

The background of the entire page is a light blue-tinted photograph of the Iowa State Capitol building in Des Moines. The building features a prominent central dome and a portico with several columns. The image is slightly faded to allow the text to be the primary focus.

IOWA TAXPAYERS
A S S O C I A T I O N

2003

Statement of Policies and Legislative Initiatives

For two-thirds of a century the Iowa Taxpayers Association (ITA) has been educating and informing its members about sound fiscal policy; providing state policy makers with objective, nonpartisan research about the impact of specific tax and spending policies; and, advocating for the adoption of rational public fiscal policy as it relates to business and corporate tax issues.

The 2003 Statement of Policies and Legislative Initiatives sets forth positions of the Association on key issues important to Iowa and to the mission and purpose of ITA.

• Table of Contents

INTRODUCTION	4
2003 PRIORITY STATEMENT	4
STATEMENT OF BASIC PRINCIPLES	5
• Taxation	5
• <i>equity</i>	
• <i>neutrality</i>	
• <i>revenue adequacy</i>	
• Spending	5
• <i>accountability</i>	
• <i>efficiency</i>	
• <i>taxpayer involvement</i>	
ITA LEGISLATIVE INITIATIVES FOR 2003	6
• Accountable Government	6
• Child Daycare Facility Tax Credit	7
• Community Development Tax Credit	7
• Employment Equity Capital Gains Treatment	7
• Government Competition with the Private Sector	9
• Machinery and Equipment Sales & Use Tax Reform	9
• Repair and Replacement Parts	9
• Sorbent Used in Processing	10
• Machinery and Equipment Exempted	10
• Military Reservist Tax Credit	11
• Property Appraisal Fee	11
• Property Tax Reform	12
• Sales and Use Tax Simplification	13
• Telecommunications Central Office Equipment Sales Tax Exemption	14
• Unemployment Compensation Surcharge Sunset	15
2002 LEGISLATIVE SUMMARY	16
ACCOMPLISHMENTS OF THE 2002 REGULAR SESSION	17
• Attraction of Venture Capital	17
• Electronic Transfer of Tangible/Intangible Personal Property	17
• Premium Tax Competitiveness	18
• Seed Capital “Angel” Tax Credit	19
• Subchapter S Corporation Apportionment Tax Credit Reform	19

TAX POLICY & ECONOMIC GROWTH	21
• Corporate Income Taxation	21
• <i>single factor formula</i>	
• <i>federal deductibility</i>	
• <i>research and development tax credit</i>	
• <i>coupling with Internal Revenue Code changes</i>	
• Machinery & Equipment Taxation	22
• Corporate Property Taxation	22
• <i>property tax relief</i>	
• <i>property tax reform</i>	
• Bond Issues	22
• <i>referendum passage rate</i>	
• <i>public project financing</i>	
• Sales and Use Taxation	23
• <i>service transactions and tangible & intangible property</i>	
• <i>internet access sales and use tax exemption</i>	
• <i>sales and use tax simplification</i>	
• Unauthorized Taxation	23
GENERAL BUDGET ISSUES	24
• General Issues	24
• Tax Expenditure Studies	24
• Unpredictable Revenue Sources	24
TAX ADMINISTRATION	25
EXECUTIVE, ADMINISTRATIVE, AND LEGISLATIVE LEADERSHIP – 2003 SESSION	26
ITA OFFICERS & BOARD OF DIRECTORS	28
ITA BUSINESS TAX COMMITTEE STRUCTURE	30

ITA MISSION STATEMENT

“Since its formation in 1935, the Iowa Taxpayers Association’s mission has been to educate and inform Iowans about sound fiscal policy; provide state policymakers with objective, nonpartisan research about the impact of specific tax and spending policies; and advocate for the adoption of rational public fiscal policy as it relates to business and corporate taxes.”



• Introduction

World events broadly affect Iowa commerce, but the day-to-day legislative and regulatory decisions of state and local governing bodies generally exert the more immediate and significant impact on our business climate. Developing, implementing, and administering tax policy is very complex. The Iowa Taxpayers Association believes the overwhelming majority of Iowa companies are exemplary corporate citizens that strive to comply with established tax laws and regulations. Fair and predictable administration of statutes and rules is imperative if the State is to present a positive economic development image.

The challenge is to find improvements that enhance, update, or streamline the business tax code and administrative rules so that Iowa maintains a progressive and competitive edge for existing business expansion, new business recruitment, and successful workforce development. Encouraging economic diversification, promoting growth in value-added agriculture, providing quality training and education, and revitalizing local government infrastructure are all critical objectives if the state expects to be a viable economic force in the years to come.

2003 PRIORITY STATEMENT

It is encouraging to note that the Governor and Legislative leaders have indicated that taxes will not be increased in 2003 to meet budgetary shortfalls. Iowa's hope for growth and prosperity for all its citizens depends on an attractive business climate where jobs are created, tax revenues are expanded and services to all Iowans are maintained. Meeting the challenges of difficult economic times is never easy, whether those challenges come to a family, a business or a government agency. We applaud the actions of state government in containing spending, which is the answer to balancing budgets, not increasing tax burdens for citizens. For these reasons, ITA sets forth the following statement. We feel this is the bedrock on which Iowa's government must base its actions in the coming session.

ITA is opposed to any statutory change or administrative interpretation resulting in any increase in taxes.

Statement of Basic Principles

TAXATION

We believe that a state tax structure should meet the tests of equity, neutrality, and revenue adequacy.

- **Equity**

Equity means that a tax imposes equal liabilities for equally situated taxpayers.

- **Neutrality**

A tax is judged to be neutral if the degree to which its imposition does not affect decisions regarding earning or spending of income and wealth. A tax is a cost, and as such, one criterion for any tax should be that it not be levied to the extent that it causes negative economic decisions.

- **Revenue Adequacy**

Revenues must be predictable and stable. While there is considerable debate over what constitutes adequate revenue, we acknowledge that government must have money to operate. As nearly as possible, equal reliance should be placed on sales/use, income, and property taxes.

SPENDING

We entrust our governments with the responsibility for spending our tax dollars, for which there must be accountability, efficiency, and taxpayer involvement.

- **Accountability**

Government agencies and officials must be accountable and accessible to their employers --- the taxpayers. Responsible fiscal policymakers should employ the standards and criteria necessary to produce sustainable budgets that Iowa taxpayers can rely on year after year. A sound budget development process does the following:

- avoids the use of one-time or time-limited sources for ongoing expenses.
- avoids implementing new programs for a partial fiscal year.
- avoids multi-year accelerating commitments.
- avoids new automatic, or “standing,” appropriations.
- accurately determines revenue and expenses.
- aligns expenses and revenue in the same fiscal year.
- avoids shifting program funding to property taxes or fees.

- **Efficiency**

Businesses have learned that successful competition requires lean and efficient operations. The same principles of management should be applied to government. State agencies must implement sound business practices such as strategic planning, service management, and performance review to measure progress that is made towards more responsible and justifiable spending habits by government.

- **Taxpayer Involvement**

We believe that in all instances, those representing us in government are well intentioned and constructive in their objectives. Even so, taxpayers cannot afford to save their opinions on government spending for Election Day. The involvement of taxpayers in the regulatory and legislative development process will lead to better and more thoughtful tax policy. One has little standing to protest if he or she does not participate in the shaping of spending and administrative decisions as they are being made.

• ITA Legislative Initiatives for the 2003 Session of the Iowa General Assembly (listed alphabetically, subject to additions)

Fiscal Year 2002 and 2003 revenue projections resulted in dramatic and historic revenue declines, and indicators point to little or no revenue growth in Fiscal Year 2004. Legislative leaders and the Governor have indicated that taxes will not be increased in 2003 to meet budgetary shortfalls. However, there are changes in Iowa's tax code that should be considered to ensure a fair, equitable and competitive tax structure that will enhance job creation and economic development in Iowa. Important work remains to be done in areas such as sales and use tax code simplification, capital gains tax reform, property tax reform, child daycare and community development tax credits, and machinery and equipment (M&E) sales and use tax reform.

• Accountable Government

General Position: ITA supports the development and use of responsible standards and criteria by fiscal policymakers to produce accountable, sustainable budgets that Iowa taxpayers can rely on year after year.

2002 Legislative Activity: None.

Perspective of ITA:

In 2001, ITA developed a **Committee on Accountable Government**. The work of this group complements and reinforces the goals of the Accountable Government Act passed in 2001. By focusing on what ITA believes are sound budgeting and financial practices, the Office of the Governor and members of the General Assembly are offered tools by this Committee through which they can provide more accountability in the practice of government.

The ITA Committee on Accountable Government reviews budget proposals and final budget action at several specific points-in-time each year, making public its findings. A list of criteria has been developed to analyze the State budget development process. Through continued encouragement of and feedback to those involved with the budget process, the hope is that --- over time --- taxpayers will arrive at a comfortable level of faith and assurance that each year's budget is sustainable in the future. The expectation is that the use of these accountable budgeting practices will foster long-term fiscal stability and sound tax policy in Iowa.

The first strategic review of State budgeting practices was conducted for Fiscal Year 2003. What follows are the criteria that were incorporated into our analysis. These standards may change over time as the process evolves:

A Sound Budget . . .

- avoids the use of one-time or time-limited sources for ongoing expenses.
- avoids implementing new programs for a partial fiscal year.
- avoids multi-year accelerating commitments.
- avoids new automatic, or "standing," appropriations.
- accurately determines revenue and expenses.
- aligns expenses and revenue in the same fiscal year.
- avoids shifting program funding to property taxes or fees.

The goal of this annual review is to encourage the key fiscal policy developers and lawmakers of Iowa to consider these criteria as the budgeting process moves forward every year. Though the primary focus of this Committee is not to suggest, develop, or endorse legislative proposals, ITA does hope to effectively complement the significant standards set forth in the Accountable Government Act and assist Legislators and the Governor in their work to make Iowa government accountable to its citizens and taxpayers.

• Child Daycare Facility Tax Credit

General Position: ITA supports providing tax credits or other incentives for any business that builds, contributes to, or operates a new or existing daycare facility, or subsidizes access to such services, for its employees.

2002 Legislative Activity: None.

Perspective of ITA:

Access to affordable childcare is important to Iowa's working parents, and is one of today's most critical workforce development issues. It has become increasingly difficult for businesses in Iowa to compete in attracting and retaining the skilled, dependable full- and part-time employees they need without convenient, adequate child daycare options for those employees with children. ITA developed the Child Daycare Facility Tax Credit legislation to address the issue. This legislative initiative offers a progressive and competitive edge in the on-going effort to expand existing and attract new business to the state.

• Community Development Tax Credit

General Position: ITA supports making tax credits available to business in exchange for their charitable contributions (cash, in-kind, labor, real estate, stocks, bonds, etc.) towards qualified Iowa-based community development and human services projects which benefit needy/disadvantaged neighborhoods and communities.

2002 Legislative Activity: None.

Perspective of ITA:

It's not unusual these days for justifiable quality of life projects in our Iowa communities to suffer delays, be put on indefinite hold, or get cancelled altogether for want of state or local government financial participation. ITA developed the **Community Development Tax Credit** legislation to address the issue.

Under this tax credit, not-for-profit, non-government, non-church affiliated 501(c)(3) organizations would bring proposed projects or programs before the Iowa Department of Economic Development for review. These non-profit organizations would assume responsibility for approaching local businesses to secure the necessary charitable support for the proposed project. Participating corporate donors would be allowed to redirect Iowa corporate income tax dollars to designated local projects, e.g., food banks, senior citizen centers, healthcare centers, community shelters, literacy and GED programs, neighborhood revitalization efforts. The contributions of these local businesses would help reduce administrative costs that would have otherwise been the responsibility of state or local government agencies had they undertaken the same project or program. The Community Development Tax Credit would heighten the awareness of Iowa businesses to specific community needs and increases the prospect for a successful outcome. A similar program has been offered in Missouri for the past 23 years with significant, quantifiable success.

• Employment Equity Capital Gains Treatment

General Position: ITA supports strengthening Iowa's ability to encourage entrepreneurial initiative, retain talented citizens, and attract investment capital by passing legislation that aligns the State's net tax rates on capital gains realized from employment equity with the lower capital gains rates in the federal code.

• ITA Legislative Initiatives for the 2003 Session (Continued)

2002 Legislative Activity: Employment Equity Capital Gains Treatment – House File 2079 (*part of the Iowa Investment Initiative, called the “New Economy Employment Initiative”*)

An Act establishing a new economy employment initiative by providing for a partial deduction under the individual income tax for the capital gain from the sale or exchange of capital stock of a corporation which was acquired by an individual on account of employment with the corporation, limiting the fiscal impact of the partial deductions, and including an effective and retroactive date provision.

What Is This?

House File 2079 would allow those who work for Iowa companies, in business at least three years and who offer stock options to all employees, a deduction on one year’s individual income tax return of 50% of the capital gains realized from those stock options received while employed by that company. An annual cap of \$3 million in capital gains benefits is allowed, prorated should those seeking the deduction exceed the amount available.

Fiscal Impact

Total deductions available for capital gains relief on stock options were capped at \$3 million. Without a cap, the Legislative Fiscal Bureau (LFB) estimated the fiscal impact of the initiative would be approximately \$10 million. LFB estimated that there would be no fiscal impact in FY03. In FY04 the estimated impact was \$1.0 million, and then \$3.0 million for FY05 and beyond.

What Happened to House File 2079?

This initiative did not progress any further than the House Ways and Means Committee. The fiscal impact of the initiative on the already declining state general fund revenues was cited as the primary reason for not moving the initiative forward in 2002.

Perspective of ITA:

Iowa perennially ranks near the bottom in national surveys that rank the effectiveness of the state at attracting entrepreneurs and venture capital. Part of the problem is that the Iowa tax code does not provide progressive, innovative compensation alternatives for start-up companies that are desperately trying to attract and retain employees with the skill sets necessary for their business to succeed.

Stock options are a key component of employee compensation packages for entrepreneurs of the New Economy. Talented people are the engine of economic prosperity, and equity sharing has proved to be a powerful tool for attracting and retaining them. Iowa’s tax law does not provide the tools the state’s business community needs to become a viable, respected player within the venture capital community. The code must be amended so that efforts at recruiting and retaining the high-skilled workers required for New Economy growth are not handicapped by an effective individual income tax rate for capital gains on stock options that can be up to 40% greater than that for normal income.

What caused this problem? The federal Tax Reform Act of 1986 eliminated the 50% exclusion on long-term capital gains income, replacing it with a lower rate of tax. Iowa had earlier adopted the concept of deductibility of federal income taxes, but did not subsequently conform its revenue code to account for the elimination of the 50% exclusion of capital gains. As a result, the effective rate of Iowa income tax on capital gains can be significantly higher than that on ordinary income. While this is mitigated somewhat by the ability to deduct Iowa tax against the federal tax liability, the tax paid to Iowa does not change. Even worse is the fact that the highest rate of tax in Iowa applies to stock options typically offered to ‘knowledge workers’ (engineers, programmers, technology specialists, and the like) in high-growth, innovative businesses. Note that in the state of Washington (Microsoft’s HQ) stock options are not taxed at all.

Start-up companies use stock options to entice to Iowa the educated, talented minds they need in order to succeed and grow. Iowa's capital gains tax code, as currently written, is not an asset that attracts these individuals.

Clearly, Iowa has an image problem when it comes to being considered a place to invest in new, innovative business ideas. When competing with New Economy-focused states we are at a definite disadvantage. It is critical that stock options become a useful addition to Iowa's New Economy tool kit.

• **Government Competition With The Private Sector**

General Position: It is not in the best interests of either state government or the people of Iowa for state agencies and local government subdivisions to compete with taxpaying businesses in providing goods and services.

2002 Legislative Activity: None.

Perspective of ITA:

One of the age-old battles fought between government and business in Iowa is the degree to which a state agency, or a political subdivision thereof, should be allowed to engage in providing goods or a service in areas of commerce where taxpaying businesses are actively engaged. Under the mantle of decreasing costs or increasing revenues to state government, these ventures usually begin small then grow to the point of jeopardizing established taxpaying businesses. Granted, the hope for decreased costs or increased revenues is tempting, but the threat to private, taxpaying enterprise entities is such that in the long run, the welfare of Iowans could be adversely affected.

For instance, the Department of Corrections has initiated a program to provide inmates "opportunities for work in meaningful job" that develop "positive attitudes.....good work habits...and marketable skills that can lead directly to gainful employment upon release from a correctional institution." A noble objective, but such ventures often come at the expense of hard working Iowa employees whose companies are forced to lay them off when they cannot match the economic advantages afforded Prison Industries. But the list does not stop there. Many Iowa firms, in a variety of businesses, are under a real disadvantage as a result of this seemingly unfair competition.

As a possible result of such a situation, a business fails, employees lose jobs, and the social contributions of both, including payment of both corporate and individual taxes and purchasing power, are diminished. Iowa is best served when government is restricted to those things which private entities cannot do, thus allowing growth by those who pay taxes, not by those who consume taxes.

• **Machinery & Equipment Sales and Use Tax Reform**

Repair & Replacement Parts

General Position: ITA supports the full and complete elimination of sales and use taxes on M&E repair/replacement parts without regard to the useful life of such parts.

2002 Legislative Activity: None.

Perspective of ITA:

Iowa manufacturers face perpetual confusion as to what the Iowa Department of Revenue and Finance considers a 'supply' for a machine (grayline rule: has a use life of less than one year making it not integral to the manufacturing process and, therefore, generally taxable) and a 'replacement part' for a machine (grayline rule: has a use life of greater than one year making it an integral part of the manufacturing process and, therefore, generally not taxable).

• ITA Legislative Initiatives for the 2003 Session (Continued)

Currently in Iowa, the sale of computers and industrial machinery and equipment and replacement parts that are used directly and primarily in processing by a manufacturer is exempt from tax. “Processing” includes nearly all aspects of manufacturing, beginning with the manufacturer’s receipt or production of raw material and ending with the manufacturer’s delivery for shipment or transfer of the finished product. “Processing” also includes the intermediate steps of manufacturing which involve the movement of the product or the holding of the product in an existing state.

Problems typically arise on audit in determining the useful life of replacement parts, particularly when the life of such parts fluctuates depending upon changes in the production schedule. The practical difficulties for Iowa manufacturers in tracking the actual useful life of replacement parts are obvious. The proposed clarification would make it clear that all replacement parts to machinery and equipment are exempt, without regard to their useful life.

Sorbent Used In Processing

General Position: ITA supports that the sales tax exemption for sorbents includes materials or gases that absorb matter or energy used in the manufacturing process.

2002 Legislative Activity: None.

Perspective of ITA:

The Iowa Code provides a sales tax exemption for “sorbents” used in the manufacturing process. The Department of Revenue and Finance has taken the position that since cutting oil and similar materials absorb energy they do not fall within the tax exemption. On audit, the Department has interpreted the meaning of sorbents as being limited to that which absorbs matter. The Department’s current position is a reversal of prior interpretations with the result that it is now taxing what was once accepted as being exempt.

This taxation is not being uniformly applied across the state, nor has this new interpretation been formally published. This change in practice is unfair to Iowa’s manufacturers, unsupported by existing law or regulation and is questionable tax administration. ITA supports clarifying language in the Iowa Code that these materials continue to qualify for the tax exemption regardless of whether they absorb matter or energy.

Machinery & Equipment Exempted

General Position: ITA supports clarification that the sale or use of machinery, equipment, and materials used to produce a pattern, mold, or die in facilities such as, but not limited to, foundries is exempt from taxation.

2002 Legislative Activity: None.

Perspective of ITA:

The foundry industry is highly competitive, and driven by product price. Imposing sales and use taxes upon sand-handling equipment and sand is equivalent to creating an expense into Iowa foundries’ cost structures that often cannot be passed along to customers. This expense can be as high as 7% of the applicable purchases and mostly absorbed by the foundries.

In addition to the taxes on sand and sand-handling equipment, an imposition of sales and use tax on patterns hurts those foundries that focus on producing special-order castings for their customers (a.k.a. “job shops”). For job shops, a large part of their business involves making patterns that are sold to their customers but are held by the foundry for use on an as-needed basis.

The Iowa Department of Revenue and Finance has indicated that these job shops must collect Iowa tax from their customers on the sale of these patterns. Due to the potential new sales tax, many customers have threatened to have the pattern made and the order filled by an out-of-state foundry. The result: Iowa-based job shops have either lost business or have been forced to absorb the Iowa tax, making it extremely difficult for Iowa foundries to operate profitably in this State.

• **Military Reservist Tax Credit**

General Position: ITA supports implementing a corporate income tax credit for those businesses that provide supplemental income or benefits to employees who have been called to active duty as military reservists.

2002 Legislative Activity: None.

Perspective of ITA:

A number of Iowa's corporate citizens have stepped up to support the national defense effort and Operation Enduring Freedom by offering supplemental income and benefits to employees who have been called to active duty as military reservists. This assistance might consist of extending health care benefits to dependents at no cost or providing income to the employee/reservist to supplement the pay and allowances provided by the military service. Assistance to the dependents of the employee/reservist might be arranged in the form of childcare services, snow removal, lawn mowing, etc. Businesses that provide supplemental income and benefits are receiving no return in labor from the employee on such an investment.

Participating businesses are incurring these expenses voluntarily. They recognize that military reservists are an integral part of the nation's defense framework and constitute a substantial portion of the United States Armed Forces --- men and women who are working to preserve and protect our way of life.

To promote continued provision of supplemental assistance and encourage other companies to do the same, a corporate income tax credit is proposed of up to \$1,000/month per active duty reservist who receives supplemental income/benefits from his or her employer. The program would be voluntary, with businesses implementing their own policy as to who qualifies to receive supplemental income and benefits. Supplemental assistance would be tax exempt to the employee/reservist, thereby allowing employers to provide the income on a reduced 'net pay' basis rather than on a tax-inclusive 'gross pay' basis.

• **Property Appraisal Fees**

General Position: ITA opposes any efforts to create an appraisal fee to cover the cost of calculating the value of centrally assessed properties.

2002 Legislative Activity: None directly. The Iowa Department of Revenue and Finance introduced language creating such an appraisal fee in 2001 and 2002. The language was removed from the initial proposed draft prior to House Ways & Means Committee consideration.

Perspective of ITA:

The creation of an appraisal fee amounts to the creating of a new tax. Calculating the value of property and then charging the taxpayer owning that property is similar to a business charging their customers an additional fee for taking the time to calculate their bill. This type of activity should be viewed as a responsibility of the taxing authorities.

• **ITA Legislative Initiatives for the 2003 Session (Continued)**

• **Property Tax Reform**

General Positions:

- ITA supports the reduction of the overall tax burden on Iowans when practical. Specifically, the property tax system needs to be consistent, fair, and equitable. ITA recognizes the importance of ensuring that local government has the necessary taxing authority at their disposal to adequately deliver a reasonable level of constituent services. Local government should be accountable to the local citizens for the amount and use of property tax revenues.
- ITA recognizes that attempts by the State to offer property tax relief have not always accomplished the objectives of the legislation. State funding of local services should be linked to a corresponding reduction in taxation to the property taxpayers. Any relief offered by the legislature should have a mechanism in place to account for corresponding reductions in property taxation.
- ITA encourages the Iowa General Assembly to consider requiring counties and cities to reduce excessive ending fund balances. A fixed percentage of excess cash reserves should be allowed. Monies in excess of the fixed percentage should be designated for a specific purpose or use, and citizens should have the opportunity to appeal such designation.
- ITA supports a consistent, statewide assessment process of industrial property as opposed to the current county-by-county process. In addition, commercial and industrial property taxpayers should have the option to appeal to the local appellate board or proceed directly to a state appellate board.
- ITA supports the certification by a county assessor that Department of Revenue and Finance procedures are properly adhered to when the property assessment is made.
- ITA supports either de-coupling residential and agricultural properties or implementing a universal capped rate for all classes of property.

2002 Legislative Activity: Property Tax Growth Limitation – Senate File 514

An Act relating to maximum property tax dollars limitation for counties and providing for the Act's applicability.

What Is This?

Senate File 514 would implement new limitations on property tax growth for counties in Iowa. Current rate limitations will be replaced with total property tax limitations. When the State increases property tax replacement funds for things such as mental health care, those new revenues will actually result in a benefit to local taxpayers and not just provide an opportunity for local officials to increase their levies. Local option sales taxes designated for property tax relief will result in local property tax relief as promised. County governments will still be able to utilize unspent balances or unlevied taxing authority to deal with unexpected expenses, while being encouraged to reduce unnecessarily large cash reserves. Dramatic swings in taxation due to uncontrollable valuation changes will be eliminated, while maintaining the current shares of taxes for all classes of property, i.e., no shifting of tax burdens. County budgets will still be able to grow at the rate of inflation and the value of new construction within their taxing jurisdiction. Should additional revenue be needed, established limits can be exceeded by voter approval.

Fiscal Impact

The Legislative Fiscal Bureau estimated the additional cost to the General Fund due to software development, additional training, and the establishment of a Commission on State and Local Taxation would be approximately \$200,000 in FY02 and \$100,000 in FY03.

What Happened to Senate File 514?

Failed to pass the Senate on April 17, 2001.....23 ayes, 26 nays.
Motion to Reconsider in the Senate prevailed on April 24, 2001.
Passed the Senate on April 24, 2001.....28 ayes, 20 nays.
Passed the House W&M Committee on April 26, 2001.
Referred to the House W & M Committee on May 8, 2001.
Subcommittee reassigned on January 17, 2002, and was not brought up for consideration due to lack of consensus.

Perspective of ITA:

A previous county government tax limitation law was passed by the Iowa Legislature in 1992. After it expired in Fiscal Year 1998, counties were able to increase their levies even though mandated funding may have declined due to increased State funding.

Iowa's current property tax system has resulted in extraordinary increases in ending balances of some county cash reserve accounts. In 1994, the excess cash on hand for all Iowa counties versus what their combined budgets requested was approximately \$400 million, or 37% in excess of the counties' total spending that year. By 1999, that cash reserve total had ballooned to \$650 million, or 50% above and beyond the total spending budgeted by Iowa's county governments. Reserve balances exist with city budgeting practices as well, though the statewide cumulative amount is not as dramatic as that seen on the county level.

• Sales and Use Tax Simplification

General Position: ITA believes that national, regional, or local efforts to simplify sales and use tax laws should result in a system that is revenue neutral and easily administered by participating businesses and taxing authorities. It must protect the sovereignty of lawmakers to consider and act upon tax policy unique to Iowa and guard against elimination of any tax benefits already established in the law. Prior to implementation, such a system should be widely advertised to, and understood by, consumers. It must also utilize non-discriminate compliance and remittance technologies that are accessible and affordable to all levels of business and commerce. Participation by business is an essential component when shaping fair and responsible tax policy. For that reason, the interests of business in Iowa should be directly represented in tax simplification efforts at any level.

ITA continues to agree that simplifying the nation's sales and use tax laws is good public policy. However, until our concerns are addressed ITA is not in a position to support the Streamlined Sales Tax Project model legislation. The Association will, however, continue monitoring, and participating in legislative developments as necessary to protect the interests of Iowans.

2002 Legislative Activity: Streamlined Sales Tax Reform Initiative – Senate File 2321

An Act relating to sales and use taxes by requiring the department of revenue and finance to collect data on the extent and the effect on taxes of electronic commerce in the state, striking the repeal of the tax treatment of sales where the substance of the transaction is delivered by electronic waves, digitally, or by way of cable or fiber optics, and establishing a committee to enter into multistate discussions on the simplification of the sales and use taxes and including an effective date.

• **ITA Legislative Initiatives for the 2003 Session (Continued)**

What is This?

The Streamlined Sales Tax Project (SSTP) is an on-going effort by the National Conference of State Legislatures to design, test, and ultimately implement a unified sales and use tax system nationwide. The goal of SSTP is to incorporate uniform definitions within tax bases, simplify audit and administrative procedures, and utilize emerging technologies to substantially reduce the burdens of tax collections for those companies engaged in remote commerce within the 50 states. There are currently thirty-four states and the District of Columbia that are voting participants in SSTP.

Senate File 2321 formalized Iowa's involvement in SSTP. This law established a delegation of Iowans to have a voting seat in the SSTP, comprised of one Representative appointed by the Speaker of the House, one Senator appointed by the Senate Majority Leader, the Department of Revenue and Finance Director, and a Governor's appointee. The SSTP has substantially completed its Streamlined Sales and Use Tax Agreement, and is planning on recommending it to the states for adoption in the 2003 legislative sessions.

What Happened to Senate File 2321?

Passed the Senate on April 8, 2002.....27 ayes, 21 nays
Passed the House on April 11, 2002.....75 ayes, 22 nays

SIGNED into law by Governor Tom Vilsack on May 10, 2002.

Perspective of ITA:

The Iowa Taxpayers Association continues to believe that the benefits of a simplified sales tax system employed by and amongst the states are obvious and worthy of the effort being expended to achieve it. The sales tax has become excessively complex to business in America, which for too long has carried the burden of its administration without being compensated fairly for the cost of compliance or use of modern technology and effective management practices to diminish its impact.

The Iowa Taxpayers Association also continues to believe that the effort to simplify the states' sales and use tax laws will be one of the most important tax reform issues ever presented to the Iowa business community, affecting all areas of commerce and industry.

The Iowa Department of Revenue and Finance has expressed a willingness to interact with the ITA Streamlined Sales Tax Project Review Committee, seeking cooperation and support from this group as the Department carries its initiative on this issue forward. ITA looks forward to continued interaction with the IDRF on this subject. However, until our concerns are addressed ITA is not in a position to support the Streamlined Sales Tax Project model legislation. The Association will, however, continue monitoring, and participating in legislative developments as necessary to protect the interests of Iowans.

• **Telecommunications Central Office Equipment Sales Tax Exemption**

General Position: ITA supports the expansion of Iowa's machinery and equipment sales and use tax exemption to include telecommunications infrastructure equipment utilized in commercial telecommunications operations.

2002 Legislative Activity: None.

Perspective of ITA:

There is a growing sense of urgency in Iowa that upgrades in the state's telecommunications infrastructure need to occur as soon as possible. Failure to adopt new technologies, particularly in rural areas, limits economic and workforce development. Many telecommunications companies that serve Iowa have been hesitant to make the significant investment of capital and human resources necessary for the state to remain competitive.

Iowa eliminated the sales and use tax for industrial machinery and equipment in the early 1990s. That machinery is also exempt from property tax. Telecommunications companies should be provided the same incentive to make investments in capital-intensive switches, transmission facilities, and software. Unlike the industrial machinery exemption, this equipment would not be exempt from property tax and all purchases would actually increase, not decrease, the tax base for local governments.

• Unemployment Compensation Surcharge Sunset

General Position: ITA opposes any legislation that would continue collection, past its current statutory sunset date, of the unemployment compensation administrative contribution surcharge, or the diversion of the surcharge for other purposes.

2002 Legislative Activity: None.

Perspective of ITA:

The current unemployment compensation administrative surtax is scheduled to expire on July 01, 2003. This tax was created in the late 1980s to fund the operation of approximately 55 rural workforce development offices across the state and has been extended several times beyond scheduled sunset dates. The Iowa Taxpayers Association encourages the Iowa Workforce Development Department to reorganize its systems, make optimum use of technology, and consolidate its rural offices statewide to provide cost effective and efficient services to businesses and employees.

• 2002 Legislative Summary

At the Iowa Taxpayers Association's Annual Meeting in 2001, acting pursuant to recommendations from its various committees, the Board of Directors adopted a list of legislative initiatives for the 2002 legislative session.

ITA staff was directed to actively support or defend positions regarding each of the identified initiatives. Four ITA initiatives were passed by the Iowa Legislature and signed by Governor Vilsack. All tax bills were monitored to evaluate their potential impact on member companies. Several other important business tax initiatives were brought forward during the 2002 Regular Session on which ITA did take a position.

Prior to the start of Session, Senate Ways & Means Chair Larry McKibben (R-Marshalltown) and House Ways & Means Chair Jamie Van Fossen (R-Davenport) developed the Iowa Investment Initiative, which focused its attention on attracting venture capital to the State. The Iowa Investment Initiative included the following five pieces of legislation:

- Iowa Capital Formation Act of 2002 (ITA initiative),
- Small Business Growth Initiative (S corporation income allocation reform – ITA initiative),
- Iowa Start-Up Company Initiative (taxable income deferment),
- Venture Capital Investment Initiative (tax credit for venture capital fund investments), and
- New Economy Employment Initiative (employment equity capital gains treatment – ITA initiative).

Four of these five initiatives were passed and signed into law. Citing budgetary shortfalls, the New Economy Employment Initiative did not progress any further than the House Ways and Means Committee.



***The complete text and history of any of these bills
is available over the Internet at:***

www.legis.state.ia.us/GA/78GA/Legislation/index.html

Accomplishments of the 2002 Regular Session

The Iowa Taxpayers Association recognizes and applauds the good work done by members of the Iowa General Assembly during 2002 to pass constructive, significant legislation supported by ITA and the Iowa business community.

- **Attraction of Venture Capital – Iowa Capital Formation Act of 2002 – House File 2078**

An Act relating to economic stimulus measures for businesses by creating an Iowa capital investment board, authorizing the organization of an Iowa capital investment corporation and an Iowa fund of funds, and authorizing the issuance of contingent tax credits to investors in the Iowa fund of funds; establishing a small business growth initiative by adjusting the allocation to Iowa of income earned by an s corporation for purposes of the state individual income tax; and including a retroactive applicability date provision.

What Was This?

The Iowa Capital Formation Act of 2002 is an initiative developed and led by the ITA Venture Capital Committee. The goals of this Act are to mobilize private capital through contingent investment tax credits and increase venture capital investment within Iowa.

The Act authorizes the formation of the Iowa Capital Investment Board (a state advisory board) and the Iowa Capital Investment Corporation (a non-profit corporation). The Iowa Capital Investment Corporation will in turn form the Iowa Fund of Funds, which will be a for-profit limited partnership or limited liability company.

The Iowa Fund of Funds will issue preferred stock to investors, which is backed by contingent investment tax credits. The Iowa Capital Investment Board is authorized to issue \$100 million of contingent investment tax credits to be issued contemporaneously with an investment in the Iowa Fund of Funds.

The Iowa Capital Investment Corporation and the Iowa Fund of Funds are directed to invest the capital (created by the investments) in several high-quality venture capital funds that commit to establish a presence in Iowa and focus on new business start-ups and expansion deals here in the state.

Fiscal Impact

The Legislative Fiscal Bureau was unable to estimate the fiscal impact.

What Happened to House File 2078

Passed the House on January 24, 2002.....	90 ayes, 3 nays
Passed the Senate, as amended, on January 24, 2002.....	39 ayes, 5 nays
House concurred and passed the bill on January 29, 2002.....	74 ayes, 25 nays

SIGNED into law by Governor Tom Vilsack on February 28, 2002.

- **Electronic Transfer of Tangible/Intangible Personal Property – Senate File 2321**

An Act relating to sales and use taxes by requiring the department of revenue and finance to collect data on the extent and the effect on taxes of electronic commerce in the state, striking the repeal of the tax treatment of sales where the substance of the transaction is delivered by electronic waves, digitally, or by way of cable or fiber optics, and establishing a committee to enter into multistate discussions on the simplification of the sales and use taxes and including an effective date.

Accomplishments of the 2002 Regular Session (Continued)

What Was This?

During the 2000 Legislative Session, House File 2562 became law and permanently excluded all intangible information service transactions from sales and use tax. It also excluded from sales and use tax the substance of a transaction delivered to the purchaser digitally, electronically, or utilizing cable, or by radio waves, microwaves, satellites, or fiber optics, and was scheduled to sunset on December 31, 2002. Under Senate File 2321, this exclusion becomes permanent.

Fiscal Impact

The Legislative Fiscal Bureau estimated that if this tax were collected it would increase the revenue by \$790,000 in Fiscal Year 2003.

What Happened to Senate File 2321?

Passed the Senate on April 8, 2002.....27 ayes, 21 nays
 Passed the House on April 11, 2002.....75 ayes, 22 nays

SIGNED into law by Governor Tom Vilsack on May 10, 2002.

• Premium Tax Competitiveness – Senate File 2318

An Act relating to the tax on premiums and subscriber contract payments received by insurance companies and health service corporations by phasing in a reduction in the tax and increasing the prepayment of the tax, providing for a study, and including an effective date.

What Was This?

This legislation cuts Iowa’s insurance premium tax rate from 2% to 1% over a four-year period beginning in calendar years 2003 (life/health) and 2004 (property/casual). Reducing the insurance premium tax rate will improve the competitive stature of our local insurance companies nationwide. A 2002 Ernst & Young report estimates that the rate reductions for life/health insurance premiums and property/casualty insurance premiums when fully phased in will generate approximately 6,000 new jobs in Iowa.

Under current law, 50% of an insurance company’s previous calendar year tax liability is pre-paid on June 1 of that calendar year. For example, in calendar year 2002, the insurance company would make a prepayment equal to 50% of the prior year’s tax liability (2001) on June 1, 2002. To offset the fiscal impact of the rate reductions, the legislation increases this pre-payment percentage from the current 50% to 100% over a period of three years.

Fiscal Impact

The Legislative Fiscal Bureau estimated that in Fiscal Year 2003, General Fund revenues would incur a \$10.2 million increase, which is designated for the Student Achievement and Teacher Quality Program. Small increases in revenues are projected for FY 2004 and 2005. General Fund revenues are projected to decrease in FY 2006 by \$32.5 million and in FY 2007 by \$64.8 million.

What Happened to Senate File 2318?

Passed the Senate on March 27, 2002.....41 ayes, 5 nays
 Passed the House, as amended, on April 10, 2002.....66 ayes, 33 nays
 Senate concurred and passed the bill on April 11, 2002.....32 ayes, 16 nays

SIGNED into law by Governor Tom Vilsack on May 9, 2002.

- **Seed Capital “Angel” Tax Credit – House File 2271**

An Act creating a tax credit for investments in qualifying businesses and community-based seed capital funds and including effective and retroactive applicability date provisions.

What Was This?

This initiative provides the use of a tax credit for a taxpayer’s investment in a community-based seed capital fund against income taxes imposed by Chapter 422, division II (personal income taxes), division III (corporate tax), division V (financial institutions), Chapter 432 (insurance companies), and Section 533.24 (credit unions). The tax credit is allowed only for cash investments in a community-based seed capital fund.

The tax credit is equal to 20% of the taxpayer’s qualified investment, with a maximum of a \$50,000 tax credit in any one qualifying business. The taxpayer and all affiliates of the investor cannot claim tax credits for more than five different investments in five different qualifying businesses each year (or a maximum of \$250,000 in tax credits per year).

The Iowa Capital Investment Board, created in House File 2078, is responsible for the registration, authorization, and distribution of the tax credits to investors.

Fiscal Impact

The total amount of tax credits issued is capped at \$10 million, and is staggered over a period of three years. \$3 million in tax credits may be issued in FY 2003, another \$3 million may be issued in FY 2004, and \$4 million in FY 2005, for a total of \$10 million. Tax credits cannot be used until three years after the investment is made, thus delaying the fiscal impact to FY 2006.

What Happened to House File 2271?

Passed the House on February 14, 2002.....	94 ayes, 0 nays
Passed the Senate, as amended, on February 15, 2002.....	44 ayes, 0 nays
House concurred and passed the bill on February 18, 2002.....	95 ayes, 2 nays

SIGNED into law by Governor Tom Vilsack on February 28, 2002.

- **Subchapter S Corporation Income Apportionment – Small Business Growth Initiative – House File 2078**

An Act relating to economic stimulus measures for businesses by creating an Iowa capital investment board, authorizing the organization of an Iowa capital investment corporation and an Iowa fund of funds, and authorizing the issuance of contingent tax credits to investors in the Iowa fund of funds; establishing a small business growth initiative by adjusting the allocation to Iowa of income earned by an S Corporation for purposes of the state individual income tax; and including a retroactive applicability date provision.

What Was This?

In 1996, the legislature passed and the Governor signed into law a bill, which reduced the Iowa income taxes paid by resident shareholders of certain Subchapter S corporations which export products or services out of Iowa. In 1997, the legislature passed and the Governor signed into law a bill that extended the benefits to all types of Subchapter S corporations. The “Small Business Growth Initiative” expands these two prior pieces of legislation to allow for 100% of the federal income tax to be deducted when determining the tax on a shareholder’s distribution (currently, only 50% is deducted) in Subchapter S Corporations. In 2001, this initiative had passed the Senate by a vote of 32-16, the House by a vote of 62-35, but was vetoed by Governor Vilsack.

Accomplishments of the 2002 Regular Session (Continued)

Fiscal Impact

According to the Legislative Fiscal Bureau, the projected loss of revenue to the state is \$900,000 in FY03 and \$800,000 in FY04.

What Happened to House File 2078?

Passed the House on January 24, 2002.....90 ayes, 3 nays
Passed the Senate, as amended, on January 24, 2002.....39 ayes, 5 nays
House concurred and passed the bill on January 29, 2002.....74 ayes, 25 nays

SIGNED into law by Governor Tom Vilsack on February 28, 2002.

ITA has a few, basic core beliefs when it comes to implementing and sustaining successful tax policy. Taxes are a very important part of the economic development equation as they contribute significantly to the relative attractiveness of the business climate. If a good climate exists it is, at a minimum, neutral regarding business decisions. Above all else, however, tax policy should provide stability and predictability.

Credits, exclusions, repeals, deductions, and other tax benefits are utilized aggressively as a key component of many competitive economic development models and proposals for cities, regions, or entire states. The availability of such “tools” is important to Iowa in its effort to attract the investors and developers that will make our state a leader in today’s robust value-added and knowledge-based economy.

The current business tax structure in Iowa continues to evolve in an effort to stay competitive with other states and we urge the legislature to keep such a focus a priority.

CORPORATE INCOME TAXATION

• Single Factor Formula

The basic structure of Iowa’s corporate income tax has been in existence since 1934. Based on the premise that a business should pay tax only on the income earned from Iowa sales, the single factor formula has been a pillar of economic development for the state.

In recent years, other states have recognized the success Iowa has had with the single factor formula and taken steps to adopt similar statutes in an effort to compete. Our neighbors are learning that to encourage the growth of export oriented business produces significant economic returns over time. With a manufacturing and value-added agricultural base like Iowa’s, such growth is an absolute must. Any efforts to alter the existing single factor formula corporate income tax structure should be rejected with vigor.

• Federal Deductibility

Understanding that this is often a subject of confusion and disagreement, it is the view of ITA that over the years federal deductibility has generally proven to be good for Iowa businesses. We support the ability of a corporation filing an income tax return in Iowa to fully deduct its federal tax payment when calculating its state tax liability. Furthermore, we support recent moves to lower Iowa’s corporate tax rates and urge that such decreases be funded through revenues in Iowa’s General Fund.

• Research & Development Tax Credit

ITA supports legislation that will permit an Iowa taxpayer to either continue calculating the research and development tax credit as is currently allowed or utilize the most current alternative method that is available to federal taxpayers.

• Coupling with Internal Revenue Code Changes

The Iowa Legislature historically updates Iowa Code references to the Internal Revenue Code on an annual basis. This is a practice commonly referred to as “coupling” where tax changes at the federal level are included at the state level. Most recently the United States Congress passed the Job Creation and Worker Assistance Act of 2002 which was signed by President Bush. Iowa chose not to “couple” with this Act primarily citing budget difficulties.

ITA understands the State’s difficulties, however ITA believes that failure to couple is shortsighted. Not coupling creates an additional burden on Iowa’s businesses, requiring them to carry two sets of records on their depreciating assets. Furthermore, an additional tax burden is created resulting in an unforeseen windfall for the State. The State’s enforcement capabilities are already stretched and this will further limit the State’s ability to collect a fair tax from all taxpayers. For these reasons, ITA supports maintaining a full coupling of the Iowa Code with the Internal Revenue Code.

• Tax Policy & Economic Growth

(Continued)

MACHINERY AND EQUIPMENT TAXATION

ITA has long supported a full exemption of property taxes on machinery and equipment. This bold concept has dramatically strengthened Iowa's efforts to compete in business growth and development by encouraging companies to expand and make significant capital investments in our state.

The machinery and equipment sales and use tax exemptions, in conjunction with the property tax exemption, allows Iowa to more effectively compete among states with regard to policies that directly impact the decisions made by business to invest in human resources and physical infrastructure.

CORPORATE PROPERTY TAXATION

- **Property Tax Relief**

Given local government reliance on the property tax to fund service delivery, the Iowa Taxpayers Association is mindful of the stress produced by expanding amounts of tax exempt property. We suggest state officials consider the institution of a Payment In Lieu Of Taxes (PILOT) to cover the cost of police and fire service for income-producing properties that are tax exempt.

- **Property Tax Reform**

ITA supports the reduction of the overall tax burden on Iowans when practical. Specifically, the property tax system needs to be consistent, fair, and equitable. ITA recognizes the importance of ensuring that local government has the necessary taxing authority at their disposal to adequately deliver a reasonable level of constituent services. Local government should be accountable to the local citizens for the amount and use of property tax revenues.

BOND ISSUES

- **Referendum Passage Rate**

In the past, concerted efforts were initiated to lower the referendum passage rate requirement for general obligation bond issues from 60% to a simple majority. ITA supports maintaining the 60% passage rate for referenda.

We believe it is time for the legislature to establish a mechanism that systematically reviews and prioritizes the physical infrastructure needs of the state. With such a process in place, ITA contends that citizens will be more likely to approve bond issues if they know that other options have been examined.

- **Public Project Financing**

Officials in Iowa have traditionally recognized the potential hazards of debt financing. ITA urges them to continue exercising caution when considering state bonding projects.

SALES AND USE TAXATION

- **Service Transactions and Tangible & Intangible Property**

In recent years, Iowa has made great strides in providing tax equity and opportunity for business growth and job creation by modifying the state sales and use tax. ITA has strongly supported these efforts and has worked cooperatively with state officials to see them realized. Now is not the time to retreat from these positive actions by instituting new taxes. ITA opposes any effort to increase sales and use taxes related to service transactions and tangible and intangible personal property.

- **Internet Access Sales & Use Tax Exemption**

ITA supports maintaining the Internet access sales and use tax exemption for Internet access and all other information made available through a computer server.

- **Sales and Use Tax Simplification**

ITA believes that national, regional, or local efforts to simplify sales and use tax laws should result in a system that is revenue neutral and easily administered by participating businesses and taxing authorities. It must protect the sovereignty of lawmakers to consider and act upon tax policy unique to Iowa and guard against elimination of any tax benefits already established in the law. Prior to its implementation, such a system should be widely advertised to, and understood by, consumers. It must also utilize non-discriminate compliance and remittance technologies that are accessible and affordable to all levels of business and commerce. Participation by business is an essential component when shaping fair and responsible tax policy. For that reason, the interests of business in Iowa should be directly represented in tax simplification efforts at any level.

UNAUTHORIZED TAXATION

Local governments are often exploring ways to increase their revenues through the taxation of business, including the imposition of franchise fees, service and maintenance fees, right of way fees, and use taxes. While ITA understands and supports the concept and application of home rule, we believe that such a principle does not include the authority to establish new taxes. As a result, we oppose attempts by local government to impose such fees and taxes without authorization from the Iowa General Assembly.

• **General Budget Issues**

GENERAL ISSUES

While ITA is a business association and focuses on business tax issues, we realize that individual tax issues impact business decisions. Individual and business taxes are often inter-related. We urge members of the General Assembly to keep this in mind when debating issues such as income, inheritance, and property taxes. Keeping Iowa competitive in these areas is important. In general, ITA supports thoughtful changes that enhance Iowa's tax climate in supporting long-term growth.

We urge the continuance of strategic planning. It is absolutely essential that Iowans develop a clear consensus on what they want state and local government to look like in the 21st Century.

TAX EXPENDITURE STUDIES

Any responsible study that portends to estimate the annual fiscal impact of incentives afforded businesses and individuals in the State tax code will not be limited only to a perfunctory listing of the those incentives and what they "cost" the State, but also include an analysis of the growth and expansion in Iowa's economy that resulted from their use. This means looking at the sort of new business that was attracted to the state along with those established companies that decided to stay and expand; the new jobs that were generated and existing jobs retained; the growth of attendant or complementary business and commerce; the expansion of the property tax base; and, the added opportunities for workforce development collaboration between employers, high schools, community colleges, and universities.

UNPREDICTABLE REVENUE SOURCES

The state should avoid over-reliance on unpredictable revenue sources. Gambling revenues, tobacco taxes, alcohol taxes, taxes on interstate services, and catalogue sales taxes are all examples of revenue sources that may be politically expedient, but in the long run are not reliable. Taxes on products such as tobacco and alcohol present a particular dilemma in that they often are raised with the expressed hope of discouraging consumption. It does not make sense to try and balance a budget or fund new programs with a tax on something whose consumption is being discouraged.

Tax Administration

The best tax policies can be undermined by poor implementation.

Business taxation can be very complex, and we believe that the overwhelming majority of businesses strive to comply with the tax laws. In order to encourage compliance and to present a positive image for economic development, fair and predictable administration is a must.

ITA understands the need for responsible enforcement of state tax laws and regulations, and we have supported many legislative proposals that enhance the authority of the Iowa Department of Revenue and Finance. However, the Department has the responsibility to not abuse the power it has been given nor violate the trust placed in it by going beyond the intent of the law in attempting to maximize revenues. Regulatory interpretation that thwarts legislative intent is a hindrance to business growth and competition.

Good legislation and good regulation encourage and enhance the opportunities for economic development. We pledge to continue working with state regulators to develop business tax policy that is generally in the best interest of Iowa and its citizens.

• Executive, Administrative, & Legislative Leadership – 2003 Session

Key Personnel In Iowa Government With Regard To Tax Policy

Executive

Governor: Thomas J. Vilsack

Lieutenant Governor: Sally J. Pederson

Governor's Chief of Staff: Steve Gleason

Governor's Policy Coordinator: Dick Oshlo

Governor's Legislative Liaison: Dusky Terry

Governor's Web Site: www.state.ia.us/governor/index.html

Administrative

Interim Director, Department of Revenue and Finance: Donald R. Cooper

Administrator, Compliance Division: Donald R. Cooper

Manager, Policy/Audit Services Section: David Casey

Department's Web Site: www.state.ia.us/government/drf/

Iowa Senate

President: Mary E. Kramer (R-West Des Moines)

President Pro Tempore: Jeff Angelo (R-Creston)

Majority Leader: Stewart E. Iverson, Jr. (R-Dows)

Minority Leader: Michael E. Gronstal (D-Council Bluffs)

Chair, Ways & Means Committee: Larry E. McKibben (R-Marshalltown)

Vice Chair, Ways & Means Committee: Doug Shull (R-Indianola)

Ranking Member, Ways & Means Committee: Joe Bolkcom (D-Iowa City)

Iowa General Assembly Web Site: www.legis.state.ia.us/

Iowa House of Representatives

Speaker: Christopher Rants (R-Sioux City)

Speaker Pro Tempore: Danny Carroll (R-Grinnell)

Majority Leader: Chuck Gipp (R-Decorah)

Majority Whip: Libby Jacobs (R-West Des Moines)

Minority Leader: Richard E. Myers (D-Iowa City)

Minority Whip: Frank Chiodo (D-Des Moines)

Chair, Ways & Means Committee: Jamie Van Fossen (R-Davenport)

Vice Chair, Ways & Means Committee: Kent Kramer (R-Johnston)

Ranking Member, Ways & Means Committee: Don Shoultz (D-Waterloo)

Iowa General Assembly Web Site: www.legis.state.ia.us/

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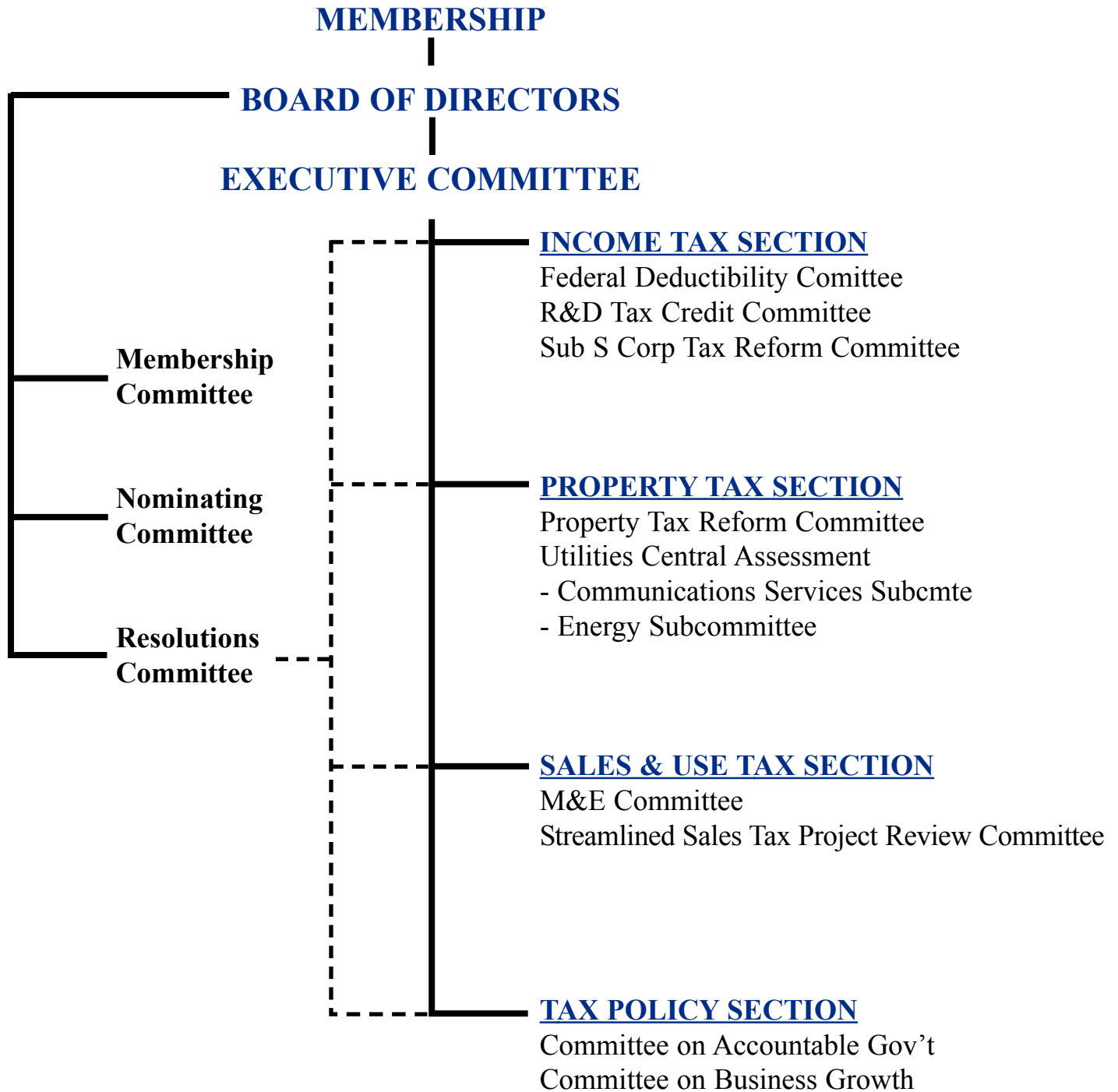
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• ITA Business Tax Committee Structure



Note: Broken line indicates communications exchange and cooperation between committees/sections.



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