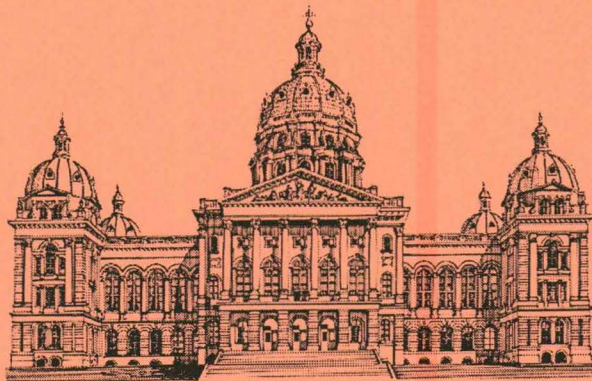


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Task Force to Study Iowa's
System of State and Local
Taxation

PROGRESS REPORT

**TASK FORCE TO STUDY IOWA'S SYSTEM
OF STATE AND LOCAL TAXATION**



Presented to the
LEGISLATIVE COUNCIL
and the
IOWA GENERAL ASSEMBLY
January 1998

Prepared by the
LEGISLATIVE SERVICE BUREAU



Legislative
Service
Bureau

PROGRESS REPORT

Task Force to Study Iowa's System of State and Local Taxation

January 1998

MEMBERS and ALTERNATES

Legislators

Senator JoAnn Douglas, Co-chair
Representative Dwight Dinkla, Co-chair
Senator Jeff Angelo
Senator Richard Drake
Senator Steve D. Hansen
Senator William Palmer
Representative John Greig
Representative Richard Myers
Representative Don Shultz
Representative James Van Fossen

Public Members

Mr. Gary Bilyeu (Assessors)
Mr. Steve Evans (Utilities)
Mr. Ron Geiger (Business)
Ms. Nancy Gilman (School Boards)
Ms. Ann Hutchinson (Cities)
Mr. Tom Jarrett (Taxpayers)
Ms. Janice Laue (Labor)
Ms. Sharon McCrabb (Counties)
Mr. Patrick Murphy (Realtors)
Mr. Jim Sage (Agriculture)
Mr. Peter Voorhees (Taxpayers)

Public Member Alternates

Ms. Marcella Thompson
Ms. Joan Thompson
Ms. Margaret Van Houten
Mr. Carl Benning
Mr. E.J. Giovannetti
Ms. Alexa Heffernan
Mr. Mark Smith
Mr. Grant Veeder
Ms. Helen Saylor
Ms. Heidi Vittetoe
Ms. Jane A. Miller

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AUTHORIZATION AND APPOINTMENT

The Task Force to study Iowa's System of State and Local Taxation was established by the Legislative Council and charged to:

"study and make recommendations regarding the state and local tax systems in this state and address the goals of tax simplification, equity, and reduction. The study shall include the local property tax system, individual income tax system, taxation of corporations, financial institutions, and other business taxation, sales, services, and use taxes, and other tax-related topics deemed appropriate by the task force. The task force may contract with one or more tax consultants or experts familiar with the Iowa state and local tax systems, or for other contract assistance deemed necessary."

Creation of the Task Force was requested in H.C.R. 22. Various constituencies were suggested for inclusion as public members in the resolution and others were added by the Legislative Council. The constituency represented is listed in parentheses after the name of the public member. The public member alternates were authorized by Task Force rules to attend on behalf of an absent member and to participate in deliberations as a member. Each public member alternate is listed following the appropriate public member.

The Task Force was authorized to spend up to \$100,000 for costs of contract assistance subject to prior approval. The Task Force is to conduct the study through the 1998 calendar year.



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1. Committee Proceedings.

The Task Force was authorized five meeting days during the 1997 Interim. The meetings were held at the State Capitol Building in Des Moines on September 3, 1997, October 8, 1997, October 22, 1997, November 12, 1997, and December 3, 1997.

Members on the Task Force were assigned to one of three subcommittees as follows:

<u>Sales and Use Tax</u>	<u>Income Tax</u>	<u>Property Tax</u>
Senator Richard Drake, Chair	Senator JoAnn Douglas, Chair	Representative Dwight Dinkla, Chair
Senator Steve D. Hansen	Senator Jeff Angelo	Representative John Greig
Ms. Janice Laue	Senator William Palmer	Representative Richard Myers
Ms. Sharon McCrabb	Representative Don Shoultz	Mr. Gary Bilyeu
	Representative James Van Fossen	Mr. Steve Evans
	Mr. Tom Jarrett	Mr. Ron Geiger
	Mr. Peter Voorhees	Ms. Nancy Gilman
		Ms. Ann Hutchinson
		Mr. Patrick Murphy
		Mr. Jim Sage

2. September 3, 1997, Meeting.

Overview. The first meeting of the Task Force started with the introduction of members and staff and then was devoted to educating the members on various subjects relating to state and local taxes. Senator JoAnn Douglas and Representative Dwight Dinkla were elected Co-chairpersons.

Director of Revenue and Finance. Director Gerald Bair of the Department of Revenue and Finance made the first presentation to the Task Force. Mr. Bair gave an overview of previous study recommendations and subsequent actions taken, tax collection aspects, and other taxpayer services, a list of differences in Iowa income tax from the federal income tax, inconsistencies existing in tax statutes as applied to various segments of the same class of taxpayers, and changes during the period from the 1986 assessment year to the 1996 assessment year in the mix of statewide taxable valuation by class of property for property tax purposes.

Utility Taxation. The Task Force learned how the municipal utilities, electric cooperatives, and the investor-owned utilities are taxed and how each utility's tax compares to the others. The presenters were Bob Haug, Executive Director, Iowa Association of Municipal Utilities; Dawn Vance, Government Relations Director, Iowa Association of Electric Cooperatives; and Mark Douglas, President, Iowa Utility Association.

CPA Perspective. Mr. Dwayne Vande Krol, Chairperson of the Taxation Committee, Iowa Society of CPAs, provided a wish list in regard to the Iowa tax structure from

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an accountant's perspective. The list includes uniformity between Iowa and federal rules and amongst the various states, certainty and stability in regard to the meaning of provisions of tax statutes, and administrative ease and simplicity in taxpayer compliance.

University of Iowa. Professor Thomas Pogue of the University of Iowa provided an overview of Iowa property taxation which included the trends, problems of a narrowing base, improvement of the system, tax collections, and valuations, both taxable and exempt. Dr. Pogue also discussed public spending and taxation in relation to economic development. This involved discussing what is economic development, facts limiting potential of development policies, assessment of impacts of public policies, taxes and competitiveness, and whether business development creates jobs.

Iowa State University. Research Associate David Swenson from Iowa State University provided comparisons of certain property tax statistics during the 1989-1997 fiscal year period. These included total taxable values and total taxable values by classification, both adjusted for inflation, and a comparison of the assessed and taxable values (adjusted for inflation) of the various classes of property in rural, urban, and metro counties.

Des Moines Chamber of Commerce. Mr. Steve Zumbach and Mr. Kent Sovern, representing the Greater Des Moines Chamber of Commerce, presented an analysis of the impact of various taxes on the manufacturing industry as compared to 11 other states and the impact of the residential property tax rollbacks on commercial and industrial property taxes.

3. October 8, 1997, Meeting.

Overview. The second meeting of the Task Force continued its education of the members on the property tax including the rollback, equalization, and tax credits and the use of property tax in the school aid formula.

Property Tax Rollback. Mr. Gene Eich of the Department of Revenue and Finance discussed the history of the assessment limitations and the rollback adjustments that were made for each class of property since the 1978 assessment year. He also provided information on the effect on the rollback for residential property if the growth due to revaluation in residential property had not been "tied" to the growth due to revaluation in agricultural property. Mr. Gary Bilyeu, Story County Assessor, presented in very simple terms the concept of rollback and what it is. Mr. Eich and Mr. Bilyeu disagreed on whether the rollback has resulted in a shift in property tax burden from residential property to commercial property.

Property Tax Equalization. Mr. Eich also explained the assessment equalization process used to equalize values within each class of property and the need for it. Tentative equalization orders are sent by August 15 every odd-numbered year to local assessors. These orders are stated as a percentage increase or decrease in the aggregate values of a specific class of property and are only made if the class is



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valued at a +5 percent or -5 percent difference from the local assessor's aggregate value. The local assessor then applies each percentage to the appropriate class of property either uniformly or on an individual plat basis. Mr. Eich noted that equalization helps maintain an equitable assessment base among classes of property and among assessing jurisdictions, which is particularly important in terms of state aid to schools.

Property Tax Credits. Mr. Ed Henderson of the Department of Revenue and Finance commented on the state cost for the homestead, elderly and disabled, military service, agricultural land, and family farm property tax credits.

School Foundation Aid. Mr. Jon Studer of the Legislative Fiscal Bureau provided the Task Force with an understanding of the state school foundation aid program and the part that property taxes play in it. Mr. Studer presented a history of the foundation aid formula along with the percent of state general fund budget spent for state aid -- 32 percent to 36 percent -- and the general concepts used in determining the amount of state aid and local property taxes. These general concepts include: district's basic budget, district cost per pupil, state cost per pupil, allowable growth, foundation level, foundation uniform levy, and additional levy. Mr. Studer also provided a chart listing by school district the taxable valuation and property tax rate for each district for the 1996-1997 school year. The taxable valuation per pupil varies from a low of \$77,000 to a high of \$400,000.

Advance for Increasing Enrollment. Dr. Veronica Stalker, Superintendent, Waukee Community Schools, presented her argument for reinstating the concept of providing an advance in school foundation aid for increasing enrollment. This concept had been in existence but was repealed in 1992. Dr. Stalker explained that a school district's pupil count for one year is based upon the previous year's actual count. This results in lower revenues from the state and on the local level for that year if actual pupil numbers increase. She provided the Task Force with her computations on her district's costs for new teacher/new student growth in the current year which will be underfunded pursuant to the present school foundation aid program.

4. October 22, 1997, Meeting.

Overview. The third meeting of the Task Force continued its education of the members on income and property tax. Information on the income tax addressed the updating of the state's references to the federal Internal Revenue Code and its impact. Information on property tax included mental health, mental retardation, and developmental disabilities funding, payments in lieu of taxes, credit and exemption data, and tax increment financing districts.

Internal Revenue Code (IRC) Update. Mr. Carl Castelda, Mr. Loren Knapp, and Mr. Bob Rogers of the Department of Revenue and Finance discussed the state's annual IRC update. Mr. Castelda provided an introduction to the concept of the state's IRC update which involves the state conforming with certain federal changes. Mr.

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Knapp summarized various provisions of the federal Taxpayer Relief Act of 1997. These involved education benefits such as the HOPE tax credit, lifetime learning credit, deduction for student loan interest, and educational individual retirement accounts; child credit; capital gains changes; retirement accounts; and other income-related provisions. Mr. Rogers provided a three-year estimate of impacts on state general fund revenues resulting from the 1997 federal legislation. The estimates included estimates based upon behavioral response to the federal legislation. Two estimates were provided for each fiscal year. These involved the impact without conforming legislation by the state and the impact that would result from conforming legislation.

Mental Health Property Tax. Mr. John Pollak of the Legislative Service Bureau provided an overview of the mental health, mental retardation, and developmental disabilities (MH/MR/DD) legislation over the past few years. Changes included the capping of the county's authority to levy for MH/MR/DD services by Senate File 69 as enacted in 1995; the provision of property tax relief and its distribution to each county; and the development of county plans to manage MH/MR/DD services. Ms. Margaret Buckton of the Legislative Fiscal Bureau provided data on the history of funding for property tax relief since fiscal year 1995-1996 for MH/MR/DD services. Her discussion mentioned the distribution formulas to local counties and a chart showing the breakdown of the property tax relief distributions by county along with that county's base year expenditure.

Payments in Lieu of Taxes. Speaking on behalf of the League of Cities was Ms. Chris Hensley, member of the Des Moines City Council. Ms. Hensley directed her comments to the problems faced by the City of Des Moines and her suggestions as to how to address these problems. The problems she described involve the rollback and the amount of tax-exempt property located in the city. Ms. Hensley suggested that state institutions and buildings, hospitals, and state-supported colleges enter into agreements to make payments for the cost of providing police and fire services by the city. She also suggested that sales tax receipts collected by the hospitals should be used for paying police and fire costs.

Property Tax Credits and Exemption Data. Mr. Mike Goedert of the Legislative Service Bureau explained the homestead, military, elderly and disabled, agricultural land, and family farm tax credits. He provided a chart that listed the dollar amounts paid by the state for each different credit for the fiscal year 1996-1997, how credit was determined, an approximate range for each credit, and a cursory noting of eligibility requirements. Mr. Goedert also provided data on the approximate market value of tax-exempt property for the 1994, 1995, and 1996 assessment years. These totals did not include government properties that are exempt. In addition, statewide totals of partial exempt properties for the 1989 through 1994 assessment years were provided.

Tax Increment Financing (TIF). Mr. Jon Studer of the Legislative Fiscal Bureau described to the Task Force the concept of using TIF districts to finance projects in certain qualified areas of a city or county. He noted the authority for TIFs has been



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available since 1958 but its use has grown rapidly over the past five years. Mr. Studer described the two basic reasons for using TIFs, which are for urban renewal purposes and for job training through community colleges. He explained the effect that TIFs had on other taxing jurisdictions, including school districts, and, as a result, the state. He remarked that for fiscal year 1996-1997 there are 1,453 TIF areas statewide with total incremental value of \$2.366 billion of net taxable value.

5. November 12, 1997, Meeting.

Overview. The fourth meeting of the Task Force involved presentations from hospital and utility representatives. The members were then assigned to subcommittees to focus on property taxation, income taxation, and sales and use taxation. The subcommittees met for the remainder of the meeting.

Association of Iowa Hospitals & Health Systems (IH & HS). Mr. Greg Boattenhamer and Mr. Kirk Norris of IH & HS spoke before the Task Force. According to Mr. Boattenhamer, IH & HS opposes any attempt to repeal property tax exemption for not-for-profit hospitals or to allow local governments the ability to collect service fees or payments in lieu of taxes from these hospitals because it would result in increased costs for hospital and medical services. The other portion of the presentation was an appeal for the removal of the state sales tax on private hospitals as this would help maintain Iowa's low health care costs.

Utility Property Tax Replacement. Mr. Steve Evans of MidAmerican Energy Company and a member of the Task Force, explained a bill draft that would exempt utility property from its present method of taxation and replace it with another method based upon a tax on generation, transmission, and delivery of gas and electricity in the state. The bill draft was worked on by the utility companies, local governments, and the Department of Revenue and Finance.

Subcommittees. The Task Force members were assigned to one of three Subcommittees. Ten were assigned to the Property Tax Subcommittee, seven to the Income Tax Subcommittee, and four to the Sales and Use Tax Subcommittee.

Property Tax Subcommittee. The Subcommittee is chaired by Representative Dwight Dinkla. The Subcommittee members agreed they would focus their scrutiny of the property tax system on the source of revenue and statutory modifications affecting the source and on use of the revenue, i.e., where the revenue should be spent. Concentrating primarily on the rollback, tax credits, and classification of property, the Subcommittee developed a series of hypothetical scenarios to present to the Department of Revenue and Finance, requesting the Department to run models showing the effect of the changes in the scenarios.

Income Tax Subcommittee. The Subcommittee chairperson is Senator JoAnn Douglas. The members suggested areas that should be looked at as possible changes to the individual or corporate income taxes. These areas include a review of all individual deductions, exemptions, and credits; establishing a flat tax by setting the individual income tax at a percent of federal tax liability or taxable

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income adjusted to be revenue neutral; tying the corporate income tax to the individual income tax; repealing the deduction for federal taxes paid under individual and corporate taxes and reducing rates; and establishing a flat tax or graduated flat tax with an income exemption for certain taxpayers. The Department of Revenue and Finance was requested to provide information. Mr. Castelda of the Department reviewed the status of the collection of sales or use tax from purchases by those making catalog sales.

Sales and Use Tax Subcommittee. The Subcommittee is chaired by Senator Richard Drake. Senator Drake stated that a ground rule for the Subcommittee is to provide revenue-neutral proposals if sales tax reductions are desired. Mr. Veeder presented a proposal to fully fund mental health, mental retardation, and developmental disability costs from State General Fund sources in lieu of property taxes. This proposal would cost approximately \$119 million initially. A possible revenue replacement for the MH/MR/DD costs would be an increase to the retail sales and use taxes. The Subcommittee also discussed the possibility of receiving taxes from direct marketers (\$13-15 million potential), applying access charges to the Internet, and authorizing an additional one cent local option tax. Other ideas proposed were limiting or reducing sales tax on clothing items below a certain sales price and granting a sales and use tax exemption for those medical care facilities which are not owned by government agencies.

6. December 3, 1997, Meeting.

Overview. The last meeting of the Task Force during the 1997 Interim was devoted to discussion by the three Subcommittees. Each Subcommittee met to work on its recommendations to the full Task Force or to identify areas or specifics which should be studied further during the 1998 calendar year.

Sales and Use Tax Subcommittee. The Subcommittee was chaired by Senator Steve Hansen in place of Senator Drake. The Subcommittee considered an increase in sales and use taxes to pay for the state assuming all local MH/MR/DD services costs in place of counties; an exemption from the sales and use taxes for clothing purchases, and for purchases by private for-profit and nonprofit hospitals; and an additional one cent local sales tax to be used for school infrastructure and transportation. The Subcommittee also discussed the taxation of food and grocery items, the taxation of Internet services, exemption from tax on utilities, and the problem of the taxation of catalog sales.

Income Tax Subcommittee. The Subcommittee was chaired by Senator JoAnn Douglas. Mr. Carl Castelda of the Department of Revenue and Finance took the Subcommittee through Iowa's individual income tax long form and described what the various steps constitute and noted the differences from the federal income tax. Information was provided by Mr. Bob Rogers of the Department of Revenue and Finance and Mr. Larry Sigel of the Legislative Fiscal Bureau on the estimated tax rates if Iowa's individual income tax would be made a percent of the federal adjusted gross income, federal taxable income, or federal tax liability. The



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computed rates were designed to be revenue neutral and were based on residents only. The Subcommittee focused its discussion on making the Iowa individual income tax simpler or more user-friendly. It was noted that the simplest approach would be to impose a percent of a taxpayer's federal tax liability as the state liability. However, it was recognized that the big drawback of this approach is the fact that the resulting rate would be 29 percent, which appears rather large.

Property Tax Subcommittee. Representative Dwight Dinkla chaired the Subcommittee. The Subcommittee focused on revising or eliminating property tax credits; allowing locals to negotiate and enforce fee-for-service agreements with tax-exempt property owners; altering the assessment process or assessment limitations; treatment of rental housing; and the effects of tax increment financing districts and tax abatements.

7. Progress Report.

The Task Force reconvened in the afternoon of December 3 and, without discussion, received the reports of the three Subcommittees. Thus the Progress Report of the Task Force consists of these reports of the Subcommittees as follows:

a. The Sales and Use Tax Subcommittee presented the following proposals for consideration by the Task Force:

- ◆ Increase the state sales and use tax by one cent to pay for all mental health, mental retardation, and development disabilities costs currently paid by local governments.

- ◆ Eliminate retail sales and use tax on clothing.

- ◆ Provide a retail sales and use tax exemption for private and nonprofit medical hospitals.

- ◆ Authorize one additional cent for the local option sales and services tax to be used by school districts for infrastructure and transportation needs. The additional one cent would be subject to approval by a simple majority of the voters with a sunset provision.

b. The Income Tax Subcommittee presented the following proposals for consideration by the Task Force:

- ◆ Consider the easiest approach to simplification of the individual income tax by taking a percent of a person's federal tax liability.

- ◆ Consider simplifying the individual income tax through the elimination of deductions and credits and adjusting the rates or standard deduction to reflect the loss sustained by those affected by such eliminations.

- ◆ Consider simplifying the individual income tax by using a percent of the person's federal adjusted gross income or federal taxable income.

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- ◆ Request that runs be done for various income groups and with certain characteristics to determine effects of the simplifications.
- c. The Property Tax Subcommittee presented the following proposals for consideration by the Task Force:
 - ◆ Consolidate the family farm property tax credit into the agricultural land property tax credit.
 - ◆ Retain the elderly/disabled and military property tax credits.
 - ◆ Examine the impact of continuing the assessment growth limitations currently on each class of property and eliminating the assessment growth limitation tie between residential and agricultural property.
 - ◆ Consider changing home rule statutes to allow local governments to negotiate and enforce fee-for-services agreements and also give consideration to further clarifying what uses of property are exempt from property tax.
 - ◆ Evaluate the continued viability of the homestead tax credit.
 - ◆ Recommend that the 1998 General Assembly evaluate and consider replacing Iowa's current method of property taxation of electric and natural gas utilities with a new system that will more effectively address the issues raised by deregulation of these utility industries.
 - ◆ Study two-tier (developed land and undeveloped land) system of property taxation.
 - ◆ Give further study to the current system of assessment and taxation of rental housing.
 - ◆ Study tax increment financing and tax abatement programs and their effect on other local governments and school district financing.

8. Written Materials Filed With the Legislative Service Bureau.

- a. **September 3, 1997, Meeting**
 - ◆ Department of Revenue and Finance -- Summary of Testimony.
 - ◆ Iowa Utility Association -- Summary of Testimony.
 - ◆ Iowa Association of Municipal Utilities -- Summary of Testimony.
 - ◆ Iowa Association of Electric Cooperatives -- Summary of Testimony.
 - ◆ Dr. Thomas Pogue -- "Iowa Property Taxation: Overview" and "Public Spending, Taxation, and Economic Development: An Outline of Issues."
 - ◆ Mr. David Swenson -- Photocopies of overlays used in presentation.
 - ◆ Greater Des Moines Area Chamber of Commerce -- "A Comparison of Business Taxes for Central Iowa Manufacturers" and "Impacts of Residential Property Tax Rollbacks on Commercial and Industrial Property Taxes."



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- ◆ Task Force Rules.

b. October 8, 1997, Meeting

- ◆ Department of Revenue and Finance -- Summary of Testimony on assessment limitations; press release on equalization.
- ◆ Mr. Gary Bilyeu -- "Rollback--What Is It?"
- ◆ Mr. Jon Studer -- Materials providing overview of the Iowa School Foundation Aid Formula; Iowa Department of Education memorandum describing other states' school financing methods; Iowa school district taxable valuation and tax rate data; and FY 1997 Iowa school district funding components.
- ◆ Dr. Veronica Stalker -- Summary of Testimony and supporting documentation.

c. October 22, 1997, Meeting

- ◆ Department of Revenue and Finance -- "Estimates of Fiscal Impact on General Fund Receipts from 1997 Federal Legislation" and a summary of selected provisions from the federal Taxpayer Relief Act of 1997.
- ◆ Mr. John Pollak -- Summary of Testimony.
- ◆ Ms. Margaret Buckton -- Summary of Testimony.
- ◆ Ms. Christine Hensley -- Summary of Testimony.
- ◆ Mr. Mike Goedert -- Property Tax Credits and Tax-Exempt Property.
- ◆ Department of Revenue and Finance -- Information on selected property tax credits and 1996 "Tax-Exempt Property Report."
- ◆ Legislative Fiscal Bureau -- "Tax Increment Financing (TIF)."

d. November 12, 1997, Meeting

- ◆ Mr. Greg Boattenhamer -- Written Testimony.
- ◆ Mr. Steve Evans -- Overlays from Testimony; Utility Company Property Tax Replacement Bill Draft.
- ◆ Tax Letters from the Department of Revenue and Finance.

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