

701—304.6(422) Out-of-state tax credits.

304.6(1) Definitions. For purposes of this rule:

“*Foreign country*” means any country, other than the United States, and any political subdivision of that country.

“*Income tax*” means any direct tax imposed upon a taxpayer and measured by the taxpayer’s income for a specified period of time. The out-of-state jurisdiction’s characterization of the tax is not controlling in the department’s determination of whether a tax is an income tax. Fees, penalty, and interest paid in connection with an income tax do not qualify. For purposes of this rule, the term “income tax” does not include a minimum tax imposed on preference items.

“*Pass-through entity*” means an entity taxed as a partnership for federal tax purposes, an S corporation, an estate, or a trust other than grantor trusts.

“*Regulated investment company*” means any domestic corporation that meets the requirements of Section 851 of the Internal Revenue Code and that has made a valid election under Section 853 of the Internal Revenue Code to have its shareholders’ pro rata share of entity-level income tax paid by the electing corporation be deemed to have been paid by its shareholders. The term “regulated investment company” includes, but is not limited to, a mutual fund.

“*State*” means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any political subdivision thereof.

“*Tiered owner*” means an owner or beneficiary of a pass-through entity that is itself a pass-through entity.

304.6(2) General application.

a. Residents. Iowa residents, including part-year residents, are allowed an out-of-state tax credit against the resident’s Iowa income tax liability for income taxes owed and paid by the resident to another state or foreign country on income for which all of the following are true:

(1) The income was derived from sources within the other state or foreign country. In determining whether income is derived from sources within that other state or foreign country, Iowa statutes and rules on the sourcing of a nonresident’s income shall govern.

(2) The income is subject to Iowa income tax. Income tax imposed by another state or foreign country on income that is not subject to Iowa income tax does not qualify for the credit.

(3) The income was earned while the taxpayer was an Iowa resident and is included on the resident’s Iowa income tax return. The credit is allowable only if the taxpayer files an Iowa income tax return as a resident or part-year resident.

b. Nonresidents. Nonresidents of Iowa shall not claim the out-of-state tax credit.

304.6(3) Rule for pass-through entities.

a. Direct owners.

(1) If the Iowa resident is a direct partner, shareholder, or beneficiary of a pass-through entity that owed and paid entity-level income tax, or income tax on a composite return basis, to another state or foreign country on income derived from sources in that state or foreign country, the resident is allowed to treat the resident’s pro rata share of that income tax as paid by the resident for purposes of the out-of-state tax credit, provided the resident’s pro rata share of that income flows through to the resident and meets the requirements of paragraph 304.6(2)“a.”

(2) The entity-level income tax or composite income tax paid to the other state or foreign country is the net state or foreign income tax actually owed and paid for the tax year on income taxed by that state or foreign country, as properly computed on the pass-through entity’s income tax return or composite return (not a withholding return) in the other state or foreign country after reduction for all nonrefundable credits provided to the pass-through entity. Paragraph 304.6(6)“b” provides an additional limitation if the Iowa resident receives a refundable credit in the other state or foreign country for the Iowa resident’s share of the income tax owed and paid by the pass-through entity. The resident’s pro rata share of entity-level income tax or composite income tax paid by the pass-through entity shall be in the same proportion as the resident’s pro rata share of income derived from sources in that state or foreign country, as properly reported on the entity’s return in the other state or foreign country.

(3) To qualify, the pass-through entity must provide to the resident a statement identifying the jurisdiction and the resident's pro rata share of the income, income tax liability, and income tax paid in that jurisdiction.

EXAMPLE 1: Partnership W earns \$2,000 of income in state A, which imposes an entity-level income tax directly on the partnership. Partnership W pays \$100 of income tax to state A. Partnership W is owned 50 percent by Partnership X and 50 percent by individual Y, a resident of Iowa. Individual Y receives a statement from Partnership W showing that Partnership W earned \$2,000 of income and paid \$100 of entity-level income tax to state A and that individual Y's pro rata share of that income and entity-level income tax is \$1,000 and \$50, respectively. If that \$1,000 of income from Partnership W is subject to Iowa income tax and included on individual Y's Iowa income tax return as earned while an Iowa resident, individual Y will be entitled to treat the \$50 of income tax paid by Partnership W to state A as paid by individual Y in the computation of Y's out-of-state tax credit.

b. Indirect owners.

(1) If the Iowa resident is an indirect partner, shareholder, or beneficiary of a pass-through entity that paid entity-level income tax, or income tax on a composite return basis, to another state or foreign country on income derived from sources in that state or foreign country, the resident is allowed to treat the resident's pro rata share of that income tax as paid by the resident for purposes of the out-of-state tax credit if both of the following requirements are satisfied:

1. The tiered owner reduces the amount of the paying pass-through entity's income tax that the tiered owner reports to its partners, shareholders, or beneficiaries by the amount of any credit available from that other state or foreign country to the tiered owner for the tax liability of the paying pass-through entity.

2. The resident's pro rata share of that income flows through one or more tiered owners to the resident and meets the requirements of paragraph 304.6(2) "a."

(2) The entity-level income tax or composite income tax paid to the other state or foreign country is the net state or foreign income tax actually owed and paid for the tax year on income taxed by that state or foreign country, as properly computed on the pass-through entity's income tax return or composite tax return (not a withholding return) in the other state or foreign country, after reduction for all nonrefundable credits provided to the pass-through entity, and after further reduction by a tiered owner for any credits provided by that other state or foreign country to the tiered owner for the tax liability of the paying pass-through entity. Paragraph 304.6(6) "b" provides an additional limitation if the Iowa resident receives a refundable credit in the other state or foreign country for the Iowa resident's share of the income tax owed and paid by a pass-through entity. The resident's pro rata share of entity-level income tax or composite income tax paid by the pass-through entity shall be in the same proportion as the resident's pro rata share of income derived from sources in that state or foreign country, as properly reported on the entity's return in the other state or foreign country, after flowing through one or more tiered pass-through entities to the resident.

(3) To qualify, the paying pass-through entity must provide to the tiered owner a statement identifying the jurisdiction and the tiered owner's pro rata share of the income, income tax liability, and income tax paid in that jurisdiction. The tiered owner, in turn, must provide the indirect partner, shareholder, or beneficiary with a statement that includes all of the following information:

1. The jurisdiction to which income tax was paid; the paying pass-through entity and any other tiered owner through which the income flowed; and the indirect partner's, shareholder's, or beneficiary's pro rata share of the paying pass-through entity's income.

2. The indirect partner's, shareholder's, or beneficiary's pro rata share of the paying pass-through entity's income tax liability and income tax paid to the other jurisdiction after reduction for any credit available to the tiered owner for the tax liability of the paying pass-through entity. If no such credit was provided to the tiered owner, the statement must include a declaration from the tiered owner to that effect.

EXAMPLE 2: Assume the same facts as Example 1. Partnership X (a tiered owner) receives a statement from Partnership W which shows that W earned \$2,000 of income in state A and paid \$100 of entity-level income tax to state A and that Partnership X's pro rata share of that income and entity-level income tax is \$1,000 and \$50, respectively. Partnership X is not eligible for a credit in state A for its share of the entity-level income tax paid by Partnership W. Partnership X is owned 50 percent by individual Z, a resident of

Iowa. Individual Z then receives a statement from Partnership X indicating that Partnership X was not eligible for a credit for the tax paid by Partnership W, that Z's pro rata share of Partnership W's income taxed by state A is \$500, and that Z's pro rata share of Partnership W's income tax imposed by and paid to state A is \$25. If that \$500 of income from Partnership W flows through Partnership X to individual Z, is subject to Iowa income tax, and is included on Z's Iowa income tax return as earned while an Iowa resident, Z will be entitled to treat the \$25 of income tax paid by Partnership W to state A as paid by Z in the computation of Z's out-of-state tax credit.

EXAMPLE 3: Assume the same facts as Example 2, except that Partnership X (a tiered owner) is eligible for a \$50 credit in state A for its share of the entity-level income tax paid by Partnership W to state A. Partnership X must reduce its share of Partnership W's entity-level income tax (\$50) that it can report to its partners by the amount of the credit provided by state A for that tax (\$50). Therefore, Partnership X cannot pass Partnership W's entity-level income tax through to individual Z, and Z cannot treat a pro rata share of Partnership W's entity-level income tax as paid by Z. However, if Partnership X is itself subject to and pays an entity-level income tax in state A, it may be allowed to pass through, and individual Z may be allowed to treat as paid by Z a pro rata share of the entity-level income tax paid by Partnership X in state A in the same manner as described in paragraph 304.6(3) "a."

304.6(4) Rule for regulated investment companies. If the Iowa resident is a shareholder of a regulated investment company making an election under Section 853 of the Internal Revenue Code, the resident shareholder is allowed an out-of-state tax credit for the resident shareholder's pro rata share of entity-level income tax paid to a foreign country or possession of the United States by the regulated investment company and treated as paid by the resident shareholder under Section 853 of the Internal Revenue Code if the income taxed by the foreign country or possession of the United States is also subject to tax in Iowa and is included on the resident shareholder's Iowa income tax return as earned while an Iowa resident. To qualify, the regulated investment company must provide to the resident shareholder a statement identifying the jurisdiction and the resident shareholder's pro rata share of the income, income tax liability, and income tax paid in that jurisdiction.

EXAMPLE 4: Individual D is a resident of Iowa and a shareholder of a mutual fund that paid income tax to foreign jurisdictions and that made an election under Section 853 of the Internal Revenue Code. On the annual, year-end tax statement, the mutual fund reported \$2,000 of income to individual D and \$10 of foreign tax paid with respect to D's income. If that \$2,000 of income from the mutual fund is subject to Iowa income tax and included on individual D's Iowa income tax return as earned while an Iowa resident, D will be entitled to treat the \$10 of income tax paid by the mutual fund to the foreign jurisdictions as paid by D in the computation of D's out-of-state tax credit.

304.6(5) Computing the out-of-state tax credit—preliminary calculation.

a. Required form. The tax credit must be computed on the IA 130, Iowa Out-of-State Tax Credit Schedule. Married taxpayers filing separate Iowa returns, or filing separately on a combined Iowa return, must complete a separate IA 130 for each spouse.

b. Computed separately by jurisdiction. The tax credit must be computed separately for each out-of-state jurisdiction. A separate IA 130 is required for each out-of-state jurisdiction. However, separate computations and separate IA 130s are not required for foreign income taxes paid by a regulated investment company.

c. Computed separately by income tax type. The tax credit must be computed separately for regular income tax and special lump-sum distribution tax. If the taxpayer was assessed a special tax on a lump-sum distribution by another state or foreign country, compute the tax credit separately under these rules using only the lump-sum distribution and lump-sum distribution tax imposed in Iowa and imposed in the other state or foreign country. A lump-sum distribution taxed by another state or foreign country shall not be included as part of gross income. A minimum tax or income tax imposed on preference items derived from sources in another state or foreign country are not eligible for the out-of-state tax credit under this rule. For rules on the out-of-state tax credit with respect to minimum tax paid, see rule 701—304.7(422).

d. Full-year Iowa residents. For a taxpayer who is an Iowa resident for the entire tax year, the income tax paid to the other state or foreign country is the sum of the following amounts:

(1) Income tax treated as paid by the resident under subrules 304.6(3) and 304.6(4). The income tax shall be treated as paid by the resident for the tax year that the out-of-state pass-through income is considered taxable Iowa income to the resident.

(2) The net state or foreign income tax actually owed and paid by the resident for the tax year on income qualifying under paragraph 304.6(2)“a,” as properly computed on the resident’s income tax return in the other state or foreign country, less all nonrefundable credits provided to the resident, and less any refundable credits provided to the resident for entity-level income taxes or composite income taxes paid by a pass-through entity. See Example 5 below.

e. Part-year Iowa residents. A taxpayer who is a part-year resident of Iowa may only claim the out-of-state tax credit against the taxpayer’s Iowa income tax liability for income tax paid to another state or foreign country on income qualifying under paragraph 304.6(2)“a” that is earned during the period of the tax year that the taxpayer was an Iowa resident. The income tax paid to the other state or foreign country is the sum of the following amounts:

(1) Income tax treated as paid by the resident under subrules 304.6(3) and 304.6(4) on income earned during the period of the tax year that the taxpayer was an Iowa resident. The income tax shall be treated as paid by the resident for the tax year that the out-of-state pass-through income is considered taxable Iowa income.

(2) The net state or foreign income tax actually owed and paid by the taxpayer for the tax year on income qualifying under paragraph 304.6(2)“a” that was earned during the period of the tax year that the taxpayer was an Iowa resident, as properly computed on the resident’s income tax return in the other state or foreign country, less all nonrefundable credits provided to the resident, and less any refundable credits provided to the resident for entity-level income taxes or composite income taxes paid by a pass-through entity. See Example 6 below.

304.6(6) *Computing the out-of-state tax credit—additional limitations and considerations.*

a. Maximum credit. The out-of-state tax credit cannot exceed the amount of Iowa income tax that would have been imposed on the same income which was taxed by the other state or foreign country. The maximum out-of-state tax credit must be computed according to the formula in this paragraph. If gross income is subject to tax in a jurisdiction at more than one level (i.e., at the pass-through entity level and at the individual level), it shall only be counted once for purposes of computing the maximum credit.

(1) Full-year Iowa residents. Gross income qualifying under paragraph 304.6(2)“a” and taxed by the other state or foreign country shall be divided by the total gross income of the Iowa resident taxpayer. This quotient, multiplied by the net Iowa tax as determined on the total gross income of the taxpayer as if entirely earned in Iowa, shall be the maximum tax credit. For tax years beginning before January 1, 2022, this quotient shall be computed as a percentage rounded to the nearest tenth of a percent (e.g., 1.2 percent). For tax years beginning on or after January 1, 2022, this quotient shall be computed as a percentage rounded to the nearest ten-thousandth of a percent (e.g., 1.2345 percent). For purposes of this subparagraph, “net Iowa tax” means the Iowa regular income tax after reduction for the nonrefundable credits provided in Iowa Code section 422.12.

EXAMPLE 5: Taxpayer A was an Iowa resident for the entire tax year but commuted across the border and worked in state Z. Taxpayer A had wages of \$30,000 in state Z. Taxpayer A filed an income tax return in state Z reporting the \$30,000 of wages and had state Z income tax liability of \$500, which is A’s preliminary out-of-state credit under subrule 304.6(5). Taxpayer A also had income of \$10,000 from rental of an Iowa farm and another \$10,000 in interest income from a personal savings account. Taxpayer A’s total gross income for the tax year was \$50,000. Thus, 60 percent ($\$30,000 \div \$50,000$) of Taxpayer A’s income was earned in state Z. Taxpayer A’s net Iowa tax on total gross income was \$817, which results in a maximum out-of-state credit of \$490 ($\$817 \times .60$). Therefore, the out-of-state tax credit allowed is \$490, because the maximum credit of \$490 was less than the preliminary credit of \$500.

(2) Part-year Iowa residents. Gross income qualifying under paragraph 304.6(2)“a” that was earned during the period of the tax year that the taxpayer was an Iowa resident and taxed by the other state or foreign country shall be divided by the total gross income of the Iowa taxpayer earned while an Iowa resident or otherwise sourced to Iowa. This quotient, multiplied by the net Iowa tax as determined on the total gross income of the taxpayer as if entirely earned in Iowa, shall be the maximum tax credit. For tax

years beginning before January 1, 2022, this quotient shall be computed as a percentage rounded to the nearest tenth of a percent (e.g., 1.2 percent). For tax years beginning on or after January 1, 2022, this quotient shall be computed as a percentage rounded to the nearest ten-thousandth of a percent (e.g., 1.2345 percent). For purposes of this subparagraph, “net Iowa tax” means the Iowa regular income tax after reduction for the nonrefundable credits provided in Iowa Code section 422.12 and after reduction for the nonresident and part-year resident credit in rule 701—304.5(422).

EXAMPLE 6: Taxpayer B was a part-year Iowa resident for the tax year. Taxpayer B resided in state Z for the first six months of the year and moved to Iowa on July 1 but continued to commute across the border and work in state Z. Taxpayer B was employed in state Z for the entire year and had wages of \$30,000 in state Z. Taxpayer B filed an income tax return in state Z reporting the \$30,000 of wages and had state Z income tax liability of \$1,000. The amount of gross income taxed by state Z while taxpayer B was an Iowa resident was \$15,000 (50 percent of the \$30,000 of state Z wages). Since 50 percent of the income earned in state Z was earned while taxpayer B was a resident of Iowa, the preliminary out-of-state credit under subrule 304.6(5) was \$500 ($\$1,000 \times .50$). Taxpayer B also had \$10,000 in farm rental income from farmland located in Iowa. Taxpayer B’s gross income earned while an Iowa resident and otherwise sourced to Iowa was \$25,000 ($\$15,000$ of wages + $\$10,000$ farm rental income). Thus, 60 percent of the gross income was earned in state Z while an Iowa resident ($\$15,000 \div \$25,000$). Taxpayer B’s net Iowa tax on total gross income was \$1,094, which results in a maximum out-of-state credit of \$656 ($\$1,094 \times .60$). Therefore, the out-of-state tax credit allowed is \$500, because the preliminary credit of \$500 was less than the maximum credit of \$656.

b. *Refund attributable to credit for entity-level income tax or composite income tax paid by a pass-through entity.* If the resident claims a refundable tax credit in another state or foreign country for entity-level income tax or composite income tax paid by a pass-through entity, that refundable credit reduces the resident’s income tax liability in that state or foreign country as described in subparagraphs 304.6(5) “d”(2) and 304.6(5) “e”(2). However, any refund attributable to that refundable credit also reduces the amount of income tax treated as paid by the resident under subrules 304.6(3) and 304.6(4). In computing this credit reduction, the refundable credit for entity-level income tax or composite income tax paid by a pass-through entity shall be applied on the other state’s or foreign country’s income tax return after all nonrefundable credits, but before any other refundable credit. The credit reduction is required whether the resident receives the refund or applies the amount to a different tax liability or tax period.

EXAMPLE 7: Individual B, a resident of Iowa and a 50 percent owner of Partnership P doing business in state Z, receives a statement from Partnership P in accordance with subparagraph 304.6(3) “a”(3) showing that P earned income in and paid entity-level income tax to state Z and individual B’s pro rata share of that income and that entity-level income tax is \$5,000 and \$250, respectively. However, individual B also receives a \$250 refundable credit from state Z for B’s share of the entity-level income tax paid by Partnership P. Individual B files an individual income tax return in state Z to report B’s pro rata share of income from Partnership P and calculates a tentative income tax of \$200, before application of the refundable credit. Individual B applies the refundable tax credit against that tentative income tax and calculates an income tax liability of \$0 and a refund of \$50 from state Z. Therefore, individual B must reduce the \$250 of entity-level income tax treated as paid by B under subrule 304.6(3) to \$200 ($\$250 - \50). Individual B files an Iowa income tax return which includes the \$5,000 of income from Partnership P earned in state Z and calculates a preliminary out-of-state tax credit under subrule 304.6(5) of \$200.

c. *Taxpayers claiming the S corporation apportionment tax credit.* A taxpayer who is a shareholder of an S corporation and who has income that was apportioned outside of Iowa through a claim to the S corporation apportionment tax credit is not permitted to claim the out-of-state tax credit on the same S corporation income. Income tax paid by the resident or a pass-through entity with respect to the S corporation income shall not be included in the resident’s preliminary credit calculation in paragraph 304.6(5) “d” or “e.” Gross income from the S corporation shall not be included in the resident’s maximum credit calculation in paragraph 304.6(6) “a.”

d. *Married taxpayers using a different filing status in the other state or foreign country.* If married taxpayers use a separate filing status in the other state or foreign country, but file jointly for Iowa tax purposes, the taxpayers must combine both spouses’ income and income tax paid in the other state or

foreign country for purposes of computing the out-of-state tax credit. If married taxpayers file jointly in the other state or foreign country, but file separate Iowa returns, or separately on a combined Iowa return, the taxpayers must prorate the income tax paid in the other state or foreign country according to each spouse's respective gross income earned in that state or foreign country.

e. Tax on income that does not flow through to resident. Entity-level income tax or composite income tax paid by a pass-through entity on income that does not flow through to the Iowa resident and meet the requirements of paragraph 304.6(2)“a” does not qualify for the out-of-state tax credit. For example, a LIFO recapture tax installment paid by an S corporation in another state would not qualify because that tax is measured by the income of the entity in the last tax year it was a C corporation, when such income did not flow through to the shareholders. Also, income tax paid by a trust in another state on income not distributed to the beneficiaries would not qualify because that income did not flow through to the beneficiaries. These examples are not intended to be exhaustive.

f. Recalculating credit following adjustments in the other jurisdiction. If the taxpayer or the taxpayer's pass-through entity amends the amount of income or income tax liability reported and paid to the other state or foreign country, either through an amended return, audit, or otherwise, the taxpayer shall file an amended Iowa return and recalculate the allowable out-of-state tax credit. Any refund must be requested by the later of three years after the due date of the return, or one year after payment of the tax, as prescribed in Iowa Code section 422.73(2)“a.” Iowa law does not provide additional time to request a refund following an audit by another state or foreign country.

g. Nonrefundable and nontransferable. The out-of-state tax credit cannot exceed the resident's tax liability; thus, no amount is eligible to be carried forward to any future tax year. The credit may not be transferred to any other person.

304.6(7) *Claiming the out-of-state tax credit—supporting documentation.* To claim the out-of-state tax credit, the taxpayer claiming the credit must submit the following to the department with the return or upon request as indicated below:

a. Out-of-state tax return. A copy of the income tax return filed with the other state or foreign country must be submitted. The department may further request a copy of the return which has been certified by the tax authority of that state or foreign country and showing thereon that the income tax assessed has been paid to them.

b. Iowa income tax return. To claim the out-of-state tax credit, a taxpayer must file an Iowa income tax return for the tax year for which the credit is claimed. A taxpayer must file an Iowa income tax return to claim the out-of-state tax credit even if the taxpayer would not otherwise have an obligation to file an Iowa income tax return for the year for which the credit is claimed.

c. Iowa out-of-state tax credit schedule. An IA 130, Iowa Out-of-State Tax Credit Schedule, must be submitted for the tax year for which the credit is claimed.

d. Pass-through entity statements. A taxpayer who is claiming an out-of-state tax credit for entity-level income tax or composite income tax paid by a pass-through entity must submit a statement from the pass-through entity that meets the requirements of subrule 304.6(3). The pass-through entity's actual income tax returns must be submitted to the department upon request. A taxpayer who is claiming an out-of-state tax credit for entity-level income tax paid by a regulated investment company must submit a statement from the regulated investment company that meets the requirements of subrule 304.6(4).

e. Additional foreign income tax documentation. A taxpayer who is claiming the out-of-state tax credit for income taxes paid to a foreign country must provide the department with a copy of federal Form 1116, Foreign Tax Credit, if that form was required to be submitted with the taxpayer's federal income tax return. This submission requirement does not mean that all amounts on federal Form 1116 qualify for the Iowa out-of-state tax credit. Additionally, if the income tax was paid in foreign currency, the taxpayer shall include a detailed explanation of how the taxpayer figured the conversion rate. The conversion rate is the rate of exchange in effect on the day the taxpayer paid the foreign income tax.

f. Proof of payment. Upon request, the taxpayer must provide the department with a photocopy, or other similar reproduction, of either:

- (1) The receipt issued by the other state or foreign country for payment of the tax, or

(2) The canceled check (both sides) with which the tax was paid to the other state or foreign country together with a statement of the amount and kind (e.g., wage or salary income, rental income, business income) of total income on which such tax was paid.

This rule is intended to implement Iowa Code section 422.8.

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