

**FINAL REPORT**  
**STATE AND LOCAL TAX REVIEW STUDY COMMITTEE**

February 1995

AUTHORIZATION AND APPOINTMENT

The State and Local Tax Review Study Committee was established by the Legislative Council and charged to "review the Iowa tax system using the criteria of the two-year Peat Marwick legislative study and make recommendations on how the tax system can treat the majority of Iowans more equitably; ensure that Iowa's tax climate remains competitive while ensuring that all individuals and businesses pay their fair share of taxes; review Iowa's various tax credits to ensure they are properly targeted to meet statewide goals in relieving the tax burden and review the basic structures of Iowa's tax system to review whether features of the system are out of step with most states' tax systems and should be modified to be more in line with a majority of states. The Study Committee shall hold a joint meeting with the Economic Development Service Delivery System Study Committee to consider issues relating to the machinery and equipment tax and Subchapter S corporations".

Members serving on the Study Committee were:

Senator William D. Palmer, Co-chairperson  
Representative Gary Blodgett, Co-chairperson  
Senator Wayne Bennett  
Senator Patrick J. Deluhery  
Senator H. Kay Hedge  
Senator Tom Vilsack  
Representative Bill Bernau  
Representative Jack Drake  
Representative Roger Halvorson  
Representative Don Shoultz

COMMITTEE PROCEEDINGS

The Study Committee was authorized four meeting days. The meetings were held at the State Capitol Building in Des Moines on August 30, 1994, September 20, 1994, October 10, 1994, and November 17, 1994. The October meeting was the joint meeting with the Economic Development Service Delivery System Study Committee.

### AUGUST 30, 1994, MEETING

The first of four meetings of the State and Local Tax Review Committee was held Tuesday, August 30, 1994. The Committee heard testimony from the following persons:

**Mr. Denny Presnall and Mr. Jerry Downin, Iowa Farm Bureau Federation** - Mr. Presnall and Mr. Downin spoke to the effect of not allowing full income tax deduction for health insurance paid by self-employed people, the cost of mental health care which is paid mostly from property taxes, and the potential impact on farmers from elimination of the federal income tax deduction.

**Ms. Linda Weindruch, Association of Business and Industry** - Ms. Weindruch suggested creating a positive business tax climate by exempting machinery and equipment from property tax, retention of federal income tax deductibility, and revision in the state sales tax base.

**Mr. Tom Bredeweg, League of Iowa Municipalities** - Mr. Bredeweg suggested uncoupling the residential property tax rollback from the agricultural property tax rollback, receipt of a refundable state income tax credit for property taxes paid on machinery and equipment in lieu of a property tax exemption, and authorizing local jurisdictions to collect payments in lieu of taxes from nongovernmental exempt property.

**Mr. Paul Coates, Iowa State Association of Counties** - Mr. Coates emphasized the opposition of counties to the property tax limitation presently in effect, and problems with rollbacks, exemptions, and credits as applied under the property tax laws, especially the state's not fully funding the credits.

**Mr. Mike Ralston, Iowa Taxpayers Association** - Mr. Ralston described the organization, commented on Iowa tax policy, and expressed concern that equity should require that any machinery and equipment tax exemption apply to both new and existing business.

**Ms. Sharon Sievers, Iowa Bankers Association** - Ms. Sievers addressed the recent trend of banks in creating subsidiaries to house their investments and also the bill proposed during the 1994 Session involving a tax on deposits in lieu of the present franchise tax.

**Mr. Harold Butz, Iowa Tax Reform Action Coalition** - Mr. Butz discussed the equity of progressive tax policy and how to make Iowa's tax system more equitable by slightly higher tax brackets, funding circuit breakers, increasing the standard deduction, and limiting business incentives.

**Mr. Don Cook, Monroe County Assessor, and Ms. Marcella Thompson, Appanoose County Assessor** - Mr. Cook and Ms. Thompson spoke of some recommendations and concerns of the Iowa Assessors Association, especially the rollback of residential property values, and the exemptions, credits, and lack of state reimbursement for credits.

**Mr. James Edwards, Printing Industries of the Midlands** - Mr. Edwards spoke in regard to new technologies that he believes should qualify for the processing exemptions of the

state sales tax and expressed his support for the passage of language similar to Senate File 196 for the printing industry.

**Mr. David Berger, MCI Telecommunications Corporation** - Mr. Berger criticized continuing the central assessment for property tax of the telecommunications industry which is now highly competitive. Central assessment is used for various utilities and involves valuation of other factors in addition to real property and had justification when monopolies controlled the industry.

The Committee members discussed the course future meetings would take, including hearing presentations on Iowa's tax system from "average" Iowa taxpayers, and meeting jointly with the Economic Development Service Delivery System Study Committee.

#### SEPTEMBER 20, 1994, MEETING

The second of four meetings of the State and Local Tax Review Study Committee was held Tuesday, September 20, 1994. The Committee heard testimony from the following persons:

**Ms. Myrt Levin, Iowa Business Council** - Ms. Levin, Chairperson of the 1991-1992 Tax Equity and Fairness Study Committee, discussed the activities of that 1991-1992 Study Committee and suggested that the state should compare its economic development strategies to its tax system to determine if the tax structure supports the objectives of the economic development strategy.

**Ms. Gretchen Tegeler, Department of Management, and State Representative Ron Corbett** - Ms. Tegeler and Representative Corbett presented and answered questions relating to the Governor's tax relief proposal which involves the use of projected surpluses to immediately fill the state cash reserve fund to its maximum and to reduce the state individual income tax rates by 15 percent over the next four years.

**Mr. Mike Abbott, American Republic Insurance Company, and Mr. Bill Timmons, Iowa Insurance Institute** - Mr. Abbott and Mr. Timmons discussed the state's gross premiums tax imposed on insurance policies and commented that because other states also have this type of tax, in addition to a retaliatory tax on insurance companies whose home states tax premiums at a higher rate, Iowa should not revise its present taxing method

**Mr. Carl Castelda, Department of Revenue and Finance** - Mr. Castelda discussed the status of the state's franchise tax on financial institutions, methods being looked at by some taxpayers to lessen the amount of tax, countermeasures possible, and the potential problems of trying to adjust the method and calculation of the tax.

**Mr. Brad Lint, Iowa Citizen Action Network** - Mr. Lint commented that Iowa's tax structure is inequitable because of the heavy reliance on regressive sales, excise, and property taxes and the state's retention of full federal income tax deductibility. He expressed concern

regarding the job creation and growth which has been claimed would arise from the exemption of certain machinery and equipment from property taxation.

**Ms. Marcia Howard, AFSCME** - Ms. Howard presented recommendations to improve Iowa's tax policy, which included expanding the sales tax base to include goods and services generally consumed by higher income individuals and businesses, eliminating the deductibility of federal income taxes, increasing both the standard deduction and personal exemption credit, developing a coherent tax policy that makes sense for all businesses, and apportioning business incomes based upon the equal weighting of property, payroll, and sales rather than just sales.

**Mr. Jeff Boeyink, Iowans for Tax Relief** - Mr. Boeyink presented that organization's case for keeping the income tax deduction for federal income tax liability.

**Mr. Robert Willis** - Mr. Willis presented his proposal that is designed to restructure the property tax so that the tax is imposed on the land values and only partially on improvements added to the land, e.g., buildings, houses, and other structures.

**Dr. Dale Bails, Public Interest Institute** - Dr. Bails commented on the validity of equity-based progressive taxation and the problems with using income as the tax base.

#### OCTOBER 10, 1994, MEETING

The joint meeting of the State and Local Tax Review Study Committee and the Economic Development Service Delivery System Study Committee was held Monday, October 10, 1994. The following presentations were made:

**Mr. David Lyons, Director, Department of Economic Development** - Mr. Lyons explained to the Committees the Iowa Department of Economic Development's proposal for the elimination of the property tax imposed on machinery and equipment. The proposal envisions eliminating the tax over a period of 10 years and providing partial replacement funds to local governments and school districts.

**Mr. Carl Castelda, Deputy Director, Iowa Department of Revenue and Finance** - Mr. Castelda discussed the taxation of Subchapter S corporations. Taxation of Subchapter S corporations is different from the taxation of other corporations in that income from Subchapter S Corporations is passed through to individual shareholders and is subject to state income taxation only on amounts distributed to the individual shareholders. Corporations other than Subchapter S Corporations and limited liability corporations are subject to the corporate income tax which apportions income based on sales in Iowa; after-corporate-tax income distributed to individuals is subject to the individual state income tax. Mr. Castelda discussed several alternative approaches to taxation of Subchapter S corporations used by other states.

**Mr. William Brown, Brown & Winick Law Firm** - Mr. Brown discussed a proposal for modifying the income taxation of Subchapter S corporations. He also discussed problems perceived by the business community relating to the taxation of resident and nonresident

shareholders of Subchapter S corporations. Mr. Brown stated the view that current Iowa Subchapter S corporation tax laws penalize resident Subchapter S corporation shareholders when compared to the tax treatment of other corporations.

The Committees engaged in joint discussion and then broke into the two separate committees for further committee discussion.

**Committee Discussion** - The State and Local Tax Review Study Committee convened separately at 1:25 p.m. to discuss recommendations relating to the repeal and phaseout of the property tax on machinery and equipment and the income taxation of Subchapter S corporations. After lengthy discussion, the Committee agreed that no recommendations would be made at this time and the November 17 meeting would be spent formulating detailed recommendations relating to the entire state tax system.

#### NOVEMBER 17, 1994, MEETING

The State and Local Tax Review Study Committee devoted the entire meeting to the discussion of several issues regarding Iowa's tax system, including the incomplete funding of existing property tax credits, the need to eliminate the property tax on machinery and equipment, and whether changes need to be made in Iowa's inheritance and estate taxes.

The Committee was unable to agree on specific legislative recommendations. There was considerable interest among all members of the Committee in the following issues:

1. The lack of funding provided to fully fund the homestead, family farm, agricultural land, and other property tax credits and whether those credits should be fully funded, changed, or eliminated before tax reductions in other areas are considered.
2. Reducing property taxes through greater state participation in the payment of county mental health costs or some other mechanism.
3. Elimination of the property tax on machinery and equipment.
4. Reducing income tax rates.

#### RECOMMENDATION

The Committee agreed that these issues should be considered further in the upcoming session of the General Assembly. The Committee also agreed that a list of the recommendations made before the Committee should be compiled by the Legislative Service Bureau and forwarded to the Committees on Ways and Means of the Senate and House of Representatives. The compiled list is attached to this report as Attachment 1.

## ATTACHMENT 1

### PROPOSALS THAT WERE DISCUSSED BY THE COMMITTEE

1. Reduce the property tax on agricultural land. Replace the lost revenue from one or more of the following: a) elimination of the homestead, family farm, and/or agricultural land tax credits; b) elimination of individual federal income tax deduction; or c) applying a one-cent sales tax increase.
2. Allow farmers to deduct 100 percent of health insurance premiums.
3. Eliminate machinery and equipment property tax.
4. All tax legislation should allow the minimum amount of discretion to the agency administering the tax.
5. Retain current federal deductibility provisions for Iowa's income tax.
6. Do not extend the sales tax to goods and services used by businesses in the production of other goods and services.
7. Uncouple residential and agricultural land valuations (would eliminate residential property tax rollback).
8. If the machinery and equipment property tax is to be repealed, make it a refundable credit to taxpayer rather than direct reimbursement to cities.
9. Require owners of tax-exempt property to negotiate with cities for payment in lieu of taxes to support essential city services.
10. Eliminate the property tax limitation which under current law is in effect for counties through fiscal year 1996-1997.
11. Fully fund the homestead credit or prorate it to the level of state funding.
12. Do not eliminate the machinery and equipment property tax; offer a corporate income tax credit to offset the amount of machinery and equipment taxes paid.
13. Make Iowa's tax system fairer and more progressive through the following: a) establish slightly higher rate brackets; b) fund circuit breakers; c) increase the standard deduction; d) use one consistent industrial development package; and e) limit the single-factor corporate tax apportionment formula to corporations not receiving state incentives.
14. Allow military and homestead credits to apply to personal income tax.
15. Enact changes regarding printing process materials in SF 196 from the 1993-94 Sessions.
16. Change the means of assessment of telecommunications interexchange carrier property from central assessment to local assessment.
17. Change the franchise tax on banks to a deposits tax.

18. Enact the Family Opportunity Plan proposed by Governor Branstad.
19. Place a limit on the amount of federal income tax which may be deducted from state income tax.
20. Eliminate federal corporate income tax deductibility as a means to replace lost property tax revenue.
21. Couple Iowa taxable income to federal taxable income instead of federal adjusted gross income; and increase the state standard deduction and the personal exemption amounts.
22. Eliminate the current corporate apportionment formula in favor of a formula which equally weights property, payroll, and sales and eliminate corporate federal deductibility.
23. Expand the sales tax to services.
24. Increase property taxes on real estate to fund reduction in sales and income taxes.
25. Enact a flat income tax.
26. Change inheritance and estate taxes to reduce incentives for people to leave the state.
27. Enact changes in the Subchapter S corporation taxation as proposed in the Senate version of HF 2415 from the 1994 Legislative Session.
28. Maintain the 2 percent insurance premiums tax.
29. Exempt interest from bonds of Iowa governmental entities.
30. Fully fund property tax credits.
31. Phase in state takeover of mental health funding, existing as well as increased expenditures.
32. Limit death taxes to the amount of credit allowed for state estate tax from the federal estate tax.
33. Cut individual income tax rates by 15 percent over 4 years.
34. Allow a limited property tax credit for livestock production facilities.
35. Eliminate the machinery and equipment property tax over 10-year period with partial state replacement funds available and tax increment financing district bonds protected.
36. Provide state reimbursement of businesses for machinery and equipment property tax paid rather than exempt machinery and equipment from tax.
37. Keep the state's promise in HF 2430, enacted in the 1994 Legislative Session, to pay one-half of new mental health costs in order to lower property taxes.

38. Increase the amount of the individual income tax personal credits.

39. Exempt all or a set portion of pension income from taxation.

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