

701—42.4(422) Out-of-state tax credits.

42.4(1) General rule. Iowa residents are allowed an out-of-state tax credit for taxes paid to another state or foreign country on income which is also reported on the taxpayer's Iowa return. The out-of-state tax credit is allowable only if the taxpayer files an Iowa resident income tax return.

If the Iowa resident is a partner, shareholder, member, or beneficiary of a partnership, S corporation, limited liability company, or trust which files a composite income tax return in another state on behalf of the partners, shareholders, members or beneficiaries, the out-of-state tax credit will be allowed for the Iowa resident. The Iowa resident must provide a schedule of the resident's share of the income tax paid to another state on a composite basis, and the out-of-state tax credit is limited based upon the calculation set forth in subrule 42.4(2).

However, if the partnership, S corporation, limited liability company or trust is directly subject to tax in another state and the tax is not directly imposed on the resident taxpayer, then the out-of-state tax credit is not allowed for the Iowa resident on the tax directly imposed on the partnership, S corporation, limited liability company, or trust. For example, if another state does not recognize the S corporation election for state purposes and a corporation income tax is imposed directly on the S corporation, then the out-of-state tax credit is not allowed for the Iowa resident shareholder on the corporation income tax paid to the other state.

42.4(2) Limitation of out-of-state tax credit. If an Iowa resident taxpayer pays income tax to another state or foreign country on any of the taxpayer's income, the taxpayer is entitled to a net tax credit; that is, the taxpayer may deduct from the taxpayer's Iowa net tax (not from gross income) the amount of income tax actually paid to the other state or country, provided the amount deducted as a credit does not exceed the amount of Iowa net income tax on the same income which was taxed by the other state or foreign country.

42.4(3) Computation of tax credit.

a. For tax years beginning on or after January 1, 1983. The limitation on the tax credit must be computed according to the following formula: Gross income taxed by another state or foreign country that is also taxed by Iowa shall be divided by the total gross income of the Iowa resident taxpayer. Said 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 against the Iowa net tax. This quotient should be computed as a percentage with a minimum of one decimal place. However, if the income tax paid to the other state or foreign country on the gross income taxed by the other state or foreign country is less than the maximum tax credit against the Iowa tax, the out-of-state credit allowed against the Iowa tax may not exceed the income tax paid to the other state or foreign country. The income tax paid to the other state or foreign country is the net state or foreign income tax actually paid for the tax year on the income taxed by the other state or foreign country and not the state or foreign income tax paid during the tax year, such as state income tax or foreign income tax withheld from the income taxed by the other state or foreign country.

b. Out-of-state tax credit examples. An individual who is an Iowa resident for the entire tax year can claim an out-of-state tax credit against the person's Iowa income tax liability for any income tax paid to another state or foreign country for the tax year on any gross income received by the individual for the year which was derived from sources outside of Iowa to the extent this gross income is also subject to Iowa income tax.

However, in the case of an individual who is a part-year resident of Iowa for the tax year, that individual can only claim an out-of-state tax credit against the person's Iowa income tax liability for income tax paid to another state or foreign country on gross income derived from sources outside of Iowa during the period of the tax year that the individual was an Iowa resident and only to the extent this gross income derived from sources outside of Iowa was also subject to Iowa income tax.

The taxpayer's out-of-state credit is computed on Schedule IA 130 which is to be filed with the taxpayer's Iowa individual income tax return. The taxpayer's income tax return or other document of the other state or foreign country supporting the income tax paid to the other state or foreign country shall be filed with the individual's Iowa income tax return to support the out-of-state tax credit claimed.

EXAMPLE 1. Gene Miller was an Iowa resident for the entire year 2002. Mr. Miller lived in Council Bluffs and worked the entire year for a company in Omaha, Nebraska. Mr. Miller had wages of \$30,000 and Nebraska income tax withheld of \$1,000. He also had income of \$10,000 from rental of an Iowa farm and another \$10,000 in interest income from a personal savings account in an Iowa bank. The amount of Mr. Miller's gross income that was taxed by Nebraska (the other state or foreign country) was \$30,000. His total gross income in 2002 was \$50,000. Thus, 60 percent of his income was earned in Nebraska. Mr. Miller's Iowa tax on line 55 of Form IA 1040 was \$917, which resulted in a potential out-of-state credit of 60 percent of the Iowa tax or \$550 because 60 percent of Mr. Miller's income was earned outside Iowa and was taxed by Nebraska. However, Mr. Miller's income tax liability on the Nebraska income tax return was only \$500. Thus, the out-of-state tax credit allowed was \$500, because that was less than the potential out-of-state tax credit of \$550.

EXAMPLE 2. Ben Smith was a part-year Iowa resident in 2002. He resided in Missouri for the first six months of the year until he moved to Keokuk, Iowa, on July 1. Mr. Smith was employed in Missouri for the entire year and had wages of \$30,000 and had Missouri income tax liability of \$1,000. Half of Mr. Smith's wages or \$15,000 of the wages was earned during the time Mr. Smith was an Iowa resident. Mr. Smith also had \$10,000 in farm rental income from farmland located in Iowa. The amount of gross income taxed by Missouri while Mr. Smith was an Iowa resident was \$15,000. Mr. Smith's gross income earned while an Iowa resident for the year was \$25,000. Thus, 60 percent of the gross income was earned in the other state while Mr. Smith was an Iowa resident. Mr. Smith's Iowa income tax on line 55 of the IA 1040 was \$1,292. This resulted in a potential out-of-state credit of \$775 because 60 percent of the gross income was earned in Missouri during the period Mr. Smith was an Iowa resident. However, since 50 percent of the income earned in Missouri was earned while Mr. Smith was a resident of Iowa and the Missouri income tax liability for the year was \$1,000, the out-of-state credit was \$500 or 50 percent of the Missouri income tax liability. The out-of-state credit allowed was \$500, because this was less than the Iowa income tax of \$775 that was applicable to the gross income earned in Missouri during the period Mr. Smith was an Iowa resident.

42.4(4) Proof of claim for tax credit. The credit may be deducted from Iowa net income tax if written proof of such payment to another state or foreign country is furnished to the department. The department will accept any one of the following as proof of such payment:

- a.* 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 (that is, whether wages, salaries, property or business) of total income on which such tax was paid.
- b.* A copy of the income tax return filed with the other state or foreign country 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.

This rule is intended to implement Iowa Code section 422.8.