# THE NEW IOWA INCOME TAX REGULATIONS

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As the result of the considerable changes made in the Iowa income tax law by the 56th General Assembly, with respect both to substance and to procedure,[1] the State Tax Commission has revised existing income tax regulations and promulgated a number of new regulations. In addition, it has taken the opportunity to renumber these regulations so that, like the federal regulations, the numbers are keyed to the related section of the law.[2] Some new regulations, primarily in the areas of corporate tax and of administration of the law, were not caused by changes in law but were the result of an attempt to bring clarity to areas that had been sources of difficulty and misunderstanding.

It is the purpose of this article to call attention to significant changes in existing regulations and to the newly adopted regulations.

## RELATIONSHIP TO FEDERAL TAX LAW

In the effort to simplify preparation of state tax returns, the legislature initially tied Iowa and federal returns together by providing that: "The term 'net income' means the adjusted gross income as computed for federal income tax purposes under the Internal Revenue Code of 1954"[3] with certain adjustments to be made thereto, and that one method of determining deductions is to take the total of those items "deductible for federal income tax purposes under the Internal Revenue Code of 1954"[4] with certain

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1 Iowa Laws 1955, 56th G.A. c. 45 (H.F. 522—rates, amount of personal exemption and dependents credit); Iowa Laws 1955, 56th G.A. c. 207 (S.F. 430—preparation of returns by Tax Commission employees); Iowa Laws 1955, 56th G.A. c. 208 (H.F. 225—determining taxable income); Iowa Laws 1955, 56th G.A. c. 209 (S.F. 22—date for filing returns); Iowa Laws 1955, 56th GA. c. 210 (limitation periods on determining income); Iowa Laws 1955, 56th G.A. c. 211 (penalties).

2 Nine complete sets of regulations had been issued between 1934 and 1954. The regulations in each set, denominated articles, were numbered in consecutive order, but were grouped by basic subject matter. The ninth set was published by the State Tax Commission in December, 1953, and also appears in 1954 IOWA DEPARTMENTAL REGULATIONS 366-430. New regulations were approved by the Attorney General on September 26, 1955, and adopted by the Commission and filed with the Secretary of State on September 27, 1955. To illustrate the new numbering system, consider Regulation 22.15(1)-2. The "22" refers to the Chapter of the Iowa Code (Chapter 422), and the "15(1)" to the Code section and subsection to which the regulation relates; the "2" indicates it is the second regulation applicable to that subsection.

3 IOWA CODE § 422.7 (1954), as amended by Iowa Laws 1955, 56th G.A. c. 208 § 6.

4 IOWA CODE § 422.9 (1954), as amended by Iowa Laws 1955, 56th G.A. c. 208 § 8.

adjustments. Nowhere in the new law does the legislature define "Internal Revenue Code of 1954" and, thus, the effect upon the Iowa tax law of amendments to federal law is not specified. Because interpretation either excluding or including federal amendments subsequent to the adoption of the new law would cause controversy and undue complications, the State Tax Commission has not attempted to define "Internal Revenue Code of 1954" for the present.[5] It is hoped that clarification of the term can be obtained at the next legislative session.

The new law also fails to specify what effect shall be given to Treasury Regulations and Revenue Rulings.[6] Commission Reg. 22.61-1 provides that the federal regulations are to be used in ascertaining adjusted gross income, deductions, and other items that by statute must be "for federal income tax purposes under the Internal Revenue Code of 1954" unless the federal regulation or ruling is beyond the authority of the Commissioner of Internal Revenue to promulgate.[7]

## RESIDENT INDIVIDUAL TAXPAYERS

In prior years spouses filing separate returns were permitted by regulation to allocate their personal tax credit in any proportion they chose,[8] and one spouse often would claim just enough of her credit to offset any tax liability, with the balance being used by the other spouse. This practice is no longer permitted, as Reg. 22.12-2 allows each spouse only $12 credit. Another prior regulation forbade amendment of returns to change them from joint to separate returns, or vice versa.[9] This has been completely reversed, and if taxpayers who file a joint return for any year beginning in 1955 or thereafter later discover that they could have saved taxes

[5] Representative Miller, one of the authors of H.F. 225, stated on the floor of the House, and in an article, that use of that term would not result in recognition of amendments to the Internal Revenue Code made after adoption of H.F. 225, except upon further action by the Iowa legislature. MILLER, *The New Iowa Income Tax Law*, 41 IOWA L. REV. 85, 86 (1955). Nothing in the text of the act itself so indicates, but the printed explanation of the bill does state: "The method of adopting federal definitions (as determined under existing law—the Internal Revenue Code of 1954) is constitutionally sound." Any determination of legislative intent thus requires evaluation of the effect of the printed explanation, and determination whether "Internal Revenue Code of 1954" does have a meaning as "existing law". Some of the people who participated in the making of the new law believed that "Code of 1954", like "Code of 1939", was a word of art including any amendments to federal tax law. It is interesting to note that Kentucky, trying to solve the same problem, tied its law to the "Internal Revenue Code in effect on January 1, 1954". KY. REV. STAT. § 141.010(3). *But see:* Sutherland, Statutory Construction § 5208 (3d ed. 1943).

[6] MILLER, *The New Iowa Income Tax Law*, 41 IOWA L. REV. 87 n. 20 (1955).

[7] The possibility that a Treasury Regulation is beyond the law and unenforceable for federal tax purposes should always be kept in mind. For examples, see *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939); *Burnet v. Chicago Portrait Co.*, 285 U.S. 1 (1932). However, it can be anticipated that the State Tax Commission will consider a Treasuary Regulation invalid only in rare situations.

[8] Art. 200, 1954 I.D.R. 401.

[9] Art. 206, 1954 I.D.R. 402.

by filing separately, they may now do so if the period for amending returns has not expired.[10]

Any Iowa resident who derives income from a business carried on in another state may be required to pay income tax to that state on that business. To reduce his total tax burden, he is permitted in some circumstances to "allocate" that part of his income to the state where it was earned and to exclude it from his Iowa taxable income.[11] Under the new law it is necessary to include this income and then deduct it by an adjustment.[12] The former regulation has been adopted in substance, but expanded to list the states in which such business income can be earned and allocated.[13] A new regulation indicates that if the business results in a loss, the amount of that loss must be added to federal adjusted gross income in determining Iowa taxable income.[14] The effect of these two regulations is to include in taxable income all income from Iowa operations and from intangibles and to exclude the effect of either gain or loss in non-Iowa businesses carried on in the designated states. Where the non-Iowa business operates at a profit, federal income tax attributable to that profit should be allocated in the same manner.[15] A further regulation provides that if the entire non-Iowa business is sold (or a part other than in the regular course of business), any gain or loss resulting from that sale is not to be excluded from Iowa taxable income.[16]

In many instances the event which gives rise to income or expense occurs in a tax period different from that in which the resulting payment is received or made. If the taxpayer is on an accrual basis, usually he will "recognize" the event and its tax consequences in the year it occurs. But, for federal income tax purposes certain events may be given special treatment, and their recognition may be spread over several years. As such special treatments were not permitted for state tax purposes prior to the 1955 tax years, taxpayers in such situations could suffer hardships or obtain a windfall unless adjustments were permitted or required. The new statute has no specific provision directed to this problem, but, as similar situations were handled by regulation in

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[10] Reg. 22.13-3.

[11] IOWA CODE § 422.8(1) (1954), as amended by Iowa Laws 1955, 56th G.A. c. 208 § 7.

[12] Reg. 22.8(1)-1.

[13] Of the states having income tax laws, the Tax Commission considers sixteen to have such provisions that allocation is permitted under the Iowa statute. These are: Arizona, Arkansas, Colorado, Georgia, Idaho, Indiana, Maryland, Minnesota, Mississippi, Missouri, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon and Wisconsin. An informal letter opinion from an assistant attorney general, in February, 1955, held that the Kansas law was not sufficiently similar to the Iowa law to permit allocation of income from businesses in that state.

[14] Reg. 22.8(1)-2; Opinion of the Attorney General, June 30, 1955. This was the practice under the prior law, which used the term "profit" rather than the term "net income", "profit" being considered to include "loss".

[15] Reg. 22.9-12; Opinion of the Attorney General, June 30, 1955.

[16] Reg. 28.8(1)-3; Opinion of the Attorney General, June 30, 1955.

the initial days of the state income tax,[17] regulations intended to alleviate possible hardships and eliminate unintended windfalls have been adopted. There are six principal situations covered.

First, if a transaction which resulted in a capital gain occurred before the 1955 tax year, the fact that all or a part of the gain is received in 1955 or a subsequent year (for example, as part of an installment payment in the sale of a farm), is immaterial—in effect, the entire gain is tax exempt.[18] Second, if merchandise was sold on an installment basis before 1955, the entire profit had to be reported at time of sale for state purposes, but could be reported in installments for federal tax purposes. A taxpayer with installment income in 1955 and subsequent years may exclude that income from his Iowa taxable income to the extent it has previously been reported for Iowa tax purposes.[19] Third, if a capital loss occurred in a tax year beginning prior to January 1, 1955, and is carried forward for federal tax purposes to tax years which begin after that date, such loss must be eliminated in computing Iowa taxable income.[20]

Fourth if net operating losses occurred prior to January 1, 1955, no carry-over for Iowa income tax purposes is permitted.[21] Fifth, if net operating losses occur in tax years beginning on or after January 1, 1955, they cannot be carried back for Iowa tax purposes to affect years beginning prior to that date, nor can they be carried forward except to the extent permitted each year for federal tax purposes.[22] Sixth, soil conservation expenditures during the 1954 tax year in excess of the allowable deduction on federal returns which are being carried forward to federal returns

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17 Official Bulletin of Board Rulings Number 1, January 24, 1935, issued by the State Board of Assessment and Review, regarding income accrued prior to January 1, 1934, was as follows:

> "Any claim existing unconditionally on January 1st, 1934, whether presently payable or not, and held by a taxpayer prior to January 1, 1934, whether evidenced by writing or not and all interest which has accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Where services were rendered prior to January 1, 1934, but paid for thereafter, the amount received for such services ordinarily should not be included in gross income. A claim for the purpose of this article means a right existing unconditionally on January 1, 1934, and then assignable whether presently payable or not."

18 Reg. 22.7-11. The gain is of course included in adjusted gross income and then excluded as an adjustment, with suitable explanation.

19 Reg. 22.7-12.

20 Reg. 22.7-13. As the loss will be included in adjusted gross income, it is eliminated by an adjustment adding the amount of the loss, even though form IT-1 suggests that adjustments are always to be deducted.

21 Reg. 22.9-6(a). Proper recording on form IT-1 requires the inclusion of the amount in deductions and the exclusion in the adjustments section, where it must be added to adjusted gross income. There may be no objection if the item is neither included in deductions reported nor in adjustments, on the State return.

22 Reg. 22.9-6(b).

for subsequent years may not be carried forward for Iowa tax purposes.[23]

Where spouses who filed joint federal returns file separate state returns, they are required to explain any division of income other than wages.[24] If they itemize deductions each is entitled only to the portion of the deductions which have been paid or accrued by him. If property is held in the name of one spouse, the other may not deduct on his individual return any taxes or other amounts paid with respect to that property.[25]

## NONRESIDENT INDIVIDUAL TAXPAYERS

To the extent that a nonresident's adjusted gross income and deductions derive from his Iowa activities, he is subject to the same rules as is the resident taxpayer. Previous comments herein which relate to determination of such income and deductions are also relevant in the case of the nonresident.

One major change has been with respect to what deductions are allowable. Under prior regulations, the nonresident could deduct only such items as were related to his Iowa activities, plus his charitable contributions and medical deductions.[26] For this reason, a resident of Rock Island, employed solely in Davenport, could not deduct his Illinois property taxes, interest paid on the mortgage on his Rock Island home, and the like. The revised regulation permits him to deduct all items allowable as deductions on his federal return if his entire adjusted gross income is from Iowa sources, and to prorate these deductions if he has both Iowa and non-Iowa income (the sole exception being the Iowa income tax).[27]

In addition, as a result of extension of the tax to capital gains, a regulation now provides that if the nonresident realizes any gains from sales or exchanges of property which has a situs within Iowa, such gains are subject to the Iowa income tax.[28]

## FIDUCIARIES

The regulation defining "fiduciary" has been restated, and specific reference to certain classes (executors, administrators, guardians and conservators) has been eliminated.[29] From the language in the new definition and in subsequent regulations pertaining to fiduciaries it is apparent that the change is one of form,

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[23] Reg. 22.9-7.

[24] Schedule A, form IT-1, and Instruction Sheet, form IT-1. Each spouse may report only income rightfully his own.

[25] Reg. 22.9-8. If one spouse chooses to claim the optional standard deduction, neither may itemize deductions. IOWA CODE § 422.9(3) (1954), as amended by Iowa Laws 1955, 56th G.A. c. 208 § 8. There is also the danger, if one spouse claims deductions with respect to property held in the name of the other, that the claimant will be treated as the true owner for inheritance tax or other purposes because of his claim.

[26] IOWA CODE § 422.9(7) (1954); Art. 299, 1954 I.D.R. 418-419.

[27] Reg. 22.9-13.

[28] Reg. 22.8(2)-10.

[29] *Compare* Art. 248, 1954 I.D.R. 407, *with* Reg. 22.6-1.

not one of substance. Except as to the computing of taxable income, the changes in the regulations applicable to fiduciaries do not contain any major deviation from prior rules.

*1. Final individual return for decedent.*

As before, the executor or administrator is responsible for the filing of a final individual income tax return for a decedent for the year of death. If decedent had not filed returns for prior years, the executor or administrator may also be called upon to submit returns for those years. (If there is no executor or administrator, the responsibility falls upon the surviving spouse or next of kin.)[30]

The new regulations provide that the final return be filed if decedent had taxable income of $600 or more.[31] As at least the full $12 credit is allowable against the tax, even though decedent lived no more than one month, many returns may be required which will be of the "no-pay" type. The $600 limit is specified in Code section 422.14, and is also justified because it may bring to light cases where returns should have been filed in prior years but were not.

The new regulations make it clear that deductions are not to be accrued and included in the final return merely because of decedent's death, and that if decedent was on an accrual basis, amounts accruing only because of his death should not be included on his final return.[32]

*2. Estates and Trusts.*

An estate or trust is a taxable entity.[33] Its returns may be either on the cash or accrual basis, but if a federal income tax return is required the basis used on the state return must be the same as that used on the federal.[34] An estate may select its own fiscal year or use the same fiscal year as the decedent had. If the same period is selected, a short-period return for the unexpired part of that year becomes necessary, and the full-year personal exemption may be taken thereon.[35]

In substance the income of the estate or trust is computed in the same manner as that of an individual, using "taxable income" as computed for federal income tax purposes (but with no deduction for personal exemption), less allowable deductions, with adjustments made by individual taxpayers such as for interest and dividends on federal and state securities, and federal and state income taxes.[36] The major complication in the computation is with respect to deductions for amounts distributable to beneficiaries. This can be a problem if the estate or trust had income taxable or deductions allowable by the federal government but not

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[30] Reg. 22.6-5(a).
[31] Reg. 22.6-5(f).
[32] Reg. 22.6-5(d), (e).
[33] Reg. 22.6-2.
[34] *Ibid.*
[35] Reg. 22.6-2, 22.6-6(b).
[36] Reg. 22.6-3, 22.6-6(d), (e).

by the state, or vice versa. This problem is met in the regulations by providing that the distributed or distributable income on the Iowa return shall bear the same ratio to net income for Iowa purposes as the amount recognized as distributed or distributable on the federal return does to net income for federal purposes. If the result is in conflict with or contrary to the terms of the will or trust instrument, the fiduciary may determine the distribution for Iowa tax purposes by any method proper under the facts.[37] In any event he should fully explain his method on the return.

A gift or bequest, except from income, cannot be deducted from net income.[38]

Previous regulations specifically distinguished between resident and nonresident estates and trusts, and defined a "resident trust".[39] Although they were not carried into the new regulations, the distinction has not been abandoned. At one point, the "resident" estate is permitted the same allocation outside Iowa of non-Iowa business income as can be claimed by the individual resident.[40]

In addition, if the estate or trust has a nonresident beneficiary, the fiduciary must report on the return what part of the beneficiary's distributive share is subject to Iowa income tax and what part is not. Further, he must withhold for Iowa income tax if withholding is necessary.[41]

*3. Guardians.*

The former regulation pertaining to returns by guardians specifically authorized deductions of compensation to the guardian, legal fees, court costs, and like items.[42] This provision has been eliminated, but if the items involved are deductible for federal tax purposes, they may be deducted for Iowa tax purposes.[43]

When the guardianship terminates, the guardian must file a final fiduciary return on form IT-4, in order to obtain the certificate from the Commission which is to be filed in his final report to the court. If individual returns for the ward for prior years have not been filed, explanation for the non-filing is called for. If such returns had been filed and there was income in the year of closing, the IT-4 return is an informational return for the purpose of obtaining the certificate, and an individual return should also be filed for the tax year of the ward in which the guardian-

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[37] Reg. 22.6-6(f). If the trust or estate has such distributable income, the fiduciary is required to file an information return on form IT-5A for resident beneficiaries or NR-5A for nonresident beneficiaries, even though the estate itself has less than $600 taxable income and files no return on form IT-4.

[38] Reg. 22.6-6(h).

[39] Art. 252, 1954 I.D.R. 407-408.

[40] Reg. 22.6-6(d).

[41] Reg. 22.6-6(f), (k).

[42] Art. 259, 1954 I.D.R. 411.

[43] IOWA CODE § 422.9 (1954), as amended by Iowa Laws 1955, 56th G.A. c. 208 § 8.

ship terminated. (If termination was due to death, the rules applicable to decedents' final returns apply.)[44]

## PARTNERSHIPS

The former definition of a partnership has been eliminated, and now, for Iowa tax law purposes, a partnership or limited partnership is "a partnership or limited partnership required to file partnership return for purposes of federal income tax."[45] An association which, under Iowa partnership law, is a partnership but which has elected for federal income tax purposes to be taxed as a corporation is to be taxed in the same manner for Iowa income tax purposes.[46]

Partnership income is taxed substantially in the same manner as before—to the partners upon their distributable shares. Every partnership must file an information return, which lists the net income of the firm, the partners' names, addresses, and their respective shares in that net income.[47]

## WITHHOLDING AGENTS AND WITHHOLDINGS

No change of substance was made in the regulations relating to withholding.[48]

## FILING OF RETURNS

What constitutes the "filing" of a return has not been defined in prior or present statutes, nor in prior regulations.[49] In the past a return apparently was assumed to be filed on the date of its receipt if on a proper or acceptable form and if duly signed by the taxpayer (or assumed to be filed on the due date if posted in time to arrive by that date but received after the expiration of the time for filing).[50] Because a substantial number of taxpayers submitted returns but failed to include the tax due, in 1955, it was felt necessary to define "filing" to include not only the submission of the signed return but also the submission with that return of such portion of the tax as is due and payable at the time of filing.[51] The return is not considered to be filed until that payment is received, and if payment is not received until after the time for filing, the taxpayer is delinquent and subject to the penalties appropriate to late filing.

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[44] Reg. 22.6-8(b).
[45] Reg. 22.15(2)-1.
[46] *Ibid.*
[47] Reg. 22.15(2)-4.
[48] *Compare* Arts. 307-316, 1954 I.D.R. 421-422, *with* Reg. 22.16-1 through Reg. 22.16-5.
[49] Time for filing and effect of failure to file on time were prescribed in IOWA CODE §§ 422.21, 422.22, 422.23 and 422.25 (1954), and Art. 217, 1954 I.D.R. 403.
[50] Art. 17, 1954 I.D.R. 403.
[51] Reg. 22.13-1(g), 22.21-5. Approximately 3,000 such returns were received in 1955, a substantial increase over the number of such returns in prior years. A similar administrative problem arises from the failure of some taxpayers to pay the second installment of their tax when due. Both problems could be resolved easily if the State adopted a withholding and estimated tax payment plan.

## AUDITS, ASSESSMENTS, AND APPEALS

Previous regulations had few provisions regarding audits, assessments and appeals. One major innovation in the new regulations is the inclusion of a number of provisions on these subjects, many of which formalize existing practice.

The power granted to the Commission by section 422.25, to examine returns and to determine the correct amount of tax,[52] is delegated to the Director of the Income Tax Division, and may be further delegated by him to such auditors, agents, clerks, or employees of the Division as he shall designate.[53] Ordinarily the agent who discovers an apparent discrepancy in a return, or that income may not have been listed, or that no return was filed though one may have been due, will so notify the taxpayer involved by ordinary mail. This notice is not an assessment, although it may state the amount of tax, penalty and interest that would be due if the available information is correct.[54]

Upon receipt of the letter "notice of discrepancy", the taxpayer may pay the additional amount said to be due, or may first discuss the matter with the signer of the letter.[55] If taxpayer pays but wants to contest the matter he should file a claim for refund.[56] Payment ordinarily is not enforced by distraint until an assessment has been made (interest continues to run if payment is not made, of course).[57] In discussing the situation, taxpayer should point

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[52] Proper interpretation of section 422.25(1) and (2), as to the period in which the Commission may examine returns, or determine the correct amount of tax, has been a subject of some controversy for several years. An Attorney General opinion, 1954 A.G. 128, interpreting these sections, was further clarified by another Attorney General opinion, dated February 1, 1955. These opinions hold that the two year limitation (raised to three by the last legislature) in subsection one applies only to mistakes discoverable by examination of the return itself, and the five year limitation in subsection two applies to omissions of income or overstatements of deductions not apparent on the return, or to failure to file a return. Several attorneys have claimed that the word "income" in subsection two should be interpreted to mean only "gross receipts", and at present writing at least two appeals from assessments for overstated deductions (deductions disallowed on federal audits) are pending in district courts. The courts may well hold that the state had five years to make such assessments, inasmuch as statutes of limitations upon the sovereign are ordinarily construed strictly against those asserting their bar, *United States v. Southern Lumber Co.*, 51 F.2d 956 (8th Cir. 1931); the Tax Commission is authorized to examine transactions which occurred within five years prior to the beginning of the audit, IOWA CODE § 422.63(1) (1954); and the taxpayer who understates his deductions may claim refund therefor within five years from the date the payment was due (or one year from the date the payment was made, whichever is later), IOWA CODE § 422.66 (1954).

[53] Reg. 22.25-1.

[54] Reg. 22.25-2.

[55] Reg. 22.25-3.

[56] *Ibid.*

[57] A lien attaches automatically upon the failure to pay tax when due, but notice of it must be filed with the county recorder where taxpayer's property is located if the lien is to be preserved against subsequent mortgagees, purchasers or judgment creditors, for value and without notice. Distress warrant proceedings to collect the tax are authorized but are not utilized by the Commission until an assessment has been made. No property of the taxpayer is exempt from seizure under such

out all matters of fact or law which he considers to be relevant, and he may be required to furnish documents and records substantiating his position.[58]

The agent with whom the situation is discussed cannot compromise any claim to tax, penalty, or interest. However, he may determine, as a result of the information submitted by the taxpayer, that the correct amount of tax is different from that suggested in the "notice of discrepancy."[59] If the taxpayer does not agree with the agent's determination, the matter may be referred to the Director of the Division for review.[60]

If no agreement as to the correct tax is reached following review, and taxpayer does not pay the amount claimed, then a formal notice of assessment is sent registered mail, over the signature of the chairman or vice-chairman of the Commission.[61] Taxpayers' statutory appellate rights, both administrative and judicial, date from the serving of this notice.[62]

If the taxpayer feels that the assessment is correct in amount but that reasons are present justifying compromise of tax, or of penalty or interest, he no longer can obtain any reduction from the Commission.[63] However, it is pointed out that, under section 19.9 of the Iowa Code, the Executive Council does have power to compromise claims of doubtful equity or collectibility. If such compromise is sought, the taxpayer should submit an offer of compromise in writing to the State Tax Commission, setting forth reasons to justify the making of the compromise. The offer will be processed by the Commsision and forwarded with its recommendation to the Executive Council for consideration. Each offer

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proceedings. IOWA CODE § 422.26 (1954). The Commission considers that interest runs until the delinquent tax has been fully paid, as the law provides that payments received shall first be applied against penalty and interest then due. IOWA CODE § 422.25(5) (1954). (In contrast, interest on unpaid sales taxes is considered chargeable only to the date of assessment, in view of the provisions of IOWA CODE § 422.58 (1954), and the absence of a requirement that payments first be applied to penalty or interest.)

[58] Reg. 22.25-3.

[59] Reg. 22.25-4.

[60] Reg. 22.25-5.

[61] Reg. 22.25-6. In order not to risk a decision that assessments were improperly made, the Commission continues to use registered mail rather than the less expensive certified mail procedure available under postal regulations since June 1, 1955.

[62] IOWA CODE § 422.57 (1954), provides that the notice of assessment of sales tax is served on taxpayer on the date it is mailed. Section 422.25, dealing with income tax assessments, does not have such a provision, and refers to "giving notice thereof to the taxpayer by registered mail".

[63] IOWA CODE § 422.25(6) (1954) permitted the Commission to waive or reduce penalties or interest in cases which justified such action. This power was removed by Iowa Laws 1955, 56th G.A. c. 211 § 2. However, the Commission may still determine whether a failure to file on time was due to reasonable cause and not willful neglect, and thus determine whether or not penalty is to be assessed. Iowa Laws 1955, 56th G.A. c. 210 § 2.

should be accompanied by a draft or certified check for the amount offered in compromise.[64]

If the taxpayer believes the assessment incorrect and desires to appeal, he must first appeal to the Commission to examine and consider the assessment.[65] The previous rule as to the manner of filing such appeals is continued, and appeals should be in writing, setting forth the facts relied upon and the reasons for making the appeal. It is desirable that the reasons why taxpayer believes the assessment wrong be clearly stated, and submission in the form of a brief and argument may be wise. If a personal hearing is desired, this should be stated, and the Commission will set a date for such hearing.[66]

Hearings usually are informal, but a formal record may be made if considered necessary.[67] Taxpayer may present his case in person, or have it presented by an attorney, or in proper circumstances by an accountant.[68] Taxpayer has the burden of proof

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[64] Reg. 22.25-7.

[65] *Cf.* Midwestern Realty Co. v. City of Des Moines, 210 Iowa 942, 231 N.W. 459 (1930). If the taxpayer pays the additional assessment, he may then choose between the statutory method of appeal and the process of claiming refund. If the Commission denies the refund claim, no provision for appeal has been made in the statutes, but the taxpayer may have the denial reviewed in a mandamus action. *Morrison-Knudsen Co., Inc., v. State Tax Commission,* 242 Iowa 33, 44 N.W.2d 449 (1951). If the taxpayer resides in Iowa jurisdiction over his appeal lies in the district court of the county of his residence, under Iowa Code § 422.29, but jurisdiction for a mandamus action apparently is only in the Polk County District Court because of the problem of obtaining service upon the Tax Commissioners. The recent case of *City of Ames v. State Tax Commission,* 71 N.W.2d 15 (Iowa 1955), combined a statutory appeal with a claim for denial of refund, both of which were considered by the Story County District Court. But at no time was any question raised as to the jurisdiction over the "mandamus" portion of the case.

A matter never discussed in any of the Supreme Court decisions reviewing assessments for income, sales or use tax deficiencies or denials of claims for refund of payments of such assessments is the scope of the review. It would seem that on "appeal" neither the district courts nor the Supreme Court should entertain objections to an assessment that taxpayer never urged before the Commission. *Cf.* Frost v. Board of Review of Oskaloosa, 114 Iowa 103, 86 N.W. 213 (1901). However, as the matter is tried de novo in the district court and the Commission's proceedings are usually not transcripted to that court, determination of the issues presented in the administrative hearing may sometimes be difficult. The author believes that taxpayer's protest to an assessment should specify clearly the bases of his objection, and that the protest should be part of the record in the "appeal" to the district court. Likewise, the Commission's Findings, Conclusions and Order should be an essential element of the record on "appeal". In many appeals the Commission's Order has been attached to taxpayer's petition as an exhibit to his pleadings, thus enabling the petition to conform to Iowa R.C.P. 368, but one attorney in a case now pending in a district court has refused to do this. It would also follow that the "mandamus review" be similarly limited in scope, for if not the taxpayer could get a broader judicial hearing by this route than by the statutory-appeal process with no apparent justification for such differentiation.

[66] Reg. 22.28-1, formerly Art. 326, 1954 I.D.R. 423.

[67] Reg. 22.28-5.

[68] Reg. 22.28-2.

that the assessment is incorrect, and in what respects.[69] Any relevant evidence may be presented, including evidence that would ordinarily be inadmissible in actions in a court of law for such reasons as hearsay, or privilege (as husband-wife). Formal introduction of evidence is not required, nor are appropriate objections necessary. The Commission may consider any material in its files, but taxpayer should be informed of the substance of such material if he has not previously been apprised of it, and he should have opportunity to rebut such evidence.[70]

In determining taxable income and making the assessment, information from a variety of sources may be used. One such source is the return made by the taxpayer to federal tax authorities, and federal audits of his return.[71] The taxpayer can be compelled to produce his books, records, papers or memoranda.[72] A new regulation points out that he may also be compelled to produce his cancelled checks, check stubs and bank statements. In view of this fact, if such material has been lost or destroyed, the Commission may examine photostatic copies or carbon copies retained by the bank.[73] Evidence obtained from federal audits, produced ma-

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[69] Reg. 22.28-3.

[70] Reg. 22.28-5.

[71] Reg. 22.63-1. Such materials are public records, but available for inspection only to a very limited extent. INT. REV. CODE § 6103. Two district courts have held that testimony of the agent of the Tax Commission who examined a taxpayer's federal return and federal audit is admissible. State Tax Commission v. Nye, Polk County Probate #36563 (1952) (claim in probate against estate for decedent's unpaid income taxes, claim sustained); Crawford v. Robb, Hamilton County Equity #17281 (1953) (action to enjoin Commission from collecting additional income tax assessment, injunction denied on the merits, court ruling that amount determined by Commission as due was to be presumed correct).

[72] IOWA CODE § 422.63 (1954); Reg. 22.63-1.

[73] Reg. 22.63-2. IOWA CODE § 421.17(7) (1954), relating to the power of the Tax Commission to hold hearings and compel witnesses to produce records and testify does contain the following proviso:

> "that no bank or loan and trust company or its officers or employees shall be required to divulge knowledge concerning the property of any person when such knowledge was obtained through information imparted as a part of a business transaction with or for such person and in the usual and ordinary course of business of said bank or loan and trust company, and was necessary and proper to the discharge of the duty of said bank or loan and trust company in relation to such business transaction. This proviso shall be additional to other provisions of the law relating to confidential and privileged communications."

This provision has never received judicial interpretation, but it would seem to be designed for protection of individuals other than the bank. Credit information obtained as part of making a loan clearly would be within the provision. It is uncertain whether giving information found in copies of cancelled checks or bank statements of the taxpayer does amount to divulging knowledge concerning the property of any person obtained through a business transaction with that person. In any event, a taxpayer should not be able to destroy his own records, which would have been subject to subpoena, and then assert a privilege that the copies of those records in the possession of the bank cannot be produced.

terials, and examination of such bank records, is available for use by the Commission.

The Commission may either remand the matter on appeal to the agent who initiated the "notice of discrepancy", or make a decision on the appeal. Remand is made only if the hearing indicates that the issue can now be settled between the employee and the taxpayer and if the taxpayer does not object to remand.[74]

If no remand is made, a decision must be made within a reasonable time which shall confirm and sustain the assessment as made, modify it in various particulars, or refuse to confirm the assessment in any respect. This decision is to be in the form of a Findings and Order, setting forth the Commission's Findings of Fact, Conclusions of Law and Decision. The decision of the majority prevails as the decision of the Commission. The Findings and Order is to be furnished by registered mail to the taxpayer.[75]

In those situations where the Commission feels that undue time may be consumed, or collection of tax jeopardized, if the usual routine procedure is followed, a jeopardy assessment may be made without the use of the "notice of discrepancy".[76] The prior regulation regarding this type of assessment has been retained.[77]

## CORPORATIONS

The definition of "corporation" has been little changed, but does now include any association or organization which reports as a corporation for federal income tax purposes.[78]

The pattern of determining corporate income in substance is the same as for individuals and fiduciaries, that is: "taxable income less the net operating loss deduction, both as computed for federal income tax purposes under the Internal Revenue Code of 1954" with appropriate adjustments for such matters as interest and dividends taxable by the United States but not by Iowa, and vice versa, "completed transactions" of prior years that carry forward for federal tax purposes, and federal and state income taxes.[79]

That pattern is broken, however, when the corporation does business both within and without Iowa. For, unlike the individual, the corporation carrying on business outside the state may allocate outside Iowa *all* income not attributable to Iowa business or an Iowa situs.[80] The regulations relating to this allocation have been revised substantially.

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74 Reg. 22.28-6.
75 Reg. 22.28-7.
76 Iowa Code § 422.30 (1954). This provision, interestingly enough, is not applicable to the corporation business tax, in Division III of Chapter 422.
77 Reg. 22.30-1, formerly Art. 328, 1954 I.D.R. 423.
78 Reg. 22.32-1.
79 Reg. 22.35-1, 22.35-6.
80 Iowa Code § 422.33 (1954); Opinion of the Attorney General, March 22, 1955. Kentucky and Oklahoma at one time had similar provisions, but have discarded them. The Kentucky provision was interpreted in *Kentucky Tax Commission v. Fourth Avenue Amusement Corporation,*

A corporation which carries on business entirely within Iowa may not allocate any income outside Iowa. If all manufacturing, sales, or other activities of the corporation are regularly carried on only in Iowa, it is considered as carrying on business entirely in the state. The fact that subsidiary corporations function in other states and transmit income to the parent in the form of interest, dividends, rents or royalties is immaterial.[81]

If the corporate business is partly carried on in Iowa and partly outside, several allocations may be necessary. Interest, dividends, rents and royalties (and related expenses) are allocated to Iowa on a situs theory if the income-producing asset is owned for "investment" rather than for "business" purposes. If owned for "business" purposes, such items can be allocated to Iowa only to the extent derived from Iowa sources or Iowa uses of an underlying asset.[82] Several examples are given in the regulations.[83] Related expenses may be either directly or indirectly related to the production of the items of income. If the income produced is allocated outside Iowa and therefore not subject to tax, the related expense must also be allocated outside Iowa and not an allowable deduction. This prevents the use of corporate funds to acquire intangible business assets outside Iowa while borrowing to build an Iowa plant and claiming as a deduction the full interest expense on the loan.[84]

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293 Ky. 668, 170 S.W.2d 42 (1943). The section is difficult to interpret and administer correctly, and should be rewritten.

[81] Reg. 22.33(1)-2.

[82] Reg. 22.33(1)-4, 22.33(1)-5. Stock ownership in a wholly-owned subsidiary is considered to be for business purposes rather than investment. Loans to such a subsidiary, royalty agreements and leasing agreements with it, probably will receive similar consideration. If the subsidiary is but partially owned, but taxpayer has more than 50% ownership, the same attitude probably will prevail. In case of a lesser ownership, the taxpayer should be able to prove that he does control the subsidiary, if his holding is to be deemed for "business" purposes. In one instance, where a corporation was set up to hold patents developed by three other corporations, each having one-third interest in the patent-holder, it was assumed that the stock was held for "business" rather than for "investment" purposes. It would seem that a corporation that merely invests funds in other corporations, and has no other activity, would be carrying on business entirely within Iowa, under Reg. 22.33(1)-2, or would not be receiving interest, dividends, rents or royalties in connection with its own business outside the state, under Reg. 22.33(1)-4 and 22.33(1)-5, and under either theory could make no allocation of such income.

[83] Interest on customers' accounts, or on loans to customers to enable them to do business, or on tax refunds, but usually not on unpaid balances of stock subscription agreements; royalties for use of a process, patent or copyright actively used by taxpayer in his own business as well, or for any processes or patents if taxpayer is regularly engaged in research and development and licensing of the fruits of such activity; rent of property where taxpayer regularly rents such types of property as a business, or where rented to a wholly or partially owned subsidiary, or where acquired for taxpayer's own business use but temporarily rented until the intended use can be accomplished.

[84] Reg. 22.33(1)-4(g). In no instance can the amount of related expense allocated outside Iowa exceed the amount of income allocated outside to which it is related.

Regardless of the purpose for which an asset was owned, any capital gain or loss on its sale is to "follow either the residence of the recipient or the situs of the business."[85]

Where the corporation derives income from business other than from the intangible assets referred to above, or than from the manufacture or sale of tangible personal property, such income is to be allocated to Iowa no matter where earned if the corporation is domiciled in or has its business situs in Iowa. Other corporations which do business in Iowa must allocate to Iowa any such income from activities in Iowa.[86] In any event, expenses directly or indirectly related to the production of that income, including general overhead items, may be allocated upon any basis which can be substantiated as just and equitable.[87]

Where the corporate income is from manufacture or sale of tangible personal property, the prior regulations are applicable with no substantial change.[88] There also has been no change in the allocation of income from operations of public utility corporations.[89]

Any methods of allocation described above need not be followed if taxpayer can persuade the Commission that the result is to subject him to taxation on a greater portion of his net income than is reasonably attributable to business or sources within Iowa. While he is supposed to suggest an alternative method, if the Commission determines that the method used is in fact inapplicable and inequitable, it may select any other method that seems best calculated to assign to the state for taxation the portion of income reasonably attributable to business and sources within Iowa.[90]

## CONCLUSION

Without doubt problems will arise that are not specifically covered in statute or regulation.[91] But, on the whole, the new regulations serve to clarify areas in which the effect of the retained portions of the old income tax law and of the new laws was not clear.

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85 Reg. 22.33(1)-7.
86 Reg. 22.33(1)-8.
87 *Ibid.*
88 Reg. 22.33(1)-9.
89 Reg. 22.33(1)-10.
90 IOWA CODE § 422.33(2) (1954); Reg. 22.33(2)-1.
91 Examples already come to light include: the basis for capital gain purposes of dairy, breeding and work livestock that were depreciated for federal tax purposes in tax years prior to 1955 but could not be depreciated for state tax purposes in those years (the Income Tax Division seems unwilling to permit any adjustment here); whether, when spouses file separate returns and one spouse's itemized deductions are less than the amount that could be claimed as optional standard deduction, the right to the greater deduction can be renounced to preserve the right of the other spouse to itemize his deductions on his return (the Division has indicated that the optional standard deduction can be refused even though larger than itemized deductions, in this circumstance).