spouse's
20 respective preference items, adjustments, and losses
21 under subparagraph (1) bear to the combined preference
22 items, adjustments, and losses under subparagraph (1)
23 of both spouses.

24 Sec. 3. Section 422.8, subsection 2, paragraph b,
25 Code 2001, is amended to read as follows:

26 b. A resident's income allocable to Iowa is the
27 income determined under section 422.7 reduced by items
28 of income and expenses from an S corporation or
29 limited liability company that carries on business
30 within and without the state when those items of
31 income and expenses pass directly to the shareholders
32 or members under provisions of the Internal Revenue
33 Code. These items of income and expenses are
34 increased by the greater of the following:

35 (1) The net income or loss of the S corporation or
36 limited liability company which is fairly and
37 equitably attributable to this state under section
38 422.33, subsections 2 and 3.

39 (2) Any cash or the value of property
40 distributions which are made only to the extent that
41 they are paid from income upon which Iowa income tax
42 has not been paid, as determined under rules of the
43 director, reduced by ~~fifty percent~~ of the amount of
44 any of these distributions that are made to enable the
45 shareholder or member to pay federal income tax on
46 items of income, loss, and expenses from the S
47 corporation or limited liability company.

48 Sec. 4. Section 422.8, subsection 6, Code 2001, is
49 amended to read as follows:

50 6. If the resident or part-year resident is a

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Page 3

1 shareholder of an S corporation which has in effect an
2 election under subchapter S of the Internal Revenue
3 Code or is a member of a limited liability company
4 which has elected to have its income taxed directly to
5 its members, subsections 1 and 3 do not apply to any
6 income taxes paid to another state or foreign country
7 on the income from the S corporation which has in
8 effect an election under subchapter S of the Internal
9 Revenue Code or from the limited liability company
10 which has elected to have its income taxed directly to
11 its members."

12 2. Title page, line 3, by inserting after the
13 word "corporation" the following: "or a limited
14 liability company".

By GRUNDBERG of Polk

H-8007 FILED JANUARY 23, 2002

Legislative Fiscal Bureau

Fiscal Note

HF 2081 - Small Business Growth Initiative (LSB 5321 HV)

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

Fiscal Note Version - New

Description

House File 2081 allows taxpayers who elect to allocate income from S-corporations between Iowa and other states to deduct 100.0% of federal income taxes paid in determining the share of the S-corporation income that is subject to Iowa income tax. Currently, only 50.0% of federal income taxes paid may be deducted in determining the amount of S-corporation income that is subject to Iowa income tax. The Bill applies retroactively to January 1, 2002.

Background

The Department of Revenue and Finance conducted a study of tax year 1998 returns to estimate the amount of deduction taken for federal taxes paid on S-corporation income. The analysis was based on a sample of returns claiming "Other Iowa Credits" on line 54 of the 1998 Iowa Individual Income Tax Long Form IA 1040. Based on the sample, \$8.6 million of S-corporation apportionment credits were estimated to have been claimed. To obtain an estimate of the impact of increasing the deduction for federal income taxes from 50.0% to 100.0%, the amount of the credit was reestimated for the 1,121 returns in the sample. With the change in the deduction, the reestimated credit amount increased to \$9.4 million.

Fiscal Impact

House File 2081 will result in a decrease in General Fund revenues equal to \$0.9 million in FY 2003 and \$0.8 million in FY 2004.

Assumptions

1. Tax year 1998 was a typical year relative to the number of taxpayers reporting income from S-corporations and electing to apportion income between Iowa and other states.
2. The share of other credits claimed accounted for by the S-corporation apportionment credit remains relatively constant from year-to-year at approximately 60.0%.
3. The distribution of S-corporation apportionment credits by amount of the claim and adjusted gross income bracket of the taxpayers remains relatively constant from year-to-year.

4. For tax year 2002, all of the deduction change impact will be realized on the tax return filed in FY 2003.
5. For tax year 2003, 12.5% of the impact will be realized in estimate payments made in FY 2003, 37.5% will be realized in estimate payments made in FY 2004, and 50.0% will be realized on final returns filed in FY 2004.

Source

Iowa Department of Revenue and Finance

_____/s/ Dennis C Prouty_____

January 25, 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.
