# 2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 2: TRUSTS & ESTATES

Land Grant University Tax Education Foundation

## LEARNING OBJECTIVES

P. 43

- ✓ Calculate the gross estate
- ✓ Understand when an estate should consider electing portability of the deceased spousal unused exclusion (DSUE)
- ✓ Determine the amount of the DSUE
- ✓ Know who has authority to obtain information and file returns for a deceased taxpayer
- ✓ Recognize income in respect of a decedent and know how it is taxed
- ✓ Identify a grantor trust
- ✓ Know what deductions are available to an estate or trust

## CHAPTER INTRODUCTION

P. 43

2021 Basic Exclusion amount is $11,700,000 per individual plus any unused exclusion portable between spouses.

**Chapter Discussion:**

1. How to calculate the gross estate, how to make the portability election, and how to make the election;
2. Who is authorized to file returns and obtain information for a deceased t/p;
3. What is income in respect of a decedent, and how it is taxed;
4. Language that makes a trust a grantor trust and trust deductions;
5. When does an estate have to file a tax return.

## THE GROSS ESTATE - ESTATE TAX OVERVIEW

P. 44

- I.R.C. §2001(a) – imposes tax on decedents who were
  - US citizens or residents of US at date of death
- Form 706 – estate tax return
- Estate Tax = gross income – deductions – credits – unused exclusions
- Practitioner Note – applicable credit is allowable credit against estate & gift tax
  - **First applied against gift tax**, then remainder applied against estate tax

## THE GROSS ESTATE

P. 44

**FIGURE 2.1**
**BASIC EXCLUSION AMOUNT**

| **YR OF DEATH** | **EXCLUSION AMOUNT** |
|---|---|
| 2011 | $5,000,000 |
| 2012 | $5,120,000 |
| 2013 | $5,250,000 |
| 2014 | $5,340,000 |
| 2015 | $5,430,000 |
| 2016 | $5,450,000 |
| 2017 | $5,490,000 |
| 2018 | $11,180,000 |
| 2019 | $11,400,000 |
| 2020 | $11,580,000 |
| **2021** | **$11,700,000** |

## THE GROSS ESTATE

P.P. 44-45

- THE BASIC EXCLUSION AMOUNT IS SCHEDULED TO REVERT TO $5,000,000 – INDEXED FOR INFLATION ($10,000,000 FOR A MARRIED COUPLE) **IN 2026**
- EX. 2.1 EVAN DIED IN 2021
- Amy was beneficiary
- Estate value of $ 17,000,000
- No taxable gifts over his lifetime
- Tax due = $ 2,120,000

  ($ 17,000,000 – $11,700,000 exclusion) x 40%)

Estate Tax > $1,000,000 tax rate = 40%. Lowest tax rate is (0-$10,000 @ 18%) graduated to 40%

## CALCULATING THE GROSS ESTATE P. 45

- Property value at time of death
  - Real
  - Personal
  - Tangible
  - Intangible
- I.R.C. §2035
- Treas. Reg. § 20.2031-1 total value included under sections 2033 through 2044
- **Cross-Reference** – Estate Planning-if estate value likely to exceed the reduced 2026 amount-see 2020 National Income Tax Workbook, pp 411-415 for planning to use the increased basic exclusion amount before the reduction.

## CALCULATING THE GROSS ESTATE P. 45

- **Decedent's Property interests include**
  - A cemetery lot owned by the decedent, value is limited to the part of the lot that can be sold and that is not designed for interment of decedent/family
  - Property subject to homestead or other exemptions under local law
  - Notes or other claims held by the decedent, even though they are cancelled by the decedent's will
  - Interest and rents accrued
  - Uncollected dividends that are payable to the decedent or his/her estate because on or before the date of the decedent's death he/she was a stockholder of record
- **Cross-Reference** – Special Use Valuation instead of FMV for farm & closely held business-see ***2020 Nat. Income Tax Workbook, pp 249-251 for discussion***.

## DOWER OR CURTESY INTERESTS P. 45

- I.R.C. §2034 – surviving spouse's dower included in gross estate
- *Example*: State's elective share law
  - The surviving spouse of a decedent who dies domiciled in this state has a right of election, under the limitations and conditions stated in this part to take an elective-share amount equal to 50% of the value of the marital-property portion of the augmented estate.

## GIFTS MADE WITHIN 3 YEARS OF DEATH P. 46

- I.R.C. §2035 – **property includes:**
  - The decedent made **a transfer** (by trust or otherwise) **of an interest in any property**, or relinquished a power with respect to any property, **during the 3-year period ending on the date of the decedent's death; and**
  - the **value of such property** (or an interest in the property) **would have been included** in the **decedent's gross estate** under I.R.C. §2036, 2037, 2038, or 2042 if the decedent had retained such transferred interest or relinquished power on the date of his/her death.
- Bona fide sale – property NOT included
- Gift tax paid – increases gross estate
- Transfers from revocable trust – treated as transfer made **directly** by the decedent

## TRANSFERS WITH RETAINED LIFE ESTATE P. 46

- I.R.C. §2036
- Transferred Interest must be retained for life, period ascertainable w/ reference to death, or period that doesn't end before death
- NOT a bona fide sale
- **Includes retained right to**:
  - Possess
  - Enjoy
  - Income
  - Designate possession, enjoyment, or income
  - Vote stock (directly of indirectly)

## EXAMPLES PP. 46-47

- **Example 2.2 Pg. 46** – **Life Estate-** 3 rental properties to revocable trust, income dist. during life of grantor, @ death remainder to 3 children. Properties included in gross estate.
- **Example 2.3 Pg. 46** – **Period Not Ascertainable without Reference to Death-Assets** transferred to revocable trust for benefit of niece. Income right reserved by grantor, but no income for last quarter & date of grantors death –DOD not ascertainable. Assets included in grantors estate.
- **Example 2.4 Pg. 47** – **Retained Right Did Not End before Death**—10 year right to use of property causes property to be included in estate after 7 years at DOD.
- **Practitioner Note – Pg. 47** Decedent deemed to have retained a right if - Discharge of Legal Obligation included in transferred property.

## TRANSFERS TAKING EFFECT AT DEATH P. 47

- **Value of decedent's property included in gross estate** if
  - **possession or enjoyment** of the property can, through ownership of such interest, **be obtained only by surviving the decedent;**
  - the **decedent retained a reversionary interest** in the property; and
  - the **value of the reversionary interest** immediately before the decedent's death is **more than 5% of the value of the property**.
- **Reversionary interest** – property transferred by the decedent **may return to** the **decedent o**r his/her **estate**
- Reversionary interest IS NOT – possibility of **inheriting the property back from someone-**
- **Example 2.5** – **No Reversionary Interest** – W to H trust income, remainder to W kids, if no kids, to W or her estate- value of reversionary int. could be included in grs. Estate.
- **Example 2.6** – **Reversionary Interest** H to W prop. for life, remainder to H or his daughter if H's DOD before W.

## REVOCABLE TRANSFERS P. 48

- Treas. Reg. §20.2038-1 – does not apply to the following:
  - **1. Transfe**r was **for adequate and full consideration** in money or money's worth
  - **2. Decedent's power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and** if the power adds nothing to the rights of the parties under local law
  - 3. A power held solely by a person other than the decedent
- **Right to amend or revoke a trust language** – "Grantor, during grantor's lifetime, reserves the right to amend or revoke the trust. Upon the death of grantor, the trust shall be irrevocable."

## ANNUITIES & JOINT INTERESTS P. 48

- **Annuities**
  - Remaining value INCLUDED in decedents gross estate (payable to decedent for life) included in gross estate
- **Joint Interest**
  - Property Value INCLUDED in gross estate (Jt. Tenant w/ survivorship right)
  - Qualified joint interest – property 50% included (tenants by entirety w/ survivorship right)

## EXAMPLE 2.7 JOINT OWNERSHIP PP. 48-49

- Frank & Freida (Brother & Sister)
- Purchase rental property
- Figure 2.2 – **Deed-Jt. Tenants, rt./survivor**
- Frank dies & interest passes to sister
- Absent other evidence, value of entire property included in Frank's gross estate
- If Freida **proves she paid half the purchase price, Franks 50% included in his estate.**

**FIGURE 2.2**
**Frank and Freida's Deed**

| QUITCLAIM DEED | |
|---|---|
| GRANTOR(s): | JUDY A. HOLBRIGHT |
| Address: | P.O. Box 3333, Coram, MT, 59912 |
| GRANTEE(s): | FRANK WILLIS and FREIDA WILLIS, as joint tenants with right of survivorship |
| Address: | P.O. Box 2222, Hungry Horse, MT 59919 |
| LEGAL DESCRIPTION: | Lot 22 of Meadow Lake Country Club Estates Phase II, according to the map or plat thereof on file and of record in the office of the Clerk and Recorder of Flathead County, Montana |

## POWERS OF APPOINTMENT P. 49

- **General power of appointment**
- Exercises & releases of a power of appointment
  - Example - Power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust.
  - Example – wife has power of testamentary disposition over property in which she does not have a vested interest.
- **Practitioner Note** – Ascertainable Standard-power is limited if extent of holder's duty to exercise or not is reasonably measurable.
- Practitioner Note – Lapse of Power of Appointment is release of power prop. Val >$5,000.

## LIFE INSURANCE PROCEEDS PP. 49-50

- Included if incidents of ownership
  - Not limited to ownership of policy
  - Include right of insured (his/her estate) to the economic benefits of the policy
  - Includes powers to:
    - Change the beneficiary
    - Surrender or cancel the policy
    - Assign the policy
    - Revoke an assignment
    - Pledge the policy for a loan
    - Obtain from the insurer a loan against the surrender value of the policy
  - Included reversionary interest

## TRANSFERS FOR INSUFFICIENT CONSIDERATION & MARITAL DEDUCTION PROPERTY P. 50

- Transfers for insufficient consideration – excess FMV of property over price received is included in gross estate
- Marital deduction property
- Practitioner Note – Basis
- Example 2.8 – Inclusion of Trust Subject to Election
  - Asset value = $ 800,000
  - Sam inherits as surviving spouse
  - Deceased spouse's estate makes QTIP election and claims marital deduction
  - FMV included in Sam's estate

# ELECTING PORTABILITY

## DECEASED SPOUSAL UNUSED EXCLUSION P. 51

- Surviving spouse adds unused exclusion from decedent spouse
- Electing Portability
  - Estate < basic exclusion – no portability necessary
  - Estate > basic exclusion – portability may be option
- Example 2.9 – No Portability Election
- Example 2.10 – Tax Practitioner Advice

## SAMPLE LETTER TO EXECUTOR P. 52

FIGURE 2.3
Sample Letter to Executor

Dear Mrs. Rivers,

Please allow me to express my sympathy for your recent loss. It is always difficult to lose a loved one and settling an estate can be time-consuming and stressful. Recently we discussed the election for portability of the deceased spousal unused exclusion (DSUE) amount. I am writing this letter to summarize that discussion, and the basis for your decision to not elect portability of your husband's DSUE.

Each US person has a basic exclusion from estate and gift tax. For taxpayers dying in 2021, that exclusion is $11,700,000. Absent any changes in the law, that amount will be reduced to approximately $6,000,000 for taxpayers dying in 2026. The DSUE election makes the exclusion portable between spouses, which means that the unused exclusion of the first deceased spouse is added to the exclusion of the surviving spouse.

Unless the estate opts out, the portability election is made automatically by timely filing a complete and properly prepared estate tax return (Form 706). The filing can be made only by an authorized person. In this case, you are the person authorized to file Form 706 because you have been appointed as executor of the estate. If the estate is filing Form 706 solely to elect portability, the deadline for filing can be up to 2 years after the date of death.

For spouses whose assets may exceed the basic exclusion amount, electing DSUE portability can be advantageous. Take, for example, spouses with a combined estate of $8,000,000. The husband died in 2021 and devised the entire estate outright to his wife. The husband's estate did not elect portability. The wife dies in 2026. Her estate has an estimated $6,000,000 exclusion and must pay estate tax on $2,000,000 ($8,000,000 – $6,000,000). If instead the husband's estate had elected portability, the husband's $11,700,000 DSUE (based on the 2021 exclusion amount) would have been carried over to the wife's estate, and the wife's $17,700,000 ($11,700,000 + $6,000,000) exclusion would have more than offset the $8,000,000 estate. The wife's estate would have owed no estate tax.

For a surviving spouse whose assets do not currently exceed the basic exclusion amount, electing portability may still be advantageous because the size of your estate may increase in the future. Also, while the basic exclusion amount is permanently indexed for inflation, subsequent tax legislation could reduce the amount of the exclusion. However, you must weigh the possible benefits of electing portability against the time and expense to make the election. A complete and properly prepared estate tax return must include an accurate calculation of the DSUE amount, which may necessitate obtaining costly appraisals of estate assets.

As we discussed, the likelihood that your estate could exceed the basic exclusion amount is small, and the cost to elect portability is high. Accordingly, you have decided to not make the election. Please let me know immediately if you have any additional questions about the portability election or if any information in this letter does not accurately reflect our discussion. Thank you.

Sincerely,
Jerome Jensen, CPA

Note: This sample letter is provided for general educational purposes. The terms of such a letter are very fact-specific, and laws in taxing jurisdictions vary. For these reasons, the sample letter is not applicable in all circumstances.

## COMBINED ESTATES & PORTABILITY P. 53

- Below two times basic exclusion – advantageous to elect portability
- Example 2.11 – Electing Portability Eliminates Estate Tax
- Above two times basic exclusion
  - Use DSUE and get step-up basis
  - But appreciation on deceased spouse's assets included in estate
  - Credit shelter trust
- Example 2.12 – Estate Planning with an A-B Trust and No Portability

## ELECTING PORTABILITY P. 54

- Practitioner Note – Nontax Use of Trusts
- Practitioner Note – Non-US Spouse
- How to Make the Portability Election
  - Form 706
  - Properly prepared return
- Who Can File the Election
  - Executor or administrator
  - If none, person in actual or constructive possession of any property
- Timely Filed Election
  - Due date 9 months after decedent's date of death
  - Request automatic 6-month extension

## ELECTING PORTABILITY PP. 54-55

Simplified Procedure

- The decedent was survived by a spouse, died after 12/31/2010, and was a citizen or resident of the US on the date of death.
- The executor is not required to file an estate tax return under §6018(a), as determined based on the value of the gross estate and adjusted taxable gifts and without regard to the need to file for portability purposes.
- The executor did not file an estate tax return within the time required by Treas. Reg. §20.2010-2(a)(1) for filing an estate tax return.
- The executor satisfies all other requirements of Rev. Proc. 2017-34.

- Private Letter Ruling

## ELECTING PORTABILITY P. 55

- Private Letter Ruling
  - Deemed good faith and reasonable if
    - Requested relief before the IRS discovered the failure to make the regulatory election;
    - Failed to make the election because of intervening events beyond the taxpayer's control;
    - Failed to make the election because, after exercising reasonable diligence (considering the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election;
    - Reasonably relied on the written advice of the IRS; or
    - Reasonably relied on qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election

## ELECTING PORTABILITY P. 55

- Private Letter Ruling
  - Did NOT act in good faith if
    - The taxpayer sought to alter a return position for which an accuracy-related penalty has been or could be imposed under I.R.C. §6662 at the time the taxpayer requested relief [considering any qualified amended return filed within the meaning of Treas. Reg. §1.6664-2(c)(3)], and the new position requires or permits a regulatory election for which relief is requested;
    - The taxpayer was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or
    - Specific facts have changed since the due date for making the election that make the election advantageous to a taxpayer, and the taxpayer's decision to seek relief involves hindsight

## COMPLETING THE ESTATE TAX RETURN PP. 55-56

- Assets of the gross estate
- Deductions
- Certified copy of the Will
- Calculate the DSUE
- Reporting of Value Not Required
  - If no filing requirement, don't have to report specific value of
  - Marital deduction property
  - Charitable deduction property

## COMPLETING THE ESTATE TAX RETURN P. 56

- Reporting items on the return even if no filing requirement
  - Description
  - Ownership
  - Beneficiary
  - "All other" information necessary to determine right to deduction
  - Estimate/range of values

## COMPLETING THE ESTATE TAX RETURN PP. 56-57

- Planning Pointer – Statue of Limitations for Valuation
- DSUE amount is lesser of
  - the basic exclusion amount, or
  - The applicable exclusion amount of the last deceased spouse reduced by the amount with respect to which the tentative tax on the estate of the deceased spouse is determined under I.R.C. §2001(b)(1)
  - Figure 2.4

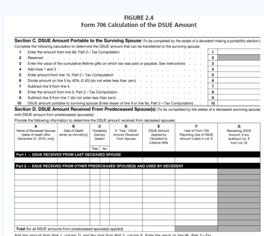

**FIGURE 2.4**
**Form 706 Calculation of the DSUE Amount**

**Section C. DSUE Amount Portable to the Surviving Spouse** (To be completed by the estate of a decedent making a portability election.)
Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

| | | | |
|---|---|---|---|
| 1 | Enter the amount from line 9d, Part 2—Tax Computation | 1 | |
| 2 | Reserved | 2 | |
| 3 | Enter the value of the cumulative lifetime gifts on which tax was paid or payable. See instructions | 3 | |
| 4 | Add lines 1 and 3 | 4 | |
| 5 | Enter amount from line 10, Part 2—Tax Computation | 5 | |
| 6 | Divide amount on line 5 by 40% (0.40) (do not enter less than zero) | 6 | |
| 7 | Subtract line 6 from line 4 | 7 | |
| 8 | Enter the amount from line 5, Part 2—Tax Computation | 8 | |
| 9 | Subtract line 8 from line 7 (do not enter less than zero) | 9 | |
| 10 | DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2—Tax Computation) | 10 | |

**Section D. DSUE Amount Received From Predeceased Spouse(s)** (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))
Provide the following information to determine the DSUE amount received from deceased spouses.

| A Name of Deceased Spouse (dates of death after December 31, 2010, only) | B Date of Death (enter as mm/dd/yy) | C Portability Election Made? Yes | No | D If "Yes," DSUE Amount Received From Spouse | E DSUE Amount Applied by Decedent to Lifetime Gifts | F Year of Form 709 Reporting Use of DSUE Amount Listed in col. E | G Remaining DSUE Amount, if any (subtract col. E from col. D) |
|---|---|---|---|---|---|---|---|
| **Part 1 — DSUE RECEIVED FROM LAST DECEASED SPOUSE** | | | | | | | |
| | | | | | | | |
| **Part 2 — DSUE RECEIVED FROM OTHER PREDECEASED SPOUSE(S) AND USED BY DECEDENT** | | | | | | | |
| | | | | | | | |
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| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| **Total** (for all DSUE amounts from predeceased spouse(s) applied) | | | | | | | |

Add the amount from Part 1, column D, and the total from Part 2, column E. Enter the result on line 9b, Part 2—Tax Computation ▶

## LAST DECEASED SPOUSE P. 58

- Most recently deceased person who was married to surviving spouse
- Even if surviving spouse remarried
- Ordering Rules
  1. DSUE
  2. Decedent's basic exclusion

## EXAMPLE 2.13 ORDERING OF DSUE P. 58

- Bart & Heather are married
- Heather died
- Elects $3,000,000 DSUE
- Bart remarries Cindy
- Bart died
- $5,000,000 taxable estate
- 1st Apply $3,000,000 DSUE
- 2nd Apply Bart's exclusion, $5,450,000
- 3rd Elect portability to Cindy

- No DSUE from Heather after Bart died
- If no portability election, then no DSUE for Cindy
- DSUE from prior deceased spouse can offset lifetime taxable gifts

## EXAMPLE 2.14 DSUE USED FOR TAXABLE GIFTS P. 58

- Whitney survives Hunter
- No taxable gifts made
- Hunter's estate elects portability
- $5,000,000 DSUE
- Whitney gifts $2,000,000 to children
- **Applies Hunter's DSUE on gift tax return**
- Hunter's DSUE remaining = $3,000,000

- Whitney marries Michael 2022
- Michael dies 2026
- Michael's estate elects portability
- $6,000,000 DSUE
- **Whitney** dies
- **DSUE = $8,000,000** (2M gift tax from Hunters DSUE + 6M from Michael)
- Estate exclusion = $14,300,000

## ELECTING PORTABILITY P. 59

- Practitioner Note – **Examining Deceased Spouse's Return when DSUE used in surviving spouse's exclusion.**
- **Opting Out of DSUE**
  - Filing Form 706 elects portability unless opt out, Figure 2.5
  - **NOT filing Form 706 automatic opt out**

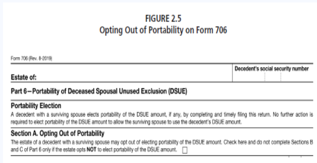


FIGURE 2.5
Opting Out of Portability on Form 706

Form 706 (Rev. 8-2019)

**Estate of:** | **Decedent's social security number**

**Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)**

**Portability Election**
A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

**Section A. Opting Out of Portability**
The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

# DEATH OF A TAXPAYER

## POWERS OF ATTORNEY P. 60

- IRS Form 2848 – Power of Attorney & Declaration of Representative
  - Narrow scope for tax matters
  - Used during lifetime
  - Act on behalf of the taxpayer
  - Terminates upon taxpayer's death
- Court-appointed administrator
  - Acts upon death of taxpayer
- Automatic transfer of assets to heirs – no administrator
  - Joint tenancy, TOD, designated beneficiary

## POWERS OF ATTORNEY P. 60

- Appoints attorney-in-fact
- Agent to act
- Broad scope – financial, tax, other matters
- General POA – terminates upon physical or mental disability
- Durable POA – valid even after physical or mental disability
- Terminate upon death
- Executor files IRS Form 2848 & Form 56

## THIRD-PARTY DESIGNEE P.P. 60-61

- **Checking the box – on filed tax return gives third party designee-**
- **Authority to**:
  - Give the IRS information missing from the taxpayer's return
  - Call the IRS for information about the processing of the taxpayer's return, or the status of a refund or payment(s)
  - Receive copies of notices or transcripts related to the tax return, upon request
  - Respond to certain IRS notices about the math errors, offsets, and return preparation
- **Cannot:**
  - receive refund checks
  - Make binding agreements
  - **Represent taxpayer** before the IRS

## EXECUTOR P. 61

- **Authority to act on behalf of taxpayer's estate**
- **Practitioner Note – Probate**
- **Deemed to be the taxpayer and is not required to file a power of attorney with the IRS**
- **File Form 56 – Notice Concerning Fiduciary Relationship**
- **Practitioner Note – Digital Assets**
- Form 4810 – **Request for Prompt Assessment to reduce time period to 18 months**
- **Form 5495 Request for Discharge From Personal Liability**

NO FIDUCIARY APPOINTMENT PP. 61-62

- **No executor appointed if assets pass by operation of law**
- **Signing a return**
  - Surviving spouse
  - Person in charge of property
- **Requesting information**
  - Heir at law, next of kin, beneficiary under the will or recipient of property
  - **Material interest – usually financial nature**
  - **Affected by the requested information**

POWER TO ACT P. 62

- **Treas. Reg. §601.503 residuary beneficiary**
  - **Form 56 – notify the IRS of the fiduciary relationship**
- **IRS may require**
  - **Evidence of discharge of executor**
  - **Evidence that executor is not responsible for disposition of matters**
  - **Statement signed under penalty of law showing relationship to decedent and right to assets**

# INCOME IN RESPECT OF A DECEDENT (IRD)

## DEFINITION OF IRD P. 63

- All **accrued income of a decedent** who **reported** his/her **income** by use of the **cash** receipts and disbursements **method**
- **Income accrued** solely by reason of the decedent's death in case of a **decedent** who **reports** his/her income by use of an **accrual method** of accounting
- **Income** to which the **decedent had** a **contingent claim** at the time of his death
- **Example 2.15** – **Pg. 63** No IRD on Post death Sale of Stock
- **Example 2.16 – Pg. 63** IRD on Predeath Sale of Apples & Transfer to Cooperative

## TAXATION OF IRD P. 64

- **Include in gross income**
  - Same character during life
- Gross income **included by**:
  - The **decedent's estate if the estate receives it**
  - The **beneficiary, if the right to income is passed directly to the beneficiary and the beneficiary receives it**
  - **Any person to whom the estate properly distributes the right to receive it**
- Example 2.17 – pg. 64 - **Estate & Beneficiary** Receive IRD
- Example 2.18 – pg. 64 - **Retained Character** of IRD
- Transfer of Right to IRD – if transferee includes in gross income, transferor does not

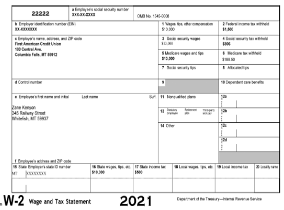
## TAXATION OF IRD P. 65

- **Example 2.19 – Transfer of IRD wages by will to spouse who includes in gross inc.**
- **Deductions – allowable if decedent was allowed**
- **Income – taxed when recipient receives it**
- **Estate tax paid by recipient– deduct on Sch. A line 16, (other itemized deductions)**
- **Treas. Reg. §1.691(c)-1 Deduction calculated:**
  - **Determine the net value of IRD items included in the gross estate**
  - **Determine how much of the estate tax is attributable to inclusion of those items**

TAXATION OF IRD PP. 65-67

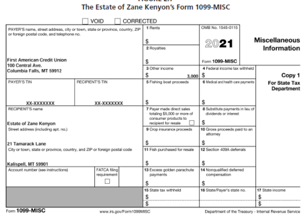
- Example 2.20 – **Calculating the Deduction for Estate Tax Paid**
- **Types of IRD**
  - Wages – earned prior to death
  - **Example 2.21** – Wages paid after death to the estate, w/h FICA & Medicare because wages paid during year of death.

FIGURE 2.6
Zane Kenyon's Form W-2


22222
a Employee's social security number XXX-XX-XXXX
OMB No. 1545-0008
b Employer identification number (EIN) XX-XXXXXXX
1 Wages, tips, other compensation $10,000
2 Federal income tax withheld $1,500
c Employer's name, address, and ZIP code
First American Credit Union
100 Central Ave.
Columbia Falls, MT 59912
3 Social security wages $13,000
4 Social security tax withheld $806
5 Medicare wages and tips $13,000
6 Medicare tax withheld $188.50
7 Social security tips
8 Allocated tips
d Control number
9
10 Dependent care benefits
e Employee's first name and initial Last name Suff.
Zane Kenyon
345 Railway Street
Whitefish, MT 59937
11 Nonqualified plans
12a
13 Statutory employee Retirement plan Third-party sick pay
12b
14 Other
12c
12d
f Employee's address and ZIP code
15 State Employer's state ID number MT XXXXXXXX
16 State wages, tips, etc. $10,000
17 State income tax $500
18 Local wages, tips, etc.
19 Local income tax
20 Locality name
Form W-2 Wage and Tax Statement 2021
Department of the Treasury—Internal Revenue Service

EXAMPLE 2.21 PP. 66-67

FIGURE 2.7
The Estate of Zane Kenyon's Form 1099-MISC


VOID CORRECTED
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
First American Credit Union
100 Central Ave.
Columbia Falls, MT 59912
1 Rents $
2 Royalties $
OMB No. 1545-0115
2021
Form 1099-MISC
Miscellaneous Information
3 Other income $ 3,000
4 Federal income tax withheld $
Copy 1
For State Tax Department
PAYER'S TIN XX-XXXXXXX
RECIPIENT'S TIN XX-XXXXXXX
5 Fishing boat proceeds $
6 Medical and health care payments $
RECIPIENT'S name
Estate of Zane Kenyon
7 Payer made direct sales totaling $5,000 or more of consumer products to recipient for resale
8 Substitute payments in lieu of dividends or interest $
Street address (including apt. no.)
21 Tamarack Lane
9 Crop insurance proceeds $
10 Gross proceeds paid to an attorney $
City or town, state or province, country, and ZIP or foreign postal code
Kalispell, MT 59901
11 Fish purchased for resale $
12 Section 409A deferrals $
Account number (see instructions)
FATCA filing requirement
13 Excess golden parachute payments $
14 Nonqualified deferred compensation $
15 State tax withheld $ $
16 State/Payer's state no.
17 State income $ $
Form 1099-MISC www.irs.gov/Form1099MISC Department of the Treasury - Internal Revenue Service

TYPES OF IRD P. 67

**Farm Income**
- Cash method farmer
- Crop share rents received prior to death
- Crop sold after death

- **Example 2.22** – Portion of Crop Share Earned before Death and sold after death is IRD, remainder is income to the estate.

TYPES OF IRD P. 68

- **US Saving Bonds – Series EE or Series I--if T/P reported interest each year- interest @ DOD –reported on decedents final return.**
- **Reporting Interest-if not reported each year-**
  - Executor **elects to include interest earned** on the bonds **before** the decedent's **death on the return**. The **transferee** (estate or beneficiary) then **includes** only the **interest earned after the date of death on its return**.
  - Executor does **not make the election**, the **interest earned up to the date of death is IRD.** All the **interest earned** before and **after the decedent's death is income to the transferee (estate or beneficiary).**
- **Example 2.23 Inherited Bond** – PR- No Election to Include Interest beneficiary reports interest @ maturity. (Interest not reported annually)

# GRANTOR TRUSTS

GRANTOR TRUSTS P. 69

- **Separate legal entity**
- **Grantor – creates the trust**
- **Trustee – manages the assets of the trust**
- **Beneficiary – person entitled to receive benefits from trust**
- Practitioner Note – Gross Estate Inclusion
- Grantor trust if the trust meets any of the grantor trust definitions in I.R.C. § § 673, 674, 675, 676, or 677.
- Grantor treated as owner
  - **Reversionary interests >5% value of trust** – return of possession or enjoyment taking effect w/I 10 yrs.

## POWER TO CONTROL BENEFICIAL ENJOYMENT PP. 69-70

- I.R.C. §674(a) – **grantor treated as the owner of any part can direct the disposition of income or principal**
- I.R.C. §674(b) – no grantor status
  - Power to apply income to support a dependent, to the extent not exercised
  - Power to control beneficial enjoyment only after occurrence of an event after which the grantor would not be treated as owner under §673
  - Power exercisable only by will (other than a power to appoint accumulated income)
  - Power to allocate income or principal among charitable beneficiaries
  - Power to distribute principal if limited by a reasonably defined standard
  - Power to temporarily withhold income
  - Power to withhold income while the beneficiary is disabled or under age 21
  - Power to allocate receipts and disbursements between income and principal

## POWER TO CONTROL BENEFICIAL ENJOYMENT P. 70

- I.R.C. §674(c) – **trustee can have the power to distribute if**:
  - Trustee is not the grantor
  - Majority of trustees are not related
  - Majority of trustees are not subordinate to grantor
- **Sample language**
  - Trustee may make distributions of income and principal in such amounts and to such of the trust beneficiaries as the trustee determines, in the trustee's sole discretion.

## ADMINISTRATIVE POWERS PP. 70-71

- I.R.C. §675 – **4 powers resulting in grantor trust**
  1. **Power to Deal with Trust Assets**
  2. **Power to Borrow without Adequate Interest or Security**

     "The trustee shall have the authority to loan to the grantor, and the grantor shall have the authority to borrow from the trust, all or any part of income or principal of the trust, without adequate interest or security. Grantor may exercise this power unconditionally, without the approval of the trustee, or any other party."
  3. **Borrowing Funds from the Trust**
  4. **Administrative Powers**
     - Vote or direct the voting of a significant interest in stock or securities
     - Control the investment of trust funds
     - Reacquire trust principal by substituting other property of an equivalent value

ADMINISTRATIVE POWERS AND OTHER TYPES OF GRANTOR TRUSTS
P. 71

**Administrative powers sample language**
"Grantor shall have the right and power at any time, acting in a nonfiduciary capacity and without consent of the trustee, to withdraw any asset of the trust if the grantor simultaneously substitutes therefor other property of an equivalent value."

- Power to Use Income for the Benefit of Grantor
- Person Other than Grantor Treated as Owner
- Cross Reference-Pg.(s) 419-421 2020 National Income Tax Workbook-grantor trust reporting.

# TRUST & ESTATE DEDUCTIONS

FIDUCIARY DEDUCTIONS P. 72

- **Costs** paid or incurred in connection with the **administration** of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust
- The **personal exemption** of an **estate or non-grantor trust**
- The **distribution deduction** for trusts **distributing current income**
- The **distribution deduction** for estates and trusts **accumulating income**

## COSTS SUBJECT TO 2% AGI FLOOR P. 72

- **Defense of a claim** against the estate, the decedent, or the nongrantor trust that are **unrelated** to the existence, validity, or administration of the **estate or trust**
- **Ownership cost**, such as condominium fees, insurance premiums, maintenance and lawn services, and auto insurance and registration
- **Tax return preparation fees** for returns for tax returns (for example, gift tax returns) that are commonly and **customarily filed by individuals**
- **Investment advice fees** (including any related services that would be provided to any individual investor as part of an investment advisory fee)
- Cost of **appraisals** for purposes **unrelated to the trust or estate** (for example, insurance)

## COSTS NOT SUBJECT TO THE 2% AGI FLOOR P. 73

The IRS issued final regulations clarifying that the deductions allowed to **nongrantor trusts and estates** under Sec. 67(e) are **not** miscellaneous itemized deductions and thus are **not affected by the temporary suspension of miscellaneous itemized deductions under the Tax Cuts and Jobs Act.** The regulations also offer guidance on how excess deductions are treated when an estate or trust terminates. T.D. 9918. 10-6-2020

## COSTS NOT SUBJECT TO THE 2% AGI FLOOR P. 73

- **Examples include:**
- Defense of a claim against the estate, the decedent, or the nongrantor trust that is related to the existence, validity, or administration of the estate or trust
- Tax preparation fees for estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax return
- Certain incremental costs of investment advice beyond the amount that is normally charged to an individual investor

## COSTS **NOT SUBJECT TO THE 2% AGI FLOOR** P. 73

- **Appraisal fees** incurred by an estate or a nongrantor trust to determine the FMV of assets as of the decedent's date of death (or the alternative valuation date), to determine value for purposes of making distributions, or if required to properly prepare the estate's or trust's tax returns or a generation-skipping transfer tax return.
- **Other fiduciary expenses that are not commonly or customarily incurred by individuals**, such as probate court fees and costs; fiduciary bond premiums; legal publication costs of notices to creditors or heirs; the cost of certified copies of the decedent's death certificate; and costs related to fiduciary accounts.

## BENEFICIARY DEDUCTIONS P. 73

- Transferred to beneficiary on termination of estate or trust.
- NOL carryover- **no carryback available**
- Capital loss carryover
  - Short-term loss for Corporate beneficiary
- Certain Excess deductions (discussed later)

## EXAMPLE 2.24 ESTATE HAS AN NOL CARRYOVER P. 74

**FIGURE 2.8**
**Alan Adams Estate Income and Deductions**

| | | |
|---|---|---|
| **Income** | | |
| Taxable interest | $2,500 | |
| Business income | 3,000 | |
| Total income | | $5,500 |
| **Expenses** | | |
| Business expenses (including administrative expenses allocable to business income) | $5,000 | |
| Administrative expenses not allocable to business income that would not have been incurred if the property were not in a trust [section 67(e) deductions] | 9,800 | |
| Total expenses | | $14,800 |

**FIGURE 2.9**
**Brian Bester's Schedule K-1, Box 11**

| 11 | Final year Deductions |
|---|---|
| A | 7,300 |
| E | 2,000 |

[Treas. Reg. § 1.642(h)-5(a) Example 1]

EXCESS DEDUCTIONS P. 75

- **Character of excess deduction** – same as in the trust
- **Deductions Allowable @ arriving at AGI retain character -** May be subject to applicable limitations of the beneficiary
- **– Ex. 2.26, pg. 75.**
- **Estate 75% to niece & 25% to nephew – Excess deductions = $11,000, all 67 (e ) deductions in arriving at AGI. Allocated based on beneficiary's interest. See Also Fig. 2.10, pg. 75.**

EXAMPLE 2.25 CALCULATION OF EXCESS DEDUCTIONS PP. 75-76

**FIGURE 2.10**
**Daria Mendez's Estate's Income and Deductions**

| | | |
|---|---|---|
| **Income** | | |
| Dividends | $3,000 | |
| Taxable interest | 500 | |
| Rent | 2,000 | |
| Capital gain | 1,000 | |
| Total income | | $ 6,500 |
| **Expenses** | | |
| Rental real estate expenses [section 62(a)(4) deduction] | $2,000 | |
| Probate fees [section 67(e) deduction] | 1,500 | |
| Estate tax preparation fees [section 67(e) deduction] | 8,000 | |
| Legal fees [section 67(e) deduction] | 2,500 | |
| Personal property taxes (nonmiscellaneous itemized deduction) | 3,500 | |
| Total expenses | | $17,500 |

REPORTING EXCESS DEDUCTIONS P. 76

**FIGURE 2.11**
**Schedule K-1 (Form 1041) Box 11 Codes – Final Year Deductions**

| Box 11 Code | Description |
|---|---|
| A | Excess deductions – Section 67(e) expenses |
| B | Excess deductions – Non-miscellaneous itemized deductions |
| C | Short-term capital loss carryover |
| D | Long-term capital loss carryover |
| E | Net operating loss carryover – regular tax |
| F | Net operating loss carryover – minimum tax |

**FIGURE 2.12**
**Schedule K-1 (Form 1041) Box 11 Code Instructions**

**Box 11, Code A–Excess Deductions on Termination – Section 67(e) Expenses**
If this is the final return of the estate or trust, and there are excess deductions on termination that are section 67(e) expenses reported to you as a beneficiary, you may deduct the excess deductions shown in box 11, code A, as an adjustment to income. Report this amount as a write-in on Schedule 1 (Form 1040), Part II, line 22. On the dotted line next to line 22, enter the amount of the expense using the code "ED67(e)." Include the expense in the total amount reported on line 22.

**Box 11, Code B–Excess Deductions on Termination – Non-Miscellaneous Itemized Deductions**
If this is the final return of the estate or trust, and there are excess deductions on termination that are non-miscellaneous itemized deductions reported to you as a beneficiary, you may deduct the excess deductions shown in box 11, code B, on the applicable line on Schedule A (Form 1040). The fiduciary will provide you with a statement of allowable deductions.

**Box 11, Codes C and D–Unused Capital Loss Carryover**
Upon termination of the trust or decedent's estate, the beneficiary succeeding to the property is allowed to deduct any unused capital loss carryover under section 1212. A short-term capital loss carryover, reported as code C, is reported on Schedule D (Form 1040), line 5. A long-term capital loss carryover, reported as code D, is reported, as appropriate, on Schedule D (Form 1040), line 12; line 5 of the 28% Rate Gain Worksheet for Schedule D, line 18; and line 16 of the Unrecaptured Section 1250 Gain Worksheet for Schedule D, line 19.

**Box 11, Codes E and F–NOL Carryover**
Upon termination of a trust or decedent's estate, a beneficiary succeeding to its property is allowed to deduct any unused net operating loss (NOL) if the carryover would be allowable to the trust or estate in a later tax year but for the termination. The deduction for regular tax purposes, reported as code E, is reported on Schedule 1 (Form 1040), line 8. A deduction for an Alternative Tax NOL (ATNOL) carryover for Alternative Minimum Tax (AMT) purposes, reported as code F, is reported on Form 6251, line 2f.

# REPORTING A TAXABLE ESTATE

## FILING REQUIREMENTS P. 77

- Gross estate exceeds basic exclusion amount (discussed earlier) Basic Exclusion Amount does not include DSUE of decedent @ Date of Death (DOD)
  - Amount @ DOD
  - **Less**- lifetime taxable gifts (if unknown, get a transcript). Write to IRS, asking for range of dates, then ask for a transcript, no charge. Or ask for copies of returns, fee charged.
- File Form 706
- Nonresident aliens File 706-NA – different from US citizens or US resident aliens
- **Due date – 9 months after date of decedent's death (always ask for an automatic 6-month extension to file as well as pay) to allow more time to complete.**

P. 77

**FIGURE 2.13**
**Form 706 Gross Estate Reporting**

**Part 5—Recapitulation. Note:** If estimating the value of one or more assets pursuant to the special rule of Reg. section 20.2010-2(a)(7)(ii), enter on both lines 10 and 23 the amount noted in the instructions for the corresponding range of values. See instructions for details.

| Item no. | Gross estate | | Alternate value | Value at date of death |
|---|---|---|---|---|
| 1 | Schedule A—Real Estate | 1 | | |
| 2 | Schedule B—Stocks and Bonds | 2 | | |
| 3 | Schedule C—Mortgages, Notes, and Cash | 3 | | |
| 4 | Schedule D—Insurance on the Decedent's Life (attach Form(s) 712) | 4 | | |
| 5 | Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance) | 5 | | |
| 6 | Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance) | 6 | | |
| 7 | Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance) | 7 | | |
| 8 | Schedule H—Powers of Appointment | 8 | | |
| 9 | Schedule I—Annuities | 9 | | |
| 10 | Estimated value of assets subject to the special rule of Reg. section 20.2010-2(a)(7)(ii) | 10 | | |
| 11 | Total gross estate (add items 1 through 10) | 11 | | |
| 12 | Schedule U—Qualified Conservation Easement Exclusion | 12 | | |
| 13 | Total gross estate less exclusion (subtract item 12 from item 11). Enter here and on line 1 of Part 2—Tax Computation | 13 | | |

P. 78

**FIGURE 2.14**
**Form 706 Elections to Delay Payment**

| | | | | |
|---|---|---|---|---|
| 3 | Do you elect to pay the taxes in installments as described in section 6166? If "Yes," you must attach the additional information described in the instructions. **Note: By electing section 6166 installment payments, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6324A lien.** | 3 | | |
| 4 | Do you elect to postpone the part of the taxes due to a reversionary or remainder interest as described in section 6163? | 4 | | |

QUESTIONS?