CHAPTER 54
ALLOCATION AND APPORTIONMENT
[Prior to 12/17/86, Revenue Department[730]]

701—54.1(422) Basis of corporate tax. Iowa Code section 422.33 imposes a tax on all corporations incorporated under the laws of Iowa and upon every foreign corporation doing business in Iowa. For corporations or other entities subject to the tax (as corporations), the tax is levied and collected only on such income as may accrue or be recognized to the corporation from business done or carried on in the state plus net income from certain sources without the state which by law follows the commercial domicile of the corporation.

If a corporation carries on its trade or business entirely within the state of Iowa, no allocation or apportionment of its income may be made. The corporation will be presumed to be carrying on its business entirely within the state of Iowa if its sales or other activities are carried on only in Iowa, even though it received income from sources outside the state in the form of interest, dividends, royalties and other sources of income from intangibles. For tax years beginning on or after January 1, 1995, an Iowa-domiciled corporation may apportion its income if it has income from intangibles that have acquired a business situs outside Iowa even if it has no other activities outside the state. (See subrules 52.1(1) and 52.1(4).)

For tax years beginning on or after January 1, 1986, the income from the operation of a farm may be allocated and apportioned within and without the state if the business activities of the corporation are carried on partly within and partly without the state. For tax years beginning on or after January 1, 1995, an Iowa-domiciled corporation may apportion its income if it has income from intangibles that have acquired a business situs outside Iowa even if it has no other activities outside the state. (See subrules 52.1(1) and 52.1(4).)

See subrule 54.1(4) for the definition of carrying on a trade or business partly within and partly without the state.

54.1(1) *Definition—operation of a farm.* A taxpayer is engaged in the operation of a farm if the taxpayer cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. For the purpose of Iowa Code section 422.33(1), a taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the operation of a farm. However, a taxpayer who receives a fixed rental (without reference to production) is engaged in the operation of a farm only if the taxpayer participates to a material extent in the operation or management of the farm. A taxpayer engaged in forestry or the growing of timber is not thereby engaged in the operation of a farm. A taxpayer cultivating or operating a farm for recreation or pleasure rather than a profit is not engaged in the operation of a farm. For the purpose of this subrule, the term "farm" is used in its ordinary, accepted sense and includes stock, dairy, poultry, fruit, and truck farms, and also plantations, ranches, ranges, and orchards. A taxpayer is engaged in the operation of a farm if the taxpayer is a member of a partnership engaged in the operation of a farm. The operation of a farm includes the sale of products produced on the farm. The purchase of livestock for feeding purposes and subsequent resale is part of the operation of a farm.

54.1(2) *Definition—property used in the operation of a farm.* Property used in the operation of a farm means land and buildings which are used in the operation of a farm. The land must be used for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. For the purposes of this subrule, the term livestock includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive furbearing animals, chickens, turkeys, pigeons, and other poultry. It does not include fish, frogs, reptiles, and the like. Land used for the sustenance of livestock includes land used for grazing such livestock.

Property used in the operation of a farm means property used in the unitary operations of a farm whether or not the acreage is contiguous.

54.1(3) *Definition—unitary operations of a farm.* Unitary operations of a farm means the operation of one or more tracts of land or the conducting of one or more types of farming operations where the operation of a farm within Iowa is integrated with, dependent upon or contributes to the operations of a farm outside the state.

54.1(4) *Definition—carrying on a trade or business partly within and partly without the state.* Carrying on a trade or business partly within and partly without the state means having business activities in at least one other state sufficient to meet the minimum constitutional standards for doing business in a state under the due process and commerce clauses of the United States Constitution. The determination of whether a corporation is carrying on a trade or business partly within and partly without the state must be made on a tax-year-by-tax-year basis. The activities of a past or future tax year have no bearing on the current year.

The following nonexclusive list of activities on a non-de minimus basis determined by aggregating all activities if physically carried on in a regular, systematic, and continuing basis by corporate officers or employees or representatives in at least one other state would constitute the minimum activities which would meet the constitutional standards for doing business in a state under the due process and commerce clauses of the United States Constitution:

The term "representative" means independent contractors, agents, brokers, and other individuals or entities who act on behalf of or at the direction of the corporation. A person may be considered a "representative" even though that person may not be considered an employee for other purposes such as withholding of income tax from commissions.

a. The free distribution of product samples, brochures, and catalogues which explain the use of or laud the product, or both.

b. Negotiation of a price for a product.

c. Demonstration of how the corporation's product works.

d. Delivery of goods to customers by the corporation in its own or leased vehicles.

e. Audit of inventory levels.

f. Recruitment, training, evaluation, and management of employees, officers, or representatives.

g. Intervention/mediation in credit disputes between customers and Iowa-located corporate departments.

h. Use of hotel rooms and homes for business meetings.

i. Assistance to wholesalers in obtaining suitable displays for products.

j. Furnishing of display racks at no charge.

k. Advice to sellers on the art of displaying goods to the public.

l. Rental of hotel rooms for short-term display of products.

m. Mere forwarding of customer questions, concerns, or problems.

n. Installation or assembly of the corporate product.

o. Ownership or lease of real estate by the corporation and used for a business purpose.

p. Solicitation of orders for, or sale of, services or real estate.

q. Solicitation of sales or sale of tangible personal property (as opposed to solicitation of orders).

r. Maintenance of a stock of inventory.

s. Existence of an office or other business location.

t. Managerial activities.

u. Collections on regular or delinquent accounts.

v. Technical assistance and training given to purchaser and user of corporate products.

w. The repair or replacement of faulty or damaged goods.

x. The pickup of damaged, obsolete, or returned merchandise from purchaser or user.

y. Rectification of or assistance in rectifying any product complaints or shipping complaints, for example.

z. Delivery of corporate merchandise inventory to corporation's distributors or dealers on consignment.

aa. Maintenance of personal property.

ab. Participation in recruitment, training, monitoring, or approval of servicing distributors, dealers, or others where purchasers of corporation's products can have such products serviced or repaired.

ac. Inspection or verification of faulty or damaged goods.

ad. Inspection of the customer's installation of the corporate product.

ae. Research.

af. Employees' or officers' use of part of their homes or other places as an office if the corporation pays for such use.

ag. The use of samples for replacement or sale; storage of such samples at home or in rented space.

ah. Removal of old or defective products.

ai. Verification of the destruction of damaged merchandise.

aj. Repair or warranty work on company goods or products after sale.

ak. Any other activities carried on in advancement, promotion, or fulfillment of the business of the corporation.

Some of the above activities may not create a tax liability in another state because of the protections afforded by Public Law 86-272, 15 USCA Sections 381-385, which prohibit the taxation of a corporation if its only activities in the state are the solicitation of orders which are approved and filled by shipment or delivery from outside the state. Irrespective of whether the corporation is taxable in another state, it may apportion its income if it carries on one or a combination of the above activities in a regular and continuing basis by corporate officers or employees in at least one other state.

The mere shipment of goods via common carrier or the United States Postal Service to non-Iowa destinations does not constitute doing business partly within and partly without the state. *Irvine Co. v. McColgan*, 26 Cal.2d 160, 157 P.2d 847 (1945); *W.J. Dickey & Sons, Inc. v. State Tax Commission*, 212 Md. 607, 131 A.2d 277 (1957); *State of Georgia v. Coca-Cola Bottling Co.*, 214 Ga. 316, 104 S.E.2d 574 (1958); *E.F. Johnson Company v. Commissioner of Taxation*, 224 N.W.2d 150 (Minnesota 1975); 1980 O.A.G. 588, and *Kuehn to Bair* #85-5-53(L).

For tax years beginning on or after January 1, 1989, a corporation domiciled in this state whose trade or business is carried on partly within and partly without the state or whose income is derived from sources partly within and partly without the state may allocate and apportion its income within and without the state. "Income from sources partly within and partly without the state" means income from real or tangible property located or having a situs within and without the state.

The term "tangible property having a situs without the state" means that a tangible property is habitually present in a state other than Iowa or it maintains a fixed and regular route through another state sufficient that the other state could constitutionally under the 14th Amendment and Commerce Clause of the United States Constitution impose an apportioned ad valorem tax on the property. *Central R. Co. v. Pennsylvania*, 370 U.S. 607, 82 S.Ct. 1297, 8 L.Ed.2d (1962); *New York Central & H. Railroad Co. v. Miller*, 202 U.S. 584, 26 S.Ct. 714, 50 L.Ed. 155 (1906); *American Refrigerator Transit Company v. State Tax Commission*, 395 P.2d 127 (Or. 1964); *Upper Missouri River Corporation v. Board of Review*, Woodbury County, 210 N.W.2d 828.

For tax years beginning on or after January 1, 1995, a corporation whose trade or business is carried on partly within and partly without the state of Iowa or whose income is derived from sources partly within and partly without the state may allocate and apportion its income within and without the state. "Income from sources partly within and partly without the state" means income from real, tangible, or intangible property located or having situses within and without the state.

This rule is intended to implement Iowa Code Supplement section 422.33(1).

701—54.2(422) Allocation or apportionment of investment income.

54.2(1) The classification of investment income by the labels customarily given them, such as interest, dividends, rents, and royalties, is of no aid in determining whether that income is business or nonbusiness income. Interest, dividends, rents, and royalties shall be apportioned as business income to the extent the income was earned as a part of a corporation's unitary business, a portion of which is conducted in Iowa. *Mobil Oil Corp. v. Commissioner of Taxes,* 455 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307, 73 L.Ed.2d 787, 102 S.Ct. 3103 (1982); *F. W. Woolworth Co. v. Taxation and Revenue Dept.,* 458 U.S. 354, 73 L.Ed.2d 819, 102 S.Ct. 3128 (1982); *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159,77 L.Ed.2d 545, 103 S.Ct. 2933 (1983). Whether investment income is part of a corporation's unitary business income depends upon the facts and circumstances in the particular situation. The burden of proof is upon the taxpayer to show that the treatment of investment income on the return as filed is proper. There is a rebuttable presumption that an affiliated group of corporations in the same line of business have a unitary relationship, although that is not the only element used in determining unitariness.

54.2(2) All business income, including capital gains or losses, may at the taxpayer's election be included in the computation of the denominator of the business activity formula provided, however, that a taxpayer cannot elect to exclude or include business investment income where the election would result in an understatement of net income reasonably attributable to Iowa.

For a tax year which begins on or after January 1, 1984, if the taxpayer has investment income which is deemed to be business income under the provisions of this rule, a written election shall be made. The election must state whether the taxpayer wishes to include or exclude investment income which is deemed to be business income under the provisions of this rule in the computation of the business activity formula. The election shall be signed by a duly authorized officer of the corporation. The election is binding on all future tax years unless the taxpayer is granted permission by the director to change the election. If the taxpayer fails to make a written election, the fact that investment income was or was not included in the computation of the business activity formula shall be deemed to be the taxpayer's election for all future tax years.

If the taxpayer makes an election to include investment income deemed to be business income in the computation of the denominator of the business activity ratio, the computation of the business activity ratio is as follows:

a. Interest income from accounts receivable. Accounts receivable interest income is included in the numerator of the business activity formula if the taxpayer receives accounts receivable interest income from customers located in Iowa. Accounts receivable interest income which cannot be segregated by geographical source shall be included in the numerator of the business activity ratio applying the same ratio as gross receipts within Iowa bear to total gross receipts.

EXAMPLE: The taxpayer operates a multistate chain of gasoline service stations, selling for cash and on credit. Interest is charged on credit sales, but the interest income cannot be segregated by geographical source. During the tax year, the taxpayer had gross receipts within Iowa of $300,000, total gross receipts everywhere of $1,000,000, and accounts receivable interest income everywhere of $10,000. Ten thousand dollars would be included in the denominator of the business activity formula, and 30 percent of $10,000, or $3,000, would be included in the numerator of the business activity formula.

b. Interest income other than accounts receivable. All other interest income determined to be business income, except nontaxable interest income, shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

c. Dividend income. All dividend income (net of special deductions) determined to be business income shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

d. Rental income. All rental income determined to be business income shall be included in the numerator of the business activity formula to the extent that property is utilized in Iowa or in its entirety if the taxpayer's commercial domicile is in Iowa and the taxpayer is not taxable in the state in which the property is utilized. The extent of utilization of tangible personal property in a state is determined by multiplying the rent by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of the property during the rental period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

e. Royalty income. All royalty income from intangible personal property determined to be business income shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa. All royalty income from tangible personal property or real property determined to be business income shall be included in the numerator of the business activity formula if the situs of the tangible personal property or real property is within Iowa.

f. Gain or loss from the sale, exchange, or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was used in the taxpayer's trade or business, shall be apportioned by the business activity ratio applicable to the return for the year the gain or loss is included in taxable income and shall be included in the computation of the business activity ratio as follows:

(1) Gain or loss from the sale, exchange, or other disposition of real property shall be included in the numerator if the property is located in this state.

(2) Gain or loss from the sale, exchange, or other disposition of tangible personal property shall be included in the numerator if:

The property has a situs in this state at the time of sale; or

The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Gains or loss from the sale, exchange, or other disposition of intangible personal property shall be included in the numerator if the taxpayer's commercial domicile is in this state.

(4) All gains or loss shall be included in the denominator of the activity ratio.

Noninclusive examples of gains or loss from the sale, exchange or other disposition of real or tangible or intangible property which may not be included in the computation of the business activity ratio because to do so would result in an understatement of net income reasonably attributable to Iowa are the gain recognized under an election pursuant to Section 338 of the Internal Revenue Code or gain recognized under Section 631(a) of the Internal Revenue Code.

g. Other miscellaneous income. All other miscellaneous income determined to be business income shall be included in the computation of the business activity formula to the extent such income items do not represent a recapture of expense.

h. Income which is not subject to Iowa tax shall not be included in the computation of the business activity ratio.

Subrules 54.2(1) and 54.2(2) are effective for tax years beginning on or after January 1, 1983.

54.2(3) For tax years beginning on or after January 1, 1995, all investment income that is business income, including capital gains or losses, shall be included in the computation of the denominator of the business activity formula if the investment income is derived from intangible property that has become an integral part of some business activity occurring regularly in or outside of Iowa. See subrule 52.1(4). All other investment business income, including capital gains or losses, may at the taxpayer's election be included in the computation of the denominator of the business activity formula provided, however, that a taxpayer cannot elect to exclude or include investment business income where the election could result in an understatement of net income reasonably attributable to Iowa. A taxpayer cannot elect to include some investment business income in and exclude other investment business income from the business activity formula. The election applies to all investment income of the taxpayer subject to the election.

For a tax year which begins on or after January 1, 1995, if the taxpayer has investment income subject to an election under the provisions of this rule, a written election shall be made. The election must state whether the taxpayer wishes to include or exclude investment income which is deemed to be business income subject to election under the provisions of this rule in the computation of the business activity formula. The election shall be signed by a duly authorized officer of the corporation. The election is binding on all future tax years unless the taxpayer is granted permission by the director to change the election. If the taxpayer fails to make a written election, the fact that investment income was or was not included in the computation of the business activity formula shall be deemed to be the taxpayer's election for future years.

The computation of the business activity formula associated with investment income is as follows where the investment income is required to be included in the business activity formula or where an election for inclusion has been made:

a. *Interest income from accounts receivable.* If an inclusion election is made, accounts receivable interest income is included in the numerator of the business activity formula if the taxpayer receives accounts receivable interest income from customers located in Iowa. Accounts receivable interest income which cannot be segregated by geographical source shall be included in the numerator of the business activity ratio applying the same ratio as gross receipts within Iowa bear to total gross receipts.

EXAMPLE: The taxpayer operates a multistate chain of gasoline service stations, selling for cash and on credit. Interest is charged on credit sales, but the interest income cannot be segregated by geographical source. During the tax year, the taxpayer had gross receipts within Iowa of $300,000, total gross receipts everywhere of $1,000,000, and accounts receivable interest income everywhere of $10,000. $10,000 would be included in the denominator of the business activity formula, and 30 percent of $10,000, or $3,000, would be included in the numerator of the business activity formula.

b. Interest income other than accounts receivable. All other interest income determined to be business income, except nontaxable interest income, shall be included in the numerator of the business activity formula to the extent that the interest-bearing asset is an integral part of some business activity occurring regularly in Iowa. If the interest-bearing asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the interest therefrom (except nontaxable interest income) shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: The taxpayer earns interest income from loans to affiliated corporations, commercial paper, bonds issued by multistate corporations, and federal income tax refunds. The interest income is business income. None of these interest-bearing assets are an integral part of some business activity occurring regularly within or without Iowa. Accordingly, the interest income produced by such assets is subject to an election of inclusion in or exclusion from the business activity formula.

c. Dividend income. All dividend income (net of special deductions) determined to be business income shall be included in the numerator of the business activity formula to the extent that the dividend asset is an integral part of some business activity occurring regularly in Iowa. If the dividend asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the dividends shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: The taxpayer earns dividend income from dividends payable from a mutual fund. The dividend income is business income. The dividends are not an integral part of some business activity occurring regularly within or without Iowa. Assume that the taxpayer had also earned interest income which was business income and which was not an integral part of some business activity occurring regularly within or without Iowa and that the taxpayer had included that interest income in the business activity formula. Under these circumstances, the taxpayer must also include the dividend income in the business activity formula. If no inclusion of investment business income had been made in the business activity formula, the taxpayer would exclude the dividend income from the formula.

d. Rental income. If an inclusion election is made, all rental income determined to be business income shall be included in the numerator of the business activity formula to the extent that property is utilized in Iowa or in its entirety if the taxpayer's commercial domicile is in Iowa and the taxpayer is not taxable in the state in which the property is utilized. The extent of utilization of tangible personal property in a state is determined by multiplying the rent by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of the property during the rental period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

e. Royalty income and licensing fees. All royalty income and licensing fees from intangible personal property determined to be business income shall be included in the numerator of the business activity formula to the extent that the royalty or licensing asset is an integral part of some business activity occurring regularly in Iowa. If the royalty or licensing asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the royalties or licensing fees shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: A, a corporation with a commercial domicile outside of Iowa, derives royalties from a trade name that is used by other corporations doing business in Iowa in their Iowa businesses. Since the royalty asset is an integral part of an Iowa business activity, A must include the royalties associated with Iowa business activity in the numerator of A's business activity formula.

EXAMPLE: The taxpayer, a corporation with a commercial domicile in Iowa, derives license fees from others who do business solely outside of Iowa. The license fees are business income. The license fees are an integral part of some business activity carried on regularly by the others outside of Iowa. The taxpayer must include the license fees in the business activity formula. If the taxpayer also had other license fees which were business income and which were not an integral part of some business activity occurring regularly within or without Iowa, these other license fees would be subject to an election of inclusion in or exclusion from the business activity formula.

If an inclusion election is made, all royalty income from tangible personal property or real property determined to be business income shall be included in the numerator of the business activity formula if the situs of the tangible personal property or real property is within Iowa.

f. Gains or losses. Gain or loss from the sale, exchange, or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer's trade or business carried on in Iowa, shall be apportioned by the business activity ratio applicable to the return for the year the gain or loss is included in taxable income and shall be included in the computation of the business activity ratio as follows:

(1) Gain or loss from the sale, exchange, or other disposition of real property shall be included in the numerator if the property is located in this state and if an election of inclusion has been made.

(2) Gain or loss from the sale, exchange, or other disposition of tangible personal property shall be included in the numerator if an election of inclusion has been made and if the property has a situs in this state at the time of sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Gain or loss from the sale, exchange, or other disposition of intangible personal property shall be included in the numerator of the business activity formula to the extent that the intangible personal property is an integral part of some business activity occurring regularly in Iowa in the tax year that gain or loss is recognized. If the intangible personal property is not an integral part of some business activity occurring regularly in or outside of Iowa in the tax year that gain or loss is recognized and if an election of inclusion has been made, the gain or loss shall be included in the numerator if the taxpayer's commercial domicile is in this state.

EXAMPLE: The taxpayer carries on its trade or business within and without Iowa. The taxpayer has patents which it licenses others to use in activities within and without Iowa. The patents are an integral part of business activity occurring regularly within and without Iowa. The taxpayer receives royalty income for the use of the patents. The taxpayer sells the patents and realizes a capital gain. The capital gain from the sale of the patents cannot be segregated by geographical source. Assume that the taxpayer is on a calendar tax year. Assume that the sale occurred on July 1. From January 1 to July 1, 5 percent of the royalties were attributable to some business activity regularly occurring in Iowa. The taxpayer should include 5 percent of the capital gain in the numerator of the business activity formula.

(4) All gain or loss shall be included in the denominator of the business activity ratio if an election of inclusion has been made or if the gain or loss is required to be included in the business activity ratio.

g. Other miscellaneous income. All other miscellaneous income determined to be business income which is not subject to an election or which is the subject of a proper election of inclusion shall be included in the computation of the business activity formula to the extent such income items do not represent a recapture of expense. The miscellaneous income shall be included in the numerator of the business activity formula if the income is from an Iowa source.

h. Other investment income. All other investment income shall be included in the numerator of the business activity formula to the extent that the intangible personal property which produced that income is an integral part of some business activity occurring regularly in Iowa. If the intangible personal property is not part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion has been made, the other investment income shall be included in the numerator if the taxpayer's commercial domicile is in this state.

i. Activity ratio. Income which is not subject to Iowa tax shall not be included in the computation of the business activity ratio.

54.2(4) Grossed-up foreign income. For purposes of administration of the Iowa corporation income tax law, gross-up (Section 78 of the Internal Revenue Code) shall be considered to be nonbusiness income, irrespective of the fact that the income creating the gross-up may be business income, and shall be allocated to the situs of the income payor.

This rule is intended to implement Iowa Code Supplement sections 422.32(2) and 422.33(1).

701—54.3(422) Application of related expense to allocable interest, dividends, rents and royalties—tax periods beginning on or after January 1, 1978. Rule 54.2(422) deals with the separation of "net" income; therefore, determination and application of related expenses must be made, as hereinafter directed, before allocation and apportionment within and without Iowa. Related expenses shall mean those expenses directly related, including related federal income taxes. *Allphin v. Joseph E. Seagram & Sons,* 204 S.W. 2d 515 (Ky. 1956).

A "directly related expense" shall mean an expense which can be specifically attributed to an item of income. Interest expense shall be considered directly related to a specific property which generates, has generated, or could reasonably have been expected to generate gross income if the existence of all of the facts and circumstances described below is established. Such facts and circumstances are as follows: (1) the indebtedness on which the interest was paid was specifically incurred for the purpose of purchasing, maintaining, or improving the specific property; (2) the proceeds of the borrowing were actually applied to the specified purpose; (3) the creditor can look only to the specific property (or any lease or other interest therein) as security for the loan; (4) it may be reasonably assumed that the return on or from the property will be sufficient to fulfill the terms and conditions of the loan agreement with respect to the amount and timing of payment of principal and interest; and (5) there are restrictions in the loan agreement on the disposal or use of the property consistent with the assumptions described in (3) and (4) above.

A deduction for interest may not be considered definitely related solely to specific property, even though the above facts and circumstances are present in form, if any of such facts and circumstances are not present in substance. Any expense directly attributable to allocable interest, dividends, rents and royalties shall be deducted from such income to arrive at net allocable income.

EXAMPLE (i): For purposes of this example, it is assumed that the taxpayer has nonbusiness rental income. The taxpayer invests in a 20-story office building. Under the terms of the lease agreements, the taxpayer provides heat, electricity, janitorial services and maintenance. The taxpayer also pays the property taxes. Construction of the building was funded through borrowings which meet the criteria of a direct expense under the provisions of this paragraph. The directly related expenses to the operation of the property are:

Interest expense	$1,200,000
Property taxes	500,000
Depreciation	500,000
Electricity	300,000
Heat	200,000
Insurance	150,000
Janitorial services	100,000
Repairs	50,000
Total expense	$3,000,000

The directly related expense of the allocable nonbusiness rental income is $3,000,000.

EXAMPLE (ii): For purposes of this example, it is assumed that the taxpayer has nonbusiness income. The taxpayer is a multistate manufacturer of processed foods. It has a nonbusiness investment portfolio which is managed by an investment firm for a fee. The fee paid for the management of the portfolio is a directly related expense to the dividends and interest income received. The fee is attributed to the various types of income on the ratio that the various types of income bear to the total income produced.

EXAMPLE (iii): Same as example (ii), except that in addition to the investments described, the taxpayer also has investments in oil properties. The depletion expense is a directly related expense to the oil royalty income.

This rule is intended to implement Iowa Code section 422.33.

701—54.4(422) Net gains and losses from the sale of assets. For purposes of administration of this rule, a capital gain or loss shall mean the sale price or value at the time of disposal of an asset less the adjusted basis, whether reportable as short-term or long-term capital gain or ordinary income for federal income tax purposes.

Nonbusiness gain or loss from the sale, exchange or other disposition of property if the property while owned by the taxpayer was not operationally related to the taxpayer's trade or business carried on in Iowa shall be allocated as follows:

54.4(1) Gains or losses from the sale, exchange or other disposition of real property located in this state are allocable to this state.

54.4(2) Gains and losses from the sale, exchange or other disposition of tangible personal property are allocable to this state if:

a. The property had a situs in this state at the time of sale; or

b. The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

54.4(3) Gains or losses from the sale, exchange or other disposition of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

54.4(4) Gains or losses from the sale, exchange or other disposition of stock of another corporation, if the activities of the other corporation were not operationally related to the taxpayer's trade or business carried on in Iowa while the stock was owned by the taxpayer, are allocable to this state if the taxpayer's commercial domicile is in this state.

This rule is intended to implement Iowa Code Supplement section 422.33(1).

701—54.5(422) Where income is derived from the manufacture or sale of tangible personal property. The law specifically provides but one method for apportioning net income derived from the manufacture or sale of tangible personal property. The part of such income attributable to business within the state shall be that proportion which the gross sales made within the state bear to the total gross sales.

In determining the total net taxable income, the apportionable income attributable to this state, as determined by use of the apportionment fraction, shall be added to the nonapportionable income allocable to this state.

When a taxpayer is engaged in manufacturing and selling or purchasing and reselling goods or products "gross sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. "Gross receipts" for this purpose means gross sales, less returns and allowances. Federal and state excise taxes shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

54.5(1) Sales of tangible personal property are in this state if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of the sales.

54.5(2) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

EXAMPLE: The taxpayer, with inventory in State A, sold $100,000 of its products to a purchaser having branch stores in several states including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. Twenty-five thousand dollars of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to $25,000 of the taxpayer's sales.

54.5(3) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

EXAMPLE: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the taxpayer's products shipped to a purchaser's warehouse in this state are property "delivered or shipped to a purchaser within this state".

54.5(4) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

EXAMPLE: A taxpayer in this state sold merchandise to a purchaser in State A. The taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is in this state.

54.5(5) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

EXAMPLE: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route the produce is diverted to the purchaser's place of business in this state. The sale by the taxpayer is attributed to this state.

54.5(6) Deliveries for transportation outside the state. The taxpayer sells merchandise to a purchaser outside this state, and the purchaser picks up the produce or makes arrangements to have the product picked up at the taxpayer's place of business in this state to be taken outside the state. The sale by the taxpayer is a sale outside this state.

54.5(7) Dock or pickup sales. The taxpayer sells merchandise to a purchaser within this state, and the purchaser picks up the product at the taxpayer's place of business outside of this state. The sale by the taxpayer is a sale in this state. *Pabst Brewing Co. v. Wis. Dept. of Revenue,* 387 N.W.2d 121 (Wis. App. 1986); *Strickland v. Patcraft Mills, Inc.*, 302 S.E.2d 544 (Ga. 1983); *Olympia Brewing Company v. Commissioner of Revenue,* 326 N.W.2d 642 (Minn. 1982); *Department of Revenue v. Parker Banana Company,* 391 So. 2d 762 (Fla. App. 1980)*; Department of Revenue v. U.S. Sugar Corporation*, 388 So. 2d 596 (Fla. App. 1980). This subrule is effective for tax years beginning on or after January 1, 1989.

This rule is intended to implement Iowa Code section 422.33.

701—54.6(422) Apportionment of income derived from business other than the manufacture or sale of tangible personal property. Income derived from business other than the manufacture or sale of tangible personal property shall be attributed to Iowa in the proportion which the Iowa gross receipts bear to the total gross receipts. Gross receipts are includable in the numerator of the apportionment factor in the proportion which the recipient of the service receives benefit of the service in this state.

54.6(1) Services other than those set forth in subrules 54.6(3) to 54.6(5) and rule 701—54.7(422). With respect to a specific contract or item of income, all gross receipts from the performance of services are includable in the numerator of the apportionment factor if the recipient of the service receives all of the benefit of the service in Iowa. If the recipient of the service receives some of the benefit of the service in Iowa with respect to a specific contract or item of income, the gross receipts are includable in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Iowa.

The following are noninclusive examples of the application of this subrule.

a. A real estate development firm from State A is developing a tract of land in Iowa. The real estate development firm from State A engages a surveying company from State B to survey the tract of land in Iowa. The survey work is completed and the plats are drawn in Iowa. The gross receipts from this survey work are attributable to Iowa and included in the numerator of the apportionment factor because the recipient of the service received all of the benefits of the service in Iowa.

b. A corporation headquartered in State Y is building an office complex in Iowa. The corporation from State Y contracts with an engineering firm from State X to oversee construction of the buildings on the site. The engineering firm performs some of their service in Iowa at the building site and also some of their service in State X. The gross receipts from the engineering service are attributable to Iowa and included in the numerator of the apportionment factor because the recipient of the service received all of the benefit of the service in Iowa.

c. A corporation from State A contracts with a computer software company from State D to develop and install a custom software application in a business office in Iowa of the company from State A. The software firm does consulting work on the project in State A and in Iowa. The software development is done in State D and in Iowa. The software package is delivered to the corporation from State A in Iowa. The gross receipts from the software development are attributable to Iowa and included in the numerator of the apportionment factor because the recipient of the service received all of the benefit of the service in Iowa.

d. A corporation located in Iowa performs direct mail activities for a customer located in State X. The direct mail activities include the preparation and mailing of materials to households located throughout the United States. The corporation located in Iowa performed some activities related to the direct mail contract in State X. One percent of the direct mailings went to addresses within Iowa. One percent of the gross receipts related to this direct mail contract are attributable to Iowa and included in the numerator of the apportionment factor because the recipient of the service received the 1 percent of the benefit of the service in Iowa.

e. A corporation located in State A performs direct mail activities for a customer located in State X. The corporation has nexus with Iowa due to other activities of the unitary business. The direct mail activities include the preparation and mailing of materials to households throughout the United States. The corporation located in State A printed and mailed the direct mail materials to households on a mailing list prepared by the direct mailing company in State A. Five percent of the direct mailings went to addresses within Iowa. Five percent of the gross receipts related to this direct mail contract are attributable to Iowa and included in the numerator of the apportionment factor.

f. A company which owns apartments in Iowa and State A contracts with a pest control corporation for pest control activities. One contract is entered into which covers 100 apartment units in Iowa and 400 apartment units in State A. Twenty percent (100/500) of the gross receipts from the pest control contract are attributable to Iowa and are included in the numerator of the apportionment factor as 20 percent of the apartment units are located in Iowa and in the absence of more accurate records, it is presumed that the number of apartment units is the best measure of the extent the recipient of the service received benefit of the service in Iowa.

If a taxpayer does not believe that the method of apportionment set forth in this subrule reasonably attributes income to business activities within Iowa, the taxpayer may request the use of an alternative method of apportionment. The request must be filed at least 60 days before the due date of the return, considering any extensions of time to file, in which the taxpayer wishes to use an alternative method of apportionment. The request should be filed with Policy Section, Technical Service Division, P.O. Box 10457, Des Moines, Iowa 50306. The taxpayer must set forth in detail the extent of the taxpayer's business operations within and without the state, along with the reasons why the apportionment method set forth in this subrule is inappropriate. In addition, the taxpayer must set forth a proposed method of apportionment and the reasons why the proposed method of apportionment more reasonably attributes income to business activities in Iowa.

If the department agrees that the proposed method of apportionment more reasonably attributes income to business activities in Iowa, the taxpayer may continue to use the proposed method of apportionment until the taxpayer's factual situation changes or the department prospectively informs the taxpayer that the method of apportionment may no longer be used.

If the taxpayer's factual situation changes and under the new factual situation the taxpayer still believes that the method of apportionment set forth in this subrule still is not appropriate, then the taxpayer must submit a new request for the use of an alternative method of apportionment.

If the taxpayer disagrees with the determination of the department, the taxpayer may file a protest within 60 days of the date of the letter setting forth the department's determination and the reasons therefor in accordance with rule 701—7.8(17A). The department's determination letter shall set forth the taxpayer's rights to protest the department's determination.

54.6(2) If the business activity consists of providing services, such as the operation of an advertising agency, or the performance of equipment service contracts, research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commission, and similar items.

In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, gross receipts include the entire reimbursed cost, plus the fee.

54.6(3) Business income of a financial organization, excepting a financial institution exempted from the corporation income tax under Iowa Code section 422.34(1) attributable to Iowa shall be:

a. In the case of taxable income of a taxpayer whose income-producing activities are confined solely to this state, the entire net income of such taxpayer.

b. In the case of taxable income of a taxpayer who conducts income-producing activities as a financial organization partially within and partially without this state, that portion of its net income as its gross business in this state is to its gross business everywhere during the period covered by its return, which portion shall be determined as the sum of:

(1) Fees, commission or other compensation for financial services rendered for a customer located in this state or an account maintained within this state;

(2) Gross profits from trading in stocks, bonds or other securities managed within this state;

(3) Interest income from a loan on real property located in this state. Interest and other receipts from assets in the nature of loans and installment obligations if the borrower is located within this state. Other fees and other miscellaneous earnings if connected with loans to borrowers within this state;

(4) Interest charged to customers within this state or to accounts maintained within this state for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts;

(5) Interest, lease payments, or other receipts from financing leases, installment sales contracts, leases or other financing instruments received from customers within this state; and

(6) Any other gross income resulting from the operation as a financial organization within this state.

A "financial organization" means an association, joint stock company or corporation a substantial part of whose assets consists of intangible personal property and a substantial part of whose gross income consists of dividends or interest or other charges resulting from the use of money or credit.

54.6(4) Net business income of construction contractors shall be attributed to Iowa in the proportion which Iowa gross receipts bear to total gross receipts. Iowa gross receipts are those gross receipts from contracts performed in Iowa.

54.6(5) A corporation's distributive share of net income or loss from a joint venture, limited liability company, or partnership is subject to apportionment within and without the state. If the income of the partnership, limited liability company, or joint venture is received in connection with the taxpayer's regular trade or business operations, the partnership, limited liability company, or joint venture income shall be apportioned within and without Iowa on the basis of the taxpayer's business activity ratio. The corporation's distributive share of the gross receipts of the partnership, limited liability company, or joint venture shall be included in the computation of the business activity ratio in accordance with the provisions of this chapter.

EXAMPLE 1: A, a corporation with a commercial domicile in State X, is engaged in business within and without Iowa whereby A sells tangible personal property. A also has an interest in a limited partnership whose business is conducted within and without Iowa. Five percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 95 percent are derived from sales and deliveries to purchasers outside of Iowa. A will include 5 percent of its distributive share of the gross receipts of the partnership in the numerator along with A's destination Iowa sales in calculating its business activity ratio. A will include 100 percent of its distributive share of the gross receipts in the denominator along with A's total sales in calculating its business activity ratio.

EXAMPLE 2: B, a corporation with a commercial domicile in State X, has no physical presence in the state of Iowa. B's only contact with Iowa is B's interest in a limited partnership whose business is conducted within and without Iowa. Ten percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 90 percent are derived from sales and deliveries to purchasers outside of Iowa. B will include 10 percent of its distributive share of the gross receipts of the partnership in the numerator in calculating its business activity ratio. B will include 100 percent of its distributive share of the gross receipts in the denominator of B's business activity ratio.

54.6(6) Gross receipts from rent or royalties or other fees received for the use of real property are attributable to this state if the real property is located in this state.

Gross receipts from rent, royalties, license fees, or other fees received for the use of tangible personal property are attributable to this state to the extent that the property is utilized in this state. The extent of utilization of tangible personal property in this state is determined by multiplying the rents, royalties, license fees or other fees by a fraction, the numerator of which is number of days or other measure of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days or other measure of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of property during the rental period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

An example of another measure of physical location of property is where a lessee of transportation equipment is required to report to the lessor miles traveled by state.

a. A lessee takes possession of a rental car in this state. Six days later after driving 1,500 miles, the rental car is returned to the lessor in this state. Absent evidence to the contrary, the rental receipts are attributable to this state.

b. A lessee takes possession of a rental car in this state. Six days later after driving 1,500 miles, the rental car is returned to the lessor in an adjacent state. Absent evidence to the contrary, it is assumed that 50 percent of the rental receipts are attributable to this state.

c. A lessee takes possession of a rental semi-truck in another state. The lessee is required to maintain mileage records by state for purposes of special fuel tax. The lessee provides copies of these records to the lessor. The lessor must use these records to determine the portion of the rental receipts that are attributable to this state.

This rule is intended to implement Iowa Code Supplement section 422.33(1).

701—54.7(422) Apportionment of income of transportation, communications, and certain public utilities corporations. Net income of these corporations, other than interest, dividends, rents and royalties, which is not specifically allocated by 54.2(422) and 54.6(422) shall be apportioned as follows:

54.7(1) Railroads shall determine their Iowa proportion of gross receipts or gross revenue from railroad operations by the following methodology:

a. Freight revenue. Freight revenue within and without Iowa shall be determined for each individual freight movement by taking the proportion of car and locomotive miles traveled in Iowa to total car and locomotive miles traveled within and without Iowa for the individual freight movement and applying such individual percentage to the gross receipts derived from the individual freight movement. Empty mileage that does not produce gross receipts shall not be used.

b. Passenger revenue. Passenger revenue within and without Iowa shall be determined by use of the same principles applicable to freight revenue.

c. Switching revenue. Unless the switching revenue is accounted for in the freight revenue or passenger revenue categories, it shall be determined in accordance with subrule 54.6(1).

d. Miscellaneous revenue. Nonexclusive examples of miscellaneous revenues include demurrage revenue, station services revenue, storage revenue, railway property rental, joint facility revenue, and amounts received from government authorities. These revenues shall be attributed to the state in which they were earned.

e. All of the above classes of revenues shall be aggregated and combined with other gross receipts or gross revenues from sources within Iowa to compose the numerator. The denominator shall be computed in accordance with 701—subrule 54.2(2).

54.7(2) Airline, truck and bus line companies, water transportation companies, freight car and equipment companies shall determine their Iowa proportion of gross receipts or gross revenues derived from transportation operations by taking the proportion of mileage traveled in Iowa to the total mileage traveled within and without the state.

54.7(3) Oil, gasoline, gas and other pipeline companies shall determine the proportion of transportation revenue derived from interstate business that is attributable to Iowa by the proportion of Iowa traffic units to total traffic units. The "traffic unit" of an oil pipeline is defined as the transportation of one barrel of oil for a distance of one mile; the "traffic unit" of a gasoline pipeline is defined to be the transportation of one barrel of gasoline for a distance of one mile; and a "traffic unit" of a gas pipeline is defined to be the transportation of 1,000 cubic feet or one dekatherm of natural or casinghead gas for a distance of one mile. The taxpayer may use either 1,000 cubic feet or one dekatherm as a "traffic unit" as long as the numerator and denominator are computed on the same basis. Any other pipeline company will use the definition of the "traffic unit" which would most nearly describe the substance transported.

54.7(4) Telecommunications companies shall determine the Iowa proportion of gross receipts or gross revenues from telecommunication operations by the following methodology:

a. Gross receipts or gross revenues from local service in this state are attributable to this state.

b. Gross receipts or gross revenues from toll services originating and terminating in this state are attributable to this state.

c. Gross receipts or gross revenues from interstate toll services originating in this state and charged to an Iowa service address are attributable to this state.

d. Gross receipts or gross revenues from interstate toll services terminating in this state and charged to an Iowa service address are attributable to this state.

e. Any other gross receipts or gross revenues from fees, access charges, toll services or other charges for communication services charged to an Iowa service address are attributable to this state. See *Goldberg v. Sweet*, 488 U.S. 252, 102 L.Ed. 2d 607, 109 S.Ct. 582. (1989)

f. All of the above classes of revenues shall be aggregated and combined with other gross receipts or gross revenues from sources within Iowa to compose the numerator. The denominator shall be computed in accordance with 701—subrule 54.2(2).

54.7(5) Radio and television companies doing business within and without Iowa shall determine their Iowa proportion of gross receipts or gross revenues derived from broadcasting operations by taking the proportion of the Iowa population served by broadcasting to the total population served by broadcasting. The population served by broadcasting shall be determined by a recognized market survey such as Arbitron. As used in this rule the term "population served by broadcasting" includes all of the residents of the broadcasting area, whether or not these residents individually elect to receive the broadcasts.

EXAMPLE: A television company has its studio and transmitter in state A. The activities of the employees and corporate officers of the television company in Iowa include solicitation of advertising, covering special news events and covering athletic events. The broadcast signal also reaches state B but the television company does not conduct any activities in state B. The population served by broadcasting is as follows: 100,000 in Iowa, 100,000 in state A, and 50,000 in state B for a total population served by broadcasting of 250,000. The television company's apportionment factor would be computed as follows: The numerator would be the Iowa population served by broadcasting and the denominator would be the total population served by broadcasting (100,000 ÷ 250,000 = 40%).

Subrule 54.7(5) is effective for tax years beginning on or after January 1, 1988.

54.7(6) Corporations in the business of publishing, selling, licensing, or distributing newspapers, magazines, periodicals, trade journals, or other printed material, or which publish, sell, license or distribute in a filmed or microfilmed image, or in an electronic media, an electronic virtual storage system or broadcasts any of the above items which have been traditionally disseminated in a printed format shall determine the Iowa portion of gross receipts by the following methodology:

a. Gross receipts from the sale of tangible personal property including printed materials, electronic storage media, fees for use of an electronic virtual storage system or fees to receive a broadcast delivered, shipped or broadcast to a purchaser or a subscriber in this state.

b. Gross receipts from advertising shall be attributed to Iowa as determined by the taxpayer's circulation factor during the tax period. The circulation factor shall be determined for each individual publication of the taxpayer containing advertising and shall be equal to the ratio that the taxpayer's Iowa circulation to purchasers and subscribers of its printed material, electronic storage media, electronic virtual storage system or broadcasts containing advertising bears to its total circulation to purchasers and subscribers everywhere.

The circulation factor for an individual publication shall be determined by reference to the rating statistics as reflected in such sources as the Audit Bureau of Circulations or other comparable sources, provided that the source selected is consistently used from year to year for such purpose. If none of the foregoing sources are available, or, if available, none is in a form or content sufficient for such purposes, then the circulation factor shall be determined from the taxpayer's books and records.

c. When specific items of advertisement can be shown, upon clear and convincing evidence, to have been distributed solely to a limited regional or local geographic area of which this state is a part, the taxpayer may petition, or the director may require, that all or a portion of such receipts be attributed to this state on the basis of a regional or local geographic area circulation factor and not upon the basis of the circulation factor provided by *"b"* above.

Such attribution shall be based on the ratio that the taxpayer's circulation to purchasers and subscribers located in this state bears to its total circulation to purchasers and subscribers located within such regional or local geographic area. This alternative attribution method shall be permitted only on the condition that such receipts are not double counted or otherwise included in the numerator of any other state.

This rule is intended to implement Iowa Code section 422.33.

701—54.8(422) Apportionment of income derived from more than one business activity carried on within a single corporate structure. Net income from corporations where more than one business activity is conducted within a single unitary corporate structure shall be apportioned by combining gross receipts or gross revenues of each business activity in the business activity ratio. Where necessary, formulas authorized by the department's rules or statute shall be used to ascertain the gross receipts from such business activities.

EXAMPLE: The taxpayer is engaged in the business of both manufacture of tangible personal property and trucking. During the tax year, the taxpayer received $1,000,000 in gross receipts, $400,000 of which was from its manufacturing operations and $600,000 of which was from its trucking operations. In its trucking operations, the taxpayer traveled 100,000 miles in Iowa and 400,000 everywhere, and in its manufacturing operations, $300,000 of sales were attributable to this state. The numerator of the business activity ratio would be $450,000, which includes $300,000 from manufacturing operations and $150,000 (100,000/400,000 × 600,000 = 150,000) from trucking operations. See subrule 54.7(2). The denominator of the business activity ratio would be $1,000,000.

This rule is intended to implement Iowa Code section 422.33.

701—54.9(422) Allocation and apportionment of income in special cases. If a taxpayer feels that the allocation and apportionment method as prescribed by Iowa Code subsection 422.33(2), or 701—Chapter 54, in the taxpayer's case results in an injustice, the taxpayer may petition the department for permission to determine the taxable net income, both allocable and apportionable, to the state on some other basis.

The taxpayer must first file the return as prescribed by Iowa Code subsection 422.33(2), and pay the tax shown due thereon. If a change to some other method is desired, a statement of objections and schedules detailing such alternative method shall be submitted to the department. The department shall require detail and proof within such time as the department may reasonably prescribe. In addition, the alternative method of allocation and apportionment will not be allowed where the taxpayer fails to produce, upon request of the department, any information the department deems necessary to analyze the request for an alternative method of allocation and apportionment. Such petition must be in writing and shall set forth in detail the facts upon which the petition is based. The burden of proof will be on the taxpayer as to the validity of the method and its results. The mere fact that an alternative method of apportionment or allocation produces a lesser amount of income attributable to Iowa is, per se, insufficient proof that the statutory method of allocation and apportionment is invalid. *Moorman Manufacturing Company v. Bair,* 437 U.S. 267, 57 L.Ed.2d 197(1978). In essence, a comparison of the statutory method of apportionment with another formulary apportionment method is insufficient to prove that the taxpayer would be entitled to the alternative formulary apportionment method. *Moorman Manufacturing Company v. Bair,* supra.

One of the possible alternative methods of allocation and apportionment is separate accounting provided the taxpayer's activities in Iowa are not unitary with the taxpayer's activities outside Iowa. Any corporation deriving income from business operations partly within and partly without Iowa must determine that net business income attributable to this state by the prescribed formula for apportioning net income, unless the taxpayer proved by clear and cogent evidence that the statutory formula apportions income to Iowa out of all reasonable proportion to the business transacted within Iowa. *Moorman Manufacturing Company v. Bair,* supra.

The burden of proof that the statutory method of apportionment attributes to Iowa income out of all reasonable proportion to the business transacted within Iowa is on the taxpayer. In order to utilize separate accounting, the taxpayer's books and records must be kept in a manner that accurately depicts the exact geographical source of profits. In any petition to utilize separate accounting, the taxpayer must submit schedules which accurately depict net income by division or product line and the amount of income earned within Iowa.

Separate accounting is not allowable for a unitary business where the separate accounting method fails to consider factors of profitability resulting from functional integration, centralization of management, and economics of scale. *Shell Oil Company v. Iowa Department of Revenue,* 414 N.W.2d 113 (Iowa 1987).

There are alternative methods of separate accounting utilizing different accounting principles. A mere showing that one separate accounting method produces a result substantially different than the statutory method of apportionment is not sufficient to justify the granting of the separate accounting method shown. The taxpayer must not only show that the separate accounting method advocated by the taxpayer in comparison with the statutory method of apportionment produces a result which, if the statutory method of apportionment were used, would be out of all reasonable proportion to the business transacted within Iowa. The taxpayer must also show that all other conceivable reasonable separate accounting methods would show, when compared with the statutory method of apportionment, that the statutory method of apportionment substantially produces a distorted result.

As used in this rule "statutory method of apportionment" means the Iowa single sales factor formula set forth in Iowa Code section 422.33, subsection 2, paragraph *"b,"* and the apportionment methods set forth in 701—Chapter 54.

All requests to use an alternative method of allocation and apportionment submitted to the department will be considered by the audit division if the request is the result of an audit or by the policy section of the technical services division if the request is received prior to audit. If the department concludes that the statutory method of allocation and apportionment is, in fact, both inapplicable and inequitable, the department shall prescribe a special method. The special method of allocation and apportionment prescribed by the department may be that requested by the taxpayer or some other method of allocation and apportionment which the department deems to equitably attribute income to business activities carried on within Iowa.

If the taxpayer disagrees with the determination of the department, the taxpayer may file a protest within 60 days of the date of the letter setting the department's determination and the reasons therefor in accordance with rule 701—7.8(17A). The department's determination letter shall set forth the taxpayer's rights to protest the department's determination.

If no protest is filed within the 60-day period, then no hearing will be granted on the department's determination under this rule. However, this does not preclude the taxpayer from subsequently raising this question in the event that the taxpayer protests an assessment or denial of a timely refund claim, but this issue will only be dealt with for the years involved in the assessment or timely refund claim.

The use of an alternative method of allocation and apportionment would only be applicable to the years under consideration at the time the special method of allocation and apportionment is prescribed. The taxpayer's continued use of a prescribed method of allocation and apportionment will be subject to review and change within the statutory or legally extended period(s).

If there is a material change in the business operations or accounting procedures from those in existence at the time the taxpayer was permitted to determine the net income earned within Iowa by an alternative method of allocation and apportionment, the taxpayer shall apprise the department of such changes prior to filing its return for the current year. After reviewing the information submitted, along with any other information the department deems necessary, the department will notify the taxpayer if the alternative method of allocation and apportionment is deemed applicable.

This rule is intended to implement Iowa Code section 422.33.

[Filed 12/12/74]
[Filed 12/10/76, Notice 9/22/76—published 12/29/76, effective 2/2/77]
[Filed 10/14/77, Notice 9/7/77—published 11/2/77, effective 12/7/77]
[Filed 9/18/78, Notice 7/26/78—published 10/18/78, effective 11/22/78]
[Filed 12/7/79, Notice 10/31/79—published 12/26/79, effective 1/30/80]
[Filed emergency 7/17/80—published 8/6/80, effective 7/17/80]
[Filed 1/16/81, Notice12/10/80—published 2/4/81, effective 3/11/81]
[Filed 11/20/81, Notice 10/14/81—published 12/9/81, effective 1/13/82]
[Filed emergency 10/26/82—published 11/10/82, effective 10/26/82]
[Filed 12/16/83, Notices 9/14/83, 11/9/83—published 1/4/84, effective 2/8/84]
[Filed 2/10/84, Notice 1/4/84—published 2/29/84, effective 4/5/84]
[Filed 3/8/85, Notice 1/30/85—published 3/27/85, effective 5/1/85]
[Filed 4/18/86, Notice 3/12/86—published 5/7/86, effective 6/11/86]
[Filed 8/22/86, Notice 7/16/86—published 9/10/86, effective 10/15/86]
[Filed emergency 11/14/86—published 12/17/86, effective 11/14/86]
[Filed 10/16/87, Notice 9/9/87—published 11/4/87, effective 12/9/87]
[Filed 4/13/88, Notice 3/9/88—published 5/4/88, effective 6/8/88]
[Filed 8/16/89, Notice 7/12/89—published 9/6/89, effective 10/11/89]
[Filed 10/27/89, Notice 9/20/89—published 11/15/89, effective 12/20/89]
[Filed 1/19/90, Notice 12/13/89—published 2/7/90, effective 3/14/90]
[Filed 7/2/92, Notice 5/27/92—published 7/22/92, effective 8/26/92]◊
[Filed 9/11/92, Notice 8/5/92—published 9/30/92, effective 11/4/92]
[Filed 1/12/95, Notice 12/7/94—published 2/1/95, effective 3/8/95]
[Filed 2/24/95, Notice 1/4/95—published 3/15/95, effective 4/19/95]
[Filed 12/1/95, Notice 10/25/95—published 12/20/95, effective 1/24/96]
[Filed 2/9/96, Notice 1/3/96—published 2/28/96, effective 4/3/96]
[Filed 9/20/96, Notice 8/14/96—published 10/9/96, effective 11/13/96]
[Filed 10/17/97, Notice 9/10/97—published 11/5/97, effective 12/10/97]

◊Two ARCs