Trust & Estates
Taxes and Planning

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Separate Shares
Taxation Issues

If a trust or estate's beneficiaries have substantially independent shares, the DNI allocable to each beneficiary is calculated as if a separate trust or estate actually existed. By independent it is meant that the economic interest of one beneficiary does not affect and is not affected by the economic interest of another beneficiary. Separate shares is important in a situation where income is accumulated for one beneficiary but a distribution is made to another of both income and principal that is in excess of the income that would be allocated to him if there actually had been a separate trust or estate. Here are two examples.

1) Decedent's will directs the executor to distribute IBM stock and all dividends from that stock to his son, Steven and the residue of the estate to his son, Michael. Separate shares

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Section 645 Election
Merging the revocable trust with the estate

Trusts, as well as estates, can function to administer and settle the affairs of the decedent and disburse the assets to the beneficiaries. Under §645, the executor of the decedent's estate and the trustee of a qualified revocable trust can elect to treat the trust as part of the estate for income tax purposes. A qualified revocable trust is one that is owned by the decedent because he or she had the power to revoke the trust under code §676.

The election to file as a merged estate is made on Form 8855 which is attached to a timely filed Form 1041 for the first tax year of the estate. If the election is made the trust need not file a Form 1041; all trust income and expenses are reported on the estate's return under the name and tax ID number of the estate. Under the separate share rules of §663(c), the merged trust and estate constitute separate shares for purposes of computing distributable net income.

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Separate Shares (continued from page 1)

exist for the IBM dividends and the estate residue.
(The distribution of the IBM stock qualifies as a bequest, so it is not a separate share).
Here the economic interest of Steven is clearly unaffected by Michael and vice versa.

2) A trust was created for the benefit of Steven, Michael & Joe, ages 21,18 & 17 respectively. Under the terms of the trust, income is required to be divided into three equal shares. Each beneficiary's share of the income is to be accumulated until he becomes 21 years of age at which time his share of the income may be either accumulated or distributed to him at the discretion of the trustee. The trustee also has discretion to invade corpus for the benefit of any beneficiary.

In the current year the trust has interest income of $20,000 and expenses of $5,000 – DNI of $15,000. The trustee in his discretion distributes $12,000 to Steven.

The trust qualifies for the separate share treatment under section 663(c) and the distributable net income must be divided into three parts for the purpose of determining the amount deductible by the trust under section 661 and the amount includible in Steven’s gross income under section 662.

Without the separate shares rule, schedule B of the 1041 would show $15,000 of DNI and other amounts paid of $12,000. Therefore the trust would have an income distribution deduction of the lesser of the two, i.e. $12,000 and taxable income of $3,000. Steven would be required to report $12,000 of income even though the trust states that income is to be divided equally.

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§645 (continued from page 1)

There are a number of advantages to making the election:

- The trust can adopt a fiscal year as part of the estate.
- The active participation rule related to passive losses and the $25,000 rental real estate allowance is waived.
- A savings on tax preparation fees.
- A deduction can be taken for funds set aside for a charity. Normally a trust can only deduct amounts actually paid out.
- The merged estate/trust is entitled to a $600 personal exemption instead of either $300 or $100 for a trust depending upon whether all income is distributed.
- Unlike a trust, an estate need not make estimated taxes for two years following the decedent’s death.

A disadvantage of the election is that the combined income of the trust and estate can push the entity into the highest tax bracket. Of course the problem is avoided if all of the combined income is distributed to the beneficiaries.

The election, once made, is irrevocable.

Compensation of Executors

5% on first $100,000 of assets received
4% on next $200,000
3% on next $700,000
2.5% on next $4,000,000
2% on amounts over $5,000,000
SCPA §2307

Compensation of Trustees

Upon Settlement
1% for paying out all money constituting principal

Annual Commissions
$10.50 per thousand on first $400,000 of principal
$4.50 per thousand on next $600,000
$3.00 per thousand on all additional principal
SCPA §2309(2)

New York Fiduciary Commissions

Separate Shares (continued from Page 2)

With the separate share rule, the DNI calculation is performed for each beneficiary. Steven's DNI here is $5,000 ($15,000 x .333). This is less than the amount actually distributed to Steven and limits the income reported by him. (The remaining $7,000 is a tax free distribution of corpus).

Summary of taxation under 663(c) with separate shares compared to results which would be reported otherwise:

K-1	Without Separate Shares	With Separate Shares
Steven	$12,000	$5,000
Michael	-	-
Joe	-	-
Trust(1041)	$3,000	$10,000

Savings & checking accounts	Principal balance at DOD plus accrued interest
Real Estate	Fair Market Value
Listed bonds & stocks	Average of high & low prices on DOD
OTC Stocks	Average bid & ask price on DOD
Load Mutual Funds	Bid price
No-load Mutual Funds	Net Asset Value
Treasury Bills	Face amount x 1- (Interest rate x days to maturity) / 365
Annuity (lump sum)	Lump sum amount
Annuity (Installments)	Commuted value (PV & beneficiary's life expectancy)
Survivor annuity (Joint & Survivor)	Amount insurance company would charge for single life annuity
Survivor annuity (Fixed duration)	Annuity for term certain with commuted basis computation
Community Property	One half of value of property
Joint tenancy with spouse	One half of value of property
Joint tenancy with other than spouse	Entire value unless portion acquired by surviving tenant
Tenants in Common	Entire value x percent of ownership
Life Insurance on decedent's life	Amount receivable by beneficiary
Life Insurance owned by decedent on life of another	Cost of buying another policy on the same insured

Form 706 Asset Valuations

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

Important Phone Numbers

2010 Tax Act Highlights

Estate Tax & GST Exemption:
2010, 2011 & 2012 - $5,000,000
Estate Tax Rate:
2010, 2011 & 2012 - 35%
GST Rate:
2010 - 0%, 2011 & 2012 - 35%
Gift Tax Exemption:
2010 - $1,000,000   2011 & 2012 - $5,000,000
Gift Tax Rate:
2010, 2011 & 2012 - 35%

The $5,000,000, 35% rule will apply for the estate tax in 2010 unless an election is made to use the modified carryover basis rules. The Act also provides portability for the estate tax exemption – any unused exemption of the decedent may be used by the surviving spouse.

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