

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapter 602
“Determination of Net Income”

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14, 422.35, and 422.61
State or federal law(s) implemented by the rulemaking: Iowa Code sections 422.35 and 422.61

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 readopt Chapter 602. Chapter 602 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 franchise taxpayers must calculate their Iowa net income as required by Iowa Code chapter 422. The present version of Chapter 602 contains a significant number of rules relating to adjustments to Iowa income that have since been repealed. It also contains several rules related to apportionment that are being moved to 701—Chapter 603. Those rules have been removed from this chapter, and the chapter has been 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 the rules themselves. The 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 the 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 economic impact of the proposed rulemaking beyond what is contained in the underlying statutes.

- **Qualitative description of impact:**

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

3. Costs to the State:

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

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

- **Anticipated effect on State revenues:**

These rules have no direct impact on State revenues. The adjustments they describe are already required or allowed by law. The additional guidance the 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 by 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 by 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 rules are imposed by the Iowa Code, and the Department has no authority to make exceptions to those not already contemplated by the law for small businesses.

Text of Proposed Rulemaking

ITEM 1. Rescind 701—Chapter 602 and adopt the following new chapter in lieu thereof:

CHAPTER 602
DETERMINATION OF NET INCOME

701—602.1(422) Computation of net income for financial institutions. “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 sections 422.35 and 422.61(3).

602.1(1) Federal consolidated groups. In the case of a financial institution 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 financial institution 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.

602.1(2) Short period returns. When a federal short period return is filed and the federal taxable income is required to be adjusted to an annual basis, the Iowa taxable income shall also be adjusted to an annual basis. The tax liability for a short period is computed by multiplying the taxable income for the short period by 12 and dividing the result by the number of months in the short period. The tax is determined on the resulting total as if it were the taxable income, and the tax computed is divided by 12 and multiplied by the number of months in the short period. This adjustment shall apply only to income attributable to business carried on within the state of Iowa.

This rule is intended to implement Iowa Code section 422.35.

701—602.2(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 franchise 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 sections 422.35 and 422.61.

701—602.3(422) Capital loss carryback. Capital losses shall be allowed or allowable for Iowa franchise 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 income. Refunds of federal corporation income taxes shall not be an adjustment in computing income subject to the franchise tax.

This rule is intended to implement Iowa Code sections 422.35 and 422.61.

701—602.4(422) Interest and dividends from federal securities. For franchise tax purposes, dividends received from corporations owned or sponsored by the federal government, or interest derived from obligations of the United States and its possessions, agencies and instrumentalities are included in the taxable income. Examples of these types of obligations are bonds issued by the

governments of Puerto Rico; Washington, D.C.; Guam and the Virgin Islands. Gains or losses from the sale or other disposition of any bonds shall be taxable for state franchise tax purposes. Interest received on federal tax refunds is taxable for Iowa franchise tax purposes.

This rule is intended to implement Iowa Code section 422.61.

701—602.5(422) Interest and dividends from foreign securities and securities of states and other political subdivisions. Interest and dividends from foreign securities and securities of states and their political subdivisions including Iowa shall be included in taxable income. Subtract interest expense allocable to interest exempt from federal income tax that was disallowed as a deduction under IRC Section 265(b) or 291(e)(1)(B).

602.5(1) Add dividends received from regulated investment companies exempt from federal income 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).

602.5(2) Add, to the extent not already included, income from the sale of obligations of the state of Iowa and its political subdivisions and interest and dividend income from these obligations. Gains or losses from the sale or other disposition of bonds issued by the state of Iowa or its political subdivisions, along with interest and dividend income from these bonds, shall be included in Iowa taxable income unless the law authorizing these obligations specifically exempts the income from the sale and interest and dividend income from Iowa franchise tax.

This rule is intended to implement Iowa Code sections 422.35 and 422.61.

701—602.6(422) Additional deduction for wages paid or accrued for work done in Iowa by certain individuals. A small business corporation, as defined by subrule 602.8(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.”

602.6(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 the department of 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 that must be made on a case-by-case basis.

602.6(2) “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.

a. 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:

- (1) An employment position requiring an average work week of 40 or more hours;
- (2) An employment position for which compensation is paid on a salaried full-time basis without regard to hours worked; or
- (3) An aggregation of any number of part-time positions that equal one full-time position. For purposes of this subrule, 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:

<u>Average Number of Weekly Hours</u>	<u>Category</u>
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)

b. 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.

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

602.6(3) Definitions.

“Annual gross revenues” means total interest received from loans and investments, service charges, management fees, fiduciary fees, commissions, and gross proceeds from the sale of securities held as investments 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:

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” means a business entity organized for profit including but not limited to an individual proprietorship, partnership, joint venture, association or cooperative. “Small business” does not include the practice of a profession.

“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 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.

602.6(4) 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 targeted jobs tax credit under IRC Section 59, that employee shall be considered to have met the qualifications for the additional wage deduction.

a. A vocational rehabilitation referral is any individual certified by a state employment agency as having a physical or mental disability that, 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.

b. 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.

602.6(5) The taxpayer shall include a schedule with the filing of the taxpayer's 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.

602.6(6) 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 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.

602.6(7) 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.

(1) 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.

(2) The taxpayer must include a schedule with the filing of the taxpayer's 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.

(3) 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.

(4) 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 franchise 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.

602.6(8) The additional deduction applies to any individual hired on or after July 1, 2001, 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 701—paragraph 502.11(7) “b” also apply to the deduction for the hiring of certain individuals in this subrule.

This rule is intended to implement Iowa Code sections 16.1 and 422.35.

701—602.7(15E,422) 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.

This rule is intended to implement Iowa Code section 15E.305.

701—602.8(422) Disallowance of expenses to carry an investment subsidiary. A taxpayer must add back, to the extent included, any deduction for that portion of the taxpayer’s expenses computed under this rule that is allocable to an investment in an investment subsidiary.

602.8(1) Definitions.

“*Affiliate*” means a corporation, trust, estate, association, or similar organization:

1. Of which a financial institution, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 percent of the number of shares voted for the election of its directors, trustees, or other individuals exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other individuals exercising similar functions; or

2. Of which control is held, directly or indirectly, through share ownership or in any other manner, by the shareholders of a financial institution who own or control either a majority of the shares of such financial institution or more than 50 percent of the number of shares voted for election of directors of such financial institution at the preceding election, or by trustees for the benefit of the shareholders of such financial institution; or

3. Of which a majority of its directors, trustees, or other individuals exercising similar functions are directors of any financial institution; or

4. That owns or controls, directly or indirectly, either a majority of the voting shares of a financial institution or more than 50 percent of the number of shares voted for the election of directors of a financial institution at the preceding election, or controls in any manner the election of a majority of the directors of a financial institution, or for the benefit of those shareholders or members all or substantially all of the outstanding voting shares of a financial institution is held by trustees; or

5. That is a bank holding company, as defined by the laws of the United States, of which a financial institution is a subsidiary, and any other subsidiary as defined by the laws of the United States, of a bank holding company.

“*Average adjusted basis*” means the financial institution’s average adjusted basis as computed pursuant to IRC Section 1016 on a separate company basis.

“*Investment subsidiary*” means an affiliate that is owned, capitalized, or utilized by a financial institution with one of its purposes being to make, hold, or manage, for and on behalf of the financial institution, investments in securities that the financial institution would be permitted by applicable law to make for its own account.

602.8(2) Calculating the addition.

- a. A financial institution that has an investment in an investment subsidiary must allocate a portion of its total expenses used in computing its federal taxable income on a separate return basis to its investment subsidiary. The expenses that are allocable to the investment in an investment

subsidiary are computed by multiplying the financial institution's total expenses used in computing its federal taxable income on a separate return basis by the ratio of the average adjusted basis in its investment subsidiary to the average adjusted basis for all assets of the financial institution.

b. A calculation of the average for the tax year of the adjusted bases of a financial institution's investment in investment subsidiaries, and total assets, held each day of the tax year is the most accurate method for determining under Iowa Code section 422.61(3) the portion of a financial institution's total expenses that is allocable to the financial institution's investment in investment subsidiaries. However, the department will generally allow the average adjusted bases of an investment in investment subsidiaries for the tax year to be calculated using the average of the adjusted bases of the investment in investment subsidiaries held by the financial institution at the end of each month within the tax year. The department generally will allow the average bases of all assets of the financial institution for the tax year to be calculated using the average bases of all assets held by the financial institution at the end of each quarter of the tax year. A financial institution may compute for any tax year, without prior permission of the director, the average adjusted bases of investment in investment subsidiaries or total assets on a more frequent basis than set forth above. However, a financial institution cannot compute these averages for any tax year on a less frequent basis than quarterly without obtaining prior approval of the director. This permission will be granted only in extraordinary circumstances. In addition, a financial institution cannot compute these averages for any tax year on a less frequent basis than it used for the preceding tax year unless the financial institution obtains prior approval of the director. A financial institution that has elected to use an estimate of the adjusted tax bases of its total assets for each of the first three quarters of the taxable year under Internal Revenue Service's Revenue Ruling 90-44 for federal income tax purposes may use this estimate for Iowa franchise purposes.

602.8(3) *Exception to the addition.* Financial institutions that elect to file a combined Iowa return with their investment subsidiaries as provided in rule 701—602.13(422) are not required to add back expenses allocable to an investment subsidiary.

This rule is intended to implement Iowa Code section 422.61.

701—602.9(422) S corporation and limited liability company financial institutions. A financial institution as defined in IRC Section 581 that has in effect an election under IRC Subchapter S, or a financial institution organized as a limited liability company under Iowa Code chapter 524 that is taxed as a partnership for federal income tax purposes must compute an amount of income as if the financial institution were subject to federal corporation income tax. The income is to be computed in the same manner as a financial institution that is subject to or liable for federal income tax under the Internal Revenue Code in effect for the applicable tax would compute its federal taxable income.

This rule is intended to implement Iowa Code section 422.61.

701—602.10(422) Section 179 expensing.

602.10(1) *In general.* Iowa taxpayers that 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.

602.10(2) *Claiming the deduction.*

a. Timing and requirement to follow federal election. A taxpayer that 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 Internal Revenue Code 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. Rule 701—302.10(422) provides section 179 rules applicable to individuals and

other noncorporate entities, while rule 701—502.10(422) provides section 179 rules applicable to corporations (both C and S corporations) and other entities subject to the corporate income tax.

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. Special information for pass-throughs. In the case of pass-through entities, section 179 limitations apply at both the entity level and the owner level. Pass-through entities that are required to file an Iowa return and that actually place section 179 assets in service should follow former numbered paragraph 602.24(2)“e”(1)“1” to account for any assets for which the total federal section 179 deductions for a given year exceeded the Iowa limitation. Owners of pass-throughs receiving section 179 deductions from one or more pass-throughs that, in the aggregate, exceed the Iowa limitations should follow former numbered paragraph 602.24(2)“e”(1)“2.”

f. 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 a given year, any excess allowable Iowa section 179 deduction may be carried forward as described in paragraph 602.10(2)“g.”

g. 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.

h. 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—602.11(422) Broadband infrastructure grant exemption.

602.11(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.

602.11(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—602.12(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.

602.12(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.

602.12(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 subject to Iowa franchise tax 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 Section 163(j) limitation.

b. Carryforward. When current-year interest expense is limited at the federal level, the disallowed business interest expense, as defined in Treas. Reg. Section 1.163(j)-1(b)(10), 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: X Bank has \$100,000 in current-year business interest expense. For federal purposes, X Bank is subject to the IRC Section 163(j) limitation. X Bank deducts \$70,000 in business interest expense on X Bank's federal return and carries the remaining \$30,000 forward to be deducted in future years. For Iowa purposes, X Bank deducts the full \$100,000 in current-year business interest expense.

The following year, X Bank has \$50,000 in current-year business interest expense. For federal purposes, X Bank 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. X Bank must add the federal carryforward amount (\$5,000) back on the company's current year Iowa return, limiting X Bank's Iowa deduction to the \$50,000 in current-year business interest expense.

602.12(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. 701—paragraph 302.17(3)“a” contains more information about the calculation and reporting of partnership-level adjustments.

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 302.17(3)“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. The example above provides specific details.

(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.

(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 that 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).

602.12(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 rule 701—502.12(422). More information can be found in Treas. Reg. Section 1.163(j)-6(l) about the application of IRC Section 163(j) to S corporations for federal purposes.

This rule is intended to implement Iowa Code sections 422.35(27) and 422.61.

701—602.13(422) Investment subsidiary combined returns. Financial institutions that own or control investment subsidiaries may elect to file combined Iowa franchise tax returns with those investment subsidiaries.

602.13(1) *Definitions.*

"Affiliate" means the same as defined in subrule 602.8(1).

"Unitary business," for purposes of this rule, means a single economic enterprise made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. A unitary business includes that part of the business that meets this definition and is conducted by a taxpayer through the taxpayer's interest in a partnership, whether the interest in that partnership is held directly or indirectly through a series of partnerships or other passthrough entities.

602.13(2) *Election to file a combined return.* A financial institution and its investment subsidiaries that did not file a combined return for the immediately preceding taxable year may elect to file a combined return in lieu of separate returns for the taxable year.

a. Making the election. The election is made by filing a return that includes both the financial institution and its investment subsidiaries on forms provided by the department, on or before the statutory due date for filing the return, including extensions. The parent financial institution may withdraw the election by filing a separate return at any time prior to the due date of the return (including extensions of time) in the first year in which the election is made, but the group cannot withdraw the election after the due date of the return (including extensions of time). All requirements of this paragraph and any additional requirements provided in the instructions to the form must be met for the election to be valid.

(1) The financial institution and each investment subsidiary that is to be included on the combined return must consent to the filing of the combined return in the same manner as members of an affiliated group consent to the filing of a consolidated return in 701—paragraph 502.2(2) "*d.*"

(2) The combined group must include the parent financial institution and all investment subsidiaries.

(3) The combined group cannot include any entity other than the parent financial institution and the investment subsidiaries.

b. Election binding. Except as provided in subrule 602.13(3), an election to file a combined return under this paragraph is binding on all future tax years.

c. Treated as financial institutions. By making this election, all investment subsidiaries agree to be treated as financial institutions under Iowa Code chapter 422, and this rule, for every tax year the election remains in effect, except as provided in rule 701—800.6(422).

602.13(3) *Discontinuing the election.* A combined group shall discontinue filing combined returns when:

a. All investment subsidiaries cease to be subsidiaries of the parent financial institution. If on or before the beginning of the tax year the parent financial institution no longer owns an investment

subsidiary, the group is not required or permitted to file combined returns. However, for combined groups that included more than one investment subsidiary, if at least one entity remains an investment subsidiary, the remaining group members must continue filing combined returns even after other investment subsidiaries have left the group. Reasons an investment subsidiary may cease to be a subsidiary of the parent for purposes of this rule include:

(1) The parent financial institution no longer owns or controls the investment subsidiary previously included in the combined group.

(2) The investment subsidiary no longer meets the definition of investment subsidiary in Iowa Code section 422.61(2).

(3) The investment subsidiary ceases to exist.

b. The parent entity ceases to be subject to Iowa franchise tax. If the parent entity ceases to be subject to Iowa franchise tax, for any reason, the group is no longer allowed to file a combined return.

(1) The following are examples of common reasons a parent financial institution may no longer be subject to Iowa franchise tax:

1. The parent financial institution is no longer doing business in Iowa as defined in 701—subrule 501.1(1).

2. The parent entity changes in character such that it no longer meets the statutory definition of “financial institution” for Iowa franchise tax purposes.

3. The parent entity ceases to exist.

(2) Members of the group that continue doing business in Iowa after the parent entity ceases to be subject to Iowa franchise tax may still be required to file Iowa income or franchise tax returns.

c. The director finds separate returns would more clearly disclose the taxable income of the combined group. If the group believes that the filing of separate returns will more clearly disclose the taxable income of each member of the combined group, the group may apply to the director to discontinue filing combined returns.

(1) Applications to discontinue filing combined returns must be submitted not later than 90 days prior to the due date of the return, including extensions of time.

(2) Applications to discontinue filing consolidated returns must include:

1. A detailed description of the taxable income of both the group on a combined basis and each entity on a separate basis.

2. A clear statement of the reasons why separate returns would more clearly disclose Iowa taxable income. The mere fact that the group’s combined tax liability is greater or less than the sum of each member’s separate tax liabilities for a given year is not, by itself, a ground for discontinuance of combined filing.

(3) Submitting the application. Applications to discontinue combined filing under this paragraph must be submitted through GovConnectIowa or by mail to:

Policy Bureau - Research and Policy Division

Iowa Department of Revenue

P.O. Box 14467

Des Moines, Iowa 50306-3467

602.13(4) *Filing combined returns.*

a. *Filed by parent financial institution.* The combined return must be filed under the name and federal employer identification number of the parent financial institution that is subject to Iowa franchise tax.

b. *Responsibility for filing and signing.* The return must be filed and signed on behalf of the combined group by an officer or employee of the parent financial institution.

c. *Tax year.* All members of the combined group are required to have the same tax year as the parent financial institution. The combined return is due on or before the statutory due date for the parent financial institution, including extensions.

602.13(5) *Combined group net income calculation.* The combined group calculates its Iowa net income as provided in this subrule.

a. Total combined income or loss. The total combined group income or loss shall be determined as follows:

(1) Each member of the combined group determines its separate income or loss by determining the member's taxable income under the Internal Revenue Code, on a separate entity basis, after making adjustments required under Iowa Code section 422.61(3).

(2) Unless otherwise provided in these rules, or by instructions on the required tax return and supporting schedules, income or loss of the members as determined under subparagraph 602.13(5) "a" (1) are combined, eliminating items of income, expense, gain, and loss from transactions between members of the combined group, applying the consolidated filing rules under the Internal Revenue Code as defined in Iowa Code section 422.3, and rule 701—502.2(422), as if the combined group were a consolidated filing group.

b. Net operating loss (NOL) deduction. The starting point for Iowa taxable income is federal taxable income, which includes the application of the federal net operating loss deduction, if any.

(1) NOL calculation. The combined group must calculate its NOL deduction, if any, by applying the applicable rules under the Internal Revenue Code as defined in Iowa Code section 422.3 and rule 701—502.2(422) as if the combined group were filing a consolidated federal income tax return. The combined group net income should then be adjusted by this combined group federal net operating loss deduction, if any, subject to the adjustments in numbered paragraph 602.13(5) "b"(2)"2."

(2) The following adjustments are required for pre-2023 federal and Iowa losses:

1. Add back to the extent included in the calculation under subparagraph 602.13(5) "a"(1) any federal net operating loss deduction attributable to losses incurred in a tax year beginning prior to January 1, 2023.

2. Subtract from the income attributable to Iowa, to the extent available, any Iowa net operating loss carryovers attributable to the parent or any investment subsidiary included in the group from a year beginning prior to January 1, 2023.

602.13(6) *Allocation and apportionment of combined group income.* Determine combined group business income or loss by eliminating from the amount determined in subrule 602.13(5) any nonbusiness income or loss or item of nonbusiness income, expense, gain, or loss.

a. Apportionment of business income.

(1) Combined group apportionment factor. The combined group apportionment factor is a percentage determined under 701—Chapter 603, where the numerator of the factor includes amounts sourced to the state for the combined group's unitary business, regardless of the separate entity to which those factors may be attributed, and the denominator of the factor includes amounts associated with the combined group's unitary business, wherever located.

(2) Separate entity apportionment factor. Except as provided in paragraph 602.13(6) "c," the separate entity apportionment factor for a member of the combined group is a percentage determined under 701—Chapter 603 where the numerator of the factor includes amounts sourced to the state for the member and the denominator of the factor includes amounts associated with the combined group's unitary business, wherever located.

(3) If a member of the combined group holds a partnership interest from which it derives apportionable income, the share of the partnership's apportionment factor(s) to be included in the apportionment factor(s) of the group is determined by multiplying the partnership's factor(s) by a ratio the numerator of which is the amount of the partnership's apportionable income properly included in the member's income, and including any guaranteed payments, and the denominator of which is the amount of the partnership's total apportionable income.

b. Allocation of nonbusiness income. Determine the amount of any combined group nonbusiness items of income, expense, gain or loss not apportioned under paragraph 602.13(6) "a" that are allocable to the state under Iowa Code sections 422.33(2) and 422.63(1) "b."

c. Combined group commercial domicile. Notwithstanding any other rule to the contrary, for purposes of determining where items of income for the combined group should be attributed, the

commercial domicile of all investment subsidiaries is deemed to be that of the parent financial institution.

602.13(7) *Payment of tax.*

a. Franchise rates. The tax liability for the combined group shall be imposed on the group's combined income as calculated under this rule and determined according to the Iowa franchise tax rate provided in Iowa Code section 422.63.

b. Liability for tax.

(1) The financial institution and each investment subsidiary included on the combined return 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 combined return for that year.

(2) If an investment subsidiary has ceased to be a member of the group and if the cessation resulted from a bona fide sale or exchange of the parent's interest in the subsidiary for fair value that 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.

(3) 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.

This rule is intended to implement Iowa Code section 422.60.