

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapters 401 and 402
“Partnerships; S Corporations”

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14

State or federal law(s) implemented by the rulemaking: Iowa Code sections 422.7, 422.15, 422.21, and 422.35

Public Hearing

A public hearing at which persons may present their views orally or in writing will be held as follows:

November 18, 2026
9 to 10 a.m.

Via videoconference call:
meet.google.com/sbm-ihix-ere

Public Comment

Any interested person may submit written or oral comments concerning this Regulatory Analysis, which must be received by the Department of Revenue no later than 4:30 p.m. on the date of the public hearing. Comments should be directed to:

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Purpose and Summary

The purpose of this proposed rulemaking is to rescind Chapter 401 and replace it with a new chapter that discusses partnerships. The purpose of this rulemaking is also to move content from 701—subrule 501.1(5) to Chapter 402. The rulemaking removes unnecessary language from Chapter 401 and 701—subrule 501.1(5) as required under Executive Order 10. The proposed rulemaking helps taxpayers understand their obligations for filing returns for partnerships and S corporations.

Analysis of Impact

1. Persons affected by the proposed rulemaking:

• **Classes of persons that will bear the costs of the proposed rulemaking:**

The proposed rulemaking does not create costs for any classes of persons.

• **Classes of persons that will benefit from the proposed rulemaking:**

Taxpayers that are required to file returns for partnerships and S corporations and tax practitioners will benefit from the proposed rulemaking.

2. Impact of the proposed rulemaking, economic or otherwise, including the nature and amount of all the different kinds of costs that would be incurred:

• **Quantitative description of impact:**

This rulemaking has no economic impact beyond that of the statutes it implements.

- **Qualitative description of impact:**

This rulemaking provides information to taxpayers that are required to file returns for partnerships and S corporations.

3. **Costs to the State:**

- **Implementation and enforcement costs borne by the agency or any other agency:**

There is no cost to the State from this proposed rulemaking beyond that of the statute it implements. There is no known cost to any other agency.

- **Anticipated effect on State revenues:**

There is no anticipated effect on State revenues from this proposed rulemaking. It only provides guidance on the requirements in statute. The guidance could help taxpayers meet their filing obligations more easily, which would reduce any impact on State revenues associated with enforcement.

4. **Comparison of the costs and benefits of the proposed rulemaking to the costs and benefits of inaction:**

Without guidance from the Department on these requirements, taxpayers that are partnerships and S corporations operating in Iowa may not comply with filing obligations correctly or may spend time and money requesting guidance from the Department.

5. **Determination whether less costly methods or less intrusive methods exist for achieving the purpose of the proposed rulemaking:**

There are no known less costly or intrusive methods.

6. **Alternative methods considered by the agency:**

- **Description of any alternative methods that were seriously considered by the agency:**

The only alternative would be not providing guidance at all or providing guidance on a case-by-case, informal basis.

- **Reasons why alternative methods were rejected in favor of the proposed rulemaking:**

Providing no guidance or providing guidance on a case-by-case, informal basis would likely result in increased costs to the Department and taxpayers through increased questions or requests for guidance and could result in inconsistent guidance given over time.

Small Business Impact

If the rulemaking will have a substantial impact on small business, include a discussion of whether it would be feasible and practicable to do any of the following to reduce the impact of the rulemaking on small business:

- Establish less stringent compliance or reporting requirements in the rulemaking for small business.
- Establish less stringent schedules or deadlines in the rulemaking for compliance or reporting requirements for small business.
- Consolidate or simplify the rulemaking's compliance or reporting requirements for small business.
- Establish performance standards to replace design or operational standards in the rulemaking for small business.
- Exempt small business from any or all requirements of the rulemaking.

If legal and feasible, how does the rulemaking use a method discussed above to reduce the substantial impact on small business?

The requirements associated with this rulemaking are imposed by the Iowa Code, and the Department has no authority to make exceptions not already contemplated by the law for small businesses.

Text of Proposed Rulemaking

ITEM 1. Rescind 701—Chapter 401 and adopt the following new chapter in lieu thereof:

CHAPTER 401
PARTNERSHIPS

701—401.1(422) General. Every partnership or limited liability company required to file a partnership return of income for federal tax purposes doing business in this state or deriving income from sources within this state is required to file as a partnership for Iowa purposes. Rule 701—501.1(422) provides more information on specific criteria related to doing business in Iowa or deriving income from real, tangible or intangible property located or having a situs in Iowa. Iowa follows the federal Treasury check-the-box regulation 26 CFR §301.7701-3 for determination of the tax status of partnerships or limited liability companies, including single-member limited liability companies.

This rule is intended to implement Iowa Code section 422.15.

701—401.2(422) Partnership returns. Every partnership doing business in Iowa or deriving income from real, tangible or intangible property located or having a situs in Iowa must make a return of income regardless of the amount of income or loss and regardless of the residence of the partners. The return shall be made on the proper form and signed by one of the partners. The return shall be made on the same period basis, calendar or fiscal, as the partnership accounts are kept, irrespective of whether the partners are reporting their incomes on a different period basis. The return shall be filed with the department on or before the last day of the fourth month after the expiration of the tax year.

This rule is intended to implement Iowa Code sections 422.15 and 422.21.

701—401.3(422) Distribution and taxation of partnership income.

401.3(1) A partnership is not subject to tax unless the partnership makes an election under Iowa Code section 422.16C, but the members of a partnership are subject to tax, except as otherwise provided in 701—subrule 303.1(6) respecting nonresident members, upon their distributive shares of the net income of the partnership, whether distributed to the members or not.

401.3(2) If the result of the partnership operation is a net loss (i.e., excess of allowable deductions from gross income), the loss may be deducted by the members (except as otherwise provided respecting nonresident members) in the same proportion that net income would have been taxable to the members.

401.3(3) If the member reports income on the same taxable year basis as that of the partnership, the distributive share of the net income (or loss) of the partnership for the taxable year must be included in or deducted from gross income on the return for that year.

401.3(4) If the taxable year of the member is different from that of the partnership, distributive shares must be included in, or the proportion of the loss deducted from, gross income for the year in which the taxable year of the partnership ends.

401.3(5) Residents of Iowa must report in total their distributive share of partnership income or loss on their Iowa income tax return. Nonresidents must report, for income tax purposes, their distributive share of partnership income or loss as determined under 701—subrule 303.1(7).

This rule is intended to implement Iowa Code sections 422.7 and 422.15.

ITEM 2. Rescind 701—Chapter 402 and adopt the following new chapter in lieu thereof:

CHAPTER 402
S CORPORATIONS

701—402.1(422) Taxation of S corporations, domestic international sales corporations, and real estate investment trusts. Certain corporations and other types of entities that are taxable as corporations for federal purposes may by federal election and qualification have a portion or all of their income taxable to the shareholders or the beneficiaries.

402.1(1) Generally, Iowa follows the federal provisions (with adjustments provided by Iowa law) for determining the amount of income and to whom the income is taxable. The entity's portion of the net income that is taxable as corporation net income for federal purposes is generally also taxable as Iowa corporation income (with adjustments as provided by Iowa law), and the shareholders or beneficiaries will report on their Iowa returns their share of the organization's income reportable for federal purposes as shareholder income (with adjustments provided by Iowa law).

a. Examples of entities that may avail themselves of pass-through provisions for taxation of at least part of their net income are:

- (1) Real estate investment trusts.
- (2) Small business corporations electing to file under Internal Revenue Code (IRC) Sections 1371 through 1378.
- (3) Domestic international sales corporations as authorized under IRC Sections 991 through 997.
- (4) Certain types of cooperatives.
- (5) Regulated investment companies.

b. Nonresident shareholders or beneficiaries are required to report their distributive share of said income reasonably attributable to Iowa sources. Schedules shall be filed with the individual's return showing the computation of the income attributable to Iowa sources and the computation of the nonresident taxpayer's distributive share. Entities with a nonresident beneficiary or shareholder shall include a schedule in the return computing the amount of income as determined under 701—Chapter 503. It will be the responsibility of the entity to make the apportionment of the income and supply the nonresident taxpayer with information regarding the nonresident taxpayer's Iowa taxable income.

c. Iowa recognizes the federal election to treat subsidiaries of a parent corporation that has elected S corporation status as qualified subchapter S subsidiaries (QSSSs). To the extent that, for federal income tax purposes, the incomes and expenses of the QSSSs are combined with the parent's income and expenses, the incomes and expenses must be combined for Iowa tax purposes.

402.1(2) S corporations that are subject to tax on built-in gains under IRC Section 1374 or passive investment income under IRC Section 1375 are subject to Iowa corporation income tax on this income to the extent such income and gains are received from business carried on in Iowa or from sources in Iowa.

a. The starting point for computing the Iowa tax on built-in gains is the amount of built-in gains subject to federal tax after considering the federal income limitation. The starting point for computing the passive investment income subject to Iowa income tax is the amount of passive investment income subject to federal tax.

b. The allocation and apportionment rules of 701—Chapter 503 apply to nonresident shareholders if the S corporation is carrying on business within and without Iowa.

c. Any net operating loss carryforward arising in a taxable year beginning prior to January 1, 2023, for which the corporation was a C corporation shall be allowed as a deduction against the net recognized built-in gain or passive investment income of the S corporation for the taxable year. For purposes of determining the amount of any such loss that may be carried to any of the 20 subsequent taxable years, after the year of the net operating loss, the amount of the net recognized built-in gain shall be treated as taxable income.

d. Except for estimated and other advance tax payments and any credit carryforward under Iowa Code section 422.33 arising in a taxable year for which the corporation was a C corporation, no credits shall be allowed against the built-in gains tax or the tax on capital gains or passive investment income.

This rule is intended to implement Iowa Code section 422.35.