

Top Ten Tactical and Strategic Issues for Fiduciary Income Tax Return Preparers

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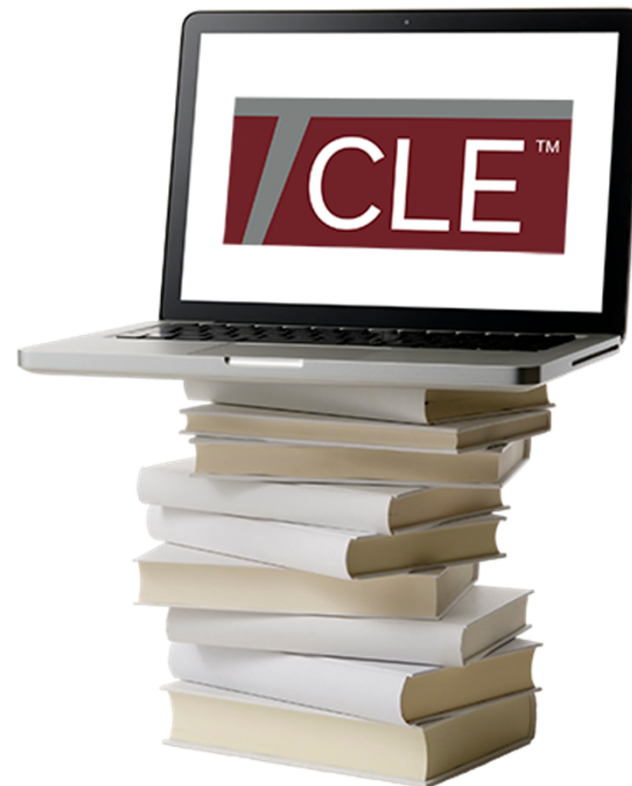
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Overview

- Form 1041 Review
- Strategic Income Tax Planning
- Ten Tips for Fiduciary Income Tax Preparers

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

B Number of Schedules K-1 attached (see instructions) **F** Check applicable boxes:

Initial return Final return Amended return
 Change in trust's name Change in fiduciary Change in fiduciary's name
 Change in fiduciary's address

C Employer identification number

D Date entity created

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)

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

Income	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	10 Interest. Check if Form 4952 is attached <input type="checkbox"/>	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	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 2016 estimated tax payments and amount applied from 2015 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 <input type="checkbox"/>	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 2017 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

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. Don't 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: <input type="checkbox"/> Form 4255 <input type="checkbox"/> 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 2016, 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	► <input type="checkbox"/>		
7 To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here. See instructions	► <input type="checkbox"/>		
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	► <input type="checkbox"/>		
9 Are any present or future trust beneficiaries skip persons? See instructions			
10 Was the trust a specified domestic entity required to file Form 8938 for the tax year (see the Instructions for Form 8938)?			





Part III Summary of Parts I and II <i>Caution: Read the instructions before completing this part.</i>		(1) Beneficiaries' (see instr.)	(2) Estate's or trust's	(3) Total
17	Net short-term gain or (loss)	17		
18	Net long-term gain or (loss):			
a	Total for year	18a		
b	Unrecaptured section 1250 gain (see line 18 of the wrksht.)	18b		
c	28% rate gain	18c		
19	Total net gain or (loss). Combine lines 17 and 18a ▶	19		

Note: If line 19, column (3), is a net gain, enter the gain on Form 1041, line 4 (or Form 990-T, Part I, line 4a). If lines 18a and 19, column (2), are net gains, go to Part V, and **don't** complete Part IV. If line 19, column (3), is a net loss, complete Part IV and the **Capital Loss Carryover Worksheet**, as necessary.

Part IV Capital Loss Limitation		
20	Enter here and enter as a (loss) on Form 1041, line 4 (or Form 990-T, Part I, line 4c, if a trust), the smaller of:	20 ()
a	The loss on line 19, column (3) or b \$3,000	

Note: If the loss on line 19, column (3), is more than \$3,000, **or** if Form 1041, page 1, line 22 (or Form 990-T, line 34), is a loss, complete the **Capital Loss Carryover Worksheet** in the instructions to figure your capital loss carryover.

Part V Tax Computation Using Maximum Capital Gains Rates	
Form 1041 filers. Complete this part only if both lines 18a and 19 in column (2) are gains, or an amount is entered in Part I or Part II and there is an entry on Form 1041, line 2b(2), and Form 1041, line 22, is more than zero.	

Caution: Skip this part and complete the **Schedule D Tax Worksheet** in the instructions if:

- Either line 18b, col. (2) or line 18c, col. (2) is more than zero, or
- Both Form 1041, line 2b(1), and Form 4952, line 4g are more than zero.

Form 990-T trusts. Complete this part **only** if both lines 18a and 19 are gains, or qualified dividends are included in income in Part I of Form 990-T, and Form 990-T, line 34, is more than zero. Skip this part and complete the **Schedule D Tax Worksheet** in the instructions if either line 18b, col. (2) or line 18c, col. (2) is more than zero.

21	Enter taxable income from Form 1041, line 22 (or Form 990-T, line 34)	21		
22	Enter the smaller of line 18a or 19 in column (2) but not less than zero	22		
23	Enter the estate's or trust's qualified dividends from Form 1041, line 2b(2) (or enter the qualified dividends included in income in Part I of Form 990-T)	23		
24	Add lines 22 and 23	24		
25	If the estate or trust is filing Form 4952, enter the amount from line 4g; otherwise, enter -0- ▶	25		
26	Subtract line 25 from line 24. If zero or less, enter -0-	26		
27	Subtract line 26 from line 21. If zero or less, enter -0-	27		
28	Enter the smaller of the amount on line 21 or \$2,550	28		
29	Enter the smaller of the amount on line 27 or line 28	29		
30	Subtract line 29 from line 28. If zero or less, enter -0-. This amount is taxed at 0% ▶	30		
31	Enter the smaller of line 21 or line 26	31		
32	Subtract line 30 from line 26	32		
33	Enter the smaller of line 21 or \$12,400	33		
34	Add lines 27 and 30	34		
35	Subtract line 34 from line 33. If zero or less, enter -0-	35		
36	Enter the smaller of line 32 or line 35	36		
37	Multiply line 36 by 15% (0.15) ▶	37		
38	Enter the amount from line 31	38		
39	Add lines 30 and 36	39		
40	Subtract line 39 from line 38. If zero or less, enter -0-	40		
41	Multiply line 40 by 20% (0.20) ▶	41		
42	Figure the tax on the amount on line 27. Use the 2016 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041)	42		
43	Add lines 37, 41, and 42	43		
44	Figure the tax on the amount on line 21. Use the 2016 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041)	44		
45	Tax on all taxable income. Enter the smaller of line 43 or line 44 here and on Form 1041, Schedule G, line 1a (or Form 990-T, line 36) ▶	45		



**SCHEDULE I
(Form 1041)**

Alternative Minimum Tax—Estates and Trusts

OMB No. 1545-0092

Department of the Treasury
Internal Revenue Service

▶ Attach to Form 1041.
▶ Information about Schedule I (Form 1041) and its separate instructions is at www.irs.gov/form1041.

2016

Name of estate or trust

Employer identification number

Part I Estate's or Trust's Share of Alternative Minimum Taxable Income

1	Adjusted total income or (loss) (from Form 1041, line 17)	1	
2	Interest	2	
3	Taxes	3	
4	Miscellaneous itemized deductions (from Form 1041, line 15c)	4	
5	Refund of taxes	5	()
6	Depletion (difference between regular tax and AMT)	6	
7	Net operating loss deduction. Enter as a positive amount	7	
8	Interest from specified private activity bonds exempt from the regular tax	8	
9	Qualified small business stock (see instructions)	9	
10	Exercise of incentive stock options (excess of AMT income over regular tax income)	10	
11	Other estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)	11	
12	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	12	
13	Disposition of property (difference between AMT and regular tax gain or loss)	13	
14	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)	14	
15	Passive activities (difference between AMT and regular tax income or loss)	15	
16	Loss limitations (difference between AMT and regular tax income or loss)	16	
17	Circulation costs (difference between regular tax and AMT)	17	
18	Long-term contracts (difference between AMT and regular tax income)	18	
19	Mining costs (difference between regular tax and AMT)	19	
20	Research and experimental costs (difference between regular tax and AMT)	20	
21	Income from certain installment sales before January 1, 1987	21	()
22	Intangible drilling costs preference	22	
23	Other adjustments, including income-based related adjustments	23	
24	Alternative tax net operating loss deduction (See the instructions for the limitation that applies.)	24	()
25	Adjusted alternative minimum taxable income. Combine lines 1 through 24	25	
Note: Complete Part II below before going to line 26.			
26	Income distribution deduction from Part II, line 44	26	
27	Estate tax deduction (from Form 1041, line 19)	27	
28	Add lines 26 and 27	28	
29	Estate's or trust's share of alternative minimum taxable income. Subtract line 28 from line 25	29	

If line 29 is:

- \$23,900 or less, stop here and enter -0- on Form 1041, Schedule G, line 1c. The estate or trust isn't liable for the alternative minimum tax.
- Over \$23,900, but less than \$175,450, go to line 45.
- \$175,450 or more, enter the amount from line 29 on line 51 and go to line 52.

Part II Income Distribution Deduction on a Minimum Tax Basis

30	Adjusted alternative minimum taxable income (see instructions)	30	
31	Adjusted tax-exempt interest (other than amounts included on line 8)	31	
32	Total net gain from Schedule D (Form 1041), line 19, column (1). If a loss, enter -0-	32	
33	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes (from Form 1041, Schedule A, line 4)	33	
34	Capital gains paid or permanently set aside for charitable purposes from gross income (see instructions)	34	
35	Capital gains computed on a minimum tax basis included on line 25	35	()
36	Capital losses computed on a minimum tax basis included on line 25. Enter as a positive amount	36	
37	Distributable net alternative minimum taxable income (DNAMTI). Combine lines 30 through 36. If zero or less, enter -0-	37	
38	Income required to be distributed currently (from Form 1041, Schedule B, line 9)	38	
39	Other amounts paid, credited, or otherwise required to be distributed (from Form 1041, Schedule B, line 10)	39	
40	Total distributions. Add lines 38 and 39	40	
41	Tax-exempt income included on line 40 (other than amounts included on line 8)	41	
42	Tentative income distribution deduction on a minimum tax basis. Subtract line 41 from line 40	42	

For Paperwork Reduction Act Notice, see the Instructions for Form 1041.

Cat. No. 515170

Schedule I (Form 1041) (2016)





Part II Income Distribution Deduction on a Minimum Tax Basis (continued)			
43	Tentative income distribution deduction on a minimum tax basis. Subtract line 31 from line 37. If zero or less, enter -0-		43
44	Income distribution deduction on a minimum tax basis. Enter the smaller of line 42 or line 43. Enter here and on line 26		44
Part III Alternative Minimum Tax			
45	Exemption amount		45 \$23,900 00
46	Enter the amount from line 29	46	
47	Phase-out of exemption amount	47 \$79,850 00	
48	Subtract line 47 from line 46. If zero or less, enter -0-	48	
49	Multiply line 48 by 25% (0.25)	49	
50	Subtract line 49 from line 45. If zero or less, enter -0-	50	
51	Subtract line 50 from line 46	51	
52	Go to Part IV of Schedule I to figure line 52 if the estate or trust has qualified dividends or has a gain on lines 18a and 19 of column (2) of Schedule D (Form 1041) (as refigured for the AMT, if necessary). Otherwise, if line 51 is— <ul style="list-style-type: none"> • \$186,300 or less, multiply line 51 by 26% (0.26). • Over \$186,300, multiply line 51 by 28% (0.28) and subtract \$3,726 from the result 	52	
53	Alternative minimum foreign tax credit (see instructions)	53	
54	Tentative minimum tax. Subtract line 53 from line 52	54	
55	Enter the tax from Form 1041, Schedule G, line 1a (minus any foreign tax credit from Schedule G, line 2a)	55	
56	Alternative minimum tax. Subtract line 55 from line 54. If zero or less, enter -0-. Enter here and on Form 1041, Schedule G, line 1c	56	
Part IV Line 52 Computation Using Maximum Capital Gains Rates			
<i>Caution: If you didn't complete Part V of Schedule D (Form 1041), the Schedule D Tax Worksheet, or the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, see the instructions before completing this part.</i>			
57	Enter the amount from line 51		57
58	Enter the amount from Schedule D (Form 1041), line 26, line 13 of the Schedule D Tax Worksheet, or line 4 of the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, whichever applies (as refigured for the AMT, if necessary)	58	
59	Enter the amount from Schedule D (Form 1041), line 18b, column (2) (as refigured for the AMT, if necessary). If you didn't complete Schedule D for the regular tax or the AMT, enter -0-	59	
60	If you didn't complete a Schedule D Tax Worksheet for the regular tax or the AMT, enter the amount from line 58. Otherwise, add lines 58 and 59 and enter the smaller of that result or the amount from line 10 of the Schedule D Tax Worksheet (as refigured for the AMT, if necessary)	60	
61	Enter the smaller of line 57 or line 60	61	
62	Subtract line 61 from line 57	62	
63	If line 62 is \$186,300 or less, multiply line 62 by 26% (0.26). Otherwise, multiply line 62 by 28% (0.28) and subtract \$3,726 from the result	63	
64	Maximum amount subject to the 0% rate	64 \$2,550 00	
65	Enter the amount from line 27 of Schedule D (Form 1041), line 14 of the Schedule D Tax Worksheet, or line 5 of the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, whichever applies (as figured for the regular tax). If you didn't complete Schedule D or either worksheet for the regular tax, enter the amount from Form 1041, line 22; if zero or less, enter -0-	65	
66	Subtract line 65 from line 64. If zero or less, enter -0-	66	
67	Enter the smaller of line 57 or line 58	67	
68	Enter the smaller of line 66 or line 67. This amount is taxed at 0%	68	
69	Subtract line 68 from line 67	69	



Strategic Income Tax Planning

- Who Is Best Taxed on Gross Income
- Effect of Kiddie Tax on Rates
- Who Benefits Most from Deductions
- State and Local Income Tax
- Consider Trust Purposes
- Effect on Future Years
- Flexibility in Trust Income Taxation
- Planning for Excess Losses

Who Is Best Taxed on Gross Income (II.J.3.a.)

Increasing a beneficiary's AGI can cause the following tax issues:

- Subtract from overall itemized deductions 3% of adjusted gross income over relevant threshold
- 3% multiplied by approx 40% tax rate = approx 1.2% additional tax

Who Is Best Taxed on Gross Income (II.J.3.a.)

Increasing a beneficiary's AGI can cause the following tax issues:

- Reduction in Particular Itemized Deductions
- Phase Out of AMT Exemption
- Phase Out of Personal Exemption
- Net Investment Income (NII) Tax

Who Is Best Taxed on Gross Income (II.J.3.a.)

- Consider Beneficiary Loss Carryovers to offset income

Effect of Kiddie Tax on Rates (II.J.3.b.)

- Parents' Rates for Regular Income Tax
- No Rule Coordinating Net Investment Income Tax

Who Benefits Most from Deductions

- Administrative Expenses Above-the-Line for Trusts But Below-the-Line for Beneficiaries
- Charitable Deduction Limitations (discussed further below)
- Code § 1244 Stock
- Special Rule for Depreciation Deductions

State and Local Income Tax

- Trust's vs. Beneficiary's Rates
- Nonresident Trust Escaping Taxation
- Effect of Grantor Trust Status on a Trust's Residence (including grantor later moving)

Consider Trust Purposes

- Protecting Beneficiary from Third Parties
- Protecting Beneficiary from Self
- Avoiding Estate Tax at Beneficiary's Death
(increased exemption might change this need)

Effect on Future Years

- Capital Gain Distribution Election
(discussed later)
- Turning On/Off Grantor Trust Powers
(discussed later)

Flexibility in Trust Income Taxation

- Support – Check for Considering or Ignoring Other Resources
- See Whether Distributions for Welfare are Permissible – Check Living Client’s Estate Plan for Welfare and 5% Withdrawal Right (described further below)

Planning for Excess Losses (II.J.3.i.)

- Cannot Pass Through Losses Other Than Depreciation (II.J.11.a.ii.(b)); Level at Which the Passive Loss Rules Apply Is Uncertain When Trust Has Net Income (II.K.2.b.iv.)
- Lose Excess Losses Except for Final Year or Net Operating Loss
- Passive Loss Rules Might Simplify Due to Suspended Losses

Tips for Fiduciary Income Tax Return Preparers (II.J.4.)

- Distributions after Yearend to Carry Out Income to Beneficiaries
- Capital Gain Elections
- Charitable Distributions
- Possible Change in Beneficiary's Residence
- Material Participation for Business or Rental Activities

Tips for Fiduciary Income Tax Return Preparers (II.J.4.)

- Making Trust a Partial Grantor Trust as to a Beneficiary
- Making the Trust a Complete Grantor Trust as to the Beneficiary
- Trapping Income in Trust Notwithstanding Distributions
- Modifying Trust to Make More Income Tax Efficient

Tips for Fiduciary Income Tax Return Preparers (II.J.4.)

- Helping the Trustee Provide Annual Notices to Beneficiaries to Reduce Exposure
 - Need to Provide Notices
 - Sample Notice

Distributions after Yearend to Carry Out Income to Beneficiaries (II.J.4.a)

- Rough Draft of Return in February
- Compare to Beneficiaries' Tax Rates
- Distributions by March 6, 2017 (II.J.2.)
- Distributions Can Carry Out Capital Gains
(see below)

Capital Gain Elections (II.J.4.b)

- Tax Preparation Software Traps Unless Take Special Steps
- Next Slides Discuss Strategic Issues, Law, and Practical Issues (II.J.8.)

Additional 5% Capital Gain Tax

Single	\$415,050
Married filing jointly	\$466,950
Trust	\$12,400 (2016)

3.8% Tax on Net Investment Income

Single	\$200,000
Married	\$250,000
Trust	\$12,400 (2016)

Indexed for Trusts But Not Individuals

Capital Gain is DNI Unless Excluded (II.J.8.a.)

Capital Gain Excluded Only If:

- From Sale of Capital Asset
- Allocated to Corpus
- Not Paid, Credited, or Required to Be Distributed to a Beneficiary
- Paid, Permanently Set Aside, or to Be Used for Charitable Purposes

Capital Asset (II.J.8.a.i.)

Not a Capital Asset:

- Code § 1231 Property
- Amortized Goodwill (self-created goodwill not amortizable is a capital asset)

Mechanism for Distributing Capital Gain: Reg. § 1.643(a)-3(b) (II.J.8.c.)

1. Allocated to income
2. Allocated to corpus but distributed consistently
3. 65-day rule distribution

Allocated to Income (II.J.8.c.i.)

- “Power to adjust” principal
- Uniform Principal & Income Act reflects Prudent Investor Rule
- No duty of consistency from year to year except unitrust

Allocated to Income

- Trust agreement can allocate capital gain to income
- Cannot “depart fundamentally from traditional principles of income and principal” per Reg. § 1.643(b)-1
- 3%-5% should be OK

Allocated to Corpus But Distributed Consistently (II.J.8.c.ii.)

- Existing trusts – probably did NOT allocate capital gain to DNI
- Solution discussed later
- New trusts – generally allocate capital gain to DNI unless beneficiary in higher federal & state combined bracket (including phase-outs)

Actual or Deemed Distribution (II.J.8.c.iii.)

- Tracing Actual Distribution Often Not Practical Unless Terminate Trust
- Referring to Capital Gain Suffices – 65-Day Rule Distribution When Trustee Refers to Capital Gain
- Can Be Inconsistent from Year to Year

Fairness Issues (II.J.8.c.v)

- Fair for cash distribution to carry out taxable income
- If not, “gross up” distribution for taxes paid by distributee
- “Gross up” payment costs remaindermen less than if the trust paid the tax

Are distributions advisable?

- Are Distributions Available?
- Protective Nature of Trust

Are distributions advisable?

- Support vs. Welfare
- Consider or Not Consider Other Resources

Additional Tax Issues

- Estate Tax on Beneficiary's Estate
- Distribution in Kind to Include in Beneficiary's Estate for Basis Step-Up (II.J.8.d.)

Protective Nature of Trust

- Very Real Creditor or Spousal Issues
- Burning a Hole in the Beneficiary's Pocket
- Beneficiary Saves But Might One Day Have Creditors

Consider Forming Partnership (II.J.8.e.)

- Trust is General Partner
- Beneficiary is Limited Partner

Partnership

- Converts Capital Gain To Trust Accounting Income
- Beneficiary Can't Spend the Partnership Interest If Distributed to Carry Out Capital Gain
- Need to Gross Up Beneficiary for Capital Gain If Use Distribution of Partnership Interest to Carry Out Capital Gain

Ideal Trust Distribution Provisions

- Distributions of income and principal for support
- Distributions of income and principal for welfare by independent trustee
- Consider 5% withdrawal right exercisable February 23 - March 5 (two weeks toward end of 65-day rule period) that trustee can turn off before the taxable year begins

Using Distributions for Welfare

- If appropriate, beneficiary can appoint person who is not a related or subordinate party (Code § 672(c))
- Distributions can carry out capital gain
- Can decant into more suitable trust or facilitate estate inclusion to get basis step-up at death

Charitable Distributions

(II.J.4.c.)

- Reduce Adjusted Gross Income
- Exclusive Way For Charitable Deductions to Reduce NII
- More Liberal than 65-Day Rule - Contribution Made on or before December 31, 2017 Can Count as a 2016 contribution
- From Gross Income (II.Q.7.c.i.)

Look for Change in Beneficiary's Residence (II.J.4.d.)

- Beneficiary Changing Residence Might Change Trust's Residence
- Generally, States Do Not Tax Nonbusiness Income Earned by a Nonresident Trust.
(II.J.3.e.i.)

Material Participation for Business or Rental Activities (II.J.4.e.)

- Passive (II.K.) = NII (II.I.8.)
- Document Trustee's Participation
- Even If Trust Taxed to Deemed Owner under Grantor Trust Rules, Consider Having Trustee Participate (discussed below)
- Beneficiary's Participation Can Trigger Depreciation (II.J.11.a.ii.(b))

Qualified Subchapter S Trust (QSST)

Beneficiary Taxed as Deemed Owner of S Corporation Stock ***Except*** for Gain on Sale of Stock or Business Assets

- Allows Beneficiary to Run through All the Lower Brackets before Getting to Higher Brackets
- For Sale of Business, See II.J.15, II.J.16., and II.J.17.

Material Participation for Trusts

Trust Type

Participant

QSST (normal operations)

Beneficiary

QSST (stock or asset sale)

Trustee*

ESBT

Trustee

* Per proposed regulations and IRS' litigation position on trust material participation

See II.K.2.

Making Trust a Partial Grantor Trust as to a Beneficiary (II.J.4.f.)

- Exercise Discretion to Declare a Distribution
- Credit Instead of Distribute
- Lapse Makes Beneficiary Partial Deemed Owner
- Portion Accumulates Over Time
- Cannot Turn Off

Making Trust a Complete Grantor Trust as to a Beneficiary (II.J.4.g.)

- Trustee Contributes Assets to S Corporation
- Convert to QSST
- Might Increase Beneficiary's Rights, Depending on How Conversion Is Done
- Can Turn Off

Qualified Subchapter S Trust (QSST)

Similar to marital deduction trust
(III.A.3.e.i.(a).):

- All income must be distributed annually to sole beneficiary
- Not as protective as trust that accumulates income
- No distribution of principal during life of sole beneficiary to anyone other than sole beneficiary

Trapping Income in Trust Notwithstanding Distributions (II.J.4.h.)

- Trustee Contributes Assets to S Corporation
- Trustee Makes ESBT Election
- Can Turn Off

Electing Small Business Trust (ESBT) (III.A.3.e.ii.)

- Can be a sprinkle trust
- All S corporation income taxed at highest income tax bracket
 - Limited deductions
 - No income distribution deduction for S corporation items
- Flexible Trusts (III.A.3.e.iv.) Discussion Follows

Flexible Trust Design – Spouses

- In many cases, do ***not*** use sprinkle credit shelter trust, which locks one into ESBT
- Bequeath all assets into a QTIP-able trust to toggle between QSST and ESBT as appropriate

Flexible Trust Design – Children

- At drafting stage, make flexible as described above but only one beneficiary
- Can give beneficiary inter vivos power of appointment
- Might be able to modify ESBT and split into one or more QSSTs (III.A.3.e.v.)
- See materials for strategic advantages and disadvantages and implementation steps

Flexible Trust Design Multiple Trusts

- **ESBT Portion Holds Only S Stock**
- **Hold Any Reinvested Distributions in Separate Investment Trust**
- **Distributions from S Corporation Trust Do Not Carry Out Income**
- **Distributions from Investment Trust Do Carry Out Income**

Toggling Between QSST and ESBT

- First Time Toggling – No Time Restrictions
- Subsequent Toggling – 36 Month Wait

Modify Trust to Make More Income Tax Efficient (II.J.4.i.)

- Settlor and Beneficiaries (depends on state)
- Decanting (helpful if distributions for welfare)

Helping the Trustee Provide Annual Notices to Reduce Exposure (II.J.4.j.)

- Trustee Liable 5 Years After Termination (Missouri or other UTC states)
- Providing Notice Cuts to 1 Year
- Litigious Beneficiaries
- Harmonious Situation
- Sample Notice – All Records on CD; Mail with Table of Contents and Receipt

Obtaining Materials

- Over 1,200 pages on business structuring with more searching functionality available by emailing sgorin@thompsoncoburn.com
- Indicate whether want quarterly newsletter with most recent version; if so, include complete contact information, including street address

Thank You

QUESTIONS

TCLE – Fiduciary Income Tax Refresher and Update



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