

Overview of Iowa Fiduciary Income Tax and Inheritance Taxes

Iowa Uniform Principal and Income Act

April, 2019

Iowa Estates / Trusts Income Tax¹

General Concepts

Iowa fiduciary income tax returns are governed by Iowa Code Section 422 and Chapter 89 of the Iowa Administrative Code.

Iowa Administrative Code Chapter 89.4(6) provides:

1. (a) Return required. General rule. A fiduciary return of income must be filed if the gross income of the estate or trust for the taxable year is \$600.00 or more, regardless of any tax liability.

(b) Exception to the general rule. A final fiduciary return of income must be filed for the taxable year in which an estate or trust is closed, regardless of the amount of gross income, if an income tax certificate or acquittance is requested. The final fiduciary return of income constitutes an application for an income tax certificate of acquittance pursuant to Iowa Code Sections 422.27, 633.477 and 633.479.

Income Taxed. IAC Chapter 89.8, in pertinent parts, provides:

Application of the Internal Revenue Code. Iowa Code Section 422.4(15) provides that taxable income of estates and trusts for Iowa income tax purposes is the same as taxable income for federal income tax purposes, subject to certain adjustments specified in Iowa Code Sections 422.7 and 422.9. Therefore, the Internal Revenue Code is also Iowa law insofar as it relates to what constitutes gross income, allowable deductions and distributions, subject to the adjustments specified above.

For tax year 2018 Iowa generally conforms with the Internal Revenue Code effective as of January 1, 2015. Due to the numerous intervening changes to the IRC, it will be necessary to make adjustments in calculating the Iowa tax. See the Iowa Nonconformity Adjustments Worksheet as well as other Iowa forms such as the IA 4562A & B (depreciation) and IA 8824 (like-kind exchanges).

Iowa Source Income

Estates of Iowa resident decedents and trusts with a situs in Iowa must report all income received from sources within and without Iowa, regardless of whether the income is from real, personal, tangible or intangible property.

Reportable income in general - foreign situs estates and trusts. Estates and trusts with a situs outside Iowa must report only that portion of its income which is derived from Iowa sources. Examples of Iowa source income include, but are not limited to: Income from real and tangible personal property

¹ Thank you to ACTEC Fellow, Brian Kane, Iowa attorney Bruce Rehmke and the Iowa State Bar Association for allowing us to use this information from the ISBA Fiduciary Income Tax Manual (2018).

with a situs in Iowa, such as a farm and from a business located in Iowa; the capital gain portion of an installment sale contract of Iowa situs property and wages, salaries and other compensation for services performed in Iowa, but received after the death of the decedent.

Gross income of an estate.

(a) In general, 26 U.S.C. Section 641(b) provides that the taxable income of an estate or trust shall be computed in the same manner as the taxable income of an individual, except as modified in Subchapter J of the Internal Revenue Code. The gross income of an individual and, therefore, the gross income of an estate or trust, is not given a definitive meaning in 26 U.S.C. Section 61. Iowa Administrative Code Section 89.8(7) paragraphs "d" to "h" describe the most common kinds of income of an estate or trust. However, those rules are not intended to identify all types of taxable income.

(b) Definition of the period of administration. The income charged to the decedent's estate is reportable by the personal representative for each taxable year during the period of the administration of the decedent's estate, if the minimum filing requirements are met. The period of administration for Iowa income tax purposes is determined by applying federal tax law to Iowa estates because Iowa income is the same as federal taxable income, subject to the adjustments provided in Iowa Code Sections 422.7 and 422.9. It is the period actually required by the personal representative to perform the ordinary duties of administration, such as the collection of assets and the payment of debts, taxes, legacies and bequests, whether the period required is longer or shorter than the period specified under the probate code. See federal regulations 1.641(b)-3(a). An estate will be considered terminated for income tax purposes when all of the assets have been distributed, except for a reasonable amount set aside in good faith for the payment of unascertained or contingent liabilities and expenses. The delay in closing the estate cannot be capricious. If the period of administration is terminated for income tax purposes, the heir or beneficiary is charged with the income.

Non-Resident Beneficiary Withholding

Nonresident beneficiaries who receive Iowa source income from an estate or trust are required to report the income on an Iowa individual income tax return. Unless a non-resident beneficiary has filed and paid estimated tax on the Iowa source income, the fiduciary of the estate or trust must withhold from the distribution of Iowa source income using a 5% rate.

It would generally be preferable for the fiduciary to accomplish the withholding by making an estimated Iowa tax payment, on behalf of the beneficiary, using Form IA 1040ES. It is the responsibility of the fiduciary to advise the non-resident beneficiary about the Iowa estimated tax payment. If a nonresident beneficiary receives the proceeds from sales of agricultural commodities, withholding is not required if the payer of the proceeds provides the Department of Revenue a statement of the proceeds at the end of the year. In that event the nonresident beneficiaries should make their own Iowa estimated tax payments.

Rates

The Iowa Trust and Estate rates are the same as individual tax rates, with the rate ranging from .36% to 8.98% for taxable income over \$71,910. The rate schedule for trusts and estates are the same as for single individuals. Iowa does not have a special capital gains tax rate.

Interest and Penalties

In 2019, the annual interest rate on underpayments is 7% or .6% per month. The rate changes annually. For a history, please see the following:

<https://tax.iowa.gov/interest-rates>

Penalties are as follows: There is a 10% Penalty for Failure to File a Timely Return. If at least 90% of the tax has been paid prior to the due date of the return, this penalty is not imposed. There is a 5% penalty if a timely return is filed but if there is a failure to pay 90% of the correct tax due as of the due date of the return. These penalties are alternatives and both will not be imposed at the same time.

There are exceptions to these penalties, generally relating to reasonable cause.

<https://tax.iowa.gov/penalty-exception-provisions>

Iowa Inheritance Tax

Chapter 450 of the Iowa Code provides for an inheritance tax for amounts inherited (both probate and non-probate assets) by individuals who are not direct ancestors or descendants of the deceased individual. Life insurance is not taxable unless payable to the decedent's estate and retirement accounts are not generally taxable even if paid to an individual who would otherwise be subject to Iowa Inheritance Tax. <https://tax.iowa.gov/inheritance>

A copy of the Iowa Inheritance Tax Rate Schedule is attached to this outline.

Iowa does not have an estate tax or a gift tax.

Iowa Uniform Principal and Income Act.

Iowa Code Chapter 637 is very close to the Uniform Principal and Income Act.

<https://www.uniformlaws.org/viewdocument/final-act-with-comments-116?CommunityKey=b20aa74e-cae7-4557-b93b-a4b416c17407&tab=librarydocuments>

The differences are as follows:

Iowa Code Section 637.102(9) excludes a government or governmental subdivision, agency, or instrumentality from the definition of “person”. The Uniform act includes such entities as persons.

The Iowa UPIA does not include a Power to Adjust between principal and income as set out in Section 104 of the Uniform Act. Understandably, there is also no corresponding section to Section 105 (Judicial Control of Discretionary Power).

Iowa Code Section 637.402 provides slightly different terms than Section 402 of the Uniform Act, with respect to characterization of distributions from a trust or estate. Primarily, the Iowa Law specifically provides that the terms of a recipient trust would control.

Iowa Code section 637.424 provides more specific rules with respect to Timber, than is the case with the Uniform Act section 412.

Subchapter 6, Iowa Code sections 637.601 et. seq. provides legislative framework for Total Return Unitrusts.