

**701—700.6(422) Reportable income and deductions.**

**700.6(1)** *Reportable income in general—Iowa estates and trusts.* Estates of Iowa resident decedents and trusts with a situs in Iowa must report all income received from sources within and without Iowa, regardless of whether the income is from real, personal, tangible, or intangible property.

**700.6(2)** *Reportable income in general—foreign situs estates and trusts.* Estates and trusts with a situs outside Iowa must report all income received from sources within and without Iowa, regardless of whether the income is from real, personal, tangible, or intangible property. Foreign situs estates and trusts must also report that portion of the income which is from Iowa sources. Examples of Iowa source income include but are not limited to income from real and tangible personal property with a situs in Iowa, such as a farm and from a business located in Iowa; the capital gain portion of an installment sale contract of Iowa situs property; and wages, salaries and other compensation for services performed in Iowa but received after the death of the decedent. Iowa source income would not include income from intangible personal property, such as annuities, interest on bank deposits, and dividends, unless the income was derived from a business, trade, profession, or occupation carried on in Iowa.

**700.6(3)** *Income from property subject to the jurisdiction of the probate court.*

*a. Probate property subject to possession by the personal representative.* Income received on probate property after the decedent's death is chargeable to the estate or to the person succeeding to the decedent's property depending on whether the personal representative has the right to, or has taken possession of, the probate property producing the income. If the personal representative has taken possession of or has the right to possession of a specific item of probate property, the income from this property is estate income. The personal representative is charged with the income from this property for each taxable year until the property is distributed or otherwise disposed of. Iowa Code section 633.351 prescribes the personal representative's responsibilities for taking possession of and handling the decedent's property. In addition, Iowa Code section 633.386 (probate code) gives the personal representative authority to lease real estate, and therefore to take possession, in order to pay the debts and charges of the estate.

*b. Income charged to the heir or beneficiary.* Under Iowa law, title to probate property, both real and personal, passes instantaneously on death to the heir or beneficiary. If property is not subject to the personal representative's right of possession under Iowa Code section 633.351 and the personal representative has not exercised the right to sell, lease, mortgage, or pledge real and personal property to pay debts and charges under Iowa Code section 633.386, the income from this probate property is not estate income. It is income to the person succeeding to the property.

**700.6(4)** *Income from nonprobate property.* Income from property not subject to the jurisdiction of the probate court is charged to the beneficiary or other person succeeding to the property. Examples of income from nonprobate property include but are not limited to property held in joint tenancy, annuity payments, pension and retirement plans not payable to the estate, and income from certain trusts created by the grantor-decedent.

**700.6(5)** *Gross income of an estate.*

*a. In general.* 26 U.S.C. Section 641(b) provides that the taxable income of an estate or trust shall be computed in the same manner as the taxable income of an individual, except as modified in Subchapter J of the Internal Revenue Code. Paragraphs 700.6(5)“d” through “q” provide a nonexhaustive list of common types of taxable income to an estate or trust.

*b. Definition of the period of administration.* The income charged to the decedent's estate is reportable by the personal representative for each taxable year during the period of the administration of the decedent's estate if the minimum filing requirements are met. The period of administration for Iowa income tax purposes is determined by applying federal tax law to Iowa estates because Iowa taxable income is the same as federal taxable income, subject to the adjustments provided in Iowa Code sections 422.7 and 422.9. It is the period actually required by the personal representative to perform the ordinary duties of administration, such as the collection of assets and the payment of debts, taxes, legacies, and bequests, whether the period required is longer or shorter than the period specified under the probate code. An estate will be considered terminated for income tax purposes when all of the assets have been distributed, except for a reasonable amount set aside in good faith for the payment of unascertained or contingent liabilities

and expenses. If the period of administration is terminated for income tax purposes, the heir or beneficiary is charged with the income.

*c. The estate's first return—special considerations.*

(1) Death terminates the decedent's taxable year. Income received the day of the decedent's death is to be reported on the decedent's final individual return.

(2) The taxable year of a decedent's estate begins the day after the decedent's death. Income received after the decedent's death is chargeable either to the decedent's estate or to the person succeeding to the property producing the income.

(3) Income the decedent had a right to receive prior to death, but did not receive before death, is not the decedent's income but is income in respect of a decedent and is chargeable either to the decedent's estate when received or to the person succeeding to the right to income. 26 U.S.C. Section 691(a) and applicable federal regulations provide more information on what constitutes income in respect of a decedent.

(4) Trade or business expenses, interest, taxes and expenses for the production of income owing by the decedent at death but unpaid, and the allowance for depletion on income not received at death are not deductible on the decedent's final return. These are deductible by the estate or the person succeeding to the property when paid.

(5) Medical expenses incurred by the decedent, but unpaid at death, are not deductible by the estate. These are deductible on the decedent's individual return for the year the expenses were incurred if paid within one year after the decedent's death and if the medical expense is not claimed as a deduction for federal estate tax purposes under 26 U.S.C. Section 2053. 26 U.S.C. Section 213(d) and federal regulations thereunder provide more information relating to deductible medical expenses of a decedent.

(6) Funeral expense is not a deductible item for income tax purposes.

(7) Unused ordinary and capital losses remaining after the decedent's income tax liability for the year of death has been determined are not carried forward to the decedent's estate. The unused losses terminate with death, except to the extent they may be used by the decedent's surviving spouse.

*d. Dividends.* All income classified as dividends under 26 U.S.C. Section 61 and 26 CFR Section 1.61-9, received or constructively received, during the taxable year constitutes gross income to the estate or trust. However, some income labeled as dividends is for tax purposes classified as interest. For example, income from cooperative banks, credit unions, domestic building and loan associations, domestic savings and loan associations, federal savings and loan associations, and mutual savings banks are considered interest and not dividends.

*e. Interest.* All interest received or constructively received during the taxable year, with the exception of interest but not capital gain, from federal securities and from certain bonds issued by the state of Iowa and its political subdivisions listed in rule 701—302.3(422) is income to the estate or trust. Interest from securities issued by a state and its political subdivisions or from foreign securities is included in gross income for Iowa tax purposes, even though the interest may be exempt from federal income tax, except for those bonds listed in rule 701—302.3(422).

*f. Partnerships and other estates and trusts.*

(1) If a partnership in which the decedent had an interest is not terminated at death, the deceased partner's share of the partnership income is considered to be all received at the end of the partnership taxable year. As a result, none of the partnership income is chargeable to the deceased partner unless the day of the partner's death coincides with the day the partnership year ends. Partnership income is chargeable to the deceased partner's estate or the person succeeding to the partner's interest, notwithstanding the fact the deceased partner may have withdrawn most or all of the deceased partner's share of the partnership income prior to death.

(2) In general, if an estate or trust and its beneficiaries have different taxable years, the beneficiary is required to report the income from the estate or trust as if it were all paid on the last day of the taxable year of the estate or trust. However, if the beneficiary dies during the taxable year of an estate or trust, the taxable income of the beneficiary's estate includes only the portion of the income of the other estate or trust that was required to be distributed to the beneficiary but was not in fact distributed to the beneficiary before

death. The income that was in fact distributed by the other estate or trust prior to the beneficiary's death is properly included in the beneficiary's final income tax return.

*g. Rents and royalties.*

(1) Income received after death for the use or occupancy of the decedent's real and personal property is the income of the decedent's estate or the income of the person succeeding to the property. If the rental income was accrued, but unpaid at death, the accrued rent is income in respect of a decedent and is to be included as income, either by the estate or the person succeeding to the right to the income, in the taxable year when payment is received.

(2) Rent is not limited to payments in cash. It includes but is not limited to crop share rental payments when the decedent was a nonparticipating landlord.

(3) Income from the sale of grain and livestock in the estate of a participating landlord that was on hand at death is classified as income from a farm or business and not rental income.

(4) Income from royalties includes but is not limited to payment for rights in books, plays, copyrights, trademarks, formulas, and patents and from the exploitation of natural resources.

*h. Farm and business income—in general.* The death of the decedent does not alter the rules under which business and farm income is computed for income tax purposes. However, the decedent's estate as a new taxpayer may adopt a taxable year or accounting method that is different from the decedent's. The rules for determining a gain or loss from the sale or exchange of assets in the decedent's estate are the same as those for an individual. However, paragraphs 700.6(5) "i" and "j" contain more information on the basis for gain or loss from the sale or exchange of property acquired from a decedent and 700.6(5) "l" for depreciation rules for property acquired from a decedent.

*i. Basis for gain or loss—the stepped-up basis.* Property acquired from a decedent receives a new basis for determining gain or loss when the property is sold or exchanged. This rule does not apply to property classified as income in respect of a decedent and certain other property designated in 26 U.S.C. Section 1014(b) and (c) and the federal regulations thereunder. The basis of property acquired from a decedent is either (1) its fair market value at the time of death or the alternative value when it has been elected for federal estate tax purposes under 26 U.S.C. Section 2032 or (2) its special use value when the property has been valued for federal estate tax purposes under 26 U.S.C. Section 2032A. The decedent's basis in the property is not relevant.

If an estate files a federal estate tax return, the basis is governed by the federal estate tax value determination.

EXAMPLE: Decedent A died July 1, 2025, owning a 160-acre Iowa farm that the decedent purchased in 1985 for \$1,000 per acre, or \$160,000. At the time of A's death, the farm had a fair market value of \$12,000 per acre, or \$1,920,000. In 1995, A and surviving spouse B purchased a residence for \$80,000 in joint tenancy. Surviving spouse B, a school teacher, contributed one-half of the purchase price of the residence; therefore, one-half of the residence is excluded from A's gross estate. At the time of A's death, the residence had a fair market value of \$250,000. Surviving spouse B received the entire estate and did not elect the alternative or special use valuation.

B's basis for gain or loss in the farm and residence is computed as follows:

<u>Asset</u>	<u>Fair Market Value at Death</u>	<u>New Basis for Gain or Loss</u>	
160-acre farm	\$1,920,000	\$1,920,000	\$320,000
Residence	250,000	165,000	½ new basis 50,000
			½ old basis <u>17,500</u>
			\$ 67,500

Since the entire farm was acquired from A, its basis is 100 percent of the fair market value at death. Only one-half of the residence was acquired from A; therefore, only one-half of the residence receives a new basis on A's death. The new basis in the residence for B is \$165,000, calculated as follows: ½ of the fair market value on the date of death ( $\$250,000 \times \frac{1}{2}$ ) = \$125,000, plus ½ of the original purchase price ( $\$80,000 \times \frac{1}{2}$ ) = \$40,000.

*j. No new basis—income in respect of a decedent.*

(1) Property or rights to income, classified as income in respect of a decedent under 26 U.S.C. Section 691, do not receive a new basis upon the decedent's death. It is a special exception to the stepped-up basis rule. 26 U.S.C. Section 1014(c) and 26 CFR Section 1.1014-1(c) provide more information.

(2) Examples of income with respect to a decedent include but are not limited to the following:

1. Wages, salary, or other compensation for personal services earned that are unpaid at death.
2. Interest accrued on obligations, such as bank accounts, certificates of deposit, bonds, and promissory notes.
3. Accrued interest and unpaid capital gain on real and personal property installment contracts.
4. Federal income tax refunds if claimed as a deduction on an Iowa income tax return.
5. Accounts receivable if the decedent was on a cash accounting basis.
6. Crop share rent if the decedent was a nonparticipating landlord on a cash basis. This also includes growing crops, which are to be valued at the time of the decedent's death or alternate valuation date.

(3) The basis for gain or loss for property classified as income with respect to a decedent is the decedent's basis in the property at the time of death.

*k. Gain or loss—holding period.* For the purpose of determining whether the sale or exchange of property is a long- or short-term gain or loss, the holding period of property acquired from a decedent begins the day after the decedent's death, regardless of how long the property was held by the decedent. 26 U.S.C. Section 1.1223 and 26 CFR Section 1.1223-1(j) provide more information. If the property acquired from a decedent is sold or otherwise disposed of within one year of the decedent's death, it will be considered to have been held over one year. In general, this is a sufficiently long holding period to qualify the sale or exchange as a long-term gain or loss transaction.

*l. Depreciation—property acquired from a decedent.* Property acquired from a decedent that is subject to the allowance for depreciation receives the same value for depreciation purposes as its basis for gain or loss in a sale or exchange, regardless of its basis or remaining useful life in the hands of the decedent. 26 U.S.C. Sections 167(g) and 1011 and 26 CFR Section 1.167(g)-1 provide more information. For the purpose of determining the life of an asset subject to the allowance for depreciation, the property is treated as if it were acquired the day after the decedent's death. More information can be found in 26 CFR Section 1.167(a)-10. The decedent's estate or other person acquiring depreciable property from the decedent may adopt a depreciation method different from that used by the decedent for the depreciable asset. Additional information can be found in 26 CFR Section 1.167(a)-7.

*m. Recognition of gain—installment sale contracts.*

(1) Death of the holder. If, as a result of the death of the holder of an installment sale obligation (usually the seller), the installment sale obligation is transferred to the debtor (usually the purchaser), or it is cancelled by the personal representative, the remaining gain from the installment sale contract not previously reported is recognized by the holder's estate as if the remaining balance due had been immediately paid in full. The merger of the asset with the debt is treated as a taxable transfer by the estate of the holder (seller) of the obligation and is income in respect of a decedent realized by the holder's estate.

(2) Held by trust. If the obligation was held by a person other than the seller, such as a trust, the cancellation of the obligation will be treated by that person as a taxable transfer immediately after the seller's death. In the absence of some act of canceling the obligation, such as by distribution or notation that results in cancellation under Iowa Code chapter 554 (Uniform Commercial Code), the disposition is considered to occur no later than the time the period of administration of the estate is ended.

(3) Related parties. For gain recognition purposes, if the seller and the debtor were related parties, the value of the installment contract is considered to be not less than full face value, regardless of its value for Iowa inheritance tax (for decedents dying before January 1, 2025) or federal estate tax purposes. A related party includes but is not limited to the spouse, child (including an adopted child), grandchild, or parent of the seller; an estate in which the seller is a beneficiary; a partnership in which the seller is a partner; a corporation in which the seller owns 50 percent or more of the stock; and a trust where the seller is a beneficiary or is treated as the owner.

(4) Additional shares. If the debtor inherits the obligation to pay or another share of the estate and the debtor's share of estate equals or exceeds the face value of the contract, the personal representative of the holder's estate must set off the contract of sale to the debtor when satisfying the debtor's share of the estate.

In this case, the entire contract is canceled and all of the unreported gain is income in respect of a decedent to the estate. If the debtor's share of the estate is less than the face value of the contract of sale, the contract of sale is canceled only to the extent of the debtor's share of the estate and only a like percentage of the unreported gain is considered income in respect of a decedent received immediately by the estate. Iowa Code section 633.471 provides information on the right of retainer and setoff.

*n. Nonresident aliens—sales of Iowa real estate.* Nonresident aliens and estates and trusts with a situs outside the United States must include the gain from the sale or exchange of Iowa real estate as taxable income, even though the real estate was not effectively connected with a trade or business carried on in the United States. Any gain paid or distributed to a nonresident alien or an estate or trust with a situs outside the United States is subject to Iowa income composite tax unless the gain has been previously accumulated and any tax due paid. Paragraph 700.4(7) "d" and 701—Chapter 405 contain more information on the requirement to pay Iowa composite tax on distributions to nonresident beneficiaries and individuals.

*o. Miscellaneous income.* Miscellaneous income includes those items of income that are subject to Iowa income tax under Iowa Code section 422.6 that are not classified as dividends, interest, rent and royalties, income from partnerships and other fiduciaries, business or farm income, and gain or loss from the sale or exchange of assets. Miscellaneous income also includes but is not limited to wages and salaries earned by the decedent that are unpaid at death and distributions to the estate from an employee's pension or retirement plan if subject to Iowa income tax.

*p. Grantor trusts.* If the income of a trust is subject to the grantor trust rules under 26 U.S.C. Sections 671 through 679, the grantor of the trust or other person specified in the trust instrument, and not the trust, is considered the owner of the income. Therefore, the income is properly reportable on the Iowa individual income tax return of the grantor or other individual treated as the owner. The fiduciary income tax return of a grantor trust is an informational return only. Items of income, deductions, and credits of a grantor trust should be reported on a separate statement attached to the fiduciary return of income. The taxable year of a grantor trust must be the same as the taxable year of either the grantor or the other individual considered the owner of the income for tax purposes.

*q. "Equity trusts"—assignment of future wages and salaries.* The assignment of future wages, salaries, or other compensation for future services by a grantor to a trust (commonly called "equity" or "family estate" trust) does not shift the tax burden on this income from the grantor to the trust. The trust is subject to the grantor trust rules under 26 U.S.C. Sections 671 through 679. The income of the trust is to be reported by the grantor on an Iowa individual income tax return.

*r. Adjustments to federal taxable income.* Iowa Code section 422.4(15) provides that the Iowa taxable income of estates and trusts is federal taxable income, without the deduction for the personal exemption, subject to the specific adjustments set forth in Iowa Code section 422.7 and the modifications relating to federal and state income tax specified in Iowa Code section 422.9. The modifications have these results:

(1) The federal exemption allowed to estates and trusts under 26 U.S.C. Section 642(b) (i.e., \$600 for an estate, \$300 for simple trust, and \$100 for a complex trust) is not deductible for Iowa income tax purposes.

(2) Interest and dividends from federal securities, but not capital gain or loss, are exempt from Iowa income tax and, therefore, are not part of the Iowa taxable income of estates and trusts.

(3) Interest and dividends from securities of a state and its political subdivisions and from foreign securities are included in Iowa taxable income in the year received, regardless of whether such interest and dividends are exempt from federal income tax. However, rule 701—302.3(422) and paragraph 700.6(5) "e" contain more information on the exemption for certain bonds issued by the state of Iowa and its political subdivisions that are not included in Iowa taxable income.

**700.6(6) Deductions from gross income.**

*a. In general.* The deductions allowable in computing taxable income of estates and trusts are generally those relating to a trade or business and the expenses attributable to investment income.

(1) The important distinction between the deductions allowable in computing federal adjusted gross income and itemized deductions for individual income tax has only limited application in determining the taxable income of estates and trusts.

(2) Many deductions in computing the taxable income of an individual have no application to the deductions allowable in computing the taxable income of an estate or trust, due to the nature of estates and trusts and the sources of their income. For example, medical expense and moving expense deductions are applicable only to individuals, but taxes and interest expenses can be incurred by both individuals and estates and trusts.

*b. Interest expense.* Interest paid on obligations secured by property subject to the personal representative or trustee's right of possession is a deduction from gross income in the year paid. Interest on debts or charges that the personal representative or trustee is obligated to pay is also a deduction against gross income in the year paid. Interest on obligations secured by property, not subject to the personal representative's right of possession, is not deductible from the gross income of the estate but is a deduction for the person succeeding to the encumbered property. No distinction is made between business and nonbusiness interest. Iowa Code section 633.278 contains more information on circumstances when the personal representative of the decedent's estate is required to pay the debt and interest on encumbered property, even though the property is not subject to the personal representative's right of possession.

*c. Taxes.* The taxes deductible against the gross income of an estate or trust are limited to the taxes deductible for individual income tax purposes under 26 U.S.C. Section 164, meaning, for tax years beginning on or after January 1, 2023, state taxes deductible for federal purposes are also allowed for Iowa purposes. Also, federal income tax is not allowed as a deduction for Iowa purposes. Real estate and personal property taxes, including the taxes due but unpaid at death, are only deductible by the estate on the decedent's property that is subject to the personal representative's right of possession.

*d. Depreciation and depletion—allocation.* If the personal representative of a decedent's estate has the right to the possession of property eligible for the depreciation allowance, the depreciation is a deduction from the estate's gross income when the income for the taxable year is accumulated by the estate. If all or part of the income for the year is distributed to the beneficiaries, the deduction for depreciation is apportioned between the estate and the beneficiaries on the basis of the income allocated to each. In the case of an estate, the deduction for depreciation follows the income.

(1) The same depreciation rules apply to simple and complex trusts, with the exception that if the trustee has the right to maintain a reserve for depreciation, and in fact does so, the deduction for depreciation is allocated to the trust to the extent of the reserve maintained, regardless of whether the income is accumulated or distributed.

(2) The rules governing the allowance for depreciation are also the rules to be applied to the allowance for depletion under 26 U.S.C. Section 611.

*e. The charitable deduction.* The charitable deduction allowed estates and trusts under 26 U.S.C. Section 642(c) is not subject to the percentage of income limitation applicable to individual taxpayers under 26 U.S.C. Section 170(b). The allowable deduction is governed by the terms of the will or trust instrument, which can provide for unlimited payments for charitable purposes. However, an unused charitable contribution carryover of the decedent remaining after the decedent's individual income tax liability for the year of death is determined is not available to the estate. The unused carryover terminates at death, except to the extent it may be used by the surviving spouse. More information can be found in Federal Regulation Section 1.170A-10(d)(4)(iii). The deduction is limited to payments of gross income or amounts permanently set aside for charitable uses. A simple pecuniary bequest to charity in the decedent's will does not qualify for the charitable deduction from the estate's income. It is a payment from the corpus of the estate.

*f. Other deductions.* The category of other deductions includes those deductions allowable in computing taxable income not receiving special itemized treatment on the Iowa fiduciary return of income. Expenses of administration include but are not limited to a reasonable fee and the necessary expenses of the attorney employed by the personal representative of an estate or the trustee of a trust, a reasonable fee and the necessary expenses of the personal representative of an estate or the trustee of a trust, accounting fees, court costs, and interest paid on federal estate tax during an extension of time to pay.

*g. The no double deduction rule.* Expenses of administration, certain debts of the decedent like medical expenses incurred prior to death, and losses during the period of administration are proper deductions in computing both the taxable income of an estate or trust (or on the decedent's individual

return in case of medical expenses) and the taxable estate for federal estate tax purposes under 26 U.S.C. Sections 2053 and 2054.

(1) The no double deduction rule only applies to trusts when the trust assets are included for federal estate tax purposes. 26 U.S.C. Section 642(g) prohibits the double deduction of those items that qualify as deductions for both taxes.

(2) To prevent the double deduction, the fiduciary return needs to be accompanied with a statement waiving the right to claim all or a portion of the item as a deduction on the federal estate tax return. This waiver is irrevocable. However, unless the waiver has been filed, the decision to claim the deduction or portion of the deduction on the federal estate tax return can be changed anytime prior to the time the item or portion of the item is finally allowed for federal estate tax purposes.

(3) The waiver requirement has no application to estates and trusts not required to file a federal estate tax return.

(4) The no double deduction rule has no application to deductions in respect of a decedent, such as deductions relating to trade or business expenses, interest, taxes, expenses for the production of income, and the allowance for depletion, which are deductible both for income tax purposes and federal estate tax purposes.

*h. The net operating loss deduction.*

(1) Generally, Iowa Code section 422.9 provides for carryovers of Iowa net operating losses.

(2) However, estates and trusts with a situs outside Iowa are allowed a deduction only for a carryover net operating loss that was incurred prior to January 1, 2023, and attributable to a trade or business activity carried on in the state of Iowa.

*i. Capital loss deduction.* The capital loss deduction of an estate or trust is computed in the same manner as the capital loss deduction for individual taxpayers. However, it is a deduction only for the estate or trust and is not distributable to a beneficiary, except in the year the estate or trust terminates. Capital losses do not enter into the computation of the deduction for income required to be distributed currently to beneficiaries. During the period of administration of the estate or trust, capital losses can be used only to offset capital gain for simple trusts required to distribute income currently. However, beneficiaries may derive immediate benefit from capital losses when capital gain is required or permitted to be distributed to beneficiaries prior to closure of the estate or trust since the losses can be used to offset gain before distribution.

*j. The distribution deduction.* Estates and trusts are allowed to deduct the amounts of income required to be distributed currently and also other amounts properly paid, credited, or required to be distributed to the extent of the distributable net income for the year. For income tax purposes, an estate of a decedent is treated as a complex trust because normally, the personal representative of an estate has the discretion of whether to distribute current income. Therefore, most distributions of income from a decedent's estate fall under the category of "other amounts properly paid, credited, or required to be distributed."

(1) For purposes of a distribution deduction under this chapter, an estate or trust shall receive a distribution deduction only for income taxable to Iowa. For example, municipal interest will be included in the distribution deduction because it is taxable to Iowa. U.S. government interest would not be included because it is not taxable to Iowa. IA 1041, Schedule B, is used to calculate the Iowa income distribution deduction.

(2) The distribution deduction allowed is limited to the distributable net income of the estate or trust for the taxable year. If amounts in excess of distributable net income are distributed to a beneficiary of a decedent's estate, the excess does not constitute taxable income to the beneficiary. Income distributed to a beneficiary of an estate or trust retains the same character in the hands of the beneficiary as it had in the estate or trust, with the exception of unused capital loss distributed on closure to a corporation, in which case the loss is treated as a short-term loss, regardless of its character in the estate or trust. In addition, unless the will or trust instrument specifically provides otherwise, a distribution to beneficiaries is considered to be a proportionate distribution of the different kinds of income composing the distributable net income of the estate or trust. The same character and proportionate distribution rule is illustrated by the following example.

EXAMPLE: Decedent A, a resident of Iowa, died February 15, 2024. Under the terms of the will, all the decedent's property was devised in equal shares to beneficiary B, a resident of Phoenix, Arizona, and beneficiary C, a resident of Cedar Rapids, Iowa. The estate adopted a calendar year as its taxable year. For calendar year 2024, the estate had distributable net income of \$50,000, which is composed of:

Interest income	\$10,000
Dividend income	5,000
Net Iowa farm income	<u>35,000</u>
Total	\$50,000

On December 20, 2024, the estate distributed \$12,500 to beneficiary B, and \$12,500 to beneficiary C. Beneficiaries B and C have received a distribution for 2024 as follows:

<u>Beneficiary B</u>		<u>Beneficiary C</u>	
Interest income	\$2,500	Interest income	\$2,500
Dividends	1,250	Dividends	1,250
Farm income	<u>8,750</u>	Farm income	<u>8,750</u>
Total	\$12,500	Total	\$12,500

The estate is entitled to a deduction of \$25,000 against gross income in 2024 for the distribution to beneficiaries B and C and owes Iowa income tax on the \$25,000 income retained in the estate. Since the interest income of the estate is 20 percent of the distributable net income, 20 percent of the distribution to beneficiaries B and C is considered interest income. Likewise, 10 percent of the estate's distributable net income is dividends and 70 percent farm income. The distribution to B and C consists of a corresponding percentage of dividends and farm income. Beneficiary C, a resident of Iowa, must report the entire distribution of \$12,500 on a 2024 Iowa individual income tax return. Beneficiary B, a resident of Arizona, is only required to report the farm income portion of the distribution (\$8,750) on a 2024 nonresident individual income tax return because dividends and interest are income from intangible personal property and were not derived from a business, trade, profession or occupation carried on within Iowa by the nonresident. 701—subrule 302.16(5) provides more information.

**700.6(7)** *The final return—special considerations.*

*a. General rule.*

(1) In the year of closure, all income received by the estate or trust is considered “other amounts properly paid or credited or required to be distributed” and must be distributed to the beneficiaries according to the terms of the governing instrument. 26 U.S.C. Section 642(h) provides for an exception to the general rule that net operating and capital losses are only available to the taxpayer incurring the loss. Therefore, in the year of closure, any capital loss and net operating loss carryover that remains unused by the estate or trust is passed through the estate or trust and is allowed as a deduction to the beneficiaries succeeding to the property.

(2) If the estate or trust in the year of termination has incurred deductions in excess of gross income that do not qualify for treatment as a net operating or capital loss, such as administration expenses, the excess deductions are passed through the estate or trust and are available to the beneficiaries. They are available only for the year the estate or trust terminates and only as an itemized deduction in the case of an individual beneficiary.

*b. Exception to the general rule.* If in the year of termination an Iowa ancillary estate makes the required distribution of its income to the primary estate that is not being terminated, instead of to the beneficiaries of the estate, it is proper in the year of closure to treat the income as if it were accumulated by the Iowa ancillary estate. This exception to the general rule relieves the primary estate from the obligation of filing a second fiduciary return, which it would be required to do except for this special rule.

**700.6(8)** *Computation of the tax due.* The tax due on the taxable income of an estate or trust is computed by using the same tax rate used for computing the individual income tax liability. The provisions of the Iowa Code relating to the maximum net income of an individual before a tax liability is incurred have no application to the tax liability of an estate or trust. The taxable income of a short taxable year is

not required to be annualized for the purpose of computing the tax liability. The tax due is to be paid in full within the time prescribed by law, not in installments.

**700.6(9) Credits against the tax.**

*a. The personal exemption credit.* The estate of a decedent and a trust, whether simple or complex, is allowed the same \$40 credit against the tax as allowed for individual taxpayers. The personal exemption credit is not prorated for short taxable years.

*b. Credit for tax paid to another state or foreign country.* Iowa Code section 422.8 grants Iowa situs trusts and estates of Iowa resident decedents, which have income derived from sources in another state or foreign country, a credit against the Iowa tax for the income tax paid to the state or foreign country where the income was derived. The credit is computed in the same manner as a full-year resident under rules 701—304.6(422) and 701—304.7(422). Foreign situs trusts and estates of foreign decedents are not allowed a credit against the Iowa tax for the income tax paid another state or foreign country on Iowa source income. Rule 701—304.6(422) as applied to an Iowa situs trust or estate is illustrated by the following example.

EXAMPLE: Decedent A died a resident of Webster City, Iowa, on February 15. Decedent A at the time of death owned income-producing property in both Iowa and Missouri. For the short taxable year ending December 31, A's estate had the following income and expenses:

Interest	\$ 5,000.00
Dividends	7,500.00
Iowa farm income	20,000.00
Missouri farm income	<u>10,000.00</u>
Iowa gross income	\$ 42,500.00
Less allowable deductions	<u>8,000.00</u>
Iowa taxable income	\$ 34,500.00
Iowa computed tax	\$ 1,311.00
Less personal credit	<u>40.00</u>
Tax subject to credit for foreign taxes paid	\$ 1,271.00
Tentative credit for tax paid to Missouri	\$ 413.00
Maximum credit	\$ 299.06
Lesser of tentative credit or maximum credit	<u>299.06</u>
Iowa tax due	\$971.94

A's estate paid \$413 of income tax to the state of Missouri on the \$10,000 Missouri farm income. This is A's tentative credit.

The maximum credit on the foreign source income is \$604.20, computed as follows:

$$\frac{\text{Foreign income included in gross income } \$10,000}{\text{Total Iowa gross income } \$42,500} \times \$1,271.00^* = \$299.06$$

\*\$1,311 is the Iowa computed tax less the \$40 personal credit.

The allowable out-of-state tax credit is \$299.06 because the \$413 of income tax paid to Missouri (tentative credit) is more than the maximum credit of \$299.06. If the Missouri tax paid had been less than the maximum credit, the allowable credit would have been the amount of income tax paid to the state of Missouri.

*c. Motor vehicle fuel tax credit.*

(1) An estate or trust incurring Iowa motor vehicle fuel tax expense attributable to nonhighway uses may, in lieu of obtaining an Iowa motor vehicle fuel refund, claim a credit against its Iowa income tax liability the Iowa motor vehicle fuel taxes paid during the taxable year.

(2) A copy of the Iowa motor vehicle fuel tax credit form IA 4136 must be submitted with the fiduciary return of income to substantiate the claim for credit. Any credit in excess of the income tax due shall be refunded to the estate or trust, subject to the right of offset against other state taxes owing.

*d. Nonresident/part-year resident credit.* The nonresident/part-year resident credit is available for part-year trusts described in subrule 700.3(3) and trusts whose situs is outside Iowa. Rule 701—304.5(422) provides more information on the computation of the nonresident/part-year resident credit allowed for individuals who are either part-year residents of Iowa or nonresidents of Iowa.

*e. Other tax credits.* All other tax credits set forth in Iowa Code chapter 422, division II, are also available for any estate or trust that meets the criteria for claiming these tax credits. Estates and trusts with a situs in Iowa that are shareholders in S corporations that carry on business within and without Iowa may use the apportionment provisions for S corporation income set forth in 701—Chapter 403. The criteria to determine whether an S corporation is carrying on business within and without Iowa is set forth in 701—subrule 503.1(4).

This rule is intended to implement Iowa Code sections 422.3 through 422.12, 422.14, 422.23, and 633.471 and chapter 452A.

[ARC 0403D, IAB 6/24/26, effective 7/29/26]