

REVENUE DEPARTMENT[701]

Adopted and Filed

Rule making related to pass-through entity composite returns

The Revenue Department hereby amends Chapter 302, “Determination of Net Income,” Chapter 304, “Adjustments to Computed Tax and Tax Credits,” Chapter 307, “Withholding,” and Chapter 404, “Composite Returns”; adopts new Chapter 405, “Composite Returns for Tax Years Beginning on or After January 1, 2022”; and amends Chapter 501, “Filing Returns, Payment of Tax, Penalty and Interest, and Tax Credits,” Chapter 601, “Filing Returns, Payment of Tax, Penalty and Interest, and Tax Credits,” and Chapter 700, “Fiduciary Income Tax,” Iowa Administrative Code.

Legal Authority for Rule Making

This rule making is adopted under the authority provided in Iowa Code sections 421.14, 422.16B and 422.68.

State or Federal Law Implemented

This rule making implements, in whole or in part, 2021 Iowa Acts, Senate File 608.

Purpose and Summary

The Department has adopted this rule making to implement the pass-through entity composite return requirements enacted in 2021 Iowa Acts, Senate File 608, division II. That legislation repealed the provisions of Iowa law that required a pass-through entity (partnership, S corporation, estate, or trust) to withhold and remit income tax on a nonresident individual’s distributive Iowa-source income from the pass-through entity and that allowed a pass-through entity to elect to file an Iowa composite return on behalf of its nonresident individual members, and replaced them with a mandatory Iowa composite return filing and tax payment requirement that applies to all nonresident members of the pass-through entity. A composite return is a return that reports the Iowa-source income of nonresident members as one group and pays Iowa income or franchise tax related to that Iowa-source income. These changes take effect for tax years beginning on or after January 1, 2022.

In general, under Iowa Code section 422.16B, a pass-through entity with nonresident members is required to file an annual Iowa composite return and pay Iowa income or franchise tax on behalf of its nonresident members related to their Iowa-source income from the pass-through entity. Nonresident members receive a refundable Iowa tax credit equal to the Iowa income or franchise tax paid on their behalf, which they may claim on their own Iowa tax returns. Nonresident members who are individuals are relieved of the requirement to file an Iowa tax return if the pass-through entity is their only Iowa-source income. Certain pass-through entities are exempt under Iowa Code section 422.16B or these amendments from the requirement to file a composite return, or remit composite return tax on behalf of one or more nonresident members, or both. This rule making includes the following:

- New Chapter 405 governs the new composite return requirements, including filing requirements, return and tax payment due dates, amended returns and refund limitations, nonresident member determinations, filing and tax payment exclusions for certain pass-through entities, tax payment exclusions for certain nonresident members, permissible elections out of the tax payment requirements, calculation of composite return tax, tax credits for composite tax paid on behalf of nonresident members, Iowa tax return filing requirements for nonresident members included on a composite return, and composite returns for nonresidents who are not members of a pass-through entity.
- New rule 701—404.10(422) addresses the nonapplication of the current composite return rules (Chapter 404) to tax years beginning on or after January 1, 2022, and certain other transition issues.

- Amendments to rules 701—304.44(422), 701—501.12(422), and 701—601.2(422), which dictate the order in which tax credits must be claimed to account for new composite tax credits available to nonresident members.
- Amendments to the Department’s withholding rules in Chapter 307 to account for the repeal of nonresident withholding requirements on pass-through entity income. This rule making also contains other technical amendments to Chapter 307 unrelated to the composite return requirements that remove superfluous rule language, correct federal law citations, and correct internal cross-references to other Iowa administrative rules.
- Amendments to the Department’s fiduciary income tax rules in Chapter 700 to strike references to the now-repealed nonresident withholding requirements and replace them with language pertaining to the new composite return requirements. These amendments in part address the personal liability of a personal representative or trustee who fails to comply with the composite return requirements and the impact that the new composite return requirements have on the Department’s issuance of an income tax certificate of acquittance.
- Amendments to subrule 302.46(2) relating to the filing of composite returns by nonresident members of professional athletic teams to clarify that the rule applies to composite returns filed under previous Iowa law for tax years beginning prior to January 1, 2022.

Public Comment and Changes to Rule Making

Notice of Intended Action for this rule making was published in the Iowa Administrative Bulletin on December 14, 2022, as **ARC 6746C**. A public hearing was held on January 13, 2023, at 10 a.m. via video/conference call. Representatives of the Iowa Bankers Association attended the public hearing and made comments consistent with the written comments they also submitted.

The comments received from the Iowa Bankers Association were generally supportive of the law and proposed rule making, but did raise some general concerns about the inability to claim Iowa tax credits and certain owner-level deductions and exemptions on the new composite return and about the interaction that state composite return systems have with certain federal Internal Revenue Code regulations imposed on S corporations and their shareholder distributions. The comments also raised four specific concerns and related requests, which are addressed below:

1. The comments requested that the adopted rule making exempt financial institutions (i.e., banks) from the composite return filing and tax payment requirements pursuant to the Department’s authority in Iowa Code section 422.16B(5)“c.” To support this request, the comments stated in part that the inability to claim Iowa tax credits on the composite return will cause “a major disruption for many S-corporation banks due to the unique nature of the franchise tax credit which is an administrative credit to avoid double taxation.” The Iowa franchise tax credit is, in fact, an administrative tax credit intended to avoid double taxation because an S corporation financial institution’s Iowa income is subject to Iowa franchise tax at the entity level and Iowa income tax at the shareholder level. Nonresident shareholders have the right under Iowa law to claim both the Iowa franchise tax credit and the Iowa composite tax credit on their own Iowa individual income tax return, so no actual double taxation exists, but receiving both of those tax benefits would require nonresident shareholders to file an Iowa individual income tax return when they might not otherwise have a return filing requirement. The Department is unclear as to whether the Legislature intended this result.

The Department agrees that it has the authority under Iowa Code section 422.16B(5)“c” to exempt financial institutions from the composite return requirements. The Department will provide financial institutions, through rule, an exemption from the requirement to file composite returns and pay composite tax for the 2022 tax year. This limited exemption is being provided because tax year 2022 composite returns will become due before the Legislature can appropriately consider this issue. However, the Department declined to provide an exemption beyond tax year 2022 because it believes a permanent change, if one is warranted, should be addressed by the Iowa Legislature.

2. The comments requested that the adopted rule making allow the Nonresident Member Composite Agreement, which is used to elect out of the composite return tax payment requirement,

to be signed and transmitted electronically between nonresident members and the pass-through entity. The Department's provision regarding electronic signatures in subrule 8.2(6) is broad enough to permit electronic signature and transmission of the Nonresident Member Composite Agreement, so no changes from the Notice have been made as a result of this comment.

3. The comments requested that the adopted rule making allow the Nonresident Member Composite Agreement, which is used to elect out of the composite return tax payment requirement, to be made on an open-ended basis rather than an annual basis. The Department has determined that requiring an annual election is the best method to ensure that the pass-through entity and its nonresident owner take notice of, and comply with, their annual filing and tax payment obligations, so the Department declined to make this change.

4. The comments requested that the adopted rule making provide that a pass-through entity is not required to file a composite tax return for the tax year if all nonresident members have signed the Nonresident Member Composite Agreement. The Department has an administrative need to know when nonresident members, for which composite tax would be due, have instead signed the Nonresident Member Composite Agreement to elect out of the composite return tax payment requirement. The Department believes the composite return is an appropriate method to report those elections to the Department, so the Department declined to make this change.

One change from the Notice has been made. A new paragraph 405.5(1)“e” in Item 8 has been added to provide a composite return filing and payment exemption during tax year 2022 for a pass-through entity that is a financial institution subject to the Iowa franchise tax, or for certain pass-through entities that wholly own a financial institution subject to the Iowa franchise tax, if the financial institution files its 2022 Iowa franchise tax return (IA 1120F) and pays any franchise tax shown due on that return. This filing and payment exemption does not apply to any pass-through entity for any tax year beginning on or after January 1, 2023.

Adoption of Rule Making

This rule making was adopted by the Department on January 27, 2023.

Fiscal Impact

This rule making has no known fiscal impact to the State of Iowa beyond that of the legislation it is intended to implement. The final Fiscal Note for 2021 Iowa Acts, Senate File 608, found that division II had no potential direct impact on state revenues or expenditures.

Jobs Impact

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

Waivers

Any person who believes that the application of the discretionary provisions of this rule making would result in hardship or injustice to that person may petition the Department for a waiver of the discretionary provisions, if any, pursuant to rule 701—7.28(17A).

Review by Administrative Rules Review Committee

The Administrative Rules Review Committee, a bipartisan legislative committee which oversees rule making by executive branch agencies, may, on its own motion or on written request by any individual or group, review this rule making at its [regular monthly meeting](#) or at a special meeting. The Committee's meetings are open to the public, and interested persons may be heard as provided in Iowa Code section 17A.8(6).

Effective Date

This rule making will become effective on March 29, 2023.

The following rule-making actions are adopted:

ITEM 1. Amend subrule 302.46(2) as follows:

302.46(2) *Filing composite Iowa returns for nonresident members of professional athletic teams.* ~~Professional~~ For tax years beginning prior to January 1, 2022, professional athletic teams may file composite Iowa returns under 701—Chapter 404 on behalf of team members who are nonresidents of Iowa and who have compensation that is taxable to Iowa from duty days in Iowa for the athletic team. However, the athletic team may include on the composite return only those team members who are nonresidents of Iowa and who have no ~~Iowa-source~~ Iowa-source incomes other than the incomes from duty days in Iowa for the team. The athletic team may exclude from the composite return any team member who is a nonresident of Iowa and whose income from duty days in Iowa is less than \$1,000. See rule 701—48.1(422) ~~about filing Iowa composite returns.~~ Information on filing composite returns for tax years beginning on or after January 1, 2022, for nonresident members of professional athletic teams can be found in rule 701—405.9(422).

ITEM 2. Amend subrule 304.44(1) as follows:

304.44(1) *Sequencing of credit deductions.* The credits against computed tax set forth in Iowa Code sections 422.5, 422.8, 422.10 through 422.12C, 422.12N, and 422.110 shall be claimed in the following sequence:

a. to *ao.* No change.

ap. Estimated payments, payment with vouchers, composite tax credits, and withholding tax.

ITEM 3. Amend subrule 307.4(1), introductory paragraph, as follows:

307.4(1) *General rules.* Payers of Iowa income to nonresidents are required to withhold Iowa income tax and to remit the tax to the department on all payments of Iowa income to nonresidents ~~except payments of wages to nonresidents engaged in film production or television production described in subrule 46.4(5); income payments for agricultural commodities or products described in subrule 46.4(6); deferred compensation payments, pension, and annuity payments attributable to personal services in Iowa by nonresidents described in subrule 46.4(7); and partnership distributions from certain publicly traded partnerships described in subrule 46.4(8) as otherwise described in this rule.~~ Withholding agents should use the following methods and rates in withholding for nonresidents:

ITEM 4. Amend subrule 307.4(2) as follows:

307.4(2) *Income of nonresidents subject to withholding.* Listed below are various types of income paid to nonresidents which are subject to withholding tax. The list is for illustrative purposes only and is not deemed to be all-inclusive.

~~1.~~ a. Personal service, including salaries, wages, commissions and fees for personal service wholly performed within this state and such portions of similar income of nonresident traveling salespersons or agents as may be derived from services rendered in this state.

~~2.~~ b. Rents and royalties from real or personal property located within this state.

~~3.~~ c. Interest or dividends derived from securities or investments within this state, when such interests or dividends constitute income of any business, trade, profession or occupation carried on within this state and subject to taxation.

~~4.~~ d. Income derived from any business of a temporary nature carried on within this state by a nonresident, such as contracts for construction and similar contracts.

~~5.~~ e. ~~The distributive share of a nonresident beneficiary of an estate or trust, limited, however, to the portion thereof subject to Iowa income tax in the hands of the nonresident.~~

~~6.~~ f. Income derived from sources within this state by attorneys, physicians, engineers, accountants, and similar sources as compensation for services rendered to clients in this state.

~~7.~~ g. Compensation received by nonresident actors, singers, performers, entertainers, and wrestlers for performances in this state. See subrule ~~46.4(5)~~ 307.4(5) for an exception to this rule.

~~8.~~ h. ~~Income received by a nonresident partner or shareholder of a partnership or S corporation doing business in Iowa. See subrule 46.4(8) for the exemption from withholding for partnership distributions from certain publicly traded partnerships.~~

9. *g.* The Iowa gross income of a nonresident who is employed and receiving compensation for services shall include compensation for personal services which are rendered within this state. Compensation for personal services rendered by a nonresident wholly without the state is excluded from gross income of the nonresident even though the payment of such compensation may be made by a resident individual, partnership or corporation.

10. *h.* The gross income from commissions earned by a nonresident traveling salesperson, agent or other employee for services performed or sales made whose compensation depends directly on volume of business transacted by the nonresident, includes that proportion of the total compensation received which the volume of business or sales by the employee within this state bears to the total volume of business or sales within and without the state.

11. *i.* Payments made to landlords by agents, including elevator operators, for grain or other commodities which have been received by the landlord as rent constitute taxable income of the landlord when sold by the landlord. ~~See subrule 46.4(6) for~~ Subrule 307.5(6) contains information about the exemption from withholding on incomes paid to nonresidents for the sale of agricultural commodities or products.

12. *j.* Wages paid to nonresidents of Iowa who earn the compensation from regularly assigned duties in Iowa and one or more other states for a railway company or for a motor carrier are not taxable to Iowa. Pursuant to ~~the Amtrak Reauthorization and Improvement Act of 1990~~ 49 U.S.C. Section 11502, the nonresidents in this situation are subject only to the income tax laws of their states of residence. Thus, when an Iowa resident performs regularly assigned duties in two or more states for a railroad or a motor carrier, the only state income tax that should be withheld from the wages paid for these duties is Iowa income tax.

13. *k.* Wages paid to nonresidents of Iowa who earn compensation from regularly assigned duties in Iowa and one or more states for an airline company. In accordance with ~~Public Law 103-272 enacted by Congress~~ 49 U.S.C. Section 40116, airline employees who are nonresidents of Iowa are subject only to the income tax laws of their states of residence or the state in which they perform 50 percent or more of their duties.

14. *l.* Wages paid to nonresidents of Iowa who earn compensation from regularly assigned duties in Iowa for a merchant marine company. In accordance with ~~Public Law 106-489 enacted by Congress~~ 46 U.S.C. Section 11108, interstate waterway workers who are nonresidents of Iowa are subject only to the income tax laws of their states of residence.

ITEM 5. Rescind subrule 307.4(8) and adopt the following **new** subrule in lieu thereof:

307.4(8) *Exemption from withholding of a nonresident's distributive share of income from a pass-through entity.* For tax years beginning on or after January 1, 2022, a partnership, S corporation, estate, or trust is not required to withhold state income tax on a nonresident member's distributive share of Iowa-source income from the pass-through entity. Instead, pass-through entities are subject to the composite return requirements in 701—Chapter 405.

ITEM 6. Amend **701—Chapter 404**, title, as follows:

COMPOSITE RETURNS FOR TAX YEARS BEGINNING PRIOR TO JANUARY 1, 2022

ITEM 7. Adopt the following **new** rule 701—404.10(422):

701—404.10(422) Repeal—transition rule.

404.10(1) *In general.* Except as otherwise provided in subrule 404.10(2), this chapter has no application to any tax year of partners, members, shareholders, beneficiaries, or employees that begins on or after January 1, 2022. The department's administrative rules on composite returns for any tax year of a partnership, limited liability company, S corporation, estate, or trust that begins on or after January 1, 2022, are located in 701—Chapter 405.

404.10(2) *Special rule for fiscal year filers in tax year 2021.* For the tax year of a partnership, limited liability company, S corporation, estate, or trust that begins in calendar year 2021 and ends in calendar year 2022, the entity may elect or be required to file a Form IA 1040C and pay tax under this chapter

for income from that tax year that is reportable by nonresident partners, members, shareholders, or beneficiaries for their tax year beginning during calendar year 2022.

EXAMPLE: Partnership P is a fiscal year filer with a tax year that runs from July 1 to June 30. The majority of Partnership P's partners are individuals who file on a calendar-year basis, thus P is required to file the Form IA 1040C on a calendar-year basis. Partnership P may elect or be required to file a Form IA 1040C to report the Iowa-source income earned by the eligible nonresident partners during Partnership P's 2021 tax year that began on July 1, 2021, and ended on June 30, 2022.

This rule is intended to implement 2021 Iowa Acts, Senate File 608, division II.

ITEM 8. Adopt the following new 701—Chapter 405:

CHAPTER 405

COMPOSITE RETURNS FOR TAX YEARS BEGINNING ON OR AFTER JANUARY 1, 2022

701—405.1(422) Composite returns. For tax years beginning on or after January 1, 2022, a pass-through entity with one or more nonresident members for any period of time during the tax year shall file a composite return using the Iowa composite return (IA PTE-C) and pay Iowa income or franchise tax on behalf of all of its nonresident members, unless an exception in rule 701—405.5(422) applies. The IA 1040C, used to file composite returns under the former composite return law in tax years beginning before January 1, 2022, has been discontinued for tax years beginning on or after that date, except as provided in 701—subrule 404.10(2). Rules related to the former composite return law are located in 701—Chapter 404.

This rule is intended to implement Iowa Code section 422.16B.

701—405.2(422) Definitions. Unless otherwise indicated in this rule or required by the context, all words and phrases used in this chapter that are defined under Iowa Code section 422.16B shall have the same meaning as provided to them under that Iowa Code section. For the purposes of this chapter:

“*Composite return*” means the IA PTE-C Iowa composite return, which reports information about the Iowa-source income or other amounts credited or paid to each nonresident member of the pass-through entity, the amount of composite return tax due on behalf of each nonresident member of the pass-through entity, and such other information as the department may require.

“*Composite return tax*” means the Iowa income tax or franchise tax due by a pass-through entity on behalf of the pass-through entity's nonresident members.

“*Department*” means the department of revenue.

“*GovConnectIowa*” means the e-services portal of the department.

“*Tax year*” means the tax year of the pass-through entity filing the composite return.

This rule is intended to implement Iowa Code section 422.16B.

701—405.3(422) Filing and payment for pass-through entities.

405.3(1) Filing requirement. A pass-through entity that is required to file an Iowa partnership return (IA 1065), Iowa income tax return for S corporations (IA 1120S), or Iowa fiduciary return (IA 1041) and that has one or more nonresident members for any period of time during the tax year is required to file a composite return unless it meets the conditions for an exception outlined in subrule 405.5(1).

a. A pass-through entity with nonresident members must file a composite return and pay composite return tax on behalf of all nonresident members, except for the nonresident members the pass-through entity can demonstrate are exempt from the composite return requirement pursuant to subrule 405.5(2) or that have elected out of the composite return requirement pursuant to rule 701—405.6(422).

b. A pass-through entity must report all of its nonresident members, including nonresident members who are exempt from or who elect out of the composite return requirement, even though the pass-through entity is not required to pay composite return tax on behalf of those nonresident members. If all nonresident members are exempt from or elect out of the composite return requirement, the pass-through entity shall file a composite return reporting required information about all of its nonresident members and showing no composite return tax due.

c. Any pass-through entity required to file its Iowa partnership return (IA 1065), Iowa income tax return for S corporations (IA 1120S), or Iowa fiduciary return (IA 1041) for a tax year in an electronic format under Iowa Code section 422.14, 422.15, or 422.36 shall also be required to file its composite return for that tax year in an electronic format. Rule 701—8.7(422) contains more information about mandatory electronic filing requirements.

d. The composite return may be filed electronically by way of the Internal Revenue Service Modernized e-File (MeF) program, also known as federal/state electronic filing; mailed to Income Tax Return Processing, Iowa Department of Revenue, P.O. Box 9187, Des Moines, Iowa 50306-9187; or hand-delivered to the department's office in the Hoover State Office Building, First Floor, 1305 East Walnut Street, Des Moines, Iowa 50319.

405.3(2) *Due date of composite return—automatic extensions.* The composite return is due and must be filed on or before the due date of the pass-through entity's Iowa partnership return (IA 1065), Iowa income tax return for S corporations (IA 1120S), or fiduciary return (IA 1041), whichever is applicable. If the pass-through entity qualifies for and receives an extension to file its Iowa income tax return, it will also automatically qualify for and receive the same period of extension to file its composite return. Any composite return filed after the due date, including extensions, may be subject to the penalty for failure to timely file a return pursuant to rules 701—10.6(421) and 701—10.9(421) and subject to other applicable penalties provided by law.

405.3(3) *Due date of composite return tax.* The composite return tax is due by the original due date of the pass-through entity's Iowa partnership return (IA 1065), Iowa income tax return for S corporations (IA 1120S), or fiduciary return (IA 1041), whichever is applicable. The filing extension described in subrule 405.3(2) does not extend the due date for paying the composite return tax. Any unpaid composite return tax is subject to interest computed from the original due date of the pass-through entity's applicable income tax return. The pass-through entity may also be subject to the penalty for failure to timely pay tax due pursuant to rule 701—10.6(421) and other applicable penalties provided by law.

405.3(4) *Payment of estimated composite return tax not required.* Pass-through entities are not required under Iowa law to make payments of estimated composite return tax. However, if a pass-through entity desires to make an estimated or other advance payment of composite return tax liability, the pass-through entity may do so electronically on GovConnectIowa or by sending a check with a voucher available on GovConnectIowa.

405.3(5) *Amended composite returns—refund limitation.*

a. If the pass-through entity becomes aware that information was erroneously stated on the composite return, including but not limited to information about the nonresident members, Iowa-source income, or composite return tax due, the pass-through entity shall file an amended composite return, except as otherwise provided in this subrule.

b. If after filing an initial composite return for a tax year the pass-through entity is required to amend its Iowa income tax return in a manner that increases the amount of composite return tax due, or the pass-through entity discovers that nonresident members were erroneously excluded from the composite return, the pass-through entity shall file an amended composite return and pay the additional composite return tax that is due. Any additional composite return tax payment determined to be due after the filing of the initial composite return shall be made by the pass-through entity. An amended composite return and additional composite return tax payment is not required if the return changes are from a centralized partnership audit or an Iowa pass-through entity audit and included in a pass-through entity's election to pay on its owners' behalf pursuant to Iowa Code section 422.25A(5).

c. If after filing an initial composite return for a tax year the pass-through entity is required to amend its Iowa income tax return in a manner that only decreases the amount of Iowa-source income reportable to one or more nonresident owners, the pass-through entity is not required to file an amended composite return. A pass-through entity may not request a refund of composite return tax paid on behalf of a nonresident member after the initial composite tax return has been filed. When composite return tax is paid by a pass-through entity on behalf of a nonresident member, it is then treated as paid by

the nonresident member and any refund of an overpayment may only be requested by the nonresident member on that nonresident member's own income, franchise, or composite return.

This rule is intended to implement Iowa Code section 422.16B.

701—405.4(422) Nonresident member determination. The following rules shall apply in determining who is a nonresident member under Iowa Code section 422.16B(1) "a":

405.4(1) A partner, shareholder, or beneficiary of a pass-through entity shall be considered a nonresident member if any of the following were true for the entire period of time that person was a partner, shareholder, or beneficiary during that pass-through entity's tax year:

a. The person is an individual and was a nonresident of Iowa.

b. The person is a business entity and did not have a commercial domicile in Iowa as defined in Iowa Code section 422.32.

c. The person is an estate or trust and did not have a situs in Iowa.

405.4(2) Any partner, shareholder, or beneficiary whose state of residence, commercial domicile, or situs, as applicable, is not known by the pass-through entity shall be considered a nonresident member.

This rule is intended to implement Iowa Code section 422.16B.

701—405.5(422) Exceptions to the composite return requirement.

405.5(1) Filing and payment exceptions for pass-through entities. Pass-through entities are not required to file a composite return or pay composite return tax if the entity meets any of the following conditions for the tax year:

a. The pass-through entity is a publicly traded partnership that meets the requirements of Iowa Code section 422.16B(5) "a."

b. The pass-through entity is engaged in disaster or emergency-related work during a disaster response period and is not required to file a composite return as provided in Iowa Code section 29C.24.

c. The pass-through entity is prohibited under federal or state law from making distributions to members. This exception applies only for years in which distributions are prohibited under federal or state law. Contractual restrictions on distributions, such as loan covenants or organization documents, do not qualify an entity for this exception.

d. None of the pass-through entity's nonresident members have a positive amount of Iowa-source income from the pass-through entity. This exception does not apply if any nonresident member has a positive amount of Iowa-source income from the pass-through entity, even if the nonresident member has elected out of the composite return pursuant to rule 701—405.6(422) and no composite return tax is due.

e. Only for tax years beginning during calendar year 2022, the pass-through entity meets one of the following requirements:

(1) The pass-through entity is a financial institution subject to the franchise tax under Iowa Code section 422.60 and files an Iowa franchise return for financial institutions (IA 1120F) required under Iowa Code section 422.62 and pays any franchise tax shown due on that return.

(2) The pass-through entity wholly owns one or more financial institutions subject to the franchise tax under Iowa Code section 422.60 that are treated as disregarded entities for federal and Iowa income tax purposes, substantially all (at least 90 percent) of the pass-through entity's gross income for the tax year is also reportable income on those wholly owned financial institutions' Iowa franchise return for financial institutions (IA 1120F) required under Iowa Code section 422.62, and those wholly owned financial institutions file their Iowa franchise return for financial institutions (IA 1120F) and pay any franchise tax shown due on that return.

This exception does not apply to any pass-through entity for any tax year beginning on or after January 1, 2023.

405.5(2) Payment exceptions for nonresident members. A pass-through entity is not required to pay composite return tax on behalf of a particular nonresident member if that nonresident member meets any of the following conditions for the tax year:

a. The nonresident member is a publicly traded partnership that meets the requirements of Iowa Code section 422.16B(5) “a.”

b. The nonresident member is exempt from Iowa income tax under Iowa Code section 422.34(2), unless the Iowa-source income of the tax-exempt entity is unrelated business income.

c. The nonresident member is an insurance company exempt from Iowa income tax under Iowa Code section 422.34(1) and instead subject to the insurance companies tax under Iowa Code section 432.1, 432.2, 432A.1, 518.18, or 518A.35.

d. The nonresident member and the pass-through entity complete and sign the Nonresident Member Composite Agreement form for the tax year as described in rule 701—405.6(422).

This rule is intended to implement Iowa Code section 422.16B.

701—405.6(422) Election out of the composite return tax requirement.

405.6(1) *In general.* A nonresident member may elect to be excluded from a pass-through entity’s composite return unless prohibited from doing so by the department under subrule 405.6(2). Electing out of the composite return only relieves the pass-through entity of the requirement to pay composite return tax on behalf of that nonresident member. It does not relieve the pass-through entity of the requirement to report that nonresident member on a composite return. For a nonresident member to be excluded from the composite return tax payment, both the nonresident member and the pass-through entity must complete and sign the Nonresident Member Composite Agreement, available on the department’s website. The Nonresident Member Composite Agreement must be completed and signed by all parties prior to the pass-through entity’s composite return due date, including extensions. The Nonresident Member Composite Agreement is only valid for the tax year for which it is executed. The nonresident member and the pass-through entity must complete and sign a separate Nonresident Member Composite Agreement for each tax year in which the nonresident member seeks to be excluded from the composite return.

405.6(2) *Circumstances in which a pass-through entity or nonresident member may not elect out of the composite return requirement.*

a. The ability to elect out of the composite return is conditionally granted by the department based on the nonresident member’s promise to comply with the filing and payment requirements listed in subrule 405.6(3) and the pass-through entity’s compliance with Iowa tax law.

b. If information available to the department indicates that the pass-through entity has not complied with Iowa tax law, including but not limited to properly reporting or sourcing its income or other tax items within and without Iowa, the department may revoke the pass-through entity’s ability to enter into a Nonresident Member Composite Agreement with its nonresident members.

c. If information available to the department indicates that a nonresident member has not complied with the filing and payment requirements listed in subrule 405.6(3), the department may revoke the pass-through entity’s ability to enter into a Nonresident Member Composite Agreement with that particular nonresident member.

d. The pass-through entity will be notified in writing of a revocation under paragraph 405.6(2) “b” or “c,” and such revocation will take effect 30 days following the date on the revocation letter. The revocation will not affect any Nonresident Member Composite Agreement entered into prior to the effective date of the revocation. After such revocation, a pass-through entity will not be allowed to enter into a Nonresident Member Composite Agreement with the affected nonresident members without written permission from the department.

405.6(3) *Filing and payment requirements for a nonresident member electing out of composite return requirement.* To elect out of the composite return requirement, a nonresident member must agree to all of the following in the Nonresident Member Composite Agreement:

a. The nonresident member shall file an Iowa income or franchise tax return, unless such return is subject to a filing threshold and the nonresident member falls below that threshold and is not required to file.

b. The nonresident member shall timely pay all Iowa income or franchise tax related to the nonresident member's distributive share of Iowa-source income from the pass-through entity, including, if applicable, estimated tax payments and composite return tax payments.

c. The nonresident member shall acknowledge that the nonresident member is subject to personal jurisdiction in Iowa for the collection of Iowa income or franchise tax liability.

405.6(4) Retention of records. The signed Nonresident Member Composite Agreement is not required to be submitted with the composite return but shall be retained by the pass-through entity and submitted to the department upon request.

405.6(5) Liability for unpaid tax, penalty, and interest for a nonresident member electing out of the composite return requirement. A pass-through entity that enters into a Nonresident Member Composite Agreement with a nonresident member will remain jointly and severally liable for any unpaid composite return tax, penalty, and interest attributable to the electing nonresident member's distributive share of Iowa-source income from the pass-through entity. If the department determines that a nonresident member has failed to comply with the tax filing and payment requirements agreed to in subrule 405.6(3), it may collect the unpaid composite return tax, penalty, and interest directly from the pass-through entity.

This rule is intended to implement Iowa Code section 422.16B.

701—405.7(422) Determination of composite return tax.

405.7(1) Each nonresident member's distributive share of Iowa-source income from the pass-through entity shall be determined at the entity level in accordance with the Iowa statutes, administrative rules, and tax forms applicable to the pass-through entity's tax type, including provisions related to the allocation and apportionment of income.

405.7(2) A partner's Iowa-source income includes the amount of nonseparately stated income, separately stated income including guaranteed payments, and separately stated deductions, attributable to Iowa as properly reported on the partner's IA 1065 Schedule K-1. A shareholder's Iowa-source income includes the amount of nonseparately stated income, separately stated income, and separately stated deductions, attributable to Iowa as properly reported on the shareholder's IA 1120S Schedule K-1. A beneficiary's Iowa-source income includes the amount of distributable net income attributable to Iowa as properly reported on the beneficiary's IA 1041 Schedule K-1.

405.7(3) No net operating loss or other owner-level tax attribute modification, or reduction for Iowa tax credits, is allowed in the computation of each nonresident member's Iowa-source income for purposes of the composite return. To claim an owner-level tax attribute modification, or an Iowa tax credit, the nonresident member must file the nonresident member's own Iowa tax return.

405.7(4) If a nonresident member's Iowa-source income is a loss, that loss cannot be netted against the Iowa-source income of another nonresident member.

405.7(5) The composite return tax for each nonresident member is computed by multiplying the nonresident member's Iowa-source income, if positive, by the highest tax rate applicable to that nonresident member. C corporations, or tax-exempt entities with unrelated business income, will be taxed at the highest corporate tax rate in Iowa Code section 422.33. Financial institutions will be taxed at the franchise tax rate in Iowa Code section 422.63. Individuals, estates, trusts, partnerships, and S corporations (except those subject to the franchise tax) will be taxed at the highest individual tax rate in Iowa Code section 422.5A. The sum of the composite return tax for all nonresident members is the pass-through entity's total composite return tax liability.

This rule is intended to implement Iowa Code section 422.16B.

701—405.8(422) Filing for nonresident members—composite tax credits.

405.8(1) In general. Nonresident members included on a pass-through entity's composite return may still have an Iowa return filing requirement. The nonresident member shall receive a refundable composite tax credit for the composite return tax paid on the nonresident member's behalf by the pass-through entity. The nonresident member's composite tax credit shall be claimed for the same tax

year that the nonresident member's Iowa-source income from the pass-through entity is required to be reported on the nonresident member's Iowa income or franchise return.

405.8(2) Nonresident member—partnership. A nonresident member that is a partnership is required to file the Iowa partnership return (IA 1065). The partnership is also subject to the composite return requirements if it has one or more nonresident members for any period of time during the tax year or if it desires to claim a composite tax credit it received from another pass-through entity. The partnership shall claim its composite tax credit on its composite return. Subrule 405.8(4) contains information related to financial institutions organized as pass-through entities.

405.8(3) Nonresident member—S corporation. A nonresident member that is an S corporation is required to file the Iowa income tax return for S corporations (IA 1120S). The S corporation is also subject to the composite return requirements if it has one or more nonresident members for any period of time during the tax year or if it desires to claim a composite tax credit it received from another pass-through entity. The S corporation shall claim its composite tax credit on its composite return. Subrule 405.8(4) contains information related to financial institutions organized as pass-through entities.

405.8(4) Nonresident member—financial institution.

a. A nonresident member that is a financial institution as defined in Iowa Code section 422.61 is required to file the Iowa franchise return for financial institutions (IA 1120F). The financial institution shall claim its composite tax credit on its Iowa franchise return for financial institutions (IA 1120F).

b. If the nonresident financial institution is organized as a pass-through entity, it is also required to file the Iowa partnership return (IA 1065) or the Iowa income tax return for S corporations (IA 1120S), as applicable, and is subject to the composite return requirements if it has one or more nonresident members for any period of time during the tax year. In such instances, the financial institution may claim its composite tax credit on its Iowa franchise return for financial institutions (IA 1120F) or its composite return.

405.8(5) Nonresident members—C corporation or tax-exempt entity. A nonresident member that is a C corporation, or a tax-exempt entity with unrelated business income, is required to file the Iowa corporation income tax return (IA 1120). The entity shall claim its composite tax credit on its Iowa corporation income tax return (IA 1120).

405.8(6) Nonresident member—estate or trust. A nonresident member that is an estate or trust is required to file the Iowa fiduciary return (IA 1041) unless the estate's or trust's taxable income is below the Iowa return filing threshold in Iowa Code section 422.14. The estate or trust is also subject to the composite return requirement if its taxable income is above the Iowa return filing threshold in Iowa Code section 422.14 and if it has one or more nonresident members for any period of time during the tax year. The estate or trust may claim its composite tax credit on its Iowa fiduciary return (IA 1041) or its composite return.

405.8(7) Nonresident members—individuals. A nonresident member that is an individual is required to file the Iowa individual income tax return (IA 1040) unless the individual's income is below the Iowa return filing threshold in Iowa Code section 422.13, or unless the individual's distributive share of pass-through entity income included on one or more composite returns is the individual's only Iowa-source income. The individual shall claim the composite tax credit on the individual's Iowa individual income tax return (IA 1040).

This rule is intended to implement Iowa Code section 422.16B.

701—405.9(422) Composite returns for nonresidents who are not members of a pass-through entity.

405.9(1) The department may require that a composite return be filed under this chapter for nonresidents who are not members of a pass-through entity. The requirement may be set forth in this chapter for a category of persons or may be made directly in writing by the department to a specific person.

405.9(2) If a person who is not required to file a composite return under this chapter desires to do so for a group of nonresidents, the person shall request and receive permission from the department before filing the composite return. In order to be a valid request, the request must be in writing and must

include sufficient information about the person making the request, the nonresidents to be included in the composite return, and the reason for filing on a composite return basis to enable the department to evaluate the request and make a determination. Once a valid request is received, the department may request additional information. Written requests shall be mailed to Policy Bureau, Research and Policy Division, Iowa Department of Revenue, P.O. Box 14467, Des Moines, Iowa 50306-3467.

This rule is intended to implement Iowa Code section 422.16B.

ITEM 9. Amend subrule 501.12(1) as follows:

501.12(1) *Sequencing of credit deductions.* The credits against computed tax set forth in Iowa Code sections 422.33 and 422.110 shall be claimed in the following sequence.

a. to ae. No change.

af. Estimated tax and payment payments, payments with vouchers, and composite tax credits.

ITEM 10. Amend subrule 601.24(1) as follows:

601.24(1) *Sequencing of credit deductions.* The credits against computed tax set forth in Iowa Code section 422.60 shall be claimed in the following sequence.

a. to p. No change.

q. Estimated tax and payment payments, payments with vouchers, and composite tax credits.

ITEM 11. Amend subrule 700.4(9) as follows:

700.4(9) *Duties of the taxpayer.*

a. to c. No change.

d. ~~*Withholding agent—general rule*~~ *Composite return requirement.* The personal representative of a decedent's estate and the trustee of a trust shall ~~withhold Iowa income tax from a distribution of Iowa taxable income to beneficiaries who are nonresidents of Iowa~~ are subject to the composite return filing and tax payment obligations under Iowa Code section 422.16B and 701—Chapter 405 if the estate or trust has nonresident beneficiaries. ~~This withholding requirement applies to both Iowa and non-Iowa situs estates and trusts. See Iowa Code subsection 422.16(12) and 701—subrule 46.4(2), item “5,” for the duty to withhold. The amount of income tax to be withheld shall be computed either based on 5 percent of the taxable Iowa income distributed or according to tax tables provided by the department. See 701—subrule 46.3(3) for the required withholding form and return to be filed with the department.~~

e. ~~*Exception to the general rule.*~~ If a nonresident beneficiary of an estate or trust who is to receive a distribution of Iowa taxable income files with the department a nonresident declaration of estimated tax and pays the estimated tax on the income declared in full, 89.4(9) “d” does not apply to the amount of the income declared. A certificate of release from the duty to withhold will be issued to the withholding agent upon request. See Iowa Code sections 422.16(12) and 422.17 and 701—subrule 46.4(3) relating to the release certificate. In addition, an estimated payment of withholding can occur if a distribution is being made to a taxable beneficiary. An estimated payment of withholding should be based on 5 percent of the taxable Iowa income. It is the department's policy to allow estimated payments of withholding to be paid directly to the department.

f. ~~*Withholding not required.*~~ Withholding is not required from the distribution made by estates and trusts of Iowa taxable income to beneficiaries who are residents of Iowa.

g. ~~*Beneficiary's share of income, deductions and credits.*~~ After the final distribution of income for the taxable year, but prior to the date for filing a beneficiary's individual income tax return, the personal representative of an estate and the trustee of a trust shall furnish each beneficiary receiving a distribution from an estate or trust a written statement specifying the amount and types of income subject to Iowa tax and the kinds and amounts of the deductions and credits against the tax. A copy of the federal schedule K-1, Form 1041, adapted to reflect Iowa taxable income, may be substituted in lieu of the statement.

h. ~~*f. Liability of a withholding agent personal representative and trustee.*~~ A withholding agent is personal representative of a decedent's estate and the trustee of a trust shall be personally liable for the amount of the Iowa composite tax required to be withheld paid under Iowa Code subsection 422.16(12) section 422.16B and 701—Chapter 405 if the income tax liability of a nonresident beneficiary which

~~is attributable to the distribution composite tax liability attributable to a nonresident beneficiary is not paid and, in addition, is personally liable for any penalty and interest due if the tax required to be withheld is not paid to the department within the time prescribed by law. See rules 701—44.1(422) to 701—44.4(422) for the application and computation of penalty and interest on income tax required to be withheld.~~

ITEM 12. Amend paragraph **700.8(7)“p”** as follows:

p. Nonresident aliens—sales of Iowa real estate. ~~For sales and exchanges occurring after June 18, 1980, nonresident~~ Nonresident aliens and estates and trusts with a situs outside the United States must include the gain from the sale or exchange of Iowa real estate as taxable income, even though the real estate was not effectively connected with a trade or business carried on in the United States. See Public Law 96-499. Any gain paid or distributed to a nonresident alien or an estate or trust with a situs outside the United States is subject to Iowa income ~~tax withholding~~ composite tax, unless the gain has been previously accumulated and any tax due paid. ~~See 89.4(9)“d” Paragraph 700.4(9)“d” and 701—subrule 46.4(2), item “5,” for the duty to withhold Iowa income tax from 701—Chapter 405 contain more information on the requirement to pay Iowa composite tax on distributions to nonresident beneficiaries and individuals.~~

ITEM 13. Amend subrule 700.10(3) as follows:

700.10(3) Requirements for a certificate of acquittance. The issuance of an income tax certificate of acquittance is dependent upon full payment of the income tax liability of the estate or trust for the period of administration. This includes the obligation to ~~withhold income~~ pay composite return tax on distributions ~~to of nonresident beneficiaries~~ beneficiaries’ Iowa-source income from the estate or trust. In the case of an estate, the income tax liability of the decedent ~~for both for~~ for prior years and the year of death must be paid to the extent of the probate property subject to the jurisdiction of the court. The probate property must be applied to the payment of the decedent’s income tax liability according to the order of payment of an estate’s debts and charges specified in Iowa Code section 633.425. If the probate property of the estate is insufficient to pay the decedent’s income tax obligation in full, the department, in lieu of a certificate of acquittance, shall issue a certificate stating that the probate property is insufficient to pay the decedent’s income tax liability and that the department does not object to the closure of the estate. In the event the decedent’s income tax obligation is not paid in full, the closure of the decedent’s estate does not release any other person who is liable to pay the decedent’s income tax obligation.

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