

## Modernizing Iowa's sales tax: Leveling the playing field

*Governor's plan would secure revenue from e-commerce and remote sales*

By Charles Bruner for the Iowa Fiscal Partnership

Sales tax plays a core role in funding Iowa's general fund budget, contributing about one-third of the revenue for Iowa's current \$7.2 billion budget.<sup>1</sup> One-sixth of Iowa's 6 percent state sales tax is earmarked for a state fund for K-12 school infrastructure.<sup>2</sup> Cities and counties also receive sales tax with 1 percent local-option tax referendum votes, with revenues directed to specific projects.

Over the last several decades, Iowa's and the nation's economies have shifted toward greater purchases of services rather than goods and toward greater purchases online and through remote locations rather than direct, local sales. To retain revenue from the sales tax, either the sales tax needs to be raised in size or broadened and modernized to reflect these changes.

Iowa periodically has updated its sales tax to cover new services and has a fairly broad tax base in that respect. Until recently, however, Iowa has not had a viable way to collect sales tax from many out-of-state vendors who make sales in Iowa, particularly through e-commerce.

Despite efforts by states, including Iowa, the federal government has not enacted legislation to clarify how state sales taxes can be imposed on out-of-state retailers. Recently, however, Colorado and a growing number of states have adopted provisions that make such collections possible, and these have been upheld in federal court.<sup>3</sup> Not only do such actions increase sales tax revenue; they also create a level playing field for in-state businesses that must compete with out-of-state retailers and are at a competitive disadvantage when they must collect sales tax and remote sellers do not.

*Iowa can modernize its sales tax to collect on e-commerce and other remote sales to generate needed revenue and level the playing field for in-state business.*

The Governor's proposed tax package would expand the Iowa sales tax and the enforcement and collection of that tax, as some other states have done. SF2383 also contains similar provisions, although amendments adopted substantially reduce their scope and revenue generation. The Department of Revenue's fiscal note on the Governor's proposal focuses upon six key elements:

- *Digital Goods*: Ending the exemption for goods purchased and delivered online, such as e-books, games, and phone apps. The exemption was enacted when the internet was new and few goods were delivered digitally.
- *Ride Sharing*: Establishing taxation of all ride services including traditional taxi services and internet-based ride-sharing businesses such as Uber and Lyft.
- *Subscription Services*: Expanding the sales and use tax to capture the change in consumption from tangible good purchases such as video game cartridges and CDs to subscription services including streaming audio and video and software as a service.

- *Online Sellers*: Expanding the definition of sales tax nexus to include any retailer selling more than \$100,000 of products or making more than 200 separate sales into the state, whether or not through an online marketplace.
- *Online Marketplaces*: Expanding the definition of retailer to include any marketplace provider (Google Play Store is an example) that facilitates sales into the state, to rectify the current disadvantage faced by traditional retailers required to charge sales tax on in-person sales while retailers in online marketplaces claim to have no such requirement.
- *Online Travel Company Websites*: Clarifying auto rental and hotel/motel tax obligations, in particular including online travel companies.

The Department of Revenue estimates these changes together will result in increased state sales tax revenues of \$46.7 million in FY2019 growing to \$137.5 million in FY2023. SF2383, as passed from the Ways and Means committee, had these six provisions but also included several new sales tax exemptions (for grain bins, agricultural consolidation, and construction equipment dealers), reducing its impact by about one-half. Adopted amendments further reduced the estimated revenue impact, to \$1.1 million in FY2019, going up to \$23.7 million in FY2023.

The full provisions in the Governor’s proposal help to cover a large share of the revenue reductions proposed in the state income tax, while the provisions in SF2383 do not even begin to cover the revenue reductions in its corporate tax cuts, let alone individual income tax cuts. The Governor’s proposal also, through LOST and SAVE, provides greater assistance to local government and school districts.

**General Fund Sales Tax Revenue Would Rise with Modernization**  
*Estimated increases with Governor, Senate plans (\$ Millions)*

	FY2019	FY2020	FY2021	FY2022	FY2023
Governor’s Proposal	\$ 46.2	\$ 110.6	\$ 120.5	\$ 128.6	\$ 177.5
SF2383 (Introduced)	\$ 22.4	\$ 65.4	\$ 73.7	\$ 80.1	\$ 87.2
SF2383 as Passed	\$ 1.1	\$ 17.5	\$ 20.9	\$ 23.1	\$ 25.7

*Source: Iowa Department of Revenue memo to Legislative Services Agency*

Like most sales tax measures, the proposed increases are somewhat regressive, taking a larger share of income from moderate and middle-income Iowans than from high-income Iowans. This, however, can be offset by other changes (particularly in the individual income tax) that are progressive.

Overall, the Governor’s proposal, if retained in its current form, does modernize Iowa’s sales tax and makes it fairer to Iowa retailers. It better assures the sales tax will maintain its role in financing the General Fund and supporting, in a small but significant way, schools and local jurisdictions with a local option sales tax.

<sup>1</sup> Governor’s Budget in Brief, FY2019. The current year General Fund budget of \$7.2 billion has been adjusted and is further being adjusted during the 2018 legislative session due to projected shortfalls. The Governor has proposed a \$7.4 billion general fund budget for FY19. About \$3 billion, or 33 percent, of projected General Fund revenues come from sales tax.

<sup>2</sup> This is known as the Secure an Advanced Vision for Education fund, or SAVE. This revenue source began as local-option tax authority, later merged into a statewide tax and pooled for more equitable distribution statewide.

<sup>3</sup> While currently upheld, the Supreme Court may rule further on this case.

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