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Revenue Continues to Show Strength in February

State revenue continues its recent strong trend, according to the Legislative Services Agency's monthly report released last week. Through the first eight months of Fiscal Year 2018, state revenue has increased $428.6 million over last year's level. The growth amounts to an increase of 9.3 percent, significantly higher than the 2.4 percent increase forecasted by the Revenue Estimating Conference in December.

For the month of February, state revenue was actually down $17.3 million when compared to February 2017. But this decline may not be a true indication of where revenue stands, as it is driven by revenue deposit changes begun last summer. February's calendar also provided positive revenue changes, which offset some of the declines from the deposit date changes. The fact that February's revenue figure is down only $17.3 million could be a sign of stronger revenue growth than what was anticipated.

In the individual categories, personal income tax collections were down $35.2 million in February when compared to last year. For the first 8 months, the personal income tax collections are still up 8.6 percent over FY 2017. This is higher than the Revenue Estimating Committee's projection of 4.2 percent.

Unlike Fiscal Year 2017, sales and use tax collections have been significantly stronger than expected. In February, collections where down when compared to last February but that change is partially due to the deposit timing change. For the fiscal year, sales tax collections are up 5.6 percent through eight months. This is running ahead of the REC projection of 3.8 percent growth.

Corporate income tax collections were low in February, accounting for just $9.9 million in revenue. This is down $5.5 million from last February. For the year, corporate tax collections are up 12.7 percent. This is significantly ahead of the December REC forecast of 7.8 percent growth.

Tax refunds were also down in February, which is likely a reflection of the Department of Revenue's policy to slow down the payment of income tax refunds in order to reduce fraud via identity theft. During last year's tax season, the Department was able to prevent over $40 million of fraudulent income tax refund claims from being paid by the state treasury. Some states are considering moving all tax refund payments until after the due day for income taxes as a way to help prevent income tax refund fraud.

The Revenue Estimating Conference will meet on Friday, at 1 PM to revise their estimates for FY 2018 and FY 2019, while also making a preliminary estimate on revenue in Fiscal Year 2020.

Governor's Tax Reform – Tax Year 2020 and Beyond

This week's newsletter will continue the discussion of the Governor's tax reform bill (House Study Bill 671). The focus of this article will be changes that the bill makes to tax year 2020 and beyond. That is the tax return that will be filed in April of 2021.

House Study Bill 671 continues the phase-out of federal deductibility by allowing only 15 percent of federal taxes paid to be deductible for tax year 2020. This deduction is fully eliminated for tax years 2021 and later. The bill also further raises the elderly/blind standard deduction to $2,070 in tax year 2021. Finally, the legislation eliminates the Iowa Alternative Minimum Tax Credit to correspond to that tax being eliminated in tax year 2019.

The legislation also provides for further rate cuts in tax year 2020 and beyond. Whether or not further rate cuts happen depends on the net tax receipts for the fiscal year prior. Under the bill, by November 1 of each fiscal year, the Department of Revenue will submit a report that identifies the net tax receipts of the fiscal year prior and the corresponding tax rates that will be in effect the following tax year.

Once a trigger has been met and tax rates reduced—rates do not increase if future tax receipts decline (rate reductions would take legislation). However—the November 1 report could state that a trigger has not been met, and rates would stay the same as they were the prior year. If you think of it as a line—you can step forward (reduce rates) or you can stop (rates stay the same)—but you cannot take a step "back" and increase rates.

The first report from the Department of Revenue will be submitted by November 1, 2019 and will tell us the tax rates for tax year 2020. Recall that the first cuts (tax year 2019) happen without a trigger. That first report will be based on actual net tax receipts that come in during fiscal year 2019.

House Study Bill 671 sets forth the automatic rates for tax year 2019 (category I) as well as four additional rate categories labeled as tax rate category II, III, IV, and V. The bill provides that each progressively higher tax rate category may take effect in future tax years if certain net tax receipt revenue targets are met or exceeded as provided in the bill. (The chart in last week's article showed these rates happening in sequential tax years as if the state met the minimum revenue target each year and took one "step.")

Tax Rate Categories by Income Bracket:

Income over:	**But not over:**	**Tax rate category I:**	**Tax rate category II:**	**Tax rate category III:**	**Tax rate category IV:**	**Tax rate category V:**
$0	$1,628	0.32%	*0.32%*	*0.30%*	*0.30%*	*0.30%*
$1,628	$3,256	0.64%	*0.64%*	*0.60%*	*0.60%*	*0.60%*
$3,256	$6,512	2.10%	*2.10%*	*2.00%*	*2.00%*	*2.00%*
$6,512	$14,652	4.05%	*4.05%*	*4.00%*	*4.00%*	*4.00%*
$14,652	$24,420	5.40%	*5.40%*	*5.30%*	*5.30%*	*5.20%*
$24,420	$48,840	5.70%	*5.70%*	*5.60%*	*5.60%*	*5.40%*
$48,840	$150,000	6.70%	*6.70%*	*6.30%*	*6.30%*	*6.30%*
$150,000	or more	7.60%	*7.40%*	*7.00%*	*7.00%*	*6.90%*

Revenue Target Requirements and Corresponding Tax Rate Categories:

Tax year:	Fiscal year determining category:	Formula	Category
2019	N/A	no formula-automatic rate reductions	I
2020	2019	$7,106,500 or more $7,323,800 or more	II III
2021	2020	if coming from category I…$7,319,700 or more if coming from category I…$7,543,500 or more if coming from category II…$7,323,800 $7,525,500 or more…	II III III IV
2022	2021	if coming from category I…$7,539,300 or more if coming from category I or II…$7,543,500 or more if coming from category I or II…$7,751,300 or more if coming from category III…$7,525,500 or more if $7,765,400 or more	II III IV IV V
2023	2022	if coming from category I…$7,765,500 or more if coming from category I or II…$7,769,800 or more if coming from category I, II, or III…$7,751,300 or more if coming from category I, II, or III…$7,998,400 or more if coming from category IV…$7,765,400	II III IV V V
2024	2023	if coming from category I…$7,998,500 or more if coming from category I or II…$8,002,900 or more if coming from category I, II, or III…$7,983,800 or more if coming from category I, II, or III…$7,998,400 or more	II III IV V
2025	2024	if coming from category I…$8,238,500 or more if coming from category I or II…$8,243,000 or more if coming from category I, II, or III…$8,223,300 or more if coming from category I, II, III, or IV…$8,238,400 or more	II III IV V

***If in any year a revenue target is not met, rates stay the same. Whatever the rates are in 2025 is where they remain for future years.**