ARC 1137C

REVENUE DEPARTMENT[701]

Adopted and Filed

Pursuant to the authority of Iowa Code sections 17A.3 and 421.17, the Department of Revenue hereby amends Chapter 40, "Determination of Net Income," and Chapter 86, "Inheritance Tax," Iowa Administrative Code.

The amendments repeal rules that are no longer relevant as a result of 2012 Iowa Acts, House File 609. Additional amendments have been made to update Iowa Code references and examples, add clarity to the rules, and eliminate unnecessary administrative burdens on the public.

Notice of Intended Action was published in the Iowa Administrative Bulletin as **ARC 1002C** on September 4, 2013. No comments were received from the public. These amendments are identical to those published under Notice of Intended Action.

After analysis and review of this rule making, no impact on jobs has been found.

These amendments are intended to implement Iowa Code sections 422.7, 450.2 to 450.4, 450.9, 450.22, 450.27 to 450.37, 450.44 to 450.49, 450.51, 450.52, 633.276, and 633.800 to 633.811.

These amendments will become effective December 4, 2013.

The following amendments are adopted.

ITEM 1. Rescind and reserve rule **701—40.59(422)**.

ITEM 2. Amend subrule 86.1(6) as follows:

86.1(6) *Safe deposit boxes and joint accounts.* Effective July 1, 1998, there is no longer a requirement for safe deposit boxes to be inventoried and reported to the department prior to the delivery of the assets to the personal representative, transferee, joint owner, or beneficiary. ~~However,~~ Additionally, effective July 1, 2005, there is no longer a requirement that all persons, banks, credit unions, and savings and loan associations ~~are required to~~ notify the department of the balance in a joint account on the date of a deceased joint owner's death and the name and address of the surviving joint owner prior to permitting the withdrawal of funds from the joint account by a surviving joint owner.

ITEM 3. Amend paragraph **86.2(1)"c"** as follows:

c. Who is not required to file a return for estate of decedents dying on or after July 1, 2004. Effective for estates with decedents dying on or after July 1, 2004, if an estate has no Iowa inheritance tax due and there is no obligation for the estate to file a federal estate tax return, even though real estate is involved, an Iowa inheritance tax return need not be filed if one of the following situations is applicable:

(1) to (3) No change.

(4) All estate assets are passed by will or intestate succession as set forth in Iowa Code chapter 633, division IV, and beginning with section 633.210, solely to individuals who are statutorily exempt from Iowa inheritance tax as set forth above in ~~subsection~~ subparagraph (3)~~.~~; or

(5) For estates of decedents dying on or after July 1, 2007, if the total aggregate value of all the tangible personal property in the estate is $5,000 or less and in-kind distributions are made. Any in-kind distribution of personal property is exempt from inheritance tax when the total aggregate value of the tangible personal property in the estate is $5,000 or less. If the total aggregate amount of tangible personal property is greater than $5,000, then the exemption for in-kind distributions of tangible personal property does not apply. See Iowa Code section 450.4(7); see also Iowa Code section 633.276 for a description of tangible personal property that qualifies.

EXAMPLE 1: The total aggregate value of the tangible personal property in the estate is $3,000. The executor makes an in-kind distribution of a diamond ring worth $1,000 to a neighbor. The diamond ring is not subject to inheritance tax.

EXAMPLE 2: The total aggregate value of the tangible personal property in the estate is $15,000. The executor makes an in-kind distribution of a diamond ring worth $1,000 to a neighbor. The diamond ring

is subject to inheritance tax because the total aggregate value of tangible personal property is greater than $5,000.

Paragraph 86.2(1)*"c"* does not apply to interests in an asset or assets that pass to both an individual listed in Iowa Code section 450.9 and that individual's spouse.

ITEM 4. Amend subparagraph **86.2(1)"d"(2)** as follows:

(2) If any interest in real estate passes on account of the decedent's death and no Iowa inheritance tax return is required to be filed and the real estate does not pass through probate administration, then one of the persons succeeding to the interest in the real property must file an affidavit in the county in which the real property is located setting forth the legal description of the real property and the fact that an Iowa inheritance tax return is not required to be filed with the department. ~~A copy of this affidavit must also be filed with the department with a schedule showing the value of the property for the purpose of ascertaining the basis of the property.~~ A copy of this affidavit must be retained by the beneficiary that holds the real estate.

ITEM 5. Amend paragraph **86.2(2)"b"** as follows:

b. Estates of decedents dying on or after July 1, 1983. For estates of decedents dying on or after July 1, 1983, the preliminary inheritance tax return is abolished and a single inheritance tax return ~~is substituted in lieu thereof~~ shall be filed. The return shall provide for schedules listing the assets includable in the gross estate, a listing of the liabilities deductible in computing the net estate, and a computation of the tax due, if any, on each share of the net estate. The return shall conform as nearly as possible to the federal estate tax return, Form 706. For information regarding Iowa returns, see subrule 86.1(5). If the estate has filed a federal estate tax return, a copy must be submitted with the Iowa return. If the federal estate return includes the schedules of assets and liabilities, the taxpayer may omit the Iowa schedules of assets from the return. However, any Iowa schedules indicating liabilities must be filed with the Iowa return due to proration of liabilities. When Iowa schedules are filed with the return, only those schedules which apply to the particular assets and liabilities of the estate are required. A return merely listing the assets and their values when the gross estate is in excess of $25,000 ($10,000 for estates of decedents dying before July 1, 2001) is not sufficient in nontaxable estates. In this case, the return must be amended to list the schedule of liabilities and the computation of the shares of the net estate before an inheritance tax clearance will be issued.

ITEM 6. Amend paragraph **86.2(2)"d"** as follows:

d. Estates of decedents dying on or after July 1, 1999. In addition to the special rule for surviving spouses set forth in paragraph *"c"* of this subrule, effective for estates of decedents dying on or after July 1, 1999, an estate that consists solely of property includable in the gross estate that is held in joint tenancy with right of survivorship and that is exclusively owned by the decedent and a lineal ascendant of the decedent, lineal descendant of the decedent, a child legally adopted in compliance with the laws of this state by the decedent or a stepchild of the decedent, or any other person declared exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9, or a combination solely consisting of such persons, is not required to file an Iowa inheritance tax return, unless such an estate has an obligation to file a federal estate tax return. Property of the estate passing by means other than by joint tenancy with right of survivorship or if any property passes by joint tenancy with right of survivorship when the title of property is held by persons other than a lineal ascendant, lineal descendant, a child legally adopted in compliance with the laws of this state, or a stepchild of the decedent or by any other person declared exempt from Iowa inheritance tax pursuant to Iowa Code section 450.9, an inheritance tax return is required to be filed.

The exemption granted to stepchildren is limited to that class of step relationships exclusively. The exemption is not extended to include any lineal ascendants or descendants of the step relationship, such as stepgrandchild, stepparent or stepgrandparent. For a definition of "stepchild" for estates of decedents dying on or after July 1, 2003, please see the definition found in 701—86.1(450).

The rate of Iowa inheritance tax imposed on a share is based upon the relationship of the beneficiary to the decedent or the type of entity that is the beneficiary. ~~A~~ For estates of decedents dying before July 1, 2001, a net estate that is less than $10,000 does not have an Iowa inheritance tax obligation. For estates

of decedents dying on or after July 1, 2001, the net estate that is less than $25,000 does not have an Iowa inheritance tax obligation. The following is the most current Iowa inheritance tax rate schedule for net estates over $25,000:

SCHEDULE B

Brother, sister (including half-brother, half-sister), son-in-law, and daughter-in-law. There is no exemption.

If the share is:
Not over $12,500, the tax is 5% of the share.

If over	But not over	Tax is	Of excess over
$ 12,500	$ 25,000	$ 625 + 6%	$ 12,500
25,000	75,000	1,375 + 7%	25,000
75,000	100,000	4,875 + 8%	75,000
100,000	150,000	6,875 + 9%	100,000
150,000	and up	11,375 + 10%	150,000

SCHEDULE C

Uncle, aunt, niece, nephew, foster child, cousin, brother-in-law, sister-in-law, stepgrandchild, and all other individual persons. There is no exemption.

If the share is:
Not over $50,000, tax is 10% of the share.

If over	But not over	Tax is	Of excess over
$ 50,000	$100,000	$ 5,000 + 12%	$ 50,000
100,000	and up	11,000 + 15%	100,000

SCHEDULE D

A firm, corporation or society organized for profit, including an organization failing to qualify as a charitable, educational or religious organization:

Effective July 1, 2001, any fraternal and social organization which does not qualify for exemption under IRC Section 170(c) ~~and~~ or 2055:

15% of the amount.

SCHEDULE E

Any society, institution or association incorporated or organized under the laws of any other state, territory, province or country than this state, for charitable, educational or religious purposes, or to a cemetery association, including a humane society not organized under the laws of this state, or to a resident trustee for use without this state, the rate of tax imposed in excess of $500:

10% of the amount.

SCHEDULE F

An unknown heir, as distinguished from an heir who is not presently ascertainable, due to contingent events: 5% of the amount.
SCHEDULE G ~~A public library or public art gallery within this state, open to the use of the public and not operated for gain, or to a hospital within this state, or a trustee for such use within this state, or to a municipal corporation for purely public purposes:~~ ~~Entirely exempt: No tax.~~ ~~(Also included in this class are bequests for the care and maintenance of the cemetery or burial lot of a decedent or the decedent's family.)~~ A charitable, religious, educational, or veterans organization as defined in IRC Section 170(c) or 2055. All other shares to income tax exempt organizations that are not defined in IRC Section 170(c) must provide their IRS letter of determination. Organizations may also be required to provide evidence that the bequest has restricted the funds to a conforming activity. Public libraries, public art galleries, hospitals, humane societies, municipal corporations, bequests for care of cemetery or burial lots of the decedent or the decedent's family, and bequests for religious services the total of which does not exceed $500. Entirely exempt: No tax.

ITEM 7. Amend subrule 86.2(4) as follows:

86.2(4) *Supplemental return—deferred interest.* When the tax has been deferred on a property interest to take effect in possession or enjoyment after the termination of a prior property interest, it shall be the duty of the owner of the future interest to file a supplemental inheritance tax return with the department, reporting the future interest for taxation. At the top of the front page of the return, the word "SUPPLEMENTAL" shall be printed.

ITEM 8. Amend subrule 86.5(1) as follows:

86.5(1) *Iowa real and tangible personal property.*

a. Real estate and tangible personal property with a situs in the state of Iowa and in which the decedent had an interest at the time of death is includable in the gross estate regardless of whether the decedent was a resident of Iowa. It is immaterial whether the property, or interest, is owned singly, jointly, or in common.

b. Certain other real and tangible personal property with a situs in the state of Iowa in which the decedent did not have an interest at death may also be part of the gross estate for tax purposes. Examples of such property transfers include, but are not limited to, transfers of real estate in which the grantor retained a life estate, life interest, interest or the power of revocation, property or interest in property in trust, and gifts made within three years of death in excess of the federal gift tax exclusion. These constitute transfers of property in which the decedent may not have an interest at death, but are includable in the gross estate for inheritance tax purposes. *In re Dieleman's Estate v. Dept. of Revenue,* 222 N.W.2d 459 (Iowa 1974); *In re English's Estate,* 206 N.W.2d 305 (Iowa 1973); and *Lincoln's Estate v. Briggs,* 199 N.W.2d 337 (Iowa 1972).

c. A nonresident decedent's interest in a corporation, limited liability company, or partnership that owns real or tangible personal property with an Iowa situs that is titled in the name of that business entity

is not subject to inheritance tax. An interest in a business entity is intangible personal property which follows the residence of the decedent for the purposes of inheritance tax.

d. Tangible personal property as defined in Iowa Code section 633.276 with an Iowa situs which is distributed in kind from the estate is not subject to inheritance tax if the aggregate value of all tangible personal property in the estate does not exceed $5,000. See 86.2(1)*"c"*(5).

ITEM 9. Rescind and reserve subrule **86.5(4)**.

ITEM 10. Amend paragraph **86.5(7)"d"** as follows:

d. Gifts made within three years prior to death—for estates of decedents dying on or after July 1, 1984. All gifts made by the donor within three years prior to death, which are in excess of the annual calendar year federal gift tax exclusion provided for in 26 U.S.C. Section 2503, subsections b and e, are included in the gross estate for inheritance tax purposes. The motive, intention or state of mind of the donor is not relevant. Date of valuation for a gift in which there was a full transfer of ownership is valued at the date in which the gift is completed. However, for a gift of an interest in property that is less than a full transfer of ownership, which includes, but is not limited to, a life estate or conditional gift, the date of valuation is the date of the death of the decedent, unless alternative valuation is chosen. Effective for estates of decedents dying on or after July 1, 2003, valuation of property transferred by the grantor or donor is based on the net market value at the date of transfer. The fact alone that the transfer is a gift, in whole or in part, and exceeds the annual calendar year exclusion for federal gift tax purposes, is sufficient to subject the excess of the transfer over the exclusion to tax. The exclusion is applied to the total amount of the gifts made to a donee in a calendar year, allocating the exclusion to the gifts in the order made during the calendar year. This rule has important application to the earliest year of the three-year period before death because the three-year period for inheritance tax purposes is measured from the date the decedent-donor died. This will only rarely coincide with a calendar year. As a result, none of the gifts made in the earliest calendar year of the three-year period prior to death, regardless of the amount, which are made before the beginning of the three-year period, measured by the decedent's death date, are subject to tax. However, gifts made before the three-year period begins in this earliest year will reduce or may completely absorb the exclusion amount that is available for the remaining part of this first-year period. The significance of the difference between the three-year period prior to death and the calendar year exclusion amount is illustrated by the following:

EXAMPLE. The decedent-donor, A, died July 1, ~~1995~~ 2012. The three-year period during which gifts may be subject to inheritance tax begins July 1, ~~1992~~ 2009. During the calendar year ~~1992~~ 2009, A made a cash gift to nephew B of ~~$11,000~~ $14,000 on May 1, ~~1992~~ 2009, and a second gift to B of $4,000 on August 1, ~~1992~~ 2009. In this example, none of the ~~$11,000~~ $14,000 gift made on May 1, ~~1992~~ 2009, is includable for inheritance tax purposes because it was made before the three-year period began, based on A's date of death. All of the $4,000 gift made on August 1, ~~1992~~ 2009, is includable for inheritance tax purposes because it is in excess of the calendar year ~~1992~~ 2009 federal gift tax exclusion of ~~$10,000~~ $13,000.

(1) Split gift. At the election of the donor's spouse, a gift made by a donor to a person, other than the spouse, shall be considered, for inheritance tax purposes, as made one half by the donor and one half by the donor's spouse. This split gift election for inheritance tax purposes is subject to the same terms and conditions that govern split gifts for federal gift tax purposes under 26 U.S.C. Section 2513.

The consent of the donor's spouse signified under 26 U.S.C. Section 2513(b) shall also be presumed to be consent for Iowa inheritance tax purposes, unless the contrary is shown. If the split gift election is made, the election shall apply to all gifts made during the calendar year. Therefore, if the election is made, each spouse may use the annual federal gift tax exclusion ~~($10,000 for 1994)~~ which shall be applied to one-half of the total value of all gifts made by both spouses during the calendar year to each donee.

(2) Types of transfers which may result in a gift. Whether a transfer of property constitutes a gift depends on the facts and circumstances surrounding each individual transfer. Transfers which may result in a gift, in whole or in part, include, but are not limited to: sales of property where the purchase price, or terms of sale, are less than fair market value; a loan of money, interest free, even though the loan is

payable on demand; the release of a retained life use of property; and the payment of a debt or other obligation of another person.

(3) Types of transfers that are not a gift. However, certain transfers which in property law would be considered a present transfer of an interest in property may not be considered gifts within the Iowa three-year rule under Iowa Code section 450.3(2). Rather the transfers may be transfers intended to take effect in possession or enjoyment at death. Examples of this kind of transfer would include, but are not limited to, transfers in trust or otherwise, with a retained life use or interest; commercial annuities where payments are made to a beneficiary upon the death of the primary annuitant; transfers that place property in joint tenancy; irrevocable transfers of real or personal property where the deed or bill of sale is placed in escrow to be delivered only upon the grantor's death. Transfers of this kind are subject to inheritance tax under Iowa Code section 450.3(3) as a transfer to take effect in possession or enjoyment at death, even though under property law an interest in the property may have been transferred prior to death. Different kinds of transfers that may constitute a taxable gift, in whole or in part, include but are not limited to the following:

EXAMPLE A. Grantor-decedent, A, on July 1, 1992, transferred to nephew B, without consideration, a 160-acre Iowa farm, reserving the life use. On the date of transfer, the farm had a fair market value of $2,000 per acre, or $320,000. On August 1, 1994, A released the retained life estate without any consideration being given and then died on December 1, 1994. The release on August 1, 1994, constitutes a gift, for inheritance tax purposes, of the value of the entire farm (less the annual gift tax exclusion), within the three-year period prior to death. What is taxable is what would have been taxable had the release not been given. *United States v. Allen,* 293 F.2d 916 (10th Cir. 1961); Rev. Ruling 56-324, 1956 2 C.B. 999. In this example, the gift is not to be valued at the time of the release of the life use, but rather at its fair market value at the time of death. See subrule 86.9(1). The real estate cannot be valued at its alternate valuation date because it is not included in the federal gross estate for federal estate tax purposes, but rather it constitutes an adjusted taxable gift not eligible for the alternate valuation date. See rule 701—86.10(450) and Federal Estate Tax Regulation Section 20.2032-1(a) and (d).

EXAMPLE B. A, on August 1, ~~1992~~ 2009, loaned brother B $450,000 which was evidenced by a non-interest-bearing promissory note, payable on demand. A died on October 1, ~~1994~~ 2011, with no part of the loan having been repaid. The principal amount of the note is includable in A's gross estate. The free use of money is a valuable property right to the debtor. *Dickman v. Commissioner,* 465 U.S. 330 (1984). Thus, in effect, A has made a gift of the value of the interest to B each year the debt remains unpaid. Assuming for purposes of illustration that the applicable federal short-term rate for the entire year is 9 percent for each year and no other gifts were made to B, A has made a gift to B of $40,500 through August ~~1993~~ 2010 (one year after the note was executed) and an additional gift of $40,500 through August 1, ~~1994~~ 2011, and two months' interest of $6,750 from August 1, ~~1994~~ 2011, to the date of death on October 1, ~~1994~~ 2011. Therefore, in calendar year ~~1992~~ 2009 A has made a gift of 5/12 of $40,500, or $16,875. After deducting the annual calendar year exclusion of ~~$10,000~~ $13,000, ~~$6,875~~ $3,875 is subject to inheritance tax. Since the loan was outstanding for all of calendar year ~~1993~~ 2010, $40,500, less the ~~$10,000~~ $13,000 exclusion, or ~~$30,500~~ $27,500, is subject to inheritance tax. For calendar year ~~1994~~ 2011 the loan was outstanding for nine months. Three-fourths of $40,500, less ~~$10,000~~ $13,000, or ~~$20,375~~ $17,375, is subject to inheritance tax.

In this example it is not necessary that the loan be made within the three-year period prior to death. It is the free use of the loan during the three-year period prior to death that constitutes the gift.

EXAMPLE C. On March 1, ~~1992~~ 2010, A sold a 160-acre Iowa farm to niece B for $1,500 per acre, or $240,000. On the date of sale, the fair market value of the farm was $2,500 per acre, or $400,000. A died on August 1, ~~1994~~ 2012. This sale is, in part, a gift. It is not a bona fide sale for an adequate and full consideration in money or money's worth, and as a result, the difference between the sale price and the fair market value of the farm on the date of sale constitutes a gift. The sale price in this example represents only 60 percent of the farm's fair market value; therefore, 40 percent of the farm is a gift. However, the gift percentage to apply to the farm's value at death is ~~38~~ 37 percent, not 40 percent, because the ~~$10,000~~ $13,000 annual gift tax exclusion must be deducted from the value of the gift. See the computation of this percentage in Example D immediately following.

EXAMPLE D. On March 1, ~~1992~~ 2010, A sold a 160-acre Iowa farm to niece B for $2,500 per acre, or $400,000, which was also the fair market value of the farm on the date of sale. The sale was an installment sale contract, payable in 20 equal annual installments of principal and interest. The unpaid principal balance is to draw interest at one-half of the prevailing Federal Land Bank loan rate, which for purposes of illustration we will assume to be the rate of 12 percent, or 6 percent per year. The annual payments of principal and interest are $34,873.82 per year. A died on August 1, ~~1994~~ 2012. In this example, the sale price in and of itself does not constitute a gift because the sale price was also the fair market value of the farm. However, the difference between the prevailing Federal Land Bank loan rate of 12 percent and the contract rate of 6 percent constitutes a gift from A to B.

The amount of the gift that is includable in the gross estate is computed by determining the present value of the future annual payments of $34,873.82 discounted to reflect a 12 percent return on the investment. The discounted value is then divided by the fair market value of the farm on the date of the sale to determine the percentage of the sale price that is a bona fide sale for full consideration and the percentage of the sale price that represents a gift before the annual exclusion. The gift percentage is then applied to the fair market value of the farm (or special use value, if applicable) at death, to determine the amount that is includable in the gross estate.

The computation in this example is as follows:

The present value of the future annual payments of $34,873.82 for 20 years to reflect a 12 percent return on an investment is $260,488.05. That is, an investor who desires to earn the market rate of return of 12 percent on an investment would only pay $260,488.05 for this 6 percent $400,000 contract of sale.

Bona Fide Sale Percentage

Present value: 260,488.05 = 65%

Sale price: 400,000.00

This is the percentage of the sale price of $400,000 that represents a bona fide sale for full consideration.

Gift Percentage

The sale price of $400,000 - $260,488.05 or $139,511.95 is the gift portion of the sale price due to the 6 percent interest rate on the contract, before the ~~$10,000~~ $13,000 annual exclusion is deducted.

The gift percentage is computed as follows:

$$\$139{,}511.95 - \text{~~\$10,000~~ \$13,000} = \frac{\text{~~129,511.95~~ \$126,511.95}}{400{,}000.00} = 32\%$$

In this example the gift percentage used to determine the amount of the farm value at death that is taxable is only 32 percent of the value because deducting the ~~$10,000~~ $13,000 exclusion reduced the gift percentage from 35 percent to 32 percent. The gift took place in the year of sale, not in the year of death. As a result, 32 percent of fair market value (or special use value, if applicable) of the farm at the time of the donor's death is includable in the gross estate for inheritance tax purposes.

ITEM 11. Amend subrule 86.5(9) as follows:

86.5(9) *Transfers reserving a life income or interest.* If the grantor transfers property, except in the case of a bona fide sale for fair consideration, reserving the income, use, possession, or a portion thereof for life, the property is includable in the gross estate for inheritance tax purposes. *In re Sayres' Estate,* 245 Iowa 132, 60 N.W.2d 120 (1953); *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973). If there is a full reservation of income, the entire value of the property in which the reservation exists is includable for tax purposes. If only a portion of the income is reserved, the amount subject to tax is the full value of the property at death multiplied by a fraction of which the total income reserved is the numerator and

the total average earning capacity of like property is the denominator. See *In re Estate of English,* 206 N.W.2d at 310.

The reservation of the life income, or portion thereof, need not necessarily be stated or contained in the instrument of transfer to be includable for taxation. The transfer of property may contain no reservation of income or other incidents of ownership in the grantor, but if there is a contemporaneous agreement between the grantor and grantee to pay the income, or portion thereof, to the grantor for life, the two instruments or agreements when considered together may be construed to be reservation of the income from the transferred property. See *In re Sayres' Estate,* 245 Iowa 132 at 141, 142, 60 N.W.2d 120 (1953) for a full discussion of the subject.

The instrument need not be in any special form. For example, it may take the form of a contract of sale to terminate at death where the payments consist of the income from the property only. In addition, the transfer to be includable for taxation is not limited to income-producing property. For example, the transfer of the grantor's dwelling, reserving the life occupancy, falls within the meaning of a reserved life income or interest. Generally, revocable trusts can be classified as reserving a life income or interest. This type of transfer does not fall within the ~~$10,000~~ annual gift exclusion.

ITEM 12. Amend paragraph **86.5(12)"a"** as follows:

~~a. *General rule.*~~ Annuities in general, including the earnings, are considered to be taxable under Iowa Code section 450.3(3) as a transfer made or intended to take effect in possession or enjoyment after the death of the grantor or donor. *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973); *In re Endemann's Estate,* 307 N.Y. 100, 120 N.E.2d 514 (1954); *Cochrane v. Commission of Corps & Taxation,* 350 Mass. 237, 214 N.E.2d 283 (1966). For exceptions for employee-sponsored retirement plans, including annuities, see 86.5(13).

ITEM 13. Rescind paragraph **86.5(12)"b."**

ITEM 14. Renumber subrules **86.5(13)** and **86.5(14)** as **86.5(14)** and **86.5(15)**.

ITEM 15. Adopt the following **new** subrule 86.5(13):

86.5(13) *Employer-provided or employer-sponsored retirement plans and individual retirement accounts.* Iowa Code section 450.4(5) provides an exemption on that portion of the decedent's interest in an employer-provided or employer-sponsored retirement plan or on that portion of the decedent's individual retirement account that will be subject to federal income tax when paid to the beneficiary. This exemption applies regardless of the identity of the beneficiary and regardless of the number of payments to be made after the decedent's death.

For the purposes of this exemption:

a. An "individual retirement account" includes an individual retirement annuity or any other arrangement as defined in Section 408 of the Internal Revenue Code.

b. An "employer-provided or employer-sponsored retirement plan" includes a qualified retirement plan as defined in Section 401 of the Internal Revenue Code, a governmental or nonprofit employer's deferred compensation plan as defined in Section 457 of the Internal Revenue Code, and an annuity as defined in Section 403 of the Internal Revenue Code.

EXAMPLE 1. The decedent was a participant in a qualified retirement plan through the decedent's employer. The beneficiary of the retirement plan is the decedent's niece. The balance in the retirement plan will be fully subject to federal income tax and included as net income pursuant to Iowa Code section 422.7 when paid to the beneficiary. As a result, Iowa inheritance tax would not be imposed on the value of the retirement plan.

EXAMPLE 2. The decedent was a participant in a qualified retirement plan through the decedent's employer. The beneficiary of the pension is the decedent's niece. A portion of the payments received by the niece will be fully subject to federal income tax and included as net income pursuant to Iowa Code section 422.7. As a result, Iowa inheritance tax would not be imposed on the value of the portion of payments included as net income. However, the remaining portion of the payments not reported as net income pursuant to Iowa Code section 422.7 would be subject to Iowa inheritance tax. See Iowa Code section 450.4.

An exemption from Iowa inheritance tax for a qualified plan does not depend on the relationship of the beneficiary to the decedent. Payments under a qualified plan made to the estate of the decedent are exempt from Iowa inheritance tax. See *In re Estate of Heuermann*, Docket No. 88-70-0388 (September 21, 1989). In addition, for the purpose of determining the taxable or exempt status of payments under a qualified plan, it is not relevant that the decedent rolled over or changed the terms of payment prior to death. Taxation or exemption of payments made under a qualified plan is determined at the date of the decedent's death.

ITEM 16. Rescind and reserve paragraph **86.6(2)"d."**

ITEM 17. Amend subparagraph **86.6(3)"a"(1)**, numbered paragraph **"2,"** as follows:

2. The liability can be deducted only from property that is included in the gross estate for Iowa inheritance tax purposes. This rule would exclude, among others, that portion of joint tenancy property which is excluded from the gross estate, wrongful death proceeds, ~~the first $10,000 in~~ gifts to each donee made within three years of death up to an amount equal to the annual federal gift tax exclusion, and property with a situs outside Iowa.

ITEM 18. Amend subrule 86.7(4), introductory paragraph, as follows:

86.7(4) *Tables for life estates and remainders for estates of decedents dying on or after January 1, 1986, and prior to January 1, 2004.* For estates of decedents dying on or after January 1, 1986, and prior to January 1, 2004, the following tables are to be used in computing the value of a life estate, an annuity for life and the value of a remainder in property. The table is based on the commissioners' standard ordinary mortality tables of life expectancy, with no distinction being made between the life expectancy of males and females of the same age. As a result, the sex of the recipient is not relevant in computing the value of the property interest received. *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris,* 463 U.S. 1073, 103 S.Ct. 3492, 77 L.Ed.2d 1236 (1983). Valuation is based on the age at the nearest birthday. The following ~~tables are~~ table is to be applied in the same manner as specified in subrule 86.7(1).

ITEM 19. Amend subrule 86.7(5), introductory paragraph, as follows:

86.7(5) *Table for an annuity for life—for estates of decedents dying on or after January 1, 1986, and prior to January 1, 2004.* The following table is to be used in computing the present value of an annuity of a given amount (specified sum) for life in estates of decedents dying on or after January 1, 1986, and prior to January 1, 2004. The table is to be used in the same manner as the table listed in subrule 86.7(2).

ITEM 20. Adopt the following **new** subrule 86.7(6):

86.7(6) *Table for life estates and remainders for estates of decedents dying on or after January 1, 2004.* For estates of decedents dying on or after January 1, 2004, the following table is to be used in computing the value of a life estate, an annuity for life and the value of a remainder in property. The following table is to be applied in the same manner as specified in subrule 86.7(1).

2001 CSO-D MORTALITY TABLE
BASED ON BLENDING 50% MALE—50% FEMALE
(PIVOTAL AGE 45)
AGE NEAREST BIRTHDAY
4% INTEREST

The two factors across the page equal 100 percent. Multiply the corpus of the estate by the first factor to obtain value of the life estate.

Use the second factor to obtain the remainder interest if the tax is to be paid at the time of probate or to determine if there would be any tax due.

AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER	AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER
0	0.94022	0.05978	60	0.54240	0.45760
1	0.93854	0.06146	61	0.52918	0.47082
2	0.93653	0.06347	62	0.51579	0.48421
3	0.93431	0.06569	63	0.50229	0.49771
4	0.93192	0.06808	64	0.48868	0.51132
5	0.92939	0.07061	65	0.47495	0.52505
6	0.92676	0.07324	66	0.46112	0.53888
7	0.92402	0.07598	67	0.44717	0.55283
8	0.92119	0.07881	68	0.43306	0.56694
9	0.91825	0.08175	69	0.41882	0.58118
10	0.91519	0.08481	70	0.40442	0.59558
11	0.91202	0.08789	71	0.38991	0.61009
12	0.90874	0.09126	72	0.37533	0.62467
13	0.90537	0.09463	73	0.36081	0.63919
14	0.90192	0.09808	74	0.34633	0.65367
15	0.89837	0.10163	75	0.33189	0.66811
16	0.89475	0.10525	76	0.31751	0.68249
17	0.89107	0.10893	77	0.30318	0.69682
18	0.88731	0.11269	78	0.28898	0.71102
19	0.88344	0.11656	79	0.27495	0.72505
20	0.87944	0.12056	80	0.26116	0.73884
21	0.87529	0.12471	81	0.24761	0.75239
22	0.87098	0.12902	82	0.23452	0.76548
23	0.86651	0.13349	83	0.22188	0.77812
24	0.86186	0.13814	84	0.20962	0.79038
25	0.85704	0.14296	85	0.19778	0.80222
26	0.85205	0.14795	86	0.18642	0.81358
27	0.84688	0.15312	87	0.17540	0.82460
28	0.84154	0.15846	88	0.16507	0.83493
29	0.83599	0.16401	89	0.15544	0.84456
30	0.83022	0.16978	90	0.14650	0.85350
31	0.82421	0.17579	91	0.13802	0.86198
32	0.81798	0.18202	92	0.12909	0.87091
33	0.81151	0.18849	93	0.12008	0.87992
34	0.80480	0.19520	94	0.11133	0.88867
35	0.79786	0.20214	95	0.10320	0.89680
36	0.79068	0.20932	96	0.09618	0.90382
37	0.78326	0.21674	97	0.09014	0.90986
38	0.77559	0.22441	98	0.08532	0.91468
39	0.76767	0.23233	99	0.07952	0.92048
40	0.75949	0.24051	100	0.07338	0.92662
41	0.75104	0.24896	101	0.06745	0.93255
42	0.74233	0.25767	102	0.06160	0.93840

AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER	AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER
43	0.73335	0.26665	103	0.05590	0.94410
44	0.72412	0.27588	104	0.05042	0.94958
45	0.71463	0.28537	105	0.04523	0.95477
46	0.70490	0.29510	106	0.04045	0.95955
47	0.69491	0.30509	107	0.03604	0.96396
48	0.68468	0.31532	108	0.03199	0.96801
49	0.67415	0.32585	109	0.02823	0.97177
50	0.66333	0.33667	110	0.02479	0.97521
51	0.65223	0.34777	111	0.02174	0.97826
52	0.64086	0.35914	112	0.01899	0.98101
53	0.62926	0.37074	113	0.01643	0.98357
54	0.61743	0.38257	114	0.01357	0.98643
55	0.60539	0.39461	115	0.01107	0.98893
56	0.59317	0.40683	116	0.00869	0.99131
57	0.58077	0.41923	117	0.00638	0.99362
58	0.56821	0.43179	118	0.00437	0.99563
59	0.55542	0.44458	119	0.00246	0.99754
			120	0.00000	1.00000

ITEM 21. Adopt the following **new** subrule 86.7(7):

86.7(7) *Table for an annuity for life—for estates of decedents dying on or after January 1, 2004.* The following table is to be used in computing the present value of an annuity of a given amount (specified sum) for life in estates of decedents dying on or after January 1, 2004. The table is to be used in the same manner as the table listed in subrule 86.7(2).

2001 CSO-D MORTALITY TABLE
BASED ON BLENDING 50% MALE—50% FEMALE
(PIVOTAL AGE 45)
AGE NEAREST BIRTHDAY
4% INTEREST

To find the present value of an annuity or a given amount (specified sum) for life, multiply the annuity by the annuity factor opposite the age at the nearest birthday of the person receiving the annuity.

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
0	78.65	23.505
1	77.73	23.464
2	76.78	23.413
3	75.81	23.358
4	74.84	23.298
5	73.86	23.235
6	72.87	23.169
7	71.89	23.101
8	70.91	23.030
9	69.92	22.956

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
10	68.94	22.880
11	67.95	22.801
12	66.97	22.718
13	65.99	22.634
14	65.01	22.548
15	64.04	22.459
16	63.07	22.369
17	62.11	22.277
18	61.15	22.183
19	60.19	22.086
20	59.23	21.986
21	58.27	21.882
22	57.32	21.774
23	56.36	21.663
24	55.40	21.547
25	54.45	21.426
26	53.49	21.301
27	52.53	21.172
28	51.58	21.038
29	50.63	20.900
30	49.67	20.755
31	48.72	20.605
32	47.76	20.449
33	46.81	20.288
34	45.85	20.120
35	44.90	19.946
36	43.95	19.767
37	43.00	19.581
38	42.05	19.390
39	41.11	19.192
40	40.16	18.987
41	39.22	18.776
42	38.28	18.558
43	37.35	18.334
44	36.42	18.103
45	35.49	17.866
46	34.57	17.623
47	33.65	17.373
48	32.74	17.117
49	31.84	16.854
50	30.94	16.583
51	30.04	16.306
52	29.15	16.021

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
53	28.27	15.731
54	27.40	15.436
55	26.54	15.135
56	25.68	14.829
57	24.84	14.519
58	24.01	14.205
59	23.19	13.886
60	22.38	13.560
61	21.57	13.229
62	20.78	12.895
63	20.00	12.557
64	19.24	12.217
65	18.49	11.874
66	17.75	11.528
67	17.02	11.179
68	16.31	10.827
69	15.60	10.470
70	14.91	10.110
71	14.23	9.748
72	13.56	9.383
73	12.91	9.020
74	12.28	8.658
75	11.66	8.297
76	11.06	7.938
77	10.47	7.580
78	9.91	7.224
79	9.36	6.874
80	8.83	6.529
81	8.32	6.190
82	7.84	5.863
83	7.38	5.547
84	6.94	5.240
85	6.52	4.944
86	6.13	4.660
87	5.75	4.385
88	5.41	4.127
89	5.09	3.886
90	4.79	3.662
91	4.51	3.451
92	4.23	3.227
93	3.94	3.002
94	3.67	2.783
95	3.43	2.580

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
96	3.21	2.405
97	3.03	2.253
98	2.88	2.133
99	2.71	1.988
100	2.53	1.835
101	2.35	1.686
102	2.18	1.540
103	2.02	1.398
104	1.87	1.260
105	1.72	1.131
106	1.59	1.011
107	1.47	0.901
108	1.35	0.800
109	1.25	0.706
110	1.16	0.620
111	1.08	0.544
112	1.00	0.475
113	0.93	0.411
114	0.86	0.339
115	0.79	0.277
116	0.73	0.217
117	0.67	0.159
118	0.61	0.109
119	0.56	0.062
120	0.50	0.000

ITEM 22. Amend subparagraph **86.9(2)"e"(2)** as follows:

(2) Acceptance of values by the department. The values offered on the inheritance tax return by the estate and its beneficiaries are accepted by the department when:

1. The department has accepted the offered values in writing, or

2. A clearance certifying full payment of the tax due or a clearance certifying no tax due is issued by the department, or

3. The department does not request an appraisal within ~~30~~ 60 days after the return has been filed in the case of the value of real estate. Notice of appraisal must be served by certified mail, and the notice is deemed completed when the notice is deposited in the mail and postmarked for delivery. However, see 86.9(2)*"e"*(3) for the rule governing values listed as "unknown" or "undetermined." See Iowa Code sections 622.105 and 622.106 for the law determining the filing date of a tax return that is mailed.

ITEM 23. Amend subparagraph **86.9(2)"e"(3)** as follows:

(3) Values listed on the return as "undetermined" or "unknown." If at the time the inheritance tax return is filed the information necessary to determine the value of an asset cannot be presently ascertained, the taxpayer may list the value of that asset as "unknown" or "undetermined." The return must contain a statement signed by the taxpayer on behalf of the estate and the beneficiaries with an interest in the property granting the department an extension of time for requesting an appraisal until ~~30~~ 60 days after an amended return is filed listing a value for the real estate. Failure to grant an extension of time will subject the real estate to an immediate request for an appraisal. The amended return shall be accompanied with sufficient facts and other information necessary to substantiate the value offered. An

agreement concerning the value of an asset presupposes that ~~both~~ the department, the beneficiaries and the estate have knowledge of the relevant facts necessary to determine value. There can be no meaningful agreement or appraisal until the relevant facts relating to value are known. See *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977), regarding the criteria that may be used to determine the value of an asset which was unknown at the time of the decedent's death.

ITEM 24. Amend rule 701—86.11(450) as follows:

701—86.11(450) Valuation—special problem areas.

86.11(1) *Valuation of life estate and remainder interests—in general.* ~~In general.~~ Life or term estates and remainders in property cannot be valued separately for inheritance tax purposes without reference to the value of the property in which the life or term estate and remainder exists. The first valuation step is to determine the value of the property as a whole. This rule applies equally to fair market value in the ordinary course of trade, whether it be valued at death or on the alternate valuation date six months after death, or at its special use value under Iowa Code chapter 450B. The second step is to apply the life estate-remainder or term tables in rule 701—86.7(450) to the whole value of the property in which the life estate-remainder or term exists. Iowa Code section 450.51 requires that value of annuities, life or term, deferred or future estates in property be computed on the basis that the use of the property is worth a return of 4 percent per year. The life estate-remainder tables in rule 701—86.7(450) make no distinction between the life expectancy of males and females. See *City of Los Angeles v. Manhart,* 435 U.S. 702, 98 S.Ct. 1370, 55 L.Ed. 657 (1978) and *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris,* 51 U.S. Law Week 5243, 77 L.Ed.2d 1238 (1983) for the requirement that retirement annuities must not discriminate on the basis of sex. However, the actual life expectancy of the particular person receiving the life estate is not relevant in determining the value of the life estate for inheritance tax purposes. *In re Estate of Evans,* 255 N.W.2d 99 (Iowa 1977), appeal dismissed, 434 U.S. 805, 98 S.Ct. 34, 54 L.Ed.2d 62.

86.11(2) *Single life estate and remainder.* The value of a single life estate and remainder in property is computed by first determining the value of the property as a whole. The life estate is then computed by multiplying the value of the property as a whole by the life estate factor in rule 701—86.7(450) for the age of the life tenant. The value of property remaining after the value of the life estate is subtracted is the value of the remainder interest in the property.

The computation of the value of a single life estate and remainder in property is illustrated by the following:

EXAMPLE: Decedent A, by will, devised to surviving spouse B, aged 68, a life estate in a 160-acre farm, with the remainder at B's death to niece C. Special use value and the alternate value were not elected. The 160-acre farm at the time of the decedent's death had a fair market value of $2,000 per acre, or $320,000.

COMPUTATION OF B's LIFE ESTATE: The life estate factor for a life tenant aged 68 under 701—86.7(450) is ~~.37936~~ .43306; that is, the use of the $320,000 for life at the statutory rate of return of 4 percent is worth ~~37.936~~ 43.306 percent of the value of the farm. Niece C's remainder factor is ~~.62064~~ .56694. The life estate-remainder factors when combined equal 100 percent of the value of the property. It is the age of the life tenant which governs the value of the remainder. The age of the person receiving the remainder is not relevant.

Value of B's Life Estate	$320,000 × ~~.37936~~ .43306 =	~~$121,395.20~~	$138,579.20
Value of C's Remainder	$320,000 × ~~.62064~~ .56694 =	~~$198,604.80~~	$181,420.80
Total Value			$320,000.00

86.11(3) *Joint and succeeding life estates.* If property includable in the gross estate is subject to succeeding or joint life estates, the following general rules shall govern their valuation:

a. There can be no greater value assigned to all of the life estate interests than the value of the life estate of the youngest life tenant. The value of the life estate of the youngest life tenant fixes the value of the remainder interest in the property.

b. If two or more persons share in a life estate, the life tenants are presumed to share equally in the life estate during the life of the older life tenant, unless the will or trust instrument specifically directs that the income or use may be allocated otherwise.

c. The age of a life tenant alone determines the value of that life tenant's interest in the property. The life tenant's state of health is not relevant to valuation. *In re Estate of Evans,* 225 N.W.2d 99 (Iowa 1977), appeal dismissed, 434 U.S. 805, 98 S.Ct. 34, 54 L.Ed.62. As a result, if a succeeding life tenant is older than the preceding life tenant, the value of the succeeding life estate is zero. These general rules can be illustrated by the following examples:

EXAMPLE 1. Decedent A, by will, devised a 160-acre farm to surviving spouse B, aged 68, for life, and upon B's death, to daughter C, aged 45, for life, and the remainder upon C's death to nephews~~,~~ D and E~~,~~ in equal shares. The 160-acre farm had a fair market value at A's death of $320,000. Neither the alternate valuation date nor special use value was elected.

COMPUTATION OF THE SUCCEEDING LIFE ESTATES AND REMAINDER

1. Value of B's Life Estate:		
Life estate factor for age 68 is ~~.37936~~ .43306		
$320,000 × ~~.37936~~ .43306 =		~~$121,395.20~~ $138,579.20
2. Value of C's Succeeding Life Estate		
Life estate factor for age 45 is ~~.67131~~ .71463		
$320,000 × ~~.67131~~ .71463 =	~~$214,819.20~~ $228,681.60	
Less: B's life estate	~~$121,395.20~~ $138,579.20	
Value of C's life estate		~~$ 93,424.00~~ $ 90,102.40
3. Value of D's ½ remainder		
Remainder factor for a life tenant aged 45 is ~~.32869~~ .28537		
as ½ of $320,000 × ~~.32869~~ .28537 =		~~$ 52,590.40~~ $ 91,318.40
4. Value of E's ½ remainder		
½ of $320,000 × ~~.32869~~ .28537		~~$ 52,590.40~~ $ 91,318.40
Total Value — life estates and remainders		$320,000.00

NOTE: In this example, the value of C's succeeding life estate is reduced by the value of B's preceding life estate because C does not have the use of the farm during B's lifetime. The value of the remainder to D and E is fixed by the age of C, the succeeding life tenant.

EXAMPLE 2: Joint and survivorship life estates and remainder. In this example, the estate elected both the alternate valuation date and special use value. This is permitted by Federal Revenue Ruling 83-31 (1983) if the gross estate and the real estate are otherwise qualified.

Decedent A, a widow, by will devised her 240-acre Iowa farm to her nephew, B, aged 52, and the nephew's wife, C, aged 48, for their joint lives and for the life of the survivor, with the remainder to D and E in equal shares. The farm had a fair market value at death of $2,200 per acre, or $528,000; the alternate value of the farm six months after death was $2,100 per acre, or $504,000. Its special use

value is $1,000 per acre or $240,000. The life estates and the remainder are computed on the basis of the special use value of $240,000.

COMPUTATION OF JOINT LIFE ESTATE — REMAINDER VALUES

1. B's share of joint life estate.		
$240,000 × ~~.59399~~ .64086 (life estate factor, age 52) =	~~$142,557.60~~ $153,806.40	
½ as B's share =		~~$ 71,278.80~~ $ 76,903.20
2. C's share of joint life estate.		
$240,000 × ~~.63966~~ .68468 (life estate factor, age 48) =	~~$153,518.40~~ $164,323.20	
Less: ½ value of life estate for B's life	~~$ 71,278.80~~ $ 76,903.20	~~$ 82,239.60~~ $ 87,420.00
3. Value of the remainder.		
The value of the remainder is computed by using the remainder factor at the age of the youngest life tenant. In this example, it is ~~.36034~~ .31532, based on C's age of 48.		
D's share of the remainder.		
½ $240,000 × ~~.36034~~ .31532 =		~~$ 43,240.80~~ $ 37,838.40
E's share of the remainder. Same as D's		~~$ 43,240.80~~ $ 37,838.40
Total value of joint life estates and the remainder		$240,000.00

NOTE: In this example, B and C share equally in the life use of the farm during the life of B, who is the eldest. As a result, each life tenant's share during B's life is worth ~~$71,278.80~~ $76,903.20. Since C is younger than B, the difference between the value of the life estates for B and C is set off to C alone. The age of the youngest life tenant (C in this example) fixes the value of the remainder interest in the farm.

86.11(4) *Fixed sum annuity for life or for a term of years.* The value of an annuity for a fixed sum of money, either for the life of the annuitant or for a specific period of time, shall be computed by determining the present value of the future annuity payments using the 4 percent annuity tables in rule 701—86.7(450). A fixed sum annuity, either for life or for a term of years, is to be distinguished from a life estate and remainder in property. A life estate in property is the use of property, and the present value of the life use cannot exceed the value of the property in which the life estate-remainder exists, regardless of the rate of return used to determine the life estate factor. A fixed sum annuity on the other hand is different. The amount of the annuity does not necessarily bear any relationship to the earning capacity or value of the property which funds the annuity. The fixed sum annuity may be for an amount larger than the 4 percent used to compute a life estate. As a result, the present value of the fixed sum annuity, computed at the statutory rate of 4 percent per year, may exceed the value of the property which funds the fixed annuity. In this case, the present value of the future annuity payments cannot exceed the value of the property which funds the annuity. The remainder in this situation has no value for inheritance tax purposes.

This subrule is illustrated by the following examples:

EXAMPLE 1. Decedent A devises a 240-acre farm to daughter B, with the provision that B pay the sum $5,000 per year to C for life. The farm is subject to a lien as security for the payment of the annuity. C, the annuitant, is 54 years old. The fair market value of the farm at A's death is $2,000 per acre, or $480,000. Neither special use value nor the alternate valuation date was elected.

COMPUTATION OF THE VALUE OF THE $5,000 ANNUITY AND THE REMAINDER REVERSION TO B. Under rule 701—86.7(450), the 4 percent annuity factor for life at age 54 is ~~14.245~~ 15.436 for each dollar of the annuity received. Therefore, C's life annuity is computed as follows:

C's Annuity		
$5,000 × ~~14.245~~ 15.436 =		~~$ 71,225~~ $ 77,180
B's Reversionary — Remainder Interest		
Value of farm	$480,000	
Less: C's annuity	~~$ 71,225~~ $ 77,180	~~$408,775~~ $402,820
Total annuity and reversion — Remainder		$480,000

NOTE: In this example, the $5,000 annuity is worth less than a life estate in the farm. A life estate would be worth $273,499.20 because the use of $480,000 at 4 percent per year would return $19,200 per year, which is much greater than the $5,000 annuity.

EXAMPLE 2: Decedent A, by will, directed that the sum of $100,000 be set aside from the residuary estate to be held in trust to pay $500 per month to B for life, and upon B's death, the remaining principal and income, if any, ~~is~~ are to be paid to C and D in equal shares. B, the annuitant, was 35 years old at the time of A's death.

Under rule 701—86.7(450), the annuity factor for a person 35 years of age is ~~19.048~~ 19.946 for each dollar of the annuity. The annuity factor is multiplied by the annual amount of the annuity, which in this case is $6,000 per year.

COMPUTATION OF THE PRESENT VALUE OF B's $6,000 ANNUITY

$500.00 × 12 = $6,000 × ~~19.048~~ 19.946 = ~~$114,288~~ $119,676, which exceeds the value of the property funding the annuity. As a result, the value for inheritance tax purposes is $100,000, the maximum amount allowed by subrule 86.11(4). The remainder to C and D has no value for inheritance tax purposes.

86.11(5) *Valuation of remainder interests.* Iowa Code section 450.51 and rule 701—86.7(450) require the value of a remainder interest in property to be computed by subtracting the present value of the preceding life or term estate from the total value of the property in which the remainder exists. Since age or time is the controlling factor in valuing life or term estates in property, the time when the preceding life or term estate is valued is crucial for determining the value of the remainder interests in the property. Iowa Code sections 450.6, 450.44 and 450.52 provide three alternative dates for valuing a remainder, or other property interest in future possession or enjoyment, for inheritance tax purposes. Each of the three dates requires valuing the preceding life or term estate on the date selected, thus in effect, valuing the remainder interest at the same time. The value of the remainder interest is based on the value of the property on the date elected for payment. *In re Estate of Wickham*, 241 Iowa 198, 40 N.W.2d 469 (1950). The remainder or term factor in rule 701—86.7(450) which is based on the age of the life tenant, or the number of years remaining in the term on the date of payment, is then applied to the value of the property to determine the value of the remainder interest. *In re Estate of Millard,* 251 Iowa 1282, 105 N.W. 2d 95 (1960). Therefore, the remainder, or other future property interest, shall be valued by the following general rules.

a. to *f.* No change.

These rules can be illustrated by the following examples:

For an example of computing remainder interests, see Examples 1 and 2 in ~~701—~~subrule 86.11(3).

EXAMPLE 1: Decedent A died July 1, ~~1993~~ 2009, and, by will, devised all of her personal property to her surviving spouse, B, and her 240-acre Iowa farm to B for his life with the remainder at B's death to two nephews, C and D, in equal shares. The surviving spouse, B, was 74 years of age when A died. The fair market value of the 240-acre farm was $2,000 per acre, or $480,000 on the date of A's death. Neither the alternate valuation date nor special use value was elected by the estate. On March 15, ~~1994~~

2010, the tax on B's life estate was paid. The tax on the remainder to C and D was therefore deferred, to be paid no later than nine months after the death of B, the life tenant. However, on October 15, ~~1995~~ 2011, due to adverse economic circumstances, B, C, and D voluntarily sold the 240-acre farm at public auction to an unrelated person for $2,100 per acre, or $504,000. B's life estate was not preserved in the sale proceeds. The tax on the remainder in this fact situation must be computed under subrule 86.11(5), paragraph *"b,"* when the life estate is terminated before the life tenant's death. The sale price of the farm and the life estate remainder factor reflecting B's age on October 15, ~~1995~~ 2011, (B's age is now 76) control the value of the remainder.

COMPUTATION OF THE REMAINDER INTEREST OF C AND D
The remainder factor in rule 701—86.7(450) for a life tenant aged 76 is ~~.73595~~ .68249.

C's ½ remainder interest	½ ($504,000 × ~~.73595~~ .68249) =	~~$185,459.40~~	$171,987.48
D's ½ remainder interest	same as C's	~~185,459.40~~	$171,987.48
Total value of remainder		~~$370,918.80~~	$343,974.96

NOTE: In this example, the value of C's and D's remainder interest in the sale proceeds is greater than the value of the remainder at the time of A's death due to the increase in the remainder factor because of B's increased age and the increase in the fair market value of the farm. However, if B's life estate had been preserved in the sale proceeds, the tax could continue to be deferred on C's and D's remainder interest. C and D cannot be required to pay the tax on their remainder until they come into possession or enjoyment of the property.

EXAMPLE 2: Decedent A at the time of her death on July 1, ~~1993~~ 2005, owned a vested remainder in a 240-acre Iowa farm, which was subject to the life use of her mother, B, who was 87 years old when A died. A's ownership of the remainder interest was not discovered until after life tenant B's death on October 15, ~~1995~~ 2007. The fair market value of the farm was $2,000 per acre or $480,000 on July 1, ~~1993~~ 2005, and $2,200 per acre or $528,000 on October 15, ~~1995~~ 2007. Neither the alternate valuation date nor special use valuation can be used in this fact situation. See rule 701—86.10(450) and subrule 86.8(4), paragraph *"c."* A's estate was reopened to include the omitted remainder in the 240-acre farm. An amended inheritance tax return was filed December 10, ~~1995~~ 2007, basing the tax on the fair market value and the remainder factor corresponding with the life tenant's age (87) on July 1, ~~1993~~ 2005. In this fact situation, the tax on A's remainder is not computed correctly, even if A's estate has offered to pay a penalty and interest on the tax due. The tax must be computed on the basis of a fair market value of $2,200 per acre and a remainder factor of 100 percent of the value of the farm. No penalty or interest would be assessed if the correct tax is paid prior to July 15, ~~1996~~ 2008, which is nine months after the life tenant's death. The life tenant's age at death is not relevant.

86.11(6) *Valuation of contingent property interests.* Contingent remainders, succeeding life estates and other contingent property interests must be valued as if no contingency exists. Factors to be considered to determine if a contingency interest exists include, but are not limited to, the interest is generally a future interest, it is not a vested interest, and vesting of the interest depends upon the occurrence of a specific event or condition being met. As a result, ~~701—~~subrule 86.11(5) applies equally to the valuation of vested and contingent property interests. The tax on a contingent property interest may be deferred until such time as it can be determined who will come into possession or enjoyment of the property. By deferring the tax under Iowa Code sections 450.44 to 450.49, a person does not have to speculate as to who will be the probable owner of the contingent interest. As a result, no one is required to pay tax on a property interest to which a vested right has not been received. Therefore, if a person exercises the right to pay the tax during the period of the contingency, that person cannot obtain a tax advantage by asserting that the value should be reduced due to a contingency, when the person would not be entitled to a reduction in value if the tax had been deferred until the ownership is determined.

This rule is illustrated by the following example.

COMPREHENSIVE EXAMPLE: Decedent A, by will, devised a 240-acre Iowa farm to B for life and upon B's death, then to C for life and the remainder after C's death to D and E in equal shares. In this example, C's succeeding life estate is contingent upon surviving B, the first life tenant. If C elects to pay the tax on the succeeding life estate within nine months after A's death, the tax is computed according to Example 1 in subrule 86.11(3) with no discount for the contingency that C may not survive B. However, C may defer the tax to be paid no later than nine months after B's death. In this case, if C does not survive B, the succeeding life estate lapses, and D and E_2 who own the remainder$_2$ will come into possession or enjoyment of the 240-acre farm. No tax will be owing on the succeeding life estate because C receives nothing. D and E will owe tax on the remainder within nine months after the death of B, if the tax was not previously paid.

For another example of computing a contingent remainder interest see *In re Estate of Schnepp*, 258 Iowa 33, 138 N.W.2d 886 (1965).

86.11(7) *Valuation of growing crops owned by the decedent.* Valuation of growing crops owned by the decedent is determined by using a proration formula. Based on the formula, the cash value of the actual crop realized in the fall of the year is prorated by attributing a portion of the value to the period before death and a portion after death. The portion attributed to the period before death is the value for Iowa inheritance tax purposes. The numerator of the ratio expresses the number of days the decedent lived during the growing season. In Iowa, the growing season for corn and beans is generally considered to be from May 15 through October 15, or 153 days. This 153-day period is the denominator of the ratio. This ratio should then be multiplied by the number of bushels realized in the fall, and then multiplied by the local elevator price at the time of maturity. However, if the estate sells the crop within a reasonable time after harvest, and the sale is an "arm's-length transaction," then the sale price of the crop can be used as a fair market value basis.

EXAMPLE: The decedent grew crops consisting of corn and beans. The decedent died August 15. The decedent lived 92 days of the growing season. In the fall of the year, 2,000 bushels of corn were harvested by the estate and sold to the local elevator for $3.10 per bushel. The value of the crop for the purpose of Iowa inheritance tax purposes is calculated as follows:

$$\frac{92}{153} \times \begin{matrix}2{,}000 \\ \text{bushels}\end{matrix} \times \begin{matrix}\$3.10 \text{ per} \\ \text{bushel}\end{matrix} = \$3{,}728.10$$

86.11(8) *Valuation of cash rent farm leases.* If the decedent at the time of death owns farm property that was subject to lease, or if the decedent rents such property, the value of the cash rent farm for inheritance tax purposes must be determined. The formula to be used is the total cash rent for the entire rental period prorated over the entire year. The proration percentage is the number of days the decedent lived during the rental period, divided by 365 days. This percentage shall then be applied to the total cash rent for the entire year. Deductions from the resulting sum are allowed for rent payments made prior to the death of the decedent. If the deduction results in a negative amount, no refund or credit is allowed.

This valuation formula is to be utilized whether the decedent is the lessor or lessee of such property.

EXAMPLES: The decedent has a cash rent farm lease agreement (beginning March 1 through the end of February of the next year) with farmer X for automatic yearly rentals. The rent is due in two installments: $10,000 on March 1 and $10,000 on September 1.

1. Decedent dies February 1, 2011. $20,000 × 338/365 = $18,520.55. Farmer X had paid his two installments in 2010. His next installment is due March 1, 2011, for the new farm rental year. Farmer X has overpaid by $1,479.45 ($18,520.55 – $20,000 = -$1,479.45). No refund or credit is allowed.

2. Decedent dies April 20, 2011. $20,000 × 51/365 = $2,794.52. Farmer X has paid his March 1 installment of $10,000. Farmer X has overpaid by $7,205.48 ($2,794.52 – $10,000 = -$7,205.48). No refund or credit is allowed.

3. Decedent dies October 10, 2011. $20,000 × 224/365 = $12,273.97. Farmer X paid his March installment but has not paid his September installment. Farmer X has underpaid at the date of death.

$12,273.97 – $10,000 = $2,273.97. This amount must be reported as an asset. It is an accounts receivable due at date of decedent's death.

This rule is intended to implement Iowa Code sections 450.44 to 450.49, 450.51 and 450.52.

ITEM 25. Amend subrule 86.14(5) as follows:

86.14(5) *"Stepped-up" basis.* If a decedent's will provides that taxes are to be paid from the residue of the estate and not the respective beneficial shares, a "stepped-up" basis will be utilized when computing the shares which will result in the appropriate beneficiaries' shares to include the tax obligation that was paid as an additional inheritance. A "stepped-up" basis is based on gifts prior to the residual share; shares paid out of the residue are not stepped-up.

EXAMPLE: Decedent's will gives $1,000 to a nephew and directs that the inheritance tax on this bequest be paid from the residue of the estate. The stepped-up share is computed as follows:

Tax: $1,000 × 10% = $100. Divide the tax by the difference between the tax rate and 100 percent (90 percent in this example): $100 divided by 90% = $111.11. Add the stepped-up tax of $111.11 to the original bequest of $1,000. This results in a stepped-up share of $1,111.11, which allows the nephew to keep $1,000 after the tax is paid.

ITEM 26. Amend subrule 86.14(10) as follows:

86.14(10) *Credit on prior transfers.* A credit is allowed for inheritance tax paid by certain beneficiaries that have received shares from a prior estate. The credit can be claimed only by the brother, sister, son-in-law and daughter-in-law of the decedent. The decedent in whose estate the credit is to be used must have died within two years of the death of the decedent in whose estate the tax for which the credit is requested was paid and the property inherited. The credit is subject to two limitations:

a. The maximum credit allowed cannot exceed the amount of the prior inheritance tax that was paid on the property in the prior estate. In other words, the inheritance tax the present decedent paid on the property in the prior estate must be prorated on the basis such property bears to the total property inherited in the prior estate; and

b. The amount of the credit cannot exceed the tax generated in the current estate on the property which was inherited from the ~~earlier~~ prior estate. This means that the tax in the current estate must be apportioned on the basis the prior estate property bears to the total property inherited by the beneficiary in the second estate. The credit cannot exceed this apportioned amount.

EXAMPLE 1: *Limitation—maximum credit allowed cannot exceed the amount of the prior inheritance tax that was paid on the property in the prior estate.*

First decedent, Sister, has two siblings. Her property passes to two brothers (A and B). Her property includes:

Real estate	$400,000
Cash, etc.	$250,000
Expenses	$150,000

Each brother inherits $250,000. The tax due from each brother is $21,375.

Brother B dies one year and two months after Sister. He leaves everything to Brother A.

Brother B's property includes:

½ interest in Sister's real estate (current value)	$225,000
Full interest in his own real estate	$500,000

½ interest in Sister's cash, etc.	$ 50,000
Full interest in his own cash, etc.	$500,000
Expenses	$200,000

Brother A inherits $1,075,000 with a current tax due of $103,875. Reduce the current tax due, $103,875, by the amount of tax paid in the prior estate, $21,375. The result is $82,500.

Percentage of Brother A's tax of $103,875 generated by Sister's property included in Brother B's estate:

$275,000/$1,075,000 = 25.58%

$103,875 × 25.58% = $26,571.23

Maximum credit cannot be more than the tax paid in the prior estate, $21,375. The tax due in this estate is $82,500.

EXAMPLE 2: *Limitation—amount of credit cannot exceed the tax generated in the current estate on the property which was inherited from the prior estate.*

First decedent, Sister, has two siblings. Her property passes to two brothers (A and B). Her property includes:

Real estate	$400,000
Cash, etc.	$250,000
Expenses	$150,000

Each brother inherits $250,000. The tax due from each brother is $21,375.

Brother B dies one year and two months after Sister. He leaves everything to Brother A.

Brother B's property includes:

½ interest in Sister's real estate (current value)	$225,000
Full interest in his own real estate	$500,000
½ interest in Sister's cash, etc.	$ 50,000
Full interest in his own cash, etc.	$500,000
Expenses	$200,000

Brother A inherits $1,075,000 with a current tax due of $103,875. Reduce the amount of the current tax due, $103,875, by the tax paid in the prior estate, $21,375. The result is $82,500.

$1,075,000 less prior estate properties worth $275,000 equals $800,000. Tax would equal $76,375.

The greater of the two computations ($82,500 v. $76,375) is the tax due in the estate. $82,500 would be due.

EXAMPLE 3: *Two-year requirement.* Same facts as above, except that Brother B dies two years and two months after the date of death of Sister. Tax is $103,875 with no reduction since it is over the two-year limitation.

EXAMPLE 4: *Multiple beneficiary issues.* Same facts as above, except that beneficiaries of Brother B have changed. If there are multiple beneficiaries in the second estate, only the beneficiaries that are brother, sister, son-in-law, or daughter-in-law relationships to the prior decedent can utilize the credit. The credit is then determined by the property value passing in this estate that can be identified as being inherited by this decedent from a prior estate.

Brother B dies one year and two months after his Sister. He leaves his real estate to Brother A and the residual assets to his two nieces.

Brother B's share of prior decedent's (Sister's) estate equals $725,000. Tax equals $68,875. Reduce the current tax due, $68,875, by the tax paid in the prior estate, $21,375. The result is $47,500.

Niece 1's share equals $175,000. Tax equals $22,250.
Niece 2's share equals $175,000. Tax equals $22,250.
Total tax for Brother B's estate with no reductions equals $113,375.
Total tax with Brother B's reduced tax is $92,000.

Computation without the prior decedent's (Sister's) property that passes to a qualified heir:

Brother B's share would be $500,000. Tax equals $46,375.
Niece 1's share remains the same since she is not a qualified heir. Tax equals $22,250.
Niece 2's share remains the same since she is not a qualified heir. Tax equals $22,250.
Total tax for this computation is $90,875.

The greater of the two computations is $92,000. $92,000 would be due.

ITEM 27. Adopt the following **new** subrule 86.14(11):

86.14(11) *Prorated cash bequests.* If the distribution of an estate includes pecuniary legacies with an estate with property located in and outside Iowa, or the estate includes specific bequests from a fund containing property located in and outside Iowa, then the Iowa inheritance tax liability for those legacies or bequests will be based on the pro rata portion of the property of the estate located in Iowa. For further

details see *Estate of Dennis M. Billingsley,* Iowa District Court of Emmet County, Case No. 13394 (July 15, 1982).

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