RA 26-372

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapter 502
"Determination of Net Income"

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14, 422.35, and 422.37
State or federal law(s) implemented by the rulemaking: Iowa Code sections 422.35 and 422.37

Public Hearing

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

November 18, 2026 9 to 10 a.m.	Via videoconference call: meet.google.com/sbm-ihix-ere

Public Comment

Any interested person may submit written or oral comments concerning this Regulatory Analysis, which 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:

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Purpose and Summary

The purpose of this proposed rulemaking is to rescind and adopt a new Chapter 502. Chapter 502 provides definitions, reporting instructions, and other useful information not included in the Iowa Code that are necessary for both taxpayers and the Department to understand how corporate income taxpayers must calculate their Iowa net income as required by Iowa Code chapter 422. The present version of Chapter 502 contains a significant number of rules relating to adjustments to Iowa income that have since been repealed. Those rules have been removed, and the chapter renumbered accordingly.

Analysis of Impact

1. **Persons affected by the proposed rulemaking:**

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

There are no significant costs to the public associated with these proposed rules themselves. These proposed rules do not impose any adjustments to income beyond what is already required by law.

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

Taxpayers, tax preparers and Department staff will benefit from this proposed rulemaking.

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 known economic impact of this proposed rulemaking beyond what is contained in the underlying statutes.

- **Qualitative description of impact:**

These proposed rules provide guidance on how corporations should calculate net income for Iowa tax purposes, including guidance for filing consolidated group tax returns.

3. **Costs to the State:**

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

These proposed rules themselves impose no additional costs on the agency. These proposed rules only clarify items relating to tax payments the department is already required by law to administer. These proposed rules have no known impact on any other agency.

- **Anticipated effect on State revenues:**

These proposed rules have no direct impact on State revenues. The adjustments these proposed rules describe are already required or allowed by law. The additional guidance these proposed rules provide may help taxpayers calculate their income more accurately the first time, saving both taxpayers and the State time and money that might otherwise be required to audit or make adjustments.

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

Providing no guidance at all would likely increase costs to both taxpayers and the Department by generating requests for guidance and other questions that could otherwise have been answered by the rules and increasing the likelihood that taxpayers are given inconsistent guidance over time.

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

There are no known less costly or less intrusive methods.

6. **Alternative methods considered by the agency:**

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

The only real alternatives are providing no guidance to taxpayers at all or providing this guidance on a more informal basis.

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

No guidance at all would likely increase costs to both taxpayers and the Department by generating requests for guidance and other questions that could otherwise have been answered by the rules and increasing the likelihood that taxpayers are given inconsistent guidance over time. Issuing this guidance through less formal means may be beneficial to the agency by making it faster and easier to make changes to the guidance when needed but could be detrimental to the public by removing the oversight inherent in the rulemaking process.

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 requirements associated with these proposed rules are imposed by the Iowa Code, and the Department has no authority to make exceptions to them not already contemplated by the law for small businesses.

Text of Proposed Rulemaking

ITEM 1. Rescind 701—Chapter 502 and adopt the following **new** chapter in lieu thereof:

CHAPTER 502
DETERMINATION OF NET INCOME

701—502.1(422) Computation of net income for corporations. Net income for state purposes shall mean federal taxable income as properly computed under the Internal Revenue Code (IRC) and shall include the adjustments in Iowa Code section 422.35.

502.1(1) *Consolidated groups.*

a. Separate Iowa/consolidated federal. In the case of a corporation that is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes but files a separate return for state purposes, taxable income as properly computed for federal purposes is determined as if the corporation had filed a separate return for federal income tax purposes for the taxable year and each preceding taxable year for which it was a member of an affiliated group. For purposes of this paragraph, the taxpayer's separate taxable income shall be determined as if the election provided by IRC Section 243(b)(2) had been in effect for all those years.

b. Consolidated Iowa/consolidated federal. More information about filing consolidated Iowa returns can be found in rule 701—502.2(422).

502.1(2) *Short periods.* When a federal short period return is filed, an Iowa return must be filed for the same period and the income calculated in the same manner as for the federal short period. If the federal taxable income is required to be adjusted to an annualized basis, the Iowa taxable income shall also be adjusted to an annualized basis.

This rule is intended to implement Iowa Code section 422.35.

701—502.2(422) Consolidated returns.

502.2(1) *Definition.* Unless otherwise stated, the terms used in this rule shall have the same meaning as when used in a comparable context in the federal income tax regulations for consolidated returns except for determining whether an affiliated group had exercised its privilege of filing a consolidated return. All references to the "commissioner" or "district director" in the federal regulations shall be construed to mean the director for purposes of this rule.

The term "common parent" shall have the same general meaning as when used in the federal income tax regulation. Where the common parent has designated one of its subsidiaries to act as agent for the affiliated group, references in this rule to "common parent" shall mean the designated agent pursuant to subparagraph 502.2(2)*"c"*(2).

502.2(2) *Filing Iowa consolidated returns.*

a. Electing to file consolidated returns. An affiliated group of corporations that did not file an Iowa consolidated return for the immediately preceding taxable year may file a consolidated return in lieu of separate returns for the taxable year.

b. Membership of the Iowa group. Each corporation that is subject to the Iowa corporation income tax and has been a member during any part of the taxable year for which the consolidated return is to be filed must consent to the filing of the consolidated return.

c. Common parent. The consolidated return shall be filed for the group by the common parent corporation. The common parent corporation of the group must attach a copy of the federal Form 851 (Affiliations Schedule) to the consolidated return.

(1) Sole agent. The common parent, for all purposes other than the making of the consent required by paragraph 502.2(2)*"d,"* shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. No subsidiary shall have authority to act for or to represent itself in any matter. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time.

(2) Designated subsidiary. Where the common parent is not subject to the Iowa income tax because it does not have an Iowa filing requirement, as described in 701—subrule 501.1(1) or because of a specific exemption under Iowa Code section 422.34 or 422.34A, the common parent shall designate as the agent for the affiliated group one of its subsidiaries subject to the Iowa income tax and notify the director of the same in writing.

d. Member consent. If a group wishes to exercise its privilege of filing a consolidated return, each subsidiary must consent to the filing of the consolidated return for the year. The subsidiaries must consent to the filing of an Iowa consolidated return by joining in the filing of an Iowa consolidated return on or before the due date, including any extensions of time. If both separate and consolidated returns are filed on or before the due date, including any extensions of time, the latest returns filed will be considered as the taxpayers' election in regard to the filing of separate or consolidated returns.

e. Time for filing. The consolidated return must be filed not later than the due date prescribed by Iowa Code section 422.21, including extensions of time for the filing of the common parent's return. The consolidated return may not be withdrawn after the due date for filing, including extensions of time, but the group may change the basis of its return at any time prior to the due date.

f. Taxable year. The taxable year of members of the group, including rules for changing the parent's taxable year, income to be included in the separate returns, and the time for making separate returns for periods not included in a consolidated return for the purposes of the Iowa Code, shall be in accordance with the rules prescribed in Treas. Reg. Section 1.1502-76(a)-(c).

g. Group existence. A group shall be considered as remaining in existence, for the purposes of the Iowa Code, in accordance with the rules prescribed in Treas. Reg. Section 1.1502-75(d).

502.2(3) *When director may require consolidated return.* The director may require a consolidated return for those members of an affiliated group of corporations that would be eligible to elect to consolidate their incomes under Iowa Code section 422.37 if the filing of separate returns for such corporations would improperly reflect the taxable incomes of said corporations or of said group.

502.2(4) *Discontinuance of filing consolidated returns.* An affiliated group that filed or was required to file a consolidated return for the immediately preceding taxable year is required to file a consolidated return for the taxable year unless it is allowed to discontinue filing consolidated returns or a federal consolidated return is not filed by the group.

a. Notification of discontinuance. In the event that a consolidated filing for Iowa tax purposes is discontinued for any reason, the common parent must notify the department in writing. The mere filing of separate returns does not, in itself, constitute sufficient notice.

b. When consolidated filing may be discontinued. A group may discontinue filing consolidated Iowa returns if any of the following factors are met:

(1) Separate federal returns. The group is not filing a federal consolidated return for the year. A group that files on a separate basis for federal income tax purposes for the tax year is not permitted to file an Iowa consolidated return for that same tax year.

(2) Determination that separate filing more clearly discloses the taxable income. The director determines that the filing of separate returns will more clearly disclose the taxable income of each member of the affiliated group. Corporations should apply to the director within a reasonable time

prior to the due date of the return, including extensions of time. Normally, this would be not later than 90 days prior to said due date. The application should explain in detail the taxable income on both a consolidated and separate basis together with the reasons why separate returns would more clearly disclose Iowa taxable income. The mere fact that the consolidated tax liability is greater or less than the combined separate liabilities is not, alone, a ground for discontinuance of consolidated filing.

(3) Change in membership. When one or more of the members of the affiliated group cease to be subject to Iowa corporate income tax, consolidation may be discontinued in whole or in part.

(4) Members no longer taxable. One or more of the members of the affiliated group has changed in character so that they are no longer taxable under the Iowa corporate income tax law.

EXAMPLE: Common parent A is a manufacturer. Subsidiary B is a company engaged in small loans. A and B file consolidated Iowa returns. In a subsequent taxable year, B changes its business by surrendering its small loan company license and obtains a state bank charter. Even though A and B continue to file federal consolidated returns, B is now a corporation exempt from tax under Iowa Code section 422.34. Therefore, A and B should discontinue filing Iowa consolidated returns.

(5) Change in ownership. The affiliated group is purchased by another corporation or affiliated group so that after the purchase the stockholders own less than 50 percent of the market value of all classes of outstanding stock of the new corporation or affiliated group, then the old group must discontinue filing Iowa consolidated returns. The new group may exercise its privilege of filing a consolidated return.

c. Separate returns required. If a group is allowed to discontinue filing consolidated returns for any taxable year, then each member of the affiliated group subject to Iowa tax must file a separate return for such year on or before the due date, including extensions of time for the filing of the consolidated return for such year.

d. Tax allocation. In any case in which amounts have been assessed and paid upon the basis of a consolidated return and where the tax liability of one or more of the corporations included in the consolidated return is to be computed in the manner described in paragraph 502.2(6)*"c,"* the amounts so paid shall be allocated between the group composed of the corporations properly included in the consolidated return and each of the corporations whose tax liability is to be computed on a separate basis or on the basis of a consolidated return of another group. Where one or more of the corporations is included in the absence of an agreement, the tax liability of the group shall be allocated as follows. The net consolidated federal income tax liability is multiplied by a fraction, the numerator of which is the taxpayer's federal taxable income as computed on a separate basis, and the denominator of which is the total federal taxable incomes of each corporation included in the consolidated return. If the computation of the taxable income of a member results in an excess of deductions over gross income, such member's taxable income shall be zero.

502.2(5) *Changes in membership of the consolidated group.*

a. Dissolution of common parent. If the common parent corporation contemplates dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it must notify the director of that fact and designate another member to act as the common parent in its place. If this notice is not given by the common parent, the remaining members may, subject to the approval of the director, designate another member to act as agent, and notice of the designation shall be given to the director. Until a written notice designating a new agent has been approved by the director, any notice of assessment or other communications mailed to the common parent shall be considered as having been properly mailed to the agent of the group. If the director has reason to believe that the existence of the common parent has terminated, the director may communicate directly with any member with respect to its liability.

b. Member leaving the group. If a subsidiary has ceased to be a member of the group and if the subsidiary files written notice of the cessation with the director, then upon request of the subsidiary, the director will furnish it with a copy of any notice concerning the tax for a consolidated return year for which it was a member. The filing of the written notification and request by a corporation shall not have the effect of limiting the scope of the agency of the common parent.

c. Common parent actions binding. Unless the director agrees to the contrary, an agreement entered into by the common parent extending the time within which a notice of assessment may be issued, or a levy or a proceeding in court begun concerning the tax for a consolidated return year shall be applicable to each corporation that was a member of the group during any part of the taxable year and to each corporation, the income of which was included in the consolidated return for the taxable year, notwithstanding that the liability of the corporation is subsequently computed on the basis of a separate return under these rules.

502.2(6) *Determination of consolidated Iowa income.*

a. Unless otherwise provided by these rules or inconsistent with the provisions of the Iowa Code, the consolidated taxable income for a consolidated return year under the Iowa Code shall be determined in the same manner and under the same procedures, including intercompany adjustments and eliminations, as are required by the federal income tax regulations in the case of a federal consolidated return.

b. If the Iowa affiliated group differs in its members from the federal affiliated group, such nonqualifying member(s) shall not be considered includable corporations and all computations hereunder shall be made as if such member(s) were not members of the affiliated group. The consolidated federal income tax liability shall be allocated between includable corporations and nonincludable corporations by paragraph 502.2(4)*"d."* Transactions with a subsidiary that is not included as part of the Iowa consolidated return shall not be considered as intercompany transactions for elimination purposes in computing the consolidated Iowa taxable income for the return period.

c. If a consolidated return erroneously includes the income of one or more corporations that were not members of the group at any time during the consolidated return year, the tax liability of such corporations will be determined upon the basis of separate returns and the consolidated return will be considered as including only the income of the corporations that were members of the group during that taxable year.

d. The apportionment provisions of Iowa Code section 422.33 shall be taken into account by an affiliated group doing business within and without Iowa. All members of an affiliated group that join in the filing of an Iowa consolidated return shall determine the portion of the consolidated net income earned within and without Iowa by the same method. All intercompany transactions shall be eliminated in the determination of the apportionment factors.

The gross receipts of each corporation that joins in the filing of an Iowa consolidated corporation income tax return shall be included in the computation of the business activity ratio. The gross receipts of each corporation that has nexus in Iowa shall be included in the numerator of the business activity ratio to the extent its gross receipts are not eliminated by intercompany adjustments and are considered Iowa gross receipts by 701—Chapter 503. The gross receipts of each corporation that has nexus in Iowa shall be included in the denominator of the business activity ratio to the extent its gross receipts are not eliminated by intercompany adjustments.

e. 701—Chapter 276 contains more information for requirements of an out-of-state business to be a part of an affiliated group filing an Iowa consolidated return that enters Iowa to perform "disaster or emergency-related work" during a "disaster response period" as those terms are defined in Iowa Code section 29C.24.

502.2(7) *Liability for tax.*

a. Except as provided in paragraph 502.2(7)*"b,"* the common parent corporation and each subsidiary subject to the Iowa corporation income tax that was a member of the affiliated group during any part of the consolidated return year shall be severally liable for the tax for the year computed in accordance with Iowa Code chapter 422, on or before the due date, not including extensions of time for the filing of the consolidated return for that year.

b. If a subsidiary has ceased to be a member of the group and if the cessation resulted from a bona fide sale or exchange of its stock for fair value and occurred prior to the date upon which any deficiency is assessed, the director may make an assessment and collection of the deficiency from the former subsidiary in an amount not exceeding the portion of the deficiency that the director

may determine to be allocable to it. If the director makes assessment and collection of any part of a deficiency from the former subsidiary, then for purposes of any credit or refund of the amount collected from the former subsidiary, the agency of the common parent under the provisions of paragraph 502.2(2)*"c"* shall not apply.

c. No agreement entered into by one or more members of the affiliated group with any other member of the group shall in any case have the effect of reducing the liability prescribed under this subrule.

502.2(8) *Computation of contribution.* Computation of a separate corporation's contribution to consolidated income subject to Iowa tax shall be as follows:

$$\frac{A}{B} \times C \times \frac{D}{A} + E = \begin{array}{l}\text{separate corporation contribution to} \\ \text{consolidated income subject to Iowa tax}\end{array}$$

A = Separate corporation gross sales within and without Iowa after elimination of all intercompany transactions.

B = Consolidated gross sales within and without Iowa after elimination of all intercompany transactions.

C = Iowa consolidated net income subject to apportionment.

D = Separate corporation gross sales within Iowa after elimination of all intercompany transactions.

E = Separate corporation income allocable to Iowa.

This rule is intended to implement Iowa Code sections 422.35 and 422.37.

701—502.3(422) Capital loss carryback.

502.3(1) Capital losses shall be allowed or allowable for Iowa corporation income tax purposes to the same extent they are allowed or allowable for federal corporation income tax purposes. Capital loss carrybacks shall be treated as an adjustment to federal taxable income to arrive at net allocable and apportionable income.

a. Accrual-basis. For accrual-basis taxpayers, the federal income tax refund shall not be accrued to the loss year but rather treated as a reduction in federal income tax paid in the carryback year.

b. Cash-basis. Cash-basis taxpayers shall include the federal income tax refund in Iowa taxable income in the year received.

502.3(2) When the carryback year has both allocable and apportionable capital gains, the capital loss carryback shall be applied pro rata on a percentage basis of the specific gain to the total gains.

EXAMPLE: Assume a taxpayer has a capital loss carryback available of $2,000. The loss would be applied in the following manner:

Carryback year Total Capital Gain	Carryback year Allocable Gain	Carryback year Apportionable Gain
$16,000	$4,000	$12,000

Allocable gain	–$4,000		
Total capital gain	–$16,000	=	¼ or 25% of carryback to allocable gain

Carryback year allocable capital gain after application of loss carryback:

$4,000 less ($2,000 × 25%) = $3,500 net allocable capital gain.

This rule is intended to implement Iowa Code sections 422.35 and 422.37.

701—502.4(422) Interest and dividends from federal securities. A discussion of the exempt status of interest and dividends from federal securities is found in rule 701—302.2(422).

This rule is intended to implement Iowa Code section 422.35.

701—502.5(422) Interest and dividends from foreign securities and from securities of state and their political subdivisions. Interest and dividends from foreign securities and from securities of states and their political subdivisions are included in Iowa taxable income. Certain types of interest and dividends are exempt from federal taxable income. To the extent such income has been excluded for federal income tax purposes, it must be added to Iowa taxable income unless the item of income is specifically exempted from state taxation by the laws or constitution of Iowa or of the United States. A list of obligations of the state of Iowa and its political subdivisions, the interest from which is exempt from Iowa corporation income tax, can be found in rule 701—302.3(422).

Add dividends received from regulated investment companies exempt from federal tax under IRC Section 852(b)(5) and subtract the loss on the sale or exchange of a share of a regulated investment company held for six months or less to the extent the loss was disallowed under IRC Section 852(b)(4)(B).

This rule is intended to implement Iowa Code section 422.35.

701—502.6(422) Additions to federal taxable income for certain federal credits.

502.6(1) *Charitable contributions relating to the charitable conservation contribution tax credit.* A taxpayer who claims a charitable conservation contribution tax credit in accordance with rule 701—800.18(422) cannot claim a deduction for charitable contributions under IRC Section 170 for the amount of the contribution for which the tax credit is claimed for Iowa tax purposes.

502.6(2) *Charitable contributions relating to school tuition organizations.* A taxpayer who claims a school tuition organization tax credit in accordance with rule 701—800.10(422) cannot claim a deduction for charitable contributions under IRC Section 170 for the amount of the contribution to the school tuition organization for which the tax credit is claimed for Iowa tax purposes.

502.6(3) *Charitable contributions relating to the endow Iowa tax credit.* A taxpayer who claims an endow Iowa tax credit in accordance with rule 701—800.12(15E,422) cannot claim a deduction for charitable contributions under IRC Section 170 for the amount of the contribution for which the tax credit is claimed for Iowa tax purposes.

502.6(4) *Charitable contributions related to the from farm to food donation tax credit.* A taxpayer who claims a from farm to food donation tax credit in accordance with rule 701—800.14(422) cannot claim a deduction for charitable contributions under IRC Section 170 for the amount of the contribution for which the tax credit is claimed for Iowa tax purposes.

This rule is intended to implement Iowa Code section 422.35.

701—502.7(422) Additional deduction for wages paid or accrued for work done in Iowa by certain individuals. A small business corporation, as defined by subrule 502.7(2), is allowed a deduction for 65 percent but not more than $20,000 of the wages paid or accrued during the tax years for work done in Iowa by qualifying employees first hired by the taxpayer during the tax year.

The employee must meet the requirements of Iowa Code section 422.35(3)*"a."*

502.7(1) The additional deduction shall not be allowed for wages paid to an individual who was hired to replace an individual whose employment was terminated within the 12-month period preceding the date of first employment. However, if the individual being replaced left employment voluntarily without good cause attributable to the employer or if the individual was discharged for misconduct in connection with the individual's employment as determined by Iowa workforce development, the additional deduction shall be allowed.

The determination of whether an individual left employment voluntarily without good cause attributable to the employer or if the individual was discharged for misconduct is a factual determination which must be made on a case-by-case basis.

502.7(2) Definitions.

"Annual gross revenues" means total sales, before deducting returns and allowances but after deducting corrections and trade discounts, sales taxes and excise taxes based on sales as determined in accordance with generally accepted accounting principles.

"Has a record of such impairment" means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities.

"Individual with a disability" means any person who has a physical or mental impairment that substantially limits one or more major life activities, has a record of such impairment, or is regarded as having such an impairment. "Individual with a disability" does not include any person whose current use of alcohol or controlled substances prevents the person from performing the duties of employment or whose employment, by reason of current use of alcohol or controlled substances, would constitute a direct threat to the property or the safety of others.

"Is regarded as having such an impairment" means a person who:

1. Has a physical or mental impairment that does not substantially limit major life activities but that is perceived as constituting such a limitation;

2. Has a physical or mental impairment that substantially limits major life activities only as a result of the attitudes of others toward such impairment; or

3. Has none of the impairments defined as physical or mental impairments but is perceived as having such an impairment.

"Major life activities" means functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working.

"Physical or mental impairment" means:

1. Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genitourinary; hemic and lymphatic; and skin and endocrine; or

2. Any mental or psychological disorder, such as intellectual disability, organic brain syndrome, emotional or mental illness, and specific learning disabilities.

"Probationary period" means the period of probation for newly hired employees if the employer has a written probationary policy. If the employer has no written probationary policy for newly hired employees, the probationary period shall be considered to be six months from the date of hire.

"Small business corporation" does not include the practice of a profession. The following conditions apply for the purpose of determining what constitutes a small business corporation.

1. A small business corporation shall not have had more than 20 full-time equivalent positions during each of the 26 consecutive weeks within the 52-week period immediately preceding the date on which the individual for whom an additional deduction for wages is taken was hired. Full-time equivalent position means any of the following:

- An employment position requiring an average work week of 40 or more hours;
- An employment position for which compensation is paid on a salaried full-time basis without regard to hours worked; or
- An aggregation of any number of part-time positions that equal one full-time position. For purposes of this definition, each part-time position shall be categorized with regard to the average number of hours worked each week as a one-quarter, half, three-quarter, or full-time position as set forth in the following table:

Average Number of Weekly Hours	Category
More than 0 but less than 15	¼
15 or more but less than 25	½
25 or more but less than 35	¾
35 or more	1 (full-time)

2. A small business corporation cannot have more than $3 million in annual gross revenues for the preceding fiscal year or as the average of the three preceding tax years.

3. A small business corporation shall not be an affiliate or subsidiary of a business that is dominant in its field of operation.

"Successfully completing a probationary period" includes those instances where the employee quits without good cause attributable to the employer during the probationary period or was discharged for misconduct during the probationary period.

"The practice of a profession" means a vocation requiring specialized knowledge and preparation including but not limited to the following: medicine and surgery, podiatry, osteopathy, osteopathic medicine and surgery, psychology, psychiatry, chiropractic, nursing, dentistry, dental hygiene, optometry, speech pathology, audiology, pharmacy, physical therapy, occupational therapy, mortuary science, law, architecture, engineering and surveying, and accounting.

502.7(3) If a newly hired employee has been certified as either a vocational rehabilitation referral or an economically disadvantaged ex-convict for purposes of qualification for the work opportunity tax credit under IRC Section 51, that employee shall be considered to have met the qualifications for the additional wage deduction.

A vocational rehabilitation referral is any individual certified by a state employment agency as having a physical or mental disability which, for the individual, constitutes or results in a substantial handicap to employment. In addition, the individual must have been referred to the employer after completion or while receiving rehabilitation services pursuant to either a state or federal approved vocational rehabilitation program.

For all other newly hired employees, the employer has the burden of proof to show that the employees meet the qualifications for the additional wage deduction.

502.7(4) The taxpayer shall include a schedule with the filing of its tax return showing the name, address, social security number, date of hiring and wages paid of each employee for which the taxpayer claims the additional deduction for wages.

502.7(5) If the employee for which an additional deduction for wages was allowed fails to successfully complete a probationary period and the taxpayer has already filed an Iowa corporation income tax return taking the additional deduction for wages, the taxpayer shall file an amended return adding back the additional deduction for wages. The amended return shall state the name and social security number of the employee who failed to successfully complete a probationary period.

502.7(6) A taxpayer who did not qualify for the additional deduction for wages paid or accrued for work done in Iowa by certain individuals set forth above is allowed an additional deduction of 65 percent not to exceed $20,000 of the first 12 months of wages paid or accrued for work done in Iowa if the new employee is:

a. An individual domiciled in this state at the time of the hiring who meets any of the following conditions:

(1) Has been convicted of a felony in this or any other state or the District of Columbia.

(2) Is on parole pursuant to Iowa Code chapter 906.

(3) Is on probation pursuant to Iowa Code chapter 907 for an offense other than a simple misdemeanor.

(4) Is in a work release program pursuant to Iowa Code chapter 904, division IX.

b. An individual, whether or not domiciled in this state at the time of the hiring, who is on parole or probation and to whom the interstate compact for adult offender supervision under Iowa Code chapter 907B applies.

The additional deduction is not allowed for wages paid to an individual who was hired to replace an individual whose employment was terminated within the 12-month period preceding the date of first employment. However, if the individual being replaced left employment voluntarily without good cause attributable to the employer or if the individual was discharged for misconduct in connection with the individual's employment as determined by the Iowa division of job service of the department of employment services, the additional deduction is allowed.

The determination of whether an individual left employment voluntarily without good cause attributable to the employer or if the individual was discharged for misconduct is a factual determination that must be made on a case-by-case basis.

The taxpayer must include a schedule with the filing of its tax return showing the name, address, social security number, date of hiring, and wages paid of each employee for whom the taxpayer claims the additional deduction for wages.

If the employee for whom an additional deduction for wages was allowed fails to successfully complete a probationary period and the taxpayer has already filed an Iowa corporation income tax return taking the additional deduction for wages, the taxpayer must file an amended return adding back the additional deduction for wages. The amended return must state the name and social security number of the employee who failed to successfully complete a probationary period.

502.7(7) The additional deduction applies to any individual, whether or not domiciled in Iowa at the time of hiring, who is on parole or probation and to whom the compact for adult offenders under Iowa Code chapter 907B applies. The amount of additional deduction for hiring this individual is equal to 65 percent of the wages paid, but the additional deduction is not to exceed $20,000 for the first 12 months of wages paid for work done in Iowa. The conditions set out in the unnumbered paragraphs under paragraph 502.7(6)*"b"* also apply to the deduction for the hiring of certain individuals in this subrule.

This rule is intended to implement Iowa Code section 422.35.

701—502.8(422) Method of accounting, accounting period. The return shall be computed on the same basis and for the same accounting period as the taxpayer's return for federal corporation income tax purposes. Permission to change accounting methods or accounting periods for corporation tax purposes is not required provided the taxpayer furnishes the department with a copy of the federal consent.

This rule is intended to implement Iowa Code section 422.35.

701—502.9(422) Deductions related to the Iowa educational savings plan trust. Certain qualifying organizations may establish Iowa education savings plan trust accounts as participants as described in Iowa Code chapter 12D. Taxpayers may make contributions to such qualifying organizations so that the organization can deposit the contribution into the organization's Iowa education savings plan trust account. However, for Iowa income tax purposes, a taxpayer must add back any portion of the federal charitable contribution deduction allowed for a contribution to a qualifying organization, to the extent that the taxpayer designated that any part of such contribution be used for the direct benefit of a dependent of a shareholder or for the benefit of any other specific person chosen by the taxpayer.

This rule is intended to implement Iowa Code section 422.35.

701—502.10(422) Section 179 expensing.

502.10(1) *In general.* Iowa taxpayers who elect to expense certain depreciable business assets in the year the assets were placed in service under IRC Section 179 must also expense those same assets for Iowa income tax purposes in that year.

502.10(2) *Claiming the deduction.*

a. Timing and requirement to follow federal election. A taxpayer who takes a federal section 179 deduction must also take the deduction for the same asset in the same year for Iowa purposes.

b. Qualifying for the deduction. Whether a specific business asset qualifies for a section 179 deduction is determined by the IRC and applicable federal regulations for both federal and Iowa purposes.

c. Amount of the Iowa deduction. Generally, the Iowa deduction must equal the amount of the federal deduction taken for the same asset in the same year, subject to special Iowa limitations. The following chart provides a comparison of the Iowa and federal section 179 dollar limitations and reduction limitations. Information about section 179 rules applicable to individuals and other noncorporate entities can be found in rule 701—302.10(422); information about the section 179 rules applicable to financial institutions subject to the franchise tax can be found in rule 701—602.10(422).

Section 179 Deduction Allowances Under Federal and Iowa Law

	Federal		Iowa	
Tax Year	Dollar Limitation	Reduction Limitation	Dollar Limitation	Reduction Limitation
2003	$ 100,000	$ 400,000	$ 100,000	$ 400,000
2004	102,000	410,000	102,000	410,000
2005	105,000	420,000	105,000	420,000
2006	108,000	430,000	108,000	430,000
2007	125,000	500,000	125,000	500,000
2008	250,000	800,000	250,000	800,000
2009	250,000	800,000	133,000	530,000
2010	500,000	2,000,000	500,000	2,000,000
2011	500,000	2,000,000	500,000	2,000,000
2012	500,000	2,000,000	500,000	2,000,000
2013	500,000	2,000,000	500,000	2,000,000
2014	500,000	2,000,000	500,000	2,000,000
2015	500,000	2,000,000	500,000	2,000,000
2016	500,000	2,010,000	25,000	200,000
2017	510,000	2,030,000	25,000	200,000
2018	1,000,000	2,500,000	70,000	280,000
2019	1,020,000	2,550,000	100,000	400,000
2020 and later	Iowa limitations and deductions are the same as federal			

d. Reduction. Both the federal and the Iowa deductions for section 179 assets are reduced (phased out dollar for dollar) for taxpayers whose total section 179 assets placed in service during a given year cost more than the amount specified (reduction limitation) for that year.

e. Income limitation. The Iowa section 179 deduction for any given year is limited to the taxpayer's income from active conduct in a trade or business in the same manner that the section 179 deduction is limited for federal purposes. If an allowable Iowa section 179 deduction exceeds the taxpayer's business income for Iowa purposes for a given year, any excess allowable Iowa section 179 deduction may be carried forward as described in paragraph 502.10(2)*"f."*

f. Carryforward. As with the federal deduction, allowable Iowa section 179 deductions claimed in a given year that exceed a taxpayer's business income may be carried forward and claimed in future years.

g. Difference in basis. Iowa adjustments for differences between the Iowa and federal section 179 deduction limitations may cause the taxpayer to have a different basis in the same asset for Iowa and federal purposes. Taxpayers are required to use forms made available on the department's website to calculate and track these differences.

This rule is intended to implement Iowa Code section 422.35.

701—502.11(422) Broadband infrastructure grant exemption.

502.11(1) *Broadband infrastructure grant exemption, generally.* Certain qualifying communications service providers may subtract, to the extent included in federal taxable income, the amount of qualifying government grants used to install broadband infrastructure that facilitates broadband service in targeted service areas at or above download and upload speeds identified by the Federal Communications Commission pursuant to Section 706 of the federal Telecommunications Act of 1996 as amended.

502.11(2) *Definitions.*

"Facilitate" shall have the same meaning as defined in Iowa Code section 8.76.

"Grant" means a transfer of money or property for a governmental purpose to a transferee that is not a related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor or a related party. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

1. "Federal grant" means any grant issued by the United States government, including any agency or instrumentality thereof.

2. "State grant" means any grant issued by any state of the United States, the District of Columbia, or a territory or possession of the United States, including any agency or instrumentality thereof.

3. "Local grant" means any grant issued by any city, county, township, school district, or any other unit of local government, including any agency or instrumentality thereof.

This rule is intended to implement Iowa Code section 422.35.

701—502.12(422) Interest expense deduction adjustments. The limit on the amount of business interest expense that a taxpayer may deduct in a taxable year under IRC Section 163(j) does not apply for Iowa purposes. This rule provides information on how taxpayers must calculate and report their business interest expense deduction for Iowa purposes. All references to the Code of Federal Regulations (Treas. Reg.) and certain other information in this rule are based on final Internal Revenue Service (IRS) regulations and guidance in effect on January 13, 2021.

502.12(1) *Definitions.* The following terms apply to the interpretation and application of this rule.

"Current-year business interest expense" means the same as defined in Treas. Reg. Section 1.163(j)-1(b)(9).

"Excess business interest expense" means the same as defined in Treas. Reg. Section 1.163(j)-1(b)(16).

"Iowa partnership" means any entity required to file an Iowa return (IA 1065) for the relevant tax year.

"Iowa S corporation" means any S corporation required to file an Iowa return (IA 1120S) for the relevant tax year.

"Non-Iowa partnership" means any entity that is required to file a federal 1065 but is not required to file an Iowa return (IA 1065) for the relevant tax year.

"Non-Iowa S corporation" means any S corporation that is not required to file an Iowa return (IA 1120S) for the relevant tax year.

502.12(2) *Corporations.* Iowa does not conform with the IRC Section 163(j) business interest expense deduction limitation. The following adjustments may be required for corporations and consolidated groups due to this nonconformity.

a. Current-year business interest expense. A taxpayer's current-year business interest expense is fully deductible to the extent permitted by IRC Section 163 for Iowa purposes without regard to any limitation under IRC Section 163(j). Even though Iowa does not conform to IRC Section 163(j), provisions of the IRC other than Section 163(j) may subject interest expense to disallowance, deferral, capitalization, or other limitations, and those other provisions of the IRC still generally apply for Iowa purposes. No additional Iowa adjustments are permitted for federal limitations such as those described in Treas. Reg. Section 1.163(j)-3(b)(4), which are determined after the application of IRC Section 163(j) for federal purposes. Treas. Reg. Section 1.163(j)-3 contains examples of other provisions of the IRC that may restrict interest expense deductions for federal and Iowa purposes, independent of the IRC Section 163(j) limitation.

b. Carryforward. When current-year interest expense, as defined in Treas. Reg. Section 1.163(j)-1(b)(10), is limited at the federal level, the disallowed business interest expense is carried forward to be deducted in future years for federal purposes, when certain conditions are met. Iowa law allows taxpayers to fully deduct current-year business interest expense, and no amounts are carried

forward for Iowa purposes. Disallowed business interest expense carryforward amounts from prior years, including excess business interest expense allocated to a partner in a prior year, cannot be deducted for Iowa purposes. All prior-year disallowed business interest expense carryforward amounts deductible under IRC Section 163(j) in the current year at the federal level, including excess business interest expense allocated to a partner in a prior year, must be added back in computing the taxpayer's Iowa income for the year.

EXAMPLE: QRS, Inc., has $100,000 in current-year business interest expense. For federal purposes, QRS, Inc., is subject to the IRC Section 163(j) limitation. QRS, Inc., deducts $70,000 in business interest expense on QRS, Inc.'s, federal return and carries the remaining $30,000 forward to be deducted in future years. For Iowa purposes, QRS, Inc., deducts the full $100,000 in current-year business interest expense.

In the following year, QRS, Inc., has $50,000 in current-year business interest expense. For federal purposes, QRS, Inc., is permitted to deduct the full $50,000 in interest expense generated in the current year, plus $5,000 of the amount that was disallowed in the previous year for a total federal deduction of $55,000. QRS, Inc., must add the federal carryforward amount ($5,000) back on the company's current-year Iowa return, limiting QRS, Inc.'s, Iowa deduction to the $50,000 in current-year business interest expense.

c. Consolidated groups. Corporations that were included on a federal consolidated return but that either file separate returns for Iowa purposes or file an Iowa consolidated return that does not include all members of the federal consolidated group are required to recalculate their proper current-year business interest expense deduction as described in paragraph 502.12(2)*"a,"* and the amount of any prior-year disallowed business interest expense carryforward that must be added back for Iowa purposes as described in paragraph 502.12(2)*"b,"* for the separate entity or Iowa consolidated group by completing pro forma federal interest expense deduction forms for the separate entity or Iowa consolidated group. Treas. Reg. Section 1.163(j)-4(d) and any other applicable federal regulations or guidance govern how Iowa consolidated groups should make this pro forma calculation. More information about the election to file Iowa consolidated returns and group membership requirements is contained in rule 701—502.2(422).

(1) Departure from group. In the event that a member leaves the consolidated group, both the newly separated member and the remaining group shall be required to include any carryforward amounts allocated to them under Treas. Reg. Section 1.163(j)-5(b)(3)(iii) in their respective Iowa incomes in the year or years the separate company or group actually deducts those amounts for federal purposes.

(2) Carryforwards from separate return limitation years (SRLY). A consolidated group is not permitted to deduct any disallowed business interest expense carryforward amount of a member arising in an SRLY for Iowa purposes and must add back such amounts on the Iowa return in the same year in which the consolidated group is permitted to deduct the SRLY carryforward amount for federal purposes. Treas. Reg. Section 1.163(j)-5(d) contains more information about the federal treatment of these carryforward amounts.

502.12(3) *Partners and partnerships.*

a. Partnership-level adjustments. Partnerships that file an Iowa income tax return for a tax year in which the partnership is subject to the IRC Section 163(j) limitation for federal purposes are permitted to deduct all current-year business interest expense at the partnership level in that tax year. More information about the calculation and reporting of partnership-level adjustments is found in 701—paragraph 302.85(5)*"a."*

b. Partner-level adjustments.

(1) Interest expense from Iowa partnerships. Iowa adjustments related to excess business interest expense of an Iowa partnership are made at the entity level as described in 701—paragraph 302.85(5) *"a"* and are reported to partners on an IA 1065 Schedule K-1. Partners are not permitted to make any Iowa adjustment at the partner level to their federal interest expense deduction for amounts of excess

business interest expense allocated from an Iowa partnership on the partner's federal Schedule K-1 related to that Iowa partnership.

EXAMPLE 1: P, a partnership doing business in Iowa, has $100,000 in current-year business interest expense. For federal purposes, $20,000 of that amount is disallowed under IRC Section 163(j). The partnership deducts $80,000 at the entity level, and the remaining disallowed $20,000 is allocated to the partners to be deducted in future years. For Iowa purposes, the $80,000 of business interest expense allowed for federal purposes is included in the partnership's non-separately stated ordinary business income (loss), and the partnership will make an adjustment on the entity's IA 1065 to deduct the $20,000 of current-year business interest expense that was disallowed for federal purposes. The $20,000 additional Iowa deduction will be reported to the partners as an all-source modification on the partners' IA 1065 Schedule K-1, and partners will receive the benefit of this all-source modification item when the partners report their Iowa partnership income on their own Iowa tax return for the year. The partners will not be permitted to make further Iowa adjustments on their own Iowa tax return for the excess business interest expense amounts passed through to them from the partnership for federal purposes.

(2) Interest expense from non-Iowa partnerships. Partners may include as part of their Iowa business interest expense deduction the total amount of current-year excess business interest expense deduction passed through to them from all non-Iowa partnerships as shown on the federal Schedule K-1 (Form 1065), line 13, code K.

EXAMPLE 2: ABC, Inc., is a corporation doing business in Iowa and a partner in P2, an out-of-state partnership with no business in Iowa and no Iowa filing obligation. P2 has $100,000 in current-year business interest expense and is subject to the IRC Section 163(j) limitation for federal purposes. At the entity level, P2 is permitted to deduct $80,000 on its federal partnership return. The $20,000 in excess business interest expense is then allocated to P2's partners. ABC, Inc., is allocated $5,000 in excess business interest expense from P2. Because P2 is not required to file an Iowa return, and therefore ABC, Inc., did not receive an IA 1065 Schedule K-1 from P2, ABC, Inc., is permitted to deduct the $5,000 allocated from P2 as current-year business interest expense on ABC, Inc.'s, Iowa income tax return.

(3) Partnership basis. A partner's basis is reduced (but not below zero) by the amount of excess business interest expense the partnership passes through to the partner each year. Treas. Reg. Section 163(j)-6(h) contains detailed information about how to make these basis adjustments. For federal purposes, immediately before disposition of the partnership interest, the partner's basis is then increased by the amount of any passed-through business interest expense which has not yet been treated as paid or accrued by the partner as described in Treas. Reg. Section 163(j)-6(h)(3). No basis increase at the time of disposition is allowed for Iowa purposes for passed-through business interest expense amounts that were deducted for Iowa but not for federal purposes due to Iowa's nonconformity with IRC Section 163(j).

502.12(4) *S corporation adjustments.* For federal purposes, IRC Section 163(j) limitations are applied at the S corporation level. Unlike partnerships, disallowed business interest expense amounts are carried forward and deducted in future years at the entity level rather than being passed through to shareholders. S corporations should calculate their entity-level business interest expense deduction for Iowa purposes under the provisions of this rule. Treas. Reg. Section 1.163(j)-6(l) contains more information about the application of IRC Section 163(j) to S corporations for federal purposes.

This rule is intended to implement Iowa Code section 422.35(11).