

Iowa enacts income tax and sales/use tax changes

Overview

On May 30, 2018, Iowa Governor Reynolds signed Senate File 2417 (S.F. 2417)¹ which includes the following modifications to Iowa tax law:

- Updates Iowa's Internal Revenue Code (IRC) conformity to the IRC in effect on March 24, 2018, for tax years beginning during the 2019 calendar year, and subsequently adopting "rolling IRC conformity" for tax years beginning on or after January 1, 2020. This change will apply for individual, corporate, and pass-through entity taxpayers.
- Reduces the corporate income tax rate effective for tax years beginning on or after January 1, 2021 to a top rate of 9.8%, and eliminates the federal income tax deduction for tax years beginning on or after January 1, 2022.
- Reduces the graduated individual income tax rates for tax year beginning on or after January 1, 2019, with the top tax rate dropping from 8.98% to 8.53%. Further tax rate reductions possible for tax years beginning January 1, 2023.
- Phases-in conformity to the IRC Section 199A Qualified Business Income (QBI) deduction for pass-through entities effective for tax year beginning on or after January 1, 2019.
- Adopts economic and click-through sales and use tax nexus standards, effective January 1, 2019.
- Adopts marketplace facilitator registration, collection, and reporting provisions for sales and use tax, hotel and motel excise tax, and automobile rental excise tax, effective January 1, 2019.
- Provides authority to the Iowa Department of Revenue to implement sales and use notification and reporting requirements, effective January 1, 2019.
- Expands Iowa sales and use tax base to include information services, software as a service, specified digital products, services related such specified digital products, charges for storage of tangible or electronic files, and ride sharing services, effective January 1, 2019.

This tax alert summarizes these law changes and provides some taxpayer considerations.

IRC conformity amendments for individual, corporate, and pass-through entity taxpayers

S.F. 2417 amends Iowa's fixed date IRC conformity to the IRC as amended and in effect as of March 24, 2018 for tax years beginning during the 2019 calendar year. This fixed date conformity will be replaced with a rolling date IRC conformity for tax years beginning on or after January 1, 2020,² though certain exceptions will continue to apply for specific tax credits which will continue to have fixed-date conformity.³ There are also certain modifications, such as bonus depreciation, that will continue to decouple from the IRC.⁴ There are also certain other modifications, such as IRC Section 179, that will partially decouple for a limited period of time before fully conforming.⁵

¹ S.F. 2417 (As Enrolled) available [here](#).

² S.F. 2417 (As Enrolled), Sec. 69, amending Iowa Code §422.3

³ S.F. 2417 (As Enrolled), Sec. 62, amending Iowa Code §422.3

⁴ S.F. 2417 (As Enrolled), Sec. 75, amending Iowa Code §422.7(39A); S.F. 2417 (As Enrolled), Sec. 95, adding Iowa Code 422.35(15)

⁵ S.F. 2417 (As Enrolled), Sec. 95, amending Iowa Code §422.35; S.F. 2417 (As Enrolled), Sec. 58, amending Iowa Code §422.7. The S.F. 2417 amendments and associated effective dates affecting the IRC Section 179 modification are beyond the scope of this alert.

Changes to corporate income tax rates

For tax year beginning on or after January 1, 2021, S.F. 2417 reduces corporate income tax rates as follows:

- From 6% (\$0 - \$25,000) and 8% (\$25,000 - \$100,000) to 5.5% for the first \$100,000 of taxable income,
- From 10% to 9% for the next \$150,000 of taxable income,
- From 12% to 9.8% for any amounts of taxable income in excess of \$250,000.

S.F. 2417 also eliminates the federal income tax deduction for corporations effective for the tax year beginning on or after January 1, 2022. Note that for tax years beginning before January 1, 2022, a subtraction is allowed equal to fifty percent of the federal income taxes paid to the extent that the taxes paid/deducted are from a tax year beginning prior to January 1, 2021.⁶

S.F. 2417 also eliminates the alternative minimum tax (AMT) effective for the tax year beginning on or after January 1, 2021⁷ and the associated AMT credit.⁸

Changes affecting individual income tax

S.F. 2417 reduces Iowa's graduated individual income tax rates for tax years beginning on or after January 1, 2019, with the top tax rate reduced from 8.98% to 8.53%.⁹ S.F. 2417 also provides for a potential drop in the top individual rate to 6.5% for tax year beginning January 1, 2023, contingent upon Iowa's net general fund revenues meeting a series of revenue targets targeting both total revenue and revenue growth.¹⁰

S.F. 2417 also provides for a full repeal of the AMT for individual taxpayers contingent upon the Iowa's net general fund revenues meeting a series of revenue targets.¹¹

Effective for tax years beginning on or after January 1, 2018, S.F. 2417 provides that individual taxpayers may elect to take a deduction for state sales and use taxes paid instead of a deduction for state and local taxes paid. This deduction is only applicable if a taxpayer also elects to deduct sales and use taxes on their federal income tax return.¹²

Modifications to IRC Section 199A QBI deduction for pass-through entities

S.F. 2417 phases-in conformity to the IRC Section 199A QBI deduction for pass-through entities as follows:

- For tax years beginning on or after January 1, 2019, an addition modification of 75% of the allowable QBI deduction taken for federal income tax purposes will be permitted.
- For tax years beginning on or after January 1, 2021, the modification will decrease to 50% of the allowable QBI deduction.
- For tax years beginning on or after January 1, 2022, the modification will further decrease to 25% of the allowable QBI deduction.¹³

S.F. 2417 also provides that the total allowable QBI deduction reported on an Iowa group return will be modified using the same addition percentages.¹⁴

Amendments to Iowa sales/use tax nexus provisions, use tax reporting, and taxable base

Economic nexus and click-through nexus

S.F. 2417 amends Iowa's sales and use tax nexus provisions such that a retailer is required to register and collect Iowa sales tax if, for the immediately preceding taxable year, a retailer has:

- Gross revenue of \$100,000 or more from Iowa sales, or

⁶ S.F. 2417 (As Enrolled), Sec. 94, amending Iowa Code §422.35

⁷ S.F. 2417 (As Enrolled), Sec. 91, amending Iowa Code §422.33(4)

⁸ S.F. 2417 (As Enrolled), Sec. 93, amending Iowa Code §422.33(7)

⁹ S.F. 2417 (As Enrolled), Sec. 73, adding Iowa Code 422.5A

¹⁰ S.F. 2417 (As Enrolled), Sec. 107, amending Iowa Code §422.5A. If specified revenue targets are met, Iowa will also begin to phase-out the federal income tax deduction for individuals.

¹¹ S.F. 2417 (As Enrolled), Sec. 105, striking Iowa Code §422.5(2)

¹² S.F. 2417 (As Enrolled), Sec. 61, amending Iowa Code §422.9(2). If specified revenue targets are met, Iowa will amend the starting point for computing Iowa net income from "Adjusted Gross Income before the net operating loss deduction" to "taxable income" modified only by the adjustments specified in the following Iowa Code sections, §422.4, §422.7, and §422.9.

¹³ S.F. 2417 (As Enrolled), Sec. 70, amending Iowa Code §422.4(16)

¹⁴ S.F. 2417 (As Enrolled), Sec. 79, amending Iowa Code §422.9. If specified revenue targets are met, Iowa will eliminate this QBI addition modification entirely.

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- Engages in 200 or more Iowa sales transactions.¹⁵

Additionally, S.F. 2417 enacts a click-through nexus provision to include a retailer who utilizes a solicitor under an agreement for a commission, fee, or other consideration, to either directly or indirectly, solicit over \$10,000 in Iowa sales whether by link on an internet site, or otherwise.¹⁶

The economic and click-through nexus provisions become effective January 1, 2019.¹⁷

Marketplace Facilitator collection provisions

S.F. 2417 adopts marketplace facilitator provisions imposing a sales and use collection responsibility on the marketplace facilitator to register for and collect Iowa sales tax on behalf of marketplace sellers that utilize the marketplace. A person will be deemed a marketplace facilitator if that person facilitates a retail sale directly or indirectly by activities including but not limited to listing, making available, or advertising tangible personal property, services, or specified digital products for sale by a marketplace seller in a marketplace owned, operated, or controlled by the person; or facilitating the sale of a marketplace seller's product through a marketplace by transmitting or otherwise communicating an offer or acceptance of a retail sale of tangible personal property, services, or specified digital products between a marketplace seller and a purchaser in a forum including a shop, store, booth, catalog, internet site, or similar forum.¹⁸ A marketplace facilitator also extends to a person that operates a physical infrastructure that connects marketplace sellers to customers, provides software development or research directly related to marketplace, provides fulfillment or storage services, set prices or offers customer service for the marketplace accept payment or performed payment processing.¹⁹ The Iowa sales and use tax marketplace facilitator provisions become effective January 1, 2019.²⁰

If such a person meets the definition of a marketplace facilitator and makes or facilitates Iowa sales on its own behalf or for one or more marketplace sellers equal to or exceeding \$100,000 or 200 or more separate transactions for an immediately preceding calendar year or a current calendar year, the marketplace facilitator must register for and collect Iowa sales tax on sales made by itself and any marketplace seller.²¹ Note that a marketplace *seller* is relieved of its requirement to collect and remit Iowa sales tax under such circumstances.²²

It should also be noted that the Iowa hotel and motel excise tax and automobile rental excise tax have also been amended to adopt similar marketplace facilitator provisions with the same economic thresholds.²³

Use tax notice and reporting requirements

S.F. 2417 provides the Iowa Department of Revenue (Department) with the authority to implement rules and penalties that include, but are not limited to, requiring sellers and facilitators who are not otherwise required to collect and remit sales and use taxes to notify purchasers of their use tax obligations on purchases, provide purchasers with periodic reports of their Iowa sales, and to provide the Department with annual reports that detail specific information related to Iowa sales transactions.²⁴

Broadened tax base; expanded "business to business" exemption

S.F. 2417 extends the sales and use tax base to certain services, most notably transactions related to information services and software as a service. "Information services" is defined as delivering or providing access to databases or subscriptions to information through any tangible or electronic medium, including but not limited to database files, research databases, genealogical information, and other similar information.²⁵ Iowa will also now impose tax on software as a service and the storage of tangible or electronic files.²⁶

¹⁵ S.F. 2417 (As Enrolled), Sec. 203, adding Iowa Code §423.14A(3)(a), (b); Iowa Code §423.14A(2)

¹⁶ S.F. 2417 (As Enrolled), Sec. 203, adding Iowa Code §423.14A(3)(f)(2)(a), (2)(b)

¹⁷ S.F. 2417 (As Enrolled), Sec. 229

¹⁸ S.F. 2417 (As Enrolled), Sec. 203, adding Iowa Code §423.14A(1)(b)(1)(a),(b)

¹⁹ Id. at 27

²⁰ S.F. 2417 (As Enrolled), Sec. 229

²¹ S.F. 2417 (As Enrolled), Sec. 203, adding Iowa Code §423.14A(3)(d)(1), (d)(2)

²² S.F. 2417 (As Enrolled), Sec. 203, adding Iowa Code §423.14A(3)(c)(1)

²³ S.F. 2417 (As Enrolled), Sec. 246, amending Iowa Code §423A.2(1); Sec. 250, amending Iowa Code §423A.5A(3), (4)(a); Sec. 252, amending Iowa Code §423C.2(3), (9); Sec. 253, amending Iowa Code §423C.3(3)(a), (3)(b)

²⁴ S.F. 2417 (As Enrolled), Sec. 204, adding Iowa Code §423.14B(2)(a), (2)(b), (2)(c). Please note that such use tax reporting requirements have not been adopted by the Department at this time.

²⁵ S.F. 2417 (As Enrolled), Sec. 155, amending Iowa Code §423.1(22A); Sec. 170, amending Iowa Code §423.2(6)(br)

²⁶ S.F. 2417 (As Enrolled), Sec. 170, amending Iowa Code §423.2(6)(bq), (bu)

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S.F. 2417 also extends sales and use tax to specified digital products including electronically transferred digital audio-visual works, digital audio works, digital books, or other digital products.²⁷ Furthermore, tax is also imposed on the service of installing, maintaining, servicing, repairing, operating, upgrading, or enhancing such specified digital products.²⁸

Iowa's sales and use tax exemption for sales of products and services to a commercial enterprise for use exclusively by the commercial enterprise (Iowa's "business to business exemption") has also been expanded by S.F. 2417 to apply to sales of information services, software as a service, storage of tangible or electronic files, documents or other records, and services related to such files, documents, and records as described above.²⁹

The sales and use tax expansion to the aforementioned services and specified digital products becomes effective January 1, 2019.³⁰

Considerations

S.F. 2417 includes changes affecting Iowa corporate, individual, and pass-through entity taxpayers in response to federal tax reform. Taxpayers should review the potential impact to their Iowa state tax obligations as a result of Iowa's IRC conformity amendments and tax rate decreases. Additionally, taxpayers should review the potential Iowa sales and use tax implications of Iowa's expanded tax base, nexus requirements (including those affecting marketplace facilitators), and potential reporting provisions. Taxpayers who may be impacted by S.F. 2417 are advised to consult with their Iowa tax advisors for further assistance.

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²⁷ S.F. 2417 (As Enrolled), Sec. 166, adding Iowa Code §423.1(55B)(a)

²⁸ S.F. 2417 (As Enrolled), Sec. 170, adding Iowa Code §423.2(6)(bs)

²⁹ S.F. 2417 (As Enrolled), Sec. 188, adding Iowa Code §423.3(103)

³⁰ S.F. 2417 (As Enrolled), Sec. 229