Combined Reporting: An Option for Apportioning Iowa Corporate Income Tax

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Executive Summary: Combined Reporting

- Corporations that are required to file Iowa corporate income tax returns may be affiliated through ownership with other corporations. These other members of the affiliated group may or may not have Iowa corporate income tax liabilities.

  - Corporations may have operations across state lines. Iowa decides what portion of corporate activity is attributable to, and taxable by, Iowa by apportioning net income of corporations *with Iowa sales* by the ratio of Iowa sales to total sales of affiliates *with Iowa sales*.
  - An alternative method of apportionment would be to apportion *all* net income of the affiliated group by the ratio of Iowa sales to total sales of *all* members of the group

- Members of an affiliated group may file Iowa returns separately or may consolidate with other affiliated members with Iowa liabilities. All members of an affiliated group must consolidate for federal purposes.

  - Members of an affiliated group that choose to file separately in Iowa and consolidate for federal purposes are designates as Iowa filing status 2.
  - Members of the same affiliated group that file in Iowa on a consolidated basis necessarily file a consolidated federal return, designated Iowa filing status 3.
  - Corporations who file separately in Iowa and separately for federal purposes are Iowa filing status 1.

- Separate/separate fliers (Iowa filing status 1) are not affected by combined reporting. They are, in general, small Iowa-domiciled corporations. These firms were ignored in the analysis.

- Data from Iowa returns was matched to federal returns for tax years 2000-2003. The over-all match rate was 85.2%. Most of the non-matches were in status 2, with only a 51.5% success rate. Status three firms (consolidated state/consolidated federal) were matched 84.0% of the time.

- A change from present apportionment policy to combined reporting for tax year 2002 would have increased corporate income tax liability by $99.5 million; for 2003, $61.7 million.

- 99.4% of the tax year 2003 increase would come from non-Iowa domiciled firms. For tax year 2002, 98.7% would come from non-Iowa corporations.

Combined Reporting

Iowa taxes income of corporations who do business in Iowa.   If these firms also do business in other states, only the share of business done in Iowa is taxed. However, these firms may have affiliates that do no business in Iowa, and intra-company transactions may reduce Iowa-share income. One alternative to the present method of determining Iowa share, called combined reporting, assesses the Iowa share of all affiliated firms' income.

I. Iowa's Corporate Income Tax Structure

Iowa presently assesses income tax on corporate entities that have sales, income, and physical presence (nexus) in Iowa. These corporate entities may be affiliated through ownership with other firms within and without the state. Currently Iowa allows either separate filings by members of an affiliated group, in which Iowa follows formal corporate structure – that is, each corporation files separately -- or consolidated filing, in which only those affiliated corporations doing business in Iowa are included on the Iowa return. All members of an affiliated group should be included on a single federal return. A unitary business operating as a single corporation would necessarily file a single Iowa return and a single federal return. Either filing status allows multi-state firms to include only those corporations doing business in Iowa and having an Iowa presence on the Iowa return.

Firms have responded to the Iowa tax environment by shifting income to other members of the affiliation that are not subject to Iowa corporate income tax – often to affiliates not subject to any state tax. Several states, such as Delaware and Nevada, do not tax corporate income. Some of the common examples of income shifting include the following:

1) Sales companies shift income to manufacturing companies with no nexus in Iowa. The sales companies -- with nexus in Iowa -- show little profit. Example 1 in the Appendix demonstrates this technique.

2) In a similar manner, oil companies can shift income to their production and refining subsidiaries, while the marketing subsidiaries doing business in Iowa have low or no profits.

3) Subsidiaries pay management fees to a parent company with no nexus in Iowa, where the management fees are in excess of the value of services rendered. Example 2 illustrates this technique.

4) Operating companies are charged for the use of intangible property. The most significant trend in income shifting started in the early 1990's. Many large umbrella corporations set up so-called "Delaware holding companies". These umbrella corporations would transfer valuable trademarks, trade names, and other intangible property to the Delaware holding company, and royalty income would be reported by the Delaware holding company based on a percentage of sales of the operating (in Iowa) company. The operating company doing business in Iowa would deduct royalty expense on its Iowa return, but the corresponding royalty income would not be reported on any tax return filed in Iowa. This enabled companies to shift a

significant portion of their income outside Iowa. Iowa law was changed in 1995 to assert that these Delaware holding companies are now subject to Iowa tax, but compliance with this law has been spotty, and most of the assessments -- approximately $20 million -- the Department has issued on this issue are currently under appeal.

5) Iowa operating subsidiaries pay rent to an affiliated real estate investment trust. This technique is illustrated in Example 3.

II. Combined Reporting

Combined reporting has been suggested as a method to increase the equity of Iowa's corporate income tax system. A combined report is simply the computational method used to determine the amount of income of a unitary business that is attributable to the operations within a particular state. The intent of combined reporting is to consolidate 100% of a unitary business' income and allocate it proportionately among all the states in which the business operates. Combined reporting would include all activity of members of the affiliated group in an Iowa corporation income tax return, not just those presently taxed, but also members whose income is not presently included. Iowa tax would be paid in proportion to the business done in Iowa.

Currently 16 states, including Illinois, Nebraska, Minnesota, Kansas, and North Dakota, require combined reporting for affiliated groups of corporations. Table 1 includes a list of those states requiring combined reporting. Other states have discretionary authority to require combined reports. Vermont instituted combined reporting for tax years beginning

on or after January 1, 2007. Vermont was the first state in two decades to change to combined reporting. Vermont corporate income tax rates were lowered in an attempt to make the change revenue-neutral. The experience of Vermont is too recent to make judgments on the results. Note that as of this writing, Michigan has no broad-based tax on the income of business. Ohio is in transition from a corporate franchise tax to a commercial activities tax.

III. Principles of Combined Reporting

To understand how the combined reporting method works, it is necessary to understand the concepts of unitary business and of apportionment. A business may be conducted through divisions of a single corporation, or through commonly controlled corporations. A business is unitary if the operations conducted by one division or corporation benefit, or are integrated with, depend on, or contribute to, operations conducted by another division or commonly controlled corporation. In other words, if separate divisions or separate corporations are interdependent or of mutual benefit, to form one integral business rather than several businesses, they are unitary. The incomes of the entities composing the unitary business are added together to arrive at combined income. The theory underlying the unitary business principle was developed in the field of property taxation during the 1870's as a way for local governments to tax railroads operating within their jurisdictions. The courts recognized that the value of the railroad system was more than the cost of rails and ties located within a particular state. The system connected two distant points and represented an integrated economic unit, of which each state could claim its appropriate share. All of the railroad's property was valued as a

single unit and a portion of the unit's value was assigned to each state by a mathematical formula. The application of the unitary approach evolved when states started to impose a tax measured by the income of corporations.

Computing the portion of the business's income that relates to its activities in a state is done through apportionment. Income can be considered the result of three kinds of economic activity: use of capital, use of labor, and market activity. These three activities are measured by a corporation's property, payroll, and sales. Many states apportion corporate income tax on all three factors. [See Table 1.] However, since the inception of corporate income tax, Iowa has used sales to compute the apportionment factor. Iowa's apportionment factor has been expanded to include other receipts, such as royalties, and is named the business activities ratio (BAR). BAR and sales will be used synonymously. The Iowa business activities ratio is the sales (and other business activities) occurring in Iowa over the total sales of all affiliated corporations doing business in Iowa. Iowa net taxable income is the net income of affiliates doing business in Iowa times the BAR.

Combined reporting would include, in the calculation of Iowa's apportionment factor, all the business activity of all affiliated firms. The numerator would include all Iowa business activity of companies having Iowa nexus." The denominator would include all business activity of all affiliated firms. The apportionment factor would be applied to all net income of all affiliated firms. An affiliation of companies with common ownership would no longer be able to bill one of its members who had Iowa nexus for goods and services applied by a non-Iowa-taxable affiliate. The change to combined reporting typically would increase the net income amount to which the apportionment factor is

applied and it typically would decrease the apportionment factor. The increase of the net income base and the decrease in the apportionment factor usually would result in an increase in Iowa taxable income. This is not necessarily the case for all corporations.

As an example of how the change to combine reporting would affect a firm, consider the hypothetical unitary business that has total sales of $1 billion and net income of $100 million. This group has a subsidiary with $10 million in Iowa sales, $100 million in total sales, and reports a net loss of $1 million and reports high management fees. Under present law, the subsidiary could file separately and not pay Iowa tax. The apportionment factor is one-tenth ($10 million Iowa/$100 million total). The subsidiary would have a net operating loss of $100 thousand that could be carried back two tax years and forward for twenty, under normal circumstances. Under combined reporting the apportionment factor is one-hundredth ($10 million/$1 billion), but net income is $100 million and Iowa taxable net income is $1 million. Note that the above example has been extremely simplified, and all allowable deductions and credits have been ignored.

It is also possible for combined reporting to lower Iowa corporate income tax liability. Consider a hypothetical unitary business that has total sales of $10 million and net income of $1 million. This group has a subsidiary with $8 million in Iowa sales, $9 million in total sales, and reports a net income of $1 million. Under present law, the apportionment factor is .8889 ($8 million/$9 million) and Iowa taxable income is $889 thousand. Under combined reporting, the apportionment factor is .8 ($8 million/$10 million) and Iowa taxable income is $800 thousand.

IV. Iowa's Recent Corporate Tax History

Prior to fiscal year 1993, Iowa held all members of a unitary business jointly and severally liable for applicable corporate income tax on a consolidated tax return. Due to constitutional considerations and effective for tax periods beginning on or after July 1, 1992, the consolidated Iowa return law was changed to a "nexus consolidated" basis. A nexus consolidated group includes the members of the federal consolidated group for federal income tax purposes that have nexus with the taxing state. The new consolidated return law allowed affiliated firms to either file Iowa corporate income tax returns for each entity (i.e., separately) or to consolidate all firms with Iowa nexus. Only those corporations doing business in Iowa and having an Iowa presence are included in the tax calculations for either filing status. However, as an affiliated group, each group files one federal return. This change created three filling statuses for Iowa corporate income tax: filing status 1, separate Iowa return and separate federal return; filing status 2, separate Iowa return and consolidated federal return; and filing status 3, consolidated Iowa return and consolidated federal return.

V. Previous Studies

In December 1994, the Department completed a report on the fiscal impact of implementing combined reporting for Iowa corporation income tax. That report reviewed Iowa corporation income tax returns filed in 1992 and 1993. For those periods, the filing

method for filing Iowa corporation income tax returns required all firms to file separately, that is, as present Iowa corporate income tax status 2.

This study concluded that implementing combined reporting would have a minimal impact on Iowa corporate income tax revenues. The study of 100 federal affiliated groups indicated additional Iowa revenue of $4.3 million for returns filed in 1992 and additional Iowa revenue of $750,000 for returns filed in 1993.

A study completed by the Department in 2003 of 50 large corporations indicated that an additional $15 million of tax for 2000 and $40 million of tax for 2001 would have been due if combined reporting was adopted for Iowa corporation income tax.

The study below expands the 2003 report and extends the analysis through tax year 2003. Tax was calculated using data for the affiliated group, as available.

VI. Taxpayers Included in the Study

As noted above, Iowa recognizes three statuses for corporations filing income tax returns. The first is firms filing a separate Iowa return and a separate federal return. The second status is firms that are part of an affiliated group filing a separate Iowa return and a consolidated federal return. The third is firms filing an Iowa "nexus consolidated" return for an affiliated group with Iowa liability; these firms are, in turn, part of an affiliated group that files a federal consolidated return.

Number of Corporate Income Tax Filers

Iowa Corporate Filing Status

	1	2	3
Tax Year	separate/separate	separate/consolidated	consolidated/consolidated
2000	29,199	6,115	1,145
2001	28,756	6,011	1,081
2002	28,569	6,133	1,129
2003	28,635	6,197	1,085
2004	27,304	6,215	1,034
2005*	22,843	4,482	842

*preliminary

Taxpayers included in the study are those whose Iowa returns can be matched to federal data available to the Department. The match rate between state data and federal data is not good (see Table 2).

The average match rate for Iowa corporate filing status 1, separate Iowa/ separate federal, is 95.4% across the four tax years available. Matching the other state filing statuses is complicated. State information systems and federal data both have the capability of carrying the firm in question's identification number and the identification number of a parent firm. Some of these parent firms are also within state information systems. All Iowa-filing firms (the first level) must first be checked to see if they have a designated parent within state files. The firms matched (second level) must be checked to see if their associated parent firm (the third level) matches federal data. All three levels must be checked for a federal match. Additionally, federal data carries two levels. An attempt was made to make all six matches. The average match rates across corporations filing separate/consolidated (state filing status 2) for the four years is 51.5%. The average match for consolidated/consolidated (state filing status three) taxpayers is 84.0%.

VII. Computation of Estimates

Combined reporting tax liabilities for all matched firms with filing status 2 or 3 were estimated based on total corporate income available from federal data. Net income from the federal consolidated return was used in the tax calculation as the appropriate entry for Iowa form 1120, line 1. Data from Iowa returns from affiliated companies were aggregated to create form lines 2 through 20, with three exceptions. First, line 5, 50% of federal taxes paid, was calculated as the larger of the sum of Iowa entries or 50% of the federal entry. Second, the Iowa apportionment percentage was calculated as the ratio of the sum of Iowa gross receipts and gross receipts from the federal data. Third, the net operating loss carryforward was aggregated from entries on the Iowa returns.

These assumptions were made in computing tax liabilities:

1) All companies in the federal consolidated group are engaged in a unitary business.
2) Iowa sales and nonbusiness income are as filed on the Iowa return(s).
3) All federally reported business income was used the denominator of the apportionment factor.
4) Federal taxes paid, while occurring on Iowa line 5, were taken from federal data. Federal refunds received (Iowa line 2) were taken from Iowa data. Federal taxes paid are a deduction from, and federal refunds received are an addition to, Iowa taxable income. It is assumed that the taxes paid as reported on federal returns would be higher that on Iowa returns and the use of the assumed higher amount would lower Iowa taxable income. Refunds received are not available from

federal data. It is assumed that the Iowa reported amount of refunds received would be lower (because it is less inclusive) than the total received across the combination. The use of the Iowa value could underestimate – it is an addition to income – Iowa tax liability

VIII. Results

The estimate of the aggregate effect of combined reporting roughly doubles the tax liability of the affected firms in tax years 2002 and 2003 (see Table 3). For tax year 2002 returns, tax liability would have increased $99.5 million under combined reporting. The reported liability was $82.7 million in tax year 2002; under combined reporting, the liability would have been $182.1 million. For tax year 2003, the liability would have increased $61.7 million above the reported $83.0 million, to $144.6 million.

Notice the sharp decrease in the estimated combined-reporting tax liability of consolidated state/consolidated federal (Iowa filing status 3) firms between tax year 2001 and 2002. Thirteen firms' liability would increase over $1 million each in 2001, going from Iowa-consolidated reporting to combined reporting. Total increase in Iowa tax liability -- from separate reporting to combined reporting -- for the thirteen firms was $287.3 million for tax year 2001; in tax year 2002 the total increase in Iowa tax liability under combined reporting for these thirteen was $33.1 million. The reduction in the gain from 2001 to 2002 due to the change from consolidated reporting to combine reporting was strictly due to these firms. An accelerated depreciation calculation – known as

“bonus depreciation” – was permitted for tax years after 2001, and may be the source of the decreased income for these firms.

The impact of combined reporting on corporations paying Iowa income tax by state of domicile is presented in Table 4. For tax year 2003, 99.4% of the $61.7 million increase would come from firms not domiciled in Iowa. Table 5 shows a breakdown of the impact by counts of those whose liability decreased (winners) and those whose liability increased (losers). Note there are a large number of instances were the tax liability does not change. Two-thirds of these firms report losses at both the state and federal level; they are evenly divided between Iowa and non-Iowa domiciled firms; and they show no particular pattern across industry groups. The aggregate combined reporting tax calculation is presented in Table 6.

IX. Discussion

There are several cautions to be noted about the result. First, the net operating loss (NOL) effects were measured by the contents of state data files. Net operating losses, under most circumstances, are first carried back two tax years and carried forward for up to twenty years. The state does not capture electronic data on NOL inventories; this information is reported on Schedule F, Iowa 1120. It is known that several firms have NOL inventories in the hundreds of millions. Additional NOL carryforwards can be allowed under a combined return since the limitation amount of Iowa net operating loss is based on Iowa sales. For example, if only one company in a federal group has nexus in Iowa that had previously used filing status 2 and applied $50,000 of a total loss of

$200,000 on the separate return to eliminate all their income, the $150,000 excess could be available in the current year to offset the higher income due to combination.

A similar issue relates to tax credits. A tax credit earned by one company can offset the entire tax of a combined group. Therefore, the use of tax credits can be accelerated if additional tax liability is computed due to combined reporting.

Second, it is assumed that all corporations in a consolidated federal group would be included in the combined Iowa return. However, if the federal group includes banks or insurance companies, for example, income from these activities – taxed under different schemes in Iowa -- would have to be excluded from the Iowa combined return.

Third, any foreign source dividend income included (line 4 of the federal 1120) has to be excluded from tax for Iowa, since foreign dividends are not taxable under Section 422.35(21), Code of Iowa, 2005. Line 4 of the federal 1120 does not indicate whether dividends are domestic or foreign source.

Fourth, these results assume that firms will not invoke a new, more effective, state-tax-avoidance strategy. For example, most of the above tax-avoidance strategies described above can be applied at the international level. Firms can create ultra-national subsidiaries and make accounting transfers across national borders. Any income transfers from Iowa operations out of the United States and transferred back as dividends are not taxed under Iowa law.

Table 1: Corporate Income Tax Schemes of the Several States

State	Corporate Income tax	Highest Marginal Rate	Federal Deductibility	Combined Reporting	Apportionment Factors			
					Property	Sales	Payroll	
Alabama		6.50%	YES		33	33	33	
Alaska		9.40%		YES	33	33	33	
Arizona		6.97%		YES	25	50	25	
Arkansas		6.50%			25	50	25	
California		8.84%		YES	25	50	25	
Colorado		4.63%		YES	50	50	0	
Connecticut		7.50%			25	50	25	
Delaware	NO							
District of Columbia		9.98%			33	33	33	
Florida		5.50%			33	33	33	
Georgia		6%			25	50	25	
Hawaii		6.40%		YES	33	33	33	
Idaho		7.60%		YES	25	50	25	
Illinois		4.80%		YES	0	100	0	
Indiana		8.50%			33	33	33	*
Iowa		12%	YES		0	100	0	
Kansas		7.35%		YES	33	33	33	
Kentucky		7%			25	50	25	
Louisiana		8%	YES		33	33	33	
Maine		8.93%		YES	25	50	25	
Maryland		7%			33	33	33	
Massachusetts		9.50%			25	50	25	
Michigan	single business tax				0.5	90	0.5	
Minnesota		9.80%		YES	12.5	75	12.5	
Mississippi		5%			33	33	33	
Missouri		6.25%	YES		33	33	33	
Montana		6.75%		YES	33	33	33	
Nebraska		7.81%		YES	0	100	0	
Nevada	NO							
New Hampshire		8.50%		YES	25	50	25	
New Jersey		9%			25	50	25	
New Mexico		7.60%			25	50	25	
New York		7.50%			25	50	25	*
North Carolina		6.90%			25	50	25	
North Dakota		7%	YES	YES	33	33	33	
Ohio	commercial activity tax				20	60	20	
Oklahoma		6%			33	33	33	
Oregon		6.60%		YES	25	50	25	
Pennsylvania		9.99%			20	60	20	
Rhode Island		9%			33	33	33	

South Carolina		5%		33	33	33	
South Dakota	financial entity income tax						
Tennessee		6.50%		20	60	20	
Texas	franchise tax			33	33	33	
Utah		5%	YES	33	33	33	
Vermont		8.90%		25	50	25	
Virginia		6%		25	50	25	
Washington	NO						
West Virginia		8.75%		25	50	25	
Wisconsin		7.90%		25	50	25	
Wyoming	NO						*

*100% Sales factor Phase-In

Table 2: Iowa – Federal Match

Number of Returns				
	Tax Year			
	2000	2001	2002	2003
FS=1				
Number of Federal Returns	22,199	21,473	21,199	20,624
Number of Iowa Returns Matched	22,199	21,473	21,199	20,624
Number or Iowa Returns	23,556	22,773	22,340	21,897
Percentage of Iowa Returns Matched	94.2%	94.3%	94.9%	94.2%
FS=2				
Number of Federal Returns	1,584	1,699	2,068	2,016
Number of Iowa Returns Matched	2,616	2,745	3,825	3,537
Number or Iowa Returns	6,218	6,050	6,263	6,145
Percentage of Iowa Returns Matched	42.1%	45.4%	61.1%	57.6%
FS=3				
Number of Federal Returns	933	897	962	869
Number of Iowa Returns Matched	979	929	996	895
Number or Iowa Returns	1,174	1,112	1,148	1,089
Percentage of Iowa Returns Matched	83.4%	83.5%	86.8%	82.2%

Table 3: Corporate Income Tax Liability Change under Combined Reporting

	Tax Year			
	2000	2001	2002	2003
FS=2				
Number of Federal Returns	1,584	1,699	2,068	2,016
Tax Liability under Combined Reporting	$39.23	$56.15	$108.18	$79.50
Tax Liability under Separate Reporting	$20.06	$13.92	$46.37	$47.78
FS=3				
Number of Federal Returns	933	897	962	869
Tax Liability under Combined Reporting	$194.56	$315.63	$73.95	$65.14
Tax Liability under Separate Reporting	$34.26	$35.40	$36.28	$35.20
All				
Tax Liability under Combined Reporting	$233.79	$371.78	$182.13	$144.64
Tax Liability under Separate Reporting	$54.33	$49.32	$82.65	$82.98
Difference in Iowa Tax Liability	$179.46	$322.46	$99.48	$61.65

amounts in millions

Table 4: Liability Change by State Filing Status

Iowa corporate income tax filing status 2, separate Iowa/consolidated federal

	Tax Year			
STATE Iowa	**2000**	**2001**	**2002**	**2003**
Number of Federal Returns	200	215	194	142
Tax Liability under Combined Reporting	$ 2.59	$ (4.45)	$ 8.47	$ 7.84
Tax Liability under separate reporting	1.30	(3.85)	7.14	7.46
STATE non Iowa				
Number of Federal Returns	1,384	1,484	1,874	1,874
Tax Liability under Combined Reporting	$ 36.64	$ 60.60	$ 99.71	$ 71.65
Tax Liability under separate reporting	18.76	17.77	39.23	40.32
All, Iowa Corporate Filing Status 2				
Number of Federal Returns	1,584	1,699	2,068	2,016
Tax Liability under Combined Reporting	$ 9.23	$ 6.15	$ 08.18	$ 79.50
Tax Liability under separate reporting	20.06	13.92	46.37	47.78

Iowa corporate income tax filing status 3, consolidated Iowa/consolidated federal

	2000	2001	2002	2003
STATE Iowa				
Number of Federal Returns	519	476	474	444
Tax Liability under Combined Reporting	$ 3.57	$ 7.86	$ 1.17	$ 7.43
Tax Liability under separate reporting	10.31	12.96	11.91	10.54
STATE non Iowa				
Number of Federal Returns	438	440	501	438
Tax Liability under Combined Reporting	$ 82.06	$ 84.78	$ 72.80	$ 57.83
Tax Liability under separate reporting	25.30	19.53	24.39	24.51
All, Iowa Corporate Filing Status 3				
Number of Federal Returns	957	916	975	882
Tax Liability under Combined Reporting	$ 95.63	$ 12.64	$ 73.98	$ 65.26
Tax Liability under separate reporting	35.61	32.48	36.30	35.05
All				
Number of Federal Returns	2,541	2,615	3,043	2,898
Tax Liability under Combined Reporting	$ 34.87	$ 68.78	$ 82.15	$ 144.76
Tax Liability under separate reporting	55.67	46.40	82.68	82.83

Tax liability amounts in millions

Results do not include Audit activity

Returns under review not included in results

Tax liability amounts in millions

Table 5: Winners and Losers

Iowa corporate income tax filing status 2, separate Iowa/consolidated federal

	Tax Year			
Iowa Tax Liability Decreases	**2000**	**2001**	**2002**	**2003**
Number of Federal Returns	430	449	573	561
Tax Liability under Combined Reporting	$ 7.31	$ 7.38	$ 1.92	$ 5.91
Tax Liability under separate reporting	19.35	16.42	18.46	23.53
Iowa Tax Liability Unchanged				
Number of Federal Returns	806	922	1,031	977
Tax Liability under Combined Reporting	$ 0.04	$ (0.10)	$ (1.88)	$ (1.92)
Tax Liability under separate reporting	0.04	(0.10)	(1.88)	(1.92)
Iowa Tax Liability Increases				
Number of Federal Returns	348	328	464	478
Tax Liability under Combined Reporting	$ 31.88	$ 48.86	$ 08.13	$ 75.51
Tax Liability under separate reporting	0.67	(2.41)	29.79	26.17
All, Iowa Corporate Filing Status 2				
Number of Federal Returns	1,584	1,699	2,068	2,016
Tax Liability under Combined Reporting	$ 39.23	$ 56.15	$ 108.18	$ 79.50
Tax Liability under separate reporting	20.06	13.92	46.37	47.78

Iowa corporate income tax filing status 3, consolidated Iowa/consolidated federal

	2000	2001	2002	2003
Iowa Tax Liability Decreases				
Number of Federal Returns	334	300	283	264
Tax Liability under Combined Reporting	$ 6.73	$ 5.15	$ 7.94	$ 6.48
Tax Liability under separate reporting	18.40	19.04	22.26	14.16
Iowa Tax Liability Unchanged				
Number of Federal Returns	508	501	548	471
Tax Liability under Combined Reporting	$ (2.75)	$ (3.88)	$ (4.19)	$ (4.01)
Tax Liability under separate reporting	(2.75)	(3.88)	(4.19)	(4.01)
Iowa Tax Liability Increases				
Number of Federal Returns	115	115	144	147
Tax Liability under Combined Reporting	$ 191.66	$ 311.36	$ 70.23	$ 62.79
Tax Liability under separate reporting	19.97	17.32	18.23	24.90
All, Iowa Corporate Filing Status 3				
Number of Federal Returns	957	916	975	882
Tax Liability under Combined Reporting	$ 195.63	$ 312.64	$ 73.98	$ 65.26
Tax Liability under separate reporting	35.61	32.48	36.30	35.05
All				
Number of Federal Returns	2,541	2,615	3,043	2,898
Tax Liability under Combined Reporting	$ 234.87	$ 368.78	$ 182.15	$ 144.76
Tax Liability under separate reporting	55.67	46.40	82.68	82.83

Tax liability amounts in millions

Results do not include Audit activity

Returns under review not included in results

Table 6: Tax Calculation

	Data Source	Tax Year			
		2000	2001	2002	2003
Iowa Receipts	IA	$84,731.77	$42,540.97	$59,859.41	$60,100.13
Gross Receipts	US	$4,856,636.35	$5,515,511.77	$17,102,189.73	$8,374,512.91
Federal Net Income under Combined Reporting	US	$419,527.17	$819,942.66	$196,108.09	$203,294.62
50% of federal refund from Iowa file	IA	$2,299.28	$488.06	$70.47	($127.91)
Other Additions from Iowa File	IA	$3,457.30	$9,372.98	$34,209.67	$18,455.48
Net Income after Additions -- IA1120 Line 4	IA	$425,283.76	$829,803.70	$230,388.23	$221,622.19
50% of federal taxes paid from Iowa File	IA	$27,588.85	$23,797.27	$38,884.42	$50,631.23
Other Reductions from Iowa File	IA	$19,449.56	$20,174.75	$17,526.00	$18,718.89
Total Reductions -- IA1120 Line 7	IA	$47,038.41	$43,972.03	$56,410.42	$69,350.12
Total Income after reductions -- IA1120 Line8	IA	$378,245.35	$785,831.68	$173,977.82	$152,272.07
Non-Business Income from Iowa file	IA	$5,058.25	$3,451.76	$3,617.79	$1,160.28
Income subject to Apportionment	calc	$373,187.10	$782,379.92	$170,360.03	$151,111.79
Apportioned Iowa Income under Combined Reporting	calc	$1,279.09	$2,545.46	$318.37	($1,066.06)
Iowa Non-business income from Iowa file	IA	$11.72	$1.41	$6.27	$3.29
Iowa Income before NOL under Combined Reporting	calc	$1,290.81	$2,546.86	$324.64	($1,062.77)
Iowa NOL from Iowa file	IA	$1,092.88	$1,290.15	$2,822.31	$2,458.60
Iowa Apportioned Income less Iowa NOL	calc	$197.93	$1,256.71	($2,497.67)	($3,521.37)
Income subject to Iowa tax under Combined Reporting	calc	$2,151.93	$3,284.89	$1,758.53	$1,422.47
Computed Iowa tax under Combined Reporting	calc	$254.62	$390.68	$206.54	$166.04
Iowa Minimum Tax	IA	$1.62	$2.69	$2.37	$2.09
Credits	IA	$22.46	$21.59	$26.78	$23.49
Calculated Tax Liability under Combined Reporting	calc	$233.79	$371.78	$182.13	$144.64
Computed Tax Liability under Separate Reporting	calc	$54.33	$49.32	$82.65	$82.98
					amounts in millions
Number of Returns		2,517	2,596	3,030	2,885

Appendix A: Examples of Avoidance

Example 1: Inter-Corporate Sales

Company A and Company B are in the same affiliated group of corporations. Company A has a large manufacturing facility in Illinois, which sells all of its goods to Company B. Company A has no connection (or "nexus") with Iowa, so Company A is not required to file an Iowa corporate income tax return.

Company B makes sales to customers in Iowa, so it is required to file an Iowa corporate income tax return. Company A sells the product to Company B at an inflated price, and Company B sells the product in Iowa at its (B's) cost. Therefore Company A shows a substantial profit and Company B shows a loss from its Iowa sales.

Under current Iowa law, Company B files an Iowa corporation income tax return showing a loss, and does not remit Iowa corporation income tax. Under a combined report the incomes of Company A and Company B would be combined, and Iowa would receive Iowa corporation income tax on Iowa's share of the total income of Company A and B.

Note that not only does Company B show no profit and pays no tax, it also has generated a net operating loss. Iowa corporations, under most circumstances, offset net income

with net operating losses going back two years and forward fifteen years, until the losses are exhausted.

Example 2: Inter-Corporate Management Fees

Company C and Company D are in the same affiliated group of corporations. Company C, the parent corporation, is a holding company that does not have any connection, or nexus, with Iowa. Company D operates retail stores in Iowa and files Iowa corporation income tax returns.

Company C charges management fees to all of its subsidiaries, including Company D, for administrative services performed by Company C. Often, the charges for these management fees are in excess of the actual services performed by Company C. Company C reports large amounts of management fee income, and Company D deducts management fee expense.

Under current Iowa law, Company D files an Iowa corporate income tax return showing deduction for management fee expenses while Company C reports management fee income and does not file an Iowa return. Under a combined report the incomes of Company C and Company D would be combined, and Iowa would receive Iowa corporate income tax on Iowa's share of the total income of Company C and D.

Example 3: Inter-Corporate Rental Charges

Example 3 was published on the front page of the Wall Street Journal, February 1, 2007. Wal-Mart Corp. has established several real estate investment trusts (REITs). REITs are investment vehicles that must have more than 100 stockholders and must distribute 90% of dividends generated. REITs are not subject to state or federal income tax. The shareholders in Wal-Mart's REITs consisted of Wal-Mart, with a vast majority of shares, and 100 top executives of Wal-Mart, each with one share apiece. Real property, that is, store buildings and surrounding real estate, in 25 states were transferred to the REITs. The local store pays rent to a REIT and deducts the rent from taxable income, as a legitimate business expense. The REITs pass the rent to Wal-Mart and the executives as dividends. The procedure is under litigation by North Carolina.