The charge for preliminary art must be billed separately to the client, either on a separate billing or separately charged for on the billing for the finished art. It must be clearly identified on the billing as preliminary art, of one or more of the types mentioned in the preceding paragraph. Proof of ordering or producing the preliminary art prior to date of contract or approval for finished art shall be evidenced by purchase orders of the buyer, or by work orders or other records of the seller.

The following situations are examples of when the sale of "finished art" is taxable:

a. Finished art which is sold to customers to be used for advertising purposes in newspapers, magazines or the like. After the advertiser contracts with the ad agency for the development of an advertising message or theme, the agency devises ideas (preliminary art) and produces the finished art. The finished art is then delivered to the advertiser or to an agent of the advertiser such as a printer or publisher who is under contract with the advertiser to publish the ad.

b. Finished art which is sold to customers, or their agents (e.g., printers), for use in producing printed material. The charge for finished art is taxable even though the art work may later be returned to the ad agency by the purchaser or the printer or used by the customer or the customer's agent to produce a nontaxable item. Since the finished art is not a part of the printed materials, the ad agency's customer is consuming the material and not buying it for resale, or using it in an exempt manner.

c. Finished art which is used to produce other tangible personal property sold by the ad agency such as letterhead stationery and business cards. The charge for such art is taxable as part of the selling price for such stationery or business cards. This is true whether or not the agency separately itemizes the charge for such stationery or business cards.

18.27(5) *Items purchased by agency, artist or designer.* An advertising agency, artist, or designer is the consumer of tangible personal property used in the operation of its business, such as stationery, ink, paint, tools, drawing tables, T-squares, pens, pencils, and other office supplies. Tax applies to the sale of such property to the agency, artist, or designer. Tax also applies where the agency, artist or designer is the consumer of taxable services.

The agency, artist, or designer is the seller of, and may purchase for resale, any item resold before use, or that becomes physically an ingredient or component part of tangible personal property sold, as, for example, illustration board, paint, ink, rubber cement, flap paper, wrapping paper, photographs, photostats, or art purchased from other artists. Tax also applies where the agency, artist, or designer is the seller at retail of taxable services.

In the event that an agency, artist, or designer is both a consumer and a retailer of such items of tangible personal property as noted in this subsection, such agency, artist or designer should:

a. Purchase such items without tax liability if the majority of the items are sold at retail and remit the tax at the time of resale or at the time such items are consumed in the operation of the business.

b. Pay tax to suppliers at the time of purchase if the majority of the items will be consumed in the operation of the business and deduct the original cost of any such items subsequently sold at retail when reporting tax on their returns.

18.27(6) *Construction.* Nothing contained in this rule shall be construed to provide for an exemption from tax for services expressly taxable in rules 701—26.17(422) and 26.39(422).

18.27(7) *Advertising agencies, commercial artists and designers as agent of client or as a nonagent.*

a. In general. A true agent relationship depends upon the facts with respect to each transaction. An agent is one who represents another, called the principal, in dealings with third persons. Advertising agencies, commercial artists, and designers may act as agents on behalf of their clients in dealing with third persons or they may act on their own behalf. To the extent advertising agencies, artists and designers act as agents of their clients in acquiring tangible personal property, they are neither purchasers of the property with respect to the supplier nor sellers of the property with respect to their principals.

b. When advertising agencies, commercial artists, and designers act as agents of their clients in purchasing property for their clients, the tax applies to the gross receipts from the sale of such property to the advertising agencies, commercial artists, and designers. Unless such advertising agencies, commercial artists and designers act as true agents, they will be regarded as the retailers of tangible personal property furnished to their clients and the tax will apply to the total amount received for such property. Further, nothing in this rule should be construed to be in variance with the opinion of the Iowa Supreme Court in *Rowe vs. Iowa State Tax Commission*, 249 Iowa 1207, 91 N.W.2d 548 (1958).

c. To establish that a particular acquisition is made in the capacity of an agent for a client, advertising agencies, commercial artists, and designers (collectively herein referred to as agency) shall act as follows:

1. The agency must clearly disclose to the supplier the name of the client for whom the agency is acting as an agent.

2. The agency must obtain, prior to the acquisition, and retain written evidence of agent status with the client.

3. The price billed to the client, exclusive of any agency fee, must be the same as the amount paid to the supplier. The agency may make no use of the property for its own account, such as commingling the property of a client with another, and the reimbursement for the property should be separately invoiced or shown separately on the invoice to the client.

d. Some charges may represent reimbursement for tangible personal property acquired by the agency as agents for its clients and compensation for performing of agency services related thereto. When an advertising agency, commercial artist, or designer establishes that it has acquired tangible personal property as agents for its clients, tax does not apply to the charge made by the agency to its client for reimbursement charges by a supplier or to the charges made for the performance of the agency's services directly related to the acquisition of personal property.

e. Advertising agencies, commercial artists, and designers acting as agents shall not issue resale certificates to suppliers.

f. Advertising agencies, commercial artists, and designers act as retailers of all items of tangible personal property produced or fabricated by their own employees when they sell to their clients. Advertising agencies, commercial artists, and designers are not agents of their clients with respect to the acquisition of materials incorporated into items of tangible personal property prepared by their employees and sold at retail to their clients.

18.27(8) *Scope.* The scope of this rule is not confined simply to advertising agencies, commercial artists and designers, but also applies to all other businesses whose activities would bring them within the scope of this rule (e.g., printers).

This rule is intended to implement Iowa Code sections 422.43 and 423.2.

701—18.28(422,423) Casual sales.

18.28(1) *Casual sales by persons not retailers or by retailers outside the regular course of business.* Casual sales are exempt from the Iowa sales and use taxes except for the casual sale of vehicles subject to registration, and vehicles subject only to the issuance of a certificate of title. On and after July 1, 1988, the casual sale of aircraft is also taxable. In order for a casual sale to qualify for exemption under this subrule, two conditions must be present: (1) the sale of tangible personal property or taxable services must be of a nonrecurring nature, and (2) the seller, at the time of the sale, must not be engaged for profit in the business of selling tangible goods or services taxed under Iowa Code section 422.43 or, if so engaged, the sale must be outside the regular course of the seller's business (Order of State Board of Tax Review, Martin Development Corporation, Docket No. 136, December 1, 1976, incorporating by reference Order of Department of Revenue Hearing Officer in Docket No. 75-28-6A-A, July 9, 1976). See subrule 18.28(2) for an explanation of the casual sale exemption applicable to the liquidation of a trade or business.

If either of the conditions above are lacking, no casual sale occurs. Moreover, prior to July 1, 1985, the casual sale exemption was limited to sales of tangible personal property, and casual enumerated taxable services did not qualify for the exemption. *KTVO, Inc. v. Bair,* Equity No. 385 Linn County District Court, September 5, 1975.

For the purposes of this subrule, the word "aircraft" refers to any contrivance now known or hereafter invented, which is designed or used for navigation of or flight in the air, for the purpose of transporting persons, property, or both or for crop dusting, aerial surveillance, recreational flying, or for providing some other service. By way of nonexclusive example, balloons, gliders, helicopters, and "ultra lights" are aircraft. Also included within the meaning of the word "aircraft" is any craft registered under Iowa Code section 328.20 or any successor statute thereto.

Sales of capital assets such as equipment, machinery, and furnishings which are not sold as inventory shall be deemed outside the regular course of business (including sales of capital assets during a retailer's liquidation) and the casual sales exemption shall apply as long as such sales are nonrecurring. This will include transactions exempted from state and federal income tax under Section 351 of the Internal Revenue Code.

Two separate selling events outside the regular course of business within a 12-month period shall be considered nonrecurring. Three such separate selling events within a 12-month period shall be considered as recurring. Tax shall only apply commencing with the third separate selling event. However, in the event that a sale event occurs consistently over a span of years, such sale is recurring and not casual, even though only one sales event occurs each year. *Des Moines Police Department v. Bair,* Equity No. CE3-1591, Polk County District Court, November 1, 1976.

EXAMPLE: Corporation A sells the company copy machine at retail to B. At the time of this sale, Corporation A is engaged in the business for profit of selling clothes at retail. Assuming that the sale of the copy machine constitutes a sale of a nonrecurring nature, there is a casual sale because the sale is outside the regular course of Corporation A's business.

EXAMPLE: Corporation C is engaged in the business of lending money secured by collateral. In the course of such business, Corporation C must repossess some collateral and sell it at retail for purposes of payment of loans. Such sales recur from time to time. Notwithstanding that Corporation C is presumably not engaged in the business of selling tangible goods or services for a profit, since the sales are recurring, there is no casual sale. *S & M Finance Co., Fort Dodge v. Iowa State Tax Commission,* 1968, Iowa 162 N.W.2d 505.

EXAMPLE: F, a farmer, does not sell tangible personal property at retail or engage in the performance of any taxable services. F liquidates the farming business and hires a professional auctioneer to auction off many items of tangible personal property. Assuming this liquidation event is casual, all items sold by the auctioneer at retail are casual sales notwithstanding that many different sales to numerous different buyers may occur. See rule 18.8(422).

EXAMPLE: H, an insurance agency, holds a semiannual event to sell its used office furniture. Even though H does not regularly sell tangible personal property at retail, the casual sale exemption does not apply because the selling events are recurring. *Des Moines Police Department v. Bair,* Equity No. CE3-1591, Polk County District Court, November 1, 1976.

EXAMPLE: I, a corporation, has one sales event every year whereby it auctions off capital assets which it has no use for or desires to replace. This event has been a planned function of I and is conducted regularly and consistently over a span of years. Even though this sale event occurs only once a year, it is of a recurring nature because of the pattern of repetitiveness present and, therefore, the casual sale exemption would not apply, regardless of the number of items sold at such sale event each year.

EXAMPLE: J, a corporation engaged in the sale for resale of tangible personal property, sells three capital assets used in J's trade or business consisting of a copy machine, a desk, and a computer. Each sale is made to different buyers and is unrelated to the other sales. The three sales occur in January, June, and October of the same year. The sale made in October consists of a desk. J has not established a pattern of recurring sales of capital assets prior to aforementioned sales of capital assets. Under these circumstances, the sale of the desk is not a casual sale, but the sales of the copy machine and the computer are casual and exempt.

EXAMPLE: K, a corporation, is primarily engaged in the business of road construction. From time to time, it sells used capital assets and scrap materials reclaimed from its road construction work to individuals and businesses. It does not advertise itself as a retailer of these assets and materials but sells them as a matter of courtesy to persons who cannot purchase them elsewhere. After 42 years of operation, it decides to liquidate. Pursuant to that decision, K employs two auctioneers to sell its capital assets and ceases operation after its assets are sold. K had only one capital asset sale during the 12 months immediately preceding each liquidation auction sale. The auction sales are exempt casual sales under this subrule (1) because they are nonrecurring, and (2) because K is not a retailer of the capital assets sold during its liquidation. See *Holland Bros. Construction Co., Inc. v. Iowa State Board of Tax Review*, 611 N.W.2d 495 (Iowa 2000).

EXAMPLE: L, a sole proprietorship, engaged in selling automobile parts at retail, incorporated. The assets of L are sold to the new corporation in exchange for stock and the new corporation now engages in selling automobile parts at retail. The casual sale exemption would apply, but only because of the exemption set out in subrule 18.28(2) infra, since the transfer involves a liquidation of L's business and the sale of L's inventory to another person (the corporatin) which will continue to engage in a similar trade or business.

The above examples are not the only ones pertaining to the questions of whether a casual sale did or did not occur. However, because of the myriad of factual situations which can and do exist, it is not possible to formulate more detailed rules on this subject matter.

18.28(2) *Special rules for casual sales involving the liquidation of a trade or business.* When retailers sell all or substantially all of the tangible personal property held or used in the course of the trade or business for which retailers are required to hold a sales tax permit, the casual sale exemption will apply to exempt those sales only when the following circumstances exist: (1) the trade or business must be transferred to another person, and (2) the transferee must engage in a similar trade or business. The trade or business transferred refers to the place where the business is located since each taxable retail business must have a sales tax permit at each location. For purposes of this casual sale circumstance, it is irrelevant whether the retailer actually has a sales tax permit or not; rather, the relevant circumstance is that the retailer was required to have a sales tax permit. See *Holland Bros. Construction Co., Inc. v. Iowa State Board of Tax Review*, 611 N.W.2d 495 (Iowa 2000). One effect of this is that a retailer who is closing as opposed to transferring a business and is selling inventory in the process of this closing is not entitled to claim the casual sale exemption under this subrule, but see subrule 18.28(1), and the resale exemption is always potentially applicable to sales of inventory. See the examples below for further explanation.

EXAMPLE: L, a hardware store, desires to liquidate the business. L had been selling tangible personal property at retail and was required to have an Iowa retail sales tax permit. L hires a professional auctioneer and all items of inventory, equipment, and fixtures are sold to various purchasers. These items consist of all or substantially all of the tangible personal property held or used by L in the course of the business for which a sales tax permit was required to be held. L, however, does not transfer the trade or business to anyone else. Under these circumstances, the casual sales exemption does not apply to the sale of the inventory, but see subrule 18.28(1) for criteria which determine whether the casual sales exemption applies to the equipment and fixtures.

EXAMPLE: The facts are the same as those in the previous example, except that L is liquidating its business because it attempted to build a new store and its entire inventory was destroyed by fire while in storage. An auctioneer sells L's equipment and trade fixtures to various purchasers. The auctioneer's sale of the equipment and trade fixtures is an exempt casual sale of the type described in subrule 18.28(1) because (1) it is nonrecurring, and (2) it is outside the usual course of L's business. See *Holland Bros. Construction Co., Inc.*, supra.

EXAMPLE: M, a sole proprietorship, incorporated. The assets of M are sold to the new corporation for stock. The new corporation engaged in a similar business. The casual sale exemption would apply.

EXAMPLE: N, an oil company, sells all or substantially all of the tangible personal property of ten company-owned service stations which were held or used in the course of its business, for which N was required to hold a sales tax permit, by bulk sales or otherwise. The sales were made to O, P, and Q and occurred at different times during the same year, each sale being unrelated. N was required to have a sales tax permit for each service station. N transferred its trade or business (each service station) to O, P, and Q, each of whom will engage in the same business N did, i.e., operation of service stations. Even though under these circumstances, the sales by N are recurring, the casual sales exemption would apply since each trade or business was transferred to another person who did engage in a similar trade or business.

EXAMPLE: R, an operator of a restaurant, auctions off to various purchasers who are not engaged in the restaurant business all or substantially all of the tangible personal property held or used in the business for which R was required to hold a retail sales tax permit. R transfers the trade or business to S who then operates a restaurant at the same location R did. Even if S did not purchase any of the tangible personal property, under these circumstances, the casual sales exemption applies. The tangible personal property held or used in the trade or business need not be sold to the same person to whom the trade or business is sold for the exemption to apply.

EXAMPLE: T, a restaurant, sells all of its tangible personal property held or used in the course of its business for which it was required to hold a sales tax permit to U. T also sells its trade or business to U. U engages in the business of operation of a dance hall and does not continue to operate the restaurant. This subrule's casual sales exemption will not apply, but see subrule 18.28(1) for the criteria of a casual sale exemption which could apply.

The above examples are not the only ones pertaining to the questions of whether a casual sale did or did not occur. However, because of the myriad of factual situations which can and do exist, it is not possible to formulate more detailed rules on this subject matter.

18.28(3) *Casual sales of services.* Special rule for services rendered, furnished, or performed on or after July 1, 1985. The "casual sale" of an enumerated service has occurred if the following circumstances exist:

a. The service was rendered, furnished, or performed on or after July 1, 1985; and

b. The service was rendered, furnished, or performed on a nonrecurring basis by a seller who, at the time of the sale of the service, is not engaged for profit in the business of selling tangible goods or services taxed under Iowa Code section 422.43, or, if so engaged, the sale was outside the regular course of the seller's business; or

c. The sales of all, or substantially all of the services held or used by a retailer in the course of the retailer's trade or business for which the retailer is required to hold a sales tax permit, if the retailer sells or otherwise transfers the trade or business to another person who engages in a similar trade or business.

EXAMPLE: V ordinarily engages in janitorial and building maintenance or cleaning which are taxable services; see rule 701—26.60(422). Once, as a favor to customer W, V cut customer W's lawn and otherwise performed the taxable service of "lawn care" for customer W. Since this performance of lawn care was not "within V's regular course of business" and was not "recurring," gross receipts from the lawn care are not subject to tax.

EXAMPLE: Corporation X rents a piece of equipment from Y. Y does not otherwise rent equipment and does not engage in the business for profit of selling tangible goods or taxable enumerated services. A casual sale qualifying for the exemption exists.

This rule is intended to implement Iowa Code sections 422.42(12), 422.45(6) and 423.4.

701—18.29(422,423) Processing, a definition of the word, its beginning and completion characterized with specific examples of processing.

18.29(1) *Processing—a definition.* For the purpose of these rules, "processing" means an operation or a series of operations whereby tangible personal property is subjected to some special treatment by artificial or natural means which changes its form, context, or condition, and results in marketable tangible personal property. These operations are commonly associated with fabricating, compounding, germinating, or manufacturing. *Linwood Stone Products Co. v. State Department of Revenue,* 175 N.W.2d 393 (Iowa 1970).

18.29(2) *The beginning of processing.* Processing begins when the "form, context, or condition" of tangible personal property is changed with the intent of eventually transforming the property into a saleable finished product. The severance of raw material from real estate is not processing, even if this severance results in a change in the form, context, or condition of the real estate. *Linwood Stone Products Co. v. State Department of Revenue,* 175 N. W.2d 393 (Iowa 1970). Furthermore, transportation of raw material after it is severed from real estate but prior to the time the initial change in the form, context, or condition of the raw material occurs is not processing. *Southern Sioux County Rural Water System, Inc. v. Iowa Department of Revenue,* 383 N.W.2d 585 (Iowa 1986).

18.29(3) *The completion of processing.* Processing ends when the property being processed is in the form in which it is ultimately intended to be sold at retail, *Hy-Vee Food Stores v. Iowa Department of Revenue,* 379 N.W.2d 37 (Iowa App. 1985). The storage or transport of property after that property is transformed into a finished product is not a part of processing.

18.29(4) *Examples of when processing begins and ends.* The following examples are intended to clarify but not to contradict the explanation of processing set out in subrules 18.29(2) and 18.29(3).

EXAMPLE A: A company blasts limestone from the ground, bulldozers pick the limestone up and put it in trucks; these trucks transport the limestone to a crusher some distance from the quarry site. The first change in the "form" or "condition" of the limestone, while it is tangible personal property, occurs when the stone is crushed in the crusher. The blasting of the stone from the ground and its transport to the crusher would be acts preparatory to and not a part of processing. Thus, fuel used in the bulldozers and transport trucks would not be fuel used in processing, *Linwood Stone Products,* supra.

EXAMPLE B: Pumps remove water from underground wells and pump that water through pipes to a water treatment plant. At the treatment plant, the water passes initially through an aeration system which adds oxygen to it. At other points in the plant, potassium and chlorine are added to the water and iron is removed. After these acts are performed, clean, drinkable water exists. The first change, however, in the condition of the water occurs when it passes through the aeration system and oxygen is added to it. The withdrawal of the water from the ground and its transport to the aeration system would not be a part of processing. Thus, electricity used by the pumps which pump the water to the aeration system would not be used in processing. However, by way of contrast, electricity used to transport the water between, for example, the aeration system and the point where potassium is added to the water would be used in processing. *Southern Sioux Rural Water System, Inc.,* supra.

EXAMPLE C: Water is processed in a treatment plant. The last act at the plant necessary to render the water drinkable or a "finished product" is the addition of chlorine. After the addition of chlorine, the water is pumped first into wells and later into water towers where it is held for distribution. The pumping of this drinkable water from the point where the chlorine is added to the wells and the tower is not a part of processing because processing of the water ended with the addition of the chlorine; thus, electricity used in these pumps is not electricity used in processing. *Southern Sioux County Rural Water System, Inc.,* supra.

18.29(5) *Integral part of the production of the product test.* Certain activities may be exempt as part of processing if those activities are very closely interconnected with, or an integral part of, the operation of the processing equipment while processing is occurring. *Southern Sioux Rural Water System, Inc.,* supra. Merely because an activity is vital or essential to a processing operation does not make that activity exempt as part of processing unless the activity itself is closely interconnected with, or an integral part of, the operation of the processing equipment while processing is occurring. *Mississippi Valley Milk Producers Ass'n v. Iowa Dept. of Revenue,* 387 N.W.2d 611 (Iowa App. 1986). See the nonexclusive example below.

A manufactures nails. In A's factory is a machine which draws steel into long rods the width of whatever nail A may wish to manufacture. After this machine draws the steel into the desired-size rods, the rods are moved to a second machine by a conveyor belt. This second machine cuts the rods into the length of nail which A desires. A second conveyor belt then transports these cut rods to a third machine which sharpens one end of the rod to a point and puts a "nail head" on the other end of the rod. The activities of the three machines are clearly processing, in that they are activities which change the form, context or condition of raw material, and as a result of those activities, marketable tangible personal property or a finished product is created. The two conveyor belts move the partially finished nails from one piece of processing equipment to another while processing is occurring. Since the activities of the conveyors are very closely interconnected with and an integral part of the operation of the various pieces of processing equipment while processing is occurring, the conveyor belts are involved in processing as well.

18.29(6) *Other specific examples of processing.* The Iowa Supreme Court has also stated that the following activities are processing: manufacturing ice, refrigerating cheese to age it from "green" to edible, refrigerating eggs to change their flavor, pasteurizing and subsequent refrigeration of milk, "hard" freezing of meat and butter for aging, canning vegetables and cooking foodstuffs; *Fischer Artificial Ice & Cold Storage Co. v. Iowa State Tax Commission,* 248 Iowa 497, 81 N.W.2d 437 (1957); and, *Mississippi Valley Milk Producers v. Iowa Dept. of Revenue and Finance,* 387 N.W.2d 611 (Ia. App. 1986), also crushing of "flat rock" limestone and treating limestone in kilns. *Linwood Stone Products Co. v. State Dept. of Revenue,* 175 N.W.2d 393 (Iowa 1970). See 701—subrule 17.3(2) for an expanded definition of processing with regard to food manufacturing.

18.29(7) *Other department rules concerned with processing.* Various sections of the Iowa Code set out activities which are defined by statute to be "processing". The rules interpreting these statutes for the purposes of sales and use tax law are the following:

a. 15.3(422,423) Certificates of resale, processing, and fuel used in processing.

b. 17.2(422) Fuel used in processing—when exempt.

c. 17.3(422,423) Electricity, steam, or other taxable services to be used in the processing of tangible personal property intended to be sold ultimately at retail are exempt from sales tax.

d. 17.9(422,423) Sales of breeding livestock, fowl, and certain other property used in agricultural production. See 701—subrules 17.9(4), 17.9(5), 17.9(6), and 17.9(7) for processing exemptions.

e. 17.14(422,423) Chemicals, solvents, sorbents, or reagents used in processing.

f. 18.3(422,423) Chemical compounds used to treat water.

g. 18.45(422,423) Sale or rental of computers, industrial machinery and equipment; refund of and exemption from tax paid for periods prior to July 1, 1997.

h. 18.58(422,423) Sales or rentals of machinery, equipment, and computers and sales of fuel and electricity to manufacturers and sales or rentals of computers to commercial enterprises for periods on and after July 1, 1997.

i. 26.2(422) Enumerated services exempt. See 701—subrule 26.2(2) for the processing exemption.

j. 28.2(423) Processing of property defined.

k. 33.3(423) Fuel consumed in creating power, heat, or steam for processing or generating electric current.

l. 33.7(423) Property used to manufacture certain vehicles to be leased.

701—18.30(422) Taxation of American Indians.

18.30(1) *Definitions.*

"American Indians" means all persons of Indian descent who are members of any recognized tribe.

"Settlement" means all lands within the boundaries of the Mesquakie Indian settlement located in Tama County, Iowa and any other recognized Indian settlement or reservation within the boundaries of the state of Iowa.

18.30(2) *Retail sales tax—tangible personal property.* Retail sales of tangible personal property made on a recognized settlement or reservation to Indians who are members of the tribe located on that settlement or reservation, where delivery occurs on the reservation, are exempt from tax *(Bryan v. Itasca County,* 426 U.S. 373, 376–77 (1976); *Moe v. Confederated Salish & Kootenai Tribes,* 425 U.S. 463, 475–81 (1976)). Retail sales of tangible personal property made on a recognized settlement or reservation to Indians where delivery occurs off the reservation are subject to tax. Retail sales of tangible personal property made to non-Indians on a recognized settlement or reservation are subject to tax regardless of where the delivery occurs. Sales made to non-Indians are taxable even though the seller may be a member of a recognized settlement or reservation.

18.30(3) *Retail sales tax—services.* Sales of enumerated taxable services and sales made by municipal corporations furnishing gas, electricity, water, heat, or communication services to Indians who are members of the tribe located on the recognized settlement or reservation where delivery of the service occurs are exempt from tax *(Bryan v. Itasca County,* 426 U.S. 373, 376–77 (1976); *Moe v. Confederated Salish & Kootenai Tribes,* 425 U.S. 463, 475–81 (1976)). Sales of enumerated taxable services or sales made by municipal corporations furnishing gas, electricity, water, heat, or communication services to Indians where delivery of the services occurs off a recognized settlement or reservation are subject to tax.

18.30(4) *Off-reservation purchases.* Purchases made by Indians off a recognized settlement or reservation are subject to tax if delivery occurs off the reservation. Purchases made by Indians off a recognized settlement or reservation are not subject to tax if delivery is made on the reservation to Indians who are members of the tribe located on that reservation.

See rule 701—33.5(423) for the taxation of tangible personal property and services where the state use tax may be applicable.

This rule is intended to implement Iowa Code sections 422.42, 422.43, and 422.45(1).

701—18.31(422,423) Tangible personal property purchased by one who is engaged in the performance of a service.

18.31(1) *In general. (Effective July 1, 1990)*

a. On and after July 1, 1990, tangible personal property purchased by one who is engaged in the performance of a service is purchased for resale and not subject to tax if (1) the provider and user of the service intend that a sale of the property will occur, and (2) the property is transferred to the user of the service in connection with the performance of the service in a form or quantity capable of a fixed or definite price value, and (3) the sale is evidenced by a separate charge for the identifiable piece or quantity of property.

b. Prior to July 1, 1990, in those circumstances in which tangible personal property is purchased by one who is engaged in the performance of a service and the property is transferred to the customer in conjunction with a performance of the service in a form or quantity which is capable of any fixed or definite price value, but the actual sale of the property is not indicated by a separate charge for the identifiable item, the burden of proving that the property was purchased for resale by one engaged in the performance of a service and not subject to tax at the time of purchase is upon the person engaged in the performance of a service who asserts this.

c. Tangible personal property which is not sold in the manner set forth in *"a"* or *"b"* above is not purchased for resale and thus is subject to tax at the time of purchase by one engaged in the performance of a service. Such tangible personal property is considered to be consumed by the purchaser who is engaged in the performance of a service and the person performing the service shall pay tax upon the sale at the time of purchase.

EXAMPLE: An investment counselor purchases envelopes. These envelopes are used to send out monthly reports to the investment counselor's clients regarding their accounts. Tax is due at the time the investment counselor purchases the envelopes if the clients are not billed for these items. Each envelope is transferred to a client in a form or quantity which is capable of a fixed or definite price value. However, there must also be an actual sale to the client (customer) of an item of personal property in order that there be a "resale" of the item.

An automobile repair shop purchases solvents which are used in cleaning automobile parts and thus in performing its automobile repair service. Tax is due at the time the automobile repair shop purchases the solvent since the solvents are not sold to the customer and, in this case, the item is not transferred to a customer in a form or quantity which is capable of a fixed or definite price value. Thus, the solvent is deemed consumed by the purchaser engaged in the performance of the service.

EXAMPLE: A retailer purchases television tubes tax-free where the retailer makes a separate charge for the tube to the customer and since the tube is transferred to the customer in a form or quantity capable of a fixed or definite price value.

EXAMPLE: A beauty or barber shop purchases shampoo and other items to be used in the performance of its service. Tax is due at the time the beauty or barber shop purchases such items from its supplier, where the customers of the beauty or barber shop are not separately billed for the item, and because it is not transferred to the customer in a form or quantity capable of a fixed or definite price value, it is being consumed by the beauty or barber shop.

EXAMPLE: A car wash purchases water, electricity, or gas used in the washing of a car. The car wash would be the consumer of the water, electricity, or gas and tax is due at the time of purchase. The items purchased by the car wash are not transferred to the customer in a form or quantity capable of a fixed or definite price value, and the customer is not billed for the item.

EXAMPLE: An accounting firm purchases plastic binders which are used to cover the reports issued to its customers. These binders would be subject to tax at the time of purchase by the firm where the customer of the firm is not billed for the item, there being no sale to the customer in such a case.

EXAMPLE: A meat locker purchases materials such as wrapping paper and tape which it uses to wrap meat for customers who provide the locker with the meat. These materials would be subject to tax at the time of purchase by the meat locker because they are not sold to the customer in a form or quantity capable of a fixed or definite price value.

EXAMPLE: A jeweler purchases materials such as main springs and crystals to be used in the performance of a service. These items are purchased by the jeweler for resale where they are transferred to the customer in a form or quantity capable of a fixed or definite price value and each item is actually sold to the customer as evidenced by a separate charge therefor.

EXAMPLE: A lawn care service applies fertilizer, herbicides, and pesticides to its customers' lawns. The following are examples of invoices to customers which are suitable to indicate a lawn care service's purchase of the fertilizer, herbicides, and pesticides for resale to those customers: "Chemicals...31 Gal....$60"; "Fertilizer...50 lbs....$100"; and "Materials applied to lawn...4 bushel...$40". The following are examples of information placed upon an invoice which would not indicate a purchase for resale to the customers invoiced: "Fifty percent of the charge for this service is for materials placed on a lawn," or "Lawn chemicals...$30" or "Fifty pounds of fertilizer was applied to this lawn."

18.31(2) *Purchases made by automobile body shops or garages with body shops (effective October 1, 1980).*

Tangible personal property purchased by body shops can be purchased for resale provided both of the following conditions are met:

1. The property purchased for resale is actually transferred to the body shop's customer by becoming an ingredient or component part of the repair work. See Iowa Code section 422.42(2) and *Cedar Valley Leasing Inc. v. Iowa Department of Revenue,* 274 N.W.2d 357 (Iowa 1979).

2. The property purchased for resale is itemized as a separate item on the invoice to the body shop's customer and is transferred to the customer in a form or quantity capable of a fixed or definite price value.

If either of the above two events is missing, there is no purchase for resale and the body shop is deemed the consumer of the item purchased.

When body shops purchase items which will be resold (see list of items in this rule) in the course of the repair activity, the vendors selling to the body shops are encouraged to accept a valid resale certificate at the time of purchase. See rule 701—15.3(422,423). Failure of the vendor to accept a valid resale certificate may subject that vendor to sales tax liability since the burden of proof would be on the vendor that a sale was made for resale. If the vendor cannot meet that burden, the vendor will be liable for the sales tax. Such burden is not met merely by a showing that the purchaser had obtained from the department an Iowa retail sales tax or retail use tax permit.

For insurance purposes, body shops are reimbursed by insurance companies for "materials" which such shops consume in rendering repair services. Some of the materials are transferred to the recipients of the repair services and some are not. Of those so transferred, such transfer is in irregular quantities and is not in a form or quantity capable of a fixed or definite price value. Therefore, body shops are generally deemed to be the consumers of materials and must pay tax on these items at the time of purchase. Nonexclusive examples of items most likely to be included in this category of "materials," whether actually transferred to customers of body shops or not, are as follows:

Abrasives
Accessories
Battery water
Body filler or putty
Body lead
Bolts, nuts and washers
Brake fluid
Buffing pads
Chamois
Cleaning compounds
Degreasing compounds
Floor dry
Hydraulic jack oil
Lubricants
Masking tape
Paint
Polishes

Rags
Rivets and cotter pins
Sand paper
Sanding discs
Scuff pads
Sealer and primer
Sheet metal
Solder
Solvents
Spark plug sand
Striping tape
Thinner
Upholstery tacks
Waxes
White sidewall cleaner

The following are nonexclusive examples of parts which can be purchased for resale since they are generally transferred to the body shop's customer during the course of the repair in a form or quantity capable of a fixed or definite price value and are generally itemized separately as parts.

Batteries
Brackets
Bulbs
Bumpers
Cab corners
Chassis parts
Doors
Door guards
Door handles
Engine parts
Fenders
Floor mats
Grills
Headlamps
Hoods
Hub caps
Radiators
Rocker panels
Shock absorbers
Side molding
Spark plugs
Tires
Trim
Trunk lids
Wheels
Window glass
Windshield ribbon
Windshields

The following are nonexclusive examples of tools and supplies which are generally not transferred to the body shop's customer during the course of the repair and therefore could not be purchased for resale. The body shop is deemed the consumer of these items since they are not transferred to a customer and therefore the body shop must pay tax to the vendor at the time of purchase.

Air compressors and parts
Body frame straightening equipment
Brooms and mops
Buffers
Chisels
Drill bit
Drop cords
Equipment parts
Fire extinguisher fluids
Floor jacks
Hand soap
Hand tools
Office supplies
Paint brushes
Paint sprayers
Sanders
Spreaders for putty
Signs
Washing equipment and parts
Welding equipment and parts

Because of the nature of their business and the formulas devised by the insurance industry to reimburse body shops for cost of "materials," it is possible for body shops, in their invoices to their customers, to separately set forth labor, resold parts, and materials. While the materials can be separately invoiced as one general item, there is no way to ascertain a definite and fixed price for each item of the materials listed in this rule and consumed by the body shops and some of such individual materials are not even transferred by body shops to their customers. Therefore, the body shops are generally the "consumers" of "materials" and do not purchase them for resale. *W. J. Sandberg Co. v. Iowa State Board of Assessments and Review,* 225 Iowa 103, 278 N.W. 643 (1938). Thus, body shops should pay tax to their suppliers on all materials purchased and consumed by them. If materials are purchased from non-Iowa suppliers who do not collect Iowa tax from body shops, such body shops should remit consumer use tax to the Department of Revenue and Finance on such materials.

Body shops must collect sales tax on the taxable service of repairing motor vehicles. See rule 701—26.5(422). However, due to the nature of the insurance formulas, it is possible for body shops to itemize that portion of their billing which would be for repair services and that portion relating to consumed "materials." It is also possible for body shops to itemize that portion of their charges for parts which they purchase for resale to their customers. Body shops do not and cannot resell the tools and supplies previously listed in this rule and are taxable on their purchases of such items.

Therefore, as long as body shops separately itemize on their invoices to their customers the amounts for labor, parts, and for "materials," body shops should collect sales tax on the labor and the parts, but not on the materials as enumerated in this rule.

EXAMPLE: A body shop repairs a motor vehicle by replacing a fender and painting the vehicle. In doing the repair work, the body shop uses rags, sealer and primer, paint, solder, thinner, bolts, nuts and washers, masking tape, sandpaper, waxes, buffing pads, chamois, solder and polishes. In its invoice to the customer, the labor is separately listed at $300, the part (fender) is separately listed at $300, and the category of "materials" is separately listed for a lump sum of $100, for a total billing of $700. The Iowa sales tax computed by the body shop should be on $600 which is the amount attributable to the labor and the parts. The materials consumed by the body shop were separately listed and would not be included in the tax base for "gross taxable services" as defined in Iowa Code subsection 422.42(16), which is taxable in Iowa Code section 422.43.

In this example, if the "materials" were not separately listed on the invoice, but had been included in either or both of the labor or part charges by marking up such charges, the body shop would have to collect sales tax on the full charges for parts or labor even though tax was paid on materials by the body shop to its supplier at time of purchase.

This rule is intended to implement Iowa Code sections 422.42, 422.43 and 423.2.

701—18.32(422,423) Sale, transfer or exchange of tangible personal property or taxable enumerated services between affiliated corporations.

18.32(1) *In general.* The sale, transfer or exchange of tangible personal property or taxable services among affiliated corporations, included but not limited to a parent corporation to a subsidiary corporation, for a consideration is subject to tax. A bookkeeping entry for an "account payable" qualifies as consideration as well as the actual exchange of money or its equivalent. Transactions between affiliated corporations may not be subject to tax where it can be shown that the affiliated corporations are operating as a unit within the meaning of Iowa Code sections 422.42(1) and 423.1(8).

18.32(2) *Affiliated corporations acting as a unit.* If an affiliated corporation acts as an agent for the other affiliated corporation in a transaction listed in 18.32(1) such corporation shall be considered as acting as a unit as set forth herein and such transactions may not be subject to tax.

This rule should not be equated with the unitary business concept used in corporation income tax law.

This rule is intended to implement Iowa Code sections 422.42(1) and 423.1(8).

701—18.33(422,423) Printers' and publishers' supplies exemption with retroactive effective date.

18.33(1) For the purposes of this rule, a "printer" is any person, a portion of whose business involves the completion of a finished, printed product for sale at retail by that person or another person. A "printer" is also any person, a portion of whose business involves the completion of a finished printed packaging material used to package products for ultimate sale at retail. The term "printer" does not include any person printing or copyrighting printed material for its own use or consumption and not for resale. A "publisher" means and includes any person who owns the right to produce, market, and distribute printed literature and information for ultimate sale at retail.

18.33(2) Effective May 4, 1995, and retroactive to July 1, 1983, the gross receipts from the sale or rental of the following to a printer or publisher are exempt from tax: acetate; antihalation backing; antistatic spray; back lining; base material used as a carrier for light sensitive emulsions; blankets; blow-ups; bronze powder; carbon tissue; codas; color filters; color separations; contacts; continuous tone separations; creative art; custom dies and die cutting materials; dampener sleeves; dampening solution; design and styling; diazo coating; dot etching; dot etching solutions; drawings; drawsheets; driers; duplicate films or prints; electronically digitized images; electrotypes; end product of image modulation; engravings; etch solutions; film; finished art or final art; fix; fixative spray; flats; flying pasters; foils; goldenrod paper; gum; halftones; illustrations; ink; ink paste; keylines; lacquer; lasering images; layouts; lettering; line negatives and positives; linotypes; lithographic offset plates; magnesium and zinc etchings; masking paper; masks; masters; mats; mat service; metal toner; models, modeling; mylar; negatives; nonoffset spray; opaque film process paper; opaquing; padding compound; paper stock; photographic materials: acids, plastic film, desensitizer emulsion, exposure chemicals, fix, developers, paper; photography, day rate; photopolymer coating; photographs; photostats; photodisplay tape; phototypesetter materials; pH-indicator sticks; positives; press pack; printing cylinders; printing plates, all types; process lettering; proof paper; proofs and proof processes, all types; pumice powder; purchased author alterations; purchased composition; purchased phototypesetting; purchased stripping and paste-ups; red litho tape; reducers; roller covering; screen tints; sketches; stepped plates; stereotypes; strip types; substrate; tints; tissue overlays; toners; transparencies; tympan; typesetting; typography; varnishes; Veloxes; wood mounts; and any other items used in a similar capacity to any of the above-enumerated items by the printer or publisher to complete a finished product for sale at retail. Expendable tools and supplies not enumerated in this subrule are subject to tax.

18.33(3) Claim for refunds of tax, interest, or penalty paid for the period of July 1, 1983, to June 30, 1995, must be limited to $25,000 in the aggregate and will not be allowed unless filed prior to October 1, 1995. If the amount of claimed refunds for this period totals more than $25,000, the department must prorate the $25,000 among all claims.

701—18.34(422,423) Automatic data processing.

18.34(1) *In general.*

a. *Applicability of tax.* For the purposes of this rule, the tax on automatic data processing is applicable to the gross receipts of:

(1) Sales and rentals of data processing equipment (hardware).

(2) Sales and rentals of tangible personal property produced or consumed by data processing equipment or prewritten (canned) computer software used in data processing operations.

(3) Certain enumerated services performed on or connected with data processing such as rental of tangible personal property, machine repair, services of machine operators, office and business machines repair, electrical installation, and any other taxable service enumerated in Iowa Code section 422.43.

b. *Definitions.*

(1) *"Computer"* means a programmed or programmable machine or device having information processing capabilities and includes word processing equipment, testing equipment, and programmed or programmable microprocessors and any other integrated circuit embedded in manufactured machinery or equipment.

(2) *"Hardware"* means the physical computer assembly and peripherals including, but not limited to, such items as the central processing unit, keyboards, consoles, monitors, memory, disk and tape drives, terminals, printers, plotters, modems, tape readers, document sorters, optical readers and digitizers.

(3) *"Canned software"* is prewritten computer software which is offered for general or repeated sale or rental to customers with little or no modification at the time of the transaction beyond specifying the parameters needed to make the program run. Canned software is tangible personal property. The term also includes programs offered for general or repeated sale or rental which were initially developed as custom software. Evidence of canned software includes the selling or renting of the software more than once. Software may qualify as custom software for the original purchaser or lessor but is canned software with respect to all others. Canned software includes program modules which are prewritten and later used as needed for integral parts of a complete program.

(4) *"Custom software"* is specified, designed, and created by a vendor at the specific request of a customer to meet a particular need and is considered to be a sale of a service rather than a sale of tangible personal property. It includes those services represented by separately stated charges for the modification of existing prewritten software when the modifications are written or prepared exclusively for a customer. Modification to existing prewritten software to meet the customer's needs is custom computer programming only to the extent of the modification and only to the extent that the actual amount charged for the modification is separately stated. Examples of services that do not result in custom software include loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program before modification was previously marketed, the new program will qualify as a custom program if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced by the records of the seller, was more than 50 percent of the contract price to the customer.

The department will consider the following records in determining the extent of modification to prewritten software when there is not a separate charge for the modification: logbooks, timesheets, dated documents, source codes, specifications of work to be done, design of the system, performance requirements, diagrams of programs, flow diagrams, coding sheets, error printouts, translation printouts, correction notes, and invoices or billing notices to the client.

(5) *"Storage media"* includes hard disks, compact disks, floppy disks, diskettes, diskpacks, magnetic tape, cards, or other media used for nonvolatile storage of information readable by a computer.

(6) *"Rental"* includes any lease or license agreement between a vendor and a customer for the customer's use of hardware or software.

(7) *"Program"* is interchangeable with the term "software" for purposes of this rule.

18.34(2) *Taxable sales, rentals and services.*

a. Sales of equipment. Tax applies to sales of automatic data processing equipment and related equipment.

b. Rental or leasing of equipment. Where a lease includes a contract by which a lessee secures for a consideration the use of equipment which may or may not be used on the lessee's premises, the rental or lease payments are subject to tax. See rule 701—26.18 on tangible personal property rental.

c. Canned software. The sale or rental for a consideration of any computer software which is not custom software is a transfer of tangible personal property and is taxable. Canned software may be transferred to a customer in the form of diskettes, disks, magnetic tape, or other storage media or by listing the program instructions on coding sheets.

(1) Tax applies whether title to the storage media on which the software is recorded, coded, or punched passes to the customer or the software is recorded, coded, or punched on storage media furnished by the customer. A fee for the temporary transfer of possession of canned software for the purpose of direct use to be recorded, coded, or punched by the customer or by the lessor on the customer's premises, is a sale or rental of canned software and is taxable.

(2) Tax applies to the entire amount charged to the customer for canned software. Where the consideration consists of license fees, royalty fees, right to use fees or program design fees, whether for a period of minimum use or for extended periods, all fees includable in the purchase price are subject to tax.

d. Training materials. Persons who sell or lease data processing equipment may provide a number of training services with the sale or rental of their equipment. Training services, per se, are not subject to tax. Training materials, such as books, furnished to the trainees for a specific charge are taxable.

e. Services a part of the sale or lease of equipment. Where services, such as programming, training or maintenance services, are provided to those who purchase or lease automatic data processing and related equipment, on a mandatory basis as an inseparable part of the sale or taxable lease of the equipment, charges for the furnishing of the services are includable in the measure of tax from the sale or lease of the equipment whether or not the charges are separately stated. (Where the purchaser or lessee has the option to acquire the equipment either with the services or without the services, charges for the services may not be excluded from the measure of tax if they are taxable enumerated services.)

f. Materials and supplies. The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated is a sale subject to tax.

Generally service bureaus are consumers of all tangible personal property, including cards and forms, which they use in providing services unless a separate charge is made to customers for the materials, in which case, tax applies to the charge made for the materials.

g. Additional copies. When additional copies of records, reports, tabulation, etc., are sold, tax applies to the charges made for the additional copies. "Additional copies" are all copies in excess of those produced on multipart carbon paper simultaneously with the production of the original and on the same printer, whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared, the tax will be measured by the charge made by the service bureau to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any) and the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multilithing, or by other means are subject to tax. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting or line drawings, and put on microfilm or photorecording paper.

h. Mailing lists. Addressing (including labels) for mailing. Where the service bureau addresses, through the use of its automatic data processing equipment or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the service bureau for the customer, tax does not apply to the charge for addressing. Similarly, where the service bureau prepares, through the use of its automatic data processing equipment or otherwise, labels to be affixed to material to be mailed, with names and address furnished by the customer or maintained by the service bureau for the customer, tax does not apply to the charge for producing the labels, regardless of whether the service bureau itself affixes the labels to the material to be mailed. However, tax would be due on any tangible personal property, such as labels, consumed by the service bureau. (See "*f*" above.) Mailing lists in the form of Cheshire tapes, gummed labels, and heat transfers which are attached to envelopes and placed in the mail by a service bureau constitute tangible personal property and are subject to tax.

i. *Services of a machine operator.* The services of a machine operator, such as a key punch operator or the operator of any other data processing equipment, when hired to operate another person's machinery or equipment, are subject to tax when contracted for and performed by someone other than an employee of the owner of the machinery and equipment.

j. *Maintenance contracts.* Maintenance contracts sold in connection with the sale or lease of canned software generally provide that the purchaser will be entitled to receive storage media on which prewritten program improvements have been recorded. The maintenance contract may also provide that the purchaser will be entitled to receive certain services, including error corrections and telephone or on-site consultation services.

(1) Nonoptional maintenance contract. If the maintenance contract is required as a condition of the sale or rental of canned software, it will be considered as part of the sale or rental of the canned software, and the gross sales price is subject to tax whether or not the charge for the maintenance contract is separately stated from the charge for software.

(2) Optional maintenance contracts prior to July 1, 1998. If the maintenance contract is optional to the purchaser of canned software, then only the portion of the contract fee representing improvements delivered on storage media is subject to sales tax if the fee for other services, including consultation services and error corrections, is separately stated. If the fee for other services, including consultation services and error corrections, is not separately stated from the fee for improvements delivered on storage media, the entire charge for the maintenance contract is subject to sales tax.

(3) Optional maintenance contracts on and after July 1, 1998. If an optional software maintenance or support contract provides for technical support services only, then no tax is imposed on the gross receipts from the performance of those services. If an optional software maintenance or support contract separately states the charges which represent improvements delivered on storage media from charges which represent other services, including consultation services and error correction, then only that portion of the contract fee representing improvements delivered on the storage media is subject to sales tax. If an optional software maintenance or support contract provides for the taxable transfer of tangible personal property and the provision of nontaxable services, and there is no separately stated charge for the taxable transfer of property or for the nontaxable service, then state sales tax of 5 percent shall be imposed on 50 percent of the gross receipts from the sale of such contracts. See 701—paragraph 18.25(3)*"c"* for more information.

18.34(3) *Nontaxable items and activities.*

a. *Custom programs.* These are programs prepared to the special order of a customer. Tax does not apply to the transfer of custom programs in the form of written procedures, such as program instructions listed on coding sheets. Tax applies to the sale of material transferred to the customer in the form of typed or printed sheets if separately invoiced.

b. *Processing a client's data.* Generally speaking, if a person enters into a contract to process a client's data by the use of a computer program, or through an electrical accounting machine programmed by a wired plugboard, the processing of a client's data is nontaxable. Such contracts usually provide that the person will receive the client's source documents, record data in machine readable form, such as in punch cards or on magnetic tape, make necessary corrections, rearrange or create new information as the result of the processing and then provide tabulated listings or record output on other media. This service will be considered nontaxable even if the total charge is broken down into specific charges for each step. The furnishing of computer programs and data by the client for processing under direction and control of the person providing the service is nontaxable even though charges may be based on computer time. The true object of these contracts is considered to be a service, even though some tangible personal property is incidentally transferred to the client. However, tax will apply to tangible personal property separately invoiced to the client.

c. *Time sharing.* Charges made for the use of automatic data processing equipment, on a time-sharing basis, where access to the equipment is by means of remote facilities, are not subject to tax. Time sharing which is, in fact, a rental of equipment and the lessee exercises the right of possession or control over the equipment is subject to tax. See 18.34(2)*"b"* and rule 701—26.18(422).

d. *Designing of systems, converting of systems, consulting, training, and miscellaneous services.* These services consist of the developing of ideas, concepts and designs. Common examples of these nontaxable services are:

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high speed input-output terminals are required).

(3) Converting manual systems to automatic data processing systems, converting present automatic data processing systems to new systems (e.g., changing a second generation system to a third generation system).

(4) Consulting services (e.g., studies of all or part of a data processing system).

(5) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(6) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

(7) Providing technical help such as analysts and programmers, usually on an hourly basis.

(8) Writing (coding) and testing of programs—contract programming. These services result in the production of customized programs. This type of service is not taxable because programming requires the development or ascertainment of information, and the evaluation of data, in addition to other development skills.

Persons engaged in providing nontaxable computer services are the consumers of all tangible personal property used in such activities, and the tax must be paid on their acquisition of such property.

This paragraph, 18.34(3)*"d,"* shall become effective for periods beginning on or after April 1, 1992.

e. *Installation charges.* Where installation charges are separately contracted for or where no contract exists, are separately invoiced, or do not constitute enumerated taxable services, they are exempt from tax. See rule 701—15.14(422,423).

f. *Pickup and delivery charges.* The tax will not apply to pickup and delivery charges which are separately contracted for or where no contract exists, are separately invoiced.

g. *Rental of computer programs.* Prior to July 1, 1984, the rental of computer programs was not subject to tax since the program did not constitute equipment. *KTVO, Inc. vs. Bair,* 1977, Iowa 225 N.W.2d, 111. For the rule regarding prewritten (canned) programs subsequent to that date, see 18.3(2)*"c."*

This rule is intended to implement Iowa Code sections 422.42, 422.45 and 423.2 and Iowa Code Supplement section 422.43 as amended by 1998 Iowa Acts, Senate File 2288.

701—18.35(422,423) Drainage tile. The sale or installation of drainage tile which is to be used in disease control, weed control, or the health promotion of plants or livestock produced as part of agricultural production for market is exempt from tax. Drainage tile, when purchased for these purposes, is therefore not subject to tax. In all other cases, drainage tile will be considered a building material and subject to tax under the provisions of Iowa Code subsection 422.42(9).

This rule is intended to implement Iowa Code sections 422.42(3), 422.42(9), and 423.2.

701—18.36(422,423) True leases and purchases of tangible personal property by lessors.

18.36(1) *True leases and purchases by lessors prior to, on, and subsequent to July 1, 1978.* The definition of a sale specified in Iowa Code subsection 422.42(2) does not include leases. Hence, the exemption from tax on sales for resale is inapplicable to the purchase of tangible personal property for the purpose of leasing such property to others, but not for the purpose of reselling such property. *Cedar Valley Leasing, Inc. v. Iowa Department of Revenue,* 274 N.W.2d 357 (Iowa 1979). However, even though the general rule is that the acquisition cost of tangible personal property purchased for the purpose of leasing it to others is subject to the Iowa sales or use tax, certain transactions are exempted from tax by statute. See subrule 18.36(4).

18.36(2) *General.* Prior to July 1, 1984, tax is due on the lease or rental payments derived from the service of equipment rental only and not from the lease or rental of other tangible personal property. See 701—subrule 26.18(1). Tax would also be due on the gross receipts received on the disposal of the tangible personal property provided no exemption exists. When property is purchased for the purpose of financing under a conditional sales contract, the property is purchased for resale, and the acquisition of the property is not subject to Iowa tax. See rule 701—16.47(422,423).

The gross receipts from the leasing of property for subletting purposes is exempt from tax as a resale of a service, but the lessee must collect tax on the gross receipts from subletting unless such subletting is otherwise exempt from tax.

a. Where a resident or nonresident lessor leases equipment to a resident or nonresident lessee and the lease contract is executed in Iowa and the equipment is delivered to the lessee in Iowa, the rental payments are subject to Iowa sales tax, even if the equipment is taken by the lessee to another state. *Williams Rentals, Inc. v. Tidwell,* 516 S.W.2d 614 (Tenn. 1974).

b. Where a nonresident lessor leases equipment to a resident or nonresident lessee and the lessee uses the equipment in Iowa, the nonresident lessor has the responsibility of collecting Iowa use tax on the lease payments, provided the lessor maintains a place of business in Iowa as provided in Iowa Code sections 423.1(6) and 423.9. Whether the lease agreement is executed in Iowa or not is irrelevant. *State Tax Commission v. General Trading Co.,* 322 U.S. 335, 64 S.Ct. 1028,88 L.Ed 1309, (1944).

c. Where a lessee is the recipient of equipment rental services as defined in *"a"* and *"b"* above and no tax has been collected from such lessee by the lessor, the lessee should remit Iowa use tax to the department of revenue and finance. In the event no tax is remitted, the department, in its discretion, may seek to collect the tax from the lessor or lessee. In the event that the lessee is the recipient of equipment rental services, and the lessor does not maintain a place of business in Iowa and does not collect use tax pursuant to Iowa Code section 423.10, such lessee shall remit tax on its rental payments to the department.

d. Where a resident lessor leases equipment to a nonresident lessee outside of Iowa, and the equipment is delivered to the lessee outside Iowa, the act of leasing is exempt from the Iowa sales tax on the rental payments. However, in the event the lessee brings the equipment into Iowa and uses it in Iowa, Iowa use tax applies to rental payments, but see *"g"* below.

e. Where a resident or nonresident lessor purchases tangible personal property in Iowa for subsequent lease in or out of Iowa and takes delivery of the equipment in Iowa, the lessor's purchase is subject to Iowa sales tax. *Dodgen Industries, Inc. v. Iowa State Tax Commission,* 160 N.W.2d 289 (Iowa 1968).

f. When a resident or nonresident lessor purchases tangible personal property outside of Iowa for the purpose of leasing it in Iowa and the equipment is brought into Iowa and used by the resident or nonresident lessee in this state, the lessor is considered as having a "use" of the property in Iowa and Iowa use tax will apply to the lessor's purchase price of the property, regardless whether or not the lessor makes any physical use of the property in Iowa. *Union Oil Company of California v. State Board of Equalization,* 1963, 34 Cal. Rpts. 872, 386 P.2d 496.

g. If a sales or use tax has already been paid to another state on the purchase price of equipment prior to the use of that equipment in Iowa, a tax credit against the Iowa use tax on the purchase price will be given. After the equipment is brought into Iowa, if a sales or use tax is properly payable and is paid to another state on the rental payments of equipment, for the same time the Iowa tax is imposed on such rentals, a tax credit against the Iowa use tax on such rental payments will be given. *Henneford v. Silas Mason Co.,* 1937, U.S.577, 57 S.Ct. 524, S1 L.Ed. 814.

18.36(3) *Leases relating to vehicles subject to registration.*

a. Vehicles as defined in Iowa Code subsections 321.1(4), (6), (8), (9), and (10) (motor trucks, truck tractors, road tractors, trailers, and semitrailers), except when designed primarily for carrying persons, can be purchased free of use tax when purchased for lease and actually leased for use outside Iowa if the subsequent sole use in Iowa is in interstate commerce or interstate transportation.

b. Tangible personal property which by means of fabrication, compounding, or manufacturing becomes an integral part of vehicles as defined in 18.36(3)*"a"* when manufactured for lease and actually leased to a lessee for use outside the state of Iowa, can be purchased free of use tax provided the sole subsequent use of the vehicle in Iowa is in interstate commerce or interstate transportation. (Iowa purchases which would be subject to Iowa sales tax do not qualify for this exemption.) See rule 701—33.7(423).

The provisions of *"a"* and *"b"* are effective for periods beginning on January 1, 1973. Also see 701—Chapter 34 of the rules relating to vehicles subject to registration.

18.36(4) *Special rules for lessors on or after July 1, 1978.* If tangible personal property is purchased for leasing, the purchase of the property is exempt from tax if the following conditions are met:

a. The person (lessor) purchasing the property is regularly engaged in the business of leasing,

b. The period of the lease is for more than one year for sales or property occurring from July 1, 1978, to May 18, 1997, inclusive; for sales of property occurring on and after May 19, 1997, the period of the lease must be for more than five months, and

c. The lease or rental receipts must be subject to tax under the service of equipment rental.

All three conditions must be met before the exemption applies.

If the exemption is properly claimed, it is lost when the property is made use of for any purpose other than leasing and the person claiming the exemption is liable for the tax based on the original purchase price. Tax paid on the leasing or rental payments would be allowed as a credit against the tax due on the purchase price.

In the following examples, assume, unless stated to the contrary, that the lease or rental receipts are subject to tax. The examples are written on the assumption that the period for an exempt lease is five months or longer. Thus, these examples are basically applicable to the period beginning May 19, 1997; however, the examples illustrate principles which are applicable to the purchase for lease exemption for periods longer than one year which was the requirements for exemption prior to May 19, 1997.

EXAMPLE: A restaurant makes a one-time purchase of office furniture which it leases to an insurance company for a period of four years. The purchase of office furniture by the restaurant would be subject to tax because the restaurant is not regularly engaged in the business of leasing. However, if the restaurant established a pattern of regularly purchasing office furniture or other tangible personal property for lease, the exemption would apply.

EXAMPLE: A company purchases a computer which will be leased for a period of three years, at which time the computer is returned to the company. The sole business of the company is to purchase this one computer for lease. The purchase of the computer is exempt from tax because the company is regularly engaged in the business of leasing.

EXAMPLE: A leasing company purchases three lawn mowers which will be leased to individuals for periods of time less than five months. The purchase of the lawn mowers by the leasing company would be subject to tax because the periods of the leases are for less than five months.

EXAMPLE: A leasing company purchases a computer which will be leased for a period of three years. The purchase of the computer is exempt from tax because the period of the lease is for more than five months.

EXAMPLE: A leasing company buys a computer. The company claims the exemption from tax, but the company uses the computer in its own operations. Tax is due on the original purchase price and the leasing company is liable for the tax due.

EXAMPLE: A leasing company purchases a copying machine which will be leased for a period of two years. After four months, the machine is returned to the leasing company and then the machine is immediately re-leased without being used by the leasing company for any other purpose. The exemption would apply because it was properly claimed and nothing occurred to cause loss of the exemption.

EXAMPLE: A leasing company purchases a copying machine which will be leased for a period of two years. After four months, the machine is returned and the leasing company then uses the machine in its own business. The exemption would no longer apply and the leasing company would be liable for the tax based on the original purchase price. Credit would be allowed against the tax due on the purchase price for any tax paid on the lease or rental payments. Assume the leasing company paid $2,000 for the copying machine and charged $200 per month plus $10 in tax per month. Since the machine is returned and the exemption is not applicable, the leasing company would owe $100 on the $2,000 acquisition cost. However, the leasing company collected $40 (four months x $10) tax on the monthly rental charges. Allowing the credit for tax collected of $40 against the total tax liability of $100 leaves a net tax liability of $60 owed by the leasing company.

EXAMPLE: A manufacturer and seller of office furniture also leases office furniture. The leases always run for a period longer than five months and the company usually has only two leases per year. The leasing operation only accounts for 1 percent of the company's total business. The company still qualifies for the exemption because it is regularly engaged in the business of leasing and the period of the lease is for more than five months.

EXAMPLE: A leasing company purchases an airplane from an aircraft dealer and leases it for a period of three years. The lease or rental payments are not taxed because of the exemption for transportation services. The leasing company would owe tax based on the acquisition cost because the lease or rental payments are not subject to tax under the service of equipment rental.

EXAMPLE: A leasing company purchases equipment and leases it to a lessee for a period of 18 months. For the first 3 months, the equipment is used by the lessee in making repairs to existing structures and the lease receipts are taxable. For the remainder of the lease period, the equipment is used in new construction of buildings and structures and the lease receipts are exempt from tax. The acquisition cost of the equipment is exempt because the exemption was properly claimed and was not subsequently lost by a use other than leasing.

EXAMPLE: A leasing company purchases from an Iowa retailer equipment on May 18, 1997, for the purpose of leasing it for a period of six months. The lease receipts will be taxable. The sales tax exemption on the acquisition cost to the lessor cannot be claimed because the sale occurred before May 19, 1997, and, at the time of the sale, no sales tax exemption applied to such acquisition cost. The exemption for acquisition cost should not be given a retroactive effect. *Jones v. Gordy,* 1935, 169 Md. 173, 180 Atl. 272.

EXAMPLE: A leasing company purchases equipment outside of Iowa on May 1, 1997. The lessee brings the equipment into Iowa on June 1, 1997, and uses it in Iowa. The lease period is nine months, and the lessee's use in Iowa is subject to Iowa use tax on the lease payments. Under these circumstances, the Iowa use tax exemption on the lessor's acquisition cost applies because it is the law in effect at the time of use in Iowa, not at the time of sale, which determines whether a use tax exemption applies. *City of Ames v. Iowa State Tax Commission,* 1955, 246 Iowa 1016, 71 N.W.2d 15; *Allis-Chalmers Mfg. Co. v. Iowa State Tax Commission,* 1958, 250 Iowa 193, 92 N.W.2d 129.

EXAMPLE: A leasing company purchases equipment not for resale and leases it to the lessee for a period of more than five months. After three months, the equipment is returned to the leasing company which then sells the equipment. Such sale is not part of the regular course of the leasing company's business. The exemption, though properly claimed, is lost because, by reason of such sale, the leasing company made use of the property for a purpose other than leasing or renting. Had the equipment been returned to the leasing company on or after five months and one day from the commencement of the lease period, and the leasing company then sold the equipment outside the regular course of its business or used the equipment in its business, the exemption for acquisition cost would not be lost. Had the equipment been purchased for resale and leased prior to such resale, the acquisition cost to the leasing company would be exempt from tax. *Herman M. Brown Co. v. Johnson,* 1957, 248 Iowa 1143, 82 N.W.2d 134. If the equipment is traded in toward the purchase price of other equipment by the leasing company, or if the leasing company disposes of the equipment after it is fully depreciated, the exemption for acquisition cost is not lost. Where sale of equipment outside the regular course of business is made by the leasing company, see also rule 18.28(422) to determine whether the casual sale exemption applies to the receipts from such sale.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee. Assume that the exemption for acquisition cost of the equipment was properly claimed. Thereafter, the lessee makes an assignment of the lease. The exemption is not lost since the assignee stands in the same position as the original lessee and such an assignment does not change the nature of the original lease period. *Berg v. Ridgway,* 1966, 258 Iowa 640, 140 N.W.2d 95.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. The leasing company sells the lease contracts, as commercial paper, to others. The exemption for acquisition cost can still be claimed and such sales of lease contracts do not cause loss of the exemption.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. Thereafter, the lease can no longer be performed because the property is destroyed by an act of God. The acquisition cost exemption is not lost.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. Thereafter, the lessee is adjudged bankrupt and the equipment is returned to the leasing company and is re-leased without being used by the leasing company for any other purpose. The acquisition cost exemption is not lost since the leasing company makes no use for any purpose other than leasing or renting.

EXAMPLE: A leasing company purchases equipment which is leased to a lessee. The criteria for the acquisition cost exemption are present. The lessee then sublets the equipment to another for a period less than five months. The acquisition cost exemption is not lost.

18.36(5) *Lease or rental of all tangible personal property now subject to tax.* On and after July 1, 1984, the lease or rental of all tangible personal property is subject to tax. See rule 701—26.18(422) for information concerning additional transactions subject to tax after that effective date.

This rule is intended to implement Iowa Code sections 422.42(2), 422.43, 422.45, 423.1, and 423.4.

701—18.37(422,423) Motor fuel, special fuel, aviation fuels and gasoline.

18.37(1) *In general.* The gross receipts from the sale of motor fuel and special fuel are exempt from sales tax under Iowa Code section 422.45(11) if (1) the fuel is consumed for highway use, in watercraft, or in aircraft, (2) the Iowa fuel tax has been imposed and paid, and (3) no refund or credit of fuel tax has been made or will be allowed. However, beginning July 1, 1985, the gross receipts from the sale of special fuel for diesel engines used in commercial watercraft on rivers bordering Iowa are exempt from sales tax, even though no fuel tax has been imposed and paid, providing the seller delivers the fuel to the owner's watercraft while it is afloat. Prior to July 1, 1988, retail sales of aviation gasoline were not exempt from sales tax under Iowa Code subsection 422.45(11). See subrule 18.37(4).

18.37(2) *Refunds or credits of motor fuel and special fuel.* Claims for refund or credit of fuel taxes under the provisions of Iowa Code chapter 452A must be reduced by any sales or use tax owing the state unless a sales tax exemption is applicable. Generally, refund claims or credits are allowed where fuel is purchased tax paid and used for purposes other than to propel a motor vehicle or used in watercraft.

18.37(3) *Refunds of tax on fuel purchased in Iowa and consumed out of Iowa.* Even though fuel is purchased in Iowa, fuel tax paid in Iowa, and the fuel tax is subject to refund under the provisions of division III of Iowa Code chapter 452A relating to interstate motor vehicle operations, the refund of the fuel tax does not subject the purchase of the fuel to sales tax. Subjecting the purchase to sales tax has the effect of imposing sales tax when fuel is consumed in interstate commerce while fuel consumed on Iowa highways in intrastate commerce is exempt from sales tax pursuant to Iowa Code subsection 422.45(11). The effect for sales tax purposes is to impose a greater tax burden on non-Iowa highway fuel consumption than Iowa highway fuel consumption thereby discriminating against interstate commerce. In addition, the effect of imposing sales tax on interstate excess purchases where intrastate highway use is not subject to the tax constitutes an export duty for purchasing fuel in Iowa and exporting it for use in another state. Such effects are in violation of the commerce clause of the United States Constitution. *Boston Stock Exchange v. State Tax Commission,* 1977, 429 U.S. 319, 97 S.Ct. 599,50 L.Ed.2d 514 and *Coe v. Errol,* 1886, 116 U.S. 517, 6 S.Ct. 475, 29L.Ed. 715.

18.37(4) *Aviation gasoline.* Tax treatment prior to July 1, 1988. Prior to July 1, 1988, all Iowa fuel tax paid on aviation gasoline used in aircraft was refundable under Iowa Code section 452A.17. Generally, aviation gasoline is not purchased for highway use or for use in watercraft, therefore, the exemption from sales and use tax found in Iowa Code subsection 422.45(11) was generally not applicable to purchases of aviation gasoline. However, Iowa Code subsection 422.52(4) provides for the collection of sales tax by way of deduction from motor fuel tax refunds allowable under Iowa Code chapter 452A. Therefore, sales tax is not assessed at the retail level but only in instances where the fuel tax paid on aviation gasoline has been refunded. If no application for a fuel tax refund relating to aviation fuel has been made, no sales tax is assessed on the aviation gasoline purchase.

18.37(5) *Gasohol*. For tax periods after April 30, 1981. Retail sales of gasohol are exempt from Iowa sales or use tax.

18.37(6) *Tax base.* The basis for computing the Iowa sales tax will be the retail selling price of the fuel less any Iowa fuel tax included in such price. Federal excise tax should not be removed from the selling price in determining the proper sales tax due. *W.M. Gurley v. Arny Rhoden* supra. Also see rule 701—15.12(422,423).

This rule is intended to implement Iowa Code sections 422.31, 422.43, 422.45(11), 422.45(22), 422.52(4), 423.1, 452A.3, and 452A.17.

701—18.38(422,423) Urban transit systems. A privately owned urban transit system which is not an instrumentality of federal, state or county government is subject to sales tax on fuel purchases which are within the urban transit systems charter.

Tax shall not apply to fuel purchases, made by a privately owned urban transit company, for use outside the urban transit system charter in which a fuel tax has been imposed and paid and no refund has been or will be allowed.

Whether an urban transit company will be considered an instrumentality of federal, state or county government for the purpose of receiving sales tax exemption on its fuel purchases, which are also exempted from fuel tax and used for public purposes, depends upon consideration of the following:

1. Whether it is created by government.
2. Whether it is wholly owned by government.
3. Whether it is operated for profit.
4. Whether it is primarily engaged in the performance of some essential governmental function.
5. Whether the payment of tax will impose an economic burden upon the corporation, or that payment of tax serves to materially impair the usefulness or efficiency of the corporation or the payment of tax materially restricts the corporation in the performance of its duties.

These above enumerated considerations are not all inclusive and the presence of some and absence of others does not necessarily establish the exemption. *Unemployment compensation of North Carolina v. Wachovia Bank and Trust Company,* 2 S.E.2d 592, 595, 215 No. Car. 491 (1939); 1976 O.A.G. 823, 827, 828.

This rule is intended to implement Iowa Code subsection 422.45(1).

701—18.39(422,423) Sales or services rendered, furnished, or performed by a county or city. The gross receipts from the sales, furnishing, or service of gas, electricity, water, heat, and communication service rendered, furnished, or performed by a county or city are subject to the tax. On and after July 1, 1985, the gross receipts from fees paid to cities and counties for the privilege of participating in any athletic sports are also subject to tax. On or after July 1, 1991, the gross receipts from any municipally owned pay television service are taxable as well. On and after April 1, 1992, the gross receipts from a county or municipality furnishing sewage service or solid waste collection and disposal service to nonresidential commercial operations are taxable (see rules 701—26.71(422,423) and 26.72(422,423) for more information).

Any other sales or services rendered, furnished, or performed by a county or city are not subject to the tax.

A "sport" is any activity or experience which involves some movement of the human body and gives enjoyment or recreation. An "athletic" sport is any sport which requires physical strength, skill, speed, or training in its performance. The following activities are nonexclusive examples of athletic sports: baseball, football, basketball, softball, volleyball, golf, tennis, racquetball, swimming, wrestling, and foot racing.

The following is a list of various fees which would be considered fees paid to a city or county for the privilege of participating in any athletic sport, and thus subject to tax under this rule. The list is not exhaustive.

1. Fees paid for the privilege of using any facility specifically designed for use by those playing an athletic sport: fees for use of a golf course, ball diamond, tennis court, swimming pool, or ice skating rink are subject to tax. These fees are subject to tax whether they allow use of the facility for a brief or extended period of time, e.g., a daily fee or season ticket for use of a swimming pool or golf course would be subject to tax. Group rental of facilities designed for playing an athletic sport would also be subject to tax.

2. Fees paid to enter any tournament or league which involves playing an athletic sport would be subject to tax. Both team and individual entry fees are taxable. Fees paid to enter any marathon or foot race of shorter duration would be subject to tax under this rule.

Not subject to tax as fees paid to a city or county for the privilege of participating in any athletic sport under this rule are the following charges. The list is not intended to be exhaustive.

1. Fees paid for lesson or instruction in how to play or to improve one's ability to play an athletic sport are not subject to tax. Golf and swimming lesson fees are specific examples of such nontaxable charges. The fees are excluded from tax regardless of whether the person receiving the instruction is a child or an adult. Fees charged for equipment rental, regardless of whether this equipment is helpful or necessary to participation in an athletic sport, are not subject to tax. The rental of a golf cart or moveable duck blind would not be subject to tax. The rental of a recreational boat is a transportation service, the gross receipts of which are not subject to tax if provided by a city or county.

2. Sales of merchandise, e.g., food or drink, to persons watching or participating in any athletic sport are not subject to tax.

3. Fees charged to improve any facility where any athletic sport is played are not subject to tax, unless such a fee must be paid to participate in an athletic sport which can be played within the facility.

4. Fees paid by any person or organization to rent any county or city facility or any portion of any county or city park shall not be subject to tax unless the portion of the park or facility is specifically designed for the playing of an athletic sport.

EXAMPLE: A local bridge club pays a fee to use a shelter house and the surrounding grounds at a county park for a picnic. During the course of the picnic, the club members set up a net and use the surrounding grounds to play volleyball. They also improvise a softball field and play a softball game there. The fee which the bridge club has paid to rent the shelter house and surrounding grounds would not be subject to tax.

5. Fees paid for the use of a campground or hiking trail are not subject to tax.

This rule is intended to implement Iowa Code sections 422.43 and 422.45.

701—18.40(422,423) Renting of rooms. The gross receipts from the renting of any and all rooms, including but not limited to sleeping rooms, banquet rooms or conference rooms in any hotel, motel, inn, public lodging house, rooming or tourist court, or in any place where sleeping accommodations are furnished to transient guests, whether with or without meals, are subject to the tax. The rental of a mobile home or of manufactured housing which is tangible personal property is treated as room rental rather than tangible personal property rental. The renting of all rooms would be exempt from the tax if rented by the same person for a period of more than 31 consecutive days. The renter must contract to rent for a single period of 31 days or more. The renter may not accumulate these 31 days by contracting for two or more rental transactions. The incremental manner in which the hotel, motel, inn, public lodging house, rooming or tourist court, or any place where sleeping accommodations are furnished to transient guests bills its customers does not influence the accumulation of days that is required to claim the exemption.

This rule is intended to implement Iowa Code section 422.43.

701—18.41(422,423) Envelopes for advertising.

18.41(1) Some envelopes which contain advertising are exempt from tax. Envelopes which are not primarily used for advertising are taxable. The primary use of the envelopes should control whether they will be taxable or exempt. *Iowa Movers and Warehouseman's Assn. v. Briggs,* 237 N.W.2d 759 (Iowa 1976).

EXAMPLE 1: XYZ mails coupons and advertisements to persons giving discounts on a certain item which is sold at retail. The envelope used to package these materials is exempt from tax since it is primarily used to contain advertising materials.

EXAMPLE 2: XYZ mails a monthly billing statement to its charge account customers. In addition to the billing statement, XYZ Company encloses an advertisement in the envelope. The envelope has a dual purpose: (1) the collection of accounts receivable and (2) the distribution of advertising. However, the envelope is not primarily used for advertising but for billing the customer, therefore, the exemption does not apply.

18.41(2) Because of the difficulty of administering this exemption, purchasers of envelopes may petition to the department for permission to use a formula to represent to the seller the portion of taxable and exempt gross receipts from envelope purchases.

This rule is intended to implement Iowa Code subsection 422.45(9).

701—18.42(422,423) Newspapers, free newspapers and shoppers' guides.

18.42(1) *General observations.* The gross receipts from the sales of newspapers, free newspapers, and shoppers' guides are exempt from tax. The gross receipts from the sales of magazines, newsletters, and other periodicals which are not newspapers are taxable. Recent cases decided by the United States Supreme Court and the Supreme Court of Iowa prohibit exempting from taxation the sale of any periodical if that exemption from taxation is based solely upon the contents of that periodical. See *Arkansas Writers' Project, Inc. v. Ragland,* 481 U.S. 221, 107 S.Ct. 1722, 95 L.Ed.2d 209 (1987) and *Hearst v. Iowa Department of Revenue & Finance,* 461 N.W.2d 295 (Iowa 1990).

18.42(2) *General characteristics of a newspaper.* "Newspaper" is a term with a common definition. A "newspaper" is a periodical, published at short, stated, and regular intervals, usually daily or weekly. It is printed on newsprint with news ink. The format of a newspaper is that of sheets folded loosely together without stapling. A newspaper is admitted to the U.S. mails as second-class material. Other frequent characteristics of newspapers are the following:

a. Newspapers usually contain photographs. The photographs are more often in black and white rather than color.

b. Information printed on newspapers is usually contained in columns on the newspaper pages.

c. The larger the cross section of the population which reads a periodical in the area where the periodical circulates, the more likely it is that the department will consider that periodical to be a "newspaper."

18.42(3) *Characteristics of newspaper publishing companies.* Companies in the business of publishing newspapers are differently structured from other companies. Often, companies publishing larger newspapers will subscribe to various syndicates or "wire services." A larger newspaper will employ a general editor and a number of subordinate editors as well, for example, sports and lifestyle editors; business, local, agricultural, national, and world news editors; and editorial page editors. A larger newspaper will also employ a variety of reporters and staff writers. Smaller newspapers may or may not have these characteristics or may consolidate these functions.

18.42(4) *Characteristics which distinguish a newsletter from a newspaper.* A "newsletter" is generally distributed to members or employees of a single organization and not usually to a large cross section of the general public. It is often published at irregular intervals by a volunteer, rather than the paid individual who usually publishes a newspaper. A newsletter is often printed on sheets which are held together at one point only by a staple, rather than folded together.

This rule is intended to implement Iowa Code section 422.45(9).

701—18.43(422,423) Written contract. On and after July 1, 1985, the gross receipts from certain additional services are subject to tax. However, these newly taxable services are exempt from tax if performed pursuant to a written services contract in effect on April 1, 1985. The exemption from taxation for these services expires June 30, 1986. The services to which this "written contract" exemption is applicable are the following: cable television; campgrounds; gun repair; janitorial and building maintenance or cleaning; lawn care, landscaping and tree trimming and removal; lobbying service; pet grooming; reflexology; security and detective services; tanning beds or salons; water conditioning and softening; the rental of recreational vehicles, recreational boats or motor vehicles subject to registration which are registered for a gross weight of 13 tons or less; and fees paid to cities and counties for the privilege of participating in any athletic sports.

A "written contract" is one which is entirely in writing, so that all of its essential terms and provisions exist in writing, and oral statements are not necessary to set out any essential term or provision, such as who the parties to the contract are or what their rights and duties are under the contract. However, if it is necessary to resort to oral statements to explain the meaning of a written provision in a contract, a "written contract" can still exist. A written contract need not consist of one document or instrument only. It can consist of two or more writings, if all the necessary provisions of the contract are contained in those writings. For the purposes of this rule, the following must be stated in writing if a written contract is to exist: The nature and specification of the service to be provided, the name of the party providing the service, the name of the party receiving the service, the "consideration" (amount and method of payment) for providing the service, the signature of one or both of the parties to the contract, depending upon circumstances, and the date upon which the contract became effective.

The written contract must be in effect on April 1, 1985, if the service to which the contract pertains is to be exempt from tax. If a contract is signed by only one of the parties to it, that contract is still a "written contract" if the party which has not signed the contract acquiesces in the promises which the party who has signed the document makes within it. *McDermott v. Mahoney,* 139 Iowa 292, 115 N.W. 32, (Iowa 1908).

EXAMPLE: A security agency sends a proposed agreement to a potential customer promising to provide the services of a uniformed security guard for the customer's business premises beginning March 15, 1985, and continuing until March 15, 1987. The agreement is signed by the security agency's president and dated February 15, 1985. The agreement is received by the potential customer's president, who does not sign it, but, on March 15, 1985, allows the security agency's uniformed guard on the premises, and makes payment for those services as stipulated in the agreement. This agreement is a "written contract"; the services of the uniformed guard are not subject to tax for the period beginning July 1, 1985, and ending June 30, 1986. The services performed between July 1, 1986, and March 15, 1987, would be subject to tax.

This rule is intended to implement Iowa Code subsection 422.43(11).

701—18.44(422,423) Sale or rental of farm machinery and equipment. On and after July 1, 1987, the gross receipts from the sale or rental of farm machinery and equipment will be exempt from tax. Effective July 1, 1996, the gross receipts from the sale of property which is a container, label, carton, pallet, packing case, wrapping, baling wire, twine, bag, bottle, shipping case or other similar article or receptacle sold for use in agricultural, livestock or dairy production are not subject to sales tax.

18.44(1) *Characteristics of and limitations upon farm machinery and equipment.* To be eligible for exemption from or refund of tax under this rule the machinery or equipment must:

a. Be directly and primarily used in production of agricultural products; and

b. Be one of the following:

(1) A self-propelled implement; or

(2) An implement customarily drawn or attached to a self-propelled implement; or

(3) A grain dryer; or

(4) An auxiliary attachment which improves the performance, safety, operation, or efficiency of a qualifying implement or grain dryer if sale or first use in Iowa is on or after July 1, 1995; or

(5) A replacement part for any item described in subparagraph (1), (2), (3), or (4).

(6) Effective July 1, 1996, the gross receipts from the sale of property which is a container, label, carton, pallet, packing case, wrapping, baling wire, twine, bag, bottle, shipping case, or other similar article or receptacle sold for use in agricultural, livestock or dairy production.

c. No vehicle subject to registration, as defined in Iowa Code subsection 423.1(7), implement customarily drawn or attached to a vehicle, auxiliary attachment, or any replacement part for a vehicle, implement, or auxiliary attachment is eligible for the exemption or refund allowed under this rule.

18.44(2) *Definitions and characterizations.* For the purposes of this rule, the following definitions apply.

a. Production of agricultural products means the same as the term "agricultural production" which is defined in 701—subrule 17.9(3), paragraph *"a,"* to mean a farming operation undertaken for profit by raising crops or livestock. Production of agricultural products begins with the cultivation of land previously cleared for planting of crops or with the purchase or breeding of livestock or domesticated fowl. Not included within the meaning of the phrase are the clearing or preparation of previously uncultivated land, the creation of farm ponds or the erection of machine sheds, confinement facilities, storage bins or other farm buildings. See *Trullinger v. Fremont County,* 223 Iowa 677, 273 N.W. 124 (1937). Machinery and equipment used for these purposes would be used for activities which are preparatory to but not a part of the production of agricultural products. The production of agricultural products ceases when an agricultural product has been transported to the point where it will be sold by the farmer or processed.

EXAMPLE. Farmer Brown uses a tractor and wagon to haul harvested corn from a field to a grain dryer located on the farm. After the corn is dried, the same tractor and wagon are used to move the grain to a storage bin, also located on the farm. Later the same tractor and wagon are used to deliver the corn from the farm to the local elevator where it is sold. After Farmer Brown deposits the corn there, the local elevator uses its own tractor and wagon to move the corn to a place of relatively permanent storage. Farmer Brown has used the tractor and wagon in the production of agricultural products and the refund or exemption would apply. The elevator has not used its tractor and wagon in such production; refund or exemption would not be lawful.

b. Farm machinery and equipment means machinery and equipment specifically designed for use in the production of agricultural products or equipment and machinery not specifically designed for this use but which are directly and primarily used in the production of agricultural products.

EXAMPLE. Farmer Jones raises livestock and the farming operation requires that fences be built to confine the livestock. Farmer Jones purchases a posthole digger that is customarily attached to a tractor and uses the digger to construct the fences used to confine the livestock. The posthole digger is not specifically designed for use in the production of agricultural products but would be directly and primarily used in the production of agricultural products. Therefore, the exemption or refund applies.

c. Self-propelled implement has the same meaning as in 701—subrule 17.9(5), paragraph *"c,"* where the term is defined to mean an implement which is capable of movement from one place to another under its own power. The term self-propelled implement includes but is not limited to the following items: skidloaders and tractors; and the following machinery if capable of movement under its own power: combines, corn pickers, fertilizer spreaders, hay conditioners/windrowers, sprayers, and bean buggies.

d. Implements customarily drawn or attached to self-propelled implements. The following is a nonexclusive, representative list of implements which are customarily drawn or attached to self-propelled implements: Augers, balers, blowers, combines, conveyers, cultivators, disks, drags, dryers (portable), farm wagons, feeder wagons, fertilizer spreaders, front- and rear-end loaders, harrows, hay loaders, mowers and rakes, husking machines, manure spreaders, planters, plows, rotary blade mowers, rotary hoes, sprayers and tanks, and tillage equipment.

e. Direct use in agricultural production. In determining whether farm machinery, equipment or any grain dryer is directly used in agricultural production, the fact that particular machinery or equipment is essential to the production of agricultural products because its use is required either by law or practical necessity does not, of itself, mean that the machinery or equipment is directly used in the production of agricultural products. Machinery or equipment coming into actual physical contact with the soil or crops during the operations of planting, cultivating, harvesting, and soil preparation will be presumed to be machinery or equipment used in agricultural production.

f. Grain dryer. The term grain dryer includes the heater and the blower necessary to force the warmed air into a grain storage bin. It does not include equipment used in grain storage or movement such as augers and spreaders or any other equipment that is not a grain dryer. Equipment other than a grain dryer which is used in grain drying may be exempt or subject to refund if the equipment is a self-propelled implement or customarily drawn or attached to a self-propelled implement.

g. Replacement parts, differing meanings of the term for the period ending June 30, 1988, and for the period beginning July 1, 1988.

(1) For the period beginning July 1, 1985, and ending June 30, 1988, a replacement part is refundable or exempt only if its cost is depreciable for state and federal income tax purposes. Replacement parts which are depreciable for state and federal income tax purposes include only those replacement parts which either materially add to the value of machinery or equipment or appreciably prolong its life. Replacement parts which only keep the machinery or equipment in its ordinarily efficient operating condition are not eligible for exemption or refund. Included within the meaning of replacement parts is any part the cost of which is depreciable for state and federal income tax purposes but which may also be deducted as a current expense. So long as the cost is depreciable the sale or lease of the replacement part is eligible for refund or exemption from tax. However, the person claiming the refund or exemption must show that the replacement part which was deducted as an expense could have been depreciated under state and federal income tax law.

(2) On and after July 1, 1988, the sale or lease of a replacement part is exempt from tax if the replacement part is essential to any repair or reconstruction necessary to farm machinery or equipment's exempt use in the production of agricultural products. The term "replacement part" does not include attachments and accessories which are not essential to the operation of the farm machinery or equipment. Nonexclusive examples of attachments or accessories are: cigarette lighters, radios, and add-on air-conditioning units.

18.44(3) *Taxable and nontaxable transactions.* The following are nonexclusive examples of sales and leases of farm machinery and equipment which are or are not subject to exemption and refund.

a. A lessor's purchase of farm machinery and equipment is not subject to tax, or is taxable subject to refund, if the machinery or equipment is leased to a lessee who uses it directly and primarily in the production of agricultural products and if the lessee's use of the machinery or equipment is otherwise exempt or subject to refund. To claim exemption from tax or a refund of tax paid, the lessor need not make exempt use of the machinery or equipment so long as the lessee does.

b. To claim refund or exemption, the owner or lessee of farm machinery or equipment need not be a farmer so long as the machinery and equipment is directly and primarily used in the production of agricultural products, and the owner or lessee and the equipment or machinery meet the other requirements of this rule. For example, a person who purchases an airplane designed for use in agricultural aerial spraying and so used after purchase is entitled to the benefits of this rule even though that person is not the owner or occupant of the land where the airplane is used.

c. The sale or lease, within Iowa, of any farm machinery, equipment, or replacement part for direct and primary use in agricultural production outside of Iowa is a transaction eligible for refund or exemption if those transactions are otherwise qualified under this rule.

18.44(4) *Auxiliary attachments.* The following is a list (not inclusive) of auxiliary attachments described in 18.44(1)*"b"*(4), the sale or first use in Iowa which is exempt from tax on and after July 1, 1995: auxiliary hydraulic valves, cabs, coil tine harrows, corn head pickup reels, dry till shanks, dual tires, extension shanks, fenders, fertilizer attachments and openers, fold kits, grain bin extensions, herbicide and insecticide attachments, kit wraps, no-till coulters, quick couplers, rear wheel assists, rock boxes, rollover protection systems, rotary shields, stalk choppers, step extensions, trash whips, upperbeaters, silage bags, and weights.

18.44(5) and **18.44(6)** Rescinded IAB 9/7/88, effective 10/12/88.

This rule is intended to implement Iowa Code subsections 422.43(3) and 422.45(26), Iowa Code chapter 422, Division IV, and Iowa Code section 422.45 as amended by 1996 Iowa Acts, chapter 1145.

701—18.45(422,423) Sale or rental of computers, industrial machinery and equipment; refund of and exemption from tax paid for periods prior to July 1, 1997. The sale or rental of computers, industrial machinery and equipment, including pollution control equipment, used in manufacturing, in research and development, or in the processing or storage of data or information by an insurance company, financial institution, or commercial enterprise is, under certain circumstances, exempt from tax and, under other circumstances, is subject to refund of sales or use tax paid. The sale or rental of machinery, equipment, or computers directly and primarily used in the recycling or reprocessing of waste products is also exempt from tax; see subrule 18.45(8). For purposes of the organization of this rule, items that may be exempt or subject to refund of tax are referred to as specified property unless the context of the rule indicates otherwise. See subrule 18.45(1) for definition of what constitutes specified property. See rule 18.58(422,423) for the manner in which the sale or rental of machinery, equipment, and computers to manufacturers and the sale or rental of computers to commercial enterprises are treated on and after July 1, 1997.

18.45(1) *Definitions.* The following words are defined for the purposes of this rule in the manner set out below.

"Commercial enterprise" includes businesses and manufacturers conducted for profit and includes centers for data processing services to insurance companies, financial institutions, businesses, and manufacturers, but excludes professions and occupations and nonprofit organizations. A hospital that is a not-for-profit organization would not be a "commercial enterprise." The term "professions" means a vocation or employment requiring specialized knowledge and often long and intensive academic preparation. The term "occupations" means the principal business of an individual. Included within the meaning of "occupations" is the business of farming. A professional corporation which carries on any business which is a "profession" or "occupation" is not a commercial enterprise.

"Computer" means stored program processing equipment and all devices fastened to it by means of signal cables or any communication medium that serves the function of a signal cable. Nonexclusive examples of devices fastened by a signal cable or other communication medium are: terminals, printers, display units, card readers, tape readers, document sorters, optical readers, and card or tape punchers. Excluded from the definition of "computer" is point-of-sale equipment. For a characterization of "point-of-sale equipment" see 701—subrule 71.1(7).

Also included within the meaning of the word "computer" is any software consisting of an operating system or executive program. Such software coordinates, supervises, or monitors the basic operating procedures of a computer. An operating system or executive program is exempt from sales tax only if purchased as part of the sale of the computer for which it operates. An operating system or executive program priced separately or sold at a later time is subject to the provisions of rule 18.34(422,423). Excluded from the meaning of the word "computer" is any software consisting of an application program. For purposes of this subrule, "operating system or executive program" means a computer program which is fundamental and necessary to the functioning of a computer. The operating system or executive program software controls the operation of a computer by managing the allocation of all system resources, including the central processing unit, main and secondary storage, input/output devices, and the processing of programs. This is in contrast to application software which is a collection of one or more programs used to develop and implement the specific applications which the computer is to perform, and which calls upon the services of the operating system or executive program.

"Directly used." Property is "directly used" only if it is used to initiate, sustain, or terminate the transformation of any activity. In determining whether any property is "directly used," consideration should be given to the following factors:

1. The physical proximity of the property in question to the activity in which it is used;
2. The proximity of the time of use of the property in question to the time of use of other property used before and after it in the activity involved; and
3. The active causal relationship between the use of the property in question and the activity involved. The fact that a particular piece of property may be essential to the conduct of the activity because its use is required either by law or practical necessity does not, of itself, mean that the property is directly used.

"Financial institution" is a bank incorporated under Iowa Code chapter 524 or federal law; a savings and loan association incorporated under Iowa Code chapter 534 or federal law; a credit union organized under Iowa Code chapter 533 or federal law; or any corporation licensed as an industrial loan company under Iowa Code chapter 536A. Excluded from the meaning of the term are loan brokers governed by Iowa Code chapter 535C and production credit associations.

"Industrial machinery and equipment" means machinery and equipment used by a manufacturer in a manufacturing establishment. Machinery is any mechanical, electrical or electronic device designed and used to perform some function and to produce a certain effect or result. The word includes not only the basic unit of the machinery but also any adjunct or attachment necessary for the basic unit to accomplish its intended function. The word also includes all devices used or required to control, regulate or operate a piece of machinery, provided such devices are directly connected with or are an integral part of the machinery and are used primarily for control, regulation or operation of machinery. Jigs, dies, tools, and other devices necessary to the operation of or used in conjunction with the operation of what would be ordinarily thought of as machinery are also considered to be "machinery." See *Deere Manufacturing Co. v. Zeiner,* 247 Iowa 1264 78 N.W.2d 527 (1956). Machinery does not include buildings designed specifically to house or support machinery. Equipment is any tangible personal property used in an operation or activity. Nonexclusive examples of equipment are: tables on which property is assembled on an assembly line and chairs used by assembly line workers.

"Insurance company" means an insurer organized or operating under Iowa Code chapter 508, 514, 515, 518, 519, or 520 or authorized to do business in Iowa as an insurer. An insurance company must have 50 or more persons employed in Iowa, excluding licensed insurance agents. Effective April 8, 1996, an insurance company means an insurer organized or operating under Iowa Code chapter 508, 514, 515, 518, 518A, 519, or 520 or authorized to do business in this state as an insurer or licensed insurance agent under Iowa Code chapter 522. Excluded from the definition of "insurance company" are fraternal and beneficial societies governed by Iowa Code chapter 512 and health maintenance organizations governed by Iowa Code chapter 514B. This list of exclusions is not intended to be exclusive.

"Manufacturer" means any person, firm, or corporation who purchases, receives, or holds personal property for the purpose of adding to its value by any process of manufacturing, refining, purifying, combining of different materials, or by packing of meats with an intent to sell at a gain or profit. Those who are in the business of printing, newspaper publication, bookbinding, lumber milling, and production of drugs and agricultural supplies are illustrative, nonexclusive examples of manufacturers. Construction contracting; quarrying; remanufacture or rebuilding of tangible personal property (such as automobile engines); provision of health care; farming; transporation for hire; mining; and the activities of restaurateurs, hospitals, and medical doctors are illustrative, nonexclusive examples of businesses which are not manufacturers. See *Associated General Contractors of Iowa v. State Tax Commission,* 255 Iowa 673, 123 N.W.2d 922 (1963) and *River Products Co. v. Board of Review of Washington County,* 332 N.W.2d 116 (Iowa Ct. App. 1982).

"Pollution control equipment" means any disposal system or apparatus used or placed in operation primarily for the purpose of reducing, controlling or eliminating air or water pollution. The term does not include any apparatus used to eliminate "noise pollution." Liquid, solid, and gaseous wastes are included within the meaning of the word "pollution."

"Processing" means an operation or series of operations whereby tangible personal property is subjected to some special treatment by artificial or natural means which changes its form, context, or condition, and results in marketable tangible personal property. See rule 18.29(422,423).

"Processing or storage of data or information." Not only a computer, but machinery or equipment may be used in the processing or storage of data or information. All computers store and process information. However, only if the "final output" for a user or consumer is stored or processed data will the computer be subject to refund or exemption of tax.

"Recycling" means any process by which waste, or materials which would otherwise become waste, are collected, separated, or processed and revised or returned for use in the form of raw materials or products. The term includes, but is not limited to, the composting of yard waste which has been previously separated from other waste. "Recycling" does not include any form of energy recovery.

"Replacement parts." Replacement parts which are depreciable for state and federal income tax purposes include only those replacement parts which either materially add to the value of industrial machinery, equipment, or computers or appreciably prolong their lives. Replacement parts which only keep machinery, equipment, or computers in their ordinarily efficient operating condition are not eligible for exemption. Included within the meaning of replacement parts is any part the cost of which is depreciable for state and federal income tax purposes but which may also be deducted as a current expense. So long as the cost is depreciable the sale or lease of the replacement part is eligible for exemption from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under state and federal income tax law.

"Research and development" means experimental or laboratory activity which has as its ultimate goal the development of new products, processes of manufacturing, refining, purifying, combining of different materials, or meat packing. The ultimate goal of research and development must be that of adding value to products. The term "research and development" does not include testing or inspection for quality control purposes, efficiency surveys, management studies, consumer surveys, advertising, promotions, or research in connection with literary, historical, or similar projects. Machinery, equipment, and computers are used "directly" in research and development only if they are used in actual experimental or laboratory activity that qualifies as research and development under this subrule.

"Specified property" means property that is a computer or industrial machinery and equipment including pollution control equipment and depreciable replacement parts for that property.

18.45(2) *Requirements.* The sale or rental of specified property is exempt from tax if:

a. The property is real property within the scope of Iowa Code section 427A.1(1)*"e"* or *"j."* For sales occurring after January 1, 1994, the property is not required to be subject to taxation as real property (however, see subrules 18.45(4) and 18.45(8)); and

b. The property is directly and primarily used in one of the following:

1. By a manufacturer in processing tangible personal property; or

2. In research and development of new products or processes of manufacturing, refining, purifying, combining of different materials or packing of meats to be used for the purposes of adding value to products; or

3. In processing or storage of data or information by an insurance company, financial institution, or commercial enterprise.

c. To qualify for refund or exemption, a computer may be taxable as either commercial or industrial real estate. Machinery and equipment must be taxable as industrial real estate only to be similarly qualified. Research and development machinery and equipment that is not taxable as industrial real estate does not qualify for refund or exemption. See 701—subrules 71.1(5) and 71.1(6) for characterizations of "commercial" and "industrial" real estate. However, see subrule 18.45(4) for an exception to the requirement that certain property be taxable as real property.

d. The following are examples of machinery which is not directly used in manufacturing:

1. Machinery used exclusively for the efficient use of other machinery. Examples are: air cooling, air conditioning, and exhaust systems.

2. Machinery used in support operations, such as a machine shop, in which production machinery is assembled, maintained or repaired.

3. Machinery used by administrative, accounting, and personnel departments.

4. Machinery used by plant security, fire prevention, first aid, and hospital stations.

5. Machinery used in plant cleaning, disposal of scrap and waste, plant communications, lighting, safety, or heating.

e. The following is an example of property directly used in research and development: Frontier Hybrid, Inc. maintains a research and development laboratory for use in developing a corn plant which is a perennial. It purchases the following items for use in its research and development laboratory: a computer which will process data relating to the genetic structure of the various corn plants which Frontier Hybrid is testing, an electron microscope for examining the structure of corn plant genes, a "steam cleaner" for cleaning rugs in the laboratory offices, and a typewriter for use by the laboratory director's secretary. The computer and the microscope are "directly" used in the research in which the laboratory is engaged; the steam cleaner and the typewriter only indirectly used. Therefore, purchase of the computer and microscope would be exempt from tax; purchase of the steam cleaner and typewriter would be subject to tax.

f. The following is an example of property used in processing or storage of information or data: A health insurance company has three computers. Computer A is used to monitor the temperature within the insurance company's building. The computer transmits messages to the building's heating and cooling systems telling them when to raise or lower the level of heating or air conditioning as needed. Computer B is used to store patient records and will recall those records on demand. Computer C is used to tabulate statistics regarding the amount of premiums paid in and the amount of benefit paid out for various classes of insured. The "final output" of Computer A is neither stored nor processed information. The final output of Computer B is stored information. The final output of Computer C is processed information. The sale, lease, or use of Computers B and C would qualify for exemption or refund.

g. The following is an example of property not used in manufacturing: A manufacturing plant located in Warren County which manufactures widgets fabricates its own patterns used in manufacturing the widgets on a metal press machine in its machine shop located in Story County. The machine shop does not sell the patterns and the metal press machine is used for no other purpose than to fabricate the patterns. The metal press machine is not used in manufacturing because there is no intent to sell the patterns used by the machine shop at a gain or profit.

18.45(3) *Exceptions.* The following specified property is not exempt:

a. Property assessed by the department of revenue and finance pursuant to Iowa Code chapters 428, 433, 434 and 436 to 438, inclusive. For electric, gas, water, and other companies assessed under Iowa Code chapter 428, only property owned by the company is assessed by the department. For railroad, telephone, pipeline, and electric transmission lines companies, property leased to as well as owned by the company is assessed by the department. See 701—Chapters 71 and 77.

b. Hand tools.

c. Point-of-sale equipment. See 701—subrule 71.1(7).

18.45(4) *Inclusions.* Property exempt from taxation for property tax purposes under the provisions of Iowa Code chapters 404 and 427B relating to urban revitalization property and industrial machinery receiving partial exemption by ordinance is also eligible for exemption from sales and use taxes even though the property is not subject to taxation as real property. Urban revitalization property and industrial machinery receiving partial exemption by ordinance are discussed in rules 701—80.8(404) and 80.6(427B), respectively. This property must meet the other requirements in subrule 18.45(2) in order to be exempt from sales and use taxes.

18.45(5) *Lessor purchases of specified property.* The analysis contained in rule 18.44(422, 423) regarding lessor purchases of farm machinery and equipment is applicable to explain that same problem regarding specified property. See subrule 18.44(3) for analysis.

18.45(6) *Rights of refund and exemption.* Rescinded IAB 10/13/93, effective 11/17/93.

18.45(7) *Designing or installing new industrial machinery or equipment.* On and after July 1, 1985, the gross receipts from the services of designing or installing new industrial machinery or equipment shall be exempt from tax. The enumerated services of electrical or electronic installation are included in this exemption. To qualify for the exemption, the sale or rental of the machinery or equipment must be subject to refund or exemption under this rule. In addition, the machinery or equipment must be "new." For purposes of this subrule, "new" means never having been used or consumed by anyone. The exemption is not applicable to reconstructed, rebuilt or repaired or previously owned machinery or equipment. The exemption is applicable to new machinery and equipment designed or installed for rental as well as for sale. The gross receipts from design or installation must be separately identified, charged separately, and reasonable in amount for the exemption to apply. A "computer" is not considered to be machinery or equipment, and its installation or design is not eligible for this exemption.

18.45(8) *Property used in recycling or reprocessing of waste products.* On and after July 1, 1989, the gross receipts from the sale or rental of machinery, equipment, or computers directly and primarily used in the recycling or reprocessing of waste products shall be exempt from tax. Machinery or equipment used in the recycling or reprocessing of waste products includes, but is not limited to, compactors, balers, crushers, grinders, cutters, or shears directly and primarily used for this purpose. The sale of an endloader, forklift, truck, or other moving device is exempt from tax if the device is directly and primarily used in the movement of property which is an integral part of recycling or reprocessing. See 18.45(8)*"c."* The sale of a bin for storage ordinarily would not be exempt from tax, storage without more not being a part of recycling or reprocessing. Certain limits for exemption placed upon industrial machinery and equipment are not applicable to machinery and equipment used in recycling or reprocessing.

For example, machinery, equipment or a computer need not meet the requirements of 18.45(2)*"a"* concerning specified property being real property for the exemption to apply. Furthermore, the exemption will apply even if the machinery, equipment or computer is purchased by a person other than an insurance company, financial institution or commercial enterprise. For instance, a person engaged in a profession or occupation could purchase property for direct and primary use in recycling or reprocessing of waste products and the exemption would apply.

a. By way of nonexclusive examples, recycling or reprocessing can begin when waste or material which would otherwise become waste is collected or separated. A vehicle used directly and primarily for collecting waste which will be recycled or reprocessed could be a vehicle used for an exempt purpose under this rule. Thus, the purchaser of a garbage truck could claim this exemption if the truck were directly and primarily used in recycling and not, for instance, in hauling garbage to a landfill. Machinery or equipment used to segregate waste from material to be recycled or reprocessed or used to separate various forms of materials which will be reprocessed (e.g., glass and aluminum) can also be used at the beginning of recycling or reprocessing.

b. Machinery and equipment directly and primarily used in recycling or reprocessing. See subrule 18.45(1) for the definition of "directly used" which is applicable to this subrule. The examples of machinery not directly used in manufacturing set out in 18.45(2)*"d"* should be studied for guidance in determining whether similar machinery is or is not used in recycling or reprocessing; e.g., machinery used in plant security (see 18.45(2)*"d"*"4") is not machinery directly used in recycling or reprocessing.

c. Integral use in recycling or reprocessing. Ordinarily, any operation or series of operations which does not transform waste or material which would otherwise become waste into new raw materials or products would not be a part of recycling or reprocessing. However, activities which do not do this, but are an "integral part" of recycling or reprocessing, are themselves recycling or reprocessing. For example, an endless belt which moves aluminum cans from a machine where they are shredded to a machine where the shredded aluminum is crushed into blocks would be an endless belt used in recycling or reprocessing and the exemption applies. See subrule 18.29(5) for a discussion of when an activity is an integral part of "processing." Some of that discussion is applicable to this subrule.

d. The end of recycling or reprocessing. Recycling or reprocessing ends when waste or a material which would otherwise become waste is in the form of raw material in which it will be used in manufacturing or in the form of a product which will be sold for use other than as a raw material in manufacturing. For instance, a corporation purchases a machine which grinds logs, stumps, pallets, and crates and other waste wood into wood chips. After grinding, the wood chips are sold and transported to purchasers to various sites where the chips are dumped on and spread out over the ground for use in erosion control. The machine which grinds the wood chips is a machine used in recycling. The truck which transports the wood chips from the machine to the sites is not used in reprocessing because, at the time the chips are placed in the truck, they are in the form in which they will be sold for use other than as a raw material in manufacturing.

This rule is intended to implement Iowa Code section 422.45(26), Iowa Code section 422.45(27) as amended by 1996 Iowa Acts, chapter 1049, and Iowa Code section 422.45(29).

701—18.46(422,423) Automotive fluids. The gross receipts from the sales of certain automotive fluids are exempt from tax. To be considered exempt, the sale must possess the following characteristics: (1) the sale must be to a retailer who will install the automotive fluid in or apply the automotive fluid to a motor vehicle; and (2) the installation or application must be done while the retailer is providing a taxable enumerated service (e.g., automobile lubrication); or (3) the automotive fluid must be installed in or applied to a motor vehicle which the retailer intends to sell and the sale of which will be subject to Iowa use tax.

Specific but nonexclusive examples of "automotive fluids" are motor oil and other automobile lubricants, hydraulic, brake, and transmission fluids, sealants, undercoatings, antifreeze, and gasoline additives.

This rule is intended to implement Iowa Code section 422.45(33).

701—18.47(422,423) Maintenance or repair of fabric or clothing.

18.47(1) As of July 1, 1987, sales of chemicals, solvents, sorbents, or reagents consumed in the maintenance or repair of fabric or clothing are exempt from tax. See 701—subrule 17.14(1) for definitions of the terms "chemical, solvent, sorbent or reagent." This subrule's exemption is mainly applicable to dry-cleaning and laundry establishments; however, it is also applicable to soap or any chemical or solvent used to clean carpeting. The department presumes that a substance is "directly used" in the maintenance or repair of fabric or clothing if the substance comes in contact with the fabric or clothing during the maintenance or repair process. Substances which do not come into direct contact with fabric or clothing may, under appropriate circumstances, be directly used in the maintenance or repair of the fabric or clothing but direct use will not be presumed.

The following are examples of substances directly used and consumed in the maintenance or repair of fabric or clothing: perchloroethlyene "perch" or petroleum solvents used in dry-cleaning machines and coming in direct contact with the clothing being dry-cleaned. Substances used to clean or filter the "perch" or petroleum solvents would also be exempt from tax, even though these substances do not come in direct contact with the clothing being cleaned. The sale of soap or detergents especially made for mixing with "perch" or petroleum solvents is exempt. The sale of stain removers to dry cleaners is exempt from tax.

A commercial laundry's purchase of detergents, bleaches, and fabric softeners is exempt from tax. A commercial laundry's purchase of water, which is a solvent, is also exempt from tax if purchased for use in the cleaning of clothing.

The purchase of starch by laundries and "sizing" by dry cleaners is not exempt from tax.

18.47(2) Also, on and after July 1, 1987, the sale of property which is a container, label, or similar article or receptacle for transfer in association with the maintenance or repair of fabric or clothing is exempt from tax. In general, the sale of any article which protects dry-cleaned or laundered clothing from dirt or helps the dry-cleaned or laundered clothing to maintain its proper shape or form in the same fashion as a container does would be exempt from tax under this subrule. By way of nonexclusive example, the sale of plastic garment bags, which protect clothing from dirt, is exempt from tax. The sale of "shirt boards" and garment hangers, both of which help clothing to maintain its proper shape, would also be exempt.

A container, label, or similar article's sale is exempt from tax only if the item is transferred to the customer of a commercial laundry, dry cleaner, or other retailer. Thus, "bundle bags" and "meese carts," used to transfer or transport clothing within a dry-cleaning establishment, are not subject to the exemption because these bags and carts remain with the dry cleaner and are not transferred to a customer.

Concerning labels, the sale of which would be exempt from tax, these labels must be affixed to the dry-cleaned or laundered clothing and transferred to the customer of the dry-cleaning or laundering establishment. By way of nonexclusive example, the sale to dry cleaners, of "special attention," "invoice" and "sorry" tags would be exempt from tax.

The sale of safety pins and other types of clips used to hang skirts and other garments from hangers would not be exempt from tax. These items do not sufficiently resemble containers or labels to the extent that their sale is exempt from tax.

This rule is intended to implement Division IV of Iowa Code chapter 422.

701—18.48(422,423) Sale or rental of farm machinery, equipment, replacement parts, and repairs used in livestock, dairy, or plant production. Sales or rental of farm machinery and equipment used in livestock or dairy production and replacement parts which occur on or after July 1, 1988, are exempt from sales and use tax. On and after July 1, 1995, machinery, equipment, and replacement parts used in the production of flowering, ornamental, or vegetable plants are exempt from tax. See rule 701—18.57(422,423).

18.48(1) *Definitions and characterizations.* For the purposes of this rule, the following definitions and characterizations of words apply.

a. "Machinery" means major mechanical machines or major components thereof which contribute directly and primarily to the livestock or dairy production process. Usually, a machine is a large object with moving parts which performs work by the expenditure of energy, either mechanical (e.g., gasoline or kerosene) or electrical.

b. "Equipment" is tangible personal property (other than a machine) directly and primarily used in livestock or dairy production. It may be characterized as property which performs a specialized function which, of itself, has no moving parts or if it does possess moving parts, its source of power is external to it. The following examples attempt to differentiate between machinery and equipment:

EXAMPLE A. An electric pump is used to pump milk into a bulk milk tank. The electric pump is machinery; the bulk milk tank is equipment.

EXAMPLE B. An auger places feed into a cattle feeder. If not "real property" (see 18.48(1)*"c"*) the auger is a piece of machinery; the cattle feeder is a piece of equipment.

c. Property used in livestock or dairy production which is neither "equipment" nor "machinery."

(1) Real property. The ground or the earth is not machinery or equipment. A building is not machinery or equipment, *Mid-American Growers, Inc. v. Dept. of Revenue,* 493 N.E.2d 1097 (Ill. App. Ct. 1986). Therefore, tangible personal property which is sold for incorporation into the ground or a building in such a manner that it will become a part of the ground or the building is taxable. Generally, property incorporated into the ground or a building has become a part of the ground or the building if removal of the property from the ground or building will substantially damage the property, ground, or building or substantially diminish the value of the property, ground, or building. Fence posts embedded in concrete and electrical wiring, light fixtures, fuse boxes, and switches are examples of property sold for incorporation into the ground or a building, respectively. The property referred to in 18.48(1)*"c"*(1) can be identified by applying the following test: Assume that the property is being sold to a contractor rather than a person engaged in livestock or dairy production. If sold to a contractor, would the retailer be required to consider the property "building material" and charge the contractor sales tax upon the purchase of this building material. If this is the case, sale of the property is not exempt from Iowa tax law. Iowa department of revenue and finance rule 701—19.3(422,423) contains a characterization of "building material" and a list of specific examples of building material.

(2) "Supplies" are neither machinery nor equipment. Tangible personal property is part of farm supplies if it is used up or destroyed by virtue of its use in livestock or dairy production or, because of its nature, can only be used once in livestock or dairy production. A light bulb is an example of a farm supply which is not machinery or equipment. The sale of some farm supplies is exempt from tax. See 701—subrule 17.9(3). See List B in subrule 18.48(7) for examples of farm supplies which could be mistaken for equipment and are not exempt from tax on other grounds.

d. "Hand tools" are tools which can be held in the hand or hands and which are powered by human effort. Hand tools specifically designed for use in livestock or dairy production are exempt from tax as "equipment." Mechanical devices that are held in the hand and driven by electricity or some source other than human muscle power are, if otherwise qualified, exempt from tax as "farm machinery." See subrule 18.48(7), List C, for examples of "hand tools" exempt and not exempt from tax.

e. Directly used in livestock or dairy production. To determine if machinery or equipment is "directly" used in livestock or dairy production, one must first ensure that the machinery or equipment is used during livestock or dairy production and not before that process has begun or after it has ended. Subrule 18.48(1), paragraph *"g,"* describes when livestock or dairy production begins and ends. If the machinery or equipment is used in livestock or dairy production, to be "directly" so used, that use must constitute an integral and essential part of production as distinguished from a use in production which is incidental, merely convenient to or remote from production. The fact that machinery or equipment is essential or necessary to livestock or dairy production does not mean that it is also "directly" used in production. Machinery or equipment may be necessary to livestock or dairy production but so remote from it that it is not directly used in that production.

(1) In determining whether machinery or equipment is used directly, consideration should be given to the following factors:

1. The physical proximity of the machinery or equipment to other machinery or equipment whose direct use is unarguable. The closer the machinery or equipment whose direct use is questioned is to the machinery or equipment whose direct use is not questioned, the more likely it is that the former is directly used in livestock or dairy production.

2. The proximity in time of the use of machinery or equipment whose direct use is questionable to the use of machinery whose direct use is not questioned. The closer in time the use, the more likely that the questioned machinery or equipment's use is direct rather than remote.

3. The active causal relationship between the use of the machinery or equipment in question and livestock or dairy production. The fewer intervening causes between the use of the machinery or equipment and the production of the product, the more likely it is that the machinery or equipment is directly used in production.

(2) The following are examples of machinery and equipment directly used in livestock or dairy production:

1. Machinery and equipment used to transport or limit the movement of livestock and dairy animals (e.g., electric fence equipment, head gates, and loading chutes).

2. Machinery and equipment used in the conception, birth, feeding, and watering of livestock or dairy animals (e.g., artificial insemination equipment, portable farrowing pens, feed carts, and automatic watering equipment).

3. Machinery and equipment used to maintain healthful or sanitary conditions in the immediate area where livestock are kept (e.g., manure gutter cleaners, automatic cattle oilers, fans, and heaters if not real property).

4. Machinery or equipment used to test or inspect livestock or dairy animals during production.

(3) The following are nonexclusive examples of machinery or equipment which would not be directly used in livestock or dairy production.

1. Machinery or equipment used to assemble, maintain, or repair other machinery or equipment directly used in livestock or dairy production (e.g., welders, paint sprayers, and lubricators).

2. Machinery used in farm management, administration, advertising, or selling (e.g., a record-keeping computer, calculating machine, office safe, telephone, books, and farm magazines).

3. Machinery or equipment used in the exhibit of livestock or dairy animals (e.g., blankets, halters, prods, leads, and harnesses).

4. Machinery or equipment used in safety or fire prevention, even though the machinery or equipment is required by law.

5. Machinery or equipment for employee or personal use. Machinery or equipment used for the personal comfort, convenience, or use by a farmer, the farmer's family or employees, or persons associated with the farmer are not exempt from tax. Examples of such machinery and equipment include the following: beds, mattresses, blankets, tableware, stoves, refrigerators, and other equipment used in conjunction with the operation of a farm home or of a migrant labor camp, or other facilities for farm employees.

6. Machinery and equipment used for heating, cooling, ventilation, and illumination of farm buildings generally rather than specifically in the immediate area where livestock are kept.

7. Vehicles subject to registration.

f. "Primarily" used in livestock or dairy production. Machinery or equipment is "primarily used in livestock or dairy production" if of the total time that unit of machinery or equipment is used, more than 50 percent of the time is in livestock or dairy production. If a unit of machinery or equipment is used more than 50 percent of the time for production and the balance of time for other business purposes, the exemption applies. If a unit of equipment is used 50 percent or more of the time for business purposes other than livestock or dairy production, the exemption does not apply. Any unit of machinery or equipment used more than 50 percent of the time directly in livestock or dairy production is subject to the exemption.

g. Beginning and end of livestock or dairy production. Livestock or dairy production begins with the purchase or breeding of livestock or dairy animals. Livestock and dairy production ceases when an animal or the product of an animal's body (e.g., wool or milk) has been transported to the point where it will be sold by the farmer or processed.

h. Farm machinery and equipment means machinery and equipment specifically designed for use in livestock and dairy production or equipment and machinery not specifically designed for this use but which are directly and primarily used in livestock or dairy production except for common or ordinary hand tools. See 18.48(1)"*d*" for a definition of "hand tools."

EXAMPLE. Farmer Jones raises livestock and fans must be used to cool the animals. Farmer Jones buys fans designed for use in a residence which he uses directly and solely to cool the livestock. The exemption applies.

i. "Self-propelled implement" has the same meaning as in 701—subrule 17.9(5), paragraph "*c*" where the term is defined to mean an implement which is capable of movement from one place to another under its own power. The term self-propelled implement includes but is not limited to the following items: skidloaders and tractors; and the following machinery if capable of movement under its own power: combines, corn pickers, fertilizer spreaders, hay conditioners/windrowers, sprayers, and bean buggies.

j. Implements customarily drawn or attached to self-propelled implements. The following is a nonexclusive, representative list of implements which are customarily drawn or attached to self-propelled implements: augers, balers, blowers, combines, conveyers, cultivators, disks, drags, dryers (portable), farm wagons, feeder wagons, fertilizer spreaders, front- and rear-end loaders, harrows, hay loaders, mowers and rakes, husking machines, manure spreaders, planters, plows, posthole diggers, rotary blade mowers, rotary hoes, sprayers and tanks, and tillage equipment.

k. The term "grain dryer" includes the heater and the blower necessary to force the warmed air into a grain storage bin. It does not include equipment used in grain storage or movement such as augers and spreaders or any other equipment that is not a grain dryer. Equipment other than a grain dryer which is used in grain drying may be exempt or subject to refund if the equipment is a self-propelled implement or customarily drawn or attached to a self-propelled implement.

l. The term "replacement parts essential to any repair or reconstruction necessary to farm machinery or equipment's exempt use in the production of agricultural products" does not include attachments and accessories not essential to the operation of the machinery or equipment itself (except when sold as part of the assembled unit) such as cigarette lighters, radios, canopies, air conditioning units, cabs, deluxe seats, and tools or utility boxes.

18.48(2) *Right of refund for farm machinery and equipment used in livestock or dairy production, basic requirements.* Rescinded IAB 10/13/93, effective 11/17/93.

18.48(3) *Treatment of replacement parts.* Rescinded IAB 10/13/93, effective 11/17/93.

18.48(4) *Packing material used in agricultural, livestock, or dairy production.* For sales occurring on or after July 1, 1996, the gross receipts from the sale of property which is a container, label, carton, pallet, packing case, wrapping, baling wire, twine, bag, bottle, shipping case, or other similar article or receptacle sold for use in agricultural, livestock, or dairy production are not subject to sales tax. This exemption also applies to producers of ornamental, flowering, or vegetable plants in commercial greenhouses or other places which sell such items in the ordinary course of business since that activity is considered to be agricultural.

18.48(5) Rescinded IAB 11/20/96, effective 12/25/96.

18.48(6) *Auxiliary attachments exemption.* On and after July 1, 1995, sales of auxiliary attachments which improve the performance, safety, operation, or efficiency of machinery or equipment are exempt from tax. Sales of replacement parts for these auxiliary attachments are also exempt on and after that date.

18.48(7) *Lists.* Lists (representative but not all-inclusive) of tangible personal property for which sales or use tax paid is or is not refundable.

LIST A. Property Used in Livestock and Dairy Production Which is Usually Real Property. See 18.48(1)*"c"*(1). Its sale is usually taxable.

barn ventilators*	livestock feeders*
conveyers*	silos
farrowing crates*	specialized flooring*
fence posts	sprinklers
fencing wire	stanchions
furnaces*	watering tanks*
gestation stalls*	ventilators*

*These items also appear in List D. Tax paid on their sale can be refundable or their sale exempt if the items are not real property.

LIST B. Taxable Farm Supplies Which Are Not Machinery or Equipment

burlap*	lubricants
disposable hypodermic syringes	marking chalk
ear tags	packages for one-time use
hog rings	

*Burlap is exempt when used in the form of a bag, container, wrap or other receptacle or packaging material.

LIST C. Hand Tools—Taxable and Nontaxable

axes
brooms
buckets
cleaning brushes
dehorners (nonelectric)*
garden hoses
grease guns
hammers
hay hooks*
hog ringers*
lamps
lanterns
milk cans*
mops
paintbrushes
pliers
scrapers
screwdrivers
shovels
wheelbarrows
wrenches

*Hand tools specially designed for use in livestock or dairy production are equipment. Tax paid on the sale or use of these hand tools is refundable.

LIST D. Farm Machinery and Equipment Directly and Primarily Used in Livestock or Dairy Production. Tax Paid is Usually Refundable or the Sale Exempt.

artificial insemination equipment
augers*
automatic feeding systems*
bulk feeding tanks*
bulk milk coolers
bulk milk tanks
cattle weaners and feeders
cattle currying and oiling machines
cattle feeders*
conveyers*
dehorners, electric
electric fence equipment
fans*
farrowing crates, houses and stalls*
feed bins*
feed carts
feed elevators*
feed grinders
feed tanks*
feeders
foggers
furnaces*
gates*
grain augers
head gates
heating pads and lamps
hog feeders*
hypodermic syringes and needles, nondisposable
livestock feeding, watering and handling equipment*
loading chutes*
LP gas tanks
manure handling equipment*
milk coolers
milk strainers
milking machines
refrigerators used to cool raw milk
silo unloaders
specialized flooring*
space heaters
sprayers
squeeze chutes*
vacuum coolers
ventilators*

*If not real property. See 18.48(1)“*c*”(1).

18.48(8) *Seller's and purchaser's liability for sales tax.* The seller shall be relieved of sales tax liability if the seller takes from the purchaser an exemption certificate stating that the purchase is of machinery or equipment meeting the requirements of subrule 18.48(4). An exemption certificate can take the form of a stamp imprinted onto one of the documents of sale. If items purchased tax-free pursuant to an exemption certificate are used or disposed of by the purchaser in a nonexempt manner, the purchaser is solely liable for the taxes and shall remit the tax directly to the department.

This rule is intended to implement Iowa Code section 422.45 as amended by 1996 Iowa Acts, chapter 1145.

701—18.49(422,423) Aircraft sales, rental, component parts, and services exemptions prior to, on, and after July 1, 1999.

18.49(1) Prior to July 1, 1999, sales in Iowa of aircraft subject to registration were subject to sales tax. On and after July 1, 1999, sales of aircraft in Iowa are subject to Iowa use tax rather than Iowa sales tax. See rule 701—31.6(423). Also, on and after that date, the use tax imposed on sales of aircraft in Iowa is collected by the Iowa department of transportation at the time of the aircraft's registration. Sales of certain aircraft parts in Iowa, the performance of taxable services in Iowa on or in connection with the repair, remodeling, or maintenance of aircraft, and the rental of aircraft in Iowa remain subject to Iowa sales tax on and after July 1, 1999. See subrule 18.49(3).

18.49(2) For the purposes of this subrule only, an "aircraft" is any contrivance known or hereafter invented which is designed for navigation of or flight in the air and is used in a scheduled interstate Federal Aviation Administration certified air carrier operation.

a. *Exempt aircraft sales.* As of July 1, 1988, and up to and including June 30, 1999, gross receipts from the sale of aircraft are exempt from tax.

b. *Exempt rental of aircraft.* Effective May 1, 1995, and retroactive to July 1, 1988, the taxable rental (see 701—26.74(422,423)) of aircraft, as defined in the introductory paragraph of this subrule, is exempt from tax.

c. *Exempt sale or rental of aircraft parts.* Effective May 1, 1995, and retroactive to July 1, 1988, gross receipts from the sale or rental of tangible personal property permanently affixed to any aircraft as a component part of that aircraft are exempt from tax. The term "component parts" includes, but is not limited to, repair or replacement parts and materials.

d. *Exempt performance of services.* Effective May 1, 1995, and retroactive to July 1, 1988, gross receipts from the rendering, furnishing, or performing of services in connection with the repair, remodeling, or maintenance of aircraft (including aircraft engines and component materials or parts) are exempt from tax.

18.49(3) For the purposes of this subrule only, an "aircraft" is any aircraft used in a nonscheduled interstate Federal Aviation Administration certified air carrier operation conducted under 14 CFR ch. 1, pt. 135. On and after July 1, 1998, the gross receipts from the sale or rental of tangible personal property permanently affixed or permanently attached as a component part of these aircraft, including but not limited to repair or replacement materials or parts, are exempt from tax. Also exempt, on and after that date, are the gross receipts from the performance of any service used for aircraft repair, remodeling, or maintenance when the service is performed on an aircraft, aircraft engine, or aircraft component material or part exempt under this subrule. Gross receipts from the sale or rental of aircraft are not exempt from tax under this subrule.

18.49(4) For the purposes of this subrule only, an "aircraft" is any contrivance known or hereafter invented which is designed for navigation of or flight in the air. On and after July 1, 1998, and up to and including June 30, 1999, the gross receipts from the sale of an aircraft to an aircraft dealer who rents or leases the aircraft to another are exempt from tax if all of the following circumstances exist:

a. The aircraft is kept in the inventory of the dealer for sale at all times.

b. The dealer reserves the right to immediately take the aircraft from the renter or lessee when a buyer is found.

c. The renter or lessee is aware that the dealer will immediately take the aircraft when a buyer is found.

As soon as an aircraft, the sale of which is exempt under this subrule, is used for any purpose other than leasing or renting, or the conditions set out in paragraphs *"a," "b,"* and *"c"* are not continuously met, the dealer claiming the exemption is liable for the tax which would have been due but for the exemption set out in this subrule. Tax will be computed on the original purchase price paid by the dealer.

See rule 701—32.13(423) for a description of the manner in which transactions described in this subrule are exempted from tax on and after July 1, 1999.

This rule is intended to implement Iowa Code section 422.45, subsections 38, 38A, 38B and 38C and Iowa Code section 423.2 as amended by 1999 Iowa Acts, chapter 168.

701—18.50(422,423) Property used by a lending organization. On and after July 1, 1988, the gross receipts from the sale of tangible personal property to a nonprofit organization organized for the purpose of lending the tangible personal property to the general public for use by the public for nonprofit purposes are exempt from tax. The exemption contained in this rule is applicable to tangible personal property only, and not to taxable services. It is applicable to the sale of that property and not to its rental to a nonprofit organization. Finally, the exemption is applicable only to property purchased by a nonprofit organization for subsequent rental to the general public. The exemption is not applicable to other property (e.g., office equipment) which the nonprofit organization might need for its ongoing existence.

This rule is intended to implement Iowa Code section 422.45(36).

701—18.51(422,423) Sales to nonprofit legal aid organizations. On and after July 1, 1988, the gross receipts from the sale or rental of tangible personal property or from services performed, rendered, or furnished to a nonprofit legal aid organization are exempt from tax.

This rule is intended to implement Iowa Code subsection 422.45(37).

701—18.52(422,423) Irrigation equipment used in farming operations. On and after July 1, 1989, the gross receipts from the sale or rental of irrigation equipment used in farming operations are exempt from tax. The term "irrigation equipment" includes, but is not limited to, circle irrigation systems and trickle irrigation systems. The term "farming operations" has the same meaning as the term "agricultural production" set out in 701—subrule 17.9(3), paragraph *"a,"* and as further characterized in 18.44(2)*"a."*

Effective May 18, 2001, and retroactive to April 1, 1995, the gross receipts from the sale or rental of irrigation equipment, as defined above, whether installed above or below ground are exempt from tax as long as the equipment is sold or rented by a contractor or farmer and the equipment is primarily used in agricultural operations.

Contractors or farmers entitled to the exemption set forth in the previous paragraph may apply for a refund of taxes, interest or penalties paid on the sale or rental of qualifying irrigation equipment for transactions that occurred between April 1, 1995, and May 18, 2001. To be eligible for refund, refund claims must be filed with the department prior to October 1, 2001. Refund claims are limited to $25,000 in the aggregate and will not be allowed if not timely filed. If the amount of refund claims totals more than $25,000 in the aggregate, the department will prorate the $25,000 among all claimants in relation to the amounts of the claimants' valid claims.

This rule is intended to implement Iowa Code section 422.45 and 2001 Iowa Acts, House File 723.

701—18.53(422,423) Sales to persons engaged in the consumer rental purchase business. On and after July 1, 1989, the gross receipts from the sale of tangible personal property, except vehicles subject to registration, to persons regularly engaged in the consumer purchase business are exempt from tax if the property (1) is sold for the purpose of utilization in a transaction involving a "consumer rental purchase agreement" as defined in Iowa Code subsection 537.3604(8), and (2) the gross receipts from the consumer rental of the property are subject to Iowa sales or use tax.

If property exempt under this rule is made use of for any purpose other than a consumer rental purchase, the person claiming the exemption is liable for the tax that would have been due had the exemption not existed. The tax shall be computed on the original purchase price to the person claiming the exemption. The aggregate of the tax paid on the consumer rental purchase of the property, not exceeding the amount of sales or use tax owed, shall be credited against the tax.

This rule is intended to implement Iowa Code section 422.45(18).

701—18.54(422,423) Sales of advertising material. On and after July 1, 1990, gross receipts from the sales of advertising material to any person in Iowa are exempt from tax if that person, or any agent of that person, will, after the sale, send that advertising material outside of Iowa and subsequent sole use of that material will be outside this state.

For the purposes of this rule "advertising material" is tangible personal property only, including paper. "Advertising material" is limited to the following: brochures, catalogs, leaflets, fliers, order forms, return envelopes, floppy discs, CD-ROMs, videotapes, and any similar items of tangible personal property which will be used to promote sales of property or services.

This rule is intended to implement Iowa Code section 422.45.

701—18.55(422,423) Drop shipment sales. A "drop shipment" generally involves two sales transactions and three parties. The first party is a consumer located inside Iowa. The second party is a retailer located outside the state. The third party is a supplier who may be located inside or outside of Iowa. The two sales transactions in question are the sale of property from the supplier to the out-of-state retailer, and the further sale of that property from the out-of-state retailer to the consumer in Iowa.