

**Taxation and Exemption of Computers Task Force  
Report of Recommendations to the General Assembly  
January 9, 2020**

*Background*

The Iowa General Assembly first enacted a sales tax exemption for computers, along with “industrial machinery and equipment,” in 1985.<sup>1</sup> The Iowa Code did not define “computer” at that time, and would not for several years. The Department of Revenue (Department) adopted rule 701—18.34, effective May 14, 1986, to implement the exemption and defined “computer.”<sup>2</sup> Sometime later, the Department expanded the definition to its current form which includes “all devices fastened to” computers. The Department’s current rules related to the exemption are in Iowa Administrative Code rule 701—231.14.

When the legislature enacted the Streamlined Sales and Use Tax Act (SSUTA) in 2003, it adopted the SSUTA definition of “computer.” The SSUTA requires member states to adopt “substantially the same” definitions as those in the SSUTA.<sup>3</sup> Noncompliance with the SSUTA can result in sanctions for member states, including Iowa. In conformity with the SSUTA definition, Iowa Code section 423.1(10) defines “computer” as “an electronic device that accepts information in digital or similar form and manipulates the information for a result based on a sequence of instructions.”

The Department did not amend its rule defining “computer” following the adoption of the SSUTA. Therefore, currently the Code definition does not match the Department’s rule definition. The rule and Code use differing terminology to describe what constitutes a computer, so depending on which definition is utilized, different items may be considered exempt when the definition is applied to Iowa Code section 423.3(47). As noted above, the rule definition includes not just a “computer” but also “...and all devices fastened to...” a computer. These “devices fastened to...” are commonly referred to by the Department and taxpayers as “computer peripherals.” Some examples of computer peripherals are mentioned in the nonexclusive list in rule 701—230.14. The inclusion of card readers and tape punchers illustrates the antiquated nature of the rule.

The Department recognizes the need to rescind the rule definition because it does not conform to the statutory definition required by the SSUTA. Recognizing the impact this rule change could have on taxpayers, the Department urged the creation of this Task Force to review the current situation and discuss potential changes. To avoid being found out of compliance with the SSUTA, the Department intends to amend its rules defining “computer” to conform to the Code definition, and notified the Task Force of this intention.

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<sup>1</sup> See Appendix A.

<sup>2</sup> See Appendix B for all Department definitions of “computer.”

<sup>3</sup> See Appendix C, SSUTA, page 52, section 327.

In addition to discussing the conflict between the rule definition and SSUTA-mandated Code definition, the Task Force discussed the ongoing uncertainty surrounding what constitutes a computer under both the statute and rule. Taxpayers claim a large variety of items are computers or computer peripherals including but not limited to desktops, laptops, tablets, smartphones, security systems, telephone systems, exterior LED signage, coin counting machines, televisions, and ATMs. Some of these items are the subject of dispute in compliance and case law on the breadth of the exemption is limited.

The Task Force met four times during the 2019 interim. In addition to thorough work to prepare for each meeting, all Task Force members participated in the extensive discussions at each meeting to try to work through the issues of defining a modern “computer” or “computer peripheral” and determining the best options to recommend to the legislature. Minutes from those meetings are attached as Appendices D through G for those interested in a more detailed review of the discussions.

### *Recommendation*

As stated above, the Department must amend its rule. Under the statute, “computer peripherals” are only exempt to the extent they constitute computers under 423.1(10) on their own. To continue a similar exemption for peripherals moving forward, the Task Force recommends the following changes which are similar to current rule while providing additional clarity and ensuring compliance with the SSUTA:

1. Codify a newly defined term (suggested below) that encompasses the items included in the definition of “computer” in rule 701—230.14 and the “computer peripherals” referenced above.
2. Include the new term in the exemption found in Code section 423.3(47).
3. Rescind the following Department rules: 701—18.34(1)“b”(1); 701—18.45(1), definition of “computer”; 701—18.58(1), definition of “computer”; and 701—230.14(2)“a”.

The Task Force suggests adding the following to Code section 423.1:

*“10A. ‘Computer peripheral’ means an ancillary device connected to a computer digitally, by cable, or by other medium, used to put information into or get information out of a computer.”*

The Task Force also recommends that the legislature convene a group such as this Task Force meet on a regular basis, perhaps annually or semiannually, to discuss issues related to new developments in technology that cause uncertainty for taxpayers and make recommendations to the legislature as needed.

This new Code definition could be accompanied by a nonexclusive list of items to be exempt as “computer peripherals,” including but not limited to the following: mouse, keyboard, graphics tablet, scanner, barcode reader, microphone, webcam, monitor, projector, printer,

headphones, speaker, and external hard drive. By making this statutory change coupled with the rescission of the Department's rule definitions, eligible taxpayers could purchase these items exempt from sales tax and the state would not be in jeopardy of being deemed not in compliance by the Streamlined Sales Tax Governing Board.

Adoption of a statutory exemption for computer peripherals and a definition of that term would solve the SSUTA compliance issue, but substantial room for dispute between taxpayers and the Department would remain. If the legislature wishes to further resolve the uncertainty about what constitutes an exempt item under Code section 423.3(47), the legislature could eliminate its reliance on the term "computer" which is tied to the vague SSUTA definition. Alternatively, the legislature could articulate with more specificity the items that it wishes to exempt. For example, rather than "computer," the legislature could list laptops and desktops. It could specifically identify smartphones, tablets, or other items that have been the subject of debate either now or in the future. Adding specificity would provide transparency, reduce the need for interpretation, and put the legislature in charge of deciding the cost and scope of the exemption. This recommendation could be adopted whether or not the legislature decides to adopt a definition of computer peripherals and exempt such items.

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The Department appreciates the General Assembly's willingness to convene this Task Force and we hope you find value in our recommendation. The Task Force includes many of the leading sales tax experts in the state, and we thank them for participating.

Sincerely,

A handwritten signature in blue ink that reads "Tim Reilly". The signature is written in a cursive style with a large, looped "y" at the end.

Tim Reilly  
Chair