701—86.5 (450) Gross estate.

86.5(1) *Iowa real and tangible personal property.*

a. Real estate and tangible personal property with a situs in the state of Iowa and in which the decedent had an interest at the time of death is includable in the gross estate regardless of whether the decedent was a resident of Iowa. It is immaterial whether the property, or interest, is owned singly, jointly, or in common.

b. Certain other real and tangible personal property with a situs in the state of Iowa in which the decedent did not have an interest at death may also be part of the gross estate for tax purposes. Examples of such property transfers include, but are not limited to, transfers of real estate in which the grantor retained a life estate, life interest, interest or the power of revocation, property or interest in property in trust, and gifts made within three years of death in excess of the federal gift tax exclusion. These constitute transfers of property in which the decedent may not have an interest at death, but are includable in the gross estate for inheritance tax purposes. *In re Dieleman's Estate v. Dept. of Revenue,* 222 N.W.2d 459 (Iowa 1974); *In re English's Estate,* 206 N.W.2d 305 (Iowa 1973); and *Lincoln's Estate v. Briggs,* 199 N.W.2d 337 (Iowa 1972).

c. A nonresident decedent's interest in a corporation, limited liability company, or partnership that owns real or tangible personal property with an Iowa situs that is titled in the name of that business entity is not subject to inheritance tax. An interest in a business entity is intangible personal property which follows the residence of the decedent for the purposes of inheritance tax.

d. Tangible personal property as defined in Iowa Code section 633.276 with an Iowa situs which is distributed in kind from the estate is not subject to inheritance tax if the aggregate value of all tangible personal property in the estate does not exceed $5,000. See 86.2(1)*"c"*(5).

86.5(2) *Foreign real estate and tangible personal property.* Real estate and tangible personal property with a situs outside the state of Iowa are not subject to the Iowa inheritance tax and, therefore, are not includable in the decedent's gross estate for tax purposes. *Frick v. Pennsylvania,* 268 U.S. 473, 45 S. Ct. 603, 69 L.Ed. 1058 (1925); *In re Marx Estate,* 226 Iowa 1260, 286 N.W.2d 422 (1939).

86.5(3) *Intangible personal property—decedent domiciled in Iowa.* Intangible personal property, or interest therein, owned by a decedent domiciled in Iowa is includable in the gross estate for inheritance tax purposes regardless of the physical location of the evidence of the property or whether the account or obligation is with a non-Iowa financial institution. *Curry v. McCanless,* 307 U.S. 357, 59 S. Ct. 900, 83 L.Ed 1339 (1939); *Lincoln's Estate v. Briggs,* 199 N.W.2d 337 (Iowa 1972).

86.5(4) *Intangible personal property—decedent domiciled outside Iowa.* Rescinded IAB 10/30/13, effective 12/4/13.

86.5(5) *Classification of property.* The property law of the state of situs determines whether property is classified as real, personal, tangible or intangible and also whether decedent had an interest in the property. *Dieleman's Estate v. Dept. of Revenue,* 222 N.W.2d 459 (Iowa 1974); *Williamson v. Youngs,* 200 Iowa 672, 203 N.W. 28 (1925).

86.5(6) *Insurance—in general.* Whether the proceeds or value of insurance is includable in the gross estate for inheritance tax purposes depends on the particular facts in each situation. Designated beneficiary and type of insurance (life, accident, health, credit life, etc.) are some of the factors that are considered in determining whether the value or proceeds are subject to tax. *In re Estate of Brown,* 205 N.W.2d 925 (Iowa 1973).

a. *Insurance proceeds subject to tax.* The proceeds of insurance on the decedent's life owned by the decedent and payable to the decedent's estate or personal representative is includable in the gross estate. Insurance owned by the decedent on the life of another is includable in the gross estate to the extent of the cash surrender value of the policy. The proceeds of all insurance to which the decedent had an interest, at or prior to death, but are payable for reasons other than death, are includable in the gross estate. *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977).

b. *Insurance proceeds not taxable.* Insurance on the decedent's life payable to a named beneficiary, including a testamentary trust, other than the insured, the estate, or the insured's personal representative, is not subject to Iowa inheritance tax. *In re Estate of Brown,* 205 N.W.2d 925 (Iowa 1973).

c. Insurance proceeds includable—depending on circumstances. Credit life insurance and burial insurance are offsets against the obligation. If the obligation is deducted in full or in part in computing the taxable shares of heirs or beneficiaries, the proceeds of the credit life and burial insurance are includable in the gross estate to the extent of the obligation. Insurance on the decedent's life and owned by the decedent, pledged as security for a debt is an offset against the debt if the insurance is the primary source relied upon by the creditor for the repayment of the obligation and is includable in the gross estate on the same conditions as credit life insurance. See *Estate of Carl M. Laartz* Probate No. 9641, District Court of Cass County, March 17, 1973; *Estate of Roy P. Petersen,* Probate No. 14025, District Court of Cerro Gordo County, May 16, 1974.

Insurance on the decedent's life, payable to a corporation or association in which the decedent had an ownership interest, while not subject to tax as insurance, may increase the value of the decedent's interest. *In re Reed's Estate,* 243 N.Y. 199, 153 N.E.47, 47 A.L.R. 522 (1926).

86.5(7) *Gifts in contemplation of death—for estates of decedents dying prior to July 1, 1984, only.* A transfer of property, or interests in property by a decedent, except in the case of a bona fide sale for fair consideration within three years of the grantor's death, made in contemplation of death, is includable in the decedent's gross estate. Any such transfer made within the three-year period prior to the grantor's death is presumed to be in contemplation of death, unless it is shown to the contrary. Whether a transfer is made in contemplation of death depends on the intention of the grantor in making the transfer and will depend on the facts and circumstances of each individual transfer.

a. Factors to be considered include, but are not limited to:

(1) The age and health of the grantor at the time of the transfer,

(2) Whether the grantor was motivated by living or death motives,

(3) Whether or not the gift was a material part of the decedent's property,

(4) Whether the gift was an isolated event or one of a series of gifts during the decedent's lifetime.

b. Factors which tend to establish that the motive for the gift was prompted by the thought of death include, but are not limited to:

(1) Made with the purpose of avoiding death taxes,

(2) Made as a substitute for a testamentary disposition of the property,

(3) Of such an amount that the remaining property of the grantor would not normally be sufficient to provide for the remaining years of the grantor and those of the grantor's household,

(4) Made with the knowledge that the grantor is suffering from a serious illness that is normally associated with a shortened life expectancy.

c. Factors which tend to establish that the gift was inspired by living motives include, but are not limited to:

(1) Made on an occasion and in an appropriate amount that is usually associated with such gift giving occasions as Christmas, birthdays, marriage, or graduation,

(2) Made because of the financial need of the donee and in an amount that is appropriate to the need,

(3) Made as a remembrance or reward for past services or favors in an amount appropriate to the occasion,

(4) Made to be relieved of the burden of management of the property given, retaining sufficient property and income for adequate support and maintenance.

For a gift to be determined to have been made in contemplation of death it is not necessary that the grantor be conscious of imminent or immediate death. However, the term means more than the general expectation of death which all entertain. It is a gift when the grantor is influenced to do so by such expectation of death, arising from bodily or mental condition, as prompts persons to dispose of their property to those whom they deem the proper object of their bounty. It is sufficient if the thought of death is the impelling cause for the gift. *U.S. v. Wells,* 283 U. S. 102, 51 S. Ct. 446, 75 L.Ed. 867 (1931); *In re Mann's Estate,* 219 Iowa 597, 258 N.W. 904 (1935).

d. Gifts made within three years prior to death—for estates of decedents dying on or after July 1, 1984. All gifts made by the donor within three years prior to death, which are in excess of the annual calendar year federal gift tax exclusion provided for in 26 U.S.C. Section 2503, subsections b and e, are included in the gross estate for inheritance tax purposes. The motive, intention or state of mind of the donor is not relevant. Date of valuation for a gift in which there was a full transfer of ownership is valued at the date in which the gift is completed. However, for a gift of an interest in property that is less than a full transfer of ownership, which includes, but is not limited to, a life estate or conditional gift, the date of valuation is the date of the death of the decedent, unless alternative valuation is chosen. Effective for estates of decedents dying on or after July 1, 2003, valuation of property transferred by the grantor or donor is based on the net market value at the date of transfer. The fact alone that the transfer is a gift, in whole or in part, and exceeds the annual calendar year exclusion for federal gift tax purposes, is sufficient to subject the excess of the transfer over the exclusion to tax. The exclusion is applied to the total amount of the gifts made to a donee in a calendar year, allocating the exclusion to the gifts in the order made during the calendar year. This rule has important application to the earliest year of the three-year period before death because the three-year period for inheritance tax purposes is measured from the date the decedent-donor died. This will only rarely coincide with a calendar year. As a result, none of the gifts made in the earliest calendar year of the three-year period prior to death, regardless of the amount, which are made before the beginning of the three-year period, measured by the decedent's death date, are subject to tax. However, gifts made before the three-year period begins in this earliest year will reduce or may completely absorb the exclusion amount that is available for the remaining part of this first-year period. The significance of the difference between the three-year period prior to death and the calendar year exclusion amount is illustrated by the following:

EXAMPLE. The decedent-donor, A, died July 1, 2012. The three-year period during which gifts may be subject to inheritance tax begins July 1, 2009. During the calendar year 2009, A made a cash gift to nephew B of $14,000 on May 1, 2009, and a second gift to B of $4,000 on August 1, 2009. In this example, none of the $14,000 gift made on May 1, 2009, is includable for inheritance tax purposes because it was made before the three-year period began, based on A's date of death. All of the $4,000 gift made on August 1, 2009, is includable for inheritance tax purposes because it is in excess of the calendar year 2009 federal gift tax exclusion of $13,000.

(1) Split gift. At the election of the donor's spouse, a gift made by a donor to a person, other than the spouse, shall be considered, for inheritance tax purposes, as made one half by the donor and one half by the donor's spouse. This split gift election for inheritance tax purposes is subject to the same terms and conditions that govern split gifts for federal gift tax purposes under 26 U.S.C. Section 2513.

The consent of the donor's spouse signified under 26 U.S.C. Section 2513(b) shall also be presumed to be consent for Iowa inheritance tax purposes, unless the contrary is shown. If the split gift election is made, the election shall apply to all gifts made during the calendar year. Therefore, if the election is made, each spouse may use the annual federal gift tax exclusion which shall be applied to one-half of the total value of all gifts made by both spouses during the calendar year to each donee.

(2) Types of transfers which may result in a gift. Whether a transfer of property constitutes a gift depends on the facts and circumstances surrounding each individual transfer. Transfers which may result in a gift, in whole or in part, include, but are not limited to: sales of property where the purchase price, or terms of sale, are less than fair market value; a loan of money, interest free, even though the loan is payable on demand; the release of a retained life use of property; and the payment of a debt or other obligation of another person.

(3) Types of transfers that are not a gift. However, certain transfers which in property law would be considered a present transfer of an interest in property may not be considered gifts within the Iowa three-year rule under Iowa Code section 450.3(2). Rather the transfers may be transfers intended to take

effect in possession or enjoyment at death. Examples of this kind of transfer would include, but are not limited to, transfers in trust or otherwise, with a retained life use or interest; commercial annuities where payments are made to a beneficiary upon the death of the primary annuitant; transfers that place property in joint tenancy; irrevocable transfers of real or personal property where the deed or bill of sale is placed in escrow to be delivered only upon the grantor's death. Transfers of this kind are subject to inheritance tax under Iowa Code section 450.3(3) as a transfer to take effect in possession or enjoyment at death, even though under property law an interest in the property may have been transferred prior to death. Different kinds of transfers that may constitute a taxable gift, in whole or in part, include but are not limited to the following:

EXAMPLE A. Grantor-decedent, A, on July 1, 1992, transferred to nephew B, without consideration, a 160-acre Iowa farm, reserving the life use. On the date of transfer, the farm had a fair market value of $2,000 per acre, or $320,000. On August 1, 1994, A released the retained life estate without any consideration being given and then died on December 1, 1994. The release on August 1, 1994, constitutes a gift, for inheritance tax purposes, of the value of the entire farm (less the annual gift tax exclusion), within the three-year period prior to death. What is taxable is what would have been taxable had the release not been given. *United States v. Allen,* 293 F.2d 916 (10th Cir. 1961); Rev. Ruling 56-324, 1956 2 C.B. 999. In this example, the gift is not to be valued at the time of the release of the life use, but rather at its fair market value at the time of death. See subrule 86.9(1). The real estate cannot be valued at its alternate valuation date because it is not included in the federal gross estate for federal estate tax purposes, but rather it constitutes an adjusted taxable gift not eligible for the alternate valuation date. See rule 701—86.10(450) and Federal Estate Tax Regulation Section 20.2032-1(a) and (d).

EXAMPLE B. A, on August 1, 2009, loaned brother B $450,000 which was evidenced by a non-interest-bearing promissory note, payable on demand. A died on October 1, 2011, with no part of the loan having been repaid. The principal amount of the note is includable in A's gross estate. The free use of money is a valuable property right to the debtor. *Dickman v. Commissioner,* 465 U.S. 330 (1984). Thus, in effect, A has made a gift of the value of the interest to B each year the debt remains unpaid. Assuming for purposes of illustration that the applicable federal short-term rate for the entire year is 9 percent for each year and no other gifts were made to B, A has made a gift to B of $40,500 through August 2010 (one year after the note was executed) and an additional gift of $40,500 through August 1, 2011, and two months' interest of $6,750 from August 1, 2011, to the date of death on October 1, 2011. Therefore, in calendar year 2009 A has made a gift of 5/12 of $40,500, or $16,875. After deducting the annual calendar year exclusion of $13,000, $3,875 is subject to inheritance tax. Since the loan was outstanding for all of calendar year 2010, $40,500, less the $13,000 exclusion, or $27,500, is subject to inheritance tax. For calendar year 2011 the loan was outstanding for nine months. Three-fourths of $40,500, less $13,000, or $17,375, is subject to inheritance tax.

In this example it is not necessary that the loan be made within the three-year period prior to death. It is the free use of the loan during the three-year period prior to death that constitutes the gift.

EXAMPLE C. On March 1, 2010, A sold a 160-acre Iowa farm to niece B for $1,500 per acre, or $240,000. On the date of sale, the fair market value of the farm was $2,500 per acre, or $400,000. A died on August 1, 2012. This sale is, in part, a gift. It is not a bona fide sale for an adequate and full consideration in money or money's worth, and as a result, the difference between the sale price and the fair market value of the farm on the date of sale constitutes a gift. The sale price in this example represents only 60 percent of the farm's fair market value; therefore, 40 percent of the farm is a gift. However, the gift percentage to apply to the farm's value at death is 37 percent, not 40 percent, because the $13,000 annual gift tax exclusion must be deducted from the value of the gift. See the computation of this percentage in Example D immediately following.

EXAMPLE D. On March 1, 2010, A sold a 160-acre Iowa farm to niece B for $2,500 per acre, or $400,000, which was also the fair market value of the farm on the date of sale. The sale was an installment sale contract, payable in 20 equal annual installments of principal and interest. The unpaid principal balance is to draw interest at one-half of the prevailing Federal Land Bank loan rate, which for purposes of illustration we will assume to be the rate of 12 percent, or 6 percent per year. The annual payments of principal and interest are $34,873.82 per year. A died on August 1, 2012. In this example, the sale price in and of itself does not constitute a gift because the sale price was also the fair market value of the farm. However, the difference between the prevailing Federal Land Bank loan rate of 12 percent and the contract rate of 6 percent constitutes a gift from A to B.

The amount of the gift that is includable in the gross estate is computed by determining the present value of the future annual payments of $34,873.82 discounted to reflect a 12 percent return on the investment. The discounted value is then divided by the fair market value of the farm on the date of the sale to determine the percentage of the sale price that is a bona fide sale for full consideration and the percentage of the sale price that represents a gift before the annual exclusion. The gift percentage is then applied to the fair market value of the farm (or special use value, if applicable) at death, to determine the amount that is includable in the gross estate.

The computation in this example is as follows:

The present value of the future annual payments of $34,873.82 for 20 years to reflect a 12 percent return on an investment is $260,488.05. That is, an investor who desires to earn the market rate of return of 12 percent on an investment would only pay $260,488.05 for this 6 percent $400,000 contract of sale.

<u>Bona Fide Sale Percentage</u>

Present value:	<u>260,488.05</u>	= 65%
Sale price:	400,000.00	

This is the percentage of the sale price of $400,000 that represents a bona fide sale for full consideration.

<u>Gift Percentage</u>

The sale price of $400,000 - $260,488.05 or $139,511.95 is the gift portion of the sale price due to the 6 percent interest rate on the contract, before the $13,000 annual exclusion is deducted.

The gift percentage is computed as follows:

$$\$139{,}511.95 - \$13{,}000 = \frac{\$126{,}511.95}{400{,}000.00} = 32\%$$

In this example the gift percentage used to determine the amount of the farm value at death that is taxable is only 32 percent of the value because deducting the $13,000 exclusion reduced the gift percentage from 35 percent to 32 percent. The gift took place in the year of sale, not in the year of death. As a result, 32 percent of fair market value (or special use value, if applicable) of the farm at the time of the donor's death is includable in the gross estate for inheritance tax purposes.

86.5(8) *Joint tenancy property—in general.* Whether the form of ownership of property is considered to be joint tenancy is determined by the property law of the state of the situs of the property. Generally, the words and phrases "to A and B as joint tenants with full rights of survivorship and not as tenants in common" create a joint tenancy form of ownership unless a contrary interest can be shown by material evidence. "To A or B, payable to the order of self" creates an alternative right of ownership and for tax purposes is treated as joint tenancy property. *In re Estate of Martin,* 261 Iowa 630, 155 N.W.2d 401 (1968); *Petersen v. Carstensen,* 249 N.W.2d 622 (Iowa 1977); *In re Estate of Louden,* 249 Iowa 1393, 92 N.W.2d 409 (1958). Joint tenancy property may be held by more than two persons. *In re Estate of Horner,* 234 Iowa 624, 12 N.W.2d 166 (1944). However, the use of the words "as joint tenants" alone without the use of the phrase "with right of survivorship" may only create a tenancy in common. *Albright v. Winey,* 226 Iowa 222, 284 N.W. 86 (1939).

a. Joint tenancy property—husband and wife alone. Generally there are no shares in joint tenancy property because each joint tenant owns the whole property. As a result, joint tenancy property is not taxed like tenancy in common property where each owner has a specific share. If the joint tenancy property is held by husband and wife alone, only one-half of the property is includable in the gross estate for inheritance tax purposes in the estate of the first joint tenant to die. However, if the survivor can establish by competent evidence that separate money or property was used and contributed to a larger percentage than one-half to the acquisition of a specific item or items of jointly held property, then the larger percentage of such item or items shall be excluded from taxation. *Ida M. Jepsen v. Bair,* No. 85, State Board of Tax Review, June 18, 1975.

b. Joint tenancy property—not held by husband and wife alone. Property held in this form of joint tenancy is includable in the gross estate of the deceased joint tenant, except to the extent the surviving joint tenant or tenants can establish contribution to the acquisition of the joint property, in which case the proportion attributed to the contribution is excluded from the gross estate. In the case of multiple joint tenancy property, excess contribution established by one surviving joint tenant cannot be attributed to another surviving joint tenant. For tax purposes, the requirement of contribution in effect establishes percentage ownership—or shares—in jointly held property that does not exist in property law. Contribution to the acquisition of jointly held property can be established by the survivor by proof, which includes, but is not limited to, evidence that the property was acquired by gift, inheritance, or purchase from the survivor's separate funds or property. Contribution means cash or cash in kind that is applied to the cost of obtaining the property at issue. Unlike joint tenancy property held solely between husband and wife, if any of the surviving joint tenants is not the spouse of the decedent, the presumed one-half exclusion is not automatically available without proof of contribution.

c. Joint tenancy—convenience or constructive trust. If the record ownership of bank accounts, certificates of deposit, and other kinds of property are held in the form of joint tenancy, but in fact are held by the decedent and another person or persons who have a confidential or fiduciary relationship with the decedent, the property is not held in joint tenancy but is held in constructive or resulting trust by the survivor for the decedent. A confidential or fiduciary relationship is any relationship existing between the parties to a transaction wherein one of the parties is duty bound to act with the utmost good faith for the benefit of the other party. In its broadest connotation, the phrase embraces those multiform positions in life wherein one comes to rely on and trust another in one's important affairs. *First National Bank v. Curran,* 206 N.W.2d 317 (Iowa 1973). The fact that the decedent furnished the funds to acquire the property or demonstrated a kind, considerate, and affectionate regard for the survivor does not in itself establish a confidential relationship between the decedent and the survivor. If the evidence to establish a contrary relationship with respect to property in the form of joint tenancy is not substantial, a joint tenancy exists as a matter of law. *Petersen v. Carstensen,* 249 N.W.2d 622 (Iowa 1977).

If a confidential relationship constituting a constructive or resulting trust is established on behalf of the decedent, the property or property interest that is the subject of the trust is part of the decedent's gross estate as singly owned property.

86.5(9) *Transfers reserving a life income or interest.* If the grantor transfers property, except in the case of a bona fide sale for fair consideration, reserving the income, use, possession, or a portion thereof for life, the property is includable in the gross estate for inheritance tax purposes. *In re Sayres' Estate,* 245 Iowa 132, 60 N.W.2d 120 (1953); *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973). If there is a full reservation of income, the entire value of the property in which the reservation exists is includable for tax purposes. If only a portion of the income is reserved, the amount subject to tax is the full value of the property at death multiplied by a fraction of which the total income reserved is the numerator and the total average earning capacity of like property is the denominator. See *In re Estate of English,* 206 N.W.2d at 310.

The reservation of the life income, or portion thereof, need not necessarily be stated or contained in the instrument of transfer to be includable for taxation. The transfer of property may contain no reservation of income or other incidents of ownership in the grantor, but if there is a contemporaneous agreement between the grantor and grantee to pay the income, or portion thereof, to the grantor for life, the two instruments or agreements when considered together may be construed to be reservation of the income from the transferred property. See *In re Sayres' Estate,* 245 Iowa 132 at 141, 142, 60 N.W.2d 120 (1953) for a full discussion of the subject.

The instrument need not be in any special form. For example, it may take the form of a contract of sale to terminate at death where the payments consist of the income from the property only. In addition, the transfer to be includable for taxation is not limited to income-producing property. For example, the transfer of the grantor's dwelling, reserving the life occupancy, falls within the meaning of a reserved life income or interest. Generally, revocable trusts can be classified as reserving a life income or interest. This type of transfer does not fall within the annual gift exclusion.

86.5(10) *Powers of appointment—in general.* Iowa Code section 450.3(4) is concerned with two aspects of powers of appointment that are subject to inheritance tax. First, the taxation of the decedent's property subject to the power of appointment in the estate of the donor (decedent), and second, the exercise, or nonexercise, of the power of appointment over the property in the estate of the donee (the decedent possessing the power).

a. General power of appointment. Whether the instrument of transfer utilized by the donor creates a general or special power of appointment is a matter of property law. For example, a devise to A for life with "power to dispose of and pass clear title ... if A so elects," creates a life estate with a general power of appointment. *In re Estate of Cooksey,* 203 Iowa 754, 208 N.W. 337 (1927). Also to A for life, "Especially giving unto A the right to use and dispose of the same as A may see fit," creates a general power of appointment, *Volz v. Kaemmerle,* 211 Iowa 995, 234 N.W. 805 (1931). However, the power to sell and convert the assets subject to the power does not in itself create a general power of appointment. *In re Estate of Harris,* 237 Iowa 613, 23 N.W.2d 445 (1946). A power is general if being testamentary, it can be exercised wholly in favor of the estate of the donee. *In re Estate of Spencer,* 232 N.W.2d 491 at 495, 496 (Iowa 1975). The definition of a general power of appointment contained in 26 U.S.C. Section 2056(b)(5) of the Internal Revenue Code would meet the test of a general power under Iowa law.

b. Special power of appointment. If there is a limitation on the donee's right to use the corpus only for care, maintenance and support, the power is special, not general. *Brown v. Brown,* 213 Iowa 998, 240 N.W. 910 (1932). Also, to A for life with power to handle the property for A's interest, limits the power of invasion of the principal for care and support only, and is therefore a special, not a general, power of appointment. *Lourien v. Fitzgerald,* 242 Iowa 1258, 49 N.W.2d 845 (1951). Also, to A for life, with unrestricted power of sale with no power over the sale proceeds creates only a special power of appointment in the donee. *McCarthy v. McCarthy,* 178 N.W.2d 308 (Iowa 1970).

If the donee's power to appoint is limited to a class or group of persons, a special, not a general, power is created. *In re Estate of Spencer,* 232 N.W.2d 491, at 496 (Iowa 1975).

c. Powers of appointment—taxation in donor's estate. If the instrument in the donor's estate creates a general power of appointment, the property subject to the power is taxed as if the property had been transferred to the donee in fee simple. Those who would succeed to the property in the event the power is not exercised are treated in the donor's estate as if they receive no interest in the property, even though in property law those who succeed to the property either by the exercise, or nonexercise, take from the donor of the power. *In re Estate of Higgins,* 194 Iowa 369 at 373, 189 N.W. 752 (1922); *Bussing v. Hough,* 237 Iowa 194 at 200, 21 N.W.2d 587 (1946).

If the instrument in the donor's estate creates a special power of appointment, the property subject to the power is taxed as if the donee of the power had received a life estate or term for years, as the case may be. Those persons who would take the property in the event the special power is not exercised are taxed in the donor's estate as if they had received the remainder interest in the property subject to the special power, although an election to defer payment of the tax may result in either no tax or a different tax obligation. This could happen, for example, if the special power is the power to invade the corpus for the health, education, and maintenance of the donee.

d. Powers of appointment in the estate of a donee dying on or after January 1, 1988. Property which is subject to a general power of appointment is includable for inheritance tax purposes in the gross estate of a donee dying on or after January 1, 1988, if the donee has possession of the general power of appointment at the time of the donee's death, or if the donee has released or exercised the general power of appointment within three years of death. Whether or not the donee of a general power exercises the general power at death is not relevant to the includability of the property subject to the general power in the estate of the donee. The mere possession of the power at death is sufficient for the property subject to the power to be included in the estate of the donee for inheritance tax purposes.

Property subject to a special power of appointment is not includable in the gross estate of the donee of the power regardless of whether the donee possesses the special power or exercised the power at death, unless a QTIP election was made under Iowa Code subsection 450.3(7) in which case the rule governing QTIP elections shall control. See paragraphs 86.5(10)*"a"* and *"b"* for the distinction between a general and special power and subrule 86.5(11) for the rule governing QTIP elections.

For inheritance tax purposes, if there is an exercise or release of the general power within three years of the donee's death, the property subject to the exercise or release is includable in the donee's estate just as if the donee had retained possession of the power at death and is taxable to those to whom the property is appointed in case the power is exercised, or to those who take in default of the exercise in case the power is released.

The general power of appointment is considered to have been exercised for the purposes of this rule when the nature of the disposition is such that if it were a transfer or disposition of the donee's property, the transfer would be subject to inheritance tax under Iowa Code section450.3. The power is considered exercised in the following three nonexclusive classes of cases: (1) where there has been some reference in the will or other instrument to the power; (2) the will or other instrument contains a reference to the property which is the subject on which the power is to be executed; (3) where the provision in the will or other instrument executed by the donee of the power would otherwise be ineffectual or a mere nullity; in other words, the provision would have no operation except as an execution of the power. *In re Trust of Stork,* 233 Iowa 413, 421, 9 N.W.2d 273 (1943). For the purposes of section 450.3(4), a release of a general power is considered to be a transfer of the property subject to the power to those who would take in default if the power was not exercised.

86.5(11) *Qualified terminable interest property (QTIP).*

a. In general. Effective for estates of decedents dying on or after July 1, 1985, property passing from the decedent grantor-donor, which qualifies as qualified terminable interest property (QTIP) within the meaning of 26 U.S.C. Section 2056(b)(7)(B) is eligible to be treated for Iowa inheritance tax purposes, if an election is made, as passing in fee to the donee-grantee surviving spouse, in the estate of the grantor-donor decedent, subject to the provisions of law and this subrule. If the election is made, the qualified property, unless it is disposed of prior to death, shall be included in the gross estate of the surviving spouse and treated as passing in fee to those succeeding to the remainder interest in the qualified property.

b. Property transfers eligible. Five factors are relevant in determining whether property passing from a decedent grantor-donor is eligible for the Iowa qualified terminable interest election. They are: (1) the death of the decedent-transferor, but not necessarily the transfer, must have occurred on or after July 1, 1985; (2) the property must meet the qualifications required in 26 U.S.C. Section 2056(b)(7)(B), or in the case of a gift within three years prior to the decedent-transferor's death, the qualifications in 26 U.S.C. Section 2523(f); (3) a valid federal election must have been made on a required federal return with respect to the qualified property for federal estate tax purposes or, for federal gift tax purposes, if the transfer occurred within three years prior to the transferor's death; and (4) the property must be included in the decedent-transferor's gross estate for Iowa inheritance tax purposes, either because the transfer occurred at death or within three years prior to the transferor's death; and (5) Iowa must have constitutional nexus with the surviving spouse or QTIP property.

If property is not eligible for an Iowa qualified terminable interest election, or if eligible, but an Iowa election is not made, it is not included in the estate of the surviving spouse grantee-donee for inheritance tax purposes by reason of Iowa Code section 450.3. The fact that the qualified property is included in the estate of the surviving spouse for federal estate tax purposes does not necessarily mean the property is automatically included in the surviving spouse's Iowa gross estate.

The treatment of the qualified property in both the grantor-donor's and the surviving spouse's estates for Iowa inheritance tax purposes is determined by the Iowa election, or lack of an election, being made in the grantor-donor's estate.

This subrule is illustrated by the following examples:

EXAMPLE 1. Decedent A died testate, a resident of Iowa, July 2, 1995, leaving a surviving spouse, B, and two children, C and D. On February 1, 1992, A transferred by deed a 160-acre Iowa farm to spouse B for life, with the remainder at B's death to two children, C and D. An election was made under 26 U.S.C. Section 2523(f) to treat the gift of the 160-acre farm as passing entirely to B in fee.

Upon A's death the 160-acre farm is not part of A's gross estate either for federal estate or for Iowa inheritance tax purposes because the transfer was made more than three years prior to death. However, upon the death of B, the surviving spouse, the 160 acres is included in B's gross estate (unless disposed of prior to death) for federal estate tax purposes, but is not included in B's Iowa gross estate. The transfer by A took place more than three years prior to death, and therefore is not included in A's Iowa estate and is not eligible for an Iowa qualified terminable interest election.

EXAMPLE 2. On October 1, 1992, grantor A executed a revocable inter vivos trust which consisted of cash and a 160-acre Iowa farm. Under the terms of the trust agreement A was to receive the trust income for life and upon A's death the trustee was to pay the trust income to A's spouse, B, for life, with the power to invade the principal for B's care and support. Upon B's death the trust was to terminate and the balance of the corpus was to be paid to A's children, C and D. A died July 2, 1995, and the personal representative elected to treat the trust assets as passing entirely in fee to the surviving spouse, B, for federal estate tax purposes. An Iowa qualified terminable interest election was not made. In this fact situation, the election qualified the trust assets for the marital deduction for federal estate tax purposes. For Iowa inheritance tax purposes, since an Iowa election was not made, the trust assets are taxed on the basis of a life estate passing to B, the surviving spouse, and the remainder passing to the children, C and D. Upon B's death, the trust corpus will be included in B's estate for federal estate tax purposes, but not in B's estate for Iowa inheritance tax purposes, because an Iowa qualified terminable interest election was not made in A's estate.

c. The qualified terminable interest election—in general. The election to treat qualified terminable interest property as passing entirely in fee to the surviving spouse in the estate of the decedent grantor-donor is an affirmative act. In the event an election is not made, the qualified property will be treated as a life estate passing to the surviving spouse with a remainder over as provided in Iowa Code section 450.3(4).

An Iowa election cannot be made unless an election has been made on the same qualified property for federal estate tax purposes on a required federal return, or in case of a gift made within three years of the decedent grantor-donor's death, for federal gift tax purposes. However, even though a federal election has been made, the personal representative of the decedent grantor-donor's estate has the option to either make or not to make the election with respect to the qualified property for Iowa inheritance tax purposes. It is sufficient for Iowa inheritance tax purposes that a valid federal election has been made. What constitutes a valid election for federal estate or gift tax purpose is determined under applicable federal law and practice and not by the department.

However, it is permissible for Iowa inheritance tax purposes to make an election for a smaller but not larger percentage of the qualified property than was made for federal estate or gift tax purposes. These general principles can be illustrated by the following examples:

EXAMPLE 1. Decedent-grantor A created a revocable inter vivos trust on October 15, 1992, which was funded by $200,000 in cash and a 160-acre Iowa farm worth $200,000. The trust provided that the trustee pay the income to A for life and upon A's death, the trustee was to pay the income to A's surviving spouse B for life, with power to invade the principal for B's care and support. Upon B's death the trust was to terminate and the balance of the principal was to be distributed to A's two children, C and D.

A died on July 2, 1995, and the principal of the trust is included in A's gross estate both for federal estate and Iowa inheritance tax purposes because the trust was revocable and A retained the income for life. A's personal representative elected to treat 50 percent of the trust assets as qualified terminable interest property for federal estate tax purposes. A's personal representative elected not to treat the qualified property as passing to B for Iowa inheritance tax purposes. This is permissible because the personal representative has the option to either elect or not to elect to treat 50 percent of the qualified property as passing in fee to the surviving spouse for Iowa inheritance tax purposes.

EXAMPLE 2. Same factual situation as Example 1. A's personal representative elects to treat only 25 percent of the qualified property as passing in fee to the surviving spouse for Iowa inheritance tax purposes. This is permissible because the personal representative is not required to make an election on all of the qualified terminable interest property on which the federal election has been made. It is sufficient that a federal election has been made for at least as large a percentage of the qualified property on which the Iowa election is made. However, an Iowa election cannot be made for a larger percentage of the qualified property than the percentage made on the federal election.

EXAMPLE 3. Same factual situation as Example 1. In this example, A's personal representative, for Iowa inheritance tax purposes, purports to elect to treat the $200,000 cash in the trust as passing in fee to the surviving spouse, but not the 160-acre Iowa farm, which is also valued at $200,000. Although the federal estate tax election is for 50 percent of the qualified property, the Iowa election is invalid even though it is made in respect to an asset which is equal in value to 50 percent of the trust principal. If the election is made for less than all of the qualified terminable interest property, the election must be for a fraction of all the qualified property. The personal representative is not permitted to select for the election some qualified assets and reject others. See Federal Estate Tax Regulation 20.2056-1(b).

d. The election—manner and form. The qualified terminable interest election shall be in writing and made by the personal representative of the decedent grantor-donor's estate on the Iowa inheritance tax return. The election once made shall be irrevocable. If the election is not made on the first inheritance tax return, the election may be made on an amended return, provided the amended return is filed on or before the due date of the return (taking into consideration any extensions of time granted to file the return and pay the tax due). The personal representative may make an election on a delinquent return, provided it is the first return filed for the estate. The filing for the purpose of protective election is not allowed. Failure to make the election on the first return filed after the due date has passed precludes making an election on a subsequent return. See 26 U.S.C. Section 2056(b)(7)(B)(V) and Internal Revenue Service Letter Ruling 8418005.

The election consists of two affirmative acts performed by the personal representative on the inheritance tax return: (1) by answering in the affirmative the question—Is the estate making a qualified terminable interest election with respect to the qualified property? and (2) by computing the share of the surviving spouse to include the qualified terminable interest property on which the election was made. In the event of an inconsistency in complying with the two requirements, the treatment given to the share of the surviving spouse shall be controlling.

e. Disposition of qualified property prior to death. A disposition of all or part of the qualified property, which was the subject of the qualified terminable interest election, prior to the death of the surviving spouse, voids the election as to that portion of the property disposed of that is not retained by the surviving spouse. In this event, the portion of the qualified property not retained by the surviving spouse shall be taxed to those succeeding to the remainder interests in the disposed property as if the tax on the remainder interest had been deferred under Iowa Code sections 450.44 to 450.49. Except in the case of special use valuation property, the tax shall be based on the fair market value of the amount of the qualified property not retained by the surviving spouse at the time the property was disposed of. *In re Estate of Wickham,* 241 Iowa 198, 40 N.W.2d 469 (1950), see subrule 86.11(5) for taxation of remainder interests when the tax is deferred. The alternate valuation date cannot be used in computing the tax. See subrule 86.10(2). If QTIP property has been valued at its special use value under Iowa Code chapter

450B, and is disposed of prior to the death of the surviving spouse, the portion of the QTIP property not retained by the surviving spouse shall be valued for taxation as follows:

1. At its special use value at the time of its disposition, if the QTIP property remains in qualified use under 26 U.S.C. Section 2032A.

2. At its fair market value at the time of its disposition, if there is a cessation of the qualified use under 26 U.S.C. Section 2032A. In case there is a cessation of the qualified use, the recapture tax provisions of Iowa Code section 450B.3 shall not apply. The tax on the remainder interest is treated as a payment of tax deferred and subject to the rules on deferred tax and not a recapture, with interest, of the tax originally imposed in the decedent grantor-donor's estate.

f. Inclusion in the estate of the surviving spouse. Upon the death of the surviving spouse the qualified terminable interest property, which was the subject of an election, that was not disposed of prior to death, shall be included in the gross estate of the surviving spouse and be treated as if it passed in fee from the surviving spouse to those succeeding to the remainder interests. The included QTIP property will receive a stepped up basis for gain or loss as property acquired from a decedent. See 26 U.S.C. Section 1014(b)(10). The relationship of the surviving spouse to the owners of the remainder interest shall determine whether the individual exemptions provided for in Iowa Code section 450.9 apply and which tax rate in Iowa Code section 450.10 shall be applicable.

Qualified property included in the estate of the surviving spouse shall be valued as if it passed from the surviving spouse in fee and shall be valued either (1) at the time of the surviving spouse's death under the provisions of Iowa Code section 450.37 and rule 86.9(450), or at its special use value under Iowa Code chapter 450B and rule 86.8(450B), if the real estate is otherwise qualified; or (2) at the alternate valuation date under the provisions of Iowa Code section 450.37(1)*"b"* and rule 86.10(450), if the property is otherwise eligible.

This subrule can be illustrated by the following examples:

EXAMPLE 1. Decedent A died testate on July 2, 1997, survived by a spouse, B, aged 65, and two step-grandchildren, C and D. Under A's will all property was left in trust to pay all of the income to B for life. Upon B's death, the trust was to terminate and the principal was to be divided equally between C and D, who are the grandchildren of surviving spouse B. The personal representative elected to treat the trust assets as passing entirely in fee to surviving spouse B. The net corpus of the trust consists of a 160-acre farm valued at $250,000 and personal property valued at $200,000.

Tax on the basis of all property passing in fee to B

Share	Tax
$450,000	$0

EXAMPLE 2. Same facts as Example 1, with the exception that the personal representative did not make an Iowa qualified terminable interest election. In this fact situation, the trust assets are taxed on the basis of a life estate passing to the surviving spouse B with a remainder over to C and D.

Share	Tax
Spouse B: Life estate factor .42226 $450,000 × .42226 = $190,017	-0-
C's share ½ remainder factor .57774 $450,000 × .57774 ÷ 2 = $129,991.50	$15,498.73
D's share—same as C's share $129,991.50	$15,498.73
Total $450,000.00	$30,997.46

In Example 1, the qualified terminable interest election results in no inheritance tax. However, as shown in Example 2, it would have cost the step-grandchildren, C and D, $30,997.46 if the election had not been made.

EXAMPLE 3. B, the surviving spouse of A in Example 1, died testate, a resident of Iowa, on October 15, 1997. Under the terms of B's will, B's grandchildren, C and D, inherit B's entire estate in equal shares. B's net estate consists of $200,000 in personal property and a 160-acre Iowa farm with a value of $250,000 both of which were the subject of a qualified terminable interest election in A's estate and in which C and D own the remainder interest. B's net estate also consisted of $100,000 in intangible personal property which B owned in fee simple.

B's net estate for Iowa inheritance tax purposes consists of the following:

$200,000, personal property from A's estate.

$250,000, 160-acre farm from A's estate.

$100,000, owned by B in fee simple.

$550,000 Total

The shares of C and D and their tax owed in B's estate are computed as follows:

Share		Tax
Beneficiary C: ½ of the net estate, or		
	$275,000	$0
Beneficiary D: (same as C)	$275,000	$0
Totals	$550,000	$0

g. The QTIP tax credit and the credit for tax on prior transfers. The credit for the additional tax paid by the surviving spouse in the estate of the decedent grantor-donor on property, which was the subject of a qualified terminable interest election, is governed exclusively by the provisions of Iowa Code section 450.3 and these rules. The credit for tax paid on prior transfers allowable under Iowa Code section 450.10(6) shall not apply. However, property received by the surviving spouse from the estate of the decedent grantor-donor, which was not the subject of a qualified terminable interest election, is eligible for the credit for the tax paid on a prior transfer, if the conditions of Iowa Code section 450.10(6) are otherwise met.

86.5(12) *Annuities.* Annuities in general, including the earnings, are considered to be taxable under Iowa Code section 450.3(3) as a transfer made or intended to take effect in possession or enjoyment after the death of the grantor or donor. *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973); *In re Endemann's Estate,* 307 N.Y. 100, 120 N.E.2d 514 (1954); *Cochrane v. Commission of Corps & Taxation,* 350 Mass. 237, 214 N.E.2d 283 (1966). For exceptions for employee-sponsored retirement plans, including annuities, see 86.5(13).

86.5(13) *Employer-provided or employer-sponsored retirement plans and individual retirement accounts.* Iowa Code section 450.4(5) provides an exemption on that portion of the decedent's interest in an employer-provided or employer-sponsored retirement plan or on that portion of the decedent's individual retirement account that will be subject to federal income tax when paid to the beneficiary. This exemption applies regardless of the identity of the beneficiary and regardless of the number of payments to be made after the decedent's death.

For the purposes of this exemption:

a. An "individual retirement account" includes an individual retirement annuity or any other arrangement as defined in Section 408 of the Internal Revenue Code.

b. An "employer-provided or employer-sponsored retirement plan" includes a qualified retirement plan as defined in Section 401 of the Internal Revenue Code, a governmental or nonprofit employer's deferred compensation plan as defined in Section 457 of the Internal Revenue Code, and an annuity as defined in Section 403 of the Internal Revenue Code.

EXAMPLE 1. The decedent was a participant in a qualified retirement plan through the decedent's employer. The beneficiary of the retirement plan is the decedent's niece. The balance in the retirement plan will be fully subject to federal income tax and included as net income pursuant to Iowa Code section 422.7 when paid to the beneficiary. As a result, Iowa inheritance tax would not be imposed on the value of the retirement plan.

EXAMPLE 2. The decedent was a participant in a qualified retirement plan through the decedent's employer. The beneficiary of the pension is the decedent's niece. A portion of the payments received by the niece will be fully subject to federal income tax and included as net income pursuant to Iowa Code section 422.7. As a result, Iowa inheritance tax would not be imposed on the value of the portion of payments included as net income. However, the remaining portion of the payments not reported as net income pursuant to Iowa Code section 422.7 would be subject to Iowa inheritance tax. See Iowa Code section 450.4.

An exemption from Iowa inheritance tax for a qualified plan does not depend on the relationship of the beneficiary to the decedent. Payments under a qualified plan made to the estate of the decedent are exempt from Iowa inheritance tax. See *In re Estate of Heuermann,* Docket No. 88-70-0388 (September 21, 1989). In addition, for the purpose of determining the taxable or exempt status of payments under a qualified plan, it is not relevant that the decedent rolled over or changed the terms of payment prior to death. Taxation or exemption of payments made under a qualified plan is determined at the date of the decedent's death.

86.5(14) *Distribution of trust property.* Property of a trust can be divided into two or more trusts, or one or more separate trusts can be consolidated with one or more other trusts into a single trust by dividing the property in cash or in kind, including in undivided interests, by pro-rata or non-pro-rata division or in any combination thereof. Division of property between trusts in this manner does not result in a "sale" of the divided property and a corresponding taxable gain.

86.5(15) *Qualified tuition plans exempt.* Effective for estates of decedents dying on or after July 1, 2008, in the event that the decedent was the sole plan participant in a qualified school tuition plan, as defined in Section 529 of the Internal Revenue Code; or in the event that a named co-plan participant does not have a lineal relationship to the named beneficiary of the qualified tuition plan, the value of the decedent's interest in the qualified tuition plan is not subject to Iowa inheritance tax and therefore is not includable in the decedent's gross estate for tax purposes. This provision applies only to qualified tuition plans in existence on or after July 1, 1998.

This rule is intended to implement Iowa Code sections 422.7(4), 450.2, 450.3, 450.4(5), 450.8, 450.12, 450.37, 450.91, 633.699, and 633.703A and Iowa Code Supplement section 450.4 as amended by 2008 Iowa Acts, House File 2673, section 2.

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