

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapter 403
“Apportionment of Income for Resident Shareholders of S Corporations”

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14 and 422.8
State or federal law(s) implemented by the rulemaking: Iowa Code sections 422.5 and 422.8

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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Department of Revenue
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P.O. Box 10457
Des Moines, Iowa 50306
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Purpose and Summary

The purpose of this proposed rulemaking is to rescind Chapter 403 and replace it with a new chapter that discusses the apportionment of income earned by resident shareholders of S corporations. The rulemaking removes unnecessary and outdated language from Chapter 403 as required under Executive Order 10. The proposed rulemaking helps resident shareholders of S corporations doing business within and without Iowa understand how to calculate the S corporation apportionment tax credit.

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 electing to apportion their income received from S corporations doing business within and without Iowa 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 electing to apportion their income received from S corporations doing business within and without Iowa.

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 properly calculate their S corporation apportionment credit, which would reduce any impact on State revenues associated with education and 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 electing to apportion their income received from S corporations may not properly comply with the tax credit calculation 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 to provide no guidance at all or to provide guidance on a case-by-case, informal basis.

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

Not providing 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 these rules 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 403 and adopt the following new chapter in lieu thereof:

CHAPTER 403

APPORTIONMENT OF INCOME FOR RESIDENT SHAREHOLDERS OF S CORPORATIONS

701—403.1(422) Apportionment of income for resident shareholders of S corporations.

403.1(1) Resident shareholders of all S corporations that carry on business within and without Iowa may, at their election, determine the S corporation income allocable to sources within Iowa by allocation and apportionment of the S corporation income. The criteria to determine whether the S corporation is carrying on business within and without Iowa is set forth in 701—subrule 503.1(3).

403.1(2) A shareholder in an S corporation that carries on business within and without Iowa that has elected to apportion income and then elects not to apportion income shall not reelect to apportion income for three tax years immediately following the first tax year in which the shareholder elected not to apportion income unless the director consents to the election.

This rule is intended to implement Iowa Code section 422.5.

701—403.2(422) Distributions.

403.2(1) Distributions from income not previously taxed by Iowa include the amount of all cash distributions and the fair market value of all property distributions made during the year, except as follows:

a. Distributions from income not subject to Iowa tax due to exclusion under Iowa Code section 422.7 (i.e., interest from federal securities or certain securities issued by Iowa). All distributions for a year shall be deemed to be made proportionally from income subject to Iowa tax and from income not subject to Iowa tax. Distributions from income apportioned outside of Iowa shall not be deemed to be made from income not subject to Iowa tax.

b. Distributions from income previously taxed by Iowa for a year in which the S corporation was a C corporation and that is taxed as a dividend or capital gain for federal income tax purposes.

c. Distributions from income previously taxed by Iowa for a year prior to the first tax year the resident shareholder elected to apportion income within and without Iowa.

d. Distributions paid from income for which the taxpayer can prove that Iowa tax has been previously paid. Any distributions paid from income apportioned outside of Iowa for tax years in which the resident shareholder elected to apportion income within and without Iowa will be considered distributions for which Iowa tax has not been previously paid and cannot be excluded for purposes of this rule.

403.2(2) For purposes of this rule, a distribution is taken into account on the date the corporation makes the distribution, regardless of when the distribution is treated as received by the shareholder. Distributions shall initially be deemed to have come from current-year income of the S corporation. If distributions during a year exceed the current income of the S corporation, any excess distributions shall be considered to have come first from the immediately preceding year's income of the S corporation, then from each preceding year's income of the S corporation in reverse chronological order, then in accordance with the ordering rules set forth in Internal Revenue Code (IRC) Section 1368 and the regulations thereunder.

EXAMPLE: An S corporation earned income of \$20,000 in 2024, income of \$30,000 in 2025 and income of \$40,000 in 2026. The S corporation made no distributions during 2024 and 2025 and made distributions of \$75,000 during 2026. The distributions will come first from the \$40,000 income earned in 2026. The excess distributions of \$35,000 will come first from the \$30,000 income earned during 2025, and the remaining \$5,000 will come from the income earned during 2024.

This rule is intended to implement Iowa Code section 422.8.

701—403.3(422) Income allocable to Iowa. To determine the amount of income allocable to Iowa from an electing S corporation, apply the allocation and apportionment rules in 701—Chapter 503.

This rule is intended to implement Iowa Code section 422.8.

701—403.4(422) Credit for taxes paid to another state. If a taxpayer elects to take advantage of the apportionment provisions for a resident shareholder of an S corporation, then the taxpayer cannot claim a credit against Iowa income tax for income taxes or taxes measured by income paid to another state or foreign country on the S corporation income. A taxpayer may claim a credit against Iowa income tax for income taxes or taxes measured by income paid to another state or foreign country on income other than S corporation income that may be earned in the tax year.

This rule is intended to implement Iowa Code section 422.8.

701—403.5(422) Example. The taxpayers are a married couple who have two dependent children. Their income consists of the one spouse's wages of \$50,000, rental loss of \$-5,000; the other spouse's S corporation income of \$500,000, and joint interest income of \$35,000. They have itemized deductions of \$60,000 and an out-of-state tax credit of \$1,150 on the S corporation income. The actual cash distribution from the S corporation was \$289,840, none of which has been previously taxed by Iowa. Federal income tax paid during the year totals \$191,214. The S corporation carries on business within and without Iowa with 10 percent of its sales in Iowa.

Wages	\$50,000
S corporation income	500,000
Interest	35,000
Rent	<u>(5,000)</u>
Total income	\$580,000
Less itemized deductions	<u>(60,000)</u>
Taxable income	\$520,000
Tax	\$19,760
Less personal credits two spouses and two dependents	<u>(160)</u>
Subtotal	\$19,600
Less out-of-state tax credit	<u>(1,150)</u>
Iowa individual tax	\$18,450
<u>Computation of credit</u>	
Total income	\$580,000
Less S corporation income	<u>(500,000)</u>
Subtotal	\$80,000
Add the greater of cash distributions not previously taxed, \$289,840 less 100% of federal taxes on S corporation income of \$164,840 = \$125,000, or income attributable to Iowa sources = \$50,000	
	<u>125,000</u>
Income attributable to Iowa sources	\$205,000
Total income	\$580,000
Taxable percentage	35.3449%
Iowa individual tax before credit	\$19,600
Credit percentage	<u>64.6551%</u>
S corporation tax credit	\$12,672

Computation of 100 percent of federal income tax attributable to S corporation income: $\$191,214 \times \$500,000 / \$580,000 = \$164,840$.

Computation of percent of income attributable to Iowa sources: $100 \times \$205,000 / \$580,000 = 35.3449\%$.

Computation of percent of income attributable to non-Iowa sources: $100\% - 35.3449\% = 64.6551\%$.

This rule is intended to implement Iowa Code section 422.8.