

CHAPTER 403  
APPORTIONMENT OF INCOME FOR RESIDENT  
SHAREHOLDERS OF S CORPORATIONS

[Prior to 11/2/22, see Revenue Department[701] Ch 50]

Chapter rescission date pursuant to Iowa Code section 17A.7: 1/1/28

**701—403.1(422) Apportionment of income for resident shareholders of S corporations.** For tax years beginning on or after January 1, 1998, resident shareholders of all S corporations which 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. For tax years beginning on or after January 1, 2013, estates and trusts with a situs in Iowa which are shareholders in S corporations which carry on business within and without Iowa can take advantage of these apportionment provisions. The criteria to determine whether the S corporation is carrying on business within and without Iowa is set forth in 701—subrule 503.1(4).

For tax years beginning on or after January 1, 1997, a shareholder in an S corporation which carries on business within and without Iowa which 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 of revenue consents to the election.

This rule is intended to implement Iowa Code section 422.5, subsection 1, paragraph “j,” as amended by 2013 Iowa Acts, Senate File 452.

[ARC 7761B, IAB 5/6/09, effective 6/10/09; ARC 1102C, IAB 10/16/13, effective 11/20/13; Editorial change: IAC Supplement 11/2/22; Editorial change: IAC Supplement 10/18/23]

**701—403.2** Reserved.

**701—403.3(422) Distributions.** 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:

1. 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). For purposes hereof, 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.

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

3. 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.

4. Distributions treated as a return of capital for federal income tax purposes for tax years beginning prior to January 1, 2004.

5. For tax years beginning on or after January 1, 2004, any 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.

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 first be deemed made from current year income of the S corporation to the extent thereof. If distributions during a year exceed the current income of the S corporation, any excess distributions shall be considered made first from the immediately preceding year income of the S corporation, and then to each preceding year income of the S corporation in reverse chronological order, and then in accordance with the ordering rules set forth in Section 1368 of the Internal Revenue Code and the regulations thereunder.

EXAMPLE: An S corporation earned income of \$20,000 in 2002, income of \$30,000 in 2003 and income of \$40,000 in 2004. The S corporation made no distributions during 2002 and 2003 and made distributions of \$75,000 during 2004. The distributions will come first from the \$40,000 income earned in 2004. The excess distributions of \$35,000 will come first from the \$30,000 income earned during 2003, and the remaining \$5,000 will come from the income earned during 2002.

This rule is intended to implement Iowa Code section 422.8, subsection 2.

[Editorial change: IAC Supplement 11/2/22]

**701—403.4(422) Computation of net S corporation income.** After making the adjustments in Iowa Code section 422.35, net S corporation income is computed by adding to or subtracting from the S corporation's ordinary income (loss) from a trade or business those items of income, losses, and expenses that flow directly to the shareholder whose separate treatment could affect the tax liability of the shareholder. In computing the amounts of income, losses, and expenses that flow directly to the shareholder, these items of income, losses, and expenses, except for interest exempt from federal income tax and itemized deductions for high-income individuals, must be reduced proportionately to the amount that the sum of all like amounts of income, losses, and expenses are reduced for federal income tax computations.

This rule is intended to implement Iowa Code section 422.8, subsection 2, as amended by 1996 Iowa Acts, chapter 1197.

[Editorial change: IAC Supplement 11/2/22]

**701—403.5(422) Computation of federal tax on S corporation income.** The amount of federal income tax related to the items of income, losses, and expenses from an S corporation is to be computed by dividing the sum of the items of income, losses, and expenses by federal adjusted gross income, and the result multiplied by the sum of the federal income tax and the federal alternative minimum tax. This resulting tax figure is to be reduced by the nonrefundable federal tax credits relating to the S corporation income which are a reduction in tax rather than a payment of tax. Credits that are deemed to be a payment of tax include, but are not limited to, backup withholding on interest, dividends and other types of income, and credit for motor vehicle fuel taxes.

For tax periods beginning prior to January 1, 2002, the distribution received from the S corporation is reduced by 50 percent of the federal tax paid by the shareholder on the S corporation income. For tax periods beginning on or after January 1, 2002, the distribution received from the S corporation is reduced by 100 percent of the federal tax paid by the shareholder on the S corporation income.

This rule is intended to implement Iowa Code section 422.8, subsection 2, as amended by 2002 Iowa Acts, House File 2078.

[Editorial change: IAC Supplement 11/2/22]

**701—403.6(422) Income allocable to Iowa.** In order 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, subsection 2, as amended by 1996 Iowa Acts, chapter 1197.

[Editorial change: IAC Supplement 11/2/22; Editorial change: IAC Supplement 10/18/23]

**701—403.7(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 may not take 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.

[ARC 8605B, IAB 3/10/10, effective 4/14/10; Editorial change: IAC Supplement 11/2/22]

**701—403.8 and 403.9** Reserved.

**701—403.10(422) Example for tax periods beginning on or after January 1, 2002.**

EXAMPLE. The following example is based on the following facts. The taxpayers are a husband and wife who have two dependent children. Their income consists of husband’s wages of \$50,000; rental loss (\$5,000); wife’s S corporation income of \$500,000; joint interest income of \$35,000. They have Iowa itemized deductions of \$20,000, 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 is a value-added corporation which carries on business within and without Iowa with 10 percent of its sales in Iowa.

*a. Computation of tax on a joint return basis.*

Wages	\$50,000
S corporation income	500,000
Interest	35,000
Rent	<u>(5,000)</u>
Total income	\$580,000
Less federal tax deduction	<u>(191,214)</u>
Subtotal	\$388,786
Less itemized deductions	<u>(20,000)</u>
Taxable income	\$368,786
Tax	\$31,696
Less personal credits husband & wife & two dependents	<u>(160)</u>
Subtotal	\$31,536
Less out-of-state tax credit	<u>(1,150)</u>
Iowa individual tax	\$30,386
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Computation of credit	
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	\$31,696
Credit percentage	<u>64.6551%</u>
Subtotal	\$20,493
Less out-of-state tax credit	<u>(1,150)</u>
S corporation tax credit	\$19,343

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:  $100 - 35.3449\% = 64.6551\%$ .

*b. Computation on a separate filing on a combined return basis.*

	Spouse	Taxpayer
Wages	\$50,000	-0-
S corporation income	-0-	\$500,000
Interest	17,500	17,500
Rent	<u>(5,000)</u>	<u>-0-</u>
Total income	\$62,500	\$517,500

Less federal tax deduction	(20,613)	(170,601)
Subtotal	\$41,887	\$346,899
Less itemized deductions	(2,156)	(17,844)
Taxable income	\$39,731	\$329,055
Tax	\$2,293	\$28,128
Less personal credits taxpayer & spouse & two dependents	(120)	(40)
Subtotal	\$2,173	\$28,088
Less out-of-state tax credit	(-0-)	(1,150)
Iowa individual tax	\$2,173	\$26,938
<b>Computation of credit</b>		
Total income	\$517,500	
Less S corporation income	(500,000)	
Subtotal	\$17,500	
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	125,000	
Income attributable to Iowa sources	\$142,500	
Total income	\$517,500	
Taxable percentage	27.5362%	
Iowa individual tax before credit	\$28,128	
Credit percentage	72.4638%	
Subtotal	\$20,383	
Less out-of-state tax credit	(1,150)	
S corporation tax credit	\$19,233	

Taxpayer's computation of 100 percent of federal income tax attributable to S corporation income:  
 $\$170,601 \times \$500,000 / \$517,500 = \$164,832$ .

Taxpayer's computation of percent of income attributable to Iowa sources:  $100 \times \$142,500 / \$517,500 = 27.5362\%$ .

Taxpayer's computation of percent of income attributable to non-Iowa sources:  $100 - 27.5362\% = 72.4638\%$ .

This rule is intended to implement Iowa Code section 422.8, subsection 2, paragraph "b."

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