

Trust & Estates

Taxes and Planning

TM Financial Services

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Elections available to the Executor on Form 706

Reporting for a Grantor Trust

The usual rules related to the taxation of trusts are not applied if certain characteristics qualify it as a Grantor Trust. In these instances, the IRS disregards the legal entity for tax purposes and requires that the individual items of income, expense and credits be reported on the grantor's individual form 1040. All revocable trusts are grantor trusts. Some irrevocable trusts are also grantor trusts for tax purposes; examples include grantor retained annuity trusts (GRATs), qualified personal residence trusts (QPRTs) and some charitable lead trusts (CLATs/CLUTs) and irrevocable life insurance trusts (ILITs).

Code sections 673 to 679 describe the rules which create a grantor trust including reversionary interests, retention of administrative powers, power to revoke the trust and the right to have income paid to grantor or grantor's spouse.

Under all circumstances the trustee can file a Form 1041 for the trust showing no income or

Part 3 of federal form 706 offers the executor a number of elections as to valuing assets or paying the estate tax liability. Here's a summary of the options:

Alternate Valuation Date –

The executor can elect to value the decedent's assets six months from the date of death (or when sold, if earlier) as an alternative to using date of death values.

In order to use the alternate date, the value of the gross estate and the estate tax must be reduced from standard valuation. Additionally, the same date must be used for all the assets, and valuations for all the assets must be provided for both the alternate date and the date of death.

14 Year Installment payment (§6166)–

The estate tax for a farm or closely held business can be deferred for up to 14 years. To qualify the interest in the farm or estate must comprise at least 35% of the value of the estate. For the first 5 years, payments of interest are required and then payments of the tax must be made in up to 10 annual installments. (Only the tax attributable to the farm or business may be deferred.)

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Grantor Trusts (continued from page 1)

expense information with a statement attached showing the various items of income, expense, credit etc. that will be reported on the grantor's personal 1040.

If the following conditions are met, a Form 1041 is not required to be filed for a grantor trust:

- Same individual is both grantor and trustee; or
- Husband & wife are sole grantors, one or both are trustees and they file a joint tax return; and
- The trust and all its assets are located within the United States.

If these criteria are met the trustee has two methods of reporting for the trust to choose from. Under both methods the trustee is not required to file a Form 1041:

1. The trustee must furnish all payers of income to the trust with the name and **tax ID number of the grantor** as well as the address of the trust. Additionally the grantor must provide the trustee with a completed, signed Form W-9; or
2. The trustee must furnish all payers of income to the trust with the name, **tax ID number and address of the trust**. Additionally the trustee must send to the IRS Forms 1099.

If a trustee had previously filed Form 1041 for a trust which meets the three requirements above, he can change by filing a final 1041 and writing on the front of the form – "Pursuant to § 1.671-4(g), this is the final Form 1041 for this grantor trust." The following year the trustee may select one of the two methods for reporting for a grantor trust without filing a Form 1041.

Executor Elections (continued from page 1)

Special-use valuation (§2032A)-

Real property that is used in a closely held business or farm can be valued substantially below its FMV by basing it upon its production value. The total decrease from FMV cannot exceed \$1,000,000. Additional requirements are that the real property must comprise 25% of the estate, 50% of the value of the estate must be real & personal property used in the business, the property must have been utilized 5 of the past 8 years and a qualified heir must have participated in the business during that time. The qualified heir must continue to participate in the business for a period of 10 years following the death of the decedent.

Deferral of tax payment on reversionary or remainder interests (§6163)-

The estate tax on a remainder interest can be deferred until 6 months after the termination of the lifetime interest. The executor must post a bond guaranteeing payment of the tax and the election has to be made prior to the estate tax payment due date.

Estate deduction for Income Taxes

When taking a deduction on an estate return for income taxes owed by the decedent, an error often made is failing to prorate the tax liability between the decedent and the surviving spouse.

Under Treas. Reg. §20.2053-6, the amount that the estate can deduct is computed by using the amounts that would have been due if they had filed separately and using the percentage between the two to determine the amount deductible on the 706:

$$\frac{\text{Decedent's Married Filing Single tax}}{\text{Total of the MFS taxes}} \times \text{Married filing jointly tax}$$

Form 706: Same Asset – Different Schedule

<u>Real Estate</u>	<u>Schedule</u>	<u>Life Insurance</u>	<u>Schedule</u>
Owned by decedent	A	Payable to Estate	D
Owned as JTWRROS	E	Owned by decedent	
Tenants in Common	A *	on life of another	F
Community Property	A **	Policy transferred	
Coop building interest	B	within 3 yrs. Of death	G
Used in sole proprietorship	F	Decedent is insured &	
Remainder interest	G	owns or has incidents	
Contracted to sell	C	of ownership	D
Subject to POA	H		

* Decedent's share

** One half

Estate Return Attachments – NJ, NY, CT & PA

<u>Document</u>	<u>NJ Inheritance</u>	<u>NJ-Estate</u>	<u>NY Estate</u>	<u>CT Gift/Estate</u>	<u>PA. Inheritance</u>
Death Certificate			X	X	
Copy of Will	X	X	X	X	X
Decedents final 1040	X				
Final 1040 filed before death		X			
Form 712				X	
Appraisals				X	X
Federal form 706		X	X	X	X
Federal form 709				X	
2001 Form 706		X			

Trusts & Estates Taxes and Planning

IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387
CT	General Information	860-297-5962
PA	General Information	717-787-8201

Capital Gains taxed to Beneficiaries

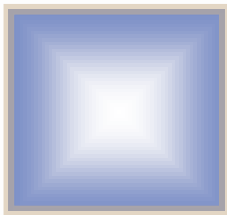
Typically capital gains are taxed to the trust or estate unless the governing document specifies otherwise. If not specified the Uniform Principal & Income Act as adopted by most states allocates capital gains to principal. As such they are not included in DNI and the resulting Income Distribution Deduction and are taxed to the estate or trust.

The exceptions to this rule are:

- Capital gains are allocated to income by the terms of the governing instrument or by local law;
- They are actually distributed to the beneficiaries;
- They are used by the executor or trustee to calculate the amount required to be distributed; or
- They are realized in the year of termination of the trust or estate.

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