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STATE TAXATION — CORPORATE INCOME TAX AND FRANCHISE TAX

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I. Purpose

This Legislative Guide endeavors to familiarize the reader with the Iowa corporate income tax and the Iowa franchise tax and to serve as a detailed supplement to other Legislative Guides that more generally discuss these taxes. As such, this information is intended to update and enhance, but not necessarily supersede, the corporate income tax and franchise tax information contained in other Legislative Guides published by the Legal Services Division of the Legislative Services Agency.

Unless otherwise noted, references to the Iowa Code are to the 2014 Iowa Code. References to the Internal Revenue Code (IRC) are to the federal Internal Revenue Code of 1986, as subsequently amended to January 2, 2013. References to the Iowa Administrative Code and case law are to references published as of October 30, 2013.

II. Introduction and Scope of Guide

The Iowa corporate income tax and franchise tax are the subject of this Legislative Guide. Iowa also has other related taxes measured by income that are outside the purview of this Guide, including the personal net income tax (Iowa Code chapter 422, division II) and the insurance premiums tax (Iowa Code chapters 432, 432A, 518, and 518A). Information relating to these and other taxes may be found in other Legislative Guides published by the Legal Services Division of the Legislative Services Agency.

A. A Note on Constitutional Limitations on State Taxation

Like all other state taxes, the corporate income tax and the franchise tax are shaped and limited by the United States Constitution. The Due Process and Commerce Clauses are two of the most frequently litigated constitutional provisions with regard to corporate income and franchise taxes, and both will be discussed at various points in this Legislative Guide. But they are not the only limitations. The Equal Protection Clause, Import-Export Clause, Duty-of-Tonnage Clause, Supremacy Clause, and the First Amendment also limit the state's power to impose the corporate income tax and the franchise tax, as do certain provisions of the Iowa Constitution. For purposes of brevity, these limitations will not be discussed further in this Guide. Information regarding some of these limitations may be found in the Legislative Guide entitled *State Taxation in Iowa: An Overview*.¹

B. A Note on the Taxation of Business Income

In order to fully understand the corporate income tax, it is helpful to briefly explore several types of business entities and methods of taxation. The taxation of the income of a business in Iowa, excluding financial institutions or insurance companies, varies depending upon the type of business. Generally, there are two methods to tax such income. One method is to first subject the business entity to a tax on its income and then to tax the owners on any dividends or other distributions they may receive. That is the method described in this Guide. The other method is to tax only the owners' distributive shares of the entity's income, whether received or not. Entities subject to this method of taxation are often referred to as "flow-through" or "pass-through" entities because their profits and

¹ Available at https://www.legis.iowa.gov/DOCS/LSA/Legis_Guide/2010/LGLSL017.PDF (last accessed October 15, 2013).



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losses flow or pass through the entity and are only taxable to the owners under the individual income tax.

For tax purposes, there are four predominant forms of business entities: sole proprietorships, partnerships, C corporations (regular corporations), and S corporations (small business corporations). An entity not required to be taxed as a C corporation often has wide latitude in choosing a tax method through elections taken for federal income tax purposes, which are often referred to as federal “check-the-box” regulations. As a result, an entity’s legal classification is not always the same as its tax classification.

1. Sole Proprietorships

Sole proprietorships are considered alter egos of an individual and their income is taxed directly to the owner under the individual income tax. For federal tax purposes, a sole proprietorship may under certain circumstances choose to be taxed as a C corporation, but Iowa does not recognize this election.²

2. Partnerships

A partnership is an association of two or more persons. A partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization that carries on any business, financial operation, or venture. Generally, a partnership does not pay income tax on the income of the partnership. Rather, the income (or loss) is listed as income (or loss) for purposes of each partner’s income tax based upon the distributive share of the partner. However, a partnership either required or electing to be taxed as a C corporation for federal income tax purposes will be taxed as a C corporation for Iowa tax purposes.³ Partnerships are required to file Iowa income tax returns containing information relating to their income, capital gains or losses, and their partners and their ownership interests.⁴

A limited liability company (LLC) is a relatively new form of business entity which, if properly structured, is usually taxed as a partnership, but which also affords the owners certain protections from personal liability against the entity’s debts and liabilities, similar to the protections afforded corporate shareholders. However, an LLC may elect to be taxed as a C corporation for federal income tax purposes, which election will result in the LLC being taxed as a corporation for Iowa income tax purposes.⁵ If a financial institution is an LLC taxed as a partnership, a member will receive an individual income tax credit for up to that portion of the franchise tax paid by the financial institution that represents the taxpayer’s share of the income of the financial institution.⁶

3. Regular Corporations

Regular corporations are most often referred to as C corporations because they are taxed under subchapter C of chapter 1 of the IRC. The term “corporation” is not

² Iowa Code §422.4(9).

³ Iowa Code §422.32(1)(d).

⁴ Iowa Code §422.15(2); Iowa Admin. Code 701-45.1-45.4.

⁵ Iowa Code §422.32(1)(d).

⁶ Iowa Code §422.11.



limited to the artificial business entity usually known as a corporation but may include other business entities which are required or have elected to be taxed as a C corporation. For Iowa corporate income tax purposes these business entities are taxed as corporations⁷ unless otherwise made exempt under state law.⁸

4. S Corporations

S corporations are a special type of corporation for federal tax purposes. They are called as such because they are taxed under subchapter S of chapter 1 of the IRC. For federal tax purposes, the income of an S corporation is taxed directly to the shareholders and the corporation is not subject to tax. The same type of treatment for Iowa income tax purposes is required.⁹ S corporations are required to file income tax returns in the same manner as C corporations.¹⁰

For a nonresident shareholder of an S corporation, only the income earned in Iowa is taxed according to the allocation and apportionment rules for corporate income taxation.¹¹ A resident shareholder may elect to subject the shareholder's distributive share to Iowa income tax regardless of where earned and receive a credit for income taxes paid to another state, or elect to take advantage of the allocation and apportionment provisions available to nonresidents.¹²

If a financial institution is an S corporation, a shareholder will receive an individual or corporate income tax credit for up to that portion of the franchise tax paid by the financial institution that represents the taxpayer's share of the income of the financial institution.¹³

C. A Note on Corporate Income Tax and Franchise Tax Revenues

The corporate income tax and franchise tax are significant sources of state revenue. The revenue fluctuates along with the economy. For the 12-month period ending in October 2013, of the \$7.58 billion in total state revenues, corporate income tax revenues were \$436.5 million or approximately 5.75 percent of total revenue, and franchise tax revenues were approximately \$40 million or approximately 0.5 percent of total revenue.¹⁴ Revenues collected are deposited into the State General Fund.¹⁵

III. History and Structure of Code Chapter

The Iowa corporate income tax was enacted in 1934 at a rate of 2 percent. Since 1981, rates progressing from a low of 6 percent to a high of 12 percent have been imposed.

⁷ Iowa Admin. Code 701-51.1(2).

⁸ Iowa Code §422.34.

⁹ Iowa Code §422.36(5).

¹⁰ Iowa Code §422.36.

¹¹ Iowa Code §§422.5(1)(j)(1), 422.8(2)(a).

¹² Iowa Code §§422.5(1)(j)(2), 422.8(2)(b); Iowa Admin. Code 701-50.1.

¹³ Iowa Code §§422.11, 422.33(8).

¹⁴ Jeff Robinson and Shawn Snyder, Fiscal Services Division, Legislative Services Agency, Twelve-month Total Net Tax Receipts through October 31, 2013, available at <https://www.legis.iowa.gov/DOCS/LSA/TT/2014/TTJWR003.PDF> (last accessed December 13, 2013).

¹⁵ Prior to fiscal year 2003-2004, \$8.8 million was paid quarterly to the cities (60 percent) and counties (40 percent) from which the franchise tax was collected.



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The corporate income tax is in division III of Iowa Code chapter 422, but other Iowa Code sections are also applicable to the tax.

Section 422.32 of division III sets out the definitions applicable to the division.

Section 422.33 of division III imposes the corporate income tax, apportions income to Iowa, and provides for tax credits.

Sections 422.34 and 422.34A of division III exempt several entities and activities from the corporate income tax.

Section 422.35 of division III provides for the computation of net income for purposes of the corporate income tax.

Sections 422.36 through 422.41 of division III provide for the administration of the corporate income tax.

Division VII (sections 422.85 through 422.93) governs the payment of estimated taxes by corporations.

The Iowa franchise tax was enacted in 1970 at a rate that has fluctuated from a low of 5 percent to a high of 8 percent. Since 1980, the franchise tax rate has been set at 5 percent. The franchise tax is in division V of Iowa Code chapter 422, but other Iowa Code sections are also applicable to the tax.

Section 422.60 of division V imposes the franchise tax and provides for tax credits.

Section 422.61 of division V sets out the definitions applicable to the division.

Sections 422.62 and 422.66 of division V provide for the administration of the franchise tax.

Section 422.63 of division V provides for the franchise tax rate and apportions income to Iowa.

Division VII (sections 422.85 through 422.93) governs the payment of estimated taxes by financial institutions.

IV. The Corporate Income Tax

A. Application

1. In General

The Iowa corporate income tax applies to corporations engaged in not only intrastate commerce, but also interstate commerce. A state's ability to exercise its taxing power on a corporation engaging in interstate commerce is constrained by the Due Process and Commerce Clauses of the U.S. Constitution and by federal law.

a. U.S. Constitutional Constraints. The imposition of an income tax on a corporation must not violate the Due Process Clause or the Commerce Clause. The Due Process Clause declares that no state may "deprive any person of life, liberty, or property without the due process of law."¹⁶ With regard to state taxation, it concerns

¹⁶ U.S. Const. amend. XIV, §1.

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the fundamental fairness of the government activity,¹⁷ and requires only that there be “some minimum connection between the state and the person, property, or transaction it seeks to tax.”¹⁸ In this context it is essentially a proxy for notice.

The Commerce Clause declares that Congress shall have the power to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”¹⁹ The Commerce Clause concerns the effects of state regulation on the national economy and thus requires a higher level of connection than the Due Process Clause.²⁰

The U.S. Supreme Court’s jurisprudence on state taxation under the Commerce Clause has developed in such a way that a state may not tax businesses engaged in interstate commerce unless such activity has a “substantial nexus” with the state.²¹ What constitutes “substantial nexus” is not necessarily the same for every type of tax. The Court has held that some sort of physical presence in a state is required to create “substantial nexus” for purposes of sales and use tax, but it has not explicitly extended that rule to income tax.²² Other Court cases dealing with income tax and the Commerce Clause have emphasized a “flexible approach based on economic reality and the nature of the activity giving rise to the income that the state seeks to tax.”²³ In other words, the U.S. Supreme Court has not delineated a bright-line rule for income tax that can be used to determine whether or not a particular corporate activity creates “substantial nexus” under the Commerce Clause. Several state courts, including Iowa, have used early U.S. Supreme Court cases, and the Court’s refusal to explicitly extend the “physical presence” rule to income tax, to pursue a more flexible “economic presence” standard. The Iowa Supreme Court has ruled that physical presence is not required under the Commerce Clause in order to impose the income tax on an out-of-state corporation when it receives the “benefit of an orderly society within the state” for the production of income.²⁴

¹⁷ *Quill Corp. v. North Dakota*, 504 U.S. 298, 312-313 (1992).

¹⁸ *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954).

¹⁹ U.S. Const. art. I, §8, cl. 3. The U.S. Supreme Court interprets this affirmative grant of power to Congress as a restriction on the states from using their taxing power to impermissibly burden interstate commerce. This is often referred to as the “negative” or “dormant” Commerce Clause.

²⁰ *Quill*, 504 U.S. at 312-313.

²¹ See *Complete Auto Transit Inc., v. Brady*, 430 U.S. 274 (1977). This “substantial nexus” test is just one prong of a four-prong test used to determine the validity of a state tax law under the Commerce Clause, but it is the first prong that must be satisfied and, therefore, it is the subject of this particular discussion. The other three prongs require that the tax must be fairly apportioned, not discriminate against interstate commerce, and be fairly related to the services provided by the state. Some of these are discussed later in this Guide.

²² See *Quill*, 504 U.S. 298, in which the U.S. Supreme Court held it was a violation of the Commerce Clause to require a seller to collect the state’s sales or use tax if the seller did not have a “physical presence” within the state. The Court held that mail and telephone solicitation of customers was insufficient to amount to “physical presence”. For more information on Iowa sales and use taxes, see the Legislative Guide entitled *State Taxation: Sales and Use Taxes*, available at https://www.legis.iowa.gov/DOCS/LSA/Legis_Guide/2013/LGLSL002.PDF (last accessed on October 15, 2013).

²³ *KFC Corporation v. Iowa Department of Revenue*, 792 N.W.2d 308, 314 (2010), in which the Iowa Supreme Court recounts previous U.S. Supreme Court cases involving challenges to state income taxes.

²⁴ *KFC*, 792 N.W.2d at 328. In this case, KFC Corp. was a Delaware corporation with a principal place of business in Kentucky. KFC Corp. licensed its trademarks and other intellectual property to KFC restaurants in Iowa that are independently owned franchisees. KFC Corp. owned no property in Iowa and had no employees in Iowa. The Court



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b. Federal Law Constraints. The Interstate Income Act of 1959, better known as Public Law No. 86-272, prohibits a state from imposing an income tax on an out-of-state corporation whose only business activities in the state are the solicitation of orders of tangible personal property that are approved and filled outside the state.²⁵ It is important to note that the law only applies to taxes on, or measured by, net income, and to sales of tangible personal property. The law was enacted in response to a 1959 U.S. Supreme Court decision in which the imposition of the Minnesota income tax was upheld against an Iowa corporation that had a sales office and several salesmen in Minnesota for the purpose of soliciting sales from Minnesota customers to be approved and filled in Iowa.²⁶

2. Application in Iowa

The corporate income tax applies to each corporation doing business in this state, or deriving income from sources within this state.²⁷ The term “corporation” includes most for-profit corporations created or organized under the laws of Iowa, the United States or other state, territory, or district, or of a foreign country.²⁸ The term is not limited to the artificial business entity usually known as a corporation but also includes joint stock companies, associations organized for pecuniary profit, and partnerships and LLCs taxed as corporations under the IRC.²⁹ Exempt from the tax are financial institutions, insurance companies, and nonprofit organizations exempt from federal income tax under IRC §501.³⁰ However, such exempt nonprofit organizations are subject to Iowa corporate income tax on unrelated business income.³¹

The term “doing business in this state,” is not statutorily defined, but “doing business” is defined by administrative rule to include all activities or transactions

regarded this as sufficient connection to Iowa to amount to the functional equivalent of “physical presence” under the Commerce Clause because the franchisees were firmly anchored in Iowa and the transactions produced revenue from use in Iowa. Interestingly, the Court also held that “physical presence” is not required under the Commerce Clause in order for Iowa to impose an income tax on revenue earned by an out-of-state corporation arising from the use of intellectual property by franchisees located within Iowa. See also *In the Matter of: Jack Daniels Properties, Inc. and Southern Comfort Properties, Inc. v. Iowa Department of Revenue*, 2011 WL 7546179 (Iowa Dept. Insp. App.) (holding that it was not a violation of the Commerce Clause to impose the corporate income tax on subsidiary owners of the “Jack Daniels” and “Southern Comfort” trademarks whose only connection to Iowa was through the licensing of the trademarks to a parent corporation who marketed and sold whiskey bearing the trademarks in Iowa).

²⁵ 15 U.S.C. §381 et seq. “Solicitation of orders” encompasses solicitation by a corporation’s employees or solicitation by an independent contractor, including an independent contractor who maintains an office in the state related to the solicitation of sales.

²⁶ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). In enacting Public Law No. 86-272, Congress was concerned that “persons engaged in interstate commerce are in doubt as to the amount of local activities within a State that will be regarded as forming a sufficient...connection with the State to support the imposition of a tax on net income from interstate operations and ‘properly apportioned’ to the State.” *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 222 (1992) (quoting S. Rep. No. 658, 86th Cong., 1st Sess., pp. 2-3 (1959)).

²⁷ Iowa Code §422.33(1).

²⁸ Iowa Admin. Code 701-51.1(2).

²⁹ Iowa Code §422.32(1)(d).

³⁰ Iowa Code §422.34. Financial institutions, including credit unions, are subject either to the franchise tax in Iowa Code chapter 422, division V, or the moneys and credits tax in Iowa Code section 533.329.

³¹ Iowa Code §422.33(1A). For more information on unrelated business income tax see Part IV, Section B, Subsection 3 of this Guide.

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conducted in Iowa for the purpose of financial or pecuniary gain or profit.³² This includes every corporation organized under the laws of Iowa and any foreign corporation operating in interstate commerce that does business in Iowa.³³ The term “deriving income from sources within this state” means income from real, tangible, or intangible property located or having a situs in this state.³⁴ Tangible property has a situs in Iowa when it is habitually present in Iowa or it maintains a fixed or regular route through Iowa.³⁵ Intangible property, while not physically present in any particular place, generally has situs in Iowa if the corporation’s commercial domicile³⁶ is in Iowa or if it has become an integral part of some business activity occurring regularly in Iowa.³⁷

Certain activities conducted in Iowa fall outside these definitions and therefore do not subject a corporation to the income tax, including the following:

- Holding meetings of the board of directors or shareholders or holding holiday parties or employee appreciation dinners.
- Maintaining bank accounts.
- Borrowing money, with or without security.
- Utilizing Iowa courts for litigation.
- Owning and controlling a subsidiary corporation which is incorporated in or which is transacting business in this state where the holding or parent company has no physical presence in the state as that presence relates to the ownership or control of the subsidiary.
- Recruiting personnel where hiring occurs outside the state.
- Training employees or educating employees, or using facilities in Iowa for this purpose.
- Utilizing a distribution facility in the state, owning or leasing property at the facility, or selling goods at the facility under certain circumstances.³⁸

³² Iowa Admin. Code 701-52.1(1)(a).

³³ Iowa Admin. Code 701-52.1.

³⁴ Iowa Code §422.33(1). For purposes of taxation, “situs” generally refers to the place where a thing is located which gives rise to sufficient contact with a state to justify in fairness the particular tax. See Black’s Law Dictionary 1387 (6th ed. 1990).

³⁵ Iowa Admin. Code 701-52.1(1)(c).

³⁶ “Commercial domicile” means the principal place from which the trade or business of the taxpayer is directed or managed. Iowa Code §422.32(1)(c).

³⁷ Iowa Admin. Code 701-52.1(1)(d), which also includes a nonexhaustive list of types of intangible property. See also Iowa Admin. Code 701-52.1(4) for examples of situations in which intangible property has a situs in Iowa. See also KFC, 792 N.W.2d 308, discussed in footnote 24.

³⁸ Iowa Code §422.34A. A distribution facility does not include an establishment where retail sales or returns of tangible personal property are processed for more than 12 days per year, unless the facility processes orders by mail, telephone, or electronic means, and also processes shipments to purchasers, if not more than 10 percent of the goods are delivered or shipped to places in Iowa. Iowa Code §422.34A(8).



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Also included is the solicitation of orders protected under Public Law No. 86-272, discussed earlier. “Solicitation of orders” includes activities that explicitly or implicitly propose a sale or that are entirely ancillary to requests for purchases. An activity is not entirely ancillary if it serves an independent business function apart from the solicitation of orders, or if the corporation has reason to perform it regardless of the sale.³⁹ The Department of Revenue maintains nonexhaustive lists of activities that do and do not qualify for protection under Public Law No. 86-272.⁴⁰

B. Calculation of Tax

Once a corporation determines it is subject to the Iowa corporate income tax, it must properly calculate the tax in four steps. First, it computes its net income. Second, it allocates and apportions the net income to Iowa to determine its taxable income. Third, it applies its taxable income to the four regular statutory tax rates, and determines if it owes the alternative minimum tax (AMT) or the unrelated business income tax. Fourth, it applies any available tax credits against the calculated tax.

1. Net Income Computation

a. In General. Iowa, like most other states, uses as the basis for the corporate income tax the federal taxable income of a corporation. Federal taxable income is essentially a corporation’s gross income less any deductions and exemptions allowed under the Internal Revenue Code (IRC). Thus, Iowa conforms to federal definitions of income and adjustments made to income. The state continues to follow federal law changes to the IRC by passage of an “IRC update bill.” However, if the state does not wish to conform to any particular IRC provision, the General Assembly may enact legislation to decouple from federal law.

The state may also enact other adjustments in computing net income provided they do not violate the U.S. Constitution, which most often happens through the Commerce Clause. An adjustment to net income violates the Commerce Clause if it discriminates against foreign commerce,⁴¹ or if it discriminates against interstate commerce by imposing greater burdens on out-of-state goods, activities, or enterprises than on in-state goods, activities, or enterprises.⁴² Discrimination against

³⁹ Iowa Admin Code 701-52.1(3). Examples of activities that are not entirely ancillary include repair, installation, service-type activities, or collection on accounts. See also *Wrigley*, 505 U.S. 214, in which the U.S. Supreme Court held that an Illinois chewing gum manufacturer’s activities in Wisconsin were “entirely ancillary” when it recruited and trained employees and used hotels and homes for sales meetings, but were not “entirely ancillary” when it supplied and sold gum to retailers who agreed to install display racks, and stored gum for these purposes within Wisconsin. However, it should be noted that activities that are sufficiently *de minimis*, and unrelated to the solicitation of orders, will not destroy a corporation’s protection from income tax under Public Law No. 86-272. Activities are sufficiently *de minimis* if they establish only a trivial additional connection to the taxing state. *Wrigley* at 231-232.

⁴⁰ Iowa Admin. Code 701-52.1(2)(a), (3).

⁴¹ For an example of foreign commerce discrimination, see *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 505 U.S. 71 (1992), discussed in footnote 56.

⁴² The prohibition against interstate commerce discrimination represents the third prong of the four-prong Commerce Clause test discussed in footnote 21.

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interstate commerce occurs not only when a tax or adjustment explicitly favors in-state commerce, but also when it has the economic effect of discrimination.⁴³

If a tax or adjustment is found to be discriminatory, it may be saved under limited circumstances if it is a “compensatory” or “complementary” tax meant to cure a comparable tax burden specific to in-state commerce.⁴⁴ The classic example is the use tax, which applies to purchases outside of a state and used in state, because it complements the sales tax, which only applies to in-state purchases. The tax may also be saved under limited circumstances if it goes beyond regulation and is part of a state’s traditional government function. For example, a state is allowed to provide a tax exemption for its own bonds while disallowing the exemption for other states’ bonds because the issuance of debt to pay for public projects is a quintessentially public function.⁴⁵

b. Iowa Net Income Computation. The starting point for computing Iowa net income is a corporation’s federal taxable income before the deduction for net operating loss.⁴⁶ From there a number of adjustments are made in order to arrive at net income by subtracting the following amounts from federal taxable income:

- Interest and dividends from federal securities.⁴⁷
- Fifty percent of the federal income taxes paid during the tax year or, for accrual-basis corporations, 50 percent of the income tax liability for the tax year, reduced by any refund received.⁴⁸
- Sixty-five percent of wages paid to individuals who were hired for the first time by the taxpayer and who had been convicted of a felony or who were on

⁴³ For examples of discriminatory taxes, see *Boston Stock Exchange v. State Tax Com.*, 429 U.S. 318 (1977) (invalidating transfer tax giving reduced rates to transfers occurring in New York through the New York Stock Exchange); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating Hawaii liquor tax exemption for certain liquors that happened to be locally produced or made from locally grown fruit); *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (invalidating West Virginia tax exemption for wholesalers who also engage in manufacturing activities in state); *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987) (invalidating Washington tax exemption for manufacturers who also engage in wholesaling activities in state); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988) (invalidating Ohio fuel tax credit for use of gasohol because credit was limited to gasohol produced in Ohio or in states that provided reciprocal tax advantages to Ohio-produced gasohol); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984) (invalidating New York franchise tax credit attributable only to receipts from exports shipped from New York); or *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating Massachusetts “premium payment” for all milk sold in-state where proceeds were earmarked for distribution only to Massachusetts’ producers).

⁴⁴ A tax must satisfy a three-prong inquiry to be considered a valid compensatory tax: 1) the state must identify the intrastate tax burden for which it is attempting to compensate; 2) the tax on interstate commerce must be shown to roughly approximate — but not exceed — the amount of the tax on intrastate commerce; and 3) the events on which the interstate and intrastate taxes are imposed must be substantially equivalent. *Oregon Waste Systems Inc. v. Dept. of Environ. Quality*, 511 U.S. 93 (1994). This is historically a very difficult inquiry to satisfy.

⁴⁵ *Department of Revenue of Ky. v. Davis*, 553 U.S. 328, 341-342 (2008).

⁴⁶ Iowa Code §422.35. The federal deduction for net operating loss is not allowed because Iowa provides its own adjustment for net operating loss. See Iowa Code §422.35(11).

⁴⁷ Iowa Code §422.35(1). With a few exceptions, states are prohibited from taxing federal securities. 31 U.S.C. §3124. See Iowa Admin. Code 701-40.2 for additional discussion of exemption status.

⁴⁸ Iowa Code §422.35(4); Iowa Admin. Code 701-53.12.



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parole, probation, or work release or, in the case of a small business, who are individuals with a mental or physical disability.⁴⁹

- The federal work opportunity credit, alcohol fuel credit, and employer social security credit to the extent these credits increased federal taxable income.⁵⁰
- Income included as a result of a sale-leaseback agreement entered into prior to January 1, 1986.⁵¹
- The loss on the sale or exchange of a regulated investment company to the extent the loss was disallowed for federal tax purposes.⁵²
- The gain from the sale of obligations of the state of Iowa and its political subdivisions if specifically exempt by statute.⁵³
- The additional first-year depreciation subtraction allowed under IRC §168(k)(4) for qualified property acquired after May 5, 2003, and before January 1, 2005, if the taxpayer so elects.⁵⁴
- The increased expensing allowance under IRC §179 that was taken for federal tax purposes for tax years beginning on or after January 1, 2003, but before January 1, 2006, if the taxpayer so elects.⁵⁵
- Foreign dividend income.⁵⁶
- Ordinary or capital gain realized from the involuntary conversion of property due to eminent domain. If the gain is not recognized because the converted property is replaced, then the deduction does not occur until the amount of the gain is subsequently realized.⁵⁷
- The amount of any biodiesel production sales tax refund provided pursuant to Iowa Code section 423.4.⁵⁸

Additional adjustments are made in arriving at Iowa net income by adding the following amounts to federal taxable income:

- Iowa income tax deducted.⁵⁹

⁴⁹ Iowa Code §§422.35(6), (6A); Iowa Admin. Code 701-53.11.

⁵⁰ Iowa Code §§422.35(5), (7), (17).

⁵¹ Iowa Code §422.35(8); Iowa Admin. Code 701-53.7. Also referred to as “safe harbor” leases.

⁵² Iowa Code §422.35(12).

⁵³ Iowa Code §422.35(18).

⁵⁴ Iowa Code §422.35(19)(b); Iowa Admin. Code 701-53.22(2).

⁵⁵ Iowa Code §422.35(20); Iowa Admin. Code 701-53.23.

⁵⁶ Iowa Code §422.35(21). This exemption codifies current practice and administrative rules based on the U.S. Supreme Court decision in *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 505 U.S. 71 (1992). Kraft, a multinational corporation, was denied a deduction for dividends it received from foreign subsidiaries even though Iowa did not tax dividends received from domestic subsidiaries. Iowa also did not provide a tax credit for the foreign taxes paid on those dividends (as is provided by the federal government, see IRC §§901, 902). The U.S. Supreme Court held that the differential treatment of domestic and foreign dividends violated the Foreign Commerce Clause. Even though the statute did not favor Iowa subsidiaries over other subsidiaries, the Court reasoned that “the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded interstate commerce...in part because matters of concern to the entire Nation are implicated.” *Id.* at 79.

⁵⁷ Iowa Code §422.35(22); Iowa Admin. Code 701-53.24.

⁵⁸ Iowa Code §422.35(25).



- Interest and dividends from securities of foreign, state, and political subdivisions and regulated investment companies to the extent they are exempt from federal income tax and not otherwise exempt from state income tax.⁶⁰
- Additional first-year depreciation subtraction allowed under IRC §168(k) (Except for the additional first-year depreciation subtraction allowed under IRC §168(k)(4) for qualified property acquired after May 5, 2003, and before January 1, 2005).⁶¹
- The increased expensing allowance under IRC §179 that was authorized in Public Law No. 111-5, §1202, taken for federal tax purposes for tax years beginning on or after January 1, 2009, but before January 1, 2010.⁶²
- Certain adjustments to gain or loss for property with a basis established prior to January 1, 1934.⁶³
- The percentage depletion amount determined under IRC §613 for oil, gas, or geothermal wells that is in excess of the cost depletion amount determined under IRC §611.⁶⁴
- The depreciation taken on a speculative shell building, defined in Iowa Code section 427.1(27), that is owned by a for-profit entity receiving the proper tax exemption, unless the taxpayer is not using the building as a speculative shell building. For state income tax purposes, depreciation is computed, and subtracted from federal taxable income, as if the building was classified as fifteen-year property.⁶⁵

2. Taxable Income Calculation — Allocation and Apportionment

a. In general. After computing net income a corporation must next calculate its Iowa taxable income. If a corporation's entire business is conducted in Iowa, the total net income is subject to tax. A corporation is presumed to be conducting its entire business in Iowa if its sales or other activities are conducted only in Iowa.⁶⁶ A corporation will be considered to also be conducting business outside Iowa if it engages in regular, systematic, and continuous activities in another state that would constitutionally permit the state to impose a tax, regardless of whether or not it does.⁶⁷

⁵⁹ Iowa Code §422.35(4).

⁶⁰ Iowa Code §422.35(2). See 2013 Acts, ch. 70, §1 (HF 575), amending Iowa Code §422.7, and Iowa Admin. Code 701-53.6 for lists of state and political subdivision obligations exempt from state taxation.

⁶¹ Iowa Code §422.35(19)(a), (19A), (19B); Iowa Admin. Code 701-53.22.

⁶² Iowa Code §422.35(24); Iowa Admin. Code 701-53.23.

⁶³ Iowa Code §422.35(3); Iowa Admin. Code 701-53.9.

⁶⁴ Iowa Code §422.35(10).

⁶⁵ Iowa Code §422.35(16); Iowa Admin. Code 701-53.17.

⁶⁶ Iowa Admin. Code 701-54.1.

⁶⁷ See Iowa Code §422.32(1)(j), defining "taxable in another state." See also Iowa Admin. Code §701-54.1(4). This administrative rule also includes a nonexhaustive list of activities that constitute conducting business in another state. It is important to note that the rule provides that the mere shipment of goods via common carrier or the U.S. Postal System to non-Iowa destinations does not qualify as conducting business in another state.



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If a corporation also conducts business outside Iowa, or if income is derived from sources outside Iowa, net income must be allocated and apportioned to Iowa according to the amount reasonably attributed to sources within this state.⁶⁸ This is done to satisfy the Due Process and Commerce Clauses, which respectively require that the income taxed by a state be “rationally related to ‘values connected with the taxing state’”⁶⁹ and “fairly apportioned”.⁷⁰ Both requirements are concerned with the avoidance of state tax formulas that create multiple taxation and gross distortions of income. Because of the complexity in apportioning the income of multistate businesses among several states, the U.S. Supreme Court developed the “unitary business principle”.⁷¹ This principle rests on two grounds: one, Iowa need not isolate a unitary business’s Iowa activities from the rest of the business, but may tax an apportioned share of the entire unitary business; and two, Iowa may not tax an out-of-state corporation’s income that is derived from an “unrelated business activity” which constitutes a “discrete business enterprise”.⁷² A unitary business is one carried on partly inside Iowa and partly outside Iowa, where the portion carried on in Iowa depends on or contributes to the business outside Iowa.⁷³ In determining whether a unitary business exists, the overriding consideration is whether there has been an exchange or transfer of value, which may be evidenced by “functional integration, centralization of management, and economies of scale.”⁷⁴

b. Distinguishing Business from Nonbusiness Income. Allocation and apportionment is accomplished by first distinguishing business from nonbusiness income. Business income is defined in part as follows:

[I]ncome arising from transactions and activity in the regular course of the taxpayer’s trade or business; or income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations; or gain or loss resulting from the sale, exchange, or other disposition of real property or of tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer’s trade or business carried on in Iowa or operationally related to sources within Iowa, or the property was operationally related

⁶⁸ Iowa Code §422.33(2).

⁶⁹ *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978) (quoting *Norfolk & Western R. Co. v. State Tax Comm’n*, 390 U.S. 317, 325 (1968)).

⁷⁰ See *Complete Auto Transit*, 430 U.S. 274. This represents the second prong of the four-prong test used to determine the validity of a state tax law under the Commerce Clause, discussed in footnote 21.

⁷¹ See *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992) for a brief history of the unitary business principle.

⁷² See *Allied Signal*, 504 U.S. at 772-773. It is important to note that, in Iowa, this principle operates to apportion income of a multistate business but does not, by itself, permit or require an affiliated group of corporations to file a combined return. For a discussion of a corporation’s reporting requirements, see Part IV, Section C of this Guide.

⁷³ Iowa Code §422.32(1)(k).

⁷⁴ *Allied Signal*, 504 U.S. at 783 (quoting *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 179 (1983)). See also *Super Valu Stores, Inc. v. Iowa Dept. of Revenue and Finance*, 479 N.W.2d 255 (1991) (holding subsidiary corporation to be part of unitary business because relationship produced “economies of scale and transfers of value”, thus sale of subsidiary was apportionable business income.)



to sources outside this state and to the taxpayer's trade or business carried on in Iowa; or gain or loss resulting from the sale, exchange, or other disposition of stock in another corporation if the activities of the other corporation were operationally related to the taxpayer's trade or business carried on in Iowa while the stock was owned by the taxpayer. A taxpayer may have more than one regular trade or business in determining whether income is business income.⁷⁵

In short, business income includes all income arising from the corporation's regular trade or business or income from the use or sale of property that is an integral part of, or operationally related to, the trade or business carried on in Iowa. All income not classified as business income is classified as nonbusiness income.

c. Nonbusiness Income Allocation. Nonbusiness income is allocated, which refers to the process of specifically assigning income to the proper state. Nonbusiness income or capital gain from intangible property is generally allocated to Iowa if the corporation's commercial domicile is in Iowa.⁷⁶ Nonbusiness income or capital gain from real property is generally allocated to Iowa if the real property is located in Iowa.⁷⁷ Nonbusiness income from tangible personal property is generally allocated to Iowa to the extent it is utilized in Iowa, but it is entirely allocated to Iowa if the corporation's commercial domicile is in Iowa and the corporation is not taxable in the other state where the property is utilized.⁷⁸ Nonbusiness capital gain from the sale of tangible personal property is allocated to Iowa if the property had a situs in Iowa at the time of sale or if the corporation's commercial domicile is in Iowa and the corporation was not taxable in the state where the property had situs.⁷⁹ Federal income taxes and other related expenses attributable to the nonbusiness income must also be allocated with the nonbusiness income.⁸⁰

d. Business Income Apportionment. Business income is apportioned to Iowa using a business activity ratio (BAR). The BAR is calculated using a single-factor sales formula, i.e., the amount of gross sales that are made within Iowa if the business involves the manufacture or sale of products, or the amount of gross receipts earned within Iowa if the business involves something other than the manufacture or sale of products, such as the provision of services.⁸¹ Most states use a three-factor formula

⁷⁵ Iowa Code §422.32(1)(b). For historical context, "business income" was once defined differently, resulting in the Iowa Supreme Court case of Phillips Petroleum Co. v. Iowa Dept. of Revenue and Finance, 511 N.W.2d 608 (1993). In that case, the Court held that capital gains resulting from transactions not in the regular course of a taxpayer's trade or business were nonbusiness income, even though the capital assets generated business income when they were used in the taxpayer's trade or business. The Iowa General Assembly overturned that ruling in 1995 Acts, ch. 141 (HF 548) by expanding the definition to its current language.

⁷⁶ Iowa Code §§422.33(2)(a)(1), (4)

⁷⁷ Iowa Code §§422.33(2)(a)(2), (4).

⁷⁸ Iowa Code §422.33(2)(a)(3).

⁷⁹ Iowa Code §422.33(2)(a)(4).

⁸⁰ Iowa Admin. Code 701-54.3. "Other related expenses" attributable to an item of nonbusiness income also includes indirectly related interest expenses that are calculated according to a formula delineated in the administrative rule.

⁸¹ Iowa Code §§422.33(2)(b)(3), (4); Iowa Admin. Code 701-54.5. Sales within Iowa are those delivered or shipped to a purchaser within Iowa, excluding deliveries for transportation out of Iowa. Iowa Code §422.33(2)(b)(6). Iowa gross receipts include those in which the recipient of the service receives benefit of the service in this state. Iowa Admin.



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based on an average of a specified percentage of total sales, property, and payroll that are made or located in the state. Iowa's single-factor sales formula was challenged in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), but was upheld by the U.S. Supreme Court as not violating the Due Process and Commerce Clauses.⁸² It is important to note that if a corporation believes the Iowa method of allocation and apportionment would subject it to taxation on a greater portion of net income than is reasonably attributable to Iowa, it may file an objection with the Department of Revenue and propose an alternative method.⁸³

In addition to sales/gross receipts, investment income (interest, dividends, rents, royalties, gains and losses, and other miscellaneous income) that is deemed to be business income derived from intangible property must be included in the calculation of the BAR to the extent that it has become an integral part of the corporation's business occurring regularly in or outside Iowa.⁸⁴ All other investment business income may, pursuant to a written election of the corporation, be included in or excluded from the calculation of the BAR.⁸⁵ If an inclusion election is made, the following investment income is included: the portion of interest from accounts receivable from customers located in Iowa⁸⁶; the entire amount of the remaining investment business income derived from intangible property if the corporation's commercial domicile is in Iowa⁸⁷; the portion of business rents and capital gains from real property that is located in Iowa⁸⁸; business rents from tangible personal property based on the percentage utilized in Iowa, but the entire amount if the corporation's commercial domicile is in Iowa and the corporation is not taxable in the other state where the property is utilized⁸⁹; and the portion of capital gains from the sale of tangible personal property that had a situs in Iowa at the time of the sale, or the entire amount if the corporation's commercial domicile is in Iowa and the corporation was not taxable in the other state where the property had situs⁹⁰.

The BAR is derived by comparing the corporation's business income attributable to Iowa, as determined above in this paragraph "d", to the corporation's total business

Code 701-54.6(1). For the apportionment of gross receipts relating to construction contractors, owners of a joint venture, limited liability company, or partnership; rental or royalties from real or tangible personal property; or transportation, communications, pipeline, or certain public utilities corporations, see Iowa Admin. Code 701-54.6(4)-(6) and 701-54.7.

⁸² The Court noted that "states have wide latitude in the selection of apportionment formulas and that formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the state is in fact 'out of all appropriate proportions to the business transacted...in that state'...or has 'led to a grossly distorted result'". *Moorman*, 437 U.S. at 274.

⁸³ Iowa Code §422.33(3); Iowa Admin. Code 701-54.9.

⁸⁴ Iowa Admin. Code 701-54.2(3).

⁸⁵ Iowa Code §422.33(2)(b); Iowa Admin. Code 701-54.2(3). The election is binding on all future tax years unless permission to change the election is granted by the director of the Department of Revenue.

⁸⁶ Iowa Admin. Code 701-54.2(3)(a). If the interest cannot be separated by geographical source, it is included in the same proportion that sales/gross receipts are included.

⁸⁷ Iowa Admin. Code 701-54.2(3)(a)-(c), (e), (h).

⁸⁸ Iowa Admin. Code 701-54.2(3)(d), (f).

⁸⁹ Iowa Admin. Code 701-54.2(3)(d), (f).

⁹⁰ Iowa Admin. Code 701-54.2(3)(f).



income except its investment business income that is properly excluded pursuant to an election. The ratio, stated as a percentage, is multiplied by the corporation's total business income, and that product is then added to Iowa nonbusiness income to arrive at Iowa taxable income.

e. Net Operating Loss. If a corporation's Iowa taxable income is a negative amount, it has a net operating loss. This loss may be carried forward for up to 20 tax years.⁹¹

3. Calculation of Tax

a. Regular Tax. To calculate the regular income tax a corporation multiplies its Iowa taxable income by the following regular rates: 6 percent on the first \$25,000 of taxable income; 8 percent on the next \$75,000; 10 percent on the next \$150,000; and 12 percent on \$250,000 or more.⁹²

b. Alternative Minimum Tax. The alternative minimum tax (AMT) is devised to ensure that at least a minimum amount of income tax is paid by corporate taxpayers who reap large savings by making use of certain tax deductions and exemptions. In essence, the AMT functions as a recapture mechanism, reclaiming some of the tax breaks primarily available to high-income corporations. The AMT is computed using a corporation's alternative minimum taxable income (AMTI), which is calculated using a somewhat complex procedure that first adds back certain federal deductions and preference items to net income and then subtracts an exemption amount equal to \$40,000, which exemption amount is reduced by 25 percent of the amount that AMTI exceeds \$150,000.⁹³ The AMT is imposed only to the extent that it exceeds the corporation's regular tax liability and is computed by multiplying AMTI by a rate of 60 percent of the highest regular corporate tax rate, i.e., 7.2 percent.⁹⁴ It is important to note that the AMT paid in a prior year can be claimed as a tax credit in a year in which the corporation's regular tax exceeds the AMT.⁹⁵

c. Unrelated Business Income Tax. Nonprofit organizations and corporations exempt from the regular Iowa corporate income tax by way of being exempt from federal income tax under IRC §501, are subject to the Iowa corporate income tax on the state's apportioned share of the unrelated business income as computed for federal tax purposes.⁹⁶ Unrelated business income generally includes income from

⁹¹ Iowa Code §422.35(11).

⁹² Iowa Code §422.33(1).

⁹³ Iowa Code §§422.33(4)(a), (c), (d). These adjustments relate to items like intangible drilling costs, depreciation and amortization, mining exploration and development costs, long-term contracts, pollution control facilities, adjusted basis, alcohol fuel credit, merchant marine capital construction funds, farming and passive activity losses, and net operating losses. See also IRC §§56-58. It also includes an increase or decrease equal to 75 percent of the difference between AMTI and a corporation's adjusted current earnings (ACE), which is calculated by making several adjustments to a corporation's income to more closely reflect earnings and profits (excluding federally tax-exempt securities). Iowa Code §422.33(4)(a); IRC §§56(c)(1), 56(g).

⁹⁴ Iowa Code §422.33(4).

⁹⁵ Iowa Code §422.33(7). For more information relating to the minimum tax credit, see Part IV, Section B, Subsection 4 of this Guide.

⁹⁶ Iowa Code §422.33(1A).



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any trade or business that is not substantially related to an organization's exempt purpose or function.⁹⁷

4. Credits

Iowa law provides several credits against the corporate income tax. Unlike a deduction or exemption, which reduces the amount of income subject to tax, a credit is a direct, dollar-for-dollar reduction in tax. These credits are subject to the same constitutional constraints relating to net income computation discussed in Part IV, Section B, Subsection 1 of this Legislative Guide. In addition, the supplemental research tax credit described in paragraph "a," and the tax credits described in paragraphs "d," "k," "l," "m," "t," and "v" of this Subsection 4 and their related programs are part of the Iowa Economic Development Authority's annual aggregate tax credit limit, which means these tax credits cannot, in total, exceed \$170 million per fiscal year.⁹⁸

The Iowa corporate income tax is reduced by the following credits:⁹⁹

a. Research Activities Tax Credit. (Effective 1985) Iowa taxpayers are allowed a research activities credit equal to 6.5 percent of the taxpayer's qualified expenditures apportionable to Iowa for increasing research activities. Qualified expenditures in Iowa are generally wages for qualified research services performed in Iowa, the cost of supplies used in conducting qualified research in Iowa, and at least 65 percent of expenses paid by the taxpayer to a person other than an employee of the taxpayer for basic research performed in Iowa. The state also provides an alternative simplified research credit consistent with the federal alternative simplified credit provided in IRC §41(c)(5).¹⁰⁰

Taxpayers approved by the Iowa Economic Development Authority under the High Quality Jobs Program or Enterprise Zone Program may be eligible for additional research activities credits by claiming the supplemental research credit. The supplemental research credit equals 10 percent for taxpayers with gross revenues of \$20 million or less, and 3 percent for taxpayers with gross revenues exceeding \$20 million. The alternative simplified supplemental research credit, consistent with the federal alternative simplified credit provided in IRC §41(c)(5), also varies based on gross revenue.¹⁰¹

An additional \$2 million in research activities credit is available for expenses related to the development and deployment of innovative renewable energy generation components manufactured or assembled in Iowa.¹⁰²

The research activities credit is refundable.

⁹⁷ See IRC §§512-513.

⁹⁸ Iowa Code §15.119(1); 2013 Acts, ch. 126, §§6-10 (HF 620).

⁹⁹ For additional information see <http://www.iowa.gov/tax/taxlaw/Taxcredits.pdf> (last accessed October 27, 2013).

¹⁰⁰ Iowa Code §422.33(5); IRC §41.

¹⁰¹ Iowa Code §§15.335, 15E.196(4).

¹⁰² Iowa Code §15.335(1)(b), (c).



b. New Jobs Tax Credit. (Effective 1985) A new jobs tax credit is allowed for increasing employment by at least 10 percent by a business under the Industrial New Jobs Training Program in Iowa Code chapter 260E. The credit is equal to 6 percent of the taxable wages paid to employees in new jobs or jobs directly related to new jobs for the taxable year in which the taxpayer elects to take the credit. It is a nonrefundable credit with a 10-year carryforward.¹⁰³

c. Historic Preservation and Cultural and Entertainment District Tax Credit. (Effective 2000) A taxpayer may receive a tax credit in an amount equal to 25 percent of the qualified rehabilitation costs¹⁰⁴ incurred in rehabilitating properties eligible to be listed on the National Register of Historic Places, historic properties in areas eligible to be designated local historic districts, local landmarks, or barns constructed prior to 1937.¹⁰⁵ In the case of commercial property, rehabilitation costs must equal the lesser of at least \$50,000 or 50 percent of the assessed value of the property, excluding the land, prior to rehabilitation. In the case of all other property, the rehabilitation costs must equal the lesser of at least \$25,000 or 25 percent of the assessed value, excluding the land, prior to rehabilitation.¹⁰⁶ In addition, the rehabilitation project must be approved by the State Historic Preservation Office of the Department of Cultural Affairs.¹⁰⁷

The total amount of tax credits that may be approved for fiscal years beginning on or after July 1, 2012, is \$45 million. Of this total, at least \$4.5 million must be allocated to new projects with costs of \$750,000 or less, at least \$13.5 million must be allocated to new projects located in certified cultural and entertainment districts or associated with Iowa Great Places agreements, at least \$9 million must be allocated to disaster recovery projects, and at least \$9 million must be allocated to projects that involve the creation of more than 500 new permanent jobs. Unclaimed tax credits may be reallocated to other projects according to the priority set out in law. Tax credits may be reserved for up to three years.¹⁰⁸ The tax credits are refundable or may be carried forward one year and, in most cases, are transferrable to another taxpayer.¹⁰⁹

d. Assistive Device Tax Credit. (Effective 2000) A taxpayer who operates a small business is allowed a tax credit equal to 50 percent of the first \$5,000 paid for the purchase, rental or modification of an assistive device¹¹⁰ or for the renovation of the workplace for an individual with a disability. A small business is one that either had gross receipts in the preceding tax year of \$3 million or less or employed not more than 14 full-time employees during its preceding tax year. Only \$500,000 in credits is

¹⁰³ Iowa Code §422.33(6).

¹⁰⁴ Qualified rehabilitation costs include amounts that are properly includable in computing the basis of the eligible property for tax purposes. Costs of sidewalks, parking lots, and landscaping do not constitute rehabilitation costs for purposes of determining the credit. Iowa Code §404A.1(2)(c).

¹⁰⁵ Iowa Code §422.33(10); Iowa Code ch. 404A.

¹⁰⁶ Iowa Code §404A.1(2)(e); 2013 Acts, ch. 112 (SF 436).

¹⁰⁷ Iowa Code §404A.3.

¹⁰⁸ Iowa Code §404A.4(4); 2013 Acts, ch. 112 (SF 436).

¹⁰⁹ Iowa Code §404A.4(3), (5).

¹¹⁰ An assistive device is an item, piece of equipment, or product system which is used to increase, maintain, or improve the functional capabilities of an individual with a disability in the workplace or on the job. Iowa Code §422.33(9)(c)(1).



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allowed per fiscal year. The credit is refundable or may be carried forward one year.¹¹¹

e. Franchise Tax Credit. (Effective 1997) A franchise tax credit is allowed for shareholders in a financial institution that have elected S corporation status for federal tax purposes. Because Iowa law does not recognize such an election for purposes of the franchise tax, the franchise tax credit is allowed in order to avoid double taxation of income. The credit is based on the taxpayer's pro rata share of the franchise tax paid by the financial institution.¹¹²

f. Alternative Minimum Tax Credit. (Effective 1988) Alternative minimum tax paid in a prior year can be claimed as a tax credit against the taxpayer's regular income tax liability in a subsequent tax year. The credit may only be claimed to the extent that the regular tax is greater than the minimum tax for a tax year. Any remaining credit is carried over to the following tax years.¹¹³

g. E-15 Plus Gasoline Promotion Tax Credit. (Effective 2011) An E-15 plus promotion tax credit is available to retail dealers who sell E-15 plus gasoline, which is gasoline with an ethanol content of at least 15 percent but less than 70 percent. The credit is not allowed for gasoline classified as E-85. For the 2012 through 2014 calendar years, the tax credit equals 3 cents per gallon. For the 2015 through 2017 calendar years, the tax credit equals 2 cents per gallon. A taxpayer may claim this tax credit even if the taxpayer also claims the ethanol promotion tax credit (on the same gallons of ethanol) or the E-85 gasoline promotion tax credit. The tax credit is refundable or may be carried forward one year. The tax credit is repealed on January 1, 2018.¹¹⁴

h. Ethanol Promotion Tax Credit. (Effective 2009) An ethanol promotion tax credit is available for retail dealers who sell and dispense ethanol blended gasoline. To receive this tax credit a taxpayer must calculate its biofuel distribution percentage, which is the sum of its total ethanol gallonage plus its total biodiesel gallonage expressed as a percentage of its total gasoline gallonage for the year.

Two tax credit schedules are applicable depending upon whether the taxpayer sells and dispenses more than 200,000 gallons of motor fuel in a year. For a taxpayer who sells and dispenses more than 200,000 gallons of motor fuel in a year, the taxpayer's biofuel threshold percentage begins at 10 percent for calendar year 2009, and increases each year until it reaches 25 percent for calendar years 2019 and 2020. For a taxpayer who sells and dispenses 200,000 gallons or less of motor fuel in a year, the taxpayer's biofuel threshold percentage begins at 6 percent for calendar year 2009, and increases each year until it reaches 25 percent for calendar year 2020.

The ethanol promotion tax credit may be calculated on a companywide or site-by-site basis. For taxpayers who meet the applicable threshold percentage, the credit rate is 8 cents per gallon. For taxpayers who do not meet the applicable threshold

¹¹¹ Iowa Code §422.33(9).

¹¹² Iowa Code §422.33(8).

¹¹³ Iowa Code §422.33(7).

¹¹⁴ Iowa Code §§422.11Y, 422.33(11D).



percentage, the credit rate is adjusted based on the taxpayer's biofuel percentage disparity. If the taxpayer's disparity equals 2 percent or less, the tax credit rate is 6 cents per gallon. If the taxpayer's disparity equals more than 2 percent but not more than 4 percent, the tax credit rate is 4 cents per gallon. A taxpayer is not eligible for a tax credit if its biofuel threshold percentage disparity is more than 4 percent. A taxpayer may claim this tax credit even if the taxpayer also claims the E-15 plus gasoline promotion tax credit or the E-85 gasoline promotion tax credit on the same ethanol gallonage. The tax credit is refundable or may be carried forward one year. The tax credit is repealed on January 1, 2021.¹¹⁵

i. E-85 Gasoline Promotion Tax Credit. (Effective 2006) An E-85 gasoline promotion tax credit is available to a retail dealer who sells and dispenses E-85 gasoline from motor fuel pumps. E-85 gasoline is gasoline with an ethanol content of at least 70 percent, but not more than 85 percent. The tax credit is calculated using a credit rate of 16 cents per gallon of E-85 gasoline which is sold and dispensed by the taxpayer. A taxpayer may claim the E-85 gasoline promotion tax credit even if the taxpayer also claims the ethanol promotion tax credit (on the same gallons of ethanol) or the E-15 plus gasoline promotion tax credit. The E-85 gasoline promotion tax credit is refundable or may be carried forward one year. The tax credit is repealed on January 1, 2018.¹¹⁶

j. Biodiesel Blended Fuel Tax Credit. (Effective 2006) A biodiesel blended fuel tax credit is available to retail dealers who sell biodiesel blended fuel that includes at least 2 percent biodiesel for calendar year 2012, and at least 5 percent biodiesel for calendar year 2013 and for each subsequent calendar year. The amount of the tax credit for 2012 is 2 cents per gallon if the fuel is at least 2 percent but less than 5 percent biodiesel, and 4.5 cents if it is 5 percent biodiesel or higher. For 2013 and beyond, the fuel must be 5 percent biodiesel or higher, and the tax credit is 4.5 cents per gallon. The credit is refundable or may be carried forward one year. The tax credit is repealed January 1, 2018.¹¹⁷

k. Equity Investment Tax Credit. (Effective 2002) A tax credit is allowed for 20 percent of the equity investment made in a qualifying business or community-based seed capital fund approved by the Iowa Economic Development Authority.¹¹⁸ The credit is focused on "angel investors" who make investments in start-up companies. A "qualifying business" is one that is principally located in Iowa; is six years old or less; is not a retailer, in real estate, or one that provides health care or otherwise requires a professional license; has a net worth of \$5 million or less; will obtain equity of at least \$250,000 within two years; and has an owner that has attained a certain level of education, training, or experience.¹¹⁹ A "community-based seed capital fund" is a fund

¹¹⁵ Iowa Code §§422.11N, 422.33(11A).

¹¹⁶ Iowa Code §§422.11O, 422.33(11B).

¹¹⁷ Iowa Code §§422.11P, 422.33(11C).

¹¹⁸ Iowa Code §§15E.43, 422.33(12)(a).

¹¹⁹ Iowa Code §15E.44(2).



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that invests in qualifying businesses and meets certain ownership and management requirements.¹²⁰

The tax credit cannot be claimed until three years after the investment is made. The maximum amount of tax credits that may be claimed by a taxpayer for investment in any one business is \$50,000. Total credits were capped at \$10 million for investments made prior to 2011.¹²¹ For investments made on or after January 1, 2011, the tax credits are capped at \$2 million per fiscal year. The credit is nonrefundable and has a five-year carryforward.¹²²

I. Investment Tax Credit. (Effective 1994) Investment tax credits are available for eligible businesses participating in the High Quality Jobs Program or the Enterprise Zone Program administered by the Iowa Economic Development Authority. The credit equals 10 percent of the new investment directly related to new jobs created or businesses constructed by eligible businesses. This means cost of machinery, real property and improvements to real property, and base rent paid to a third-party developer for a period not to exceed 10 years. The tax credit is amortized equally over five calendar years, is nonrefundable, and has a seven-year carryforward.¹²³

An eligible housing business that is participating in the Enterprise Zone Program can receive an investment tax credit equal to 10 percent of the new investment, not to exceed new investment used for the first \$140,000 of value, directly related to the building or rehabilitating of a minimum of four single-family homes or one multiple dwelling unit building containing three or more individual dwelling units. The credit is nonrefundable and has a seven-year carryforward.¹²⁴

m. Innovation Fund Investment Tax Credit. (Effective 2011) An innovation fund investment tax credit equal to 25 percent of a cash investment in a certified innovation fund is available for investments made on or after January 1, 2013. Innovation funds must meet several criteria to be certified by the Iowa Economic Development Authority. The aggregate amount of credits that may be authorized per year cannot exceed \$8 million. The credits are nonrefundable, transferrable, and have a five-year carryforward.¹²⁵

n. Iowa Fund of Funds Tax Credit. (Effective 2002) An Iowa capital investment corporation was created to organize the Iowa fund of funds managed by a private venture fund manager. The fund manager makes investments in private seed and venture capital funds which have made a commitment to consider equity investments in businesses located in Iowa. Investors in the Iowa fund of funds are guaranteed a certain rate of return. However, a contingent tax credit is allowed for

¹²⁰ Iowa Code §15E.45.

¹²¹ See 2011 Iowa Code §15E.43(4).

¹²² Iowa Code §§15.119, 15E.43.

¹²³ Iowa Code §§15.333, 15E.196, 422.33(12)(b).

¹²⁴ Iowa Code §§15E.193B, 422.33(12)(b).

¹²⁵ Iowa Code §§15.119, 15E.52, 422.33(13); 2013 Acts, ch. 117 (HF 615).



investments made into the Iowa fund of funds to the extent the actual rate of return on these investments does not meet the rate of return guaranteed to investors.¹²⁶

Pursuant to litigation and agreements among various interested parties in 2012, the contingent tax credits are capped at \$57 million in the aggregate and are redeemable at a maximum of \$20 million per year.¹²⁷ Legislation was enacted in 2013 to provide for the wind-up and eventual repeal of the Iowa Fund of Funds Program. As a result, the organization of a new fund of funds and the making of new investments by the fund of funds is prohibited. New investments in the fund of funds, the issuance of new credit certificates, and various other acts are prohibited except in limited circumstances.¹²⁸

o. Endow Iowa Tax Credit. (Effective 2003) An endow Iowa tax credit is allowed equal to 25 percent of an endowment gift made to an endow Iowa qualified community foundation to be used for charitable purposes. The contribution may not be deducted as a charitable deduction for state tax purposes. The aggregate amount of credits that may be authorized per year cannot exceed \$6 million, and any one taxpayer may not receive a credit greater than \$300,000. Ten percent of the credits are reserved each year for endowment gifts of \$30,000 or less, but they may be distributed to other applicants if demand is insufficient.¹²⁹ The credit is nonrefundable and has a five-year carryforward.

p. Wind Energy Production Tax Credit. (Effective 2004) A tax credit is allowed based upon the number of kilowatt-hours of electricity sold or used for on-site consumption by a wind production facility that meets certain energy production requirements and that was originally placed in operation between July 1, 2005, and June 30, 2012. The credit equals the number of kilowatt-hours sold or used times one cent. The Iowa Utilities Board must determine the eligibility of the facility for the credit. The maximum amount of nameplate generating capacity in the aggregate for all qualified facilities determined eligible for the credit may not exceed 50 megawatts. An owner of a facility cannot own more than two qualified facilities eligible for the tax credit. To be eligible for the tax credit, the facility must be located in a city or county that has enacted an ordinance for the special valuation of wind energy conversion property pursuant to Iowa Code section 427B.26, and must be eligible for such special valuation, or it must receive approval from the board of supervisors or city council. Each qualified facility may receive tax credit certificates for a period of 10 years. The certificates are nonrefundable, have a seven-year carryforward, and may be transferred to other persons.¹³⁰

¹²⁶ Iowa Code §§15E.61-15E.71, 422.33(20).

¹²⁷ For additional information regarding the Iowa fund of funds program, see the presentation by the Iowa Department of Revenue to the Legislative Tax Expenditure Committee on December 12, 2012, available at <https://www.legis.iowa.gov/DOCS/LSA/IntComHand/2013/IHMFM007.PDF> (last accessed on October 28, 2013). See also Iowa Code §15E.66(1), (5).

¹²⁸ 2013 Acts, ch. 140, §§129-132 (SF452), enacting Iowa Code §15E.72 effective June 20, 2013.

¹²⁹ Iowa Code §§15E.305, 422.33(14).

¹³⁰ Iowa Code §422.33(16); Iowa Code ch. 476B.



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q. Renewable Energy Tax Credit. (Effective 2005) Either a producer or purchaser of renewable energy may apply to the Iowa Utilities Board for a tax credit equal to one and one-half cents per kilowatt-hour of electricity or \$4.50 per million British thermal units of heat for a commercial purpose, methane gas, refuse-derived fuel, or other biogas used to generate electricity; or \$1.44 per 1,000 standard cubic feet of hydrogen fuel produced and sold by an eligible renewable energy facility or used for on-site consumption by the producer.

Upon receipt of an application, the board determines whether or not the facility from which the energy was generated and sold is an eligible renewable energy facility. An eligible renewable energy facility may be a wind energy conversion facility, biogas recovery facility, biomass conversion facility, methane gas recovery facility, solar energy conversion facility, or refuse conversion facility. To be eligible, the facility must meet certain ownership and energy production requirements and must be placed into service on or after July 1, 2005, but before January 1, 2015. The board cannot find as eligible, in the aggregate, more than 363 megawatts of nameplate generating capacity for wind energy conversion facilities and more than 53 megawatts of nameplate generating capacity for all other types of facilities and 167 billion British thermal units of heat for commercial purposes. Because of these and other statutory limitations, a waiting list of eligible facilities is maintained in the event additional capacity becomes available.

The board calculates the amount of energy generated and sold by the renewable energy facility and notifies the Department of Revenue of the amount of energy eligible for the tax credit. The department then issues the appropriate tax credit certificates to the applicant. Renewable energy tax credit certificates cannot be issued for renewable energy purchased or produced for on-site consumption after December 31, 2024.

Each renewable energy facility may receive tax credit certificates for a period of 10 years. The certificates have a seven-year carryforward and may be transferred once to another person. A person who receives a wind energy production tax credit under Iowa Code chapter 476B is not eligible to claim the renewable energy tax credit. A person who is eligible for the renewable energy tax credit is not eligible to receive the solar energy system tax credit under Iowa Code section 422.33(29).¹³¹

r. Agricultural Assets Transfer Tax Credit. (Effective 2007) The agricultural assets transfer tax credit is available as part of the Beginning Farmer Tax Credit Program administered by the Iowa Finance Authority to taxpayers who help beginning farmers acquire agricultural assets by lease or rental agreement. Agricultural assets include land, depreciable agricultural property, crops, or livestock.¹³² To be eligible, a beginning farmer must be a resident of the state with sufficient farm education, training, or experience, must have access to adequate working capital and production items, must materially participate in farming, and must not maintain or manage an

¹³¹ Iowa Code §422.33(16); Iowa Code ch. 476C.

¹³² Iowa Code §175.37; 2013 Acts, ch. 125 (HF 599).



amount of land and assets greater than that necessary to support a beginning farmer.¹³³

The agreement must be for a period of at least two years but not more than five years and must be based on a cash basis or a commodity share basis or both. If based on a cash basis, the amount of the credit is 7 percent of the gross amount paid to the taxpayer under the agreement. If based on a commodity share basis, the amount of the credit is 17 percent of the amount paid to the taxpayer from crops or animals sold. However, if the beginning farmer is a veteran, both percentages are increased by one additional point for one year. The Iowa Finance Authority may elect to use an alternative method to compute a tax credit for a crop share basis lease based on the average per bushel yield in the same county where the leased land is located by a per bushel state price. The maximum tax credit that may be issued to a taxpayer is \$50,000. The tax credit is nonrefundable and has a five-year carryforward.¹³⁴ Not more than \$8 million in tax credits may be issued per year.¹³⁵

s. Custom Farming Contract Tax Credit. (Effective 2013) The custom farming contract tax credit is available as part of the Beginning Farmer Tax Credit Program administered by the Iowa Finance Authority to taxpayers who contract with a beginning farmer to do custom work related to the production of crops or livestock. The contract must be in writing, cannot exceed 12 months, and cannot be substantially higher or lower than the market rate for similar contracts. The taxpayer must make all management decisions, but the beginning farmer may make day-to-day operational decisions affecting production. The beginning farmer must furnish any necessary equipment, and must furnish labor on a regular, continuous, and substantial basis. In addition, the taxpayer and the beginning farmer cannot have a common interest in the land or be related. The credit equals 7 percent of the gross amount paid to the beginning farmer, and is allowed only for the amount paid on a cash basis equaling at least \$1,000. The tax credit is increased by one additional percentage point for one year if the beginning farmer is a veteran. The maximum tax credit that may be issued to a taxpayer is \$50,000. The tax credit has a five-year carryforward.¹³⁶ Not more than \$4 million in tax credits may be issued per year.¹³⁷

t. Credit for Certain Sales Taxes Paid by Third-Party Developers. (Effective 2004) A tax credit is allowed equal to the sales tax paid by a third-party developer on gas, electricity, water, or sewer service; goods, wares, or merchandise; or services rendered relating to the construction and equipping of a facility of an eligible business participating in the High Quality Jobs Program administered by the Iowa Economic Development Authority.¹³⁸ A business must meet criteria specified in Iowa Code section 15.329 in order to qualify as an eligible business under the program.

¹³³ Iowa Code §175.36B; 2013 Acts, ch. 125 (HF 599).

¹³⁴ Iowa Code §§175.37, 422.33(21)(a); 2013 Acts, ch. 125 (HF 599).

¹³⁵ Iowa Code §175.39; 2013 Acts, ch. 125 (HF 599).

¹³⁶ Iowa Code §§175.38, 422.33(21)(b); 2013 Acts, ch. 125 (HF 599).

¹³⁷ Iowa Code §175.39; 2013 Acts, ch. 125 (HF 599).

¹³⁸ Iowa Code §§15.331C, 422.33(19).



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u. Charitable Conservation Contribution Tax Credit. (Effective 2008) A tax credit is provided for charitable contributions of real estate for conservation purposes. The amount of the tax credit is equal to 50 percent of the fair market value of an interest in qualified real property located in the state which is conveyed in perpetuity by the taxpayer to a qualified organization as an unconditional charitable donation exclusively for conservation purposes. However, the tax credit cannot exceed \$100,000. “Qualified organization” and “conservation purpose” mean the same as defined in IRC §170(h) except for certain conveyances of open space to fulfill density requirements. The amount of the contribution for which the tax credit is claimed is not deductible in determining taxable income for state tax purposes. The tax credit is nonrefundable and has a 20-year carryforward.¹³⁹

v. Redevelopment Tax Credits. (Effective 2009) A two-tiered system of tax credits administered by the Iowa Economic Development Authority is provided for the redevelopment of certain underutilized properties.

Investors who redevelop grayfield sites are eligible for a credit in an amount equal to 12 percent of the qualifying investment. Grayfield sites are those that have infrastructure in place but the property’s current use is outdated. If the development meets certain green development standards, an additional credit in the amount of 3 percent of the investment is available. “Green development” means development that meets or exceeds the sustainable design standards adopted by the State Building Code Commissioner.

Investors who redevelop brownfield sites are eligible for a credit in an amount equal to 24 percent of the qualifying investment. Brownfield sites are those that have potential environmental contamination. If the development meets certain green development standards, an additional credit in the amount of 6 percent of the investment is available.

The Brownfield Redevelopment Advisory Council approves the amount of each tax credit. A qualifying project is not eligible for more than 10 percent of the total amount of credits authorized in any one fiscal year. The total amount of tax credits authorized is \$5 million for FY 2011-2012 and \$10 million for FY 2012-2013 and each fiscal year thereafter. Therefore, no qualifying project is eligible for more than \$500,000 for FY 2011-2012 and more than \$1 million for FY 2012-2013 and each fiscal year thereafter. The tax credits are nonrefundable, have a five-year carryforward, and are transferrable. The tax credit is repealed on June 30, 2021.¹⁴⁰

w. Disaster Recovery Housing Project Tax Credit. (Effective 2009) A tax credit is available for a portion of a taxpayer’s investment in a qualifying disaster recovery housing project. To qualify for the credit, the property must be owned by the taxpayer and located in an area declared a major disaster area during the period of time beginning May 1, 2008, and ending August 31, 2008. The project must involve the construction or rehabilitation of housing and must meet the criteria for low-income housing tax credits under IRC §42. Additionally, the project must meet certain

¹³⁹ Iowa Code §422.33(25).

¹⁴⁰ Iowa Code §§15.291-15.295, 422.33(26); 2013 Acts, ch. 126, §§8-10 (HF 620).



requirements relating to residential housing density, educational services accessibility, and the prevention or mitigation of future natural disasters.

The tax credit equals 75 percent of the taxpayer's costs directly related to the project and incurred on or after May 12, 2009, and before July 1, 2010. The amount of the credit is divided by five and applied equally to the taxpayer's tax liability over a five-year span starting with the 2011 calendar year. The credit is nonrefundable and is not eligible for carryforward. The maximum amount of credits that may be issued per year is \$3 million.¹⁴¹

x. School Tuition Organization Tax Credit. (Effective 2006) A tax credit is available for voluntary contributions made to a school tuition organization (STO) that is exempt from federal income tax. The tax credit is equal to a maximum of 65 percent of the amount of the contribution. The contribution may not be deducted as a charitable deduction for state tax purposes or be designated for any particular student. At least 90 percent of its total revenue must be used by the STO to provide tuition grants to "eligible students," who are defined in statute as members of households that have total annual incomes of not more than three times the federal poverty level. The STO must limit the tuition grants provided to children who reside in Iowa, must provide grants to students at more than one school, and must only provide grants to eligible students. The tuition grants are to be used to allow the eligible students to attend a nonpublic elementary or secondary school located in the state.

The tax credit is claimed by attaching a tax credit certificate to the taxpayer's tax return. An STO is authorized to issue a percentage of the total annual tax credit certificates equal to the ratio that the students served by that STO bears to the total number of students served by all STOs. The tax credit is nonrefundable and has a five-year carryforward.¹⁴²

The total approved tax credits are \$8.75 million for tax years 2012 and 2013, and \$12 million for tax year 2014 and subsequent tax years.¹⁴³ Of these totals, the maximum that may be issued to corporations is \$2,187,500 for tax years 2012 and 2013, and \$3 million for tax year 2014 and subsequent tax years.¹⁴⁴

y. Solar Energy System Tax Credit. (Effective 2012) A solar energy system tax credit is available for a corporation equal to 50 percent of the federal energy credit provided in IRC §48, not to exceed \$15,000.

The federal energy credit is available for solar electric, heating, and cooling property and for equipment using solar energy to illuminate structures using fiber-optic distributed sunlight.¹⁴⁵ The federal credit applies to property placed in service before 2017, so the federal credit and the Iowa credit will be available for the 2012 through 2016 tax years.

¹⁴¹ Iowa Code §§16.211, 422.33(27).

¹⁴² Iowa Code §§422.11S, 422.33(28).

¹⁴³ Iowa Code §422.11S. See also 2013 Acts, ch. 122, §§5-7 (HF 625), amending Iowa Code §422.11S.

¹⁴⁴ Iowa Code §422.33(28).

¹⁴⁵ See IRC §48(a)(3)(A)(i), (ii).



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Taxpayers who claim this tax credit are not eligible to claim the renewable energy tax credit under Iowa Code chapter 476C. The tax credit is nonrefundable and has a 10-year carryforward.¹⁴⁶ The cumulative amount of credits that may be issued to corporations, and to individuals under Iowa Code section 422.11L, cannot exceed \$1.5 million.

z. From Farm to Food Donation Tax Credit. (Effective 2013) A tax credit is available for a taxpayer who produces a food commodity and donates it to an Iowa food bank or an Iowa emergency feeding organization. The food must not be damaged, out-of-condition, or unfit for human consumption. The credit equals 15 percent of the value of the food, as established according to the federal guidelines for charitable contributions of food under IRC §170(e)(3)(C), or \$5,000, whichever is less. The contribution may not be deducted as a charitable deduction for state tax purposes. The credit is nonrefundable and has a five-year carryforward.¹⁴⁷

aa. Fuel Tax Credit. (Effective 1975) The fuel tax credit is available for fuel tax paid on the purchase of certain motor fuel or undyed special fuel for use in certain vehicles and is in lieu of the motor fuel tax refund allowed under Iowa Code section 452A.17. The tax credit is refundable or may be carried forward until depleted.¹⁴⁸

C. Corporate Income Tax Collection

1. Estimated Tax

If a corporation's income tax is reasonably expected to be more than \$1,000 for the taxable year, the corporation is required to make payments of estimated tax.¹⁴⁹ The total estimated tax is due in equal installments depending on when the corporation first establishes that estimates will be owed. Installments are due by the end of the fourth, sixth, ninth, and twelfth months of the taxable year.¹⁵⁰ A new corporation with an initial short taxable year (fewer than 12 months) is required to pay estimates according to the length of the taxable year and the annualized amount of its income.¹⁵¹ A corporation with a short taxable year by reason of liquidation or other federal requirement pays estimated tax as if the tax year was a full 12 months, except that no estimate is owed for a tax year of 3 months or less.¹⁵²

A corporation is subject to an underpayment penalty if the estimated tax paid during the taxable year is less than the total tax liability determined at the end of the

¹⁴⁶ Iowa Code §§422.11L, 422.33(29).

¹⁴⁷ See 2013 Acts, ch. 140, §§139-144, 146, 147 (SF 452), enacting Iowa Code §§422.11R, 422.33(30), and Iowa Code ch. 190B.

¹⁴⁸ Iowa Code §§422.110-112.

¹⁴⁹ Iowa Code §422.85.

¹⁵⁰ Iowa Code §422.86. Corporations with tax liability exceeding \$80,000 in the tax year prior to the most recently completed tax year must pay estimated tax installments electronically. Iowa Admin. Code 701-56.2(2)(d).

¹⁵¹ Iowa Code §422.92; Iowa Admin. Code 701-56.3(1)(a). Annualization of income is done by multiplying the income for the appropriate period by the number of months in the taxable year and then dividing the resulting amount by the number of months in the period. This amount of income becomes the basis upon which the estimates must be paid. For information on annualizing income to avoid the underpayment penalty, see Iowa Code §422.89(3) and Iowa Admin. Code 701-56.5(2).

¹⁵² Iowa Code §422.92; Iowa Admin. Code 701-56.3(1)(b).



taxable year.¹⁵³ The penalty can be avoided by paying estimates according to the corporation's tax liability shown on the previous full-year return, or according to the current tax rates but using the tax information from the previous year's return, or according to an annualized basis.¹⁵⁴

2. Tax Return Filing Dates

Corporation tax returns must be filed by the last day of the fourth month after the close of the corporation's tax year. Cooperatives must file a return on or before the 15th day of the ninth month following the close of the cooperative's tax year. Nonprofit corporation returns with unrelated business income are due on the 15th day of the fifth month following the close of the nonprofit corporation's tax year. Corporation returns covering a short tax year are due 45 days after the due date of the federal tax return.¹⁵⁵ The total tax due is required to be paid in full at the time of filing the return.¹⁵⁶

A foreign corporation is not required to file an income tax return if its only activity involves the storing of tangible personal property in Iowa for 60 consecutive days or less in a warehouse for hire located in Iowa and if the stored property is not delivered or shipped so as to be included in the corporation's gross sales within the state.¹⁵⁷

An affiliated group of corporations may elect to file a consolidated return, which is a single comprehensive return covering the activities of all corporations in the affiliated group subject to the corporate income tax in Iowa.¹⁵⁸ The consolidated return provides for numerous intercompany adjustments and eliminations of transactions and items between the corporations to more clearly reflect the income tax liability of the entire group.¹⁵⁹ The director of the Department of Revenue may require a consolidated return if the filing of separate returns would improperly reflect the taxable incomes of the corporations or the group.¹⁶⁰

3. A Note on Combined Reporting

An important aspect of the Iowa consolidated return is that it only includes corporations in an affiliated group that are subject to the Iowa corporate income tax.¹⁶¹ It has been argued that this creates inequities in taxation by giving a corporation the opportunity to shift income and expenses between itself and other members of the

¹⁵³ Iowa Code §422.88. The penalty is calculated by applying the interest rate set out in Iowa Code section 421.7 to the amount of the underpayment.

¹⁵⁴ Iowa Code §422.89; Iowa Admin. Code 701-56.5.

¹⁵⁵ Iowa Code §422.21(1).

¹⁵⁶ Iowa Code §422.24.

¹⁵⁷ Iowa Code §422.36(6).

¹⁵⁸ Iowa Code §422.37. An affiliated group generally includes a parent/subsidiary corporate relationship in which the parent owns at least 80 percent of the voting and equity rights of one or more subsidiaries, and all other subsidiaries have the same relationship with another subsidiary in the group. See Iowa Code §422.32(1)(a); IRC 1504(a).

¹⁵⁹ Iowa Code §422.37(7); Iowa Admin. Code 701-53.15(4)-(8) and 701-53.16.

¹⁶⁰ Iowa Code §422.37; Iowa Admin. Code 701-53.15(2).

¹⁶¹ Iowa Code §422.37(2), (3).



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affiliated group that are not subject to Iowa tax.¹⁶² In response, numerous states mandate combined reporting, predicated on the concept of the previously discussed unitary business principle.¹⁶³ Combined reporting is simply a method of calculating income tax which requires an affiliated group of corporations that constitute a unitary business to compute tax using the activities of all members, not just those subject to tax in the state. The tax consequences of a change to combined reporting for any particular unitary business depends on its facts and circumstances. It will have no effect on a unitary business that conducts its entire business in Iowa, but it will affect a multistate unitary business's calculation of net income and its business activity ratio (BAR). The Iowa Department of Revenue estimates that these businesses would typically see an increase in net income because more business activity is subject to tax, but would see a decrease in their BAR because a smaller percentage of their total business would be conducted in Iowa. This would result in an increase in Iowa taxable income for most, but not all, corporations.¹⁶⁴

V. The Franchise Tax

A. Application

The franchise tax applies to financial institutions for the privilege of doing business in this state.¹⁶⁵ "Financial institution" includes state banks, national banking associations, trust companies, federally and state-chartered savings and loan associations, financial institutions chartered by the Federal Home Loan Bank Board, and production credit associations.¹⁶⁶ It does not apply to credit unions, which are subject to the moneys and credits tax.¹⁶⁷ The tax applies directly to the financial institution regardless of how it is organized because Iowa does not recognize a financial institution's election under the Internal Revenue Code (IRC) to have its income taxed directly to the owners.¹⁶⁸

The term "doing business in the state" is not statutorily defined, but "doing business" is defined by administrative rule to include all activities or transactions conducted for the purpose of financial gain or profit.¹⁶⁹ The same Due Process and Commerce Clause concerns that apply to the imposition and calculation of the corporate income tax also apply to the franchise tax.

B. Calculation of Tax

A financial institution calculates the franchise tax similarly to the corporate income tax. First, it computes its net income. Second, it allocates and apportiones the net income to

¹⁶² For more information regarding this see the Iowa Department of Revenue's report entitled "Combined Reporting: An Option for Apportioning Iowa Corporate Income Tax" (March 2007), available at <http://www.iowa.gov/tax/taxlaw/IDRCCombinedReportingCorpTax.pdf> (last accessed October 29, 2013).

¹⁶³ See Part IV, Section B, Subsection 2, Paragraph "a" of this Guide.

¹⁶⁴ "Combined Reporting" at pp. 7-8.

¹⁶⁵ Iowa Code §422.60(1).

¹⁶⁶ Iowa Code §422.61(1).

¹⁶⁷ Iowa Code §533.329.

¹⁶⁸ Iowa Code §422.61(3)(g); Iowa Admin. Code 701-59.21. See Iowa Code §§422.11, 422.33(8) for information relating to the franchise tax credit, which is allowed to avoid the double taxation of income.

¹⁶⁹ Iowa Admin. Code 701-59.25(1).



Iowa to determine its taxable income. Third, it applies net income to the franchise tax rate, and determines if it owes the alternative minimum tax (AMT). Fourth, it applies any available tax credits against the calculated tax.

1. Net Income Computation

The franchise tax is measured by net income. The computation of net income for a financial institution is substantially similar to the computation of net income for corporate income tax purposes. A financial institution starts with federal taxable income prior to the net operating loss and makes the adjustments listed for corporate tax purposes.¹⁷⁰ However, all interest and dividends from securities of federal, state, and local political subdivisions are added back, no deductibility for federal income taxes is available, and the financial institution's interest expense allocated to interest exempt for federal income tax purposes may be subtracted.¹⁷¹ Because of the discrepancy in the taxation of interest and dividends between financial institutions and other businesses, an incentive is created for financial institutions to establish investment subsidiaries and transfer interest-producing assets to them. To counteract this loss of franchise tax revenue, a deduction is disallowed for that portion of all expenses attributable to the investment in such subsidiary. The amount of expenses disallowed are in the proportion that the financial institution's investment in the investment subsidiary bears to the total assets of the financial institution.¹⁷²

2. Taxable Income Calculation — Allocation and Apportionment

a. In general. If a financial institution's entire business is carried on in Iowa then the total net income is subject to tax.¹⁷³ A financial institution is presumed to be carrying on its business entirely within Iowa if its activities are carried on only within Iowa.¹⁷⁴ A financial institution will be considered to also be conducting business outside Iowa if it engages in regular and continuing activities in another state that would constitutionally permit the state to impose a tax, regardless of whether or not it does.¹⁷⁵

If business is also conducted outside Iowa, net income must be allocated and apportioned to Iowa in much the same manner as is done for the corporate income tax.¹⁷⁶ A financial institution first distinguishes business from nonbusiness income and specifically allocates its nonbusiness income to Iowa. Business income is then apportioned using the business activity ratio (BAR),¹⁷⁷ but the following rules also apply to the calculation because of the unique nature of a financial institution's business:

¹⁷⁰ Iowa Code §422.61(3).

¹⁷¹ Iowa Code §422.61(3). Although states are generally prohibited from taxing federal securities, an exception exists for a nondiscriminatory franchise tax. See 31 U.S.C. §3124(a)(1).

¹⁷² Iowa Code §422.61(3)(f).

¹⁷³ Iowa Code §422.63.

¹⁷⁴ Iowa Admin. Code 701-59.25.

¹⁷⁵ These activities include the solicitation of loans by traveling loan officers, the collection of overdue accounts, or any other activities carried on in advancement, promotion, or fulfillment of the business of the financial institution. Iowa Admin. Code 701-59.25(2).

¹⁷⁶ See generally Iowa Admin. Code 701-59.27-59.29.

¹⁷⁷ See Part IV, Section B, Subsection 2, paragraph "d" of this Guide for a discussion of the business activity ratio.



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- Interest and other receipts from loans are attributable to Iowa if the borrower is located in Iowa.¹⁷⁸
- Service charges and fees from credit cards are attributable to Iowa if the individual holder resides in Iowa or if the corporate holder has its commercial domicile in Iowa.¹⁷⁹
- Merchant discount income from credit card transactions with a merchant are attributable to Iowa if the merchant is located in Iowa.¹⁸⁰
- Receipts for the performance of fiduciary services are attributable to Iowa if the services are principally performed in Iowa.¹⁸¹
- Income from securities are normally attributable to Iowa if the financial institution's commercial domicile is in Iowa, with a few exceptions. If the income is used to maintain federal and state reserve deposit requirements, it is attributable to Iowa based on the ratio that total deposits in Iowa bear to total deposits everywhere. If the income is held by a state treasurer or other public official or pledged to secure public or trust funds in a bank, it is attributable to Iowa if the banking office where the secured deposit is maintained is in Iowa.¹⁸²
- Receipts from traveler's checks and money orders are attributable to Iowa if the office that issued them is located in Iowa.¹⁸³
- Fees for financial services are attributable to Iowa if the customer is located in Iowa or the account is maintained in Iowa.¹⁸⁴
- Receipts from management services are attributable to Iowa if the recipient of the services is located in Iowa.¹⁸⁵

The BAR is derived by comparing the financial institution's business income attributable to Iowa, as determined above in this paragraph "a," to the financial institution's total business income except its investment business income that is properly excluded pursuant to an election. The ratio, stated as a percentage, is multiplied by the financial institution's total business income and that product is then added to Iowa nonbusiness income to arrive at Iowa taxable income.

b. Net Operating Loss. If a financial institution's Iowa taxable income is a negative amount, it has a net operating loss. This loss may be carried forward for up to 20 tax years.¹⁸⁶

¹⁷⁸ Iowa Admin. Code 701-59.28(2)(e)-(g).

¹⁷⁹ Iowa Admin. Code 701-59.28(2)(h).

¹⁸⁰ Iowa Admin. Code 701-59.28(2)(i).

¹⁸¹ Iowa Admin. Code 701-59.28(2)(j).

¹⁸² Iowa Admin. Code 701-59.28(2)(k).

¹⁸³ Iowa Admin. Code 701-59.28(2)(l).

¹⁸⁴ Iowa Admin. Code 701-59.28(2)(m).

¹⁸⁵ Iowa Admin. Code 701-59.28(2)(o).

¹⁸⁶ Iowa Admin. Code 701-59.2-59.4.



3. Calculation of Tax

a. Regular Tax. To calculate the regular tax a financial institution multiplies its Iowa taxable income by 5 percent.¹⁸⁷

b. Alternative Minimum Tax. The calculation of the alternative minimum tax (AMT) for the franchise tax is similar to the calculation of AMT for the corporate income tax, except for the treatment of federally tax-exempt securities in calculating alternative minimum taxable income (AMTI).¹⁸⁸ The AMT is imposed only to the extent it exceeds the financial institution's regular tax liability and is computed by multiplying AMTI by 3 percent.¹⁸⁹ A tax credit for the AMT paid in prior years is available in the same manner as the corporate income tax credit.

4. Credits

The Iowa franchise tax is reduced by the following credits which are provided in the same manner, and with the same limitations, as the equivalent corporate income tax credits:¹⁹⁰

- Alternative minimum tax credit.¹⁹¹
- Historic preservation and cultural and entertainment district tax credit.¹⁹²
- Investment tax credit.¹⁹³
- Endow Iowa tax credit.¹⁹⁴
- Wind energy production and renewable energy tax credits.¹⁹⁵
- Tax credit for certain sales taxes paid by a third-party developer.¹⁹⁶
- Iowa fund of funds tax credit.¹⁹⁷
- Redevelopment tax credits.¹⁹⁸
- Innovation fund investment tax credit.¹⁹⁹

C. Franchise Tax Collection

A financial institution pays estimated tax under the same requirements and in the same manner that a corporation pays estimated tax under the corporate income tax.²⁰⁰

¹⁸⁷ Iowa Code §422.63.

¹⁸⁸ Iowa Code §422.60(2)(b). See footnote 93 for more information on the calculation of AMTI.

¹⁸⁹ Iowa Code §422.60(2)(a).

¹⁹⁰ For additional information on these tax credits see Part IV, Section B, Subsection 4 of this Guide.

¹⁹¹ Iowa Code §422.60(3).

¹⁹² Iowa Code §422.60(4).

¹⁹³ Iowa Code §422.60(5).

¹⁹⁴ Iowa Code §422.60(6).

¹⁹⁵ Iowa Code §422.60(7).

¹⁹⁶ Iowa Code §422.60(8).

¹⁹⁷ Iowa Code §422.60(9).

¹⁹⁸ Iowa Code §422.60(10).

¹⁹⁹ Iowa Code §422.60(11).



Corporate Income Tax and Franchise Tax

Franchise tax must be paid, and franchise tax returns must be filed, on or before the last day of the fourth month following the end of the financial institution's taxable year or on or before the 45th day after the federal return is due, whichever date is later.²⁰¹ Franchise tax returns covering a short tax year are due 45 days after the due date of the federal tax return.²⁰² There is no provision in Iowa law for the filing of consolidated franchise tax returns for financial institutions.

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²⁰⁰ See Iowa Code §§422.85-422.93.

²⁰¹ Iowa Code §422.62.

²⁰² Iowa Code §§422.61(4), 422.62.