TAX REPORTING AND POST-MORTEM TAX MATTERS

BY

JUSTIN T. MANNINO

Lukinovich, APLC

4415 Shores Drive, Suite 200

Metairie, Louisiana 70006 USA

Telephone: (225) 756-5454

Facsimile: (225) 756-5441

E-mail: justin@lukinovichlaw.com

A. Final Tax Returns Timeline, Forms and Filing Procedure.

The executor must file Form 706 to report estate and/or GST tax within nine (9) months after the date of the decedent's death. If the are unable to file Form 706 by the due date, the executor may receive an extension of time to file using IRS Form 4768 - Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes, to apply for an automatic six (6) month extension of time to file. *See* IRS Form 706 Instructions.

The estate and GST taxes must be filed and paid timely. An executor can utilize a private delivery service to meet this rule. According to the IRS Form 706 Instructions, the authorized private delivery services include only the following: Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, FedEx International First, FedEx First Overnight, FedEx International First Next Flight Out, and FedEx International Economy, United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, UPS Worldwide Express, and UPS Next Day Air Early AM.

The IRS Form 706 must be filed with the Department of Treasury, Internal Revenue Service Center, Cincinnati, Ohio 45999. If the taxes are paid by check, the checks should be made out to the United States Treasury. According to the IRS Form 706 Instructions, “please write the decedent's name, social security number (SSN), and “Form 706” on the check to assist us in posting it to the proper account.” The federal estate taxes may also be paid electronically (free of charge) but must be paid no later than 8:00 P.M. EST the day before the deadline.

If an IRS Form 706 is required to be filed and federal estate tax is due, it must be paid, as a general rule, within nine months after the death of the decedent. 26 U.S.C.A. § 6151.

B. Requesting Deadline Extensions.

If additional time is needed to file IRS Form 706, regulations provide for an automatic six-month extension of time for filing IRS Form 706, without the necessity of stating a reason for the requested extension. *See* IRS Form 4868.

It is also possible to get an extension of time to pay estate tax for reasonable cause. If granted, the extension period cannot exceed ten (10) years from the date the tax is otherwise payable. *See* IRC Section 6161(a)(2).

C. Income Tax Considerations in Probate

1. Selecting a Tax Year: Calendar or Fiscal?

Fiscal year elections are only available to estates. Trusts are generally required to be filed in according to the calendar year.

An estate may select a fiscal period, not in excess of twelve (12) months that is in accordance with its accounting records and statements. IRC Section 441. Generally, using a fiscal year end will assist in deferring tax on income and allowing beneficiaries time to plan for its inclusion in their personal returns. The fiscal year selection may also minimize the number of tax returns that have to be filed.

The executor will need to select calendar or fiscal year upon the filing of the initial IRS Form 1041. An additional form will be needed to change the accounting period of an estate - Form 1128, Application To Adopt, Change, or Retain a Tax Year. *See* IRS Form 1041 Instructions.

2. Decedent's Final Income Tax Return

The final income tax return for a decedent is substantially similar as for that of a living person. All income through the date of the decedent's death must be reported, and all credits and deductions that the decedent is entitled to can be claimed.

A decedent's tax return should be claimed on a Form 1040, 1040-A, or 1040-EZ, just as it would be if the decedent were still alive.

It is also very important to make sure that the decedent does not have any other outstanding income tax liability. Often times, a decedent may have died after a long, protracted illness, and paying taxes are of the least of his or her worries. Therefore, it is a good practice to request a tax transcript from the Internal Revenue Service. A Form 4506-T, Request for Transcript of Tax Return, will be the form that needs to be completed to get a transcript.

If any taxes are owed, make sure to claim the debt on the tableau of distribution. From there, the taxes should be paid for all years (year of death and preceding years). If a refund is due, a Form 1310 will need to be submitted by the estate representative.

3. Estate Income Tax Return

Whenever someone dies, his or her assets may generate income after death. For example, stocks, CDs, bonds, rental property, and the like may income-generating assets. If the estate generates more than six hundred ($600.00) dollars in annual gross income, then the estate is

required to file an income tax return on an IRS Form 1041. In order to file an IRS Form 1041, then the executor will need to request an employer identification number (EIN) from the IRS. The executor should apply online with the Internal Revenue Service for an EIN. It is generally a quick process to obtain an EIN online.

However, if the income that the assets generate is distributed to beneficiary, then it is reported on a K-1 (like a partnership or limited liability company taxed as a partnership).

A trust or decedent's estate is allowed an income distribution deduction for distributions to beneficiaries. Income distributions are reported to beneficiaries and the IRS on Schedules K-1 (Form 1041).

An estate, like an individual, must pay estimated income tax on a quarterly basis. IRS Form 1041-ES.

4. Tax on Income Earned by Estate after Decedent's Death.

Income in respect of a decedent (IRD) is income that is payable after the death of the person who was entitled to it and that would have been taxable to him or her if the person had lived to receive it. The income is not includible in the decedent's final tax return because it was not payable until after death, but it is taxable to the estate or the beneficiary. IRC Section 691.

The character of the income as capital or ordinary gain remains the same for the recipient of the income.

IRA distributions are income in respect of a decedent.

Cases:

Edward D. Rollert Residuary Trust v. C.I.R., 752 F.2d 1128 (6th Cir. 1985) – The amounts paid pursuant to postmortem bonus are IRD because under the facts of the case, the decedent had a right or entitlement to the bonus payments at the date of death. IRC Section 691 requires the principal to report the entire amount of bonus installments paid as income in the year when received, without a basis in the property.

Trust Company of Georgia v. Ross, 262 F. Supp. 900 (N.D. Ga. 1966) – Proceeds received by the estate were IRD and taxable. Payment received was realized as a consequence of negotiations and an agreement made by decedent during his lifetime, and there were no acts of any consequence performed by the estate other than the formal closing which gave rise to the payments. Stock was in an escrow beyond his control and decedent was contracted to sell.

Estate of Peterson v. C.I.R., 667 F.2d 675 (6th Cir. 1981) - Four-factor test to determine whether sale proceeds constituted "income in respect of a decedent". The case says to look to the following: (1) whether the decedent entered into a legally significant arrangement regarding the subject matter of the sale; (2) whether the decedent performed the substantive (non-ministerial) acts required as preconditions to the sale; (3) whether there existed at the time of the decedent's death any economically material contingencies which might have disrupted the sale; and (4) whether the decedent would have eventually received the sale proceeds if he / she had lived.

5. Beneficiary Income Tax Considerations

A beneficiary may receive income (or property that produces income) from the decedent at the time of death. Below outlines the process of calculating the income tax consequences complex trusts or estates:

COMPLEX TRUST / ESTATE				
Step		Acronym	Applicable IRC §	Formula
A	Fiduciary Accounting Income	FAI	643(b)	FAI = Taxable interest + TEI
B	Federal Gross Income	GI	1001, 61(a)(4), 103	GI = rents + dividends + taxable interest + tax-exempt interest – tax-exempt interest + capital gain – capital loss
C	Tentative Taxable Income (exclusive of the distribution deduction)	TTI	641(b), 63(a), 265(a)(1), 1.652(b)-3(a), (b) Part 9 Briar Patch, 165(a), (c); Depreciation = 642(e), 167(d); Personal exemption = 642(b)(3) No STD = 63(c)(6)(D)	TTI = GI – *deductions allowed – personal exemption (PE) + $0 STD
D	Distributive Net Income	DNI	643(a)(1), (2), (3) & (5)	DNI = TTI + PE – CG + TEI – TEI expenses – Amounts deductible but for IRC §265 + capital loss deduction – capital gain

E	661 Trust distribution deduction	661(a)(1)	Determine the 661(a)(1) amount which is the FAI. If there is additional amount to be distributed, it is under 661(a)(2) – the additional amount that must be distributed per the trust agreement. Distribution deduction cannot exceed the DNI of the trust. See 661(a) flush language.	
F	Taxable Income of the Trust	TIT or TI	63, 641	TIT = TTI - §661 distribution deduction
G	§662(a) = Amount potentially reportable in the GI of the Beneficiary	§662(a)(1)		Separate by beneficiary. Amount potentially reportable in GI of Beneficiary = (FAI of Beneficiary / Total FAI) * DNI
		§662(a)(2)		
H	§662(b) = Character	662(b)	662(b)	Separate by beneficiary. (Amount of type of income / total amount of DNI) * amount potentially includable
I	Net Taxable Amount	NTA		Separate by beneficiary. Basically, it is the (G) – TEI in (H)
CHECK:	TTI = TIT + NTA C = F + I			

To the extent that one of the beneficiaries receives DNI, then there is income. The Code provides that the mandatory distributee "drinks" first and the remainder goes to the second tier beneficiaries.

Separate Shares Rule. IRC §663(c) provides that separate shares treated as separate estates/ trusts. For the sole purpose of determining the amount of DNI in the application of IRC §§

661,662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts.

Summary of separate shares rule: IRC § 663(c) requires that separate and independent shares of different beneficiaries in the same estate or trust be treated as separate shares or trusts in determining the DNI allocable to respective beneficiaries.

Separate share treatment is not elective. If a complex trust or estate is properly treated as having separate and independent shares, such treatment must prevail in taxable years of the trust or estate unless an event occurs as a result of which the terms of the trust or estate instrument and the requirements of proper administration require different treatment.

Separate share comes into existence upon the earliest moment that a fiduciary may reasonably determine, based upon the known facts, that a separate economic interest exists.
Treas. Reg. 1.663(c)-3(a). A separate share may exist if the instrument provides that upon the death of the beneficiary of the share, the share will be added to the shares of the other beneficiaries of the trust.

Separate share rule does not permit the filing of separate complex trusts or estates for any purpose other than the application of DNI. It does not permit separate share treatment for purposes of filing returns and tax payment, deduction of personal exemption under IRC § 642(b), and allowance to beneficiaries of trust or estate to net operating losses or capital losses carried over on termination of the trust/estate under IRC § 642(h).

C = Tentative Taxable Income (TTI)

If the trust is required to distribute all income currently, the trust gets a $300 exemption amount, regardless of whether it is a simple or complex trust. Otherwise, a trust will get a $100 personal exemption via 151/642(b)(3)/642(b)(2) if income does *not* have to be distributed currently. Estates get a $600 personal exemption. IRC § 642(b)(1).

If you have an expense that is not allocable to a particular class of income, then you should allocate a reasonable portion of the fee between the different classes of income. Allocate among the classes of income based on the gross DNI.

As for the charitable deduction, IRC § 642(c)(1) overrides IRC §170, so there is a deduction for the amount of the charitable deduction. The charitable deduction under 642(c) must be made out of gross income (GI), and not corpus of the trust.

Treas. Reg. 1.642(c)-3(b)(2) provides that in the absence of a specific provision allocating the charitable deduction, it is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each bears to the total of all classes. IRC §642(c)(2) only applies to estates.

D = Distributable Net Income (DNI)

DNI marries taxable income and fiduciary accounting income. It is a calculation that locates income between the estate and its beneficiaries. DNI serves as a quantitative limitation on the amount of the deduction under IRC §§ 651, 661, and the amount of the inclusion under IRC §§ 652, 662. It also has a qualitative function, which flavors the income. Starts with TTI and then flows from there. DNI is pro-taxpayer.

DNI Provisions

- IRC § 643(a) = DNI means the taxable income of the estate or trust computed with the following modifications, i.e. START with TTI.

- IRC § 643(a)(1) = No deduction under IRC §§ 651, 661 (relating to addition Distribution Deductions)

- IRC § 643(a)(2) = + $300 personal exemption (trust), $600 personal exemption (estate)

- IRC § 643(a)(3) = Take out capital gains / capital losses (excluded); Subtract it if there are capital gains and add back any capital losses.

- IRC § 643(a)(5) = + tax-exempt income (reduced by expenditures charged to TEI – would be deductible in respect of disbursements allocable to such interest but for the provisions of 265 relating to disallowance of certain deductions).

E = IRC § 661 deduction

IRC § 661(a) deduction limitation insists that the deduction cannot exceed DNI. IRC §661(a) provides that in any taxable year, there shall be allowed as a deduction in computing taxable income of an estate or trust, the sum of (1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income / corpus to the extend such amount is paid out of income for such taxable year); and (2) any other amounts properly paid or credited or required to be distributed for such taxable year; but such deduction shall not exceed the DNI of the estate or trust.

Watch out for tax-exempt income. IRC § 661(c) provides that no deduction is allowed under IRC § 661(a) for amounts that will not be included in the beneficiary's GI. Therefore, a practitioner must determine how much of the distribution is tax-exempt income [Formula = [Distribution under IRC § 661(a)(2)] * (TEI/DNI) = Portion of TEI]. The remainder will be the trust distribution deduction.

G = Amount potentially reportable in the GI of the beneficiary

IRC § 662(a) provides that subject to subsection (b), there shall be included in gross income of the beneficiary to whom an amount specified in 661(a) is paid, credited, or required to be distributed (by an estate or trust described in IRC §661) the sum of the following amounts: (1) Amounts to be distributed currently. The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount required to be distributed currently to *all* beneficiaries exceeds the DNI of the estate or trust, then in lieu of the amount provided in the preceding sentence, there shall be included in the GI of the beneficiary an amount which bears the same ratio to DNI as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. (2) Other amounts distributed. All other amounts properly paid, credited, or required to be distributed to such beneficiary for the tax year. If the sum of (A) the amount of income fore the taxable year required to be distributed currently to all beneficiaries, and (B) all other amounts properly paid, credited or required to be distributed to all beneficiaries exceeds the DNI of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the GI of the beneficiary an amount which bears the same ratio to DNI as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to other amounts properly paid, credited or required to all beneficiaries

DNI must be reduced by the DNI distributed to the mandatory beneficiaries.

IRC § 662(a)(2) provides that if the fiduciary accounting income (FAI) added to the other amounts required to be distributed exceeds the DNI (reduced by the amounts specified in IRC 662(a)(2)(A), take the amount specified in IRC 662(a)(2)(A), subtract it from DNI to determine

the residual DNI. The residual DNI (RDNI) will be zero. With a discretionary distribution, use DNI with the adjustment for the charitable deduction. Basically, take DNI and reduce it by that amount in 662(a)(2)(A) [current distribution]. Then multiply the amount by the following proportion: (amount distributed to the beneficiary/total amount to be distributed to all beneficiaries after taking out A in the denominator)

The practitioner must proceed beneficiary by beneficiary with respect to each of the provisions: IRC §662(a)(1); IRC §662(a)(2)(A); and IRC §662(a)(2)(B).

D. Proper Use of Disclaimers and Valuation Discounts

Disclaimers

IRC Section 2046. Disclaimers. For provisions relating to the effect of a qualified disclaimer for purposes of this chapter, see section 2518.

IRC Section 2518. Disclaimers. (a) General rule. For purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person. (b) Qualified disclaimer defined. For purposes of subsection (a), the term “qualified disclaimer” means an irrevocable and unqualified refusal by a person to accept an interest in property but only if—(1) such refusal is in writing; (2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of—(A) the day on which the transfer creating the interest in such person is made, or (B) the day on which such person attains age 21, (3) such person has not accepted the interest or any of its benefits, and (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either—(A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer. (c) Other rules. For purposes of subsection (a)—(1) Disclaimer of undivided portion of interest. A disclaimer with respect to an undivided portion of an interest which meets the requirements of the preceding sentence shall be treated as a qualified disclaimer of such portion of the interest. (2) Powers. A power with respect to property shall be treated as an interest in such property. (3) Certain transfers treated as disclaimersA written transfer of the transferor’s entire interest in the property—(A) which meets requirements similar to the requirements of paragraphs (2) and (3) of subsection (b), and (B) which is to a person or persons who would have received the property had the transferor made a qualified disclaimer (within the meaning of subsection (b)), shall be treated as a qualified disclaimer.

Notes:

- IRC 2518 treats a person who makes a qualified disclaimer of an interest as if the interest was never transferred.
- Requirements for Qualified Disclaimer
    - (1) Must be in writing;
    - (2) Must be irrevocable and unqualified;
    - (3) Transfer to person of age of majority: Delivered to the transferor, transferor’s legal representative, or legal titleholder within 9 months of the transfer.

- (4) Transfer of interest to minor: Delivered to the transferor, transferor's legal representative, or legal titleholder within 9 months of the date the minor turns 21.
- (5) No acceptance or use of the disclaimed interest (*see* Reg. 25.2518-2(d)(1));
- (6) Disclaiming person may not direct who the interest goes to.
- (7) identifies disclaimed interest.

Valuation

The gross estate is defined in IRC § 2031 - "The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated."

IRC § 2031 provides what is going to be included in the gross estate, but the specific provisions are found thereafter. According to this Code provision, the time of valuation is the date of death.

The Regulations under this Code section provide some guidance. Value is the fair market value at the time of the decedent's death. Treas. Reg. 20.2031-1(b). The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. More than likely, this means that it is probably the highest and best use of the property. For example, if I had a house on a large, undeveloped plot of land on the Mississippi River near LSU and the highest and best use is an apartment complex, then the value of an apartment complex would need to be included.

Using the fair market value is a good thing because of IRC 1014(a)(1) because the step-up in basis wipes out lurking gain in an asset (long term, short term, 1245).

IRC § 2032 provides an exception or alternative to the date of death valuation. It is an election by the executor, but it does not allow for picking and choosing different assets to have a different valuation date. It's an all or nothing proposition. The alternate valuation date may not exceed six (6) months from the date of death. IRC § 2032 provides the following:

> IRC § 2032. Alternate valuation.
>
> (a) General.—The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows: (1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition; (2) In the case of property not distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date 6 months after the decedent's death; (3) Any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time.
>
> (b) Special rules.--No deduction under this chapter of any item shall be allowed if allowance for such items is in effect given by the alternate valuation provided by this section. Wherever in any other subsection or section of this chapter reference is made

> to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this section, then—(1) for purposes of the charitable deduction under section 2055 or 2106(a)(2), any bequest, legacy, devise, or transfer enumerated therein, and (2) for the purpose of the marital deduction under section 2056, any interest in property passing to the surviving spouse, shall be valued as of the date of the decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date 6 months after the decedent's death (substituting, in the case of property distributed by the executor or trustee, or sold, exchanged, or otherwise disposed of, during such 6-month period, the date thereof).
>
> (c) Election must decrease gross estate and estate tax.--No election may be made under this section with respect to an estate unless such election will decrease—(1) the value of the gross estate, and (2) the sum of the tax imposed by this chapter and the tax imposed by chapter 13 with respect to property includible in the decedent's gross estate (reduced by credits allowable against such taxes).

IRC § 1014(a)(2) provides for the step-up in basis, as follows: (a) In general.--Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be . . . (2) in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections,

IRC § 2032A provides an alternate valuation of certain farming and other small business use, as the income from these operations may be insufficient to pay the estate tax it produces. While there are relief statutes, 2032A makes farm land a tax shelter and may eliminate new farmers from coming in. Congress was trying to encourage the use of real property for farming. Congress wanted to make sure that the income potential of the farm was positive. Agricultural economists have argued that small farms are inefficient, and that the 2032A has increased the price of farmland. Note that there is a recapture provision under this Code section.

Valuation Discounts

Fair market value is the value that a willing buyer and willing seller would sell the property freely and without any duress. In this situation, there are certain valuation discounts or premiums that can apply due to the types or degrees of interest in a piece of property. Here are some of the types of discounts and premiums available:

- Minority Interest Discount;
- Fractional Interest Discount;
- Control Premium;
- Blockage Discount;
- Marketability Discount;
- Key Person Discount; and
- Litigation Discount.

E. Claiming Estate Tax Portability

The basic exclusion amount for persons dying in 2016 is $5,450,000.00. This amount is the basic exclusion for the combined gift and estate taxes.

Portability allows a surviving spouse to utilize whatever amount remains of the deceased spouse's unused basic exclusion amount (DSUE).

To preserve the portability, a IRS Form 706 (Estate Tax Return) must be filed when the first spouse dies. The form must be filed even if no taxes are due. This may be a costly endeavor that requires expertise from specialized preparers and valuation experts, but it may be worth it in the long run.

Portability should be a consideration for any estate planner, but it may require looking beyond the facts of the instant situation. For example, assume that a married couple has a nontaxable estate of $2 million when the first spouse dies. Preserving portability (filing a Form 706) may not be readily apparent in this situation. However, assume that the surviving spouse is likely to inherit millions of dollars from a family member who is not doing well. Neglecting to preserve portability could eventually cost the surviving spouse's estate forty cents on the dollar in inheritance once the inheritance and other assets exceed $5,450,000.00.

The Portability Election has some appeal. It is easier to administer and provides flexibility than a traditional, hard-wired bypass trust.

However, portability may not be as good at minimizing transfer taxes because the GST exemption is not portable. In essence, it wastes the first spouse's GST exemption. Also, another negative aspect may be that assets are subject to the determination as to how the surviving spouse wants the assets distributed. This is a huge problem in blended families.

F. Estate and Gift Tax Considerations - When Do You Need to File Form 706?

The IRS Form 706 is the United States Estate (and Generation-Skipping Transfer) Tax Return.

The executor / administrator / personal representative / succession representative decides whether to file an IRS Form 706. 26 U.S.C. Section 2203 defines the term "executor" for purposes of the Internal Revenue Code as "the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent." Basically, the executor is the person designated by the court of local jurisdiction to have authority, and if not, it is the person who holds the assets. If there is a revocable trust in place, there should be a provision in the Trust that provides for the trustee to give input in making the portability election.

An executor will definitely need to file a federal estate tax return when the decedent's gross estate, plus adjusted taxable gifts and specific exemption, is more than $5,450,000, or when the executor elects to "transfer the DSUE amount to the surviving spouse, regardless of the size of the decedent's gross estate." Instructions, IRS Form 706. The gross estate is determined in accordance with IRC Sections 2031-2046.

There are costs associated in filing an IRS Form 706. It can be very expensive to value the assets of the estate. Some entity valuations may cost thousands of dollars per entity.

See "Section A, Final Tax Returns Timeline, Forms and Filing Procedure" for information on the filing deadlines of the federal estate tax return.

G. Coordinating with Decedent's Accounting or Investment Advisors.

It is important to coordinate with the Decedent's accounting or investment advisors. A certified public accountant should be contacted to assist with the completion of the Form 706. The investment advisors are critical to helping to find out the appropriate date of death valuation for the decedent's financial portfolio.

Also, the accountants and investment advisors can assist the attorney with making sure that the attorney completes the forms appropriately to carry out the estate plan before the decedent dies.

Recommendation: Obtain written authorization from the client to speak to these advisors freely.

H. Generation-Skipping Transfer (GST) Tax Implication.

The GST exemption is important because the portability does not apply to the GST. Only the federal gift tax and federal estate tax can be "ported" and cannot be carried over.

The GST exemption is indexed for inflation, the 2016 GST exemption is $5,450,000.00.

The theory behind the GST Tax is that the transfer of property should be taxed at least once at each generation. This is an additional layer of tax. It applies to lifetime transfers or gifts at death. The GST Tax was first enacted in 1976, and the current version of the tax (1986 tax) makes sure that tax is paid on the transfer of property to each generation or skips in between generations.

IRC §2601 imposes the tax - "*A tax is hereby imposed on every generation-skipping transfer (within the meaning of Subchapter B)."* IRC §2611 defines GST - "(a) In general.--For purposes of this chapter, the term "generation-skipping transfer" means— (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip." All three of those events involve the transfer of property to a "skip person." Thus, the GST tax is only imposed when there is a transfer to a skip person. In order to answer that question you must identify the transferor, the transferee and then look at the relationship between the two.

IRC § 2652 defines "transferor" as follows: (a) Transferor.—For purposes of this chapter--(1) In general.--Except as provided in this subsection or section 2653(a), the term "transferor" means — (A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor. (2) Gift-splitting by married couples.--If, under section 2513, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of this chapter.

A skip person can be either a natural person or a trust, not a corporation.

For an individual to qualify as a skip person, the transfer or beneficiary of the trust must be two or more "generational assignments" below the transferor. IRC § 2613(a)(1). But the GST tax only applies to generations below the transferor, as it is not applied to transfers to ascendants.

A spouse is assigned the same generation as the transferor, regardless of age. Children, who are lineal descendants, are one generation below the transferor, and grandchildren are two generations below the transferor.

If a person is not a lineal descendant of the transferor's grandparent, then the Code imposes age range limitations. Individuals older than the transferor or not more than 12.5 years younger are deemed to be in the same generational level as the TR. See IRC §2651(d)(1). Individuals more than 12.5 years younger, but not more than 37.5 years younger than the transferor, are assigned one generational level below the transferor (which basically is the same as the Transferor's child pursuant to IRC §2651(d)(2)). If an individual is greater than 37.5 years younger, but not more than 62.5 years younger than the transferor, are classified two generational levels below the transferor (which is the same generation as the Transferor's grandchild pursuant to IRC §2651(d)(2).

A taxable termination involves involves a termination of an interest in property that is held in trust. *See* IRC §2612(a). Basically, a non-skip person is the primary beneficiary who receives the property before transferred to a skip person. In addition, no federal estate or federal gift tax can be due at the time. It is a tax exclusive tax.

A taxable distribution is the residual category and occurs in the absence of a direct skip or taxable termination. There must be a discretionary or mandatory distribution from a trust to a skip person, who can be either an individual or a trust. It is a tax exclusive tax.

The GST Tax is computed as follows:

GST Tax = Taxable amount * applicable rate [*See* IRC § 2602]

Taxable amount = the value of the property involved in the GST transfer

Applicable rate = maximum federal estate tax rate * the inclusion ratio [*See* IRC § 2641]

Inclusion ratio = (1 *less* the applicable fraction) [*See* IRC §2642(a)(1)]

Applicable fraction = GST exemption / [value – (federal and state death taxes + charitable deductions)]

If applicable fraction is 1, then there is no GST tax. If the applicable fraction is 0, then there is full taxation, and if it is between 0 and 1, then there is partial taxation.

I. Handling Common Property Tax Issues

IRC Section 2040. Joint Interests. (a) General rule.--The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time

acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

(b) Certain joint interests of husband and wife.--

(1) Interests of spouse excluded from gross estate.--Notwithstanding subsection (a), in the case of any qualified joint interest, the value included in the gross estate with respect to such interest by reason of this section is one-half of the value of such qualified joint interest.

(2) Qualified joint interest defined.--For purposes of paragraph (1), the term “qualified joint interest” means any interest in property held by the decedent and the decedent's spouse as--

(A) tenants by the entirety, or

(B) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

Notes: IRC Section 2040(b) is the Code’s attempt at equalizing community property states and all the non-community property states. This Code subsection provides a rule that exactly one-half of property held by the decedent and the surviving spouse is included in the decedent’s gross estate. It does not matter whether the qualified joint interest (as tenants by the entirety or JTROS) was separate or community property. Consideration paid by the decedent does not matter for purposes of this Code subsection.

Question: A parcel of immovable property owned by Decedent and Surviving Spouse. Decedent paid $15,000.00 and Surviving Spouse paid $10,000.00 at its acquisition in 2010. At the Decedent’s death, the immovable property was worth $50,000.00. What is the result under Section 2040?

Answer: Under IRC 2040(b), half of the value at death is included in the Decedent’s gross estate. It doesn’t which spouse paid, or how much the spouses respectively paid. This rule is for administrative ease.

Form **1041** Department of the Treasury—Internal Revenue Service

U.S. Income Tax Return for Estates and Trusts

2015 OMB No. 1545-0092

▶ **Information about Form 1041 and its separate instructions is at *www.irs.gov/form1041*.**

A Check all that apply:
- ☐ Decedent's estate
- ☐ Simple trust
- ☐ Complex trust
- ☐ Qualified disability trust
- ☐ ESBT (S portion only)
- ☐ Grantor type trust
- ☐ Bankruptcy estate-Ch. 7
- ☐ Bankruptcy estate-Ch. 11
- ☐ Pooled income fund

For calendar year 2015 or fiscal year beginning , 2015, and ending , 20

Name of estate or trust (If a grantor type trust, see the instructions.)

C Employer identification number

Name and title of fiduciary

D Date entity created

Number, street, and room or suite no. (If a P.O. box, see the instructions.)

E Nonexempt charitable and split-interest trusts, check applicable box(es), see instructions.
- ☐ Described in sec. 4947(a)(1). Check here if not a private foundation . . . ▶ ☐
- ☐ Described in sec. 4947(a)(2)

City or town, state or province, country, and ZIP or foreign postal code

B Number of Schedules K-1 attached (see instructions) ▶

F Check applicable boxes: ☐ Initial return ☐ Final return ☐ Amended return ☐ Net operating loss carryback ☐ Change in trust's name ☐ Change in fiduciary ☐ Change in fiduciary's name ☐ Change in fiduciary's address

G Check here if the estate or filing trust made a section 645 election . . . . ▶ ☐ Trust TIN ▶

Income

Line	Description	Line	Amount
1	Interest income	1	
2a	Total ordinary dividends	2a	
b	Qualified dividends allocable to: **(1)** Beneficiaries ________ **(2)** Estate or trust ________		
3	Business income or (loss). Attach Schedule C or C-EZ (Form 1040)	3	
4	Capital gain or (loss). Attach Schedule D (Form 1041)	4	
5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5	
6	Farm income or (loss). Attach Schedule F (Form 1040)	6	
7	Ordinary gain or (loss). Attach Form 4797	7	
8	Other income. List type and amount ________	8	
9	**Total income.** Combine lines 1, 2a, and 3 through 8 ▶	9	

Deductions

Line	Description	Line	Amount
10	Interest. Check if Form 4952 is attached ▶ ☐	10	
11	Taxes	11	
12	Fiduciary fees	12	
13	Charitable deduction (from Schedule A, line 7)	13	
14	Attorney, accountant, and return preparer fees	14	
15a	Other deductions **not** subject to the 2% floor (attach schedule)	15a	
b	Net operating loss deduction (see instructions)	15b	
c	Allowable miscellaneous itemized deductions subject to the 2% floor	15c	
16	Add lines 10 through 15c ▶	16	
17	Adjusted total income or (loss). Subtract line 16 from line 9 . . . 17		
18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	
19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
20	Exemption	20	
21	Add lines 18 through 20 ▶	21	

Tax and Payments

Line	Description	Line	Amount
22	Taxable income. Subtract line 21 from line 17. If a loss, see instructions	22	
23	**Total tax** (from Schedule G, line 7)	23	
24	**Payments: a** 2015 estimated tax payments and amount applied from 2014 return	24a	
b	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	24b	
c	Subtract line 24b from line 24a	24c	
d	Tax paid with Form 7004 (see instructions)	24d	
e	Federal income tax withheld. If any is from Form(s) 1099, check ▶ ☐	24e	
	Other payments: **f** Form 2439 ________ ; **g** Form 4136 ________ ; Total ▶	24h	
25	**Total payments.** Add lines 24c through 24e, and 24h ▶	25	
26	Estimated tax penalty (see instructions)	26	
27	**Tax due.** If line 25 is smaller than the total of lines 23 and 26, enter amount owed	27	
28	**Overpayment.** If line 25 is larger than the total of lines 23 and 26, enter amount overpaid	28	
29	Amount of line 28 to be: **a Credited to 2016 estimated tax** ▶ ; **b Refunded** ▶	29	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of fiduciary or officer representing fiduciary | Date | ▶ EIN of fiduciary if a financial institution

May the IRS discuss this return with the preparer shown below (see instr.)? ☐ **Yes** ☐ **No**

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Schedule A Charitable Deduction. Do not complete for a simple trust or a pooled income fund.

1	Amounts paid or permanently set aside for charitable purposes from gross income (see instructions)	1	
2	Tax-exempt income allocable to charitable contributions (see instructions)	2	
3	Subtract line 2 from line 1	3	
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4	
5	Add lines 3 and 4	5	
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes (see instructions)	6	
7	**Charitable deduction.** Subtract line 6 from line 5. Enter here and on page 1, line 13	7	

Schedule B Income Distribution Deduction

1	Adjusted total income (see instructions)	1	
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 19, column (1) (see instructions)	3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1 (see instructions)	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-	7	
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law . . . 8		
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	
12	Enter the amount of tax-exempt income included on line 11	12	
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	

Schedule G Tax Computation (see instructions)

1	**Tax: a** Tax on taxable income (see instructions)	1a			
	b Tax on lump-sum distributions. Attach Form 4972	1b			
	c Alternative minimum tax (from Schedule I (Form 1041), line 56)	1c			
	d **Total.** Add lines 1a through 1c ▶			1d	
2a	Foreign tax credit. Attach Form 1116	2a			
b	General business credit. Attach Form 3800	2b			
c	Credit for prior year minimum tax. Attach Form 8801	2c			
d	Bond credits. Attach Form 8912	2d			
e	**Total credits.** Add lines 2a through 2d ▶			2e	
3	Subtract line 2e from line 1d. If zero or less, enter -0-			3	
4	Net investment income tax from Form 8960, line 21			4	
5	Recapture taxes. Check if from: ☐ Form 4255 ☐ Form 8611			5	
6	Household employment taxes. Attach Schedule H (Form 1040)			6	
7	**Total tax.** Add lines 3 through 6. Enter here and on page 1, line 23 ▶			7	

Other Information

		Yes	No
1	Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses.		
	Enter the amount of tax-exempt interest income and exempt-interest dividends ▶ $ ______		
2	Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?		
3	At any time during calendar year 2015, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country?		
	See the instructions for exceptions and filing requirements for FinCEN Form 114. If "Yes," enter the name of the foreign country ▶ ______		
4	During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See instructions		
5	Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see the instructions for required attachment		
6	If this is an estate or a complex trust making the section 663(b) election, check here (see instructions) ▶ ☐		
7	To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here (see instructions) ▶ ☐		
8	If the decedent's estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here ▶ ☐		
9	Are any present or future trust beneficiaries skip persons? See instructions		