# REVENUE DEPARTMENT[701]

**Regulatory Analysis**

Notice of Intended Action to be published: Iowa Administrative Code 701—Chapter 203
"Elements Included in and Excluded from a Taxable Sale and Sales Price"

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14, 422.68, and 423.42
State or federal law(s) implemented by the rulemaking: Iowa Code sections 423.1, 423.2, 423.3, and 423.24

## Public Hearing

A public hearing at which persons may present their views orally or in writing will be held as follows:

October 25, 2023
9 a.m. to 12 noon

Via video/conference call:
meet.google.com/cox-brcn-tok?hs=122&authuser=0

## Public Comment

Any interested person may submit written or oral comments concerning this Regulatory Analysis. Written or oral comments in response to this Regulatory Analysis must be received by the Department of Revenue no later than 4:30 p.m. on the date of the public hearing. Comments should be directed to:

Alana Stamas
Department of Revenue
Hoover State Office Building
P.O. Box 10457
Des Moines, Iowa 50306-3457
Phone: 515.350.3932
Email: alana.stamas@iowa.gov

## Purpose and Summary

The purpose of this proposed rulemaking is to readopt Chapter 203. The Department proposes revisions to the chapter to remove portions of the rules that the Department determined are obsolete, unnecessary, or duplicative of statutory language. The chapter describes the Department's interpretation of the underlying statutes to help the public understand elements included in and excluded from a taxable sale. These rules reduce uncertainty about what constitutes sales price.

## Analysis of Impact

1. Persons affected by the proposed rulemaking:

- Classes of persons that will bear the costs of the proposed rulemaking:

The proposed rules do not create costs for any class of persons.

- Classes of persons that will benefit from the proposed rulemaking:

The public, including retailers and purchasers, will benefit from clarification about what elements are included in and excluded from a taxable sale.

2. Impact of the proposed rulemaking, economic or otherwise, including the nature and amount of all the different kinds of costs that would be incurred:

- Quantitative description of impact:

There is no economic impact associated with the proposed rules beyond what is contained in statute.

- Qualitative description of impact:

These proposed rules reduce uncertainty about what elements are included in and excluded from a taxable sale. Failing to adopt them would lead to confusion, questions to the Department, and potential errors in calculating sales price.

3. Costs to the State:

- Implementation and enforcement costs borne by the agency or any other agency:

There are no costs to the agency of implementing the rules beyond those that would otherwise be required to administer the statutes.

- Anticipated effect on state revenues:

There is no anticipated effect on state revenues. However, the rules clarify elements included in and excluded from a taxable sale, making it more likely that the correct amount of tax will be remitted.

4. Comparison of the costs and benefits of the proposed rulemaking to the costs and benefits of inaction:

The cost of inaction would be failing to update the chapter to remove obsolete language and language that is duplicative of the statute. The benefit of the proposed rules is reducing confusion about when a taxable sale occurs.

5. Determination whether less costly methods or less intrusive methods exist for achieving the purpose of the proposed rulemaking:

The proposed rulemaking is not costly or intrusive. The purpose of the rules is to provide guidance on what constitutes a taxable sale. The Department considered the option of not having rules explaining the elements of a taxable sale but determined that the rules provide useful clarification to the public.

6. Alternative methods considered by the agency:

- Description of any alternative methods that were seriously considered by the agency:

The Department considered the possibility of not providing rules on this topic but determined that it provides useful guidance to the public beyond what is provided by the statutes.

- Reasons why alternative methods were rejected in favor of the proposed rulemaking:

Proceeding without these rules would lead to confusion about whether certain elements are included in or excluded from a taxable sale.

## Small Business Impact

If the rulemaking will have a substantial impact on small business, include a discussion of whether it would be feasible and practicable to do any of the following to reduce the impact of the rulemaking on small business:

- Establish less stringent compliance or reporting requirements in the rulemaking for small business.
- Establish less stringent schedules or deadlines in the rulemaking for compliance or reporting requirements for small business.
- Consolidate or simplify the rulemaking's compliance or reporting requirements for small business.
- Establish performance standards to replace design or operational standards in the rulemaking for small business.
- Exempt small business from any or all requirements of the rulemaking.

If legal and feasible, how does the rulemaking use a method discussed above to reduce the substantial impact on small business?

The proposed rulemaking does not have a substantial impact on small business. The rules do not make any special distinctions for small businesses. The rules do not impose any requirements on businesses, other than taxation requirements imposed by the underlying statutes.

## Text of Proposed Rulemaking

ITEM 1. Rescind 701—Chapter 203 and adopt the following **new** chapter in lieu thereof:

CHAPTER 203
ELEMENTS INCLUDED IN AND EXCLUDED
FROM A TAXABLE SALE AND SALES PRICE

**701—203.1(423) Tax not to be included in price.** When a retailer prices an article for retail sale and displays or advertises the same to the public with that price marked, the price so marked or advertised shall include only the sales price of such article unless it is stated on the price tag that the price includes tax.

EXAMPLE: The advertised or marked price is $1. When a sale is made, the purchaser must pay tax in addition to the $1 sales price or agree to pay $1.07, which represents the purchase price plus state sales tax of 6 percent plus local option sales tax of 1 percent, which, when added, becomes a part of the sale price or charge.

This rule does not prohibit advertising or displaying the sale price plus tax or the price including tax, as shown in the following examples:

"This dress—$10 plus tax" or "This dress—$10.70 including tax."

When a retailer conspicuously advertises in such manner and position so that it may be readily seen and read by the public that the price "includes tax," the retailer will be allowed to determine sales price by dividing the total of such retailer's price which includes tax by the applicable percentage. For example, a retailer in a jurisdiction that has the state sales tax rate of 6 percent plus a 1 percent local option tax would use a factor of 107 percent.

However, where an invoice is given to the purchaser as a part of the sale, either the invoice must show the tax separately from the retailer's price or it must be stated on each invoice that tax is included in the retailer's price. If the invoice states "tax included," the seller may determine sales price by the applicable percent method described above. It shall be the responsibility of the retailer that uses or has used the applicable percent method for reporting to provide proof that the retailer has complied with the method of advertising or displaying the retailer's price, as described above.

This rule is intended to implement Iowa Code sections 423.14 and 423.24.

**701—203.2(423) Finance charge.** Interest or other types of additional charges that result from selling on credit or under installment contracts are not subject to sales tax when such charges are separately stated and when such charges are in addition to an established cash sales price. However, if finance charges are not separately stated and a sale is made for a lump sum amount, the tax is due on the total retailer's price.

When interest and other types of additional charges are added as a condition of a sale in order to obtain title rather than as a charge to obtain credit where title to goods has previously passed, such charges will be subject to tax even though they may be separately stated. More information is contained in rule 701—213.3(423), relating to conditional sales contracts.

This rule is intended to implement Iowa Code section 423.1(51).

**701—203.3(423) Retailers' discounts, trade discounts, rebates and coupons.**

**203.3(1)** *Retailers' discounts.* A retailer's discount reduces the retailer's price of a property or service with the remainder being the actual sales price of the goods charged in the account. The purchaser entitled to the discount will never owe the retailer's price as a debt, the debt being the sales price after the agreed discount has been deducted. The word "discount" means "to buy at a reduction."

Any discount a retailer allows that reduces a retailer's price to a sales price is a proper deduction when collecting and reporting tax. This is not the case when the retailer offers a discount to a purchaser but bills and collects tax on the retailer's price rather than on the sales price. The customer must receive the benefit of the discount, for sales tax purposes, in order for the retailer to exclude the discount from the sales price when collecting and reporting tax.

Certain retailers bill their customers on a gross and net basis, with the difference considered to be a discount for payment purposes. When a customer does not resolve the bill within the net payment period, tax shall apply on the gross charge shown on the billing, the gross charge having become the taxable sales price by virtue of the customer's failure to take the action, which allows the discount to be taken.

**203.3(2)** *Rebates.* A "rebate" is a return of part of an amount paid for a product. Manufacturers' rebates are not discounts and cannot be used to reduce the sales price received from a sale or to reduce the purchase price of a product. This subrule applies even though the rebate is used by the retailer to reduce the retailer's price to a sales price or is used by the purchaser as a down payment. The rebate is considered a transaction between the manufacturer and the purchaser.

**203.3(3)** *Coupons.* Coupons issued by the producer of a product are not discounts and cannot be used as an abatement from the retailer's price of the product. Coupons issued by the retailer that actually reduce the price of the product to the purchaser are treated as a discount as provided in subrule 203.3(1).

EXAMPLE 1: Customer C acquires a 30¢ off coupon issued by the manufacturer of A-B Bandages for A-B Bandages. The coupon can be redeemed at a store that sells the product. Customer C goes to Store D and purchases a box of A-B Bandages, which shows a price of $1.50. C pays $1.20 plus the 30¢ coupon. Store D is reimbursed the 30¢ for the coupon by the manufacturer. Tax is due on the $1.50 because Store D's total sales price is $1.50. The coupon is not used as a discount in this situation.

EXAMPLE 2: Restaurant E offers a two-for-the-price-of-one coupon for its super hamburger. Each hamburger normally sells for $2. The coupon can only be redeemed at Restaurant E's retail store. Customer F acquires the coupon and redeems it at Restaurant E's store. The purchase price for Customer F was $2 for both hamburgers. The tax is due on the $2 because

this amount is the sales price for Restaurant E, even though the value of the two hamburgers would normally be $4. In this situation, the sales price for the two hamburgers is $2.

**203.3(4)** *Trade discounts.* A "trade discount" is a discount from a seller's list price that is offered to a class or category of customer, e.g., retailers or wholesalers. Trade discounts given or allowed by manufacturers, distributors, or wholesalers to retailers or by manufacturers or distributors to wholesalers and payments made by manufacturers, distributors, or wholesalers directly to retailers or by manufacturers or distributors to wholesalers to reduce the sales price of a manufacturer's, distributor's, or wholesaler's product (e.g., cigarettes) or to promote the sale or recognition of the manufacturer's, distributor's, or wholesaler's product are not to be included in any taxable sales price. This subrule does not apply to coupons issued by manufacturers, distributors, or wholesalers to consumers; more information is contained in subrule 203.3(3).

This rule is intended to implement Iowa Code section 423.1(51).

**701—203.4(423) Excise tax included in and excluded from sales price.**

**203.4(1)** An excise tax that is not an Iowa sales or use tax may be excluded from the sales price or purchase price of the sale or use of property or taxable services only if all of the following conditions exist:

*a.* The excise tax is imposed upon the identical sales price on which the Iowa sales tax is imposed or upon the purchase price that measures the amount of taxable use or upon a use identical to the Iowa taxable use and not upon some event or activity that precedes or occurs after the sale or use.

*b.* The legal incidence of the excise tax falls upon the purchaser who is also responsible for payment of the Iowa sales tax. The purchaser must be obligated to pay the excise tax either directly to the government in question or to another person (e.g., the retailer) who acts as a collector of the tax. *Gurley v. Rhoden*, 421 U.S. 200, 95 S. Ct. 1605, 44 L.Ed.2d 110 (1975) contains a description of the circumstances under which the legal, as opposed to the economic, burden of an excise tax falls upon the purchaser.

*c.* The name of the excise tax is specifically stated, and the amount of the excise tax is separately set out on the invoice, bill of sale, or another document that embodies a record of the sale.

EXAMPLE 1: The federal government imposes an excise tax upon the act of manufacturing certain tangible personal property within the United States. The amount of the tax is measured as a percentage of the price for the first sale of the property, which is usually to a wholesaler. However, one particular manufacturer sells its manufactured goods at retail in Iowa. Even if this tax meets the requirements for exclusion of paragraphs 203.4(1)*"b"* and *"c"* above, it is not excludable because it does not meet the requirements of paragraph 203.4(1)*"a."* The tax is not imposed upon the act of selling but upon the prior act of manufacturing. The tax is merely measured by the amount of the proceeds of the sale.

EXAMPLE 2: The federal government imposes an excise tax of 4 percent on a retailer's sales price from sales of tangible personal property. The law allows the retailer to separately identify and bill a customer for the tax. However, if a retailer fails to pay the tax, the government cannot collect it from a purchaser, and if the government assesses tax against the retailer and secures a judgment requiring the retailer to pay the tax, the retailer that has failed to collect the tax from a purchaser on the initial sale has no right of reimbursement from the purchaser. This tax is not excludable from Iowa excise tax. Its economic burden falls upon the purchaser. However, since neither the government nor the retailer has any legal right to demand payment of the tax from a purchaser, the legal incidence of the tax is not upon the purchaser and the tax would not meet the requirements of paragraph 203.4(1)*"b"* above.

**203.4(2)** The following federal excise taxes are to be included in the sales price upon which Iowa sales tax is to be paid for purposes of collecting Iowa sales tax:

*a.* The federal gallonage taxes imposed by 26 U.S.C. Sections 5001, 5041, and 5051 on distilled spirits, wines, and beer.

*b.* The tax imposed by 26 U.S.C. Section 5701 with regard to cigars, cigarettes, cigarette papers and tubes, smokeless tobacco, and pipe tobacco.

*c.* The federal tax imposed under 26 U.S.C. Section 4081 on gasoline.

**203.4(3)** The following excise taxes are excluded from the amount of the sales price:

*a.* The federal tax imposed by 26 U.S.C. Section 4251(a) on the communication services of local telephone service, toll telephone service, and teletypewriter exchange service.

*b.* The federal tax imposed by 26 U.S.C. Section 4051 upon the first retail sale of automobile and truck chassis and bodies, truck trailer and semitrailer chassis and bodies and tractors of the kind chiefly used for highway transportation in combination with trailers or semitrailers.

This rule is intended to implement Iowa Code section 423.1(51).

**701—203.5(423) Trade-ins.**

**203.5(1)** Trade-ins.

*a.* When tangible personal property is traded toward the purchase price of other tangible personal property, the sales price shall be only that portion of the purchase price that is payable in money to the retailer if the conditions in paragraph 203.5(1)*"b"* are met.

*b.* The tangible personal property is traded to a retailer, the property traded is the type normally sold in the regular course of the retailer's business and either subparagraph 203.5(1)*"b"*(1) or 203.5(1)*"b"*(2) is true.

(1) The tangible personal property traded to a retailer is intended by the retailer to be ultimately sold at retail; or

(2) The tangible personal property traded to a retailer is intended to be used by the retailer or another in the remanufacturing of a like item.

EXAMPLE 1: Customer A owns a car valued at $5,000. Customer A trades a used car to XY Car Dealer for a used car valued at $12,000. XY Car Dealer normally sells used cars. Use tax would be due on the $7,000 in money that Customer A paid to XY Car Dealer, as both conditions in paragraph 203.5(1)*"b"* and subparagraph 203.5(1)*"b"*(1) have been met.

EXAMPLE 2: John Doe has a pickup truck with a value of $2,000. John wants a boat, so he offers to trade his $2,000 pickup to ABC Boat Dealer for the purchase of a boat valued at $5,000. ABC Boat Dealer is a new and used boat dealer. ABC Boat Dealer agrees to accept the $2,000 pickup and $3,000 cash in trade for the boat. In this example, the tax would be computed on $5,000. The trade-in provision would not apply because the condition in paragraph 203.5(1)*"b"* has not been met. The property traded is not the type of property normally sold by ABC Boat Dealer in the regular course of the boat dealer's business.

EXAMPLE 3: ABC Corporation trades 500 bushels of corn and $500 cash to the local cooperative elevator for the purchase of various hand tools. In its regular course of business, the local cooperative elevator sells grain for processing into bread. The trade-in provision in this example would not apply because the condition in subparagraph 203.5(1)*"b"*(1) has not been met. When ultimately sold by the cooperative elevator, the grain traded toward the purchase price of the hand tools is sold for processing and not at retail.

EXAMPLE 4: Hometown Appliance store is in the business of selling stoves, refrigerators, and other various appliances in Iowa. Hometown Appliance has a refrigerator valued at $650. Customer A wishes to trade a used refrigerator toward the purchase price of the new refrigerator. Hometown Appliance agrees to accept Customer A's used refrigerator at a value of $150 toward the purchase price of the new refrigerator. Customer A pays Hometown Appliance $500 in cash. The trade-in provision applies as both conditions in paragraph 203.5(1)*"b"* and subparagraph 203.5(1)*"b"*(1) have been met, and tax would be due on the $500.

Several months later, Hometown Appliance sells the used refrigerator it received from Customer A to the local school district, which is exempt from sales tax on its purchase. The trade-in provision on the original transaction is still applicable because both conditions in paragraph 203.5(1)*"b"* and subparagraph 203.5(1)*"b"*(1) were met. The sale is "at retail," even if the sales price is exempt from tax.

EXAMPLE 5: ABC Auto Supply is in the business of selling various types of automobile and farm implement supplies. The normal selling price for a car generator is $80. ABC Auto Supply allows a $20 trade-in credit to any customer who wishes to trade in an unworkable generator. At the time ABC Auto Supply accepts the unusable generator, it knows that the generator will not be sold at retail; however, ABC Auto Supply also knows that the generator will be sold to XYZ Company, which is in the business of rebuilding generators by using existing parts plus new parts. In this example, the trade-in provision would apply since conditions in paragraph 203.5(1)*"b"* and subparagraph 203.5(1)*"b"*(2) have been met.

**203.5(2)** All the provisions of subrule 203.5(1) apply to the trade-in of vehicles subject to registration when the trade involves retailers of vehicles.

When vehicles subject to registration are traded among persons who are not retailers of vehicles subject to registration, the conditions set forth in subrule 203.5(1) need not be met. The purchase price is only that portion of the purchase price represented by the difference between the total purchase price of the vehicle subject to registration acquired and the value of the vehicle subject to registration traded.

This rule applies only when a vehicle is traded for tangible personal property, regardless of whether the transaction is between a retailer and a nonretailer or between two nonretailers. The vehicle traded in must be owned by the person(s) trading in the vehicle. It is presumed that the name or names indicated on the title of the vehicle dictate ownership of the vehicle as set forth in Iowa Code chapter 321.

EXAMPLE 1: John Doe has an automobile with a value of $2,000. John and his neighbor Bill Jones, who has an automobile valued at $3,500, decide to trade automobiles. John pays Bill $1,500 cash. Vehicles subject to registration are subject to use tax, which is payable to the county treasurer at the time of registration. In this example, John would owe use tax on $1,500 since this is the amount John paid Bill and tax is only due on the cash difference. Bill would not owe any use tax on the vehicle acquired through the trade.

EXAMPLE 2: Joe has a Ford automobile with a value of $5,000. Joe and his friend Jim, who has a Chevrolet automobile also valued at $5,000, decide to trade automobiles. Joe and Jim make an even trade, automobile for automobile, with no money changing hands. In this example, there is no tax due on either automobile because there is no exchange of money.

**203.5(3)** Trade for services or specified digital products. The trade-in provisions referenced in Iowa Code section 423.1(51) and found in Iowa Code section 423.3(59) do not apply to taxable enumerated services or specified digital products. When taxable enumerated services or specified digital products are traded, the sales price would be determined based on the value of the service or specified digital products or other consideration.

EXAMPLE: A and B agree that A will purchase a car that B now owns. The two parties agree on a purchase price of $9,000. In return for transfer of title from B, A agrees to pay B $7,000 in cash and to paint B's house with paint provided by B. A and B agree that the value of B's house painting services is $2,000. House painting is a taxable enumerated service; rule 701—219.13(423) contains more information about this service. Since the trade-in provisions are not applicable to the value of taxable enumerated services, the purchase price of the car is $9,000 and not $7,000.

**203.5(4)** Three-way trade-in transactions. In a three-way trade-in transaction, the agreement provides that a lessee sells to a third-party dealer a vehicle (or other tangible personal property) that the lessee owns. The lessor then purchases another vehicle from the third-party dealer at a reduced price and leases the vehicle to the lessee. The difference between the reduced sale price and retail price of the vehicle is not allowed as a trade-in on the vehicle for use tax purposes.

EXAMPLE: Customer A enters into a three-way agreement with Lessor B. Under the terms of the contract, Customer A sells a 2005 Ford Taurus owned by A to Used Car Dealer C. The retail price for the Ford Taurus is $30,000. Used Car Dealer C then sells the Ford Taurus to Lessor B for the reduced price of $25,000. Lessor B then leases the Ford Taurus to Customer A for a period of 12 months. The $5,000 difference between the reduced sale price and the retail price of the vehicle is not allowed as a trade-in on the sale of the vehicle for use tax purposes.

This rule is intended to implement Iowa Code sections 423.1(51) and 423.3(59).

**701—203.6(423) Installation charges when tangible personal property is sold at retail.** When the sale of tangible personal property includes a charge for installation of the personal property sold, the current rate of tax shall be measured on the entire sales price from the sale. The installation charges would not be taxable if the installation service is not an enumerated service, and where a sales agreement exists, the installation charges are separately contracted. If the written contract contains no provisions separately itemizing such charges, tax is due on the full contract price with no deduction for installation charges, whether or not such installation charges are itemized separately on the invoice.

If the installation services are enumerated services, the installation charges would not be taxable if (1) the services are exempt from tax (e.g., the services are performed on or connected with new construction, reconstruction, alteration, expansion or remodeling of a building or structure) or the services are rendered in connection with the installation of new industrial machinery or equipment, and (2) where a sales agreement exists, the installation charges are separately contracted. If the written contract contains no provisions separately itemizing such charges, tax is due on the full contract price with no deduction for installation charges, whether or not such installation charges are itemized separately on the invoice. If no written contract exists, the installation charges must be separately itemized on the invoice to be exempt from tax. More information is contained in rule 701—219.13(423).

This rule is intended to implement Iowa Code section 423.1(51).

**701—203.7(423) Service charge and gratuity.** When the purchase of any food, beverage or meal automatically and invariably results in the inclusion of a mandatory service charge to the total price for such food, beverage or meal, the amounts so included shall be subject to tax. The term "service charge" means either a fixed percentage of the total price of or a charge for food, a beverage or a meal.

The mandatory service charge shall be considered: (1) a required part of a transaction arising from a taxable sale and a contractual obligation of a purchaser to pay to a vendor a charge arising directly from and as a condition of the making of the sale and (2) a fixed labor cost included in the price for food, a beverage or a meal even though such charge is separately stated from the charge for the food, beverage or meal.

When a gratuity is voluntarily given for food, a beverage or a meal, it shall be considered a tip and not subject to tax.

This rule is intended to implement Iowa Code sections 423.1(51) and 423.2(1).

**701—203.8(423) Payment from a third party.** The sales price from the sales of tangible personal property, services, or enumerated services includes consideration received by the seller from third parties. The following conditions shall apply:

**203.8(1)** The seller actually receives consideration from a party other than the purchaser, and the consideration is directly related to a price reduction or discount on the sale;

**203.8(2)** The seller has an obligation to pass the price reduction or discount through to the purchaser;

**203.8(3)** The amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and

**203.8(4)** One of the following criteria is met:

*a.* The purchaser presents a coupon, certificate or other documentation to the seller to claim a price reduction or discount where the coupon, certificate or documentation is authorized, distributed or granted by a third party with the understanding that the third party will reimburse any seller to whom the coupon, certificate or documentation is presented;

*b.* The purchaser self-identifies to the seller as a member of a group or organization entitled to a price reduction or discount (a "preferred customer" card that is available to any patron does not constitute membership in such a group); or

*c.* The price reduction or discount is identified as a third-party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate or other documentation presented by the purchaser.

This rule is intended to implement Iowa Code chapter 423.