

Senate File 636 - Introduced

SENATE FILE 636

BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO SF 593)

A BILL FOR

1 An Act relating to the exclusion from the individual income tax
2 of certain net capital gains from the sale of real property
3 used in a business, and including applicability provisions.
4 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

DIVISION I

CAPITAL GAINS TAXATION — MATERIAL PARTICIPATION

1
2 Section 1. Section 422.7, subsection 21, paragraph a, Code
3 2019, is amended by adding the following new subparagraph:

4 NEW SUBPARAGRAPH. (3) (a) For purposes of determining
5 the material participation of a taxpayer under this paragraph
6 with regard to a partnership, subchapter S corporation, limited
7 liability company, estate, or trust whose capital gain flows
8 through to the owners or beneficiaries for federal income tax
9 purposes, material participation shall be determined at the
10 owner or beneficiary level according to the activities of each
11 owner or beneficiary.
12

13 (b) For purposes of determining material participation of a
14 taxpayer under this paragraph with regard to the sale of real
15 property used in a business or rental arrangement by an estate
16 or trust, all beneficiaries or owners of the estate or trust
17 shall be treated as materially participating in the business or
18 rental arrangement if one or more of the executors or trustees
19 of the estate or trust are materially participating in the
20 business, or if the real property is leased to another person,
21 the executor or trustee is materially participating in the
22 lessee's business that uses the real property. The ten-year
23 period described in paragraph "a", subparagraph (1), is deemed
24 to be met by any combination of material participation by the
25 decedent or settlor or one or more executors or trustees, in
26 the aggregate, over the ten-year period.

27 Sec. 2. APPLICABILITY. This Act applies to tax years
28 beginning on or after January 1, 2020.

29 DIVISION II

30 CAPITAL GAINS TAXATION — MATERIAL PARTICIPATION — FUTURE

31 INCOME TAX CHANGES

32 Sec. 3. 2018 Iowa Acts, chapter 1161, section 113,
33 subsection 21, paragraph a, subparagraph (3), is amended to
34 read as follows:

35 (3) "Materially participated" or "material participation"

1 means the same as ~~“material participation”~~ defined in section
2 469(h) of the Internal Revenue Code, except under the
3 following circumstances:

4 (a) For purposes of determining the material participation
5 of a taxpayer with regard to a partnership, subchapter S
6 corporation, limited liability company, estate, or trust whose
7 capital gain flows through to the owners or beneficiaries for
8 federal income tax purposes, material participation shall be
9 determined at the owner or beneficiary level according to the
10 activities of each owner or beneficiary.

11 (b) For purposes of determining material participation
12 of a taxpayer with regard to the sale of real property used
13 in a business or rental arrangement by an estate or trust,
14 all beneficiaries or owners of the estate or trust shall
15 be treated as materially participating in the business or
16 rental arrangement if one or more of the executors or trustees
17 of the estate or trust are materially participating in the
18 business, or if the real property is leased to another person,
19 the executor or trustee is materially participating in the
20 lessee’s business that uses the real property. The ten-year
21 period described in paragraph “b”, is deemed to be met by
22 any combination of material participation by the decedent or
23 settlor or one or more executors or trustees, in the aggregate,
24 over the ten-year period.

25 EXPLANATION

26 The inclusion of this explanation does not constitute agreement with
27 the explanation’s substance by the members of the general assembly.

28 DIVISION I — CAPITAL GAINS TAXATION — MATERIAL
29 PARTICIPATION. Under current law, a taxpayer’s net capital
30 gain from the sale of a business, or from the sale of real
31 property used in a business, is exempt from the individual
32 income tax if the taxpayer held the real property or the
33 business for a minimum of 10 years, and materially participated
34 in the business for 10 years. “Material participation” refers
35 to the level of involvement a taxpayer has in the operations

1 of a business, and whether or not any particular taxpayer
2 materially participates in a business is determined under the
3 Internal Revenue Code.

4 This bill requires that for purposes of determining material
5 participation of a taxpayer for the capital gain tax exemption
6 with regard to a partnership, S corporation, limited liability,
7 estate, or trust whose capital gain flows through to the owners
8 or beneficiaries for federal income tax purposes, material
9 participation shall be determined at the owner or beneficiary
10 level according to the activities of each owner or beneficiary.

11 The bill also provides an exception to this material
12 participation requirement for the sale of real property used
13 in a business or rental arrangement which, under certain
14 circumstances, attributes the material participation of certain
15 representatives of an estate or trust to the beneficiaries or
16 owners of that estate or trust. For purposes of determining
17 material participation of a taxpayer with regard to the sale
18 of an estate's or trust's real property used in a business or
19 rental arrangement, all the beneficiaries or owners of the
20 estate or trust shall be treated as materially participating in
21 a business or rental arrangement for any year if an executor or
22 trustee of the estate or trust is materially participating in
23 the estate's or trust's business or, if the real property is
24 leased to another person, the executor or trustee is materially
25 participating in the lessee's business that uses the real
26 property. The bill also provides that the 10-year material
27 participation requirement under Code section 422.7(21)(a)(1)
28 can be satisfied by any combination of years of material
29 participation attributable to decedent, settlor, or one or more
30 executors or trustees, aggregated over the 10 years preceding
31 the sale.

32 Division I applies to tax years beginning on or after January
33 1, 2020.

34 DIVISION II — CAPITAL GAINS TAXATION — MATERIAL
35 PARTICIPATION — FUTURE INCOME TAX CHANGES. The bill amends

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1 2018 Iowa Acts, chapter 1161, section 113, to align future
2 income tax changes with the changes in Division I of the bill.
3 By operation of law, the changes in Division II will begin
4 in tax year 2023 or in a later tax year, contingent upon the
5 satisfaction of certain net general fund revenue amount and
6 growth targets.