



**LEGISLATIVE  
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# LEGISLATIVE GUIDE

## *Legal Services Division*



**Note to Reader:**

Legislative Guides, prepared in an objective and nonpartisan manner, provide a general survey of a particular area of the law and are intended for use primarily by members of the Iowa General Assembly and their staffs. Legislative Guides are updated periodically to reflect changes in the law. The reader is cautioned against using information contained in a Legislative Guide to draw conclusions as to the legality of a particular behavior or set of circumstances.

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State Capitol  
Des Moines, IA 50319

December 2016

## STATE TAXATION — CORPORATE INCOME TAX AND FRANCHISE TAX

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# Corporate Income Tax and Franchise Tax



## 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 2017 Iowa Code. References to the Internal Revenue Code (IRC) are to the federal Internal Revenue Code of 1986, as subsequently amended to January 1, 2015.<sup>1</sup> References to the Iowa Administrative Code are to the Iowa Administrative Code published as of September 13, 2016.

## 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 and Federal Law Limitations on State Taxation

The corporate income tax and the franchise tax are shaped and limited by the United States Constitution and federal law. The Due Process and Commerce Clauses are two of the most frequently litigated constitutional provisions with regard to corporate income and franchise taxes, 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 federal law and the Iowa Constitution. Some of these may be discussed briefly in this Guide, but a detailed discussion of these limitations may be found in the Legislative Guide entitled *State Taxation: An Overview*.<sup>2</sup>

### 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

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<sup>1</sup> However, if applying this Guide to the period beginning January 1, 2015, and ending December 31, 2015, and to tax years beginning during the 2015 calendar year, references to the IRC are to the federal Internal Revenue Code of 1986, as subsequently amended to January 1, 2016. See 2016 Iowa Acts, ch. 1007 (HF 2433), §§1-5.

<sup>2</sup> Available at <https://www.legis.iowa.gov/perma/10172016384> (last visited June 2, 2016).



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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 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.<sup>3</sup>

## 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.<sup>4</sup> 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.<sup>5</sup>

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.<sup>6</sup> If a financial institution is an LLC taxed as a partnership, the financial institution will be subject to the Iowa franchise tax at the entity level, but members 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.<sup>7</sup>

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<sup>3</sup> Iowa Code §422.4(9).

<sup>4</sup> Iowa Code §422.32(1)(d).

<sup>5</sup> Iowa Code §422.15(2); Iowa Admin. Code 701-45.1 – 701-45.4.

<sup>6</sup> Iowa Code §422.32(1)(d).

<sup>7</sup> Iowa Code §§422.11, 422.61(3)(g).

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## 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 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 corporations<sup>8</sup> unless otherwise made exempt under state law.<sup>9</sup>

## 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.<sup>10</sup> S corporations are required to file income tax returns containing information relating to their income, capital gains or losses, and their shareholders and ownership interests.<sup>11</sup>

If a financial institution is an S corporation, the financial institution will be subject to the Iowa franchise tax at the entity level, but shareholders 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.<sup>12</sup>

## 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 July 31, 2016, of the \$8.1 billion in total state revenues, corporate income tax revenues were \$378.7 million or approximately 4.68 percent of total revenue, and franchise tax revenues were approximately \$41.5 million or approximately .51 percent of total revenue.<sup>13</sup> Revenues collected are deposited into the State General Fund.<sup>14</sup>

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

<sup>8</sup> Iowa Admin. Code 701-51.1(2).

<sup>9</sup> Iowa Code §422.34.

<sup>10</sup> Iowa Code §422.36(5).

<sup>11</sup> Iowa Code §422.36.

<sup>12</sup> Iowa Code §§422.11, 422.33(8), 422.61(3)(g).

<sup>13</sup> Jeff Robinson, Fiscal Services Division, Legislative Services Agency, Twelve-Month Total Net Tax Receipts Through July 31, 2016, available at <https://www.legis.iowa.gov/perma/12072016514> (last visited September 13, 2016).

<sup>14</sup> 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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Iowa Code 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 (Iowa Code 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.

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

## IV. The Corporate Income Tax

### A. Application

The corporate income tax applies to each corporation doing business in this state, or deriving income from sources within this state.<sup>15</sup> 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.<sup>16</sup> The term is not limited to the artificial business entity usually known as a corporation but also includes

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<sup>15</sup> Iowa Code §422.33(1). A state’s ability to impose income tax on a corporation is constrained by the Due Process Clause and Commerce Clause of the U.S. Constitution. The Commerce Clause prohibits a state from imposing income tax on a corporation engaged in interstate commerce unless such activity has a “substantial nexus” with the state. Thus, activities that constitute “doing business in the state” or “deriving income from sources within this state” must satisfy the constitutional requirement of “substantial nexus.” For a detailed discussion of the Due Process Clause and the Commerce Clause, see Part II of the Legislative Guide entitled State Taxation: An Overview, *available at* (<https://www.legis.iowa.gov/perma/10172016384>).

<sup>16</sup> Iowa Admin. Code 701-51.1(2).

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joint stock companies, associations organized for pecuniary profit, and partnerships and LLCs taxed as corporations under the IRC.<sup>17</sup> Exempt from the tax are financial institutions, insurance companies, and nonprofit organizations exempt from federal income tax under IRC §501.<sup>18</sup> However, such exempt nonprofit organizations are subject to Iowa corporate income tax on unrelated business income.<sup>19</sup>

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 conducted in Iowa for the purpose of financial or pecuniary gain or profit.<sup>20</sup> This includes every corporation organized under the laws of Iowa and any foreign corporation operating in interstate commerce that does business in Iowa.<sup>21</sup> 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.<sup>22</sup> Tangible property has a situs in Iowa when it is habitually present in Iowa or it maintains a fixed or regular route through Iowa.<sup>23</sup> Intangible property, while not physically present in any particular place, generally has situs in Iowa if the corporation’s commercial domicile<sup>24</sup> is in Iowa or if it has become an integral part of some business activity occurring regularly in Iowa.<sup>25</sup>

Certain activities conducted in Iowa by a foreign corporation<sup>26</sup> 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

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<sup>17</sup> Iowa Code §422.32(1)(d).

<sup>18</sup> 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.

<sup>19</sup> Iowa Code §422.33(1A). For more information on unrelated business income tax see Part IV, Section B, Subsection 3, of this Guide.

<sup>20</sup> Iowa Admin. Code 701-52.1(1)(a).

<sup>21</sup> Iowa Admin. Code 701-52.1.

<sup>22</sup> Iowa Code §422.32(1)(g). 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 (6th ed. 1990).

<sup>23</sup> Iowa Admin. Code 701-52.1(1)(c).

<sup>24</sup> “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).

<sup>25</sup> 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.

<sup>26</sup> “Foreign corporation” includes any corporation not organized under the laws of Iowa. Iowa Code §422.32(1)(f).



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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.<sup>27</sup>
- Soliciting orders of tangible personal property that are approved and filled outside the state.<sup>28</sup>
- The storage of goods in the state for 60 consecutive days or less in a warehouse for hire located in the state and if the stored goods are not delivered or shipped so as to be included in the corporation's gross sales within the state.<sup>29</sup>
- The performance of disaster or emergency-related work during a disaster response period by a qualifying out-of-state business.<sup>30</sup>

### B. Corporate Income Tax Calculation

Once a corporation determines it is subject to the Iowa corporate income tax, it must properly calculate the tax in four steps. First, it calculates its net income. Second, it allocates and apports 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 Calculation

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.

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<sup>27</sup> 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).

<sup>28</sup> 15 U.S.C. §381 et seq. For more information on the federal Interstate Income Act of 1959, better known as Public Law No. 86-272, see Part II, Section A, Subsection 4, of the Legislative Guide entitled State Taxation: An Overview, available at <https://www.legis.iowa.gov/perma/10172016384>.

<sup>29</sup> Iowa Code §422.36(6).

<sup>30</sup> See 2016 Iowa Acts, ch. 1095 (SF 2306), §§2, 7, 14, 15 (codified at Iowa Code §§29C.24, 422.36(7)).



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**a. Subtractions.** The starting point for computing Iowa net income is a corporation's federal taxable income before the deduction for net operating loss.<sup>31</sup> 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.<sup>32</sup>
- 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.<sup>33</sup>
- 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 parole, probation, or work release and, in the case of a small business, who are individuals with a mental or physical disability.<sup>34</sup>
- The federal work opportunity credit, alcohol and cellulosic biofuel fuels credit, and employer social security credit to the extent these credits increased federal taxable income.<sup>35</sup>
- Income included as a result of a sale-leaseback agreement entered into prior to January 1, 1986.<sup>36</sup>
- The loss on the sale or exchange of a regulated investment company to the extent the loss was disallowed for federal tax purposes.<sup>37</sup>
- The gain from the sale of obligations of the state of Iowa and its political subdivisions if specifically exempt by statute.<sup>38</sup>
- Foreign dividend income.<sup>39</sup>
- Ordinary or capital gain realized from the involuntary conversion of property due to eminent domain. If the gain is not recognized because the converted

<sup>31</sup> 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).

<sup>32</sup> 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.

<sup>33</sup> Iowa Code §422.35(4); Iowa Admin. Code 701-53.12.

<sup>34</sup> Iowa Code §422.35(6), (6A); Iowa Admin. Code 701-53.11.

<sup>35</sup> Iowa Code §422.35(5), (7), (17).

<sup>36</sup> Iowa Code §422.35(8); Iowa Admin. Code 701-53.7. Also referred to as "safe harbor" leases.

<sup>37</sup> Iowa Code §422.35(12).

<sup>38</sup> Iowa Code §422.35(18).

<sup>39</sup> 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 I.R.C. §§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 to interstate commerce...in part because matters of concern to the entire Nation are implicated." *Id.* at 79.



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property is replaced, then the deduction does not occur until the amount of the gain is subsequently realized.<sup>40</sup>

- The amount of any biodiesel production sales tax refund provided pursuant to Iowa Code section 423.4.<sup>41</sup>

### **b. Additions**

- Iowa income tax deducted.<sup>42</sup>
- 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.<sup>43</sup>
- Additional first-year depreciation subtraction allowed under IRC §168(k).<sup>44</sup>
- 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.<sup>45</sup>
- Certain adjustments to gain or loss for property with a basis established prior to January 1, 1934.<sup>46</sup>
- 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.<sup>47</sup>
- 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 15-year property.<sup>48</sup>
- Amounts deducted for federal tax purposes as a charitable contribution to the extent such contribution was made to an organization for the purpose of deposit in the Iowa Education Savings Plan Trust established in Iowa Code chapter 12D, and the taxpayer designated that any part of the contribution be used for the direct benefit of any dependent of a shareholder of the taxpayer, or any other single beneficiary designated by the taxpayer.<sup>49</sup>

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<sup>40</sup> Iowa Code §422.35(22); Iowa Admin. Code 701-53.24.

<sup>41</sup> Iowa Code §422.35(25).

<sup>42</sup> Iowa Code §422.35(4).

<sup>43</sup> Iowa Code §422.35(2); Iowa Admin. Code 701-53.6.

<sup>44</sup> Iowa Code §422.35(19)(a), (19A), (19B); Iowa Admin. Code 701-53.22. The additional first-year depreciation subtraction under I.R.C. §168(k)(4) was allowed for qualified property acquired after May 5, 2003, and before January 1, 2005.

<sup>45</sup> Iowa Code §422.35(24); Iowa Admin. Code 701-53.23.

<sup>46</sup> Iowa Code §422.35(3); Iowa Admin. Code 701-53.9.

<sup>47</sup> Iowa Code §422.35(10).

<sup>48</sup> Iowa Code §422.35(16); Iowa Admin. Code 701-53.17.

<sup>49</sup> See 2016 Iowa Acts, ch. 1104, §§4-6 (codified at Iowa Code §422.35(13)).



## 2. Taxable Income Calculation — Allocation and Apportionment

**a. In General.** After computing net income a corporation must next calculate its Iowa taxable income. In other words, it must determine how much of its total net income is subject to tax in Iowa. 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.<sup>50</sup> A corporation will be considered to 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.<sup>51</sup> If a corporation conducts business inside and outside of Iowa, or if income is derived from sources partly inside and partly outside of Iowa, net income must be allocated and apportioned to Iowa according to the amount reasonably attributed to sources within this state.<sup>52</sup>

**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 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.<sup>53</sup>

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<sup>50</sup> Iowa Admin. Code 701-54.1.

<sup>51</sup> See Iowa Code §422.32(1)(k), defining "taxable in another state." See also Iowa Admin. Code 701-54.1(4). This administrative rule 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.

<sup>52</sup> Iowa Code §422.33(2). The fair apportionment of income among states is required by the Commerce Clause of the U.S. Constitution, which is concerned in part with the avoidance of state tax formulas that create multiple taxation and gross distortions of income. For a detailed discussion of the Commerce Clause and the concept of "fair apportionment," see Part II, Section A, Subsection 1, Paragraph b, of the Legislative Guide entitled *State Taxation: An Overview*, available at <https://www.legis.iowa.gov/perma/10172016384>.

<sup>53</sup> 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 (Iowa 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



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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.<sup>54</sup> Nonbusiness income or capital gain from real property is generally allocated to Iowa if the real property is located in Iowa.<sup>55</sup> 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.<sup>56</sup> 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.<sup>57</sup> Federal income taxes and other related expenses attributable to the nonbusiness income must also be allocated with the nonbusiness income.<sup>58</sup>

**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.<sup>59</sup> Many states use a three-factor formula 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.

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in the taxpayer's trade or business. The Iowa General Assembly overturned that ruling in 1995 Acts, ch. 141 by expanding the definition to its current language.

<sup>54</sup> Iowa Code §422.33(2)(a)(1)(a), (d)(iii).

<sup>55</sup> Iowa Code §422.33(2)(a)(1)(b), (d)(i).

<sup>56</sup> Iowa Code §422.33(2)(a)(1)(c).

<sup>57</sup> Iowa Code §422.33(2)(a)(1)(d)(ii).

<sup>58</sup> 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.

<sup>59</sup> Iowa Code §422.33(2)(a)(2)(c), (d); 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)(a)(2)(h). Iowa gross receipts include those in which the recipient of the service receives benefit of the service in this state. Iowa Admin. Code 701-54.6(1). Income from the performance of disaster or emergency-related work during a disaster response period by a qualifying out-of-state business is not allocated to Iowa. Iowa Code §§29C.24, 422.33(2)(a)(2)(f). Gross receipts from broadcasting are apportioned to Iowa based on the proportion derived from customers whose commercial domicile is in the state, except those broadcasting receipts from national or local political advertising directed exclusively at one or more markets in the state, which are all apportioned to Iowa. Iowa Code §422.33(2)(a)(2)(e). 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 property 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.

## Corporate Income Tax and Franchise Tax



Supreme Court as not violating the Due Process and Commerce Clauses.<sup>60</sup> 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.<sup>61</sup>

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.<sup>62</sup> 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.<sup>63</sup> If an inclusion election is made, the following investment income is included: the portion of interest from accounts receivable from customers located in Iowa;<sup>64</sup> the entire amount of the remaining investment business income derived from intangible property if the corporation's commercial domicile is in Iowa;<sup>65</sup> the portion of business rents and capital gains from real property that is located in Iowa;<sup>66</sup> 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 utilized;<sup>67</sup> 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 situs.<sup>68</sup>

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 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.

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<sup>60</sup> 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. For a detailed discussion of the Due Process Clause and the Commerce Clause, see Part II of the Legislative Guide entitled *State Taxation: An Overview*, available at <https://www.legis.iowa.gov/perma/10172016384>.

<sup>61</sup> Iowa Code §422.33(3); Iowa Admin. Code 701-54.9.

<sup>62</sup> Iowa Admin. Code 701-54.2(3).

<sup>63</sup> 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.

<sup>64</sup> 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.

<sup>65</sup> Iowa Admin. Code 701-54.2(3)(a)-(c), (e), (h).

<sup>66</sup> Iowa Admin. Code 701-54.2(3)(d), (f).

<sup>67</sup> Iowa Admin. Code 701-54.2(3)(d).

<sup>68</sup> Iowa Admin. Code 701-54.2(3)(f).



## Corporate Income Tax and Franchise Tax

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**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.<sup>69</sup>

### 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.<sup>70</sup>

**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.<sup>71</sup> 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.<sup>72</sup> 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.<sup>73</sup>

**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.<sup>74</sup> Unrelated business income generally includes income from any trade or business that is not substantially related to an organization's exempt purpose or function.<sup>75</sup>

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<sup>69</sup> Iowa Code §422.35(11).

<sup>70</sup> Iowa Code §422.33(1).

<sup>71</sup> Iowa Code §422.33(4)(b)(1), (3), (4). 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 I.R.C. §§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)(b)(1); I.R.C. §56(c)(1), (g).

<sup>72</sup> Iowa Code §422.33(4)(a).

<sup>73</sup> Iowa Code §422.33(7). For more information relating to the minimum tax credit, see Part IV, Section B, Subsection 4, of this Guide.

<sup>74</sup> Iowa Code §422.33(1A).

<sup>75</sup> See I.R.C. §§512-513.



## 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. Tax credits can be nonrefundable or refundable, and nontransferable or transferable.

A nonrefundable tax credit reduces tax liability in the tax year for which it is claimed. If the tax credit amount exceeds the taxpayer's tax liability, the remaining tax credit amount is lost or, in some cases, may be carried forward to subsequent tax years and used to reduce tax liability in those years.

A refundable tax credit also reduces tax liability in the tax year for which it is claimed. However, if the tax credit amount exceeds the taxpayer's tax liability, the remaining tax credit amount is not lost, but instead is issued to the taxpayer in the form of a tax refund. In lieu of receiving a refund, a taxpayer frequently has the option to carry forward any remaining tax credit balance to the following tax year.

A nontransferable tax credit may only be claimed by the taxpayer who qualifies for the credit. A transferable tax credit may be claimed by the taxpayer or transferred to another person. Transferable tax credits are usually nonrefundable, but in some instances are refundable. The number of times such tax credits may be transferred, the type of persons eligible to transfer or obtain the credit, and whether or not the transferred amount may be a complete or partial transfer, depends on the unique statutory rules of each transferable credit. However, most transferable tax credits share similar procedural rules for documenting a transfer with the Department of Revenue through the use of certificates and replacement certificates. It is quite common for transferable tax credits to be sold or exchanged on a secondary market, and Iowa law generally provides that any consideration received or paid for such tax credits is not considered taxable income or allowed as a tax deduction for purposes of Iowa income tax.

The Department of Revenue requires taxpayers with multiple tax credits to claim them in a specified order, and generally allows nonrefundable tax credits to be claimed before refundable tax credits.<sup>76</sup>

In addition, the supplemental research tax credit described in paragraph "a," and the tax credits described in paragraphs "d," "k," "l," "m," "t," "v," "aa," and "bb" 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.<sup>77</sup>

The Iowa corporate income tax is reduced by the following credits:<sup>78</sup>

**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

<sup>76</sup> Iowa Admin. Code 701-42.44.

<sup>77</sup> Iowa Code §15.119(1).

<sup>78</sup> For additional information, see <https://tax.iowa.gov/sites/files/idr/Tax%20Credits%20Users%20Manual%202016.pdf> (last visited December 8, 2016).



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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).<sup>79</sup>

Taxpayers approved by the Iowa Economic Development Authority under the High Quality Jobs 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.<sup>80</sup>

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.<sup>81</sup>

The research activities credit is refundable.

**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.<sup>82</sup>

**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 expenditures<sup>83</sup> made in rehabilitating properties that meet the Department of Cultural Affairs' criteria for rehabilitation and that are 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.<sup>84</sup> In the case of commercial property, rehabilitation expenditures 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 expenditures must equal the lesser of at least \$25,000 or 25 percent of the assessed value, excluding the land, prior to rehabilitation.<sup>85</sup> In order to receive the credit, the rehabilitation project must be approved by and registered with the Economic

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<sup>79</sup> Iowa Code §422.33(5); I.R.C. §41.

<sup>80</sup> Iowa Code §15.335.

<sup>81</sup> Iowa Code §15.335(1)(b), (c).

<sup>82</sup> Iowa Code §422.33(6).

<sup>83</sup> See Iowa Code §404A.1(7), defining "qualified rehabilitation expenditures."

<sup>84</sup> Iowa Code §§404A.1(8)(a), (b), 404A.2(1), (2), 422.33(10).

<sup>85</sup> Iowa Code §404A.1(8)(c).





Development Authority, and the eligible taxpayer must enter into and fulfill an agreement for the successful completion of the program's requirements.<sup>86</sup>

The maximum amount of tax credits that may be awarded each fiscal year is \$45 million, except under certain circumstances.<sup>87</sup> First, for fiscal years beginning on or after July 1, 2016, up to \$4.5 million of unawarded tax credits may be carried forward to the next fiscal year and awarded in that fiscal year.<sup>88</sup> Second, for fiscal years beginning on or after July 1, 2016, tax credit awards that are irrevocably declined on or before June 30 of the next fiscal year may be re-awarded during that same fiscal year.<sup>89</sup> Finally, certain amounts of tax credits reserved but later declined, or available for approval, before July 1, 2014, may be awarded before July 1, 2016.<sup>90</sup>

The tax credits are refundable or may be carried forward five years, and are transferable to another person.<sup>91</sup>

**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 device<sup>92</sup> 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 allowed per fiscal year. The credit is refundable or may be carried forward one year.<sup>93</sup>

**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.<sup>94</sup>

**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.<sup>95</sup>

**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

<sup>86</sup> Iowa Code §404A.3.

<sup>87</sup> Iowa Code §404A.4(1), (2)(d), (3)(b).

<sup>88</sup> Iowa Code §404A.4(3).

<sup>89</sup> Iowa Code §404A.4(2)(a).

<sup>90</sup> Iowa Code §404A.4(2)(b), (c).

<sup>91</sup> Iowa Code §404A.2(3), (4).

<sup>92</sup> 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).

<sup>93</sup> Iowa Code §422.33(9).

<sup>94</sup> Iowa Code §422.33(8).

<sup>95</sup> Iowa Code §422.33(7).



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credit is not allowed for gasoline classified as E-85. For January 1 through May 31 of each calendar year, the tax credit equals 3 cents per gallon. For June 1 through September 15 of each calendar year, the tax credit equals 10 cents per gallon. For September 16 through December 31 of each calendar year, the tax credit equals 3 cents per gallon. A taxpayer may claim this tax credit even if the taxpayer also claims the ethanol 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, 2025.<sup>96</sup>

**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 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.<sup>97</sup>

**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 or the E-15 plus gasoline promotion tax credit on the same ethanol gallonage. The E-85 gasoline promotion tax

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<sup>96</sup> Iowa Code §§422.11Y, 422.33(11D).

<sup>97</sup> Iowa Code §§422.11N, 422.33(11A).

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credit is refundable or may be carried forward one year. The tax credit is repealed on January 1, 2025.<sup>98</sup>

**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 5 percent biodiesel. The amount of the tax credit for 2013 through 2017 is 4.5 cents per gallon. The amount of the tax credit for 2018 and beyond is 3.5 cents per gallon if the fuel is at least 5 percent but less than 11 percent biodiesel, and 5.5 cents per gallon if the fuel is 11 percent biodiesel or higher. The credit is refundable or may be carried forward one year. The tax credit is repealed January 1, 2025.<sup>99</sup>

**k. Equity Investment Tax Credit.** (Effective 2002) A tax credit is allowed for 25 percent of the equity investment in the form of cash made in a qualifying business approved by the Iowa Economic Development Authority.<sup>100</sup> 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 \$10 million or less; has at least two investors and has equity of at least \$500,000; and is participating in an entrepreneurial assistance program.<sup>101</sup>

The maximum amount of tax credits that may be issued per calendar year for investment in any one business is \$500,000.<sup>102</sup> The maximum amount of tax credits that may be issued per calendar year to an individual and his or her spouse or dependent shall not exceed \$100,000 combined.<sup>103</sup> The tax credits are capped at \$2 million per fiscal year.<sup>104</sup>

Tax credits claimed against the individual income tax are refundable or may be carried forward one year. Tax credits claimed against the corporate income tax and all other available taxes are nonrefundable and have a three-year carryforward.<sup>105</sup>

**l. Investment Tax Credit.** (Effective 1994) Investment tax credits are available for eligible businesses participating in the High Quality Jobs Program administered by the Iowa Economic Development Authority. The credit equals 10 percent of the new investment directly related to new jobs created or retained by projects of 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.<sup>106</sup>

<sup>98</sup> Iowa Code §§422.11O, 422.33(11B).

<sup>99</sup> Iowa Code §§422.11P, 422.33(11C).

<sup>100</sup> Iowa Code §§15E.43, 422.33(12)(a).

<sup>101</sup> Iowa Code §15E.44(2). Entrepreneurial assistance program participation requirement may be waived by the Economic Development Authority. Iowa Code §15E.44(2)(c).

<sup>102</sup> Iowa Code §15E.43(2)(c).

<sup>103</sup> Iowa Code §15E.43(2)(b).

<sup>104</sup> Iowa Code §15.119(2)(d).

<sup>105</sup> Iowa Code §15E.43(1)(d).

<sup>106</sup> Iowa Code §§15.333, 422.33(12)(b).



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**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, transferable one time, and have a five-year carryforward.<sup>107</sup>

**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 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.<sup>108</sup>

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.<sup>109</sup> 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 tax credit certificates, and various other acts are prohibited except in limited circumstances.<sup>110</sup>

**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. The credit is nonrefundable and has a five-year carryforward.<sup>111</sup>

**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

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<sup>107</sup> Iowa Code §§15.119(2)(e), 15E.52, 422.33(13).

<sup>108</sup> Iowa Code §§15E.61-15E.71, 422.33(20).

<sup>109</sup> 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/IHMF007.PDF> (last visited August 12, 2016). See also Iowa Code §15E.66(1), (5), (7).

<sup>110</sup> 2013 Iowa Acts, ch. 140, §§129-132, enacting Iowa Code §15E.72.

<sup>111</sup> Iowa Code §§15E.305, 422.33(14).



June 30, 2012. The credit equals the number of kilowatt-hours sold or used times 1 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.<sup>112</sup>

**q. Renewable Energy Tax Credit.** (Effective 2005) A purchaser of renewable energy may apply to the Iowa Utilities Board for a tax credit equal to 1.5 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. The producer may claim the credit if the energy produced is 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 in this state on or after July 1, 2005, but before January 1, 2018. The board cannot find as eligible more than an aggregate of 363 megawatts of nameplate generating capacity for wind energy conversion facilities and more than a combined 63 megawatts of nameplate generating capacity and, annually, 167 billion British thermal units of heat for commercial purposes for all other types of facilities. 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, 2027.

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.

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<sup>112</sup> Iowa Code §422.33(16); Iowa Code ch. 476B.



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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).<sup>113</sup>

**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.<sup>114</sup> 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 amount of land and assets greater than that necessary to support a beginning farmer.<sup>115</sup>

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 10-year carryforward.<sup>116</sup> Not more than \$8 million in tax credits may be issued per year.<sup>117</sup> Several aspects of the tax credit, including the amount of the credit, are scheduled to change on January 1, 2018.<sup>118</sup>

**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 24 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

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<sup>113</sup> Iowa Code §422.33(16); Iowa Code ch. 476C.

<sup>114</sup> Iowa Code §§16.80, 422.33(21)(a).

<sup>115</sup> Iowa Code §16.79.

<sup>116</sup> Iowa Code §16.80.

<sup>117</sup> Iowa Code §16.82.

<sup>118</sup> See 2014 Iowa Acts, ch. 1080, §§122, 125; 2014 Iowa Acts, ch. 1112, §§1-16.

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least \$1,000 per year. 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 10-year carryforward.<sup>119</sup> Not more than \$4 million in tax credits may be issued per year.<sup>120</sup> The tax credit is repealed on January 1, 2018.<sup>121</sup>

**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.<sup>122</sup> A business must meet criteria specified in Iowa Code section 15.329 in order to qualify as an eligible business under the program.

**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.<sup>123</sup>

**v. Redevelopment Tax Credits.** (Effective 2009) Investors who plan to redevelop a grayfield site or brownfield site may apply to the Iowa Economic Development Authority to receive tax credits through the Redevelopment Tax Credits Program.<sup>124</sup> Grayfield sites are those that have infrastructure in place but the property’s current use is outdated. Brownfield sites are those that have potential environmental contamination. Qualifying redevelopment projects are reviewed and scored by the Brownfield Redevelopment Advisory Council and the Economic Development Authority Board, and then qualifying projects may be awarded a tax credit by the Economic Development Authority Board. Tax credit awards may not exceed 12 percent of a qualifying investment in a grayfield site, and 24 percent of a qualifying investment in a brownfield site. However, the maximum credit is 15 percent or 30 percent, respectively, if the project meets certain green development requirements. “Green development” means development that meets or exceeds the sustainable design standards adopted by the State Building Code Commissioner.

<sup>119</sup> Iowa Code §§16.81, 422.33(21)(b).

<sup>120</sup> Iowa Code §16.82.

<sup>121</sup> 2014 Iowa Acts, ch. 1080, §120, 125.

<sup>122</sup> Iowa Code §§15.331C, 422.33(19).

<sup>123</sup> Iowa Code §422.33(25).

<sup>124</sup> Iowa Code §§15.291-15.295, 422.33(26).



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Not more than \$10 million in tax credits may be awarded each fiscal year, and of that amount not more than \$1 million may be awarded to any one qualifying redevelopment project.<sup>125</sup>

The tax credits are refundable for nonprofit corporations that meet certain criteria, nonrefundable for all other taxpayers, are transferable, and have a five-year carryforward.<sup>126</sup>

The tax credit is repealed on June 30, 2021.<sup>127</sup>

**w. 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 an STO's 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.<sup>128</sup>

The tax credit is claimed by including 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.<sup>129</sup>

The total approved tax credits are \$12 million per tax year.<sup>130</sup> Of this total, the maximum that may be issued to corporations is \$3 million per tax year.<sup>131</sup>

**x. Solar Energy System Tax Credit.** (Effective 2012) A solar energy system tax credit is available for a corporation equal to a certain percentage of the federal energy credit provided in IRC §48.<sup>132</sup> The federal energy credit is available for solar electric, heating, and cooling property, and for business equipment using solar energy to illuminate structures using fiber-optic distributed light.<sup>133</sup> The Iowa credit equals 60 percent of the federal credit for installations occurring before January 1, 2016, and 50 percent of the federal credit for installations occurring after January 1, 2016. The

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<sup>125</sup> Iowa Code §§15.119(2)(f), (3), 15.293A(5), (6).

<sup>126</sup> Iowa Code §15.293A(1)(c), (2)(d).

<sup>127</sup> Iowa Code §15.293A(8).

<sup>128</sup> Iowa Code §§422.11S(1), (2), (6); 422.33(28).

<sup>129</sup> Iowa Code §422.11S(3), (7), (8).

<sup>130</sup> Iowa Code §422.11S(8).

<sup>131</sup> Iowa Code §422.33(28).

<sup>132</sup> Iowa Code §§422.11L, 422.33(29).

<sup>133</sup> See I.R.C. §48(a)(3)(A)(i), (ii) (2016); Iowa Code §422.11L(6).



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credit cannot exceed \$20,000 per separate and distinct installation.<sup>134</sup> Tax credit applications must be filed by May 1 following the year of installation.<sup>135</sup>

Taxpayers who claim the 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. The cumulative amount of all solar energy tax credits that may be issued to individuals and corporations cannot exceed \$5 million. Of that amount, at least \$1 million must be reserved for residential solar energy system installation claims made under Iowa Code section 422.11L(1)(a), which cannot exceed \$5,000 per separate and distinct installation. If less than \$1 million is claimed during the year for those installations, the remaining amount may be made available for other claims. Any credit amounts that go unclaimed may be made available for the following year in addition to the annual \$5 million cap.<sup>136</sup>

The federal credit relating to solar electric, heating, and cooling property applies to property placed in service before 2022, so the corresponding Iowa credit will be available through the 2021 tax year.<sup>137</sup> The federal credit relating to solar illumination using fiber-optic distributed light applies to property placed in service before 2017, so the corresponding Iowa credit will be available through the 2016 tax year.<sup>138</sup>

**y. 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.<sup>139</sup>

**z. 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.<sup>140</sup>

**aa. Workforce Housing Investment Tax Credit.** (Effective 2014) A workforce housing investment tax credit is available as part of the Workforce Housing Tax Incentives Program administered by the Iowa Economic Development Authority.<sup>141</sup> Housing businesses seeking tax credits for a housing project under the program are required to apply to and enter into an agreement with the authority for the completion of the project. The credit cannot exceed 10 percent of the qualifying new investment

<sup>134</sup> Iowa Code §422.11L(1).

<sup>135</sup> Iowa Code §422.11L(3)(d). However, see 2016 Iowa Acts, ch. 1128 (HF 2468), §14, for provisions relating to eligibility of late tax credit applications for solar energy systems installed during the 2014 and 2015 calendar years.

<sup>136</sup> Iowa Code §422.11L(2)-(4).

<sup>137</sup> See I.R.C. §48(a)(2)(A)(i)(II) (2016); Iowa Code §422.11L(6).

<sup>138</sup> See I.R.C. §48(a)(3)(A)(ii) (2016); Iowa Code §422.11L(6).

<sup>139</sup> Iowa Code §§422.11R, 422.33(30), and Iowa Code ch. 190B.

<sup>140</sup> Iowa Code §§422.110, 422.111.

<sup>141</sup> Iowa Code §§15.351-15.356, 422.33(15).



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of the housing project. “Qualifying new investment” means costs that are directly related to the acquisition, repair, rehabilitation, or redevelopment of a housing project in this state, and includes costs that are directly related to new construction of dwelling units if the new construction occurs in a distressed workforce housing community, as determined by the authority. The credit is nonrefundable with a five-year carryforward, and is transferable.

The maximum aggregate amount of tax incentives (tax credit and sales and use tax refund) that may be awarded for a housing project shall not exceed \$1 million,<sup>142</sup> and the maximum amount of tax incentives that may be awarded by the authority under the program in a fiscal year shall not exceed \$20 million.<sup>143</sup>

**bb. Renewable Chemical Production Tax Credit.**<sup>144</sup> (Effective 2016) A tax credit is available for eligible businesses that produce renewable chemicals in Iowa from biomass feedstock between 2017 and 2026.<sup>145</sup> Eligible businesses must be physically located in Iowa, in compliance with all other agreements with the Economic Development Authority, operated for profit under single management, and must organize, expand, or locate in Iowa on or after April 6, 2016.<sup>146</sup> Certain service, medical, retail, and other businesses are excluded from eligibility.<sup>147</sup>

The tax credit equals the product of \$.05 multiplied by the number of pounds of renewable chemicals produced during the calendar year in excess of the eligible business’s pre-eligibility production threshold. The tax credit is refundable, has a one-year carryforward, and is nontransferable.<sup>148</sup>

The maximum amount of tax credits that may be issued to an eligible business for each calendar year of renewable chemical production shall not exceed \$1 million or \$500,000, depending on whether the eligible business has been operating in Iowa at the time of application for five or fewer years, or more than five years, respectively. An eligible business cannot receive more than five tax credits (representing five separate calendar years of renewable chemical production) under the program.<sup>149</sup>

The maximum aggregate amount of tax credits that may be awarded each fiscal year by the Economic Development Authority shall not exceed \$10 million, and credits may not be issued prior to July 1, 2018, or claimed by the taxpayer prior to September 1, 2018.<sup>150</sup> The credit is repealed July 1, 2030.<sup>151</sup>

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<sup>142</sup> Iowa Code §15.354(4).

<sup>143</sup> Iowa Code §15.119(2)(g).

<sup>144</sup> See 2016 Iowa Acts, ch. 1065 (SF 2300), §§4-11, 14-16 (codified at Iowa Code §§15.317-15.322, 422.33(22)).

<sup>145</sup> Iowa Code §§15.319(1), 422.33(22). An eligible business cannot receive a tax credit for renewable chemicals produced before the date the business first qualified as an eligible business. See Iowa Code §15.318(3)(b).

<sup>146</sup> Iowa Code §15.317(1), (2), (4), (6).

<sup>147</sup> Iowa Code §15.317(3), (5).

<sup>148</sup> Iowa Code §15.319. The credit is unavailable for the production of a secondarily derived building block chemical if that chemical is also the subject of a credit at the time of production as a first product. Iowa Code §15.319(1).

<sup>149</sup> Iowa Code §15.318(3).

<sup>150</sup> Iowa Code §15.119(2)(h); 2016 Iowa Acts, ch. 1065 (SF 2300), §14.

<sup>151</sup> Iowa Code §15.322.



## 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.<sup>152</sup> 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.<sup>153</sup> 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.<sup>154</sup> 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.<sup>155</sup>

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 taxable year.<sup>156</sup> 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.<sup>157</sup>

### 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.<sup>158</sup> The total tax due is required to be paid in full at the time of filing the return.<sup>159</sup>

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

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<sup>152</sup> Iowa Code §422.85.

<sup>153</sup> 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).

<sup>154</sup> 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).

<sup>155</sup> Iowa Code §422.92; Iowa Admin. Code 701-56.3(1)(b).

<sup>156</sup> 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.

<sup>157</sup> Iowa Code §422.89; Iowa Admin. Code 701-56.5.

<sup>158</sup> Iowa Code §422.21(1).

<sup>159</sup> Iowa Code §422.24.



## Corporate Income Tax and Franchise Tax

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group subject to the corporate income tax in Iowa.<sup>160</sup> 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.<sup>161</sup> 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.<sup>162</sup>

### 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.<sup>163</sup> 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 affiliated group that are not subject to Iowa tax.<sup>164</sup> In response, numerous states mandate combined reporting, predicated on the concept of the previously discussed unitary business principle.<sup>165</sup> 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.<sup>166</sup>

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<sup>160</sup> 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); I.R.C. §1504(a).

<sup>161</sup> Iowa Code §422.37(7); Iowa Admin. Code 701-53.15(4)-(8), 701-53.16.

<sup>162</sup> Iowa Code §422.37; Iowa Admin. Code 701-53.15(2).

<sup>163</sup> Iowa Code §422.37(2), (3).

<sup>164</sup> 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 <https://tax.iowa.gov/reports/combined-reporting-option-apportioning-iowa-income-tax> (last visited September 6, 2016).

<sup>165</sup> Combined reporting is predicated on the concept of the unitary business principle, which was created by the U.S. Supreme Court to deal with the complexity of fairly apportioning a corporation's multistate income between states, as is required by the Commerce Clause of the U.S. Constitution. For a detailed discussion of the Commerce Clause, fair apportionment, and the unitary business principle, see Part II, Section A, Subsection 1, Paragraph b, of the Legislative Guide entitled State Taxation: An Overview, available at <https://www.legis.iowa.gov/perma/10172016384>.

<sup>166</sup> "Combined Reporting" at 7-8.



## V. The Franchise Tax

### A. Application

The franchise tax applies to financial institutions for the privilege of doing business in this state.<sup>167</sup> “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.<sup>168</sup> It does not apply to credit unions, which are subject to the moneys and credits tax.<sup>169</sup> 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.<sup>170</sup> 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.<sup>171</sup>

### B. Franchise Tax Calculation

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

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.<sup>172</sup> 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.<sup>173</sup> 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

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<sup>167</sup> Iowa Code §422.60(1). See footnote 15 for a brief discussion of the constitutional constraints on a state’s ability to impose income tax on a corporation, which also apply to the imposition of the franchise tax.

<sup>168</sup> Iowa Code §422.61(1).

<sup>169</sup> Iowa Code §533.329.

<sup>170</sup> 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.

<sup>171</sup> Iowa Admin. Code 701-59.25(1).

<sup>172</sup> Iowa Code §422.61(3).

<sup>173</sup> 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).



## Corporate Income Tax and Franchise Tax

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investment in the investment subsidiary bears to the total assets of the financial institution.<sup>174</sup>

### 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.<sup>175</sup> A financial institution is presumed to be carrying on its business entirely within Iowa if its activities are carried on only within Iowa.<sup>176</sup> 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.<sup>177</sup>

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.<sup>178</sup> 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),<sup>179</sup> but the following rules also apply to the calculation because of the unique nature of a financial institution's business:

- Interest and other receipts from loans are attributable to Iowa if the borrower is located in Iowa.<sup>180</sup>
- 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.<sup>181</sup>
- Merchant discount income from credit card transactions with a merchant are attributable to Iowa if the merchant is located in Iowa.<sup>182</sup>
- Receipts for the performance of fiduciary services are attributable to Iowa if the services are principally performed in Iowa.<sup>183</sup>
- 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

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<sup>174</sup> Iowa Code §422.61(3)(f).

<sup>175</sup> Iowa Code §422.63.

<sup>176</sup> Iowa Admin. Code 701-59.25.

<sup>177</sup> 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).

<sup>178</sup> See generally Iowa Admin. Code 701-59.26 - 701-59.29. See footnote 52 for a brief discussion on the constitutional requirement of "fair apportionment."

<sup>179</sup> See Part IV, Section B, Subsection 2, Paragraph d, of this Guide for a discussion of the business activity ratio.

<sup>180</sup> Iowa Admin. Code 701-59.28(2)(e)-(g).

<sup>181</sup> Iowa Admin. Code 701-59.28(2)(h).

<sup>182</sup> Iowa Admin. Code 701-59.28(2)(i).

<sup>183</sup> Iowa Admin. Code 701-59.28(2)(j).

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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.<sup>184</sup>

- Receipts from traveler's checks and money orders are attributable to Iowa if the office that issued them is located in Iowa.<sup>185</sup>
- Fees for financial services are attributable to Iowa if the customer is located in Iowa or the account is maintained in Iowa.<sup>186</sup>
- Receipts from management services are attributable to Iowa if the recipient of the services is located in Iowa.<sup>187</sup>

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.<sup>188</sup>

### 3. Calculation of Tax

**a. Regular Tax.** To calculate the regular tax a financial institution multiplies its Iowa taxable income by 5 percent.<sup>189</sup>

**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).<sup>190</sup> 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.<sup>191</sup> 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:<sup>192</sup>

<sup>184</sup> Iowa Admin. Code 701-59.28(2)(k).

<sup>185</sup> Iowa Admin. Code 701-59.28(2)(l).

<sup>186</sup> Iowa Admin. Code 701-59.28(2)(m).

<sup>187</sup> Iowa Admin. Code 701-59.28(2)(o).

<sup>188</sup> Iowa Admin. Code 701-59.2 – 701-59.4.

<sup>189</sup> Iowa Code §422.63.

<sup>190</sup> Iowa Code §422.60(2)(b). See footnote 71 for more information on the calculation of AMTI.

<sup>191</sup> Iowa Code §422.60(2)(a).

<sup>192</sup> For additional information on these tax credits see Part IV, Section B, Subsection 4, of this Guide.



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- Alternative minimum tax credit.<sup>193</sup>
- Historic preservation and cultural and entertainment district tax credit.<sup>194</sup>
- Investment tax credit.<sup>195</sup>
- Endow Iowa tax credit.<sup>196</sup>
- Wind energy production and renewable energy tax credits.<sup>197</sup>
- Tax credit for certain sales taxes paid by a third-party developer.<sup>198</sup>
- Iowa fund of funds tax credit.<sup>199</sup>
- Redevelopment tax credit.<sup>200</sup>
- Innovation fund investment tax credit.<sup>201</sup>
- Solar energy system tax credit.<sup>202</sup>
- Workforce housing investment tax credit.<sup>203</sup>

### 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.<sup>204</sup>

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.<sup>205</sup> Franchise tax returns covering a short tax year are due 45 days after the due date of the federal tax return.<sup>206</sup> There is no provision in Iowa law for the filing of consolidated franchise tax returns for financial institutions.

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<sup>193</sup> Iowa Code §422.60(3).

<sup>194</sup> Iowa Code §422.60(4).

<sup>195</sup> Iowa Code §422.60(5).

<sup>196</sup> Iowa Code §422.60(6).

<sup>197</sup> Iowa Code §422.60(7).

<sup>198</sup> Iowa Code §422.60(8).

<sup>199</sup> Iowa Code §422.60(9).

<sup>200</sup> Iowa Code §422.60(10).

<sup>201</sup> Iowa Code §422.60(11).

<sup>202</sup> Iowa Code §422.60(12).

<sup>203</sup> Iowa Code §422.60(13).

<sup>204</sup> See Iowa Code §§422.85-422.93.

<sup>205</sup> Iowa Code §422.62.

<sup>206</sup> Iowa Code §§422.61(4), 422.62.