TRUST UPDATE

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Presented By...

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What is a Trust?

- A trust is an arrangement whereby a trustee takes legal title to property to protect and conserve it for the benefit of another (a beneficiary).
  - ✓ A trust is a fiduciary relationship between a trustee and beneficiary with respect to property.
  - ✓ Can be established either through a will (a testamentary trust) or during the grantor’s lifetime (an inter vivos trust).
  - ✓ The funding of a trust is not a taxable event for income tax purposes but can have gift tax consequences

What is a Trust?

(Continued)

- Trusts must obtain an employer identification number "EIN" in order to file returns and make payments to the IRS.
- Trusts are a "creature of state law".

Key Terms

- Grantor
  - ✓ This term can refer to a Settlor, Transferor, or a Trustor. This term describes a person who creates or transfers property to a trust.
- Beneficiary
  - ✓ This is a person that has a present or future beneficial interest in a trust or that, in a capacity other than that of a trustee or protector, holds a power of appointment over trust property. The beneficiary owns the equitable interest in the trust property.
  - ✓ Can be contingent
  - ✓ Can be unascertained (ex – unborn beneficiaries)
  - ✓ Charitable and non-charitable beneficiaries

Key Terms
(Continued)

- Income Beneficiary
  - ✓ A person to whom or which currently, or in the future, some, or all, of the net income of a trust may (or, sometimes, must) be paid.
- Principal Beneficiary
  - ✓ A person to whom distributions of some, or all, of the trust's principal may (or, sometimes, must) be paid.
- Remainder Beneficiary
  - ✓ A person entitled to receive principal when an income interest ends.
- The income and remainder beneficiaries, for example, are frequently not the same persons. Distributions to the income beneficiary reduce what will eventually be available for the remainder beneficiary.

Key Terms
(Continued)

- Fiduciary (adjective)
  - ✓ Of, relating to, or involving a confidence or trust.
- Fiduciary (noun)
  - ✓ A personal representative or a trustee.
    - Includes an executor or administrator.
  - ✓ This describes the person who will administer the trust in accordance with the grantor’s/ settlor’s wishes/ directions as set forth by the terms of the trust. The fiduciary owns the legal interest in the trust property.

Why Set up A Trust?

- A method of passing wealth to successive beneficiaries/ generations well into the future and/ or of distributing it to multiple beneficiaries.
- A method of investing assets and preserving and managing wealth for individuals who are unable or unwilling to do so effectively.
- A method of controlling the timing of distributions to beneficiaries. For example, a trust can be used to delay the distribution of cash or other property to children or other beneficiaries until they reach a certain age.
- A method of controlling the ultimate recipients of property. For example, a trust can specify the identity of a successive beneficiary in the event of the death of a current beneficiary.
- Privacy.
- A method to carry out charitable intent.

Types of Trusts

- Grantor Trust
  - ✓ From Form 1041 instructions: "…a legal trust under applicable state law that is not recognized as a separate taxable entity for income tax purposes because the grantor or other substantial owners have not relinquished complete dominion and control over the trust".
  - ✓ All of the income and deductions of the trust are treated as belonging directly to the grantor or owner and are therefore not taxed to the trust.
  - ✓ It is possible for only a portion of a trust to be treated as a grantor trust.

Types of Trusts
(continued)

- Non-grantor Trust
  - ✓ Trusts other than grantor trusts
  - ✓ The trust is taxed on the portion of its income which is not treated as having been distributed to its beneficiaries.
  - ✓ The beneficiaries pay tax on the portion distributed to them.

Types of Trusts

(Continued)

- Electing Small Business Trust ("ESBT")
  - ✓ Permissible S corporation shareholder if election is made by the trustee.
  - ✓ The "grantor portion" is the portion, if any, of the trust that is treated as owned by the grantor or another person.
  - ✓ The "S portion" is the portion of the trust that consists of S corporation stock and that is not treated as owned by the grantor or another person.
    - ➢ The S portion of the trust is treated as a separate trust.
    - ➢ The items of income and deduction attributable to the S-portion are always taxed at the trust level, even if distributions to beneficiaries are made from the S portion.

Types of Trusts

(Continued)

- Electing Small Business Trust (“ESBT”) (continued)
  - ✓ The “non-S portion” is the portion that consists of all assets other than S corporation stock and that is not treated as owned by the grantor or another.
    - Distributions to beneficiaries from the non-S portion **AND FROM THE S PORTION** are potentially deductible from the net income of the non-S portion.
  - ✓ Only one tax return is filed for such a trust.
    - Separate tax calculations are made for each portion and the taxes are added together.

Types of Trusts

(Continued)

- Split-Interest Charitable Trusts
  - ✓ Charitable Remainder Trusts
    - ➢ Charitable Remainder Annuity Trust (CRAT)
    - ➢ Charitable Remainder Unitrust (CRUT)
    - ➢ File Form 5227, not Form 1041
  - ✓ Charitable Lead Trusts
    - ➢ Charitable Lead Annuity Trust (CLAT)
    - ➢ Charitable Lead Unitrust (CLUT)
    - ➢ Can be either grantor-type or non-grantor-type
    - ➢ File Form 1041 and Form 5227
  - ✓ Charitable Income Trusts (Nonqualifying Nongrantor Charitable Lead Trust)
    - ➢ Income interest not structured as an annuity or unitrust amount.
    - ➢ File Form 1041

Types of Trusts

(Continued)

- Nonexempt charitable trusts
  - ✓ All unexpired interests are for charitable purposes
  - ✓ If treated as a private foundation, file Form 990-PF and, usually, Form 1041.
  - ✓ If not treated as a private foundation, file, usually, Form 1041 and possibly Form 990.

Types of Trusts

(Continued)

- Crummey Trust
- Generation-Skipping Trust
- Qualified Disability Trust
- Liquidating Trust
- Business Trust
  - ✓ Not taxed under Subchapter J.
- Real Estate Investment Trust
  - ✓ Not taxed under Subchapter J.
- Other

Revocable vs. Irrevocable
(Continued)

- Revocable
  - ✓ This is a type of trust that is created by the settlor while he or she is living which he or she retains the right to revoke.
  - ✓ The right to revoke could be exercisable either by the settlor alone or in conjunction with another, or by a third party to whom the settlor granted the power to revoke.
  - ✓ This type of trust is ignored for federal income tax purposes and the settlor is taxed on the income of the trust.

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Revocable vs. Irrevocable

- Irrevocable
  - ✓ This describes a trust, whereby the original creator of the trust, no longer has “control or dominion” over the assets in the trust.

Simple vs. Complex

- Simple Trust - (MUST meet all three):
  1. The terms of the trust provide that all of its income is required to be distributed currently.
  2. The terms of the trust do not provide that any amounts are to be paid, set aside, or used in the tax year for charitable purposes.
  3. The trust does not distribute any amounts other than its income required to be distributed currently.

For this purpose, “income” means the amount of income of the trust for the taxable year determined under the terms of the governing instrument and local law (accounting income).

Simple vs. Complex

(Continued)

- Complex Trust
  - ✓ Any trust (other than a grantor type trust) that does not meet the simple trust requirements for a given tax year.
- Whether a trust is classified as a simple trust or as a complex trust is determined on a year-by-year basis.
- A trust that is required to distribute all of its accounting income currently is entitled to a $300 exemption.
- A decedent's estate is entitled to a $600 exemption
- Most other trusts get a $100 exemption.
- Note: The TCJA amended Sec. 151 to suspend the personal exemptions for individuals; however, trusts and estates remain entitled to their personal exemptions under Sec. 642(b).

Authority - Governing Document

- Trusts are usually evidenced by a written document.
  - ✓ Also referred to as “governing instrument”, “trust instrument” or “trust agreement”.
- Grantor’s/ settlor’s wishes/ directions are set forth in the governing document.
- Trustee’s powers are granted in the trust document.
- Testamentary Trusts – the will is usually the trust document.

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Other Authority

State (Non-Income Tax)

- Discretion of Trustee to the extent given to the fiduciary by the governing document
- Uniform Principal and Income Act (UPIA)
  - ✓ Promulgated by the Uniform Law Commission (formerly, the National Conference of Commissioners on Uniform State Laws)
  - ✓ The 1997 Uniform Principal and Income Act substantially changed the previous Acts (1931 and 1962).
  - ✓ Amended in 2000 and 2008
  - ✓ A version of the 1997 Act has been adopted, **with modifications**, by most states

Other Authority

State (Non-Income Tax) (continued)

- Uniform Fiduciary Income and Principal Act of 2018
  - ✓ Was approved in July 2018
  - ✓ Revised former Uniform Principal and Income Acts
  - ✓ Has only been adopted by one state so far
- www.uniformlaws.org to determine what version your state follows – search for “Principal and Income Act”

Other Authority

State (Non-Income Tax) (continued)

- Uniform Trust Code (UTC)
  - ✓ Promulgated by the Uniform Law Commission
  - ✓ Goal is to make trust law uniform among states
  - ✓ Has been adopted, with modifications, by 34 states and the District of Columbia

Accounting Income

- If the terms of a trust require that all or a portion of trust income be distributed, or if its terms limit the maximum amount of discretionary distributions to current beneficiaries to the amount of trust income, the calculation of fiduciary accounting income determines the dollar amount of distributions that a beneficiary must or could receive (and also determines what the remainder beneficiaries will **not** receive).

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Accounting Income
(continued)

- Fiduciary Accounting Income/ Trust Accounting Income
  - ✓ Governing Document
  - ✓ Discretion of trustee to the extent given to the fiduciary by the governing document
  - ✓ Uniform Principal and Income Act – as enacted by trust's state of residency
- Income
  - ✓ Money or property which a fiduciary receives as a current return from a principal asset

Accounting Income
(continued)

- Net Income
  - ✓ Total receipts allocated to income during an accounting period; minus
  - ✓ Disbursements made from income during the period; plus or minus
  - ✓ Transfers to or from income during the period

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Accounting Income

(continued)

- Principal
  - ✓ Property held in trust for distribution to a remainder beneficiary when the trust terminates
- Accounting income is not defined in the Internal Revenue Code. It is a state law concept.
- For purposes of code sections 641 through 669 (Subchapter J, excluding the grantor trust rules), the term “income”, when not preceded by the words “taxable”, “distributable net” or “gross” means fiduciary accounting income (Section 643(b)).

Accounting Income
(continued)

- Examples of receipts typically allocated to income in PA, if not addressed in the trust document:
  - ✓ Taxable interest
  - ✓ Tax-exempt interest
  - ✓ Dividends
  - ✓ Rents

Accounting Income
(continued)

- Examples of disbursements typically made from income in PA, if not addressed in the trust document:
  - ✓ Interest, except interest on death taxes
  - ✓ Ordinary repairs
  - ✓ Real estate taxes and regularly recurring taxes assessed against principal
  - ✓ All or a portion of trustee fees
  - ✓ All or a portion of investment advisory fees
  - ✓ All or a portion of income tax preparation fees
  - ✓ Income taxes required to be paid by the trustee on receipts allocated to income

Accounting Income
(continued)

- Examples of receipts typically allocated to principal in PA, if not addressed in the trust document:
  - ✓ Money or other property received from a principal asset's sale, exchange, liquidation or change in form

Accounting Income

(continued)

- Examples of disbursements typically made from principal in PA, if not addressed in the trust document:
  - ✓ Extraordinary expenses incurred in connection with the administration, management or preservation of trust property and the distribution of income
  - ✓ Extraordinary repairs
  - ✓ Legal fees and expenses of accountings and legal proceedings
  - ✓ All or a portion of trustee fees
  - ✓ All or a portion of investment advisory fees
  - ✓ All or a portion of tax preparation fees
  - ✓ Income taxes required to be paid by the trustee on receipts allocated to principal even if the tax is called an income tax

Accounting Income
(continued)

- Character of receipts from entities in PA, if not addressed in the trust document:
  - ✓ "Entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund, among others.
  - ✓ Except as otherwise provided, money received from an entity, including reinvested cash dividends, is allocated to income.

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Accounting Income

(continued)

- Character of receipts from entities in PA, if not addressed in the trust document (continued):
  - ✓ Property other than money, excluding reinvested cash dividends, received from an entity is allocated to principal.
  - ✓ Money received in one distribution or a series of related distributions in exchange for all or part of a trust’s interest in the entity is allocated to principal.
  - ✓ Money received in total or partial liquidation of the entity is allocated to principal (defined on next page).
  - ✓ Money received from a regulated investment company or a real estate investment trust is allocated to principal if the money received is a short-term or long-term capital gain dividend for federal income tax purposes.

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Accounting Income
(continued)

- ✓ Character of receipts from entities in PA, if not addressed in the trust document (continued):
  - ✓ Money is received in partial liquidation:
    - ➢ To the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation; or
    - ➢ If the total amount of money and property distributed by the entity to its owners in one distribution or a series of related distributions is greater than 20% of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.

Accounting Income
(continued)

- Character of receipts from entities in PA, if not addressed in the trust document (continued):
  - Money is **not** received in partial liquidation, **nor may it be taken into account under the 20% test above**, to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on the taxable income of the entity that distributes the money.

Accounting Income
(continued)

- Schedule K-1 pass-through items from a partnership or other pass-through entity do not generate fiduciary accounting income.

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Accounting Income
(continued)

- The trust’s tax attorney and/ or drafter of the governing document should be consulted when the calculation of fiduciary accounting income is not entirely clear.

Distributable Net Income (DNI)

- A trust is not taxable on the portion of its taxable income for which it is allowed a distribution deduction. The beneficiary is taxable on that portion.
- DNI is the maximum amount that a trust may deduct when it makes distributions to its beneficiaries **or when it is required to make, but has not yet paid, distributions of its fiduciary accounting income**. It is the maximum amount of distributions that could be taxable to the beneficiaries.

Distributable Net Income (DNI)

(continued)

- DNI is a federal tax concept and is defined in IRC Section 643(a).
- Fiduciary accounting income is a state law concept.

Distributable Net Income (DNI)

(continued)

- DNI means the taxable income of the estate or trust as modified:
  - ✓ The personal exemption is added back.
  - ✓ Tax-exempt interest, net of allocable expenses, is added.
  - ✓ **In many, if not most, cases, any net capital gain is subtracted, except that in the year of termination any net capital gain is included in DNI.**
  - ✓ In the case of some trusts which distribute current income only, extraordinary dividends and taxable stock dividends are subtracted.

Distributable Net Income (DNI)

(continued)

- DNI is recomputed for alt min purposes under the same principles that apply for regular tax. The result is “Distributable Net Alternative Minimum Taxable Income” (DNAMTI). Fiduciary accounting income is not recomputed for alt min purposes.

Distribution Deduction

- In general, distributions made by the trust, **whether from income or from principal**, "carry out" the DNI of the trust to the beneficiaries. This includes required distributions of fiduciary accounting income that have not been paid to the beneficiaries by the end of the year.

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Distribution Deduction

(continued)

- The trust's distribution deduction is a deduction of some or all of its taxable distributable **net** income, not of its gross income and gross deductions.
- The trust does not receive a distribution deduction for the portion, if any, of the deductions for depreciation, depletion and amortization which is directly apportioned to the beneficiaries.

Distribution Deduction

(continued)

- The items of deduction of the trust that enter into the computation of DNI are allocated among the items of income.
  - ✓ All deductible items directly attributable to one class of income, including nontaxable income, such as tax-exempt interest, are allocated to that class of income.

Distribution Deduction

(continued)

- All deductible items which are not directly attributable to a specific class of income may be allocated to **any** item of income included in computing DNI, **but a portion must be allocated to nontaxable income.**
- If the deductions directly attributable to a particular class of taxable income exceed the gross income from that class, the excess may be allocated to any other class of taxable income.
- Tip: allocate expenses to highest tax rate income first (tax software has options for this)

Distribution Deduction

(continued)

- The character of the DNI distributed is the same in the hands of the beneficiaries as in the hands of the estate or trust. This includes the taxable and nontaxable components of DNI.

Distribution Deduction

(continued)

- Unless the trust instrument specifically provides otherwise, or unless local law requires a different allocation, the distribution deduction for the trust, and the taxable income of the beneficiaries, as well as the portion of the distribution attributable to nontaxable income, is treated as consisting of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to total DNI.

Distribution Deduction

(continued)

- The distribution deduction is recomputed for alternative minimum tax purposes, using “Distributable Alternative Minimum Taxable Income” (DNAMTI) rather than DNI. In computing DNAMTI and its components, as well as in determining the character of the distribution in the hands of the beneficiaries, the same principles apply as do for regular tax purposes. Fiduciary accounting income is not recomputed for alt min purposes.

Allocating Expenses to Tax-Exempt Income (TEI)

- As discussed above, the items of deduction of a trust that are directly attributable to tax-exempt income are allocated to it, and are therefore, not deductible, and a portion of all deductions not directly attributable to any specific class of taxable income, must be allocated to tax-exempt income. These are sometimes referred to as "indirect" deductions or "indirectly related" deductions.

Allocating Expenses to Tax-Exempt Income (TEI)

- In general, an estate or trust allocates deductions between taxable and tax-exempt income based on the relative amounts of gross taxable and tax-exempt income, excluding capital gains, unless capital gains are included in DNI.

Subchapter J

- Internal Revenue Code (IRC)
  - ✓ Title 26 of the U.S. Code
  - ✓ Subtitle A - Income Taxes
  - ✓ Chapter 1. Normal Taxes and Surtaxes
  - ✓ Subchapter J. Estates, Trusts, Beneficiaries and Decedents. Code Sections 641 – 692.
  - ✓ Part I of Subchapter J. Estates, Trusts and Beneficiaries. Code Sections 641 – 685.
  - ✓ Part II of Subchapter J. Income in Respect of Decedents. Code Sections 691 – 692.

Subchapter J

(Continued)

- Section 641(b) states that the taxable income of an estate or trust is to be computed in the same manner as in the case of an individual, except as otherwise provided in Part I of Subchapter J.

Federal Filing Requirements

- The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic trust taxable under IRC Section 641 with:
  - ✓ **Any** taxable income for the year,
  - ✓ Gross income for the tax year of $600 or more, OR
  - ✓ A beneficiary who is a nonresident alien

- The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic estate with:
  - ✓ Gross income for the tax year of $600 or more, OR
  - ✓ A beneficiary who is a nonresident alien

Filing Deadlines

- Original Filing Date: April 15th
- 5 1/2 Month Automatic Extension with Form 7004
- Extension Filing Date: September 30th
- Estimated Tax Payments
  - ✓ 1st Quarter / Extension: April 15th
  - ✓ 2nd Quarter: June 15th
  - ✓ 3rd Quarter: September 15th
  - ✓ 4th Quarter: January 15th

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Form 1041 - Income

- Interest
- Dividends
- Schedule C – Business Income or Loss
- Schedule D - Capital Gains
- Schedule E - Rents, Royalties and Income/Loss from Pass-throughs
- Form 4797 Ordinary Gains / Losses
- Form 8582 - Passive Income
- Form 461 – Limitation on Business Losses (N/A for tax years after 12/31/2017 and before 1/1/2021 per CARES Act)

Form 1041 - Income

- Excess Business Losses – CARES Act changes
  - ✓ 2018 returns filed with an excess business loss can be amended and a refund sought. Ditto for 2019, if filed
  - ✓ Loss limitation rule kicks back in starting in 2021
  - ✓ Other technical corrections made, retro to 2018
    - Wages are not business income (N/A to trusts)
    - Capital losses are not business losses
    - Capital gains attributable to a trade/business are business income

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Form 1041 - Income

- NOL carryforward and carryback
  - ✓ 80% limitation for use of 2018 NOL carryforwards is removed for tax years 2019 and 2020
  - ✓ 2019 NOL unrestricted for use in 2020.
  - ✓ Starting in 2021, NOL carryforwards arising in tax years 2017 and prior are unrestricted but NOLs created in 2018 through 2020 are 80% restricted
  - ✓ 5 year carryback allowed for 2018 through 2020 losses
  - ✓ Taxable income for purposes NOL utilization is determined without regard to deductions for QBI, FDII and GILTI
  - ✓ Technical corrections included:
    - ➢ Fiscal year filers – NOLs for tax years beginning before 1/1/18 and ending after 12/31/17 eligible for 2 year carryback and 20 year carryforward
    - ➢ 80% limitation is computed after reduction for pre-2018 NOLs

Form 1041 – Deductions

- Interest
- Taxes
- Fiduciary Fees/Trustee Fees
- Charitable Deduction
- Attorney, Accountant & Tax Prep Fees
- Other Deductions – Not subject to 2% floor
- Qualified Business income deduction
- Suspended by TCJA: Miscellaneous 2% Deductions

Interest

- Reported on Form 1041, page 1, line 10 or, in some cases, on Schedule E
- Interest reported on page 1 line 10 is similar to individual Schedule A line 9
- Investment Interest Expense
  - ✓ Form 4952 needed
  - ✓ Limitation applies to a trust just as it does to individuals.
  - ✓ Deduction is allowed to the extent of investment income less investment expenses.
  - ✓ Any excess not allowed in current year can be carried forward to subsequent tax years.
  - ✓ Separate Form 4952 is done for AMT purposes.
  - ✓ Per 4952 instructions, report any that is attributable to a trade or business that is not a passive activity with the other expenses for that trade or business (for example: report the activity of trading personal property for the account of owners of interests in the activity on Schedule E)

Interest

(continued)

- Business interest
  - ✓ Form 8990 needed
  - ✓ The law contained new 163(j) which replaced the predecessor with the same name. (Old 163(j) has been in existence for a long time but it was only applied in very narrow situations.)
  - ✓ A trust with business interest expense, a disallowed business interest expense carryforward or current year or prior year excess business interest expense, generally must file Form 8990, unless an exclusion from filing applies.
  - ✓ A trust is not required to file Form 8990 if the taxpayer is a small business taxpayer* and does not have excess business interest expense from a partnership.
  - ✓ If the trust has no direct business interest, normally this will form will be needed due to amounts passed through from K-1s.

*beyond the scope of this course

Taxes

- Reported on Form 1041, page 1, line 11
- Deductible
  - ✓ State and local income taxes, real estate taxes and personal property taxes (limited to $10,000 by the TCJA)
  - ✓ Real estate taxes & personal property taxes incurred by a trust or estate in carrying on a trade or business, or an activity under Sec. 212 (not limited to $10,000)
  - ✓ Foreign taxes UNLESS claim the foreign tax credit
- Non-Deductible
  - ✓ Federal income tax or excise tax
  - ✓ Federal and State estate/gift/inheritance taxes

Fiduciary Fees

- Reported on Form 1041, page 1, line 12
- No similar deduction on Schedule A for individuals
- Also called Trustee Fees
- For the administration of the trust and not related to investment advisory fees
- Fees that would not be incurred if the property was not held in trust
- Not subject to the 2% of AGI limitation
- Deductible for alternative minimum tax

Charitable Deduction

- Reported on Form 1041, page 1, line 13 and Form 1041, Schedule A (on the top of page 2)
- Unlike individuals, there is no AGI limitation on the amount of charitable deduction that they can take; Code section 642(c), which, rather than section 170, governs in the case of an estate or trust, contains special rules:
  - ✓ Must be paid out of income
    - ➢ Noncash contributions are likely to have been paid out of trust principal, not income
  - ✓ Must be specifically provided for in the trust document
- What about charitable amounts from partnership K-1s? At Sisterson we assume the first rule is met with respect to contributions of cash (the second does not apply to flow-through amounts) and report them in full.

Attorney, Accountant & Tax Prep Fees

- Reported on Form 1041, page 1, line 14
- For trusts, these are NOT subject to the 2% of AGI limitation and they are deductible for alt min purposes.

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Other Deductions

- Reported on Form 1041, page 1, line 15a:
  - ✓ Includes administration expenses, other than fiduciary fees, that would not have been incurred if the property was not held in trust
  - ✓ Some may be similar to individual Schedule A line 28 deductions; may come from partnership K-1s.
  - ✓ Depreciation – If the trust holds depreciable property, the depreciation expense is allocated between the trust and the beneficiary according to how trust accounting income is allocated.
    - The same applies to amortization and depletion.
    - The trust's share is reported on line 15a unless reportable on Schedule C, E or F.
    - The beneficiary's share is reported on Schedule K-1, box 9 ("Directly apportioned deductions").

Other Deductions

(continued)

Net Operating Loss deduction (discussed on earlier slide)

- Reported on page 1 line 15b:
- Deductible for alt min but amount may be different

Section 199A – Qualified Business Income Deduction

- Sec. 199A, also introduced by the TCJA, provides a deduction generally equal to 20% of the net "qualified business income" to any taxpayer other than a corporation, with several limitations.
- This deduction on pass-through income is, therefore, available to trusts and estates.

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Section 199A – Qualified Business Income Deduction

(continued)

- In case of a non-grantor trust, all pertinent QBI information must be allocated between the trust or estate and its beneficiaries.
- This based on the relative proportion of the trust's distributable net income (DNI) that is distributed, or required to be distributed to the beneficiary vs. retained by the trust or estate.
- The beneficiary's share of the QBI items is reported on Schedule K-1, line 14 (Code I).

Section 199A – Qualified Business Income Deduction
(continued)

- Beginning in 2019 Form 8995 is be used to calculate the QBI deduction.
- Trust deduct on Form 1041, Page 1, Line 20.
- An ESBT must compute the QBI deductions separately for the S and non-S portions of the trust

Miscellaneous 2% Deductions - Suspended

- From partnership K-1s – watch footnotes to K-1, Lines 13L and 13W can include former 2% deductions (don’t assume K-1 is correct)
- Others
  - ✓ Management fees
  - ✓ Investment advisory fees
  - ✓ Commitment fees
  - ✓ Bank fees
  - ✓ Brokerage account fees

Form 1041
– Deductions –

- Additional considerations –
  - ✓ The trust has to allocate expenses to tax-exempt income, if it has any (to be discussed later).
  - ✓ The trust can offset net investment income on Form 8960 with expenses (also to be discussed later).

Form 8960 Deductions

- Reported on Part II of Form 8960
  - ✓ Investment Interest Expense
  - ✓ State and local income taxes
  - ✓ Miscellaneous other (non-2%) deductions
  - ✓ Other expenses go on line 10 “Additional modifications” and include –
    - ➢ Fiduciary/trustee fees
    - ➢ Attorney, Accountant & Tax Prep Fees
- Reported on Part III of Form 8960
  - ✓ Distribution Deduction – line 18b

Tax Computation

- Form 1041 Schedule G (on page 2)
  - ✓ Regular tax
  - ✓ Less: Foreign tax credit
  - ✓ Alternative minimum tax
  - ✓ Net investment income tax
  - ✓ ESBT tax – Regular, AMT and impact of NII tax
  - ✓ Tax table – A trust is taxed at 37% for taxable income over $12,950 for 2020.

Tax Computation

- Impact of qualified dividends
  - ✓ Q-divs are split between the trust and the beneficiaries based on DNI
    - Any that stay in the trust are taxed at the favorable tax rate
    - The portion that goes out to the beneficiary is reported on Schedule K-1 box 2b (net of any expenses allocated to the qualified dividends going out to the beneficiary). If that is the case, the amount on Schedule K-1 box 2b will not agree to the amount on Form 1041 page 1 line 2b(1).)

Tax Computation

- Alternative Minimum Tax
  - ✓ Form 1041 Schedule I is comparable to Form 6251 for individuals
  - ✓ AMT tax rate is 28%
  - ✓ The qualified dividend calculation will be different for AMT purposes than Regular tax purposes whenever the AMT DNI is not the same as Regular Tax DNI
  - ✓ The beneficiary K-1 box 12B is used to report any adjustment to the qualified dividends that flow out to the beneficiary

Pennsylvania

- Resident trust
  - ✓ Formed by a PA resident (settlor) while alive or via will at death - generally
    - McNeil v. Commonwealth – 2013 case ruled even though trust was set up by PA resident with PA resident beneficiaries PA could not assess tax because books, records, trustees, administration all outside of PA.
  - ✓ PA taxes resident trusts on undistributed worldwide income

Pennsylvania

- Nonresident trusts
  - ✓ Taxed only on undistributed income from sources within PA (generally business income)
  - ✓ Non-resident withholding required on business income distributed to non-residents

Pennsylvania

- PA rules for taxable distributions mirror federal DNI rules – calculation done on PA Sch DD
  - ✓ The same accounting income used for federal is used for PA
- Grantor Trusts are not recognized by PA
  - ✓ PA 41 must be filed for all irrevocable grantor trusts
  - ✓ Example – intentionally defective grantor trust

Thank you!!

SISTERSON
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