

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapters 404 and 405
“Composite Returns”

Iowa Code section(s) or chapter(s) authorizing rulemaking: 422.16B

State or federal law(s) implemented by the rulemaking: Iowa Code section 422.16B

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
Hoover State Office Building
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 404 and to rescind and adopt a new Chapter 405 that relates to the requirements of composite returns. The rulemaking rescinds Chapter 404, which is no longer applicable, and removes unnecessary language from Chapter 405 as required under Executive Order 10. The proposed rulemaking helps taxpayers understand their obligations for composite return tax and clarifies the requirements for composite returns.

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 composite returns and remit composite return tax and taxpayers that can claim composite tax credits 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 legislation it implements.

- **Qualitative description of impact:**

This rulemaking provides information to taxpayers that are required to file composite returns and taxpayers who can claim composite tax credits.

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 obligations more easily, which would reduce any impact on State revenues from enforcement of the requirements.

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 subject to the composite return requirements and taxpayers who are permitted to claim composite returns may do so incorrectly 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 providing no 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:**

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 and reserve **701—Chapter 404.**

ITEM 2. Rescind 701—Chapter 405 and adopt the following new chapter in lieu thereof:

CHAPTER 405
COMPOSITE RETURNS

701—405.1(422) Composite returns. 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.

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 defined in Iowa Code section 422.16B have the same meaning when used in this chapter. For the purposes of this chapter:

“*Composite return*” means the IA PTE-C Iowa composite return that 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.

“*Iowa income tax return*” means the pass-through entity’s IA 1065 Iowa partnership return, the IA 1120S Iowa income tax return for S corporations, or the IA 1041 Iowa fiduciary return, whichever is applicable.

“*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 a pass-through entity Iowa income tax return 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 must be filed as instructed on the return.

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 income tax return. 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 Iowa Code section 421.27 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 income tax return. 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 income tax return. The pass-through entity may also be subject to the penalty for failure to timely pay tax due pursuant to Iowa Code section 421.27 and other applicable penalties provided by law.

405.3(4) *Payment of estimated composite return tax not required.* Pass-through entities are not required 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 cannot 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. 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.

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 premiums 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 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 prior to the pass-through entity’s

composite return due date including extensions. The Nonresident Member Composite Agreement is available on the department's website. The Nonresident Member Composite Agreement is only valid for the tax year for which it is executed, and a separate Nonresident Member Composite Agreement must be executed 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 cannot 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 files 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 timely pays 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 acknowledges 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 individual tax rate in Iowa Code section 422.5. 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 can claim its composite tax credit on its partnership return or 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 can claim its composite tax credit on its S corporation return or 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 can 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. 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 member—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 can 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 member—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 can 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.