Chapter 3: Trust Essentials

3

Please note. Corrections were made to this workbook through January of 2021. No subsequent modifications were made.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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TRUST BASICS

As the population continues to age,[1] people are becoming increasingly concerned with finding ways to control or direct how assets are managed in the event of their incapacity or receipt by future generations. Trust arrangements are therefore becoming more popular as the vehicle of choice to address these goals.[2] Many tax clients consider their tax professional to be their most trusted advisor, and they may begin their exploration of trusts by asking the tax professional for advice. As a result, it is important for tax professionals to become familiar with the ins and outs of trust legalities, not in an effort to provide legal advice, but to guide the client in their thought process and to understand what tax filing requirements may exist once a client has established a trust. A thorough understanding of trust issues is also important in order to prepare accurate returns based on the facts and circumstances of each client engagement in this area.

This chapter addresses these issues by introducing the example of Grant Diego. In this example, Grant starts at the inquiry stage, then proceeds to trust establishment, and finally to trust tax return preparation.

Example 1. Grant Diego becomes a widower in 2018 at age 45. He has custody of his minor child, Benny, who is age 11. Realizing he now has complete financial responsibility not just for himself, but also for his minor child, he contacts his longtime friend and tax professional, Ida Know, and asks her what financial decisions he should consider. He tells Ida that he believes he needs a trust after he attends a free presentation at a local restaurant. Ida explains that she is not an attorney, but as Grant's most trusted advisor, she agrees to help Grant begin the process of determining the questions he should consider.

Specifically, Ida asks Grant to consider the following questions.

- What are his goals and issues?
- Does he want to prevent his child from inheriting assets when he is too young?
- Should he consider life insurance ownership arrangements?
- Does he wish to consider costs to his child when inheriting assets?
- Does he wish to control when and how the child receives assets?
- Does he want to keep assets within his family?
- Why does he think he needs a trust?
- What he is trying to accomplish by establishing a trust?
- What is his tolerance for income to be taxed in a trust?
- Could his goals be met by other means (e.g., payable on death (POD) or transfer on death (TOD), beneficiary designations, joint tenancy, tenancies in common, etc.)?

In addition to asking Grant to consider these questions, Ida suggests Grant conduct an inventory of his current assets. His inventory consists of the following assets.

- A house worth $250,000
- Non-retirement investments with a current market value of $50,000
- A $1 million life insurance policy for which beneficiaries are currently unknown
- A rental property Grant manages himself with a current market value of $900,000

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1. *By 2030, All Baby Boomers Will Be Age 65 or Older*. Dec. 10, 2019. US Census Bureau. [www.census.gov/library/stories/2019/12/by-2030-all-baby-boomers-will-be-age-65-or-older.html] Accessed on Aug. 10, 2020.

2. *Protect Your Assets with a Trust*. 2020. Merrill Edge. [merrilledge.com/article/protect-your-assets-with-trust] Accessed on Aug. 10, 2020.

The rental property consists of a small house Grant believes is worth approximately $137,500. The rest of the property is farmland from which Grant receives rental income. Grant does not actively farm the ground but handles all financial decisions related to the rental house and farmland.

Ida suggests that once Grant has considered these questions and quantified the asset inventory, he should consult with an attorney.

Grant schedules a meeting with an attorney, Miranda Powell, to discuss his needs and desires. The attorney begins by educating Grant about asset titling and nontrust options to consider such as the following.

- Outright ownership — probate
- Non-probate property such as the following.
  - Joint tenants with right of survivorship (JTWROS)
  - POD account registration
  - TOD account registration

Note. Practitioners are encouraged to review the property ownership rules in the state in which the client resides.

Grant thanks Miranda for her explanations about nontrust options but believes these options do not provide control over distribution of assets in a manner that would protect Benny from financial indiscretions or improper outside influences if he passes away while Benny is a minor.

Miranda then begins to explain the concept of a trust.

TRUST TERMINOLOGY

A trust is a separate legal entity. The Restatement (Second) of Trusts[3] defines a trust as:

a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.

For federal tax purposes, Treas. Reg. §301.7701-4(a) defines a trust as:

an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting and conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts . . . Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

A trust, therefore, arises from a **contractual arrangement** under which an individual, usually known as the **grantor, trustor, or settlor,** transfers legal ownership of property to another party. That party, the **trustee,** has the duty of holding and administering the trust property for the enjoyment and benefit of a third party known as the **beneficiary.** The property contained within the trust is usually referred to as the **trust principal** or **corpus,** although some legal documents use the Latin word **res.** The terms of the **trust instrument** set forth the duties of the trustee and the rights of the beneficiary with respect to trust assets and any income generated.

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3. See *Trusts: Common Law and IRC 501(c)(3) and 4947.* Thomas, Ward L. and Henzke, Jr., Leonard J. 2003. [www.irs.gov/pub/irs-tege/eotopica03.pdf] Accessed on Feb. 14, 2020.

Individuals may transfer assets to trusts to protect and conserve those assets for the beneficiaries. Trusts are also used to protect assets for a variety of reasons. Some people, for example, create trusts to protect the financial interests of minor children and other family members who are incapable of competently managing the assets.

Trust Instrument

The **trust instrument** is the written document that sets forth the authority, duties, and rights of the parties involved. The instrument may also be known as an **agreement, indenture, declaration,** or **deed.**[4] The instrument generally states the following.[5]

- The purpose of the trust and the conditions that will terminate the trust
- The assets placed in the trust
- The powers and limitations of the trustee, as well as reporting requirements and other provisions
- Who is or are the beneficiary(ies), or equitable owner(s) of the property and when, or if, income and or property (corpus) is to be distributed to the beneficiary(ies)
- The trustee's compensation, if any

A trust is created under the laws of the state in which it is domiciled. State law also governs the relationships between the parties to the trust instrument — the trustee and the beneficiaries — as well as the construction and effect of the instrument and its enforcement.

The importance of the terms of the trust instrument cannot be overstated. State law gives grantors great latitude in creating trusts and with it the ability to control the rights to the property — both income and corpus. However, if the trust instrument says nothing about a particular issue, then state law controls the matter.[6] For example, if the trust instrument simply says that a beneficiary is to receive the income of the trust annually, **income is defined by state law** and not necessarily by generally accepted accounting principles (GAAP) or tax accounting principles.

Income and Remainder Beneficiaries

Trust instruments are generally drafted to distinguish between income beneficiaries and remainder beneficiaries. **Income beneficiaries** receive the income produced by the trust assets. **Remainder beneficiaries** (also known as **remaindermen**) receive the assets upon expiration of the income beneficiaries' interests.

A clause about mandatory distributions of income may be expressed as follows.

> *The Trustee shall invest and reinvest the trust corpus, shall collect and receive the income therefrom and, after paying all expenses and costs incident thereto, shall distribute the net income to X, annually or more frequently, for the rest of X's life. Upon X's death, the then corpus of this trust shall be distributed to Y, absolutely free of all trust, whereupon this trust shall terminate and be of no further force or effect.*

A clause about discretionary distributions of income may be expressed as follows.

> *The Trustee shall distribute as much or all of the income to the beneficiary as the Trustee believes appropriate to provide for the beneficiary's support, health, and education and shall periodically add all undistributed income to principal. Upon the beneficiary's death, the Trustee shall distribute all accrued and undistributed income and all principal then comprising the trust to his spouse, if living, otherwise equally among their issue.*

These clauses provide that one group of beneficiaries is entitled to all or a portion of fiduciary accounting income (FAI), whereas the other group of beneficiaries is entitled to the remainder of the corpus. (FAI is explained later in this chapter.)

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4. *Questions and Answers About Trusts.* Aug. 2015. U.S. Department of the Treasury, Bureau of the Fiscal Service. [www.treasurydirect.gov/forms/savpdp0049.pdf] Accessed on Oct. 10, 2019.
5. *BusinessDictionary.com.* 2019. Web Finance, Inc. [www.businessdictionary.com/definition/trust-agreement.html] Accessed on Oct. 10, 2019.
6. Uniform Trust Code (UTC) §108(b)(2).

FEDERAL EMPLOYER IDENTIFICATION NUMBER

One of the first questions a practitioner should ask a client who has a trust is whether the trust has applied for or received a federal employer identification number (FEIN). If the trust does not have an FEIN, the client and their tax professional should determine if one is necessary. Generally all nongrantor and certain grantor trusts (except certain grantor-owned revocable trusts) require an FEIN.[7] (See the discussion later under "Filing Methods," for information about the proper tax identification number (TIN) to be used for grantor trusts.)

If an FEIN is needed, one can be obtained using any of the following methods.[8]

- **Apply online** at **uofi.tax/20b2x1** [www.irs.gov/businesses/small-businesses-self-employed/apply-for-an-employer-identification-number-ein-online]. The online application is free and provides an immediate FEIN for the taxpayer.

> **Caution.** Applying for an FEIN online is only available Monday through Friday, 7 a.m. to 10 p.m. Eastern Standard Time. Only entities with a principal business location or residence in the United States or a U.S. territory are eligible to apply online.

- **Complete a Form SS-4**, *Application for Employer Identification Number,* and mail it to one of the following addresses. The IRS processes a paper copy of Form SS-4 and issues an FEIN within four weeks.
  - If the taxpayer's principal business, office, or agency is located in one of the 50 states or the District of Columbia, the Form SS-4 should be mailed to:

    Internal Revenue Service
    Attn: EIN Operation
    Cincinnati, OH 45999

  - If the taxpayer has no principal place of business or principal office or agency in any state, the form should be mailed to:

    Internal Revenue Service
    Attn: EIN International Operation
    Cincinnati, OH 45999

- **Fax the completed Form SS-4 to one of the following numbers.** If the taxpayer's fax number is provided, a fax with the FEIN will be sent back within four business days.
  - If the taxpayer's principal business, office, or agency is located in one of the 50 states or the District of Columbia, the fax should be sent to 855-641-6935.
  - If the taxpayer has no principal place of business or principal office or agency in any state, the fax should be sent to 855-215-1627 (within the United States) or 304-707-9471 (outside the United States).

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7. *Do You Need an EIN?* Jul. 16, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/do-you-need-an-ein] Accessed on Dec. 9, 2019.

8. *How to Apply for an EIN.* Jul. 10, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/how-to-apply-for-an-ein] Accessed on Oct. 10, 2019.

A taxpayer is limited to one FEIN application per responsible person per day.[9] For a trust, the **responsible person** is the grantor, owner, or trustor.[10] This limitation is applicable to all requests for FEINs, whether made online, or by fax or mail.[11]

Note. If a taxpayer cannot locate their FEIN, they can request a duplicate certificate by calling 800-829-4933, 7:00 a.m.–7:00 p.m. local time, Monday through Friday. An operator will ask for identifying information and provide the number over the telephone to an authorized person. Examples of authorized persons include a sole proprietor, a partner in a partnership, a corporate officer, a trustee of a trust, and an executor of an estate.[12]

Practitioner Planning Tip

Practitioners are advised to obtain a copy of the original SS-4 to determine how the trust was titled with the IRS to take into account any abbreviations. Titling and abbreviation differences may cause delays in filing returns.

TYPES OF TRUSTS

A tax practitioner must determine what type of trust the client has in order to establish the proper filing procedures. There are two general types of trusts — **grantor** (revocable) and **nongrantor** (irrevocable). Determining what type of trust has been established may require consultation with the drafting attorney to fully understand the terms of the trust and how those terms affect the tax filing requirements.

The distinction between revocable and irrevocable trusts is determined by the ability of the grantor to change the terms of the trust.

GRANTOR (REVOCABLE) TRUSTS

A **grantor trust** is a trust in which the grantor retains control over the assets and/or benefits from the assets. If a grantor retains beneficial enjoyment of the trust property or retains the right to control **who** will enjoy the property, the trust entity is disregarded for income tax purposes.[13] The grantor is treated as the owner of the property and is taxed personally on all of the trust income derived from the grantor trust.

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9. Ibid.
10. *Responsible Parties and Nominees.* Jul. 10, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/responsible-parties-and-nominees] Accessed on Oct. 10, 2019.
11. *How to Apply for an EIN.* Jul. 10, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/how-to-apply-for-an-ein] Accessed on Oct. 10, 2019.
12. *Lost or Misplaced Your EIN?* Jul. 10, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/lost-or-misplaced-your-ein] Accessed on Oct. 10, 2019.
13. See IRC §§671–678.

All revocable trusts are by definition grantor trusts. An irrevocable trust can be treated as a grantor trust if any of the grantor trust definitions contained in the following Code sections apply.

- IRC §671 — Under the general rule, when the grantor or another person is regarded as the owner of any portion of a trust, the income, deductions, and credits attributable to that portion of the trust are included in calculating the taxable income and credits of the grantor or other person.
- IRC §673 — The grantor has retained a reversionary interest (meaning ownership of the trust assets will revert at some point to the grantor) in the trust.
- IRC §674 — The grantor or a nonadverse party has certain powers over the beneficial interests under the trust.
- IRC §675 — Certain administrative powers (such as the power to substitute assets of equivalent value) over the trust exist under which the grantor can or does benefit.
- IRC §676 — The grantor or a nonadverse party has the power to revoke the trust or return the corpus to the grantor.
- IRC §677 — The grantor or a nonadverse party has the power to distribute income to or for the benefit of the grantor or the grantor's spouse.

A trust is **revocable** if the grantor or a nonadverse party can alter or cancel trust provisions in whole or in part[14] (e.g., terminate the trust and reacquire the property in the trust). The taxation of a revocable living trust is governed by the grantor trust rules (discussed later).

A revocable living trust, as the name suggests, is created before death.[15] An individual transfers assets to a revocable trust during their lifetime. Because the trust is revocable, the grantor can generally reacquire the assets in the trust at any time. The grantor never loses control of the property. In most cases, the grantor of the trust is named as the trustee to simplify the process. As the trustee, the grantor may retain the ability to buy, sell, transfer, borrow, or take other actions with trust assets.

Practitioner Planning Tip

Individuals often use revocable trusts to avoid going through the estate administration process, frequently referred to as the probate process. Issues that may be associated with probate include the attorney's fees and other costs, delays in transferring property to the intended beneficiaries, and publicity. (Probate is a public process, whereas a trust is generally not open to the public.) If an individual owns property located in different states, multiple probate proceedings — referred to as "ancillary administrations" — may be necessary, which can increase expenses and further complicate the probate process. Individuals may want to weigh those cost savings against the cost of creating and administering the trust itself.

14. IRC §676.

15. See Instructions for Form 1041.

Typically, with a revocable trust, the grantor retains the right to change or amend the trust.[16] For state law purposes, assets transferred to a revocable trust are titled in the name of the trust, a process known as **funding the trust.** The assets held in the trust are not subject to probate when the grantor dies because the trust holds legal title to the trust assets. Failure to transfer titled assets, such as real estate and brokerage accounts, to the trust may result in those assets being subject to probate unless a different method such as POD or TOD is employed to avoid probate.

Generally, a revocable trust becomes irrevocable upon the death of the grantor. The trust then serves as a **will substitute** because it serves to transfer property at death, just as a will does. The successor trustee (assuming the deceased grantor was the initial trustee) retains or distributes the trust assets in accordance with the trust instrument. Therefore, the assets held in the trust bypass the probate process.

Note. A revocable trust avoids the probate process but the trust assets do not avoid inclusion in the grantor's gross taxable estate for federal estate tax purposes.

A living (or inter vivos) trust is normally coupled with a simple pour-over will. This type of will provides that any assets not titled in the name of the trust are poured over to the trust to be managed and distributed in accordance with the provisions of the trust. It provides a safety feature in case some of the decedent's assets were not transferred to the trust. The pour-over assets distributed to the trust by the will **are subject to the probate process.**

Note. The probate process and the distribution of assets by a will are generally governed by state probate laws. Each state generally has a probate code that outlines these rules. For an example, see the Uniform Probate Code at **uofi.tax/20b2x2** [www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=ea6eb709-a22b-87c7-1c42-4336cfeb8148].

Note. Creating a revocable trust to avoid probate **is only effective** when the deceased grantor's assets are titled in the name of the trust. This requires actually transferring assets to the trust. For an asset with a title (e.g., real estate, vehicle, stock, or bond), the title must be registered in the name of the trust. For an asset without a title (e.g., jewelry or farm machinery), a bill of sale, assignment, or other appropriate transfer document should clearly indicate that the trust holds legal title to the asset.

Practitioner Planning Tip

When preparing the income tax return, a practitioner may want to review Forms 1099 and Schedules K-1 with the client to ensure the forms are being issued in the taxpayer's name rather than the trust's name. If the client intends for the assets to be part of their trust, the client must have the asset retitled.

16. IRC §676.

Filing Methods[17]

There are four optional filing methods that the trustee may choose to report a grantor trust's income and expenses. These methods apply **only** to grantor trusts and not to nongrantor trusts. **Methods 1 and 2 are only available to a grantor trust owned by one grantor** or one person treated as the owner of the trust. For this purpose, a trust owned entirely by a husband and wife is treated as owned by one grantor as long as they file a joint return.

Method 1. The trustee, who may be the grantor, gives the **grantor's** name and tax identification number to all the payors of income. As a practical matter, the grantor does this by giving the payor their own social security number (SSN) and address. This income is then reported on the grantor's individual tax return as if earned directly by the grantor.

If the grantor is not the trustee of the trust, the trustee has additional reporting obligations, as set forth in Treas. Reg. §1.671-4(b)(2)(ii). The trustee must furnish the grantor (or other person treated as the owner of the trust) with a statement detailing the following information.

- The trust's items of income, deduction, and credit for the tax year
- The identification of the payor of each item
- The information necessary to take each item into account in computing the grantor's or other owner's taxable income
- Notice to the grantor (or other owner) that the items of income, deduction, and credit and other information shown on the statement must be included in calculating the taxable income and credits of the grantor (or other person) on the income tax return of the grantor (or other person)

The trustee is not required to obtain an FEIN or file a return with the IRS under this method.

Example 2. Carson and Vanessa are married taxpayers who file a joint return. They are co-trustees of the CV Trust. Under the grantor trust rules, they are treated as co-owners of the trust property because the trust is revocable. All the income is taxed to them. The trust received capital gain and dividend income during the tax year, and Carson and Vanessa furnished the payors with Vanessa's SSN and home address. For reporting purposes, Carson and Vanessa simply report the trust's capital gain and dividend income on their joint return.

Method 2. The trustee gives the **trust's** name, address, and FEIN to all payors of income during the tax year. After the tax year ends, the trustee issues the proper Form 1099 (i.e., interest, dividends, capital gains, etc.) to the grantor (or other person treated as owner) to report the income or gross proceeds paid to the trust during the tax year. These forms show the trust as the payor and the grantor (or other owner) as the payee. The trustee must report each type of income in the aggregate and each item of gross proceeds separately.

If the grantor is not the trustee of the trust, the trustee has additional reporting obligations, as set forth in Treas. Reg. §1.671-4(b)(2)(iii). The trustee must furnish the grantor (or other person treated as the owner of the trust) with a statement detailing the following information.

- The trust's items of income, deduction, and credit for the tax year
- The information necessary to take the items into account in calculating the grantor's (or other owner's) taxable income
- A notice to the grantor (or other owner) that the items of income, deduction, and credit and other information shown on the statement must be included in calculating the taxable income and credits of the grantor (or other owner) on the income tax return of the grantor (or other owner)

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17. Instructions for Form 1041; Treas. Reg. §1.671-4(b).

Method 3. This method is available for a trust treated as owned by two or more grantors or other persons. The trustee gives all payors of income during the tax year the name, address, and FEIN of the trust. After the tax year ends, the trust files Forms 1099 with the IRS for the trust income that is treated as owned by the grantors or other persons. Each Form 1099 should show the trust as the payor and an individual grantor (or other person treated as owner of the trust) as the payee. The trustee must report each type of income in the aggregate and each item of gross proceeds separately. Each grantor or other owner must be given a copy of the Form 1099 along with a statement containing income and expense information necessary to properly complete their own tax return.

Method 4. This method is available for trusts that have an FEIN. Form 1041, *U.S. Income Tax Return for Estate and Trusts,* is used.[18] If the entire trust is a grantor trust, only the entity information should be entered on the form. No dollar amounts are entered on Form 1041; instead, dollar amounts of income and expenses are shown on an attachment to the form.

In some circumstances, part of a trust can be considered a grantor trust and the other part considered a nongrantor trust.

Note. For further details on the characterization of a trust as a grantor or nongrantor trust, see the instructions for Form 1041.

In addition to the four methods mentioned previously, if only part of the trust is a grantor-type trust, the portion of the income, deductions, etc., that is allocable to the nongrantor part of the trust is reported on Form 1041. The amounts allocable to the grantor are shown only on an attachment to the form. The attachment should include all of the following information.

- The name, identifying number, and address of the person or persons to whom the income is taxable
- The trust income, deductions, and credits that must be reported on the individual returns of the grantor or other person under IRC §§671 through 678
- Any deductions or credits that apply to this income

If the grantor trust has been filing Form 1041 and the trustee wants to change to optional method 1, 2, or 3, the trustee can file a final return for the tax year that immediately precedes the first year for which the trustee reports under an alternative method. On the top of the final return, the trustee must write "Pursuant to §1.671-4(g), this is the final Form 1041 for this grantor trust."[19] The "final return" box must also be checked. In subsequent years, the information that had been reported on the Form 1041 is reported on the grantor's Form 1040, *U.S. Individual Income Tax Return.*

Note. At the death of the grantor who created the revocable trust, the trust becomes irrevocable. The trust name that refers to "revocable" does not need to be changed.

18. Instructions for Form 1041.

19. Treas. Reg. §1.671-4(g)(1).

NONGRANTOR (IRREVOCABLE) TRUSTS

Generally, if a grantor cannot terminate the trust arrangement, the trust is said to be **irrevocable.**[20] The grantor is considered to make a permanent transfer that constitutes a completed gift for gift tax purposes, and gift tax may apply. An irrevocable trust can be created during the grantor's life or through a will when the grantor dies.

In addition, because there has been an irrevocable transfer, the trust is usually treated as a separate taxable entity, distinct from the grantor and the beneficiaries. However, an irrevocable trust may still be treated as a grantor trust and not as a separate taxable entity in certain cases, such as the use of intentionally defective grantor trusts for certain estate planning purposes.

Example 3. PJ wishes to have a $100,000 certificate of deposit removed from his estate, so he places the asset into an irrevocable trust. The contribution of the certificate of deposit to an irrevocable trust represents a completed gift. The current value exceeds the 2020 annual tax-free gift exclusion amount[21] and therefore a gift tax return must be filed.

The trust document included the following provision.

This trust is irrevocable, and Grantor may not alter, amend, revoke, or terminate it in any way.

Example 4. Use the same facts as **Example 1.** Grant decides to establish a trust provision in his will for his son Benny. Provisions of the trust arrangement include the following.

- Staged payouts of principal to Benny at ages 25, 30, and 35, or more frequently as the trustee may deem appropriate.
- Annual charitable contributions from the trust to Grant's church.

Because Grant is mostly concerned about how his assets are conserved after his death for Benny's long-term benefit, he asked the attorney not to draft the trust with a goal to minimize taxes but rather to address his concerns about Benny receiving or squandering assets too early in life. Using a trust provision in his will also satisfies Grant's desire to retain control over his assets while he is still living.

After signing the trust documents, the titles of assets were changed to properly reflect the funding of the trust.

SIMPLE AND COMPLEX TRUSTS

The distinction between simple and complex trusts is determined by the distributions made by the trust.

A **simple trust** meets **all three** of the following requirements.[22]

1. The trust instrument requires that all income be distributed currently for the tax year (regardless of whether the current income distributions are actually made).
2. The trust instrument must not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes.
3. The trust does not make distributions of principal (corpus) during the year.

A trust that qualifies as a **simple trust** for the tax year is allowed to deduct from gross income any income amounts actually required to be distributed to beneficiaries regardless of whether or when income is distributed.[23]

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20. *Abusive Trust Tax Evasion Schemes — Questions and Answers.* Sep. 12, 2019. IRS. [www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers] Accessed on Oct. 31, 2019.

21. Rev. Proc. 2019-44, 2019-47 IRB 1093.

22. Treas. Reg. §1.651(a)-1; Instructions for Form 1041.

23. IRC §651(a) and Treas. Reg. §1.651(a)(2).

To qualify as a simple trust under federal tax rules, the amount that must be currently distributed is the **income** as defined under the laws of the state in which the trust was established and under the trust instrument.[24] If the trust agreement does not specify how income and principal should be accounted for and taxed, state law utilizing some form of the Uniform Trust Code (UTC)[25] or the Revised Uniform Principal and Income Act (RUPIA) (discussed in the following section) make this determination. Therefore, it is important to determine where the trust was established, where the trust business is being conducted, or where the trust is being administered to determine which state's laws apply.

Example 5. During her lifetime, Mildred placed her assets into the "Mildred Revocable Living Trust." When she died in 2018, the trust became irrevocable (although the name of the trust and establishment date remain the same). The trust document does not require that any amounts be paid, permanently set aside, or used for charitable purposes. It does require that the income be distributed annually. The following excerpt appears in the trust document.

> *The Trustee shall pay to my husband the net income from the trust at least annually. In addition, the Trustee may distribute to my husband so much or all of the principal of the trust as the Trustee in the Trustee's sole discretion determines is needed for his health, support, maintenance, and education.*

In 2019, the trust earned $3,000 in interest income. It did not pay any expenses in 2019 and did not make any distributions. **The trust is treated as a simple trust for tax purposes in 2019.** Even though no distributions were made, the trust received a distribution deduction on its income tax return, and Mildred's husband included the $3,000 as income on his 2019 personal tax return.

Note. The distribution deduction and taxation of beneficiaries are discussed later in this chapter.

A **complex trust** is any trust that does not qualify as a simple trust.[26]

The classification of a trust may vary from year to year. For example, if a trustee is required to distribute all trust income currently but also has the discretion to make distributions out of trust principal, the trust is simple in any year in which principal is not distributed, but complex in any year in which principal is distributed.

Example 6. Use the same facts as **Example 5.** In 2020, Mildred's trust earned $3,500 in interest income. In addition to this income, the trustee distributed $10,000 of the trust's corpus to Mildred's husband in 2020. Because of the principal distribution, the trust is treated as a complex trust for 2020.

24. Treas. Reg. §1.643(b)-1.

25. A copy of the UTC can be found at www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=3d7d5428-dfc6-ac33-0a32-d5b65463c6e3.

26. Treas. Reg. §1.661(a)-1.

DEFINING AND ACCOUNTING FOR TRUST INCOME

UNIFORM PRINCIPAL AND INCOME ACT[27]

The Uniform Principal and Income Act (UPIA) formally addressed the concept of FAI when it was created in 1931. One of the primary purposes of UPIA was to deal with the problems of adjusting principal and income between beneficiaries, remaindermen, and other parties with current or future interests in trust assets. UPIA was prepared in response to a demand for legislation — primarily from trustees who were concerned about discharging their fiduciary duties in light of an ever-increasing number of technical problems. These problems included determining principal and income and dealing with the conflicting opinions of the courts on these issues. UPIA was subsequently modified in 1962 and again in 1997, and these revised statutes are collectively referred to as RUPIA.

In July 2018, the Uniform Law Commission approved the Uniform Fiduciary Income and Principal Act (UFIPA),[28] which made additional changes to RUPIA. A major change made by UFIPA is the expanded power for trustees to adjust income or establish a unitrust approach,[29] although many states have added unitrust provisions to their existing statutes. UFIPA requires that a fiduciary determine how their power to adjust will assist the fiduciary in remaining impartial as to the investment direction of trust assets.

> **Observation.** The goal of these law changes is to give fiduciaries more flexibility in determining income. With this increased flexibility comes greater responsibility to follow the terms of the trust instrument and increased potential accountability to beneficiaries, who may believe the fiduciary did not act the way a "prudent man" would have under similar circumstances. A fiduciary can be criticized for being too conservative as well as for being too aggressive in investment decisions or in the distribution of income.

As of February 2020, Utah was the only state to adopt UFIPA, but legislation was also introduced in Tennessee in 2020.[30]

FIDUCIARY ACCOUNTING INCOME

To understand the income taxation of trusts, a tax professional must have a basic understanding of trust accounting (fiduciary accounting). Trust accounting[31] is essentially maintaining records of deposits and disbursements, notes and ledgers of every monetary transaction, performing monthly accounting, and then reconciling the accounts. This accounting is then used to determine the trust's income, which is a necessary step that must be taken before preparing the tax return for any trust or beneficiary.[32]

FAI[33] is a unique concept. It is neither **taxable income nor GAAP income.** Some practitioners incorrectly assume that taxable income and FAI are the same. For example, interest on municipal bonds is excluded in determining taxable income but included in determining FAI. Practitioners may also incorrectly assume that FAI is the same as income determined using GAAP. Both of these assumptions are as inaccurate as believing that taxable income and GAAP income are equivalent.

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27. The 2008 version of the UPIA can be accessed at www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=3d79cfdc-0b53-f752-8e59-a6dc04ddb5fd.

28. *Uniform Fiduciary Income and Principal Act.* Uniform Law Commission. [www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=8194047f-f2aa-440b-4c66-a0ad7711108c] Accessed on Aug. 18, 2020.

29. UFIPA §203.

30. *Fiduciary Income and Principal Act.* Uniform Law Commission. [www.uniformlaws.org/committees/community-home?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c] Accessed on Feb. 19, 2020.

31. *Practice Guide for Fiduciary (Trust) Accounting.* Dec. 2007. AICPA Tax Division. [www.boa.virginia.gov/docs/aicpapracticeguideforfiduciary_trust_accounting.pdf] Accessed on Dec. 19, 2019.

32. Instructions for Form 1041.

33. *National Fiduciary Accounting Standards.* May 1984. The American College of Trust and Estate Counsel. [www.fiduciarylawblog.com/wp-content/uploads/2013/08/Fiduciary_Accounting_Standards.pdf] Accessed on Dec. 19, 2019.

For a trust, FAI is the amount to be distributed or accumulated for income beneficiaries as defined by the trust instrument or will. If the trust instrument or will is silent, the amount is determined under state law.

Many of the rules and practices of fiduciary accounting derive from the fact that the trustee or executor has the fiduciary responsibility to protect the rights of each beneficiary. In this regard, the laws of most states require an annual report to the beneficiaries. The law views the accounting as a report of the results of the trustee's decisions and actions relative to the beneficiaries' interests. Beneficiaries and other interested parties review the accounting for the period to see the changes in principal and income. In addition, beneficiaries want to know whether they are being treated fairly and whether the trustee has properly discharged their duties.

It follows that the primary concern of fiduciary accounting is the proper allocation of the receipts and disbursements of the trust among the various competing interests. Historically, rules and laws have existed that neatly categorize certain receipts as income (e.g., interest, dividends, and rents). More recently, trust instruments have given the trustee the power to allocate receipts and disbursements between income and corpus as the trustee believes is appropriate.

As mentioned earlier, trust instruments are drafted to distinguish between income beneficiaries and remainder beneficiaries. **Income beneficiaries** are entitled to all or a portion of FAI, whereas **remainder beneficiaries** are entitled to the remainder of the trust's assets. Thus, the main duty of trust accounting and the trustee is to ensure that the amount accruing to each class of beneficiaries is correctly determined. In short, the trustee must allocate receipts and disbursements properly.

So, what is FAI? Unfortunately, the trust instrument often provides little or no guidance in what can be a high-stakes game for all parties. The trustee's major task is to provide a fair return to the income beneficiary but to maintain the principal for the remainder beneficiary. Income and remainder beneficiaries may sharply disagree about how an item should be allocated.

For instance, if gains on the sale of property are allocated to principal, what effect does an investment strategy that stresses investment in growth stocks have on an income beneficiary's interests? The remainder beneficiary would get all of the income and the income beneficiary would get nothing. In any situation, the trustee must be impartial, and the accountant may be called on to help the trustee make the allocation.

Example 7. Connor's father, Bradley, died in 2018. Under the terms of Bradley's will, $100,000 was left in a trust that provides income to Connor annually. Upon Connor's death, the remainder is to go to Bradley's granddaughter, Emma. The residuary of the estate was placed in a separate trust for Emma. Under the agreement, Connor receives the income from the trust annually.

One of the assets left in trust is a vacant lot worth $25,000, which is its income tax basis. If the lot is sold for $25,000, there is no gain and the entire $25,000 is allocated to principal because proceeds from the disposition of principal are generally allocable to principal. However, if the lot is sold for $30,000, a gain is recognized and must be allocated to income or principal. Under these circumstances, Connor benefits if the proceeds are allocated to income, but Emma benefits if the proceeds are allocated to principal.

To determine how to allocate the proceeds, the practitioner should refer to the trust instrument. If the trust instrument is silent, state law governs.

Note. The income tax treatment and subsequent allocation of capital gains between income and principal are discussed later in this chapter.

FAI Not a Tax Concept

FAI (or trust accounting income) is the income as **determined under the terms of the trust instrument.** However, when the trust instrument is silent regarding the treatment of a particular receipt or disbursement, state law governs. The default to state law is useful for the trustee because it provides both guidance and protection. For the accountant, it provides a roadmap for calculating FAI when the trust instrument is silent on that issue. Every state has a principal and income statute. Most of these laws are modeled after UPIA or RUPIA.

As emphasized earlier, FAI is not a tax concept and is not computed using any rules prescribed by the Code. In fact, IRC §643(b) makes it clear that whenever Subchapter J (Code sections that deal with taxation of estates and trusts and their beneficiaries) refers to **income** and it is not modified by a term such as **taxable, gross, distributable net,** or **undistributed net,** the reference is to FAI.[34]

CALCULATING FAI

Normally, the provisions of the trust instrument or the will control the calculation of income even if a state's laws provide for a different treatment. Section 103 of the UPIA provides that the grantor can give the trustee complete discretion in allocating receipts and disbursements between income and principal.

Items of Income and Expense

FAI is the amount available for current or future distribution to the income beneficiaries. It is an all-cash concept: gross receipts less disbursements (e.g., net receipts). Nothing is accrued unless provided in the trust instrument, the will, or state law.

FAI for a trust is whatever the trust instrument or the will says it is. Nonetheless, under most state laws (and trust instruments), certain items are allocated to income while others are usually allocated to corpus. Typical items allocated to income include the following.[35]

- Interest income
- Dividend income
- Net rental income from real or personal property
- Net profits from operation of a trade or business (with losses usually charged to corpus)
- All or a portion of trustee or executor commissions
- Depreciation

Depreciation. Depreciation (as well as depletion and amortization) for trust assets can be a bit confusing. The first issue concerns the basic concept of depreciation. Most accountants normally consider depreciation as a noncash expenditure. However, in the trust arena, depreciation involves the movement of cash to offset the decreased value of a wasting asset (e.g., oil or coal) to the remainder beneficiary.

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34. See the many references to income in IRC §§651, 652, 661, and 662.

35. See RUPIA as amended, §§401–415 and 501–506.

Example 8. A trust is created that requires all income to be distributed to the income beneficiary, Isabel, during her life. Upon Isabel's death, the principal is to be distributed to the remainder beneficiary, Reid.

If the trust principal consists of corporate bonds, the payments of interest to Isabel generally do not reduce the value of the remainder that Reid is to receive after Isabel's death. This is because the production of income by the bonds does not diminish the bonds' remaining value.

However, if the trust corpus consists of a mine that produces coal, the situation is quite different. In this case, Isabel receives royalty income as the coal is mined and sold. If all the coal is extracted during Isabel's lifetime, the remainder — the mine — is worth little or nothing when Reid ultimately becomes the owner. It is a "wasting" asset.

The distributions of interest income from the bonds do not reduce corpus like the income attributable to the mining of coal.

Typically, when a trust with a wasting asset is established, some of the income from the wasting asset is retained by the trustee and added to the trust corpus. The remaining income is distributed to beneficiaries.

Depreciation is handled in a similar way. Once the amount of depreciation is determined, the trustee establishes a reserve for depreciation.[36] Income is withheld and added to the depreciation reserve. The effect is to reduce the amount paid to the income beneficiary and to set aside this amount in principal. Doing this means that resources will be available to the remainderman for use later in replacing the property.

The question is **whether** there should be a reserve for depreciation. The trust instrument may or may not require a reserve for depreciation.[37] Similarly, state law may or may not require a depreciation reserve. In this situation, the 1997 RUPIA gives the trustee discretion as to whether depreciation is charged.[38]

Finally, if a reserve for depreciation is required, the **amount** of depreciation must be calculated. Depreciation methods for FAI purposes may differ substantially from those used for financial or tax accounting purposes. To illustrate, assume a trust holds rental property. The trust instrument may define depreciation as an amount equal to 10% of gross rents or 15% of net rents, whichever is larger. Alternatively, the trust instrument may call for depreciation equal to the amount normally calculated using GAAP, or for trust depreciation to be exactly equal to tax depreciation. Regardless of the amount of depreciation calculated for FAI purposes, the trust calculates and deducts tax depreciation using the same methods as other tax return filings.

Income Taxes. Taxes imposed on receipts allocated to income are usually charged against income. Under this view, state income taxes normally are allocated to income. However, if a tax is imposed on a gain from the sale of property and the proceeds realized from the transaction are allocated to principal, the related tax should also be allocated to principal.

Property Taxes. Although property taxes are levied on trust assets, they are usually paid out of trust income and allocated to income.

Note. During the Tax Cuts and Jobs Act (TCJA) period (tax years beginning after December 31, 2017, and ending before January 1, 2026), trusts and estates have the same $10,000 state and local income tax limitation as individuals.[39]

36. See *All You Really Need to Know about Subchapter J You Learned from This Article.* Sherman, Jeffrey G. Winter 1998. Missouri Law Review. [scholarship.law.missouri.edu/cgi/viewcontent.cgi?article=3348&context=mlr] Accessed on Nov. 5, 2019. See also Treas. Reg. §1.611-1(c)(4).

37. Ibid. See also IRC §§167(d) and 611(b)(4).

38. RUPIA §503.

39. TCJA §11042, revising IRC §164(b)(6). The law amends §164(b) by limiting the total deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes to a maximum of $10,000 per year ($5,000 for married individuals filing separately). This limitation does not apply to any real property taxes or personal property taxes incurred by a trust or estate for the operation of a trade or business.

Ordinary Expenses. Expenses incurred in the administration, management, or preservation of the trust property are usually charged against income.[40] However, the trust instrument should be consulted as to the allocation of expenses between income and principal.

Because FAI is not a tax concept, the restrictions on such items as passive losses, the 2% floor on miscellaneous itemized deductions (prior to 2018), and similar limitations are **not taken into account** in computing FAI. (They do apply, however, in calculating taxable income.)

Premiums and Discounts. Bond premiums and discounts are not taken into account in calculating FAI. There is no provision for amortization, as there normally is for financial and tax accounting. This treatment can produce some extremely inequitable situations.

For example, assume that a zero coupon bond is purchased at a sizable discount in order to produce a market interest rate of 10%. Without adjustment, the income beneficiary will receive nothing, even though the real rate of return on the bond is 10%.

Observation. There is no particular correlation between FAI and taxable income. For example, in arriving at a trust's taxable income, a trustee commission allocable to corpus is just as deductible as one allocated to income. The account from which an expense is paid — income or corpus — is irrelevant in the calculation of taxable income.

Deductible expenses that are charged to corpus could result in FAI being greater than trust taxable income. For example, if deductible trustee commissions are paid out of corpus, FAI is not affected but taxable income is affected.

If a fiduciary receives tax-exempt income (which is included in FAI even though it is tax-exempt), FAI could be greater than trust taxable income. On the other hand, if a trust realizes capital gains that are allocable to corpus, the trust's taxable income may exceed its FAI. The comprehensive example shown later in the chapter illustrates these concepts.

Distributions from Entities (Corporations, Partnerships, S Corporations). The RUPIA specifically addresses the allocation of distributions received from entities. It provides that cash distributions from an entity generally are allocated to trust income.[41] This rule applies to distributions from corporations (with no distinction between a C corporation and an S corporation), partnerships, limited liability companies, regulated investment companies (mutual funds), and real estate investment trusts (REIT).

Under the RUPIA, the amount of FAI derived from partnerships and S corporations is not the amount of taxable income that flows through or that is allocated to the owners; it is solely the amount of distributions actually received. The receipt of a Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.,* from a partnership or S corporation that reports taxable income to the trust is irrelevant except to the extent that it reports distributions.

Example 9. The Ruben Trust owns a 10% interest in a partnership. This year, the partnership had interest income of $20,000 and net income from its rental operations of $60,000. The partnership opted to distribute income of $10,000, including $1,000 to the Ruben Trust.

For tax purposes, the partnership issues a Schedule K-1 showing that the trust's share of partnership taxable income is $8,000 (($20,000 interest income + $60,000 rental income) × 10%). However, the FAI for the trust is $1,000, which is the amount of the distribution. This is true even though the trust's distributable net income (discussed later) includes the $8,000 of taxable income.

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40. RUPIA §501(3).

41. RUPIA §401(b).

Although the amount of income from an entity is normally equal to the amount of cash received from it, there are several exceptions.[42]

- Cash received in one distribution, or a series of related distributions, in exchange for part, or all, of a trust's interest in the entity is allocated to principal (redemptions).
- Cash received in total or partial liquidation of the entity is allocated to principal.
- Cash received from a mutual fund or REIT that is a capital gain dividend for federal income tax purposes is allocated to principal. Nontaxable distributions from these entities are allocated to income.
- Distributions of property by an entity are allocated to principal (e.g., a C corporation distributes land to a trust). Dividends reinvested are allocated to principal.

Items Allocated to Corpus

Cash receipts and disbursements that are usually allocated to corpus include the following.

1. Consideration received on the sale or exchange of trust property (It is the proceeds derived from the sale that are allocated to corpus, not merely the net gain or loss.)[43]
2. Taxes on gains and profits allocated to principal[44]
3. Casualty losses
4. Reinvested stock dividends
5. Insurance proceeds on property forming a part of principal
6. Extraordinary dividends (e.g., a dividend paid by a corporation from the sale of one of its operations)
7. Expenses incurred to prepare property for rent or sale (extraordinary repairs)
8. Loan repayments
9. All or a portion of trustee commissions

Note. If income is accumulated in a trust, it follows that a portion of the trust's tax liability is attributable to the accumulated income. This tax is allocated to income.[45]

Example 10. The Jones Irrevocable Trust sold stock that was part of the trust corpus. It received $20,000 net of commissions for the stock and realized a $6,000 gain on the sale. It paid $900 in federal income tax.

The $20,000 receipt is allocated to corpus. Similarly, the income tax is charged to corpus because it is attributed to the sale of assets that are part of corpus. Thus, the net increase to corpus is $19,100 ($20,000 – $900).

Although the gross sales proceeds are allocated to corpus, it is the net gain that is taxable to the trust.

42. RUPIA §401(c).
43. See RUPIA §404(2).
44. See RUPIA §502(a)(1)–(7).
45. IRC §671.

Example 11. The Blair Irrevocable Trust is a simple trust; therefore, all the FAI is required to be distributed. In a simple trust, all the federal, state, and local taxes paid by the trust are charged to corpus. This is because the income tax liability of a simple trust normally is due solely to capital gains or other items allocated to corpus.

If the Blair Trust were a complex trust and some of the FAI was accumulated, then the tax attributable to the accumulated income would normally be charged against that account. However, a trust instrument sometimes provides that the income tax liability should be charged elsewhere (e.g., corpus or distributed income).

Effect of Total Return Trust on Calculation

If the trust adopts a total return (unitrust) investment strategy (discussed next), the trustee has the power to adjust the normal allocation of receipts and disbursements. Once the allocations have been made in accordance with the trust instrument and state law, the trustee can shift income to corpus and corpus to income. Obviously, doing so may lead to disputes between the beneficiaries and the trustee.

To prevent such controversies, some states have adopted a total return or unitrust approach to defining income.[46] Under this method, the trust instrument specifies a fixed percentage of the value of the trust's assets (revalued annually) as FAI. This way, regardless of how the assets are invested, the income beneficiaries receive the same percentage of the trust assets' value each year as income.

If the total return (unitrust) approach is used, the trust instrument should identify the composition of the distributions. For example, the document may state that any income distribution is considered to come first from traditional income sources (e.g., dividends and interest) and then from corpus (e.g., capital gains).

For income tax purposes, final regulations effective January 2, 2004, revised the definition of FAI for income tax purposes to make it consistent with the total return concept.[47] According to the regulations, an allocation between income and corpus under state law is respected if state law provides for a reasonable apportionment between income and remainder beneficiaries of the trust's total return for the year. For this purpose, the total return includes not only ordinary and tax-exempt income but also capital gains and unrealized appreciation. For example, a state statute that permits the trustee to make adjustments between income and corpus to fulfill the trustee's duty of impartiality to the income and the remainder beneficiaries satisfies this **reasonable apportionment test.**

The regulations warn, however, that "trust provisions that depart fundamentally from traditional principles of income and principal will generally not be recognized."[48] For example, if a trust provides that all trust income be paid to the income beneficiary but defines ordinary dividends and interest as principal, the trust will not be considered as requiring that all its income be currently distributed for purposes of IRC §642(b) (the exemption amount available to the trust, discussed later) or IRC §651 (the distribution deduction). The effect of the rule is to give trustees great discretion in the allocation of receipts and disbursements.

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46. Treas. Regs. §§1.642(c)-5(i) and 1.664-3.

47. Treas. Reg. §1.643(b)-1.

48. Ibid.

TRUST SITUS

If a state's law governs the accounting treatment when a trust is silent, it is obviously important to know which state law (or country) governs. However, determining this is not as easy as it might seem.

Trust situs controls. **Situs** is usually defined as the place in which the trust is administered. It is typically the legal jurisdiction in which the trustee is located. In any particular situation, situs may not be obvious. For example, if the grantor creates a trust in the state in which they live, names a trustee who lives in another state, and identifies beneficiaries living in several states, there may be questions regarding situs. Similarly, if the trust is created in one state but the grantor moves to another state, there may be questions. Moreover, the type of property may have some bearing on trust situs. In some states, real estate owned within that state may determine situs. As might be expected, in situations in which the laws of one jurisdiction differ from those of another, situs can be critical.

Caution. The situs of a trust does not necessarily control whether a state income tax return should be filed in a particular state. Individual state laws should be consulted to determine situs and tax return filing requirements.

Situs has no effect on federal income taxes. However, situs may be important for a number of purposes, and a grantor is generally free to locate the trust wherever it is deemed most advantageous. The situs can generally be changed if desirable or necessary.

Practitioner Planning Tip

Generally, trust documents are not filed with a state agency, other than that which may be required under the Uniform Probate Code.[49] Practitioners should be aware of the rules of the state in which the trust is operating or property is located.

BASIS OF TRUST PROPERTY

The basis of property transferred to the trust depends on whether the trust purchased the property or acquired property directly from a decedent or by gift. If the trust is created under the decedent's will (a testamentary trust), the rules for determining the basis of inherited property typically result in a basis equal to the property's value at the date of the decedent's death.[50]

If the property was acquired by lifetime gift, the carryover basis rules for gifts contained in IRC §1015 apply. The trust's basis is the same as the donor's basis unless the property's value was less than its basis at the time of transfer (i.e., it has a built-in loss at the date of the transfer). In this latter case, the basis of the property depends on the sales price of the property. The basis for gain is the donor's carryover basis, whereas the basis for loss is the fair market value (FMV) at the time of the gift. In addition, the basis of the gifted property is increased by any suspended passive losses.[51]

If the trust is a revocable trust, the gift is not complete until the trust loses its revocable status. If the change in status is due to the grantor's death, the assets normally receive a step up in basis for qualifying assets because all assets of the trust will be included in the grantor's gross estate.[52] Even an irrevocable trust may be includable in the gross estate, such as in the case of an irrevocable transfer of the remainder interest in a trust with a retained income interest.[53]

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49. *Probate Code*. Uniform Law Commission. [uniformlaws.org/committees/community-home?CommunityKey=35a4e3e3-de91-4527-aeec-26b1fc41b1c3] Accessed on Aug. 10, 2020.

50. IRC §1014.

51. IRC §469(j)(6)(A).

52. IRC §2038.

53. IRC §2036(a).

DETERMINING TAXABLE INCOME

IRC §641(b) provides that a trust's taxable income is calculated in the same manner as that of an individual, modified by §§641–644. The **tax formula** follows.[54]

	Gross income
–	Exclusions
	Total income
–	Deductions for adjusted total income (taxes, fiduciary fees, charitable contributions, net operating loss, certain other expenses (§67(e))
	Adjusted total income
–	Income distribution deduction
–	Deduction for estate and generation-skipping taxes
–	Qualified business income deduction (QBID)
–	Exemption
	Taxable income

3

A trust is not allowed a standard deduction, and any deductible items are itemized and subtracted from gross income to arrive at taxable income. Indeed, adjusted gross income (AGI), a familiar term on individual returns, is not found on Form 1041.[55]

Nevertheless, the limitations based on AGI that apply to miscellaneous itemized deductions (which are not allowed during the TCJA years) and personal casualty and theft losses (i.e., the 2% and 10% floors, respectively) do apply to trusts.[56] For this reason, IRC §67(e) indicates what deductions are considered in determining AGI for these purposes. These rules effectively produce the formula given previously, although it never appears in such form on the return.

INCOME TAX ISSUES

When property is transferred to a trust as part of its creation, the issue of taxation arises. Is the trust or its beneficiaries liable for the income taxes on the property transferred to the trust?

The law adopts the long-standing rule of IRC §102 concerning gifts and bequests and provides that a gift or devise should not be subject to income tax. Therefore, the transfer of property to the trust produces no income tax upon creation of the trust and, furthermore, the same treatment holds when the property is ultimately distributed to the beneficiaries. However, the income from the property is taxable.

Conceptual Overview

As mentioned earlier, subchapter J of the Code contains the rules governing the income taxation of trusts and other fiduciary entities. The taxable income of a trust is calculated in the same manner as that for an individual with only a few modifications.[57] The primary concern of subchapter J is who reports the taxable income — the trust or the beneficiary. In all cases, practitioners should remember that total taxable income of the trust is taxed once — to the fiduciary or the beneficiary, not to both.

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54. See Form 1041.

55. Form 1041, line 17, refers to "adjusted total income," a term that is not defined in the law. Adjusted total income is taxable income of the trust before the income distribution deduction, the estate tax deduction, and the exemption deduction. Determination of AGI for trusts is governed by IRC §67(e).

56. IRC §67(e).

57. IRC §641(b).

Perhaps the best way to understand the tax treatment of trusts is to compare their treatment to that of partnerships and corporations. A C corporation and its shareholders are separate taxable entities. As a result, income received by the corporation can be taxed twice — once at the corporate level and again when the after-tax income is distributed to the shareholders as dividends. In contrast, a partnership is not a taxable entity but rather acts as a conduit. Income flows through the partnership to the individual partners, who report their share of partnership income regardless of whether it is actually distributed.

The tax treatment of trusts does not adopt either of these approaches in its entirety. It appears that the authors of the fiduciary rules rejected the corporate approach, believing that the income of a trust should only be taxed once. Conceptually, this seems appropriate, given that the fiduciary is merely an agent acting to protect and conserve the assets for the beneficiary. On the other hand, treating trusts like partnerships was deemed unacceptable. If this method were used, a beneficiary would be charged with income but not have any power to obtain the cash necessary to pay the tax. Consequently, a compromise plan was adopted. This approach borrows from both the corporate and the partnership schemes.

The basic principle underlying the design of fiduciary income taxation is that the taxable income of the trust should only be taxed once. This is accomplished by treating the trust as a separate taxable entity, like a corporation. **Taxable** income received by the fiduciary generally is taxed to the entity. This ensures that any taxable income received is taxed currently. However, the tax burden is shifted to the beneficiaries to the extent that the trust distributes or is required to distribute its income. This shifting is accomplished mechanically by granting a deduction to the trust for any distributions of income. Such distributions are then included in the gross income of the beneficiary. In effect, the deduction is simply the mechanism used to allocate the income between the trust and the beneficiaries.

This treatment is very similar to how a corporation pays salaries to its owners and deducts those salaries in calculating its taxable income. In such a case, the income is taxed only once. Like a partnership, however, the income distributed to the beneficiaries **retains its character.**

Example 12. Among the assets contained in Kitty's complex trust is a $100,000 bond, which pays taxable interest annually at a rate of 1%. In 2019, the trust received $1,000 of interest income and distributed $750 to Kitty. Because of this distribution, $750 of the taxable interest income is allocated to Kitty, the beneficiary.

Kitty included the $750 in her taxable interest income. The trust reported $250 (the remaining taxable income). The $1,000 of taxable income is taxed only once: $250 to the trust and $750 to Kitty.

For reporting purposes, the trust filed a Form 1041 that showed $250 of trust taxable income. It reported the $750 on a Schedule K-1 issued to Kitty.

Grantor trusts, as discussed earlier, are not taxed in this manner. A grantor trust generally is one in which the grantor retains so much control over the trust property (e.g., the grantor can revoke the trust) that the trust is ignored altogether for income tax purposes. As a result, the income of a grantor trust is taxed to the grantor and the trust normally is not taxed.[58]

58. See IRC §§671–678.

Income Tax Rates

The Code provides a special tax rate schedule in IRC §1(e) for trusts. Like the tax rate schedules for individual taxpayers, the trust tax brackets are adjusted annually for inflation.

For 2020, trusts are taxed at the following rates.[59]

Trusts and Estates

If Taxable Income Is			
Over	**But Not Over**	**The Tax Is**	**Of the Amount Over**
$ 0	$2,600	10%	$ 0
2,600	9,450	260.00 + 24%	2,600
9,450	12,950	1,904.00 + 35%	9,450
12,950		3,129.00 + 37%	12,950

For 2020, the top trust tax rate of 37% starts at $12,951 of taxable income, as compared with $518,401 for single taxpayers and $622,051 for joint filers.[60] This compression severely limits the potential for shifting income to trusts to minimize taxes.

Net Investment Income Tax

Trusts may also be subject to the net investment income tax (NIIT). The NIIT may affect the tax liability of a trust. If a trust is subject to income tax under the Code, then that trust is also subject to the NIIT rules.

As mentioned earlier, trusts are allowed to deduct **income distributions** to beneficiaries.[61] Therefore, in most cases, distributed income is not subject to income tax or the NIIT at the trust level.

Each year, trusts are liable for the 3.8% NIIT on the **lesser of:**[62]

- The trust's **undistributed** net investment income (NII) for the year, **or**
- The **excess** (if any) of the trust's AGI over the dollar amount at which the highest tax bracket for trusts begins **($12,951 for 2020[63]).**

Undistributed NII for the trust is calculated by first determining the trust's NII.[64] NII includes some forms of **income** and **capital gains** the taxpayer receives during the year. However, not all income or capital gains become part of the taxpayer's NII. Both the **income** and the **capital gain** components have some exceptions that are not subject to the 3.8% NIIT.

59. Rev. Proc. 2019-44, 2019-47 IRB 1093.
60. Ibid.
61. IRC §§651 and 661.
62. IRC §1411(a)(2).
63. Rev. Proc. 2019-44, 2019-47 IRB 1093.
64. Treas. Reg. §1.1411-3(e).

Generally, **NII includes** the following types of income.[65]

1. Taxable interest, dividends, nonqualified annuity distributions, royalties, rents, and substitute interest or dividends, other than such income that is derived in the ordinary course of a trade or business
2. Income from a passive activity[66] or from a covered trade or business (i.e., a trade or business that trades in financial instruments or commodities)
3. Net capital gains attributable to the disposition of property other than property held in a trade or business (Only net gains included in taxable income are subject to the NIIT.)[67]

The following is a list of common income types that are **not considered NII.**[68]

- Wages
- Unemployment compensation
- Operating income from a nonpassive business
- Social security benefits
- Alimony
- Tax-exempt interest
- Self-employment income
- Alaska Permanent Fund Dividends (see Rev. Rul. 90-56, 1990-2 CB 102)
- Distributions from certain qualified plans (those described in §§401(a), 403(a), 403(b), 408, 408A or 457(b))

The NII for a trust is based on all the NII amounts **received** by the trust during the year.[69] After the amount of the trust's NII that was received is determined, the undistributed NII is calculated using the following general formula.[70]

	Trust NII
−	Amount allowed as a deduction under trust tax law for distributions of net income made to beneficiaries
−	Amount allowed as a deduction under trust tax law for any amounts permanently paid or set aside for charitable contributions
	Undistributed NII subject to NIIT

The NII that the trust distributes to beneficiaries retains its character as NII and forms part of the NII of each beneficiary for the tax year.[71]

Note. The concept of **material participation** is referred to extensively in the NIIT rules.[72] It may be difficult to determine whether a trust materially participates in an activity. The IRS has not yet provided any direct guidance on this issue. For further details on the material participation concept and how trusts are affected by the material participation rules, see the 2014 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Passive Activities. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

65. IRC §§1411(c)(1) and (2).
66. As defined in IRC §475(e)(2).
67. IRC §1411(c)(1)(A)(iii).
68. *Questions and Answers on the Net Investment Income Tax.* Apr. 3, 2020. IRS. [www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax] Accessed on Jul. 9, 2020.
69. Treas. Reg. §1.1411-3(e).
70. Ibid.
71. Treas. Reg. §1.1411-3(e)(3)(ii).
72. IRC §§1411(c)(2) and 469.

> **Note.** The NIIT rules for estates are generally the same as those for trusts. For more information about the NIIT, see the 2014 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Affordable Care Act Update. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

Exempt Trusts

Treas. Reg. §1.1411-3(b)(1) specifically exempts the following trusts from the NIIT.

- Trusts established exclusively for religious, charitable, scientific, literary, or educational purposes or to prevent cruelty to children or animals
- Tax-exempt trusts under IRC §501 (includes trusts organized as civic leagues, social welfare organizations, chambers of commerce, and social or recreation clubs)
- Charitable remainder trusts (However, the beneficiaries of such trusts are subject to the NIIT rules.)
- Any other trusts, funds, or accounts that are statutorily tax exempt, such as Archer medical savings accounts, health savings accounts, §529 qualified tuition programs, and Coverdell education savings accounts
- Trusts (or portions of trusts) that are treated as **grantor trusts**
- Foreign trusts (However, the U.S. beneficiaries of such trusts are subject to the NIIT rules.)

Capital Gain Rates

The rules governing property transactions for individuals also apply to trusts. In the case of sales of capital assets, the fiduciary computes its net capital gain or loss under IRC §1222. Net short-term capital gains are taxed as ordinary income, whereas net long-term capital gains are taxed at 0%, 15%, or 20%. For the 2020 tax year, the 0% rate applies to amounts up to $2,650. The 15% rate applies to amounts over $2,650 and up to $13,150. The 20% rate applies to amounts above $13,150.[73]

A net capital loss can be used to offset up to $3,000 of other income and carried over until it is exhausted.[74] Capital losses normally are not passed through to a beneficiary. They are deductible only on the trust return, except upon termination when they are passed to the beneficiaries.[75]

> **Note.** Capital losses and net operating losses deductible upon termination are discussed in more detail later.

Estimated Taxes[76]

Trusts are responsible for paying estimated taxes using the same rules that apply to individuals, with some exceptions. A trust can avoid penalties if it pays the lesser of 90% of the current year's tax or 100% of the prior year's tax. (The trust must pay 110% if the prior year's AGI exceeded $150,000 and less than two-thirds of gross income for the current or prior year is from farming or fishing.) A trust created at death can pay estimated taxes using either the estate tax rules or the trust rules.

For a tax year ending less than two years after the decedent's death, no estimated tax payments are due for a trust that is treated as owned by the decedent if the trust receives the residue of the decedent's estate under the will.

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73. Rev. Proc. 2019-44, 2019-47 IRB 1093.
74. IRC §1211(b).
75. IRC §642(h).
76. IRC §6654.

Special IRC §643(g) Estimated Tax Election[77]

A unique rule enables a trust that makes unnecessary estimated tax payments during the year (e.g., the trust has no liability because it distributed all its income) to treat such payments as being made by its beneficiaries. The trustee may elect to treat **any portion** of an estimated tax payment made by the trust as paid by a beneficiary.

If the trustee makes this election, **a beneficiary is treated as having received a distribution on the last day of their tax year equal to the taxes deemed paid.** The distribution is treated as an estimated tax payment made by the beneficiary on January 15 of the following year.

This provision applies only if a timely election is filed.[78] The trustee makes the election using Form 1041-T, *Allocation of Estimated Tax Payments to Beneficiaries.* This form must be filed on or before the 65th day (March 6 for most trusts) after the close of the trust's tax year.

Some benefits of making the election are as follows.

1. The amount of income taxed to the trust at higher rates can be reduced.
2. The beneficiary may be able to avoid underpayment penalties.

Example 13. A complex trust made estimated tax payments of $300. After the close of the 2019 tax year, the trustee determined that the trust received $1,000 of dividend income and distributed $400. The trust's tax liability is only $50, calculated as follows.

	Payment Allocated All to Trust
Dividend income	$1,000
Distribution deduction	
Distributions during the year	(400)
§643(g) election amount	0
Exemption	(100)
Taxable income	$ 500
Actual tax at 10%	$ 50
Estimated tax payments	(300)
Overpayment	($ 250)

The trust elects to treat the $250 overpayment in taxes as a distribution to the beneficiary by filing Form 1041-T within 65 days after the close of the tax year. The trust's estimated tax payments are reduced to $50 ($300 estimated payments − $250 deemed distribution), and its tax liability is reduced to $25, as shown in the following table. The beneficiary treats the $250 deemed distribution as an estimated tax payment made on January 15, 2020.

77. IRC §643(g).

78. Instructions for Form 1041-T.

	Overpayment Allocated to Beneficiary
Dividend income	$1,000
Distribution deduction	
Distributions during the year	(400)
§643(g) election amount	(250)
Exemption	(100)
Taxable income	$ 250
Actual tax at 10%	$ 25
Estimated tax payments	(50)
Overpayment	($ 25)

Caution. This election cannot be used to allocate **federal tax withholding** to beneficiaries. Practitioners should check state rules for the states in which trust returns are being filed.

Alternative Minimum Tax[79]

The TCJA repealed the alternative minimum tax (AMT) for corporations and modified it for individual taxpayers. The AMT exemption amount for estates and trusts in 2020 is $25,400 and is adjusted annually for inflation. The phaseout of the exemption in 2020 begins at $84,800.[80]

Qualified Business Income Deduction[81]

If a trust operates a trade or business (e.g., reported on Schedule C, *Profit or Loss From Business,* Schedule E, *Supplemental Income and Loss,* or Schedule F, *Profit or Loss From Farming*), it may be eligible for a qualified business income deduction (QBID). QBID is calculated using the combined qualified business income (QBI) under IRC §199A(b)(2) plus 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership (PTP) income. The QBID amount is 20% of the QBI for each trade or business if the taxpayer's taxable income is under the threshold amount.[82] Taxable income of a nongrantor trust, for the purpose of determining whether the trust exceeds the threshold amount, is determined before the income distribution deduction (IDD) and exemption amount.[83] QBID for a trust may also include pass-through QBI from a partnership, S corporation, and other estates or trusts for which the trust is a beneficiary.

79. IRC §55(d).

80. Rev. Proc. 2019-44, 2019-47 IRB 1093.

81. *Tax Cuts and Jobs Act, Provision 11011 Section 199A — Qualified Business Income Deduction FAQs*. Jul.16, 2019. IRS. [www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs]. Accessed on Oct. 11, 2019.

82. IRC §199A(b)(2).

83. Prop. Treas. Reg. §1.199A-6(d)(3)(iii).

The threshold amount for nongrantor trusts in 2020 is $163,300.[84] If the taxpayer's income exceeds the threshold, the §199A(b)(2) amount is the lesser of the following.

1. 20% of the QBI for each trade or business, or
2. The greater of:
   a. 50% of the W-2 wages of the qualified trade or business, or
   b. The sum of 25% of the W-2 wages of the qualified trade or business, plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property.

The deductible amount is the combined QBI amount, limited to 20% of the excess of the taxpayer's taxable income for the tax year over the taxpayer's net capital gain (and qualified dividends) for that tax year.

A trust that distributes part of its income may need to allocate the QBID between the trust and the beneficiaries. This concept is illustrated in the comprehensive example at the end of this chapter.

Exemptions[85]

As mentioned earlier, trusts are allowed an exemption in calculating taxable income. The amount of the exemption for a trust depends on whether the trust is required to distribute all its income for the year.

- The exemption for a simple trust is $300. As mentioned earlier, a simple trust is one that is required to distribute all its income currently and is prevented by the trust instrument from making charitable contributions.
- If a trust that is required to distribute all its income annually is allowed to make charitable contributions, it is not a simple trust. Even so, it is still entitled to a $300 exemption.[86]
- A qualified disability trust (QDT) is entitled to an exemption[87] of $4,300 for 2020.[88]

Note. Qualified disability trusts are not covered in this chapter. More information about these trusts can be found in the instructions for Form 1041 and the 2010 *University of Illinois Federal Tax Workbook,* Chapter 7: Estate and Trust Taxation. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

- All other trusts are allowed an exemption of $100 per year. Most complex trusts are entitled to a $100 exemption.

Note. The exemption amounts for simple trusts and complex trusts are not subject to an annual inflation adjustment. The exemption for a QDT is the same amount as the personal exemption for the tax year (which is subject to an annual inflation adjustment).[89] The QDT exemption amount is phased out when the QDT's modified AGI exceeds a certain level. For the definition of a QDT and details of the exemption phaseout, see the Form 1041 instructions.

84. See IRC §§199A(b)(3) and (e)(2). Nongrantor trusts are subject to the same threshold amount as single and head of household taxpayers. Per Rev. Proc. 2019-44, 2019-47 IRB 1093, the threshold amount for single and head of household taxpayers is $163,300.

85. Instructions for 2020 Form 1041-ES.

86. Treas. Reg. §1.642(b)-1(b).

87. IRC §642(b)(2)(C)(iii)(I) and (II). During the TCJA period, the personal exemption is suspended. IRC §642(b)(2)(C)(iii) clarifies that the personal exemption for a qualifying disability trust is $4,150 and adjusted for inflation in years after 2018 through the suspended period.

88. Rev. Proc. 2019-44, 2019-47 IRB 1093.

89. See IRC §642(b)(2)(C)(i).

Tax-Exempt Income and Expenses

Trusts cannot deduct expenses related to tax-exempt income.[90] If a trust has both taxable and tax-exempt income, expenses that are **directly** related to the production of tax-exempt income are not deductible. **Indirect** expenses that are related to both taxable and tax-exempt income must be allocated.[91] Common examples of **indirect** expenses include the following.[92]

- Trustee commissions
- Rental of safe deposit boxes
- State income and personal property taxes

The allocation of expenses should be calculated using a reasonable method based on the facts and circumstances of each case. One permissible method allocates expenses using the ratio of tax-exempt income to total income.[93]

$$\textbf{\% Expenses not deductible against taxable income} = \frac{\textbf{Tax-exempt income}}{\textbf{Total income}}$$

Example 14. In 2019, the Swanson Family Trust earned \$25,000 of interest on municipal bonds, \$10,000 of interest on certificates of deposit, and \$15,000 of rental income. Thus, the trust's total income is \$50,000 (\$25,000 + \$10,000 + \$15,000). The interest earned on the municipal bonds is tax-exempt.

The trust incurred accounting fees of \$6,000. Using the preceding formula, 50% of the expenses are not deductible against taxable income (\$25,000 tax-exempt income ÷ \$50,000 total income). Therefore, \$3,000 (\$6,000 × 50%) of the accounting fees are allocated to tax-exempt income and are nondeductible.

GROSS INCOME AND DEDUCTIONS

Gross income is determined in the same manner as gross income of an individual. It typically includes the following components.[94]

- Dividends
- Interest
- Rents
- Royalties
- Income from partnerships, S corporations, and other trusts or estates
- Gains from the sale or exchange of property (capital gains)
- Income of a trade or business

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90. IRC §265(a)(1).
91. Treas. Reg. §1.652(b)-3.
92. Treas. Reg. §1.652(b)-3(c).
93. Rev. Rul. 63-27, 1963-1 CB 57.
94. IRC §61(a).

Deductions in General

Trusts may deduct the same expenses that individuals may deduct. These generally include the following.

- Ordinary and necessary expenses paid or incurred in a trade or business[95]
- Expenses incurred in connection with the production or collection of income, as well as the management, conservation, or maintenance of property[96]
- Expenses in connection with the determination, collection, or refund of any tax[97]

Like the deductions for individuals, these deductions for trusts may be limited (e.g., reduced to the extent they are allocable to tax-exempt income).

Charitable Contributions[98]

A charitable contribution deduction is available to a trust only if the underlying trust instrument requires the fiduciary to give part of the trust's gross **income** to a charity. A clause in a will bequeathing an amount to a charity does not create a charitable contribution deduction for income tax purposes.

> **Observation.** Distributions to a charitable beneficiary are not considered part of the distribution deduction. Instead, distributions to a charitable beneficiary are accounted for as charitable contributions. Charitable contributions are reported on Form 1041, Schedule A, line 1.

For a contribution to qualify as a deduction, it must be made pursuant to the trust instrument. **Deductions are not allowed for discretionary contributions made by the trustee.**

Qualified Donee.[99] The recipient of a contribution must be a qualified charitable organization. Qualified organizations are essentially the same group of eligible recipients that exists for individual and corporate contributions, except organizations that otherwise qualify need not be created or organized in the United States.

Source of Charitable Contribution. A deduction is allowed only for contributions of gross taxable income.[100] Charitable contributions from tax-exempt income are not deductible. For this purpose, a contribution is deemed to consist of a proportion of each type of income the trust receives, including tax-exempt income.[101] Thus, if a trust's income is 60% tax-exempt, then 60% of any charitable contribution is not deductible.

> **Observation.** It may be possible to circumvent the limitation. For example, if the trust instrument is drafted in such a way that contributions can only be made from taxable income (if any), the contribution arguably will not consist of any tax-exempt income and will be fully deductible. Moreover, there is economic substance to this approach because the charity will not receive a distribution unless the trust has taxable income.
>
> Similarly, the trust instrument may contain a provision that specifies that tax-exempt income is distributed to taxable beneficiaries and that all payments to charities be made from taxable gross income. Alternatively, the instrument might provide that any distributions to a charity are first paid out of available taxable income and any distributions to private beneficiaries are first paid out of available tax-exempt income. The question is whether the regulations require the contribution to have substantial economic effect, much like the rules imposed on partnership allocations in IRC §704(b). (That is, the allocation will only be recognized if the provision has significant nontax consequences.)

95. IRC §162.
96. IRC §212.
97. Ibid.
98. IRC §642(c)(1).
99. IRC §642(c)(1), referencing IRC §170(c)(2)(A).
100. IRC §642(c)(1).
101. Treas. Reg. §1.643(a)-5(b).

Set Asides for Future Charitable Contributions. No deduction is allowed for contributions of trust corpus — only for contributions of income. For many years, trusts were able to claim a deduction for income that was permanently **set aside for future payment** to charitable organizations (even though it was not currently paid). To curb potential abuses associated with this practice, such set-aside deductions are not permitted for trusts created after October 9, 1969.[102]

Throwback Election.[103] If a contribution is paid after the close of the tax year but before the close of the next tax year, the trustee may elect to deduct the payment in the preceding year. This rule enables a trust to determine the amount of income for the year that may be available for contributions, to make the contribution in the following year, and to get a deduction for the previous year. The election is irrevocable and must be made by the extended due date of the tax return for the succeeding year. Information that should be included in the election is specified in Treas. Reg. §1.642(c)-1(b)(3).

Charitable Contributions of Remainder Interests.[104] Contributions of remainder interests or income interests to a charitable organization must meet special rules to qualify for deduction. Problems exist (an explanation of such problems is beyond the scope of this material) if a trust realizes income that would be considered **unrelated business taxable income** to the charity if the charity had received it directly and such income is distributed to the charity. Generally, such income is taxable to the charity, and the trust is required to reduce its charitable contribution accordingly. In such cases, a Schedule K-1 is issued to the charity.

Itemized Deductions

The **standard deduction** available to individual taxpayers is **not available to trusts.** Trusts must itemize all deductions.

Miscellaneous Itemized Deductions. Prior to the enactment of the TCJA, individual taxpayers could deduct miscellaneous itemized deductions subject to a threshold of 2% of their AGI under IRC §67. Trusts and estates also typically followed these provisions.

IRS Notice 2018-61[105] clarifies that an estate or trust may continue to deduct expenses incurred in the administration of an estate or trust, which are expenses that would not have been incurred if the estate or trust had not been established. Even prior to the TCJA, investment advisory fees were argued to be specific to an estate or trust even though these types of fees could be incurred regardless of whether an estate or trust holds a brokerage account or whether an individual holds the brokerage account. Under the TCJA, estates and trusts can **no longer** deduct investment advisory fees.[106] However, trustee fees, attorney fees, accounting fees, and some other administration expenses such as appraisal fees incurred by an estate or nongrantor trust are still deductible.

Under IRC §67(e), deductions **are not considered** miscellaneous itemized deductions if they are:

- Incurred in the administration of the trust, and
- Would **not** have been incurred if the property were **not** held in the trust.[107]

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102. IRC §§642(c)(2) and (3).
103. IRC §642(c)(1); Treas. Reg. §1.642(c)-1(b)(2) and (3).
104. See IRC §664.
105. IRS Notice 2018-61, 2018-31 IRB 278.
106. See Treas. Reg. §1.67-4.
107. IRC §67(e) extends the exemption from the limitation by making the expenses deductible in arriving at AGI.

The expense must be unique to the trust. For example, trustee fees are not considered miscellaneous itemized deductions and are not subject to the 2% limitation because they meet both of the previous tests. Expenses that are **not** subject to the 2% limitation and **are** deductible in arriving at AGI include the following.

1. Trustee fees
2. Tax preparation fees[108]
3. Charitable contributions
4. Deductions for income distributions
5. Certain other expenses under §67(b)

Determination of Limitation Amount. Even though miscellaneous itemized deductions are not allowed during the TCJA years, understanding the calculations for miscellaneous itemized deduction limitations is important and can be quite complicated. Because the AGI of the trust depends on the amount of the distribution deduction and the distribution deduction in turn depends on taxable income after taking miscellaneous itemized deductions into account, calculating allowable miscellaneous itemized deduction may require using simultaneous algebraic equations. The instructions for Form 1041 explain how to make this calculation.

Excess Deductions

A trust that operates a trade or business or that has an interest in a partnership or S corporation that experiences losses may have a net operating loss (NOL). Trusts are entitled to an NOL deduction.[109] An NOL results when the deductions exceed gross income with certain modifications.[110] Deductions are not allowed for distributions to beneficiaries, charitable contributions, exemptions, and other items as provided in IRC §172.[111]

When calculating a trust NOL, certain modifications are made such that nonbusiness expenses (e.g., trustee and attorney fees) are deductible only to the extent of nonbusiness income (e.g., interest and dividends). The excess of nonbusiness expenses over nonbusiness income — referred to as **excess deductions** — is generally lost. However, if the trust has deductions that exceed gross income in the last tax year of the trust (the year of termination), the excess flows through to the beneficiaries.[112] In determining the amount of excess deductions, the exemption deduction and the charitable contribution deduction are ignored.

The effect of the excess deductions provision is to allow those deductions that are not considered in calculating the NOL to pass through to the beneficiaries. However, it is important to note that **this rule only applies to deductions incurred in the year of termination.[113]**

Year of Termination. Upon termination of a trust, IRC §642(h) allows beneficiaries to receive some or all of the entity's capital loss and NOL carryovers, as well as any excess deductions.

The capital loss and NOL carryovers that were not used as of the termination year do not expire. Instead, they pass through to the beneficiaries even if they did not arise in the year of termination.[114] Any capital loss carryovers that flow through to individual beneficiaries may be used by those individuals until the carryovers are exhausted. Corporate beneficiaries may only use capital loss carryovers for five years.

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108. Treas. Reg. §1.67-4(b)(3).
109. IRC §§642(d) and 172.
110. IRC §§172(c) and (d).
111. See IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts.*
112. IRC §642(h)(2).
113. For the importance of properly timing deductions, see *Westphal v. Comm'r,* 37 TC 340 (Nov. 28, 1961).
114. Treas. Reg. §1.642(h)-1(a).

NOLs may be carried forward indefinitely.[115] For NOLs passing out of the trust to beneficiaries, the final year of the trust and the first year of the beneficiary are counted as separate tax years. If the beneficiary dies before using the NOL or capital loss carryovers, the carryovers are lost.

A beneficiary may report their share of excess deductions as a miscellaneous itemized deduction. Consequently, the beneficiary must itemize in order to obtain a benefit from the pass-through deduction.

Note. As described earlier, because miscellaneous itemized deductions are suspended during the TCJA period, taxpayers receive no benefit for these excess deductions, even if they are able to itemize deductions. In addition, the beneficiary can only claim the deductions in the year in which the trust year ends. If the sum of the excess deductions and the beneficiary's other deductions exceed the beneficiary's income, **the excess deductions do not create an NOL** and therefore cannot be carried backward or forward.[116]

Example 15. In 2019, the Grand Trust terminated. For its final year, the trust had nonbusiness income of $50,000 and legal fees of $100,000. The excess deductions of $50,000 ($50,000 – $100,000) pass through to the beneficiary, Matt, who unfortunately cannot claim the $50,000 as a miscellaneous itemized deduction because such deductions are not allowed during the TCJA period.

Nonbusiness expenses, such as legal fees, are not deductible in computing an NOL. As a result, the trustee should ensure that excess deductions occur only in the year of termination. For example, a cash-basis trust could postpone paying legal fees until the final year.

Observation. Careful timing of income and expenses may allow deductions to offset trust income and may avoid excess deductions on termination, which, as explained above, may not benefit beneficiaries during the TCJA period.

Example 16. The Haven Trust operates a sole proprietorship. In 2019, the trust terminated and all the trust assets were distributed to the beneficiary, Jerry. For the year of termination, the trust reported the following.

Business income	$ 3,000
Nonbusiness income	2,500
Total income	$ 5,500
Business expenses	$ 5,000
Trustee and attorney fees	9,800
Total expenses	$14,800

The trust's NOL and excess deductions are calculated as follows.

Business income	$3,000
Business expenses	(5,000)
NOL	($2,000)
Nonbusiness income	$2,500
Trustee and attorney fees	(9,800)
Excess deductions	($7,300)

Because this is the year of termination, the NOL and the excess deductions pass to Jerry as the beneficiary of the property. Jerry is entitled to an NOL deduction of $2,000. He would have been entitled to a miscellaneous itemized deduction for the excess deductions of $7,300 if the TCJA had not been enacted.

If this were not the year of termination, the trust would carry the NOL forward to be used in future years. The excess deductions would be lost.

115. IRC §172.

116. Treas. Reg. §1.642(h)-2(a).

Excess Business Loss Limitation[117]

Noncorporate taxpayers (including trusts) may be subject to excess business loss (EBL) limitations. An EBL is the amount by which the total deductions from all trades or businesses of a taxpayer exceed total gross income and gains attributable to those trades or businesses plus $250,000 (indexed for years after December 31, 2018) for single taxpayers, estates, and trusts. A trade or business can include, but is not limited to the following.

- Schedule F and Schedule C activities
- The activity of being an employee
- An activity reported on Form 4835, *Farm Rental Income and Expenses*
- Other business activities reported on Schedule E
- Business gains and losses reported on Form 4797, *Sales of Business Property,* and Form 8949, *Sales and Other Dispositions of Capital Assets*

EBLs also include pass-through income and losses attributable to a trade or business, including farming losses from casualty losses or losses because of disease or drought. EBLs that are disallowed are treated as NOLs, which are carried forward.[118]

> **Note.** Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act[119] enacted on March 27, 2020, for tax years 2018 through 2020, the EBL rules are repealed.[120] However, EBL rules **are in effect** for tax years beginning **after** December 31, 2020, and before January 1, 2026.
>
> Returns filed for tax years 2018 and 2019 that applied the EBL rules in effect before the enactment of the CARES Act should be amended.

DISTRIBUTIONS

A critical principle in fiduciary taxation is that all distributions (other than specific bequests) carry current trust income, or FAI, to the extent that the distribution does not exceed FAI. Distributions in excess of current trust income ordinarily are treated first as distributions of previously taxed income (i.e., accumulated income) and then as distributions of the trust property (corpus).

Normally, these excess distributions are nontaxable to the beneficiary. Distributions of the trust corpus are tax-free because the beneficiary is simply receiving the gifted or inherited property that would have been nontaxable if the property had been received directly. Distributions of the previously taxed income are tax-free because the income has already been subject to tax at the trust level.

Three basic principles underlie the statutory framework of IRC §§651 and 661.

1. Total taxable income of the trust must be identified, and it is taxed only once.
2. The total taxable income is taxed to either the trust or beneficiary, but not to both.
3. The sum of the taxable income of the trust and the taxable income of the beneficiary must equal the total taxable income (before consideration of exemptions for each taxpayer). In short, whatever amount is deductible by the trust for distributions is taxable income to the beneficiary. (The amount of the deduction should be the same as the total taxable income reported to the beneficiary on the Schedule K-1.)

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117. IRC §461(l).
118. *Excess Business Losses*. Nov. 6, 2019. IRS. [irs.gov/newsroom/excess-business-losses] Accessed on Aug. 10, 2020.
119. PL 116-136.
120. PL 116-136 §2304(a)(1)(A) and (B), amending IRC §461(l)(1).

Requirements to Distribute Income[121]

The determination of whether trust income must be distributed currently depends on the terms of the trust instrument and the applicable state law. As discussed previously, a simple trust must distribute current income. If the trust instrument provides that, when determining distributable income, a reasonable amount of the current income must be retained for depreciation or other purposes, then this does not disqualify a trust from being considered a simple trust.

A complex trust may also be required to distribute income if that requirement is part of the trust instrument. However, it is not necessary that the trust instrument specify the amount to be distributed. The exact amount can be left up to the fiduciary's discretion to allocate among classes of beneficiaries or named beneficiaries.

Distributable Net Income

The rules that govern calculation of the distribution deduction contained in §§651 and 661 presume that all distributions made by the fiduciary entity first represent both current taxable and nontaxable net income that can be distributed. Distributions are deemed to first consist of current taxable and nontaxable income, rather than accumulated income, receipts allocated to corpus, or corpus itself. The amount of current taxable and nontaxable income that the trust can distribute is the **distributable net income (DNI).**

Every distribution of DNI represents a pro-rata share of taxable and nontaxable income that is distributable. The trust deducts the amount of taxable income included in the DNI that is distributed, and the beneficiaries report the same amount as taxable income.

Example 17. In 2019, the Abby Trust reported $80,000 of dividend income and $20,000 of tax-exempt interest. It distributed $40,000. How much of the distribution is deductible by the trust, and how much is taxable to the beneficiary?

Amounts distributed are considered DNI. The trust receives a deduction for the taxable DNI it distributes, and the beneficiaries are taxed on the taxable DNI they receive. The trust's DNI is the net taxable and tax-exempt income that is distributable. The total DNI is $100,000, 80% of which is taxable ($80,000 ÷ $100,000) and 20% is tax exempt ($20,000 ÷ $100,000).

The $40,000 distributed is assumed to be DNI (not corpus), and 80% of that is **taxable** DNI. Of the $40,000 distributed, the trust can deduct the taxable portion of $32,000 (80% × $40,000). The balance of $8,000 (20% × $40,000) is tax exempt.

The beneficiary has $32,000 of taxable income and $8,000 of tax-exempt income. Therefore, the trust's deduction of $32,000 (the amount of its taxable income it is allocating to the beneficiary) is equal to the amount of taxable income received by the beneficiary, which is reported on Schedule K-1.

DNI is calculated on page 2 of Form 1041, Schedule B. The calculation is represented by the following formula.

	Adjusted total income (taxable income before distribution deduction and exemption) (line 17 of Form 1041)
+	Net capital losses
−	Capital gains and other income allocable to corpus and not available for distributions
+	Tax-exempt income net of allocated expenses and available for distribution
	Distributable net income

Deduction for Distributions. After the amount of taxable income is determined, it must be allocated between the trust and the beneficiaries. Determining the amount of income taxable to each depends on the amount of annual distributions from the fiduciary.

121. Treas. Reg. §1.651(a)-2.

Capital Gains.[122] Capital gains are ordinarily excluded from DNI and are not considered paid, credited, or required to be distributed to any beneficiary. However, capital gains are included in DNI to the extent they are allocated to one of the following.

1. Income, but if income under the applicable state statute is defined as, or consists of, a unitrust amount, a discretionary power to allocate capital gains to income must be exercised consistently (The amount so allocated may not be greater than the excess of the unitrust amount over the amount of DNI.)
2. Corpus, but **consistently** treated by the fiduciary on the trust's books, records, and tax returns as part of the distribution to a beneficiary
3. Corpus, but actually distributed to a beneficiary or used by the fiduciary in determining the amount distributed or required to be distributed to a beneficiary

Under option 3, capital gains can be included in DNI when the fiduciary uses the capital gains to determine the amount of the distribution. A trustee who intends to include capital gains in the distribution to beneficiaries **should document the decision** prior to making the distribution.

Example 18. The Rally Trust's assets include Blackacre and other property. The trust instrument states that Bessie, the trustee, must hold Blackacre for 10 years. She must then sell it and distribute all the sales proceeds to Wilbur, the beneficiary. Because Bessie uses the sales proceeds (including any realized capital gains) to determine how much is distributed to Wilbur, any capital gain realized from the sale of Blackacre is included in Rally Trust's DNI for the tax year.

Note. Treas. Reg. §1.643(a)-3 contains several examples that illustrate the rules pertaining to the inclusion of capital gains in DNI.

Including capital gains in DNI under any of the three alternatives must be done either:

1. In accordance with the terms of the trust instrument and applicable local law, or
2. In accordance with a reasonable and impartial exercise of discretion by the fiduciary.

Capital gains that are paid, permanently set aside, or used for charitable contributions must also be included in the calculation of DNI.

Practitioner Planning Tip

A practitioner may be tempted to recommend that capital gains or losses be treated as part of the income distribution. However, the treatment of capital gains must be determined by the trust document. Preparers may think that it is preferable to treat a distribution as including capital gains/ losses due to an added incentive to distribute the capital gains to beneficiaries. This is because the 20% capital gains rate applies to 2020 trust income exceeding $12,500. In contrast, the 2020 threshold is $441,450 for single taxpayers, $469,050 for heads of household, $248,300 for married filing separately taxpayers, and $496,600 for married filing jointly taxpayers.[123]

122. Treas. Reg. §1.643(a)-3.

FILING REQUIREMENTS[124]

The fiduciary (or one of the joint fiduciaries) **must** file Form 1041 for a domestic trust taxable under IRC §641 that meets any of the following conditions.

1. Any taxable income for the tax year
2. Gross income of $600 or more (regardless of taxable income)
3. A beneficiary who is a nonresident alien

A trust is a **domestic trust** if both of the following apply.

- A U.S. court is able to exercise primary supervision over the administration of the trust (court test).
- One or more U.S. persons have the authority to control all substantial decisions of the trust (control test).

> **Note.** See Treas. Reg. §301.7701-7 for more information on the court and control tests.

A trust (other than a trust treated as wholly owned by the grantor) with all the following attributes is also treated as a domestic trust.

- Existed on August 20, 1996
- Treated as a domestic trust on August 19, 1996
- Elected to continue to be treated as a domestic trust

If a domestic trust becomes a foreign trust, it is treated under IRC §684 as transferring all its assets to a foreign trust. This rule applies except to the extent that a grantor or another person is treated as the owner of the trust when it becomes a foreign trust.

A trust that is not a domestic trust is treated as a **foreign trust.** The trustee of a foreign trust must file Form 1040NR, *U.S. Nonresident Alien Income Tax Return,* instead of Form 1041. In addition, a foreign trust with a U.S. owner generally must file Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner.*

123. Rev. Proc. 2019-44, 2019-47 IRB 1093.

124. Instructions for Form 1041.

Tax Year

A trust is generally required to file its Form 1041 using a calendar yearend.[125] However, an election can be made under IRC §645 to treat a decedent's revocable trust as part of an estate. If the election is made, the trust adopts the estate's fiscal yearend. The election is made by filing Form 8855, *Election To Treat a Qualified Revocable Trust as Part of an Estate.*[126]

> **Note.** IRC §645 elections are explained in more detail later in this chapter.

> **Note.** Foreign trusts or trusts with beneficiaries that are non-U.S. persons may have other filing requirements and international tax compliance obligations in addition to the annual income tax filing obligations mentioned in this chapter. For further details, see the 2015 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: Foreign Asset Disclosure. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

Due Dates

A trust return is due by the 15th day of the fourth month after the close of the tax year (usually, April 15). An automatic **5½-month** extension can be obtained by completing Form 7004, *Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns.*[127] If the trust is terminated (e.g., all assets are distributed), the tax year ends at the end of the month of final distribution and the return is due by the 15th day of the fourth month following the close of this short tax year.

Interest charges apply to any balance due if the tax is not paid on time.[128] There are also two penalties for failing to file a trust return on time. One is a **failure-to-file** penalty of 5% per month or part of a month, up to a maximum of 25%. The other is a **failure-to-pay** penalty of 0.5% to 1% per month, up to a maximum of 25%. Both of these penalties are based on a percentage of the balance owed on the trust tax return. **If no balance is due, no penalties are assessed.**

TAXATION OF BENEFICIARIES

The amount of a trust's taxable income that is included in the gross income of the beneficiary is governed by §652 for simple trusts and §662 for complex trusts. Both provisions require the beneficiary to include only the taxable amount received in income. (As mentioned earlier, DNI also includes nontaxable income and nondeductible expenses.)

ALLOCATION OF DNI AMONG BENEFICIARIES

In certain situations, a trust distributes more than the **current** DNI. This might occur when the trust distributes income that was previously accumulated. If the amount distributed exceeds DNI for the year, the question arises as to which beneficiary receives the DNI and therefore the taxable income. If there is more than one beneficiary, the DNI is allocated to the beneficiaries based on the relative amounts of distributions that each receives.

> **Observation.** During the TCJA period when the miscellaneous itemized deductions are eliminated, the adjusted total income will increase. As a result, DNI increases. FAI will remain the same, because the allocation of expenses for FAI is not a tax concept but rather is controlled by the trust's governing document or under the rules of the UPIA or the RUPIA. The likely outcome is that FAI becomes the more common IDD limitation for distributions to beneficiaries, which may result in trusts and estates paying more income tax at the trust level than before the TCJA was enacted.

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125. IRC §644.

126. Instructions for Form 1041.

127. Ibid.

128. Ibid.

Example 19. A simple trust has ordinary dividends of $125,000, local property taxes of $18,000, and an exemption amount of $300. Under the trust document, local property taxes are allocated entirely to income. Under the TCJA, the deduction of state taxes for DNI is limited to $10,000. FAI is now less than DNI, resulting under §651(b) in FAI serving as the allowable IDD. Income is now taxed at the trust level, rather than passing to the beneficiaries, as it would have prior to the TCJA.

	Tax Year 2017 (pre-TCJA)	Tax Year 2018 (after enactment of TCJA)
FAI	$125,000 dividends − $18,000 property taxes = $107,000	$125,000 dividends − $18,000 property taxes = $107,000
Total income	$125,000 − $18,000 = $107,000	$125,000 − **$10,000 property tax limit** = $115,000
DNI	$107,000	**$115,000**
IDD (limited to FAI)	$107,000	**$107,000**
Trust's taxable income	$107,000 DNI − $107,000 IDD − $300 exemption = **($300)**	$115,000 DNI − $107,000 − $300 = **$7,700**

Example 20. A trust has dividend income of $50,000 and $10,000 of trustee commissions allocable to corpus. FAI is $50,000, and DNI is $40,000 ($50,000 – $10,000).

During the year, the trust made distributions of $30,000 to Adam and $20,000 to Bettie. Because the DNI of $40,000 does not cover all the distributions, it must be allocated between the beneficiaries based on the amount of FAI received by each. As a result, Adam is deemed to receive DNI of $24,000 (($30,000 Adam's distribution ÷ $50,000 total distributions) × $40,000 DNI), and Bettie is deemed to receive DNI of $16,000 (($20,000 Bettie's distribution ÷ $50,000 total distributions) × $40,000 DNI).

The amounts that Adam and Bettie received in excess of DNI represent either corpus or accumulated income. These amounts are normally nontaxable.

TIER SYSTEM FOR DNI ALLOCATION[129]

The rights of some beneficiaries to income may take precedence over the rights of others. (Some are required to receive distributions, while others receive only discretionary distributions.) To accommodate this, the distribution rules provide priorities for allocating DNI and therefore the amounts of taxable and nontaxable income allocable to the beneficiaries.

The Code establishes a **two-tiered DNI allocation system.** DNI (calculated without regard to the charitable contribution deduction) is first allocated to the beneficiaries who are **required** to receive distributions currently — the **first-tier beneficiaries.** DNI is allocated based on each beneficiary's pro-rata share of the first-tier distributions.

After DNI is allocated to the first-tier beneficiaries, any remaining DNI is allocated to charitable contributions.

After reducing DNI by the first-tier distributions and charitable contributions, any remaining DNI is allocated to the **second-tier beneficiaries** (those who receive discretionary distributions). The allocation is based on each beneficiary's pro-rata share of the second-tier distributions.

129. IRC §662.

Example 21. A trust has DNI of $60,000. It did not make any charitable contributions. During the year, the trust made required distributions of $30,000 to Alex and $10,000 to Brittany. In addition, the trustee made discretionary distributions of $40,000 to Alex and $20,000 to Brittany.

DNI is allocated as follows.

		Alex		Brittany		Total
Required distributions			$30,000		$10,000	$ 40,000
Discretionary distributions			40,000		20,000	60,000
Total distributions			$70,000		$30,000	$100,000
DNI before contributions	$60,000					
First tier	(40,000)	$30,000		$10,000		
DNI available for charity	$20,000					
Charitable distributions	0					
DNI for second tier	$20,000	13,333 [a]		6,667 [b]		
DNI received (taxable income)		$43,333	(43,333)	$16,667	(16,667)	
Nontaxable distribution of corpus			$26,667		$13,333	

[a] $\$20{,}000 \text{ second-tier DNI} \times \dfrac{\$40{,}000 \text{ Alex's second-tier distribution}}{\$60{,}000 \text{ total second-tier distributions}} = \$13{,}333$

[b] $\$20{,}000 \text{ second-tier DNI} \times \dfrac{\$20{,}000 \text{ Brittany's second-tier distribution}}{\$60{,}000 \text{ total second-tier distributions}} = \$6{,}667$

CHARITABLE CONTRIBUTIONS

The treatment of a contribution/distribution to a charitable organization is confusing. On one hand, a contribution is treated as an expense. On the other hand, the charity is sometimes treated like a beneficiary in that it absorbs taxable and nontaxable DNI just like any beneficiary**.**

The charity is **not** considered a beneficiary when computing the deduction for distributions to beneficiaries. Charitable deductions are generally not allowed as deductions from DNI or first-tier beneficiaries.[130] The limitation does not apply to second-tier beneficiaries.[131]

DISCRETIONARY DISTRIBUTIONS: 65-DAY RULE

A complex trust can elect under IRC §663(b) to treat any distribution to a beneficiary made during the first 65 days of a tax year as an amount paid or credited on the last day of the previous tax year. The election is irrevocable for the tax year and is effective only for the year of the election.[132]

The maximum amount of these so-called "throwback distributions" is limited to the prior year's trust income (or DNI if larger) reduced by distributions. This amount is determined using the following formula.[133]

	Larger of the throwback year's trust income or DNI
−	Amounts paid in the throwback year (except that which was thrown back)
	Maximum amount that can be thrown back

130. IRC §661(a)(1).

131. IRC §661(a)(2).

132. Treas. Reg. §§1.663(b)-1 and 1.663(b)-2.

133. Ibid.

Example 22. Karly receives distributions from a trust at the discretion of the trustee, Caleb. Shortly after the beginning of 2020, Caleb determined that the trust had income of $10,000 and DNI of $8,000 for 2019. A review of the distributions made in 2019 revealed that $5,500 was distributed on January 15, 2019, which Caleb elected to treat as distributed in 2018. An additional $6,000 was distributed on August 12, 2019. The maximum amount of 2020 distributions that Caleb can treat as having been distributed in 2019 is calculated as follows.

Throwback year 2019: larger of trust income ($10,000) or DNI ($8,000)	$10,000
Amounts paid in throwback year 2019 (except that which was thrown back to 2018)	(6,000)
Maximum amount that can be thrown back from 2020 to 2019 and deducted in 2019	$ 4,000

The trust can distribute an additional $4,000 within the first 65 days of 2020 and deduct that amount for 2019. If the trust distributes $4,000 during 2020 and makes the election, Karly must appropriately account for the $4,000 on her 2019 tax return.

The 65-day rule only applies to complex trusts and estates. The rule does not apply to simple trusts because all income of simple trusts is deemed to be distributed, regardless of whether it actually is.

The §663(b) election must be made by the extended due date of the trust return.[134] The election is made by checking the box on Form 1041, Schedule G, line 6, under "Other Information."

Form 1041 (2019) Page **3**

	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 2019, 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 the 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		
10	Was the trust a specified domestic entity required to file Form 8938 for the tax year (see the Instructions for Form 8938)?		
11a	Did the estate or trust distribute S corporation stock for which it made a section 965(i) election?		
b	If "Yes," did each beneficiary enter into an agreement to be liable for the net tax liability? See instructions		
12	Did the estate or trust make a section 965(i) election for S corporation stock held on the last day of the tax year? See instructions		
13	**ESBTs only.** Does the ESBT have a nonresident alien grantor? If "Yes," see instructions		
14	**ESBTs only.** Did the S portion of the trust claim a qualified business income deduction? If "Yes," see instructions		

Form **1041** (2019)

The §663(b) election need not be made for all distributions made during the 65-day period — only for whatever amount the trust specifies (subject to the preceding limitations).

[134] Treas. Reg. §1.663(b)-2.

SPECIFIC GIFTS AND BEQUESTS

A trustee may list specific gifts and bequests within a trust instrument. The trust instrument may list an organization or person as a beneficiary of a specific piece of property, dollar amount, or percentage of the trust balance.

GAIN AND LOSS

A trust does not recognize gain or loss when specific property is distributed via gift or bequest. A property distribution is treated as a gift or bequest of specific property if it is distributed all at once or in **no more than** three installments.[135]

However, gain or loss is realized by the trust when there is a distribution of property **in kind** if the distribution satisfies a right to receive:[136]

- A specific dollar amount distribution,
- Specific property other than that distributed, or
- Income if the income is required to be distributed currently.

The beneficiary acquires a basis equal to the trust's adjusted basis immediately before the transfer, adjusted for any gain or loss recognized by the trust.[137] The amount of the trust's distribution deduction and the amount includable in the beneficiary's gross income **is the lesser of the beneficiary's basis in the property or the FMV of the property.**[138] The amount of gain or loss is calculated as the difference between the amount of the bequest satisfied and the trust's basis in the distributed property.[139]

Election to Realize Gain or Loss

A gain or loss is realized by the trust on an in-kind distribution if the trustee elects under §643(e)(3) to recognize a gain or loss. The gain or loss is calculated as if the property were sold to the beneficiary at FMV.[140] The election applies to **all** distributions made by the trust during the tax year and may be revoked only with the consent of the IRS.[141]

IRC §645 ELECTION

Under §645, a qualified revocable trust can be treated and taxed for income tax purposes as part of an estate (not as a separate trust) if both the executor of the estate and the trustee elect this treatment. If the election is made, only one tax return has to be filed, and the trust income is reported using the estate's fiscal yearend.

The election must be made by the due date (including extensions) of Form 1041 for the first tax year of the estate (or the filing trust) and is irrevocable. This due date is generally the 15th day of the 4th month after the close of the first tax year of the estate.[142] The due date applies even if the combined related estate and electing trust do not have sufficient income to require filing a Form 1041.

The election is made by filing Form 8855. Line G of Form 1041 should be checked to indicate that the trust made a §645 election.

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135. IRC §663(a)(1).
136. Treas. Reg. §1.661(a)-2(f).
137. IRC §643(e)(1).
138. IRC §643(e)(2).
139. *W. R. Kenan, Jr. v. Comm'r,* 114 F.2d 217 (2nd Cir.1940); Rev. Rul. 66-207, 1966-2 CB 243.
140. IRC §643(e)(3)(A)(ii).
141. IRC §643(e)(3)(B).
142. Instructions for Form 8855.

Example 23. In 2000, Marcus Wellstone was concerned about his health and wanted to make sure his assets would be properly managed if he became incompetent. On the advice of his attorney, accountant, and family, he set up a revocable living trust that named his son and accountant as co-trustees. The trust instrument specifies that upon Marcus's death, the trust is to distribute half the trust assets to his son, Thomas, and the other half to his daughter, Sara.

Marcus passed away on January 4, 2019. After consulting with Marcus's attorney and accountant, Thomas, who is the executor, decided to elect under §645 to merge the estate and the grantor trust.

Following is a summary of the Forms 1099 received for 2019.

	Total	Trust Income	Estate Income
Trust dividends	$35,000	$35,000	
Interest	14,500	10,000	$4,500

The §645 election is made by filing Form 8855. The combined 2019 trust and estate income is reported on one Form 1041. These forms follow.

2020 Workbook

For Example 23

Form **1041** Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts
▶ Go to *www.irs.gov/Form1041* for instructions and the latest information.
2019 OMB No. 1545-0092

A Check all that apply:
- [x] 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 2019 or fiscal year beginning , 2019, and ending , 20

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

C Employer identification number 37-1234567

Name and title of fiduciary
Thomas Wellstone

D Date entity created 01/04/2019

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

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
Tampa, FL 33601

B Number of Schedules K-1 attached (see instructions) ▶ 2

F Check applicable boxes: [x] 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 ▶ [x] Trust TIN ▶ 37-7654321

Income	1	Interest income	1	14,500
	2a	Total ordinary dividends	2a	35,000
	b	Qualified dividends allocable to: (1) Beneficiaries ____ (2) Estate or trust ____		
	3	Business income or (loss). Attach Schedule C (Form 1040 or 1040-SR)	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 or 1040-SR)	5	
	6	Farm income or (loss). Attach Schedule F (Form 1040 or 1040-SR)	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	49,500
Deductions	10	Interest. Check if Form 4952 is attached ▶ [ ]	10	
	11	Taxes	11	
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions	12	
	13	Charitable deduction (from Schedule A, line 7)	13	
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14	
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a	
	b	Net operating loss deduction. See instructions	15b	
	16	Add lines 10 through 15b ▶	16	
	17	Adjusted total income or (loss). Subtract line 16 from line 9 — 17: 49,500		
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	49,500
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20	
	21	Exemption	21	600
	22	Add lines 18 through 21 ▶	22	50,100
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23	(600)
	24	**Total tax** (from Schedule G, Part I, line 9)	24	0
	25	2019 net 965 tax liability paid from Form 965-A, Part II, column (k), line 3	25	
	26	**Total payments** (from Schedule G, Part II, line 17)	26	
	27	Estimated tax penalty. See instructions	27	
	28	**Tax due.** If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed	28	
	29	**Overpayment.** If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid	29	
	30	Amount of line 29 to be: **a Credited to 2020** ▶ ; **b Refunded** ▶	30	

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.	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2019)

3

For Example 23

Form **8855**
(Rev. January 2009)
Department of the Treasury
Internal Revenue Service

Election To Treat a Qualified Revocable Trust as Part of an Estate

OMB No. 1545-1881

Part I **Estate (or Filing Trust) Information**

Name of estate (or the filing trust, if applicable (see instructions)) **Estate of Marcus Wellstone**	**Employer identification number** (see instructions) **37 1234567**
Name of executor (or the filing trustee, if applicable) **Thomas Wellstone**	Type of entity prior to the election: ☒ Domestic estate ☐ Foreign estate ☐ Domestic trust ☐ Foreign trust
Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address) **123 N Silver Street**	
City or town, state, and ZIP code (if a foreign address, see instructions) **Tampa, FL 33601**	Date of executor's appointment **01/04/2019**

Under penalties of perjury, I, as executor (or filing trustee):

- Confirm that under applicable local law or the governing document, I have the authority to make this election for the estate (if executor) or trust (if filing trustee) and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for the above-named estate (or filing trust, if applicable);
- Confirm that an agreement has been reached with the trustees of each qualified revocable trust (QRT) joining in the election to allocate the tax burden of the combined electing trusts and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that the related estate's (or filing trust's, if applicable) share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Agree to accept responsibility for filing a complete, accurate, and timely income tax return, when required by law, for the combined electing trust(s) and related estate, if any, for each tax year during the election period;
- (If I am the filing trustee) confirm that if there is more than one QRT making this election, that I have been appointed by the trustees of each QRT making this election to be the filing trustee and I agree to accept the responsibility of filing the appropriate income tax return for the combined electing trust(s) for each tax year during the election period and all other responsibilities of the filing trustee;
- (If I am the filing trustee) represent that no executor has been appointed for a related estate and to the best of my knowledge and belief, one will not be appointed;
- (If I am the filing trustee) agree that, if an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the late appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of executor (or filing trustee)	Date

Part II **Decedent Information**

Name of decedent	SSN of the decedent	Date of death
Marcus Wellstone	**555 44 3333**	**01/04/2019**

For Paperwork Reduction Act Notice, see page 4. Cat. No. 24542R Form **8855** (1-2009)

For Example 23

Form 8855 (1-2009) Page **2**

Part III **Qualified Revocable Trust Information**

Name of trust	Employer identification number (see instructions)
Wellstone Revocable Trust	**37 – 7654321**

Name of trustee
Thomas Wellstone

Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address)
123 N Silver Street

City or town, state, and ZIP code (if a foreign address, see instructions)
Tampa, FL 33601

Under penalties of perjury, I, as trustee of the above-named trust:

- Confirm that under applicable local law or the governing instrument, I have the authority to make this election for the trust and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for this trust;
- Agree to timely provide the executor (or filing trustee if there is no executor) with all the trust information necessary to permit the executor (or filing trustee, if applicable) to file a complete, accurate, and timely Form 1041 (or Form 1040-NR for a foreign estate) for the combined electing trust(s) and the related estate, if any, for each tax year during the election period;
- Confirm that an agreement has been reached with the trustees of each QRT joining in the election, and the executor of the related estate, if any, to allocate the tax burden of the combined electing trust(s) and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that this trust's share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Confirm that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855, the trustee that completed Part I has been appointed the filing trustee, and to the best of my knowledge and belief, an executor has not been appointed to administer a related estate and one will not be appointed;
- Agree that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855 and an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the later appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information of the electing trust contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of trustee	Date

Name of trust	Employer identification number (see instructions)

Name of trustee

Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address)

City or town, state, and ZIP code (if a foreign address, see instructions)

Under penalties of perjury, I, as trustee of the above-named trust:

- Confirm that under applicable local law or the governing instrument, I have the authority to make this election for the trust and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for this trust;
- Agree to timely provide the executor (or filing trustee if there is no executor) with all the trust information necessary to permit the executor (or filing trustee, if applicable) to file a complete, accurate, and timely Form 1041 (or Form 1040-NR for a foreign estate) for the combined electing trust(s) and the related estate, if any, for each tax year during the election period;
- Confirm that an agreement has been reached with the trustees of each QRT joining in the election, and the executor of the related estate, if any, to allocate the tax burden of the combined electing trust(s) and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that this trust's share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Confirm that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855, the trustee that completed Part I has been appointed the filing trustee, and to the best of my knowledge and belief, an executor has not been appointed to administer a related estate and one will not be appointed;
- Agree that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855 and an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the later appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information of the electing trust contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of trustee	Date

Form **8855** (1-2009)

Example 24. Use the same facts as **Example 1** and **Example 4.** Ida Know receives a call from Amanda DePanda, the sister of Grant Diego, who explains to Ida that Grant was killed in a tragic automobile accident on March 7, 2019. As Grant's most trusted advisor, Amanda assumes Ida would be knowledgable about what legal documents Grant may or may not have created after his spouse passed away. Ida responds that she thought Grant had made some legal arrangements but was not certain. Amanda states she has a whole box of papers to go through and requests Ida set some time aside to review the box. Ida agrees.

Having attended trust seminars in the past, Ida pulls out the following worksheet from her study materials to help her prepare for her meeting with Amanda.

Trust Tax Appointment Checklist:

____ Copy of trust document

____ Did the trust obtain a federal ID number? What is the number? ____________

____ Copy of the SS-4 assignment letter to get the proper naming of the trust (abbreviations, etc.)

____ Record of income and disbursements for the trust

____ Forms W-9 with names, addresses, and tax ID numbers for trustee(s) and beneficiaries and their respective shares:

____

____

____

____

____

____ All Forms 1099 for the tax year received by the trust or to be reported by the trust

Upon discovering the trust document and becoming familiar with the terms of Grant's trust (which Miranda, Grant's attorney, helped Ida to understand), it was determined that on March 7, 2019, Grant's trust established a nongrantor trust for his son, Benny. Because the trust is a nongrantor trust established for Benny, there is an annual tax filing requirement and therefore an FEIN must be obtained. The trust will continue in existence until Benny reaches age 35.

The trust specified that a reserve for depreciation of $5,000 must be maintained. In addition, both capital gains and 50% of the trustee's commissions must be allocated to the principal account. Tax depreciation for the year is the same as the reserve for depreciation.

In 2019, pursuant to the terms of the trust, the trust made a charitable contribution of $20,000 from income, and the trustee determined distributions of $85,000 were to be made to Benny. Given the following information, what is the trust's DNI?

Rental income	$100,000
Tax-exempt income	10,000
Dividends	15,000
Long-term capital gain	50,000
Rent expense	10,000
Reserve for depreciation and tax depreciation	5,000
Trustee commission	8,000

Taxable income **before** the distribution deduction is calculated as follows.

Rental income		$100,000
Dividends		15,000
Long-term capital gain		50,000
Gross income		$165,000
Less:		
Rent expense	$10,000	
Depreciation	5,000	
Trustee commission	7,360 [a]	
Charitable contribution	18,400 [b]	
Exemption deduction	100	
	$40,860	(40,860)
Taxable income before distributions		$124,140

[a] $8,000 − (($10,000 tax-exempt income ÷ $125,000 total income excluding capital gains) × $8,000)

[b] $20,000 − (($10,000 tax-exempt income ÷ $125,000 total income excluding capital gains) × $20,000)

DNI is calculated as follows.

Taxable income before distribution deduction		$124,140
Exemption		100
Adjusted total income		$124,240
Less: long-term capital gain		(50,000)
Plus: net tax-exempt income:		
Tax-exempt income	$10,000	
Allocable trustee commissions	(640) [a]	
Allocable charitable contribution	(1,600) [b]	
Net tax-exempt income	$ 7,760	7,760
DNI		$ 82,000

[a] (($10,000 tax-exempt income ÷ $125,000 total income excluding capital gains) × $8,000)

[b] (($10,000 tax-exempt income ÷ $125,000 total income excluding capital gains) × $20,000)

Under §661(a), the trust is allowed a deduction for the FAI distributed to the beneficiary, or $85,000. However, §661(c) limits the distribution deduction to the portion of taxable DNI deemed distributed, or $74,240, which is calculated as follows.

DNI		$82,000
Less: net tax-exempt interest		
Tax-exempt income	$10,000	
Allocable trustee commissions	(640)	
Allocable charitable contributions	(1,600)	
	$ 7,760	(7,760)
Deduction for distributions		$74,240

The trust is treated as having distributed all the DNI ($82,000) because it distributed $85,000. Because 100% of DNI is distributed, 100% of the trust's net tax-exempt income ($7,760) is also considered distributed. No deduction is allowed for the portion of the net tax-exempt income deemed distributed because it was not included in taxable income. As a result, the trust's deduction for distributions is calculated by subtracting the net tax-exempt income from total DNI.

The taxable income for the trust is $49,900, calculated as follows.

Taxable income before distribution deduction	$124,140
Deduction for distributions	(74,240)
Trust taxable income	$ 49,900

Observation. A charity that receives contributions from a trust is considered a beneficiary of a trust. However, it is not treated as a beneficiary for purposes of computing the deduction for distributions. The amounts distributed to the charity are accounted for as part of the charitable contribution deduction.

Completed forms for this example follow.

For Example 24

Tax Return Summary

For calendar year 2019, or tax year beginning , and ending

BENNY DIEGO TRUST 35-0123456

Income			
Interest			
Dividends	15,000		
Schedule C - business income / loss			
Schedule D - capital gains / losses	50,000		
Schedule E - rents / royalties / partnerships	85,000		
Schedule F - farm income / loss			
Form 4797 - ordinary income			
Other income			
Total income		150,000	
Deductions			
Interest (* includes investment interest)			
Charitable deduction	18,400		
Other deductions	7,360		
Income distribution deduction	74,240		
Estate tax deduction			
Qualified business income deduction			
Exemption	100		
Total deductions		100,100	
Taxable income			49,900
Taxes / Credits			
Tax on taxable income	8,935		
Alternative minimum tax			
Foreign tax credit			
Other credits			
Other taxes	1,900		
Total tax		10,835	
Payments			
Estimated tax payments			
Tax withheld			
Other payments			
Total payments			
Adjustments			
Estimated tax penalty			
Applied to next year's estimated tax			
Interest on late payments			
Failure to file penalty			
Failure to pay penalty			
Total adjustments			
Balance due			10,835
Refund			

Next Year's Estimates				**Miscellaneous Information**	
1st quarter		Qualified dividends to:		Amended return	
2nd quarter		Beneficiaries		Estimated payments allocated to beneficiaries	
3rd quarter		Estate or trust			
4th quarter		Accounting income	106,000	Number of beneficiaries	1
Total		Distributable net income	82,000	Number of Schedule(s) K-1	1
				Return due date	July 15, 2020

For Example 24

Form **1041** Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts 2019 OMB No. 1545-0092
▶ Go to *www.irs.gov/Form1041* for instructions and the latest information.

3

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 2019 or fiscal year beginning , 2019, and ending , 20

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

Name and title of fiduciary
Amanda DePanda, Trustee

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

City or town, state or province, country, and ZIP or foreign postal code
Indianapolis, IN 46201

C Employer identification number
35-0123456

D Date entity created
3/07/2019

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)

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

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	1	Interest income	1	
	2a	Total ordinary dividends . . . See Statement 1	2a	15,000
	b	Qualified dividends allocable to: **(1)** Beneficiaries ______ **(2)** Estate or trust ______		
	3	Business income or (loss). Attach Schedule C (Form 1040 or 1040-SR)	3	
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4	50,000
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040 or 1040-SR)	5	85,000
	6	Farm income or (loss). Attach Schedule F (Form 1040 or 1040-SR)	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	150,000
Deductions	10	Interest. Check if Form 4952 is attached ▶ ☐	10	
	11	Taxes	11	
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions . See Statement 2	12	7,360
	13	Charitable deduction (from Schedule A, line 7)	13	18,400
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14	
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a	
	b	Net operating loss deduction. See instructions	15b	
	16	Add lines 10 through 15b ▶	16	25,760
	17	Adjusted total income or (loss). Subtract line 16 from line 9 . . . 17 124,240		
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	74,240
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20	
	21	Exemption	21	100
	22	Add lines 18 through 21 ▶	22	74,340
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23	49,900
	24	**Total tax** (from Schedule G, Part I, line 9)	24	10,835
	25	2019 net 965 tax liability paid from Form 965-A, Part II, column (k), line 3	25	
	26	**Total payments** (from Schedule G, Part II, line 17)	26	
	27	Estimated tax penalty. See instructions	27	
	28	**Tax due.** If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed	28	10,835
	29	**Overpayment.** If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid	29	
	30	Amount of line 29 to be: **a Credited to 2020** ▶ ; **b Refunded** ▶	30	

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.	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2019)

For Example 24

Form 1041 (2019) Benny Diego Trust 35-0123456 Page 2

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	20,000
2	Tax-exempt income allocable to charitable contributions. See instructions	2	1,600
3	Subtract line 2 from line 1	3	18,400
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	18,400
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	18,400

Schedule B — Income Distribution Deduction

1	Adjusted total income. See instructions			1	124,240
2	Adjusted tax-exempt interest			2	7,760
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See instructions			3	0
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	0
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	(50,000)
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-			7	82,000
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8	106,000		
9	Income required to be distributed currently			9	
10	Other amounts paid, credited, or otherwise required to be distributed			10	85,000
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions			11	85,000
12	Enter the amount of tax-exempt income included on line 11			12	7,760
13	Tentative income distribution deduction. Subtract line 12 from line 11			13	77,240
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-			14	74,240
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18			15	74,240

Schedule G — Tax Computation and Payments (see instructions)

Part I — Tax Computation

1	**Tax:**				
a	Tax on taxable income. See instructions	1a	8,935		
b	Tax on lump-sum distributions. Attach Form 4972	1b			
c	Alternative minimum tax (from Schedule I (Form 1041), line 54)	1c	0		
d	**Total.** Add lines 1a through 1c ▶			1d	8,935
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	0
3	Subtract line 2e from line 1d. If zero or less, enter -0-			3	8,935
4	Tax on the ESBT portion of the trust (from ESBT Tax Worksheet, line 17). See instructions			4	
5	Net investment income tax from Form 8960, line 21			5	1,900
6	Recapture taxes. Check if from: ☐ Form 4255 ☐ Form 8611			6	
7	Household employment taxes. Attach Schedule H (Form 1040 or 1040-SR)			7	
8	Other taxes and amounts due			8	
9	**Total tax.** Add lines 3 through 8. Enter here and on page 1, line 24 ▶			9	10,835

Part II — Payments

10	2019 estimated tax payments and amount applied from 2018 return	10	
11	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	11	
12	Subtract line 11 from line 10	12	
13	Tax paid with Form 7004. See instructions	13	0
14	Federal income tax withheld. If any is from Form(s) 1099, check here ▶ ☐	14	
15	2019 net 965 tax liability from Form 965-A, Part I, column (f), line 3	15	
16	Other payments: **a** Form 2439 ____; **b** Form 4136 ____; **Total** ▶	16c	
17	**Total payments.** Add lines 12 through 15 and 16c. Enter here and on page 1, line 26 ▶	17	

Form **1041** (2019)

For Example 24

Form 1041 (2019) **Benny Diego Trust** **35-0123456** Page **3**

Other Information		Yes	No
1	Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses.	X	
	Enter the amount of tax-exempt interest income and exempt-interest dividends . . . ► $**10,000 Stmts 3, 4**		
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?		X
3	At any time during calendar year 2019, 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?		X
	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		X
5	Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see the instructions for the required attachment		X
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		X
10	Was the trust a specified domestic entity required to file Form 8938 for the tax year (see the Instructions for Form 8938)?		X
11a	Did the estate or trust distribute S corporation stock for which it made a section 965(i) election?		X
b	If "Yes," did each beneficiary enter into an agreement to be liable for the net tax liability? See instructions		
12	Did the estate or trust make a section 965(i) election for S corporation stock held on the last day of the tax year? See instructions		X
13	**ESBTs only.** Does the ESBT have a nonresident alien grantor? If "Yes," see instructions		
14	**ESBTs only.** Did the S portion of the trust claim a qualified business income deduction? If "Yes," see instructions		

Form **1041** (2019)

For Example 24

SCHEDULE D (Form 1041)
Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1041, Form 5227, or Form 990-T.
▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9 and 10.
▶ Go to *www.irs.gov/F1041* for instructions and the latest information.

OMB No. 1545-0092
2019

Name of estate or trust	Employer identification number
Benny Diego Trust	35-0123456

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? ☐ Yes ☒ No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Note: *Form 5227 filers need to complete **only** Parts I and II.*

Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b .				
1b Totals for all transactions reported on Form(s) 8949 with **Box A** checked				
2 Totals for all transactions reported on Form(s) 8949 with **Box B** checked				
3 Totals for all transactions reported on Form(s) 8949 with **Box C** checked				

4 Short-term capital gain or (loss) from Forms 4684, 6252, 6781, and 8824	4	
5 Net short-term gain or (loss) from partnerships, S corporations, and other estates or trusts . . .	5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 9 of the 2018 Capital Loss Carryover Worksheet	6	( )
7 **Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). Enter here and on line 17, column (3) on the back . . . . ▶	7	

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .				
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked				
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked				
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked.				

11 Long-term capital gain or (loss) from Forms 2439, 4684, 6252, 6781, and 8824	11	
12 Net long-term gain or (loss) from partnerships, S corporations, and other estates or trusts	12	
13 Capital gain distributions	13	50,000
14 Gain from Form 4797, Part I	14	
15 Long-term capital loss carryover. Enter the amount, if any, from line 14 of the 2018 Capital Loss Carryover Worksheet	15	( )
16 **Net long-term capital gain or (loss).** Combine lines 8a through 15 in column (h). Enter here and on line 18a, column (3) on the back . . . . ▶	16	50,000

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. Cat. No. 11376V **Schedule D (Form 1041) 2019**

For Example 24

Schedule D (Form 1041) 2019 **Benny Diego Trust** 35-0123456 Page **2**

Part III Summary of Parts I and II
Caution: *Read the instructions **before** completing this part.*

			(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		50,000	50,000
b	Unrecaptured section 1250 gain (see line 18 of the worksheet.)	18b			
c	28% rate gain	18c			
19	**Total net gain or (loss).** Combine lines 17 and 18a ▶	19		50,000	50,000

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:

a The loss on line 19, column (3) **or b** $3,000 . . . . 20 ( )

Note: *If the loss on line 19, column (3), is more than $3,000**, or** if Form 1041, page 1, line 23 (or Form 990-T, line 39), 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 23, 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 39, 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 23 (or Form 990-T, line 39)			21	49,900		
22	Enter the **smaller** of line 18a or 19 in column (2) but not less than zero	22	50,000				
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	50,000				
25	If the estate or trust is filing Form 4952, enter the amount from line 4g; otherwise, enter -0- ▶	25	0				
26	Subtract line 25 from line 24. If zero or less, enter -0-			26	50,000		
27	Subtract line 26 from line 21. If zero or less, enter -0-			27	0		
28	Enter the **smaller** of the amount on line 21 or $2,650			28	2,650		
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	2,650
31	Enter the **smaller** of line 21 or line 26			31	49,900		
32	Subtract line 30 from line 26			32	47,350		
33	Enter the **smaller** of line 21 or $12,950			33	12,950		
34	Add lines 27 and 30			34	2,650		
35	Subtract line 34 from line 33. If zero or less, enter -0-			35	10,300		
36	Enter the **smaller** of line 32 or line 35			36	10,300		
37	Multiply line 36 by 15% (0.15) ▶					37	1,545
38	Enter the amount from line 31			38	49,900		
39	Add lines 30 and 36			39	12,950		
40	Subtract line 39 from line 38. If zero or less, enter -0-			40	36,950		
41	Multiply line 40 by 20% (0.20) ▶					41	7,390
42	Figure the tax on the amount on line 27. Use the 2019 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	8,935		
44	Figure the tax on the amount on line 21. Use the 2019 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041)			44	16,821		
45	**Tax on all taxable income.** Enter the **smaller** of line 43 or line 44 here and on Form 1041, Schedule G, Part I, line 1a (or Form 990-T, line 41) ▶					45	8,935

Schedule D (Form 1041) 2019

3

For Example 24

SCHEDULE E (Form 1040 or 1040-SR)
Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041.
▶ Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. 13

Name(s) shown on return: Benny Diego Trust
Your social security number: 35-0123456

Part I Income or Loss From Rental Real Estate and Royalties **Note:** If you are in the business of renting personal property, use **Schedule C** (see instructions). If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2019 that would require you to file Form(s) 1099? (see instructions) . . . . . . ☐ Yes ☒ No
B If "Yes," did you or will you file required Forms 1099? . . . . . . ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	123 Main Street, Indianapolis, IN 46201
B	
C	

1b	Type of Property (from list below)		Fair Rental Days	Personal Use Days	QJV
A	1	A	365		☐
B		B			☐
C		C			☐

2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the **QJV** box only if you meet the requirements to file as a qualified joint venture. See instructions.

Type of Property:
1 Single Family Residence
2 Multi-Family Residence
3 Vacation/Short-Term Rental
4 Commercial
5 Land
6 Royalties
7 Self-Rental
8 Other (describe)

Income:	Properties:		A	B	C
3	Rents received	3	100,000		
4	Royalties received	4			
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions	8			
9	Insurance	9			
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12			
13	Other interest	13			
14	Repairs	14			
15	Supplies	15			
16	Taxes	16	10,000		
17	Utilities	17			
18	Depreciation expense or depletion	18	5,000		
19	Other (list) ▶	19			
20	Total expenses. Add lines 5 through 19	20	15,000		
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	85,000		
22	Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	( )	( )	( )

23a	Total of all amounts reported on line 3 for all rental properties	23a	100,000
b	Total of all amounts reported on line 4 for all royalty properties	23b	
c	Total of all amounts reported on line 12 for all properties	23c	
d	Total of all amounts reported on line 18 for all properties	23d	5,000
e	Total of all amounts reported on line 20 for all properties	23e	15,000
24	**Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	85,000
25	**Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	( )
26	**Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18. Otherwise, include this amount in the total on line 41 on page 2	26	85,000

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11344L **Schedule E (Form 1040 or 1040-SR) 2019**

For Example 24

Schedule E (Form 1040 or 1040-SR) 2019 Attachment Sequence No. 13 Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.
Benny Diego Trust

Your social security number
35-0123456

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II Income or Loss From Partnerships and S Corporations — Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column **(e)** on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(f)** on line 28 and attach **Form 6198** (see instructions).

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section . . . . ☐ **Yes** ☐ **No**

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A			☐		☐	☐
B			☐		☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A					
B					
C					
D					
29a Totals					
b Totals					

30	Add columns (h) and (k) of line 29a.	30	
31	Add columns (g), (i), and (j) of line 29b.	31	( )
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	

Part III Income or Loss From Estates and Trusts

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

38 (a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

Part V Summary

40	Net farm rental income or (loss) from **Form 4835.** Also, complete line 42 below	40	
41	**Total income or (loss).** Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18 ▶	41	85,000
42	**Reconciliation of farming and fishing income.** Enter your **gross** farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AC; and Schedule K-1 (Form 1041), box 14, code F (see instructions) .	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

Schedule E (Form 1040 or 1040-SR) 2019

For Example 24

Form **8960**

Department of the Treasury
Internal Revenue Service (99)

Net Investment Income Tax— Individuals, Estates, and Trusts

► Attach to your tax return.
► Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227
2019
Attachment Sequence No. 72

Name(s) shown on your tax return: Benny Diego Trust
Your social security number or EIN: 35-0123456

Part I Investment Income ☐ Section 6013(g) election (see instructions)
☐ Section 6013(h) election (see instructions)
☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	15,000
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (see instructions)	4a	85,000		
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	85,000
5a	Net gain or loss from disposition of property (see instructions)	5a	50,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	50,000
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	150,000

Part II Investment Expenses Allocable to Investment Income and Modifications

9a	Investment interest expenses (see instructions)	9a			
b	State, local, and foreign income tax (see instructions)	9b			
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	
10	Additional modifications (see instructions)			10	7,360
11	Total deductions and modifications. Add lines 9d and 10			11	7,360

Part III Tax Computation

12	Net investment income. Subtract Part II, line 11, from Part I, line 8. Individuals, complete lines 13–17. Estates and trusts, complete lines 18a–21. If zero or less, enter -0-			12	142,640
	Individuals:				
13	Modified adjusted gross income (see instructions)	13			
14	Threshold based on filing status (see instructions)	14			
15	Subtract line 14 from line 13. If zero or less, enter -0-	15			
16	Enter the smaller of line 12 or line 15			16	
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			17	
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a	142,640		
b	Deductions for distributions of net investment income and deductions under section 642(c) (see instructions)	18b	92,640		
c	Undistributed net investment income. Subtract line 18b from 18a (see instructions). If zero or less, enter -0-	18c	50,000		
19a	Adjusted gross income (see instructions)	19a	68,300		
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b	12,750		
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c	55,550		
20	Enter the smaller of line 18c or line 19c			20	50,000
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			21	1,900

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2019)

For Example 24

Form **8995**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction Simplified Computation

► Attach to your tax return.

► Go to *www.irs.gov/Form8995* for instructions and the latest information.

OMB No. 1545-0123

2019

Attachment Sequence No. 55

Name(s) shown on return: **Benny Diego Trust**

Your taxpayer identification number: **35-0123456**

1	(a) Trade, business, or aggregation name	(b) Taxpayer identification number	(c) Qualified business income or (loss)
i	Schedule E	35-0123456	85,000
ii			
iii			
iv			
v			

2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	85,000		
3	Qualified business net (loss) carryforward from the prior year	3	( )		
4	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0-	4	85,000		
5	Qualified business income component. Multiply line 4 by 20% (0.20)			5	17,000
6	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions)	6			
7	Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year	7	( )		
8	Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-	8			
9	REIT and PTP component. Multiply line 8 by 20% (0.20)			9	
10	Qualified business income deduction before the income limitation. Add lines 5 and 9			10	17,000
11	Taxable income before qualified business income deduction	11	50,000		
12	Net capital gain (see instructions)	12	50,000		
13	Subtract line 12 from line 11. If zero or less, enter -0-	13			
14	Income limitation. Multiply line 13 by 20% (0.20)			14	
15	Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return ►			15	
16	Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-			16	( )
17	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-			17	( )

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 37806C Form **8995** (2019)

For Example 24

2019	Federal Statements	Page 1
Client 03	Benny Diego Trust	35-0123456
7/08/20		03:41PM

Statement 1
Form 1041, Line 2a
Total Ordinary Dividends

....	$ 15,000.
Total	$ 15,000.

Statement 2
Form 1041, Line 12
Fiduciary Fees

Fees:	$ 8,000.
Less 8 % Allocated to Tax-exempt Income	-640.
Total	$ 7,360.

Statement 3
Form 1041, Other Information, Line 1
Tax Exempt Income

....	$ 10,000.
Total	$ 10,000.

Statement 4
Form 1041, Other Information, Line 1
Alloc. of Expenses to Tax-exempt Income

Tax-Exempt Interest	$ 10,000.
Total Tax-Exempt Income	$ 10,000.
Taxable Dividends	$ 15,000.
Gross Income from Rents & Royalties	100,000.
Tax-Exempt Income	10,000.
Total Gross Income	$ 125,000.

```
Tax-Exempt Income        10,000.
-------------------------------- x 100 =        8%
Total Gross Income      125,000.
```

Total Indirect Deductions - Allocable	$ 8,000.
Percentage Allocable to Tax-Exempt Income	8%
Amount Allocable to Tax-Exempt Income	$ 640.
Tax-Exempt Interest and Dividends	$ 10,000.
Less: Allocated Indirect Deductions	640.
Less: Allocated Charitable Deductions	1,600.
Net Tax-exempt Interest and Dividends	$ 7,760.

For Example 24

661117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) **2019**

Department of the Treasury
Internal Revenue Service

For calendar year 2019, or tax year

beginning / / 2019 ending / /

Beneficiary's Share of Income, Deductions, Credits, etc.

▶ See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

35-0123456

B Estate's or trust's name

Benny Diego Trust

C Fiduciary's name, address, city, state, and ZIP code

Amanda DePanda
955 Compton Street
Indianapolis, IN 46201

D ☐ Check if Form 1041-T was filed and enter the date it was filed

E ☐ Check if this is the final Form 1041 for the estate or trust

Part II Information About the Beneficiary

F Beneficiary's identifying number

333-45-6789

G Beneficiary's name, address, city, state, and ZIP code

Benny Diego
955 Compton Street
Indianapolis, IN 46201

Beneficiary 1

H ☒ Domestic beneficiary ☐ Foreign beneficiary

Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items

1	Interest income	
2a	Ordinary dividends	11,640
2b	Qualified dividends	
3	Net short-term capital gain	
4a	Net long-term capital gain	
4b	28% rate gain	
4c	Unrecaptured section 1250 gain	
5	Other portfolio and nonbusiness income	
6	Ordinary business income	
7	Net rental real estate income	62,600 STMT
8	Other rental income	
9	Directly apportioned deductions	
10	Estate tax deduction	
11	Final year deductions	
12	Alternative minimum tax adjustment	
13	Credits and credit recapture	
14	Other information	
	A	7,760
	E*	11,640 STMT
	I*	85,000 STMT

*See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. www.irs.gov/Form1041 Cat. No. 11380D Schedule K-1 (Form 1041) 2019

For Example 24

35-0123456 BENNY DIEGO TRUST | 8/7/2020 10:51 AM

Federal Statements

FYE: 12/31/2019

Benny Diego
333-45-6789

Schedule K-1, Box 7 - Rental Real Estate Income

Description	Amount
(Passive Activity)	$ 85,000
Less Allocated Expenses	-22,400
Total	$ 62,600

Schedule K-1, Box 14, Code E - Net Investment Income Information

Description	Amount
Dividend Income	$ 11,640

For Example 24

Statement A—QBI Pass-through Entity Reporting

Pass-through entity's name: Benny Diego Trust			Pass-through entity's EIN: 35-0123456	
Beneficiary's name: Benny Diego			Beneficiary's identifying number: 333-45-6789	
Beneficiary's Share of:		☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB
QBI or Qualified PTP Items Subject to Beneficiary-specific Determinations		123 Main Street		
	Ordinary business income			
	Rental income	85,000.		
	Other			
W-2 Wages				
UBIA of Qualified Property				
Section 199A Dividends				
Beneficiary's Share of:		☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB
QBI or Qualified PTP Items Subject to Beneficiary-specific Determinations				
	Ordinary business income			
	Rental income			
	Other			
W-2 Wages				
UBIA of Qualified Property				

3

2020 Workbook

For Example 24

Form **1041** | **Allocation of Expenses by Income Type**
Tax Basis
For calendar year 2019, or tax year beginning , and ending | **2019**

Name: BENNY DIEGO TRUST | Taxpayer Identification Number: 35-0123456

	Interest	U.S. Interest	Dividends	Qualified Dividends	U.S. Dividends
Income			15,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			960		
Charitable deduction			2,400		
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions			3,360		
Subtotal			11,640		
Reclassified losses					
Net income (Calculated)			11,640		
Net income (Force)					

	Other	Ordinary Business	Rental Real Estate	Other Rental	ESBT / QSST
Income			85,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			6,400		
Charitable deduction			16,000		
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions			22,400		
Subtotal			62,600		
Reclassified losses					
Net income (Calculated)			62,600		
Net income (Force)					

	Short-Term Gains	Long-Term Gains	Section 1231 Gains	Other Nontaxable	Tax-Exempt
Income		50,000			10,000
Less deductions:					
Interest					
Taxes					
Fiduciary fees					640
Charitable deduction					1,600
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions					2,240
Net income (Calculated)		50,000			7,760
Net income (Force)					

For Example 24

3

Form 1041	Allocation of Expenses by Income Type Accounting Income Basis For calendar year 2019, or tax year beginning , and ending	2019

Name: BENNY DIEGO TRUST

Taxpayer Identification Number: 35-0123456

	Interest	U.S. Interest	Dividends	Qualified Dividends	U.S. Dividends
Income			15,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			480		
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions			480		
Additions					
Subtractions					
Subtotal			14,520		
Reclassified losses					
Net income (Calculated)			14,520		
Net income (Force)					

	Other	Ordinary Business	Rental Real Estate	Other Rental	ESBT / QSST
Income			85,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			3,200		
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions			3,200		
Additions					
Subtractions					
Subtotal			81,800		
Reclassified losses					
Net income (Calculated)			81,800		
Net income (Force)					

	Short-Term Gains	Long-Term Gains	Section 1231 Gains	Other Nontaxable	Tax-Exempt
Income					10,000
Less deductions:					
Interest					
Taxes					
Fiduciary fees					320
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions					320
Additions					
Subtractions					
Net income (Calculated)					9,680
Net income (Force)					

For Example 24

Form 1041	Schedule I - Adjusted Tax-Exempt Interest Worksheet For calendar year 2019, or tax year beginning , and ending		2019
Name: BENNY DIEGO TRUST			Taxpayer Identification Number: 35-0123456
	Total Tax-Exempt (Schedule B, line 2)	**Private Activity Bonds** (Schedule I, line 8)	**Other Tax-Exempt** (Schedule I, line 31)
Total tax-exempt interest	10,000		10,000
Interest expense			
Taxes			
Fiduciary fees	640		640
Charitable deduction	1,600		1,600
Attorney, accountant fees			
Other deductions			
Total deductions	2,240		2,240
Adjusted tax-exempt interest	7,760		7,760

Observations

1. Because the trust's taxable income of $49,900 is less than its net capital gain of $50,000, all the income is taxed at favorable capital gains rates.[143]
2. It is assumed that the rental real estate activity rises to the level of a trade or business only for QBID purposes,[144] or the trust meets the requirements for safe harbor treatment.[145]

> **Note.** The determination that the rental activity rises to the level of a trade or business is for QBID purposes only. A rental activity is still considered a passive activity and as such is subject to NIIT as described below and shown above on Form 8960, *Net Investment Income Tax — Individuals, Estates, and Trusts.*

3. The capital gain, ordinary dividends, and net rental income are all subject to the 3.8% NIIT (discussed earlier). The NIIT is shown on line 5 of Schedule G.
4. After the required allocation of indirect expenses to tax-exempt income, any remaining indirect expenses may be allocated to any other type of income such as ordinary, passive, capital gain, etc.

In the previous example, all amounts of QBI were allocated to the beneficiary because the income distributed exceeded DNI. The following example illustrates the allocation of QBI partly to the trust and partly to the beneficiary by reducing the actual distribution to the beneficiary to $40,000.

Example 25. Use the same facts as **Example 24,** except the actual distributions made to Benny (the beneficiary) were $40,000.

143. See IRC §1(h)(1).
144. IRC §119A(d)(1)(A).
145. Rev. Proc. 2019-38, 2019-42 IRB 942.

3

For Example 25

Tax Return Summary

For calendar year 2019, or tax year beginning , and ending

BENNY DIEGO TRUST 35-0123456

Income			
Interest			
Dividends	15,000		
Schedule C - business income / loss			
Schedule D - capital gains / losses	50,000		
Schedule E - rents / royalties / partnerships	85,000		
Schedule F - farm income / loss			
Form 4797 - ordinary income			
Other income			
Total income		150,000	
Deductions			
Interest (* includes investment interest)			
Charitable deduction	18,400		
Other deductions	7,360		
Income distribution deduction	36,215		
Estate tax deduction			
Qualified business income deduction	7,585		
Exemption	100		
Total deductions		69,660	
Taxable income			80,340
Taxes / Credits			
Tax on taxable income	19,584		
Alternative minimum tax			
Foreign tax credit			
Other credits			
Other taxes	3,345		
Total tax		22,929	
Payments			
Estimated tax payments			
Tax withheld			
Other payments			
Total payments			
Adjustments			
Estimated tax penalty			
Applied to next year's estimated tax			
Interest on late payments			
Failure to file penalty			
Failure to pay penalty			
Total adjustments			
Balance due			22,929
Refund			

Next Year's Estimates				**Miscellaneous Information**	
1st quarter		Qualified dividends to:		Amended return	_
2nd quarter		Beneficiaries		Estimated payments allocated	
3rd quarter		Estate or trust		to beneficiaries	
4th quarter		Accounting income	106,000	Number of beneficiaries	1
Total		Distributable net income	82,000	Number of Schedule(s) K-1	1
				Return due date	July 15, 2020

For Example 25

Form **1041** — Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts
► Go to www.irs.gov/Form1041 for instructions and the latest information.
2019 — OMB No. 1545-0092

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 2019 or fiscal year beginning , 2019, and ending , 20

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

Name and title of fiduciary
Amanda DePanda, Trustee

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

City or town, state or province, country, and ZIP or foreign postal code
Indianapolis, IN 46201

C Employer identification number: **35-0123456**

D Date entity created: **03/07/2019**

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)

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

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	1	Interest income	1	
	2a	Total ordinary dividends — See Statement 1	2a	15,000
	b	Qualified dividends allocable to: (1) Beneficiaries ______ (2) Estate or trust ______		
	3	Business income or (loss). Attach Schedule C (Form 1040 or 1040-SR)	3	
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4	50,000
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040 or 1040-SR)	5	85,000
	6	Farm income or (loss). Attach Schedule F (Form 1040 or 1040-SR)	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	150,000
Deductions	10	Interest. Check if Form 4952 is attached ► ☐	10	
	11	Taxes	11	
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions — See Statement 2	12	7,360
	13	Charitable deduction (from Schedule A, line 7)	13	18,400
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14	
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a	
	b	Net operating loss deduction. See instructions	15b	
	16	Add lines 10 through 15b ►	16	25,760
	17	Adjusted total income or (loss). Subtract line 16 from line 9 — 17: 124,240		
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	36,215
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20	7,585
	21	Exemption	21	100
	22	Add lines 18 through 21 ►	22	43,900
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23	80,340
	24	**Total tax** (from Schedule G, Part I, line 9)	24	22,929
	25	2019 net 965 tax liability paid from Form 965-A, Part II, column (k), line 3	25	
	26	**Total payments** (from Schedule G, Part II, line 17)	26	
	27	Estimated tax penalty. See instructions	27	
	28	**Tax due.** If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed	28	22,929
	29	**Overpayment.** If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid	29	
	30	Amount of line 29 to be: **a Credited to 2020** ► ; **b Refunded** ►	30	

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.	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2019)

For Example 25

Form 1041 (2019) Benny Diego Trust 35-0123456 Page 2

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	20,000
2	Tax-exempt income allocable to charitable contributions. See instructions	2	1,600
3	Subtract line 2 from line 1	3	18,400
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	18,400
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	18,400

Schedule B — Income Distribution Deduction

1	Adjusted total income. See instructions	1	124,240
2	Adjusted tax-exempt interest	2	7,760
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	(50,000)
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-	7	82,000
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law — 8: 106,000		
9	Income required to be distributed currently	9	0
10	Other amounts paid, credited, or otherwise required to be distributed	10	40,000
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	40,000
12	Enter the amount of tax-exempt income included on line 11	12	3,785
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	36,215
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	74,240
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	36,215

Schedule G — Tax Computation and Payments (see instructions)

Part I — Tax Computation

1	**Tax:**				
a	Tax on taxable income. See instructions	1a	19,584		
b	Tax on lump-sum distributions. Attach Form 4972	1b			
c	Alternative minimum tax (from Schedule I (Form 1041), line 54)	1c	0		
d	**Total.** Add lines 1a through 1c ▶			1d	19,584
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	0
3	Subtract line 2e from line 1d. If zero or less, enter -0-			3	19,584
4	Tax on the ESBT portion of the trust (from ESBT Tax Worksheet, line 17). See instructions			4	
5	Net investment income tax from Form 8960, line 21			5	3,345
6	Recapture taxes. Check if from: ☐ Form 4255 ☐ Form 8611			6	
7	Household employment taxes. Attach Schedule H (Form 1040 or 1040-SR)			7	
8	Other taxes and amounts due			8	
9	**Total tax.** Add lines 3 through 8. Enter here and on page 1, line 24 ▶			9	22,929

Part II — Payments

10	2019 estimated tax payments and amount applied from 2018 return	10	
11	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	11	
12	Subtract line 11 from line 10	12	
13	Tax paid with Form 7004. See instructions	13	0
14	Federal income tax withheld. If any is from Form(s) 1099, check here ▶ ☐	14	
15	2019 net 965 tax liability from Form 965-A, Part I, column (f), line 3	15	
16	Other payments: **a** Form 2439 ____ ; **b** Form 4136 ____ ; **Total** ▶	16c	
17	**Total payments.** Add lines 12 through 15 and 16c. Enter here and on page 1, line 26 ▶	17	

Form **1041** (2019)

For Example 25

Form 1041 (2019) Benny Diego Trust 35-0123456 Page **3**

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 . . . ▶ $ **10,000 . St 3 St 4**		X	
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?			X
3	At any time during calendar year 2019, 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?			X
	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			X
5	Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see the instructions for the required attachment			X
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			X
10	Was the trust a specified domestic entity required to file Form 8938 for the tax year (see the Instructions for Form 8938)?			X
11a	Did the estate or trust distribute S corporation stock for which it made a section 965(i) election?			X
b	If "Yes," did each beneficiary enter into an agreement to be liable for the net tax liability? See instructions			
12	Did the estate or trust make a section 965(i) election for S corporation stock held on the last day of the tax year? See instructions			X
13	**ESBTs only.** Does the ESBT have a nonresident alien grantor? If "Yes," see instructions			
14	**ESBTs only.** Did the S portion of the trust claim a qualified business income deduction? If "Yes," see instructions			

Form **1041** (2019)

For Example 25

SCHEDULE D (Form 1041)

Department of the Treasury Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1041, Form 5227, or Form 990-T.
▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9 and 10.
▶ Go to *www.irs.gov/F1041* for instructions and the latest information.

OMB No. 1545-0092

2019

Name of estate or trust	Employer identification number
Benny Diego Trust	35-0123456

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? ☐ Yes ☒ No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Note: *Form 5227 filers need to complete* ***only*** *Parts I and II.*

Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b .				
1b Totals for all transactions reported on Form(s) 8949 with **Box A** checked				
2 Totals for all transactions reported on Form(s) 8949 with **Box B** checked				
3 Totals for all transactions reported on Form(s) 8949 with **Box C** checked				

4	Short-term capital gain or (loss) from Forms 4684, 6252, 6781, and 8824	4	
5	Net short-term gain or (loss) from partnerships, S corporations, and other estates or trusts . . .	5	
6	Short-term capital loss carryover. Enter the amount, if any, from line 9 of the 2018 Capital Loss Carryover Worksheet	6	( )
7	**Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). Enter here and on line 17, column (3) on the back . . . . ▶	7	

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .				
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked				
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked				
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked.				

11	Long-term capital gain or (loss) from Forms 2439, 4684, 6252, 6781, and 8824	11	
12	Net long-term gain or (loss) from partnerships, S corporations, and other estates or trusts	12	
13	Capital gain distributions	13	50,000
14	Gain from Form 4797, Part I	14	
15	Long-term capital loss carryover. Enter the amount, if any, from line 14 of the 2018 Capital Loss Carryover Worksheet	15	( )
16	**Net long-term capital gain or (loss).** Combine lines 8a through 15 in column (h). Enter here and on line 18a, column (3) on the back . . . . ▶	16	50,000

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. Cat. No. 11376V **Schedule D (Form 1041) 2019**

For Example 25

Schedule D (Form 1041) 2019 Benny Diego Trust 35-0123456 Page **2**

Part III Summary of Parts I and II
Caution: *Read the instructions* ***before*** *completing this part.*

			(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		50,000	50,000
b	Unrecaptured section 1250 gain (see line 18 of the worksheet.)	18b			
c	28% rate gain	18c			
19	**Total net gain or (loss).** Combine lines 17 and 18a ▶	19		50,000	50,000

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:
a The loss on line 19, column (3) **or b** $3,000 . . . 20 ( )

Note: *If the loss on line 19, column (3), is more than $3,000,* ***or*** *if Form 1041, page 1, line 23 (or Form 990-T, line 39), 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 23, 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 39, 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 23 (or Form 990-T, line 39)			21	80,340		
22	Enter the **smaller** of line 18a or 19 in column (2) but not less than zero	22	50,000				
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	50,000				
25	If the estate or trust is filing Form 4952, enter the amount from line 4g; otherwise, enter -0- ▶	25	0				
26	Subtract line 25 from line 24. If zero or less, enter -0-			26	50,000		
27	Subtract line 26 from line 21. If zero or less, enter -0-			27	30,340		
28	Enter the **smaller** of the amount on line 21 or $2,650			28	2,650		
29	Enter the **smaller** of the amount on line 27 or line 28			29	2,650		
30	Subtract line 29 from line 28. If zero or less, enter -0-. This amount is taxed at 0% ▶					30	0
31	Enter the **smaller** of line 21 or line 26			31	50,000		
32	Subtract line 30 from line 26			32	50,000		
33	Enter the **smaller** of line 21 or $12,950			33	12,950		
34	Add lines 27 and 30			34	30,340		
35	Subtract line 34 from line 33. If zero or less, enter -0-			35	0		
36	Enter the **smaller** of line 32 or line 35			36	0		
37	Multiply line 36 by 15% (0.15) ▶					37	0
38	Enter the amount from line 31			38	50,000		
39	Add lines 30 and 36			39	0		
40	Subtract line 39 from line 38. If zero or less, enter -0-			40	50,000		
41	Multiply line 40 by 20% (0.20) ▶					41	10,000
42	Figure the tax on the amount on line 27. Use the 2019 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041)			42	9,584		
43	Add lines 37, 41, and 42			43	19,584		
44	Figure the tax on the amount on line 21. Use the 2019 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041)			44	28,084		
45	**Tax on all taxable income.** Enter the **smaller** of line 43 or line 44 here and on Form 1041, Schedule G, Part I, line 1a (or Form 990-T, line 41) ▶					45	19,584

Schedule D (Form 1041) 2019

For Example 25

SCHEDULE E (Form 1040 or 1040-SR)
Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
► Attach to Form 1040, 1040-SR, 1040-NR, or 1041.
► Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. 13

Name(s) shown on return: **Benny Diego Trust**
Your social security number: **35-0123456**

Part I Income or Loss From Rental Real Estate and Royalties **Note:** If you are in the business of renting personal property, use **Schedule C** (see instructions). If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2019 that would require you to file Form(s) 1099? (see instructions) ☐ Yes ☒ No
B If "Yes," did you or will you file required Forms 1099? ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	123 Main Street Indianapolis, IN 46201
B	
C	

1b	Type of Property (from list below)		2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.	Fair Rental Days	Personal Use Days	QJV
A	1		A	365		☐
B			B			☐
C			C			☐

Type of Property:
1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental
2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

Income:	**Properties:**		A	B	C
3	Rents received	3	100,000		
4	Royalties received	4			
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions	8			
9	Insurance	9			
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12			
13	Other interest	13			
14	Repairs	14			
15	Supplies	15			
16	Taxes	16	10,000		
17	Utilities	17			
18	Depreciation expense or depletion	18	5,000		
19	Other (list) ►	19			
20	Total expenses. Add lines 5 through 19	20	15,000		
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	85,000		
22	Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	( )	( )	( )

23a	Total of all amounts reported on line 3 for all rental properties	23a	100,000
b	Total of all amounts reported on line 4 for all royalty properties	23b	
c	Total of all amounts reported on line 12 for all properties	23c	
d	Total of all amounts reported on line 18 for all properties	23d	5,000
e	Total of all amounts reported on line 20 for all properties	23e	15,000
24	**Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	85,000
25	**Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	( )
26	**Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18. Otherwise, include this amount in the total on line 41 on page 2	26	85,000

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11344L **Schedule E (Form 1040 or 1040-SR) 2019**

For Example 25

Schedule E (Form 1040 or 1040-SR) 2019 — Attachment Sequence No. 13 — Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.	Your social security number
Benny Diego Trust	35-0123456

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II **Income or Loss From Partnerships and S Corporations** — **Note:** If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column **(e)** on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(f)** on line 28 and attach **Form 6198** (see instructions).

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section . . . ☐ **Yes** ☐ **No**

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A			☐		☐	☐
B			☐		☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A					
B					
C					
D					
29a Totals					
b Totals					

30	Add columns (h) and (k) of line 29a . . .	30	
31	Add columns (g), (i), and (j) of line 29b . . .	31	( )
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31 . . .	32	

Part III **Income or Loss From Estates and Trusts**

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a . . .	35	
36	Add columns (c) and (e) of line 34b . . .	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36 . . .	37	

Part IV **Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder**

38 (a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

Part V **Summary**

40	Net farm rental income or (loss) from **Form 4835.** Also, complete line 42 below . . .	40	
41	**Total income or (loss).** Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18 ▶	41	85,000
42	**Reconciliation of farming and fishing income.** Enter your **gross** farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AC; and Schedule K-1 (Form 1041), box 14, code F (see instructions) .	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules . . .	43	

Schedule E (Form 1040 or 1040-SR) 2019

For Example 25

Form **8960** Department of the Treasury Internal Revenue Service (99)

Net Investment Income Tax— Individuals, Estates, and Trusts
▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227
2019
Attachment Sequence No. 72

Name(s) shown on your tax return: Benny Diego Trust
Your social security number or EIN: 35-0123456

Part I Investment Income ☐ Section 6013(g) election (see instructions)
☐ Section 6013(h) election (see instructions)
☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	15,000
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (see instructions)	4a	85,000		
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	85,000
5a	Net gain or loss from disposition of property (see instructions)	5a	50,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	50,000
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	150,000

Part II Investment Expenses Allocable to Investment Income and Modifications

9a	Investment interest expenses (see instructions)	9a			
b	State, local, and foreign income tax (see instructions)	9b			
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	
10	Additional modifications (see instructions)			10	7,360
11	Total deductions and modifications. Add lines 9d and 10			11	7,360

Part III Tax Computation

12	Net investment income. Subtract Part II, line 11, from Part I, line 8. Individuals, complete lines 13–17. Estates and trusts, complete lines 18a–21. If zero or less, enter -0-			12	142,640
	Individuals:				
13	Modified adjusted gross income (see instructions)	13			
14	Threshold based on filing status (see instructions)	14			
15	Subtract line 14 from line 13. If zero or less, enter -0-	15			
16	Enter the smaller of line 12 or line 15			16	
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			17	
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a	142,640		
b	Deductions for distributions of net investment income and deductions under section 642(c) (see instructions)	18b	54,615		
c	Undistributed net investment income. Subtract line 18b from 18a (see instructions). If zero or less, enter -0-	18c	88,025		
19a	Adjusted gross income (see instructions)	19a	106,325		
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b	12,750		
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c	93,575		
20	Enter the smaller of line 18c or line 19c			20	88,025
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			21	3,345

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2019)

For Example 25

Form **8995**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction Simplified Computation

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8995* for instructions and the latest information.

OMB No. 1545-0123

2019

Attachment Sequence No. 55

Name(s) shown on return	Your taxpayer identification number
Benny Diego Trust	35-0123456

1	(a) Trade, business, or aggregation name	(b) Taxpayer identification number	(c) Qualified business income or (loss)
i	Schedule E	35-0123456	43,537
ii			
iii			
iv			
v			

2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	43,537		
3	Qualified business net (loss) carryforward from the prior year	3	(0)		
4	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0-	4	43,537		
5	Qualified business income component. Multiply line 4 by 20% (0.20)			5	8,707
6	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions)	6	0		
7	Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year	7	(0)		
8	Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-	8	0		
9	REIT and PTP component. Multiply line 8 by 20% (0.20)			9	0
10	Qualified business income deduction before the income limitation. Add lines 5 and 9			10	8,707
11	Taxable income before qualified business income deduction	11	87,925		
12	Net capital gain (see instructions)	12	50,000		
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	37,925		
14	Income limitation. Multiply line 13 by 20% (0.20)			14	7,585
15	Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return ▶			15	7,585
16	Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-			16	(0)
17	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-			17	(0)

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 37806C Form **8995** (2019)

For Example 25

2019 **Federal Statements** **Page 1**

Client 03 **Benny Diego Trust** **35-0123456**

7/08/20 03:41PM

Statement 1
Form 1041, Line 2a
Total Ordinary Dividends

	$	15,000.
Total	$	15,000.

Statement 2
Form 1041, Line 12
Fiduciary Fees

Fees:	$	8,000.
Less 8 % Allocated to Tax-exempt Income		-640.
Total	$	7,360.

Statement 3
Form 1041, Other Information, Line 1
Tax Exempt Income

	$	10,000.
Total	$	10,000.

Statement 4
Form 1041, Other Information, Line 1
Alloc. of Expenses to Tax-exempt Income

Tax-Exempt Interest	$	10,000.
Total Tax-Exempt Income	$	10,000.

Taxable Dividends	$	15,000.
Gross Income from Rents & Royalties		100,000.
Tax-Exempt Income		10,000.
Total Gross Income	$	125,000.

```
Tax-Exempt Income        10,000.
--------------------------------- x 100 =        8%
Total Gross Income      125,000.
```

Total Indirect Deductions - Allocable	$	8,000.
Percentage Allocable to Tax-Exempt Income		8%
Amount Allocable to Tax-Exempt Income	$	640.

Tax-Exempt Interest and Dividends	$	10,000.
Less: Allocated Indirect Deductions		640.
Less: Allocated Charitable Deductions		1,600.
Net Tax-exempt Interest and Dividends	$	7,760.

For Example 25

661117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) **2019**

Department of the Treasury
Internal Revenue Service

For calendar year 2019, or tax year

beginning / / 2019 ending / /

Beneficiary's Share of Income, Deductions, Credits, etc.

▶ See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

35-0123456

B Estate's or trust's name

Benny Diego Trust

C Fiduciary's name, address, city, state, and ZIP code

Amanda DePanda
955 Compton St
Indianapolis, IN 46201

D ☐ Check if Form 1041-T was filed and enter the date it was filed

E ☐ Check if this is the final Form 1041 for the estate or trust

Part II Information About the Beneficiary

F Beneficiary's identifying number

333-45-6789

G Beneficiary's name, address, city, state, and ZIP code

Benny Diego
955 Compton Street
Indianapolis, IN 46201

Beneficiary 1

H ☒ Domestic beneficiary ☐ Foreign beneficiary

Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items

1	Interest income	
2a	Ordinary dividends	5,678
2b	Qualified dividends	
3	Net short-term capital gain	
4a	Net long-term capital gain	
4b	28% rate gain	
4c	Unrecaptured section 1250 gain	
5	Other portfolio and nonbusiness income	
6	Ordinary business income	
7	Net rental real estate income	30,537 STMT
8	Other rental income	
9	Directly apportioned deductions	
10	Estate tax deduction	
11	Final year deductions	
12	Alternative minimum tax adjustment	
13	Credits and credit recapture	
14	Other information	
A		3,785
E*		5,678 STMT
I*		41,463 STMT

*See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. www.irs.gov/Form1041 Cat. No. 11380D Schedule K-1 (Form 1041) 2019

For Example 25

35-0123456 BENNY DIEGO TRUST 8/7/2020 10:17 AM

Federal Statements

FYE: 12/31/2019

Benny Diego
344-45-6789

Schedule K-1, Box 7 - Rental Real Estate Income

Description	Amount
(Passive Activity)	$ 41,464
Less Allocated Expenses	-10,927
Total	$ 30,537

Schedule K-1, Box 14, Code E - Net Investment Income Information

Description	Amount
Dividend Income	$ 5,678

For Example 25

Statement A—QBI Pass-through Entity Reporting

Pass-through entity's name: Benny Diego Trust	**Pass-through entity's EIN:** 35-0123456
Beneficiary's name: Benny Diego	Beneficiary's identifying number: 333-45-6789

Beneficiary's Share of:	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB
QBI or Qualified PTP Items Subject to Beneficiary-specific Determinations	123 Main Street		
Ordinary business income			
Rental income	41,463.		
Other			
W-2 Wages			
UBIA of Qualified Property			
Section 199A Dividends			
Beneficiary's Share of:	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB	☐ PTP ☐ Aggregated ☐ SSTB
QBI or Qualified PTP Items Subject to Beneficiary-specific Determinations			
Ordinary business income			
Rental income			
Other			
W-2 Wages			
UBIA of Qualified Property			

For Example 25

Form **1041** — **Allocation of Expenses by Income Type**
Tax Basis
For calendar year 2019, or tax year beginning , and ending
2019

Name: BENNY DIEGO TRUST
Taxpayer Identification Number: 35-0123456

	Interest	U.S. Interest	Dividends	Qualified Dividends	U.S. Dividends
Income			15,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			960		
Charitable deduction			2,400		
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions			3,360		
Subtotal			11,640		
Reclassified losses					
Net income (Calculated)			11,640		
Net income (Force)					

	Other	Ordinary Business	Rental Real Estate	Other Rental	ESBT / QSST
Income			85,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			6,400		
Charitable deduction			16,000		
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions			22,400		
Subtotal			62,600		
Reclassified losses					
Net income (Calculated)			62,600		
Net income (Force)					

	Short-Term Gains	Long-Term Gains	Section 1231 Gains	Other Nontaxable	Tax-Exempt
Income		50,000			10,000
Less deductions:					
Interest					
Taxes					
Fiduciary fees					640
Charitable deduction					1,600
Attorney, accountant fees					
Other deductions					
Reserved					
Total deductions					2,240
Net income (Calculated)		50,000			7,760
Net income (Force)					

For Example 25

Form 1041	Allocation of Expenses by Income Type Accounting Income Basis For calendar year 2019, or tax year beginning , and ending	2019

Name: BENNY DIEGO TRUST

Taxpayer Identification Number: 35-0123456

	Interest	U.S. Interest	Dividends	Qualified Dividends	U.S. Dividends
Income			15,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			480		
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions			480		
Additions					
Subtractions					
Subtotal			14,520		
Reclassified losses					
Net income (Calculated)			14,520		
Net income (Force)					

	Other	Ordinary Business	Rental Real Estate	Other Rental	ESBT / QSST
Income			85,000		
Less deductions:					
Interest					
Taxes					
Fiduciary fees			3,200		
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions			3,200		
Additions					
Subtractions					
Subtotal			81,800		
Reclassified losses					
Net income (Calculated)			81,800		
Net income (Force)					

	Short-Term Gains	Long-Term Gains	Section 1231 Gains	Other Nontaxable	Tax-Exempt
Income					10,000
Less deductions:					
Interest					
Taxes					
Fiduciary fees					320
Charitable deduction					
Attorney, accountant fees					
Other deductions					
Miscellaneous deductions					
Total deductions					320
Additions					
Subtractions					
Net income (Calculated)					9,680
Net income (Force)					

For Example 25

Form 1041 — **Schedule I - Adjusted Tax-Exempt Interest Worksheet** — **2019**

For calendar year 2019, or tax year beginning , and ending

Name	Taxpayer Identification Number
BENNY DIEGO TRUST	35-0123456

	Total Tax-Exempt (Schedule B, line 2)	Private Activity Bonds (Schedule I, line 8)	Other Tax-Exempt (Schedule I, line 31)
Total tax-exempt interest	10,000		10,000
Interest expense			
Taxes			
Fiduciary fees	640		640
Charitable deduction	1,600		1,600
Attorney, accountant fees			
Other deductions			
Total deductions	2,240		2,240
Adjusted tax-exempt interest	7,760		7,760

Observations

1. Income tax liability for the trust is higher in this example than in **Example 24** because the trust retained more taxable income. This is not necessarily a negative outcome, depending on the intent of the trust.
2. The trust's DNI is \$82,000 and \$40,000 was distributed. Therefore, there is an allocation of the QBI and rental income (**Example 24** concluded that the rental activity rose to the level of a trade of business for QBID purposes). The allocation of QBID and rental net income is based on the percentage of the distribution as compared with actual DNI (\$40,000 distribution ÷ \$82,000 DNI = 48.7805%).
3. As a result of the allocation, the remainder of the QBI (\$43,537, which is 51.2195% of \$85,000) is reflected on Form 8995, *Qualified Business Income Deduction Simplified Calculation,* of the trust return.