Income Taxation of Trusts and Estates – Fundamentals

Jeremiah W. Doyle IV, Esq.
Senior Vice President
BNY Mellon Wealth Management
One Boston Place
Boston, MA
Jere.doyle@bnymellon.com

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What We’ll Cover – Part I, The Basics

- Structure of Subchapter J
- Basic Rules and Tax Rates
- Types of Trusts
- Trust Accounting Income (TAI)
- Taxable Income
- Distributable Net Income (DNI)
- Distribution System - Simple Trusts
- Distribution System – Complex Trusts - How DNI Gets Allocated
  - Tier System
  - Separate Share Rule
  - 65 Day Rule
  - Specific Bequests
  - Distributions in Kind
- Charitable Deductions
- Depreciation
- §645 Election
- Terminations – Capital Loss C/O and Excess Deductions
- Drafting and Planning Ideas
Income Taxation of Trusts and Estates
Code Outline

• PART I, SUBCHAPTER J
  – Subpart A - Sec. 641-646 - General Rules
  – Subpart B - Sec. 651-652 - Simple Trusts
  – Subpart C - Sec. 661-664 - Complex Trusts and CRTs
  – Subpart D - Sec. 665-668 - Accumulation Distributions
  – Subpart E - Sec. 671-679 - Grantor Trusts
  – Subpart F - Sec. 681-685 - Misc. Rules

• PART II, SUBCHAPTER J
  – Sec. 691-692 - Income in Respect of a Decedent
Income Taxation of Trusts and Estates

• Separate Taxable Entities

• Taxable Income Computed in Same Manner as Individuals (Sec. 641(b))

• Own Tax Year and Method of Accounting

• Receive Income/Pay Expenses

• Income Taxed to Entity or Beneficiary
Election of Estate’s Fiscal Year-End

• Fiduciary may select estate’s fiscal year-end

• May be the last day of any month as long as first FYE doesn’t exceed one year
  – Trust MUST use calendar year
    • Trust may get benefit of fiscal year by making a §645 election

• Election made by filing income tax return with the selected year-end

• May allow deferral of payment of tax
  – Cut off fiscal year before receipt of substantial income
  – Distributions from estate are deemed made to beneficiary on last day of estate’s taxable year regardless of the actual date of distribution
Election of Estate’s Fiscal Year-End

Year of Inclusion - A beneficiary recognizes distributions from the trust or estate in the taxable year of the beneficiary with which or in which the taxable year of the trust or estate ends. §652(c) and §662(c).
Administration Expense Election

• Governed by §642(g)

• Deduct on either the estate tax return (706) or fiduciary income tax return (1041)

• Waiver required if expenses taken on 1041

• Not an “all or nothing” election
  – E.g. split executor fee between 706 and 1041
Administration Expenses

- Consist of attorney’s fees, accountant’s fees, executor’s commissions, filing fees, surety bonds premiums, appraisal fees, etc.
- Deductible on Federal estate tax return (706) or fiduciary income tax return (1041), but not both
- Fiduciary can elect where to take expenses (706 or 1041) - the so-called Sec. 642(g) election
- Generally, not subject to 2% floor
  - Test: would expenses be uncommon (or unusual or unlikely) for an individual to incur?
- Generally, claim on return with highest tax rate
Non-Deductible Expenses - Sec. 265

- Sec. 265 disallows any deduction attributable to T/E income
- Generally applies to deductions for production of income, usually trustee’s fees and executor’s fees
- If trust/estate has T/E income, portion of trustee’s and executor’s fees are nondeductible
- No specific allocation formula
  - Fiduciary can use any reasonable method
Non-Deductible Expenses - Sec. 265 Example

- FACTS:
  - Trust has $30,000 taxable interest and $10,000 T/E interest
  - Incurs $20,000 trustee fee
  - Portion of trustee fee attributable to T/E income is non-deductible

\[
\frac{10,000 \text{ T/E income}}{40,000 \text{ Total income}} \times 20,000 \text{ fees} = 5,000 \text{ non-deductible}
\]
### 2016 Fiduciary Income Tax Rates

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<th>Not Over</th>
<th>Rate</th>
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<td>39.6%</td>
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Types of Trusts

- Simple
- Complex
- Grantor
Simple Trust

- Required to distribute accounting income annually
- Makes no principal distributions, and
- Makes no distributions to charity
Complex Trust

- Accumulates income
- Makes discretionary distributions of income or mandatory or discretionary distributions of principal, or
- Makes distributions to charity
Grantor Trust

• Grantor or beneficiary has one or more “powers” described in Sec. 673-678

• Result: All income, expenses and credits “flow through” and are taxed to the Grantor or beneficiary regardless of whether distributions are made

• Subpart A-D, Subchapter J (rules for taxation of trusts and estates) do not apply to Grantor trusts
Trust Accounting Income (TAI)

- Governs amount of distributions

- Trustee allocates receipts/disbursements between accounting income and principal

- Accounting income and principal is determined by governing instrument or, if instrument silent, by state law
  - May be governed by UPIA or unitrust statute
## Trust Accounting Income (TAI)

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<td>Capital Gains</td>
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<td>Muni Bond Int</td>
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<tr>
<td>Expenses</td>
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</table>
Trust Accounting Income - TAI

• BACKGROUND
  • Prudent Investor Act
    – Modern portfolio theory – invest for total return
    • Replaces the traditional notions of income and principal
    – Enactment of the Uniform Principal and Income Act
    – Enactment of Unitrust statutes
Trust Accounting Income - TAI

- **TRUST ACCOUNTING INCOME**
  - Could be TAI defined under:
    - Traditional definition of income and principal
    - Unitrust statute
      - Must be no less than 3%, no more than 5% of FMV of trust assets
    - Uniform Principal and Income Act
      - Requirements:
        » Trust is managed under the Uniform Prudent Investor Act
        » The beneficiary must be eligible for income distributions
        » The distribution is not favorable to one beneficiary over another
Taxable Income of Trust or Estate

- Computed same as individual

- Exemptions: $600/$300/$100

- Different rules for charitable deductions

- Depreciation deduction allocated between entity and beneficiary

- Distribution deduction

- Administration expenses - some not subject to 2% floor

- AGI - same as individual reduced by (1) personal exemption, (2) distribution deduction and (3) some administration expenses are subtracted “off the top,” i.e. subtracted from taxable income to arrive at AGI
Taxable Income – 3.8% Surtax

• §1411 imposes 3.8% surtax on net investment income of individuals, estates and trust for taxable years beginning after 12/31/2013.

• The surtax is in addition to all other taxes imposed by Subtitle A (income taxes), including the alternative minimum tax. §1411(a)(1).

• For estates and trusts, the surtax applies to the lesser of:
  – Adjusted Gross Income (AGI) in excess of the highest income tax bracket threshold ($12,400 in 2016), or
  – Undistributed net investment income. §1411(a)(2)

• The highest income tax bracket for estates and trusts is indexed for inflation each year whereas the threshold for individuals is fixed at $250,000 (married filing joint and surviving spouses), $200,000 (single and head of household) and $125,000 (married filing separately). §1(f); §1411(b).
• The 3.8% surtax is imposed on three classes of income:
  – Gross income from interest, dividends, rents, royalties and annuities,
  – Gross income from:
    • passive activity, or
    • A trade or business of trading in financial instruments or commodities, and
  – Net gain
3.8% Surtax - Bottom Line

- Simple trusts – all accounting is distributed so NII, except capital gain, is subject to tax at the beneficiary level if over the applicable threshold.
  - Capital gain subject to 3.8% surtax at the trust level

- Complex trusts and estates – subject to 3.8% surtax on accumulated income and capital gain

- Grantor trust – 3.8% surtax determined at the beneficiary level
3.8% Surtax - Formula

1. Undistributed “net investment income” for such taxable year, or

3.8% x the lesser of:

2. The excess (if any) of AGI (as defined in §67(e)) for such taxable year, over the dollar amount at which the highest bracket in §1(e) begins for such taxable year ($12,400 in 2016).
Income Taxation of Trusts and Estates

- Income Taxed to Either Entity or Beneficiary
  
  - If income is *accumulated* and not deemed distributed, it is taxed to the trust or estate
  
  - If income *distributed*:
    
    - Trust gets deduction for amount of distribution, limited to DNI
    
    - Beneficiary accounts for income distributed on his own tax return, limited to DNI
Income Taxation of Trusts and Estates - Distributable Net Income (DNI)

- Distributable Net Income (DNI) governs:
  - Amount of trust or estate’s distribution deduction
  - Amount beneficiary accounts for on his own return
  - Character of income in beneficiary’s hands
DNI acts as ceiling on entity’s distribution deduction

DNI acts as ceiling on amount beneficiary accounts for on his return

Trust/Estate

Beneficiary
DNI - Sec. 643(a)

• Start With Taxable Income and . . .

  – *Add back* the distribution deduction

  – *Add back* the personal exemption

  – *Subtract out* capital gains/*add back* capital losses allocable to principal (except in the year of termination)

  – *Subtract out* extraordinary dividends and taxable stock dividends allocated to corpus for simple trust

  – *Add back* net tax-exempt income
DNI – Easy Example

Facts – Trust income:
- Interest $10,000
- Dividends $15,000
- Trustee’s fees 5,000

DNI:
- Taxable income $19,900
- Add: Exemption $100
- DNI $20,000

Taxable income:
Interest $10,000
Dividends $15,000
Less: Tr fees ($5,000)
Net $20,000
Less: exemption ($100)
Taxable income $19,900
DNI – Example with LTCG

• Facts – Trust income:
  – Interest $10,000
  – Dividends $15,000
  – LTCG $30,000
  – Trustee’s fees 5,000

Taxable income:

Interest $10,000
Dividends $15,000
LTCG $30,000
Less: Tr fees $(5,000)
Net $50,000
Less: exemption $(100)
Taxable income $49,900

DNI:

Taxable income $49,900
Less: LTCG $(30,000)
Add: Exemption $100
DNI $20,000
DNI – Example with LTCG and T/E Interest

- **Facts – Trust income:**
  - Interest $10,000
  - Dividends $15,000
  - LTCG $30,000
  - T/E Interest $5,000
  - Trustee’s fees $5,000

**Taxable income:**
- Interest $10,000
- Dividends $15,000
- LTCG $30,000
- Less: Tr fees ($4,167)
- Net $50,833
- Less: exemption ($100)
- Taxable income $50,733

**DNI:**
- Taxable income $50,733
- Less: LTCG ($30,000)
- Add: Net T/E interest $4,167
- Add: Exemption $100
- DNI $25,000

**Allocation of expenses to T/E interest:**
- T/E Interest $5,000
- $5,000 T/E Interest x $5,000 = (833)
- $30,000 TAI
- Deductible trustee’s fees $4,167
DNI - Sec. 643(a)

• Note: capital gains generally taxed to trust or estate

  – Exceptions:
    • 3 situations under Reg. 1.643(a)-3
    • Paid to or set permanently set aside for charity. Reg. 1.643(c)
    • year of termination

• Note: The rules regarding DNI and the distribution deduction are applied differently to simple trusts versus complex trusts and estates

• Distributions of principal as well as income will “carry out” DNI

  – Exception: Specific bequests under Sec. 663(a)(1)
Distributions - Simple Trust
Beneficiary Taxed on Lower of TAI or DNI
Gains Taxed to Trust

Trust Gets Distribution
Deduction Equal to DNI

Simple Trust

Gains

DNI

Beneficiary Accounts for DNI

Beneficiary

Trust income retains its character in Beneficiary’s hands
Distributions - Complex Trusts and Estates

**Trust/Estate Accumulates Income**

Gains and DNI Taxed to Trust

Complex Trust

Gains

DNI
Distributions - Complex Trusts and Estates

Beneficiary Taxed on Distributions Up to DNI

Gains Taxed to Trust

Trust Gets Distribution
Deduction Equal to Distributions up to DNI

Complex Trust

DNI

Beneficiary Accounts for Distributions Up to DNI

Beneficiary

Trust income retains its character in Beneficiary’s hands
Distributions - Applicable Code Sections

Simple Trusts

- 651
- 652

Complex Trusts/Estates

- 661
- 662
## Distributions - Applicable Code Sections

<table>
<thead>
<tr>
<th>Distribution Deduction</th>
<th>Simple Trusts</th>
<th>Complex Trusts/Estates</th>
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<td>Distribution Deduction</td>
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<tr>
<td>Amt Bene Accounts For</td>
<td>652</td>
<td>662</td>
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Distribution System – Simple Trusts

• Distribution deduction - trust is entitled to deduct all of its TAI (but not in excess of its DNI)
  – Items of income not included in gross income (e.g. tax-exempt income) are not deductible by the trust

• Inclusion by beneficiary – the TAI (but not in excess of its DNI) is includible in the beneficiary’s gross income
  – Items of income not included in gross income (e.g. tax-exempt income) are not includible in the beneficiary’s income

• Example: Simple trust has TAI and DNI for the year is $9,000. The TAI must be distributed to A. The trust gets a distribution deduction of $9,000 and the beneficiary must include $9,000 in his income.
Distribution System – Simple Trusts

- Multiple beneficiaries - If there is more than one beneficiary, the DNI is apportioned among them in proportion to the TAI received by each beneficiary.

- Example: Trust requires one-third of TAI be distributed to A and two-thirds of TAI be distributed to B. TAI and DNI for the year is $9,000. The trust gets a distribution deduction of $9,000.

  - A must report $3,000 (1/3 of $9,000) and B must report $6,000 (2/3 of $9,000).
Distribution System – Simple Trusts

• Character of income – items of income retain the same character in the hands of the beneficiary as they had in the hands of the trust

• Example: Trust requires one-third of TAI be distributed to A and two-thirds of TAI be distributed to B. TAI and DNI for the year is $9,000. The TAI and DNI consists of $6,000 of dividends and $3,000 of interest. The trust gets a distribution deduction of $9,000.

  – A must report $3,000 (1/3 of $9,000) and B must report $6,000 (2/3 of $9,000).

  – A’s $3,000 distribution consists of $2,000 of dividends and $1,000 is interest.

  – B’s $6,000 distribution consists of $4,000 of dividends and $2,000 of interest
Complex Trusts - Allocation of DNI

• Generally, DNI is allocated among beneficiaries proportionately, based on distributions to each beneficiary.

• As with simple trusts, distributions from an estate or complex trust are generally considered to carry out a pro rata part of each item of DNI.
  
  – In other words, distributions from a complex trust or estate is deemed to consist of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to the total DNI.
Complex Trusts - Allocation of DNI

- Example:
  - Trust has $20,000 of DNI
  - Trustee distributes $30,000 to A and $10,000 to B
  - Under normal pro-rata rules, A would include $15,000 of DNI ($30,000 distribution/$40,000 total distribution x $20,000 DNI)
  - Under normal pro-rata rules, B would include $5,000 of DNI ($10,000 distribution/$40,000 total distribution x $20,000 DNI)
Complex Trusts – Special Rules in the Allocation of DNI

• FIVE IMPORTANT CONCEPTS:
  • Tier System
  • Separate Share Rule
  • 65 Day Rule (§663(b) election)
  • Specific Bequests - §663(a)(1)
  • Distributions in Kind - §643(e)
Complex Trust and Estates
Tier System

• Two tiers:
  – First Tier - Distribution of income *required* to be distributed currently
  – Second Tier - Distribution of *all other amounts* paid, credited or required to be distributed
Complex Trust and Estates
Tier System

DNI

First Tier Beneficiary

Second Tier Beneficiary

DNI is taxed first to FTB and any balance of DNI is taxed to STB
Complex Trust and Estates
Tier System - Example

Facts:  $40,000 DNI and TAI
Trust requires A receive 50% of income
Trustee makes discretionary
distributions of $20,000 to each B and C

A is FTB (Gets 50% of $40,000 TAI)
B and C are STB (Discretionary Benes)
Complex Trust and Estates
Tier System - Example

$40,000   DNI

($20,000)  DNI  for FTB

$20,000   DNI for STB

Divided by 2   STB

$10,000   DNI for Each STB
Complex Trust and Estates
Tier System - Example

$40,000
DNI

A
$20,000 DNI
FTB

B
$10,000 DNI
STB

C
$10,000 DNI
STB
Complex Trusts – Separate Share Rule

• General rule: DNI is allocated proportionately to beneficiaries based on distributions made to each

• However, disproportionate distributions to beneficiaries from a trust or estate can lead to different tax treatment for different beneficiaries

• The separate share rule is designed to cure this inequity

• The separate share rule allocates DNI among the beneficiaries based on distributions of their “share” of DNI

• Distributions to beneficiaries who don’t have separate shares are allocated DNI based on distributions made to them over the total distributions made to all the beneficiaries in a particular year i.e. a proportionate share of DNI
Complex Trusts - Separate Share Rule

_Solely for purposes of computing DNI_, substantially separate and independent shares of different beneficiaries of a trust are treated as separate trusts.

Effect: Treat multiple beneficiaries of single trust or estate as if each were the sole beneficiary of a single trust solely for determining how much DNI each distribution carries out.

Result: beneficiary is not taxed on more than his share of DNI.
Complex Trusts – Separate Share Rule

• Example:
  – Trust has $20,000 of DNI

  – Trustee distributes $30,000 to A and $10,000 to B

  – Under normal pro-rata rules, A would include $15,000 of DNI ($30,000 distribution/$40,000 total distribution x $20,000 DNI)

  – Under normal pro-rata rules, B would include $5,000 of DNI ($10,000 distribution/$40,000 total distribution x $20,000 DNI)

  – Added fact: separate share rule applies. A’s separate share earns $10,000 of DNI and B’s separate share earns $10,000 of DNI
## Complex Trusts – Separate Share Rule

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<thead>
<tr>
<th>A’s Separate Share</th>
<th>B’s Separate Share</th>
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<tr>
<td>DNI: $10,000</td>
<td>DNI: $10,000</td>
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<tr>
<td>Distribution: $30,000</td>
<td>Distribution: $10,000</td>
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<tr>
<td>Amount included in A’s income: $10,000, limited to his share of DNI</td>
<td>Amount included in B’s income: $10,000, limited to his share of DNI</td>
</tr>
</tbody>
</table>

Trust files one income tax return, takes a $20,000 distribution deduction, A includes $10,000 in income (even though he received $30,000 in distributions) and B includes $10,000 in income.
Complex Trusts - Separate Share Rule

• Applies to estates and trusts

• DNI computed separately for each share

• Mandatory, not elective

• Only affects share of DNI
  – Doesn’t allow filing multiple returns
  – Doesn’t allow separate calculation of tax

• Want to avoid separate share rule?
  – Draft as a “spray” trust
  – Provide in trust document that the shares subdivide into separate trusts
65 Day Rule aka Sec. 663(b) Election

- Applies to complex trusts and estates

- Allows fiduciary to treat distribution made within 65 days of Y/E as being made on 12/31 of preceding year

- Election must be made by due date of return

- Election is irrevocable

- Year by year election (e.g. good for 1 year only)

- Limited to > DNI less current year distributions or TAI not distributed
65 Day Rule aka Sec. 663(b) Election

12/31 2014

65 Days

12/31 2015
Facts: $10,000 DNI for 2014
Distributes $6,000 in 2014, $4,000 in 2015
Specific Bequests - Sec. 663(a)(1)

- Bequest of specific sum of money or specific property *do not carry out DNI*

- Requirements:
  - Paid all at once, or
  - Paid in not more than 3 installments

- Amount of bequest must be ascertainable at focal date e.g. date of death

- Not deductible by trust/estate or taxable to beneficiary
Section 643(e) Election – Distributions in Kind – Residuary Bequests

• Estate/Trust may *elect*, but is not required, to recognize G/L

• Distribution carries out DNI, but amount of DNI depends on whether the Section 643(e) election was made
  – No Election: DNI carried out is *lesser* of basis or FMV of distributed property
  – Election: DNI carried out is FMV of distributed property

• Basis of property to beneficiary is basis of property to estate/trust plus or minus any gain or loss the estate/trust elects to recognize on the distribution

• Holding period tacks if basis is same “in whole or in part” as transferor’s basis, otherwise, holding period starts anew
Charitable Deduction - Sec. 642(c)

• Requirements:
  – Paid from gross income
  – Paid pursuant to the governing document

• Unlimited in amount

• No distribution deduction

• Generally, must be actually paid in current year or preceding year
  – Estates and pre-1969 trusts get charitable deduction if “permanently set aside”
Depreciation - Sec. 642(e)

• Trusts:
  – Depreciation apportioned between income beneficiary and the trust per trust document
  – If no provisions in trust, depreciation apportioned on basis of trust income allocable between beneficiary and trust

• Estates:
  – Depreciation allocable on basis of income allocable to beneficiary and estate
Depreciation - Sec. 642(e)
Example

- FACTS:
  - Trust owns apartment building
  - $2,500 depreciation deduction
  - Trust pays all income to beneficiary

Beneficiary is entitled to entire $2,500 depreciation deduction
Depreciation - Sec. 642(e)
Exceptions

• GR: Depreciation allocated based in TAI allocated to trust/estate and beneficiary

• 2 exceptions - both apply to trusts:
  – Trust inst or local law indicates who get depreciation deduction
  – Trustee maintains depreciation reserve, trust gets deduction to extent trustee transfers income to reserve for depreciation
Depreciation - Sec. 642(e)  
Example

- FACTS:
  - Depreciation deduction is $5,000
  - TAI is $20,000
  - Inst requires trustee to maintain depreciation reserve
  - Trustee transfers $5,000 of income for depreciation reserve

- RESULT: Entire $5,000 depreciation deduction is allocated to trust
§645 Election

- Treats “qualified revocable trust” as part of decedent’s estate for Federal fiduciary income tax purposes

- Election made jointly by estate’s personal representative and trustee
  - Election for limited period of time
  - See final regulations for making and terminating the election and tax treatment of trust and estate while election is in effect
  - Election made on Form 8855 by due date of fiduciary income tax return for the first taxable year of the estate, including extensions
§645 Election – Benefits

- File one return, combining estate and trust income

- Use fiscal year-end

- Qualify for estate fiduciary income tax charitable deduction
  - More liberal than trust fiduciary income tax charitable deduction

- $25,000 PAL deduction for rental R/E for 2 years of estate

- Eligible to hold S stock for duration of election

- Trust not obligated to make estimated tax payments for any taxable year ending within 2 years of the decedent’s death
Termination of Trusts and Estates - Sec. 642(h)/Unused Loss Carryovers and Excess Deductions

- NOL, capital loss c/o and “excess deductions” pass to the beneficiary on termination of an estate or trust
- Pass through only in the year of termination
Capital Loss C/O

- Unused capital loss c/o passes to beneficiary in year of termination of trust or estate
- No time limit on beneficiary to use capital loss c/o
Capital Loss C/O
Example

- FACTS:
  - Trust incurs $30,000 LTCL in 2013.
  - Trust terminates in 2014, LTCL c/o still $30,000
  - $30,000 LTCL c/o passes to beneficiary on termination
  - Beneficiary can use LTCL c/o to offset his own personal capital gains or, if he has no gains, deduct up to $3,000 each year against ordinary income
“Excess Deductions”

• “Excess deductions” occur where trust/estate expenses exceed income in year of termination

• “Excess deductions” pass through to beneficiary on termination of trust/estate

  – Beneficiary can deduct on his personal return

• Deductible as miscellaneous itemized deduction subject to 2% floor

  – If beneficiary doesn’t itemize, he can’t use deduction
“Excess Deductions”
Example

• FACTS:
  • Estate has $30,000 of income and $50,000 executor’s fee for 2014.
  • Estate terminates in 2014
  • “Excess deductions” are $20,000 ($30,000 - $50,000)
  • Estate reports the $20,000 excess deduction to the beneficiary on a Form K-1 (“tax letter”)
  • Beneficiary can take $20,000 “excess deduction” on his own personal return as a miscellaneous itemized deduction subject to the 2% floor
Dirty (Baker’s) Dozen – Drafting and Planning Ideas

• Select fiscal year-end for estates

• Administration expense election

• Flexible drafting to include gains in DNI

• Include boilerplate language to allow non-pro-rata distributions – see Rev. Rul. 69-486

• Use specific bequests to avoid DNI carryout - §663(a)(1)

• Avoid separate share rule, if desired, by drafting as a spray trust or having trust divide into separate subtrusts
Dirty (Baker’s) Dozen – Drafting and Planning Ideas

• Take advantage of §643(e) election to control taxation of capital gains and DNI carryout

• Consider §645 election to take advantage of estate’s more favorable rules

• Draft carefully to qualify for §642(c) fiduciary income tax charitable deduction

• Avoid excess deductions in year prior to termination

• Remember the 3.8% surtax when drafting trusts

• Consider “Kenan” gain when drafting formula clauses – pecuniary versus fractional
Dirty (Baker’s) Dozen – Drafting and Planning Ideas

• Extra Credit – not mentioned in the lecture but very important

• Separate share rule has special rule that applies to income in respect of a decedent (IRD).

• IRD is allocated to any share that could “potentially” be funded with IRD, whether or not actually funded with IRD

• If intent is for IRD to go to a particular share (e.g. marital trust), draftsperson must so state in the trust instrument

• If IRD is not specifically allocated, surprises could result
Summary

• Trust or estate is a separate taxable entity
• Income is taxed to either estate/trust or beneficiary
• Concept of “distributable net income” (DNI) determines
  – Amount of distribution deduction
  – Amount included in beneficiary’s income
  – Character of income
• DNI affected by
  – Tier system of allocating DNI
  – Separate share rule
  – 65 day rule
  – Section 663(a)(1) for specific bequests
  – Section 643(e) rules for distributions in kind
• This stuff is really complicated
Resources

• Federal Income Taxation of Estates, Trusts and Beneficiaries, 3rd Edition by Ferguson, Freeland and Ascher (Aspen/CCH)

• 1041 Deskbook (Practitioners Publishing Co – updated annually)

• Income Taxation of Trusts and Estates, 852-3rd (BNA portfolio – Estate, Gift and Trust series)


• Federal Income Taxation of Trusts and Estates, by Zaritsky and Lane, 3rd Edition (RIA/Thompson/West)

• Income Taxation of Fiduciaries and Beneficiaries by Byrle M. Abbin, 2 volumes, 2016 Edition (CCH)