701—302.87(422) Capital gain deduction for certain types of net capital gains. Information relating to the Iowa capital gain deduction available for tax years prior to January 1, 2023, can be found in prior versions of rule 701—302.38(422). Prior versions of the Iowa Administrative Code are located here: www.legis.iowa.gov/law/administrativeRules/agencies. For tax years beginning on or after January 1, 2023, net capital gains from the sale of real property used in a farming business and the sale of certain livestock described in subrules 302.87(5) and 302.87(6) may be excluded in the computation of net income for qualified individual taxpayers. To exclude qualifying capital gains, a taxpayer has to meet certain holding period and material participation requirements, unless otherwise indicated in this rule.

302.87(1) *Definitions.* Unless otherwise indicated in this rule or required by the context, all words and phrases used in this rule that are defined under Iowa Code section 422.7(13) shall have the same meaning as provided to them under that Iowa Code section.

"Disabled individual" means an individual who is receiving benefits as a result of retirement from employment or self-employment due to disability. In addition, a person is considered to be a disabled individual if the individual is determined to be disabled in accordance with criteria established by the Social Security Administration or other federal or state governmental agency.

302.87(2) *Material participation.* If the taxpayer has regular, continuous, and substantial involvement in the operations of a farming business that meets the criteria for material participation in an activity under Section 469(h) of the Internal Revenue Code and the federal tax regulations for material participation in 26 CFR Sections 1.469-5 and 1.469-5T for the applicable number of years required under Iowa law for the deduction, the taxpayer has met the material participation requirement. Section 469(h)(3) of the Internal Revenue Code does not apply when determining material participation for the purposes of this rule.

a. Work done in connection with an activity is not participation in the activity if the work is not of a type that is customarily done by an owner and one of the principal purposes for the performance of the work is to avoid the disallowance of any loss or credit from the activity.

b. Work done in an activity by an individual in the individual's capacity as an investor is not material participation in the business or activity unless the investor is directly involved in the day-to-day management or operations of the activity or business. Investor-type activities include the study and review of financial statements or reports on operations of the activity, preparing or compiling summaries or analyses of finances or operations of the activity for the individual's own use, and monitoring the finances or operations of the activity in a nonmanagerial capacity.

c. A highly relevant factor in material participation in a business is how regularly the taxpayer is present at the place where the principal operations of a business are conducted. In addition, a taxpayer is likely to have material participation in a business if the taxpayer performs all functions of the business. The fact that the taxpayer utilizes employees or contracts for services to perform daily functions in a business will not prevent the taxpayer from qualifying as materially participating in the business, but the services will not be attributed to the taxpayer.

d. In determining whether a particular taxpayer has material participation in a business, participation of the taxpayer's spouse in a business must also be taken into account. Activity done by a taxpayer's spouse is considered activity done by the taxpayer. The spouse's participation in the business must be taken into account even if the spouse does not file a joint state return with the taxpayer or if the spouse has no ownership interest in the business. The activities of other family members, employees, independent contractors, vendors, laborers, or consultants are not attributed to the taxpayer to determine material participation.

e. Generally, an individual will be considered as materially participating in a tax year if the taxpayer satisfies or meets any of the following tests:

(1) The individual participates in the farming business for more than 500 hours in the taxable year.

(2) The individual's participation in the farming business constitutes substantially all of the participation of all individuals in the business (including individuals who are not owners of interests in the business) for the tax year.

EXAMPLE: Taxpayer A is a teacher in a small town in southeast Iowa. Taxpayer A owns 20 acres of farmland. Taxpayer A grows various crops on this land and is the only one who works on the farm. In the summer of 2023, there was a drought killing most of Taxpayer A's crops so Taxpayer A spent only 80 hours in 2023 growing crops. Taxpayer A is deemed to have materially participated in the farming business in 2023.

(3) The individual participates in the farming business for more than 100 hours in the tax year, and no other individual (including individuals who are not owners of interests in the business) participates more in the business than the taxpayer during the tax year.

(4) The individual participates in two or more businesses, excluding rental businesses, in the tax year and participates for more than 500 hours in all of the businesses and more than 100 hours in each of the businesses, and the participation is not material participation within the meaning of one of the tests in subparagraphs 302.87(2)*"e"*(1) through (3), (5) and (6).

EXAMPLE: Taxpayer B is a full-time CPA. Taxpayer B owns a restaurant and a farm. In 2023, Taxpayer B spent 400 hours working on the farm and 150 hours at the restaurant, and other individuals spent more time in the business activity than Taxpayer B did. Taxpayer B is treated as a material participant in each of the businesses in 2023.

(5) The individual materially participated (determined without regard to this subparagraph) in a farming business for five of the ten years preceding the applicable tax year.

EXAMPLE: Taxpayer C is the co-owner of a farming business. Taxpayer C stopped farming in 2018 after 15 years of farming. Since Taxpayer C stopped farming, Taxpayer C has retained interest in the farming business. Taxpayer C is considered to be materially participating in the business in 2019, 2020, 2021, 2022, and 2023 because Taxpayer C materially participated in the farming business during five of the ten years immediately preceding 2019, 2020, 2021, 2022, and 2023.

(6) The individual participates in the business activity for more than 100 hours and, based on all the facts and circumstances, the individual participates on a regular, continuous, and substantial basis. Management activities of a taxpayer are not considered for purposes of determining if there was material participation if either of the following applies: any person other than the taxpayer is compensated for management services or any person provides more hours of management services than the taxpayer.

f. The following paragraphs provide additional information regarding material participation:

(1) Limited partners of a limited partnership. The limited partners will not be treated as materially participating in any activity of a limited partnership except in a situation where the limited partner would be treated as materially participating under the material participation tests in subparagraphs 302.87(2)*"e"*(1) or 302.87(2)*"e"*(5) above if the taxpayer were not a limited partner for the tax year.

(2) Cash farm lease. A taxpayer who rents out farmland on a cash basis is not materially participating in a farming business. The burden is on the taxpayer to show that the taxpayer materially participated in the farming business operated on the cash-rented farmland.

(3) Farmer landlord involved in crop-share arrangement. A farmer landlord is subject to self-employment tax on net income from a crop-share arrangement with a tenant. The landlord is considered to be materially participating with the tenant in the crop-share activity if the landlord satisfies one of the four following tests:

TEST 1: The landlord does any three of the following: (1) pays or is obligated to pay for at least half the direct costs of producing the crop; (2) furnishes at least half the tools, equipment, and livestock used in producing the crop; (3) consults with the tenant; and (4) inspects the production activities periodically.

TEST 2: The landlord regularly and frequently makes, or takes part in making, management decisions substantially contributing to or affecting the success of the enterprise.

TEST 3: The landlord worked 100 hours or more spread over a period of five weeks or more in activities connected with crop production.

TEST 4: The landlord has done tasks or performed duties which, considered in their total effect, show that the landlord was materially and significantly involved in the production of the farm commodities.

(4) Conservation reserve program (CRP). Activities conducted under the CRP do not fall within the definition of "farming business" under Iowa Code section 422.7. If a taxpayer's only activity is managing CRP land, the taxpayer does not meet the material participation requirement. A taxpayer may still meet the material participation requirement if the taxpayer materially participates in a farming business through a different activity.

(5) Recordkeeping requirements. Taxpayers are required to provide proof of services performed and the hours attributable to those services. Detailed records should be maintained by the taxpayer, on as close to a daily basis as possible at or near the time of the performance of the activity, to verify that the material participation test has been met. However, material participation can be established by any other reasonable means, such as approximating the number of hours based on appointment books, calendars, or narrative summaries. Records prepared long after the activity, in preparation of an audit or proceeding, are insufficient to establish participation in an activity.

302.87(3) *Lifetime election.* A retired farmer may make a single lifetime election on a form prescribed by the department to exclude all qualifying capital gains from the sale of real property used in a farming business and the sale of certain livestock described in subrules 302.87(5) and 302.87(6). If a retired farmer makes the election described in this subrule, the retired farmer is not eligible to make the election to exclude the net income received pursuant to a farm tenancy agreement covering real property under Iowa Code section 422.7(14) and rule 701—302.88(422) or claim the beginning farmer tax credit under Iowa Code section 422.11E in the same tax year or any subsequent tax year. The election is irrevocable once made.

a. Beginning farmer tax credit. A retired farmer shall not utilize an unclaimed amount of a beginning farmer tax credit in the same tax year they are making an election described in this subrule or in subrule 302.88(3) or in any subsequent tax year.

b. Surviving spouses. A surviving spouse of a deceased retired farmer may be eligible to make the election described in this subrule or the election described in subrule 302.88(3) or exclude the qualifying income pursuant to the election made by the retired farmer prior to death.

(1) A surviving spouse of a deceased retired farmer may make the election described in this subrule or the election described in subrule 302.88(3) on behalf of the deceased retired farmer that the retired farmer would have been eligible to make prior to death. A surviving spouse may only make an election on behalf of the deceased retired farmer by the due date of the tax return, including extensions, for the tax year immediately following the tax year of the retired farmer's death.

EXAMPLE 1: Farmer A, a retired farmer, owned real property used in a farming business, Plot 1. Farmer A was married to Spouse B. Farmer A sold Plot 1 which generated a capital gain. Farmer A died later that tax year. Farmer A qualified to make an election to exclude qualifying capital gains from the calculation of net income prior to death but did not make an election before death. Spouse B can make an election on behalf of Farmer A on the final tax return.

(2) If a retired farmer made the election described in this subrule or the election described in subrule 302.88(3) prior to death, the surviving spouse of the deceased retired farmer may exclude the qualifying income pursuant to the election made by the retired farmer prior to death. A surviving spouse cannot change the election the deceased retired farmer made. Any election made by the retired farmer prior to death is binding on all real property used in a farming business owned by the retired farmer at the time of death. This election is only binding on the retired farmer and the surviving spouse.

EXAMPLE 2: Farmer C, a retired farmer, owned real property used in a farming business, Plot 2. Farmer C was married to Spouse D. Farmer C met the material participation and holding period requirements. Farmer C made the election to exclude net income from a farm tenancy agreement described in subrule 302.88(3) from Plot 2. Farmer C then died. Spouse D inherited Plot 2 from Farmer C. Spouse D does not qualify to make an election. Spouse D may exclude net income from a farm tenancy agreement from Plot 2 pursuant to the election Farmer C made before death. Spouse D cannot exclude qualifying capital gains with regard to Plot 2 or claim the beginning farmer tax credit.

EXAMPLE 3: Assume the same facts as Example 2 but Spouse D does qualify to make an election independent of Farmer C. Spouse D still cannot exclude qualifying capital gains from Plot 2 or claim the beginning farmer tax credit unless Spouse D disclaims Farmer C's election and makes an election as described in subparagraph 3.

EXAMPLE 4: Farmer E, a retired farmer, owned real property used in a farming business, Plot 3, Plot 4, and Plot 5. Farmer E was married to Spouse F. Farmer E met the holding period and material participation requirements. Farmer E sold Plot 3, which generated a capital gain. Farmer E made an election to exclude the capital gain. Farmer E then died. Spouse F inherited Plot 4 and Plot 5 from

Farmer E. Plot 4 and Plot 5 are bound by the election Farmer E made before death. Spouse F is eligible to exclude the capital gain from the sale of Plot 4 and Plot 5 pursuant to the election Farmer E made. Spouse F cannot exclude net income from a farm tenancy agreement from Plot 4 or Plot 5 or claim the beginning farmer tax credit.

EXAMPLE 5: Farmer G, a retired farmer, owned real property used in a farming business, Plot 6 and Plot 7. Farmer G was married to Spouse H. Farmer G met the holding period and the material participation requirements. Farmer G made the election to exclude net income from a farm tenancy agreement described in subrule 302.88(3) from Plot 6 and Plot 7. Farmer G then died. Spouse H inherited Plot 6 and Plot 7. Spouse H is bound by the election made by Farmer G on Plot 6 and Plot 7 and may exclude the net income from a farm tenancy agreement for those plots. Spouse H gets remarried to a new spouse, Spouse J. Spouse H then dies. Spouse J inherits Plot 6 and Plot 7 from Spouse H. Spouse J is not a surviving spouse of a retired farmer and is not bound by the election Farmer G originally made on Plot 6 and Plot 7. Spouse J may make an election described in this subrule or described in subrule 302.88(3) on Plot 6 and Plot 7 if Spouse J meets the eligibility criteria.

(3) A surviving spouse of a deceased retired farmer may disclaim the election made by the retired farmer. If a surviving spouse of a deceased retired farmer makes this disclaimer, the surviving spouse is not eligible to deduct qualifying income pursuant to an election made by the retired farmer prior to death. A surviving spouse of a deceased retired farmer shall make this disclaimer on a form prescribed by the department and file the form with the surviving spouse's income tax return. A surviving spouse must make the disclaimer by the due date of the tax return, including extensions, for the tax year immediately following the tax year of the retired farmer's death. If the surviving spouse excluded income on the surviving spouse's return for the tax year of the retired farmer's death pursuant to the election the retired farmer made and wants to disclaim the election, then the surviving spouse must amend the surviving spouse's return to include that income in Iowa net income and adjust tax liability accordingly. If no disclaimer is made by the due date, including extensions, of the surviving spouse's income tax return for the tax year immediately following the tax year of the retired farmer's death, then the surviving spouse is no longer eligible to make a disclaimer and is bound by the election the retired farmer made. The disclaimer is irrevocable once made. Once a disclaimer has been made, a surviving spouse may make a single lifetime election that would also apply to the land previously bound by the deceased retired farmer's election if the surviving spouse meets the definition of a retired farmer. A surviving spouse may make a single lifetime election that would apply to land not bound by the deceased retired farmer's election if the surviving spouse meets the eligibility criteria.

EXAMPLE 6: Farmer K, a retired farmer, owned real property used in a farming business, Plot 8. Farmer K was married to Spouse L. Farmer K met the holding period and the material participation requirements. Farmer K made the election to exclude net income from a farm tenancy agreement described in subrule 302.88(3) from Plot 8. Farmer K then died. Spouse L inherited Plot 8 from Farmer K. Spouse L independently qualifies as a retired farmer to make an election described in this subrule or the election described in subrule 302.88(3). Spouse L may exclude net income from a farm tenancy agreement from Plot 8 pursuant to the election Farmer K made before death, or Spouse L may disclaim that election and make Spouse L's own election to exclude capital gains from Plot 8.

EXAMPLE 7: Assume the same facts as Example 6 except Spouse L does not independently qualify as a retired farmer to make an election described in this subrule or the election described in subrule 302.88(3). Spouse L may exclude net income from a farm tenancy agreement from Plot 8 pursuant to the election Farmer K made before death, or Spouse L may disclaim that election and not exclude income because Spouse L does not qualify to make an election as a retired farmer.

c. Joint owners. A retired farmer may exclude income pursuant to the election described in this subrule or the election described in subrule 302.88(3) to the extent of the retired farmer's ownership interest in the real property.

(1) A retired farmer who owns real property used in a farming business jointly with a spouse and makes the election described in this subrule or the election described in subrule 302.88(3) may only exclude qualifying income from that real property to the extent of the retired farmer's ownership interest held in that real property. The retired farmer's ownership interest does not include the ownership interest

of the retired farmer's spouse. If each spouse qualifies as a retired farmer, each spouse may make different elections on the property they jointly own to the extent of their respective ownership interests. There is a rebuttable presumption that spouses who jointly own real property used in a farming business each have a 50 percent ownership interest in the real property. This can be rebutted with documentation proving a different ownership percentage.

EXAMPLE 8: Farmer M and Farmer N, both retired farmers, are married and own Plot 9 jointly. They each have a 50 percent ownership interest in Plot 9. They both qualify to make the election to exclude qualifying capital gains or net income from a farm tenancy agreement. They file jointly for Iowa tax purposes. In 2023, Farmer M and Farmer N receive $50,000 total in net income from a farm tenancy agreement covering Plot 9. Farmer M makes the election to exclude net income from a farm tenancy agreement. Farmer N does not make an election. Farmer M is eligible to exclude $25,000, 50 percent of the net income from Plot 9, from net income. Farmer N must include $25,000, 50 percent of the net income from the farm tenancy agreement, in net income. Farmer N is still eligible to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement in a subsequent tax year.

EXAMPLE 9: Assume the same facts as Example 8 except Farmer N makes the same election to exclude net income from a farm tenancy agreement. On the jointly filed return, Farmer M and Farmer N can exclude from net income $50,000, 100 percent of the net income from a farm tenancy agreement.

EXAMPLE 10: Assume the same facts as Example 8 except Farmer N does not qualify to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement. Farmer M can exclude from net income $25,000, 50 percent of the net income received from a farm tenancy agreement on Plot 9. Farmer N must include in net income $25,000, 50 percent of the net income from the farm tenancy agreement on Plot 9.

(2) A retired farmer who owns real property used in a farming business jointly with someone who is not the retired farmer's spouse may only exclude qualifying income from that real property to the extent of the retired farmer's ownership interest held in the real property.

EXAMPLE 11: Farmer O, a retired farmer, owns Plot 10 jointly with Farmer P. Farmer O and Farmer P are not taxed as a partnership. Farmer O has a 60 percent ownership interest in Plot 10, while Farmer P has a 40 percent ownership interest. Farmer O qualifies to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement. Farmer P does not. Farmer O and Farmer P sell Plot 10 for a capital gain of $100,000. Farmer O elects to exclude the capital gain. Farmer O may exclude from net income $60,000, 60 percent of the capital gain. Farmer P is required to include $40,000 in net income, 40 percent of the capital gain.

302.87(4) *Net capital gains from the sale of real property used in a farming business.* Net capital gains from the sale of real property used in a farming business may be excluded from the owner's Iowa net income if the owner held the real property used in a farming business for ten or more years and materially participated in a farming business for at least ten years. If the taxpayer is a retired farmer, the taxpayer must make the election described in subrule 302.87(3) to exclude qualifying capital gains. It is not required that the property be located in Iowa for the owner to qualify for the deduction.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.87(2). If the taxpayer is a retired farmer and materially participated in a farming business for ten or more years in the aggregate, then the taxpayer will meet the material participation requirements. If the taxpayer is not a retired farmer, the taxpayer must have materially participated in a farming business for the ten years immediately preceding the sale. When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.87(2)*"e"*(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. If the taxpayer has held the real property used in a farming business and sells the property to a relative of the taxpayer, the net capital gain from the sale may be excluded from net income regardless of whether the taxpayer met the material participation or holding period requirements.

c. In situations in which real property was sold by a partnership, S corporation, limited liability company, estate, or trust and the capital gain from the sale of the real property flows through to the owners of the business entity for federal income tax purposes, the owners may exclude the capital gain from their net incomes if the real property was held for ten or more years and the owners had materially participated in a farming business for ten years prior to the date of sale of the real property, or ten years in the aggregate if the owner is a retired farmer.

d. Installments received in the tax year from installment sales of real property used in a farming business are eligible for the exclusion of capital gains from net income if all relevant criteria were met at the time of the installment sale.

EXAMPLE: A taxpayer received an installment payment in 2025 from the sale of real property used in a farming business that occurred in 2023. The installment received in 2025 would qualify for the exclusion if the taxpayer had held the real property for a minimum of ten years and had materially participated in a farming business for a minimum of ten years at the time of the sale in 2023.

e. Capital gains from the sale of real property by a C corporation do not qualify for the capital gain deduction.

f. The following noninclusive examples illustrate how this subrule applies:

EXAMPLE 1: S corporation, X, owned 1,000 acres of farmland. Taxpayer A is the sole shareholder of X and had materially participated in X for more than ten years at the time that X sold 500 acres of the farmland for a capital gain of $100,000. X owned the farmland for more than ten years at the time of the sale. The capital gain recognized by X that passed through to Taxpayer A as the shareholder of X can be excluded from Iowa net income because Taxpayer A met the material participation and holding period requirements.

EXAMPLE 2: Taxpayer B and Taxpayer C are brothers who both owned 50 percent of the stock in an S corporation, Y, that owned 1,000 acres of farmland. Taxpayer B managed all the farming operations for Y from the time Y was formed in 2010. Taxpayer C did not participate in the farming operations. Y sold 200 acres of the farmland to another brother, Taxpayer D, for a $50,000 gain. $25,000 of the capital gain passed through to Taxpayer B, and $25,000 of the capital gain passed through to Taxpayer C. Both Taxpayer B and Taxpayer C had owned the corporation for at least ten years at the time the land was sold, but only Taxpayer B had materially participated in the corporation for at least ten years. Taxpayer B may exclude the $25,000 capital gain from the land sale because he met the time held and material participation requirements. Taxpayer C may exclude the $25,000 capital gain because the land was sold to a relative of Taxpayer C.

EXAMPLE 3: Taxpayer E owned and materially participated in a farming business for 15 years and raised row crops. There were 500 acres of land in the farming business, 300 acres had been held for 15 years, and 200 acres had been held for five years. Taxpayer E sold the 500 acres of land. Taxpayer E cannot exclude the capital gain from the sale of the 200 acres that had only been held for five years. Taxpayer E may exclude the capital gain from the sale of the 300 acres of land that had been held for 15 years.

EXAMPLE 4: Taxpayer F owned and materially participated in a farming business for more than ten years. In this business, Taxpayer F farmed a neighbor's land on a crop-share basis throughout the period. Taxpayer F bought 80 acres of land and farmed that land for six years until Taxpayer F sold the land for a capital gain of $20,000. Taxpayer F cannot exclude the capital gain because the farmland had been held for less than ten years even though Taxpayer F materially participated in a farming business for more than ten years.

EXAMPLE 5: Taxpayer G and Taxpayer H were partners in a partnership since 2008 that owned 80 acres of farmland. Taxpayer G and Taxpayer H are both over 55 years old. The land was sold in 2023 when Taxpayer G and Taxpayer H retired from farming. In all the years Taxpayer G and Taxpayer H were partners in the partnership, Taxpayer G materially participated in the farming business. Taxpayer H was a material participant for the years 2008-2013 and 2018-2023. Taxpayer G and Taxpayer H realized a capital gain of $50,000 from the land sale, which was divided equally between them. Taxpayer G was able to exclude $25,000 of the capital gain that Taxpayer G received from the sale since Taxpayer G had held the land and materially participated in a farming business for at least ten years at the time the land was sold. Taxpayer H was able to exclude $25,000 of the capital gain because, although Taxpayer H had not materially participated in a farming business for ten consecutive years when the land was sold, Taxpayer H was a retired farmer and had materially participated in a farming business for ten years in the aggregate.

EXAMPLE 6: Taxpayer J had a farming business that Taxpayer J owned and materially participated in for 20 years. There were two tracts of farmland in the farming business. Taxpayer J sold one tract of farmland in the farming business that Taxpayer J had held for more than ten years for a $50,000 capital gain. The farmland was sold to a person who was not a relative. During the same year, Taxpayer J had $30,000 in long-term capital losses from sales of stock. In this situation, the capital gains would not be applied against the capital losses. Because the capital losses are unrelated to the farming business, Taxpayer J does not have to reduce the Iowa capital gain deduction by the capital losses from the sales of stock.

EXAMPLE 7: Taxpayer K had owned farmland, Plot A, and had materially participated in a farming business since 2010. In 2018, Taxpayer K entered into a like-kind exchange under Section 1031 of the Internal Revenue Code for farmland, Plot B. Taxpayer K continued to materially participate in a farming business. Plot B was sold in 2023, resulting in a capital gain. Under Section 1223 of the Internal Revenue Code, the holding period for the capital gain starts in 2010. Taxpayer K held Plot B for less than ten years, but because Taxpayer K met the ten-year holding period requirement under Section 1223, the capital gain from the sale qualifies for the Iowa capital gain deduction.

EXAMPLE 8: Taxpayer L and Taxpayer M, a married couple, owned farmland in Iowa since 1995. Taxpayer L died in 2010 and, under Taxpayer L's will, Taxpayer M acquired a life interest in the farm. The farmland was managed by their child, Taxpayer N, after Taxpayer L's death. Taxpayer N had a remainder interest. Taxpayer M died in 2018, and Taxpayer N continued to materially participate and manage the farm operation. Taxpayer N sold the farmland in 2023 and reported a capital gain. Under Section 1223 of the Internal Revenue Code, the holding period for the capital gain starts in 2010, when Taxpayer L died. Because the holding period for the capital gain was ten years or more, and Taxpayer N met the material participation requirement, Taxpayer N can deduct the capital gain.

302.87(5) *Net capital gains from the sale of cattle or horses used for certain purposes and held for 24 months by taxpayers who are retired farmers.* Net capital gains from the sale of cattle or horses held for 24 months or more for draft, breeding, dairy, or sporting purposes may be excluded from the taxpayer's Iowa net income if the taxpayer is a retired farmer and the taxpayer made the election described in subrule 302.87(3). The retired farmer must have materially participated in the farming business in which the cattle or horses were held for five of the eight years preceding the retired farmer's retirement or disability and must have sold all or substantially all of the retired farmer's interest in the farming business by the time the election is made. For purposes of this subrule and subrule 302.87(6), "substantially all" means 90 percent of the interest in the farming business.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.87(2). When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.87(2)*"e"*(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. Whether cattle or horses sold by the taxpayer after the taxpayer has held them 24 months or more were held for draft, breeding, dairy, or sporting purposes may be determined from federal court cases on such sales and the standards and examples included in 26 CFR Section 1.1231-2. Proper records should be kept showing purchase and birth dates of cattle and horses. The absence of records may make it impossible for the owner to show that the owner held a particular animal for the necessary holding period. Whether cattle or horses are held for draft, breeding, dairy, or sporting purposes depends on all the facts and circumstances of each case.

c. Capital gains from sales of qualifying cattle or horses by an S corporation, partnership, or limited liability company, where the capital gains flow through to the owners of the respective business entity for federal income tax purposes, qualify for the capital gain deduction to the extent the owners receiving the capital gains are retired farmers who meet all the relevant criteria.

d. Capital gains from sales of qualifying cattle or horses by a C corporation are not eligible for the capital gain deduction.

302.87(6) *Net capital gains from the sale of breeding livestock, other than cattle or horses, held for 12 or more months by taxpayers who are retired farmers.* Net capital gains from the sale of breeding livestock, other than cattle or horses, held for 12 or more months may be excluded from the taxpayer's Iowa net income if the taxpayer is a retired farmer and the taxpayer made the election described in subrule 302.87(3). The retired farmer must have materially participated in the farming business in which the breeding livestock, other than cattle or horses, were held for five of the eight years preceding the retired farmer's retirement or disability. The retired farmer must have sold all or substantially all of the retired farmer's interest in the farming business by the time the election is made.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.87(2). When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.87(2)*"e"*(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. If livestock other than cattle or horses is considered to have been held for breeding purposes under the criteria established in 26 CFR Section 1.1231-2, the livestock will also be deemed to have been breeding livestock for purposes of this rule. Proper records should be kept showing purchase and birth dates of breeding livestock. The absence of records may make it impossible for the owner to show that the owner held a particular animal for the necessary holding period. Whether livestock are held for breeding purposes depends on all the facts and circumstances of each case.

c. Capital gains from sales of qualifying livestock other than cattle or horses by an S corporation, partnership, or limited liability company, where the capital gains flow through to the owners of the respective business entity for federal income tax purposes, qualify for the capital gain deduction to the extent the owners receiving the capital gains are retired farmers who meet all the relevant criteria.

d. Capital gains from the sale of breeding livestock other than cattle or horses by a C corporation are not eligible for the capital gain deduction.

302.87(7) *Installments from sales consummated before January 1, 2023.* Installments from sales that were consummated before January 1, 2023, that result in net capital gains qualify for the capital gain deduction if the requirements of Iowa Code section 422.7(21) and rule 701—302.38(422), as they existed prior to January 1, 2023, were met at the time the sale was consummated.

This rule is intended to implement Iowa Code section 422.7(13).

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