

## What The Heck Is The 'Franchise Tax?'

The Iowa legislature reduced funding to local governments by \$60 million during the 2003 legislative session. But those people familiar with the events surrounding SF 453 know that the cut was originally proposed to be \$70 million. Along with the reduction in machinery and equipment (M&E) replacement funding and the elimination of personal property replacement funding, the initial bill eliminated the local share of the franchise tax revenues. Tired of the screams coming from cities and counties around the state, or perhaps finally becoming privy to the follies of the bill, the Legislature eventually restored \$8.8 million of franchise tax funding and increased M&E funding in the final bill. While many people were understandably upset over the proposed loss of revenues, few truly know what the franchise tax is, who pays it and how locals get a share of the revenue. This article hopes to answer those questions and clarify this somewhat confusing topic.

Iowa's franchise tax is not imposed on the gross receipts of Burger King, Quizno's, or any other franchised business in the state. In this case, the term 'franchise' does not refer to the most commonly thought of definition of the word: "Authorization granted to someone to sell or distribute a company's goods or services in a certain area." Instead, the term refers to "a privilege or right granted a person or group by a government, especially the establishment of a corporation's existence." The group being granted the privilege of existence by Iowa, and thus the group upon which the franchise tax is imposed, is banks.

The franchise tax is essentially a 5% income tax imposed on banks for the privilege of doing business in this state. If the taxpayer is a multi-state company, only that portion of its adjusted net income attributable to Iowa business is taxed. The tax is collected by the Department of Revenue and Finance and initially deposited in the state's general fund. Every year, according to Iowa Code §405A.10, a portion of the franchise

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tax revenues are distributed back to the local governments whence they came. The 'passback,' so to speak, has been set at \$8.8 million since 1997 (prior to an across-the-board budget cut). Any revenues in excess of the cap are retained in the state's general fund. Because franchise tax revenues usually total around \$32 million, the state has kept about \$23 million each year.

Prior to the implementation of the \$8.8 million cap on the local share, franchise tax revenues were divided on a percentage basis – 55% to the state and 45% to the locals. The local portion was further divided then as it is now – 60% to cities and 40% to counties. So prior to 1997, the total breakdown of franchise tax revenues was 55% to the state, 27% to cities and 18% to counties. Now, however, because of the cap on the local share, the breakdown is 72% to the state, 17% to cities and 11% to counties. The state keeps 17% more of the pie now than it did only seven years ago; and apparently it still isn't enough. It is a little worrisome that a state with a \$5 billion budget has resorted to bullying tactics over \$8 million.

Here is something else that should worry local governments: the Reinvention Bill, SF 453, repealed Iowa Code §405A.10, the section that contains the standing appropriation of franchise tax revenue to local governments. A later bill, SF 458, appropriated \$8.8 million for franchise tax revenue allocation for fiscal year 2004, *but did not undo the repeal of §405A.10*. That means the franchise tax allocation is no longer a standing appropriation; the legislature must explicitly appropriate those dollars each year to allow them to go back to local governments. If the results of the 2003 session are any indication, that is unlikely to happen in the coming years. Therefore, counties should not plan on receiving any franchise tax revenues in their FY05 budgets.

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