



Iowa Tax Law Makes Some Changes Now, But Others are Far Off and Contingent

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Kristine A. Tidgren

Note: The Iowa Department of Revenue has [launched a new webpage](#), where it will be publishing its latest guidance and information on the new Iowa law.

On May 5, 2018, the Iowa Legislature passed [S.F. 2417](#), a significant overhaul of the Iowa tax code. Federal tax reform implemented by the Tax Cuts & Jobs Act set the stage for this legislation. Following is a review of key provisions included in the bill that Governor Reynolds signed into law on May 30, 2018.

Tax Year 2018 Highlights

The law makes a number of changes beginning with the 2018 tax year. These changes apply retroactively to January 1, 2018.

Section 179

The law increases Iowa's section 179 deduction from \$25,000 to \$70,000 for tax year 2018 for individual taxpayers. The phase-out threshold for this deduction is increased from \$200,000 to \$280,000.

The law also addresses the section 179 glitch we've written about in more detail [here](#). This problem arises when a taxpayer is allocated greater section 179 deduction amounts than are allowed under Iowa law by multiple partnerships or S corporations, or from an out-of-state entity. In these cases, the Iowa taxpayer has been unable to use the excess deduction at all, even though the taxpayer has been required to reduce his or her basis to correspond with the amount of the federal deduction passed through.

The law addresses this problem by allowing the taxpayer to elect to deduct the amount in excess of the Iowa limit evenly over a five-year period beginning the following tax year. This election is made possible by new subsection § 422.7(52). Taxpayers who make the election cannot take the section 179 deduction for that tax year for any eligible property, but must depreciate the cost using the appropriate MACRS convention. This election is for one tax year and electing out of it in the subsequent tax year does not affect the taxpayer's ability to continue to take the five-year deduction of the excess from a prior year's election.

Tax-Free IRA Distributions to Certain Public Charities for Individuals 70 ½ and older

Beginning in 2018, the law conforms Iowa tax law with the federal PATH Act provision allowing taxpayers 70 ½ and older to make tax-free distributions from their IRAs to a qualified charity.

State Sales & Use Tax Deduction

Beginning in 2018, the law allows taxpayers who itemize deductions to choose to deduct state sales and use tax instead of state income and property tax. This provision conforms Iowa law to another provision of the PATH Act. Taxpayers must elect to deduct the sales and use tax on their federal return to make this choice on their state return.

Earned Income Tax Credit

Beginning in 2018, the law conforms Iowa law to federal law with respect to PATH Act provisions that increased phase-out amounts and credit percentages for the earned income tax credit.

Accounting Method Changes

Beginning in 2018, the law allows taxpayers to use accounting method changes made possible by the Tax Cuts & Jobs Act for purposes of calculating Iowa income.

Teacher Expense Deduction

Beginning in 2018, the law allows elementary and secondary teachers to apply the deduction allowed under federal law for out-of-pocket expenses up to \$250 when calculating Iowa income.

529 Plans

Beginning January 1, 2018, the law conforms Iowa law with the new federal provisions for 529 plans. As such, "qualified education expenses" include (in addition to those associated with attending college) up to \$10,000 per beneficiary, per year for tuition expenses for attending an accredited elementary or secondary (K-12) school in Iowa.

Like-Kind Exchange for Personal Property

For 2018, the law does not couple with the Tax Cuts & Jobs Act elimination of IRC § 1031 like-kind exchange treatment for personal property. As such, Iowa continues to recognize deferred gain or loss for personal property exchanges in tax year 2018, even though federal law does not. This will require a new Iowa form or method to account for these transactions.

Bonus Depreciation

Iowa does not recognize additional first-year depreciation in tax year 2018.

Domestic Production Activities Deduction

For 2018, Iowa does not specifically couple with the federal repeal of the DPAD deduction. Because Iowa law continues to point to the federal tax code as it existed on January 1, 2015 (absent specific exceptions), it appears that Iowa law will continue to recognize DPAD in 2018. How this would work is unknown. We are investigating this issue.

Research Activities Credit

The law retroactively modifies eligibility for the research activities credit. Iowa issued [guidance explaining the changes](#) on July 23, 2018. For tax years beginning **January 1, 2017**, taxpayers must meet two eligibility requirements to be eligible for the credit:

1. Claim and be allowed a Federal Research Credit under section 41 for the same taxable year.
2. Be engaged in one of the following industries:
 1. Manufacturing
 2. Life Sciences
 3. Software Engineering
 4. Aviation and Aerospace

Significantly, the taxpayer cannot be engaged in the following industries:

- Agricultural production or agricultural cooperatives
- Contractors, subcontractors, builders or contractor-Retailers engaged in commercial and residential installation / repair including but not limited to:
 - HVAC installation/repair
 - Plumbing and pipe fitting
 - Security system installation
 - Electrical installation/repair
- Accountants
- Architects
- Collection agencies
- Finance or investment companies
- Publishing companies
- Real estate companies
- Retailer
- Transportation companies
- Wholesalers

IDOR guidance states that if a business already filed a credit claim for a prior tax year and is no longer eligible, the business should file an amended return to add back the amount of the Research Activities Credit claimed. The business should file an amended return by October 31, 2018, in order to avoid receiving a notice of assessment from the Department.

Tax Year 2019 Highlights

For tax years beginning in 2019, the law couples Iowa tax law with federal tax law as of March 24, 2018, with some exceptions.

Section 179

For tax year 2019, the law sets Iowa's section 179 deduction at \$100,000 for all taxpayers, with a phase-out threshold of \$400,000. Iowa Code § 422.7(51).

The law also provides taxpayers with an option in 2019 to make a subsection § 422.7(52) election, as detailed above, to prevent the loss of cost recovery when the Section 179 deduction is passed through to the taxpayer from an entity or entities in an amount exceeding the Iowa limit.

Bonus Depreciation

Additional first-year depreciation allowed under IRC §168(k) of federal law does not apply in computing net income for state tax purposes.

QBI Deduction

In 2019, the law allows taxpayers to deduct from their Iowa taxable income an amount equal to 25 percent of their federal IRC § 199A "qualified business income" deduction. This amount would seem to include the IRC § 199A(g) deduction passed through to some patrons by their cooperatives, although the law does not make this clear.

Like-Kind Exchange for Personal Property

In 2019, Iowa law will be coupled with federal law with respect to the elimination of IRC § 1031 like-kind exchange treatment for personal property. Taxpayers, however, may *elect* non-recognition of gain or loss treatment for the 2019 tax year. The Director of Revenue is tasked with issuing rules regarding the administration of this election. This election will be useful for taxpayers who trade depreciated equipment for something newer and are faced with recognition of recapture income, absent deferral treatment. This primarily remains an issue in 2019 because Iowa's section 179 deduction is only \$100,000 that year.

Tax Rates

Beginning in 2019, individual tax rates are lowered, although not substantially. For income of \$73,361 and above, for example, the rate is reduced from 8.98 percent to 8.53 percent in 2019. Following is a chart showing the reduced rates:

Taxed Income Brackets*		Current Law Tax Rates	TY 2019 Rates
Lower Limit	Upper Limit		
\$ 0	\$ 1,628	0.36%	0.33%
\$ 1,629	\$ 3,256	0.72%	0.67%
\$ 3,257	\$ 6,512	2.43%	2.25%
\$ 6,513	\$ 14,652	4.50%	4.14%
\$ 14,653	\$ 24,420	6.12%	5.63%
\$ 24,421	\$ 32,560	6.48%	5.96%
\$ 32,561	\$ 48,840	6.80%	6.25%
\$ 48,841	\$ 73,260	7.92%	7.44%
\$ 73,261	And Over	8.98%	8.53%

*Estimated TY 2019 brackets. Iowa tax brackets are indexed annually for inflation.

(Tables are copied from the Legislative Services Agency Fiscal Note regarding SF 2417)

AMT

The law retains the individual AMT, which is set at 75 percent of the maximum state individual income tax rate for the tax rate, rounded to the nearest one-tenth of one percent, times the state alternative minimum taxable income of the taxpayer. The corporate AMT is also retained through tax year 2020.

\$10,000 Limit for State and Local Taxes

The law provides that the federal \$10,000 limit on the deduction for state and local taxes (or sales tax in lieu of those taxes) does not apply in computing taxable income for state tax purposes.

Corporate Tax Rates

Corporate tax rates remain unchanged in 2019.

Net Operating Losses

Although the Tax Cuts & Jobs Act has restricted a farmer's federal net operating loss carryback to two years, the law allows a taxpayer engaged in the trade or business of farming to carryback losses for five years. Iowa Code § 422.9(3)(d).

Sales & Use Taxes

Beginning January 1, 2019, the law expands the sales and use tax base to include items and services not previously subject to sales tax in Iowa. These include information services, digital goods and services related to installing specified digital products, ride sharing, subscription services, online sellers, online marketplaces, and online travel agent websites. In light of the U.S. Supreme Court's decision in [South Dakota v. Wayfair](#), the number of retailers that must comply with this new sales tax is expanded. Read the Iowa Department of Revenue's response to Wayfair [here](#).

Tax Years 2020 & Beyond

For tax years beginning on or after January 1, 2020, **the law implements rolling conformity with federal tax law, with certain exceptions.**

Section 179

Beginning in 2020, the law allows Iowa taxpayer's to take a Section 179 deduction equal to the federal limit. The federal deduction is currently \$1 million, with a \$2.5 million threshold. Both numbers will be indexed for inflation

Bonus Depreciation

Additional first-year depreciation allowed under IRC §168(k) of federal law does not apply in computing net income for state tax purposes.

Like-Kind Exchange

For tax years beginning January 1, 2020, or later, the Iowa like-kind exchange law will be the same as the federal law. No deferral will be allowed for exchanges of personal property. The impact of this change will be limited because the Iowa Section 179 deduction will be fully coupled with federal law at this time. Real property will continue to be eligible for § 1031 gain or loss deferral treatment under both state and federal law.

Individual Tax Rates

In tax years 2019 through 2022, the individual rates are lowered as depicted in the chart above. Beginning with tax year 2023, Iowa's individual income tax rates will be more significantly restructured and lowered if two revenue targets are met:

- Actual general fund revenue must total at least \$8.3146 billion in the previous fiscal year
- Actual net general fund revenue for the previous fiscal year must exceed the actual net general fund revenue level for the fiscal year immediately prior to the previous year by at least 4 percent.

First, the number of tax brackets would be reduced from nine to four. Second, the rates would be lowered as follows:

Table 2 – Contingent Income Tax Rates

Taxed Income Brackets		Contingent Rates TY 2023
Lower Limit	Upper Limit	
\$ 0	\$ 6,000	4.40%
\$ 6,001	\$ 30,000	4.82%
\$ 30,001	\$ 75,000	5.70%
\$ 75,001	And Over	6.50%

If the trigger conditions are met, federal deductibility would also be eliminated for individuals.

Capital Gain Deduction Restricted

Beginning with tax year 2023, the Iowa capital gain deduction will apply only to net capital gain from the sale of real property *used in a farming business if sold to lineal descendants or other certain relatives*. This change will apply only when the two revenue targets stated above are met (and lower individual rates are triggered):

- Actual general fund revenue must total at least \$8.3146 billion in the previous fiscal year
- Actual net general fund revenue for the previous fiscal year must exceed the actual net general fund revenue level for the fiscal year immediately prior to the previous year by at least 4 percent.

Current law allows net capital gain from the sale of real property used in a business to be deducted from Iowa income if the other requirements of the deduction (such as 10-year ownership and material participation are met).

QBI Deduction

In 2020, like 2019, the law allows taxpayers to deduct from their Iowa taxable income an amount equal to 25 percent of their federal IRC § 199A “qualified business income” QBI deduction. In 2021, this percentage increases to 50 percent, and for tax years beginning in 2022, it increases to 75 percent. If the revenue targets above are met in years 2023 through 2025, the Iowa deduction will be 100 percent of the federal QBI deduction. This is because the revenue trigger would cause federal taxable income, rather than federal adjusted gross income, to be the starting point for tax calculations.

Corporate Tax Rates

Beginning in 2021, corporate income tax rates are reduced from a high of 12 percent to 9.8 percent.

Table 3 – Corporate Income Tax Rates

Taxed Income Brackets		Current Law Tax Rates	TY 2021 Rates
Lower Limit	Upper Limit		
\$ 0	\$ 25,000	6.0%	5.5%
\$ 25,001	\$ 100,000	8.0%	5.5%
\$ 100,001	\$ 250,000	10.0%	9.0%
\$ 250,001	And Over	12.0%	9.8%

Corporate AMT

The law retains the corporate AMT through 2020 (despite its elimination under federal law), but eliminates it beginning in tax year 2021.

Federal Deductibility

The law does not allow corporations to deduct federal income taxes paid for tax years beginning on or after January 2021.

Other Noteworthy Provisions

- The law extends the innovation fund through 2023, but substantially scales back and narrows the applicability of the research credit.
- Instead of eliminating or revising many other credits, the law authorizes the legislative council to initiate a study committee to evaluate tax credits available under Iowa law, including Iowa's utilization of tax credits as a tool for promoting and supporting economic growth and development. The legislature will consider the council's report during the 2020 legislative session.
- The law eliminates the geothermal tax credit allowed under Iowa Code § 422.10A and the geothermal heat pump tax credit allowed under Iowa Code § 422.11I, beginning in 2019.
- The law did not increase funds for the Beginning Farmer Tax Credit. As such, it remains capped at \$6 million, as we've [detailed previously](#).

Conclusion

This is a summary of some of the key provisions included in this new law. We will be further analyzing the impact of its provisions on Iowa taxpayers, particularly agricultural producers, in the days ahead.

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