Death and Taxes

Course #5640D/QAS5640D

Course Material
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Introduction

A key component of financial planning is planning for death. Death is a topic that few people want to think about, yet, without planning individuals and their families can incur some significant unpleasant surprises. The value of an individual’s estate is a significant factor in the amount of tax due at death. This course covers many of the tax issues that occur at death and the planning thereof.

Chapter 1 provides a general understanding of when estate and gift taxes apply and when they do not. What is the unified credit? How is the estate tax calculated? What is the gift tax and when does it apply? What is the generation skipping tax?

Chapter 2 discusses filing a decedent’s final income tax return. What income must be included? What exemptions and deductions are available? When is the final return due?

Chapter 3 explores the tax benefits available to survivors when filing their own income tax return after the death of an individual who was their spouse, their child, or someone that qualified as the individual’s dependent. What special benefits are allowed? What is income in respect of the decedent?

Chapter 4 discusses the importance of planning ahead when small or family businesses are owned, especially when members of the owner’s family want to maintain the business following the owner’s death. What form of ownership is easiest to transfer upon death? Can an election be made to defer estate taxes? What are the special rules for family farms and other small businesses?

These and other related questions will be answered in this course.
I. Introduction

If an individual gives someone money or property during his or her lifetime, the individual may be subject to federal gift tax. The money and property an individual owns when he or she dies (his or her estate) may be subject to federal estate tax. The purpose of this chapter is to provide a general understanding of when these taxes apply and when they do not. It explains how much money or property an individual can give away during his or her lifetime or leave to his or her heirs at death before any tax will be owed.

A. RECENT MAJOR CHANGES TO ESTATE AND GIFT TAXES

On December 17, 2010, Congress enacted and on December 18, 2010 the President signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“2010 Tax Relief Act”), legislation that extends the 2001 tax cuts for two more years, temporarily increases estate, gift, and generation skipping tax exemption amounts, and temporarily reduces the estate tax rate. The 2010 Tax Relief Act came just thirteen days prior to the scheduled expiration of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which, but for the 2010 Tax Relief Act, would have resulted in increased taxes for many Americans.

Highlights of the 2010 Tax Relief Act include:

- The federal estate tax exemption amount was raised to $5 million for all deaths occurring in 2010-2012.
- The federal estate tax rate was set at 35% for 2010-2012.
- The estates of decedents dying in 2010 can choose between: (1) estate tax (based on a $5 million exemption and 35% top rate) and a step-up in basis, or (2) no estate tax and modified carryover basis. In technical terms, the Act achieves this choice by making the estate tax and basis changes effective retroactively for estates of decedents dying after 2009 but allowing the opt-out choice for estates of decedents dying in 2010.
- The federal estate and gift tax was unified again at $5,000,000 for 2011-2012.
- The generation skipping transfer (“GST”) tax exemption amount is set at $5,000,000 and a 35% rate for 2011 and 2012.
- Stepped up basis reinstituted. For deaths occurring in 2011 and 2012, stepped up income tax basis of assets received from a decedent is now reinstated.
- These changes are also temporary and will once again change if no action is taken by Congress prior to December 31, 2012.
B. RELATIONSHIP BETWEEN ESTATE AND GIFT TAXES

Unlike most tax structures, the estate tax and gift tax are unified – integrated – into one tax system again effective with the start of year 2011. The federal estate and gift tax imposes a tax on transferring assets: one tax catches transfers made during your life – the gift tax; the other catches transfers at death – the estate tax. Transfers while an individual was alive and at his or her death are combined and subject to one progressive tax. The rates are the same for both taxes.

The reunification of the gift and estate tax exemptions (made effective again by the passage of the 2010 Tax Relief Act) provides planning opportunities for clients who may have used all of their $1,000,000 gift tax exemption who now desire to make additional large lifetime gifts, but who don't want to pay gift tax.

C. NORMALLY NO TAX OWED

Most gifts are not subject to the gift tax and most estates are not subject to the estate tax. (Only about 2% of all estates are subject to the estate tax.) For example, there is usually no tax if an individual makes a gift to his or her spouse or a qualified charity or if his or her estate goes to their spouse or qualified charity upon death. If an individual makes a gift to someone else, the gift tax does not apply until the value of the gifts given to that person is more than the annual exclusion for the year.

Even if tax applies to a gift or estate, it may be eliminated by the Unified Credit, discussed later.

D. NO RETURN NEEDED

Generally, an individual does not need to file a gift tax return unless he or she gives someone, other than his or her spouse, money or property worth more than the annual exclusion for that year. Although a return may be required, no actual gift tax will become payable until the cumulative lifetime taxable gifts exceed the applicable exclusion amount.

The donor is primarily responsible for the payment of the Gift Tax. An estate tax return generally will not be needed unless the estate is worth more than the applicable exclusion amount for the year of death. This amount is shown in the section under Unified Credit, below.

E. NO TAX ON PERSON RECEIVING GIFT OR ESTATE

The person who receives a gift or estate generally will not have to pay any gift tax or estate tax because of it. In addition, that person will not have to pay income tax on the value of the gift or inheritance received. Note, however, that there are some technical applications for "Income in Respect of the Decedent" under Internal Revenue Code §691 that will have to be considered for income earned but not otherwise taxed prior to the date of death.
F. NO INCOME TAX DEDUCTION

Making a gift or leaving an estate to a decedent's heirs does not ordinarily affect federal income tax. An individual cannot deduct the value of gifts made (other than gifts that are deductible charitable contributions).

Example.

Chuck has a valuable stamp collection that has been appraised at $10,000. He would like to give the collection to his grandson, Harold, before his death. If he chooses to make the gift, it will not be subject to gift tax because it is below the taxable threshold. However, Chuck is not entitled to take a deduction from his income tax for the value of the collection. The gift has no impact on Chuck's current tax liability whatsoever.

G. UNIFIED CREDIT

1. Application to Estate and Gift Taxes

A credit is an amount that eliminates or reduces tax. The unified credit applies to both the gift tax and the estate tax. An individual must subtract the unified credit from any gift taxes that he or she owes. Any unified credit that is used against an individual's gift tax in one year reduces the amount of credit that he or she can use against his or her gift tax in a later year. The total amount used against an individual's gift tax reduces the credit available to use against his or her estate tax.

2. Amount of Credit

For gift tax purposes in year 2009, the unified credit was $345,800, and the applicable exclusion amount was $1,000,000. For estate tax purposes in year 2009, the unified credit was $1,455,800 and the applicable exclusion amount was $3,500,000.

In 2010, the gift tax remains in place with a lifetime exclusion amount of $1,000,000. Also for 2010, the estate exclusion was set to $5,000,000 by the recently passed 2010 Tax Relief Act.

Lastly, the 2010 Tax Relief Act provides for the reunification of the gift and estate tax exemptions for 2011 and 2012. The legislation provides for a $5,000,000 unified exemption and a 35% tax rate for estates and gifts exceeding the $5,000,000 exemption level.
II. Estate Taxes: An Overview

A. FORM 706

The executor of a decedent's estate uses Form 706 to figure the estate tax imposed by Chapter 11 of the Internal Revenue Code. This tax is levied on the entire taxable estate, not just on the share received by a particular beneficiary. Form 706 is also used to compute the generation-skipping transfer (GST) tax imposed by Chapter 13 on direct skips (transfers to skip persons of interests in property included in the decedent's gross estate). A copy of Form 706 and its instructions are provided in Appendix A. Details of the obligations of an executor in filing the decedent's final tax return are provided in the next chapter.

B. WHICH ESTATES MUST FILE

Federal law provides an exemption from estate tax in an amount that varies from year to year. For example, for decedents dying in 2010, Form 706 must be filed by the executor for the estate of every U.S. citizen or resident whose gross estate, plus adjusted taxable gifts and specific exemption, is more than $5,000,000. If the value of the estate is less than the applicable exemption in the decedent's year of death, no return is required. Current rules are shown in Table 1-1, next.

Table 1-1. Increased Estate Tax Applicable Exclusion Amount

An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate exceeds the applicable exclusion amount.

<table>
<thead>
<tr>
<th>Year</th>
<th>Exclusion Amount</th>
</tr>
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<tbody>
<tr>
<td>2003</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2004 and 2005</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2006, 2007, 2008</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>2010</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>2011</td>
<td>$5,000,000</td>
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</tbody>
</table>

To determine whether an executor must file a return for the estate, add:

- The adjusted taxable gifts (under § 2001(b)) made by the decedent after December 31, 1976;

- The total specific exemption allowed under § 2521 (as in effect before its repeal by the Tax Reform Act of 1976) for gifts made by the decedent after September 8, 1976; and

- The decedent's gross estate valued at the date of death.
C. GROSS ESTATE AND TAXABLE ESTATE

The gross estate includes all property in which the decedent had an interest (including real property outside the United States). It also includes:

- Certain transfers made during the decedent's life without an adequate and full consideration in money or money's worth;
- Annuities;
- The includible portion of joint estates with right of survivorship (see the instructions on the back of Schedule E);
- The includible portion of tenancies by the entirety (see the instructions on the back of Schedule E);
- Certain life insurance proceeds (even though payable to beneficiaries other than the estate) (see the instructions on the back of Schedule D);
- Property over which the decedent possessed a general power of appointment;
- Dower or curtesy (or statutory estate) of the surviving spouse; and
- Community property to the extent of the decedent's interest as defined by applicable law.

After determining the gross value of a decedent’s estate, the personal representative should take all possible deductions to reduce the taxable estate. These deductions include:

- Funeral expenses paid out of the decedent’s estate;
- Debts the decedent owed at the time of death; and
- The marital deduction (generally, the value of the property that passes from the decedent’s estate to his or her surviving spouse).

D. ADMINISTRATIVE EXPENSES

Expenses of administering an estate can be deducted from the gross estate in figuring the federal estate tax.

1. Typical Expenses

In general, administration expenses deductible in figuring the estate tax include:

- Fees paid to the fiduciary for administering the estate;
- Attorney, accountant, and return preparer fees;
expenses incurred for the management, conservation, or maintenance of property; and

expenses in connection with the determination, collection, or refund of the estate's tax liability.

2. No Double Dipping

Administrative expenses cannot be claimed for both estate tax and income tax purposes. The expenses incurred in the sale of property are deductible from the gross estate only if the sale was necessary to pay decedent debts, or to preserve or distribute the property of the estate.

E. MARITAL DEDUCTION

One of the primary deductions for married decedents is the marital deduction. All property that is included in the gross estate and passes to the surviving spouse is eligible for the marital deduction. The property must pass "outright." In some cases, certain life estates also qualify for the marital deduction.

F. CHARITABLE DEDUCTION

If the decedent leaves property to a qualifying charity either during his or her life or at death, it is deductible from the gross estate. Potential donors must be sure the "charity" they are considering qualifies for tax purposes.

Generally, only the five following types of organizations can be qualified organizations:

- A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States (including Puerto Rico). It must be organized and operated only for one or more of the following purposes:
  - Religious.
  - Charitable.
  - Educational.
  - Scientific.
  - Literary.
  - The prevention of cruelty to children or animals.

  Certain organizations that foster national or international amateur sports competition also qualify;

- War veterans' organizations, including posts, auxiliaries, trusts, or foundations, organized in the United States or any of its possessions;

- Domestic fraternal societies, orders, and associations operating under the lodge system (note that contribution to this type of organization is deductible only if it is to be used solely for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals);
- Certain nonprofit cemetery companies or corporations (note that a contribution to this type of organization is not deductible if it can be used for the care of a specific lot or mausoleum crypt); and

- The United States or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions (note that to be deductible, a contribution to this type of organization must be made solely for public purposes).

**Example 1.**

*Ozzie contributes cash to his city's police department to be used as a reward for information about a crime. The city police department is a qualified organization, and his contribution is for a public purpose. He can deduct his contribution.*

**Example 2.**

*Sharon makes a voluntary contribution to the social security trust fund, not earmarked for a specific account. Because the trust fund is part of the U.S. Government, she contributed to a qualified organization. She can deduct her contribution.*

The following list gives some examples of qualified organizations:

- Churches, a convention or association of churches, temples, synagogues, mosques, and other religious organizations;

- Most nonprofit charitable organizations such as the Red Cross and the United Way;

- Most nonprofit educational organizations, including the Boy (and Girl) Scouts of America, colleges, museums, and day-care centers if substantially all the child care provided is to enable individuals (the parents) to be gainfully employed and the services are available to the general public. However, if the contribution is a substitute for tuition or other enrollment fee, it is not deductible as a charitable contribution;

- Nonprofit hospitals and medical research organizations;

- Utility company emergency energy programs, if the utility company is an agent for a charitable organization that assists individuals with emergency energy needs;

- Nonprofit volunteer fire companies;

- Public parks and recreation facilities; and

- Civil defense organizations.
1. Giving Property That Has Decreased in Value

One of the more technical areas of charitable giving involves gifts of property that have decreased in value. If an individual contributes property with a fair market value that is less than his or her basis in it, the deduction is limited to its fair market value. An individual cannot claim a deduction for the difference between the property's basis and its fair market value. Common examples of property that decreases in value include clothing, furniture, appliances, and cars.

2. Giving Property That Has Increased in Value

Another common estate planning tool involves the gift or property that has appreciated in value. If an individual contributes property with a fair market value that is more than his or her basis in it, he or she may have to reduce the fair market value by the amount of appreciation (increase in value) when calculating his or her deduction.

Different rules apply to figuring the deduction, depending on whether the property is ordinary income property or capital gain property.

Property is ordinary income property if its sale at fair market value on the date it was contributed would have resulted in ordinary income or in short-term capital gain. Examples of ordinary income property are inventory, works of art created by the donor, manuscripts prepared by the donor, and capital assets held 1 year or less.

Property used in a trade or business is considered ordinary income property to the extent of any gain that would have been treated as ordinary income because of depreciation had the property been sold at its fair market value at the time of contribution.

The amount an individual can deduct for a contribution of ordinary income property is its fair market value less the amount that would be ordinary income or short-term capital gain if the owner sold the property for its fair market value. Generally, this rule limits the deduction to the owner's basis in the property.

**Example.**

Lonnie, who knows he has only six months to live, donates stock that he has held for 5 months to his church. The fair market value of the stock on the day he donates it is $1,000, but he paid only $800 (his basis). Because the $200 of appreciation would be short-term capital gain if Lonnie sold the stock, his deduction is limited to $800 (fair market value less the appreciation).

Property is capital gain property if its sale at fair market value on the date of the contribution would have resulted in long-term capital gain. Capital gain property includes capital assets held more than one year.
Capital assets include most items of property that an individual owns and uses for personal purposes or investment. Examples of capital assets are stocks, bonds, jewelry, coin or stamp collections, and cars or furniture used for personal purposes. For purposes of figuring a charitable contribution, capital assets also include certain real property and depreciable property used in a trade or business and, generally, held more than one year. (Individuals may have to treat this property as partly ordinary income property and partly capital gain property.)

When figuring the deduction for a gift of capital gain property, an individual can usually use the fair market value of the gift. However, in certain situations, they must reduce the fair market value by any amount that would have been long-term capital gain if the individual had sold the property for its fair market value. Generally, this means reducing the fair market value to the property's cost or other basis. This must be done if:

- The property (other than qualified appreciated stock) is contributed to certain private nonoperating foundations;
- The contributed property is tangible personal property that is put to an unrelated use by the charity; or
- The individual chooses the 50% limit instead of the 30% limit, discussed later.

The reduced deduction applies to contributions to all private nonoperating foundations other than those qualifying for the 50% limit, discussed later.

However, the reduced deduction does not apply to contributions of qualified appreciated stock. Qualified appreciated stock is any stock in a corporation that is capital gain property and for which market quotations are readily available on an established securities market on the day of the contribution. But stock in a corporation does not count as qualified appreciated stock to the extent the individual and his or her family contributed more than 10% of the value of all the outstanding stock in the corporation.

The term tangible personal property means any property, other than land or buildings, that can be seen or touched. It includes furniture, books, jewelry, paintings, and cars. The term unrelated use means a use that is unrelated to the exempt purpose or function of the charitable organization. For a governmental unit, it means the use of the contributed property for other than exclusively public purposes.

Example.

If a painting contributed to an educational institution is used by that organization for educational purposes by being placed in its library for display and study by art students, the use is not an unrelated use. But if the painting is sold and the proceeds are used by the organization for educational purposes, the use is an unrelated use.
An individual should not reduce his charitable contribution if he includes the ordinary or capital gain income in his gross income in the same year as the contribution. This may happen when an individual transfers installment or discount obligations or when he or she assigns income to a charitable organization.

Example.

Ray donates an installment note to a qualified organization. The note has a fair market value of $10,000 and a basis to Ray of $7,000. As a result of the donation, Ray has a short-term capital gain of $3,000 ($10,000 – $7,000), which he includes in his income for the year. Ray’s charitable contribution is $10,000.

3. Bargain Sales

A bargain sale of property to a qualified organization (a sale or exchange for less than the property's fair market value) is partly a charitable contribution and partly a sale or exchange. The part of the bargain sale that is a sale or exchange may result in a taxable gain.

The part that is a charitable contribution is calculated in three steps:

Step 1. Subtract the amount the individual received for the property from the property's fair market value at the time of sale. This gives the fair market value of the contributed part.

Step 2. Find the adjusted basis of the contributed part. It equals: Adjusted basis of entire property x fair market value of contributed part ÷ fair market value of entire property.

Step 3. Determine whether the amount of the charitable contribution is the fair market value of the contributed part (which was found in Step 1) or the adjusted basis of the contributed part (which was found in Step 2). Generally, if the property sold was capital gain property, the charitable contribution is the fair market value of the contributed part. If it was ordinary income property, the charitable contribution is the adjusted basis of the contributed part.

Example.

Bernard sells ordinary income property with a fair market value of $10,000 to a church for $2,000. Bernard’s basis is $4,000 and his adjusted gross income is $20,000. Bernard makes no other contributions during the year. The fair market value of the contributed part of the property is $8,000 ($10,000 – $2,000). The adjusted basis of the contributed part is $3,200 ($4,000 x ($8,000 ÷ $10,000)). Because the property is ordinary income property, Bernard’s charitable contribution deduction is limited to the adjusted basis of the contributed part. He can deduct $3,200.
4. Limits on Deductions

If an individual’s total contributions for the year are 20% or less of his or her adjusted gross income, this section does not apply. However, for someone considering making large contributions to reduce the size of his or her taxable estate, the following rules are very important.

The amount of an individual’s deduction is limited to 50% of his or her adjusted gross income, and may be limited to 30% or 20% of his or her adjusted gross income, depending on the type of property donated and the type of organization to which it is given.

a. 50% Limit

The 50% limit applies to the total of all charitable contributions made during the year. This means that an individual’s deduction for charitable contributions cannot be more than 50% of his or her adjusted gross income for the year.

The 50% limit is the only limit that applies to gifts to organizations listed below under 50% Limit Organizations. But there is one exception. A 30% limit also applies to these gifts if they are gifts of capital gain property for which an individual figures his or her deduction using fair market value without reduction for appreciation.

b. 50% Limit Organizations

Only the following types of organizations are 50% limit organizations:

- Churches, and conventions or associations of churches;
- Educational organizations with a regular faculty and curriculum that normally have a regularly enrolled student body attending classes on site;
- Hospitals and certain medical research organizations associated with these hospitals;
- Organizations that are operated only to receive, hold, invest, and administer property and to make expenditures to or for the benefit of state and municipal colleges and universities and that normally receive substantial support from the United States or any state or their political subdivisions, or from the general public;
- The United States or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions;
 Corporations, trusts, or community chests, funds, or foundations organized and operated only for charitable, religious, educational, scientific, or literary purposes, or to prevent cruelty to children or animals, or to foster certain national or international amateur sports competition. These organizations must be “publicly supported,” which means they normally must receive a substantial part of their support, other than income from their exempt activities, from direct or indirect contributions from the general public or from governmental units;

 Organizations that may not qualify as “publicly supported” but that meet other tests showing they respond to the needs of the general public, not a limited number of donors or other persons. They must normally receive more than one-third of their support either from organizations described in above or from persons other than “disqualified persons”;

 Most organizations operated or controlled by and operated for the benefit of those organizations described above;

 Private operating foundations;

 Private nonoperating foundations that make qualifying distributions of 100% of contributions within 2½ months following the year they receive the contribution. A deduction for charitable contributions to any of these private nonoperating foundations must be supported by evidence from the foundation confirming that it made the qualifying distributions timely. A copy of this supporting data should be attached to the tax return; and

 A private foundation whose contributions are pooled into a common fund, if the foundation would be described above but for the right of substantial contributors to name the public charities that receive contributions from the fund. The foundation must distribute the common fund’s income within 2½ months following the tax year in which it was realized and must distribute the corpus not later than 1 year after the donor’s death (or after the death of the donor’s surviving spouse if the spouse can name the recipients of the corpus).

 c. 30% Limit

 A 30% limit applies to the following gifts:

 Gifts to all qualified organizations other than 50% limit organizations. This includes gifts to veterans’ organizations, fraternal societies, nonprofit cemeteries, and certain private nonoperating foundations; and

 Gifts for the use of any organization.

 However, if these gifts are of capital gain property, they are subject to the 20% limit, described later, rather than the 30% limit.
d. Special 30% Limit for Capital Gain Property

A special 30% limit applies to gifts of capital gain property to 50% limit organizations. However, the special 30% limit does not apply when an individual chooses to reduce the fair market value of the property by the amount that would have been long-term capital gain if they had sold the property. Instead, only the 50% limit applies.

This special 30% limit for capital gain property is separate from the other 30% limit. Therefore, the deduction of a contribution subject to one 30% limit does not reduce the amount an individual can deduct for contributions subject to the other 30% limit. However, the total an individual can deduct cannot be more than 50% of his or her adjusted gross income.

Example.

Paul’s adjusted gross income is $50,000. During the year, he gave capital gain property with a fair market value of $15,000 to a 50% limit organization. Paul does not choose to reduce the property’s fair market value by its appreciation in value. He also gave $10,000 cash to a qualified organization that is not a 50% limit organization. The $15,000 gift of property is subject to the special 30% limit. The $10,000 cash gift is subject to the other 30% limit. Both gifts are fully deductible because neither is more than the 30% limit that applies ($15,000 in each case) and together they are not more than the 50% limit ($25,000).

e. 20% Limit

The 20% limit applies to all gifts of capital gain property to or for the use of qualified organizations (other than gifts of capital gain property to 50% limit organizations).

f. Calculating a Deduction When Limits Apply

If an individual’s contributions are subject to more than one of the limits just discussed, he or she can deduct them as follows:

1. Contributions subject only to the 50% limit, up to 50% of your adjusted gross income.

2. Contributions subject to the 30% limit, up to the lesser of:
   a. 30% of adjusted gross income, or
   b. 50% of adjusted gross income minus your contributions to 50% limit organizations, including contributions of capital gain property subject to the special 30% limit.

3. Contributions of capital gain property subject to the special 30% limit, up to the lesser of:
   a. 30% of adjusted gross income, or
   b. 50% of adjusted gross income minus your other contributions to 50% limit organizations.
4. Contributions subject to the 20% limit, up to the lesser of:
   a. 20% of adjusted gross income,
   b. 30% of adjusted gross income minus your contributions subject to the 30% limit,
   c. 30% of adjusted gross income minus your contributions of capital gain property subject to the special 30% limit, or
   d. 50% of adjusted gross income minus the total of your contributions to 50% limit organizations and your contributions subject to the 30% limit.

Example.

Martha’s adjusted gross income is $50,000. During the year, she gave her church $2,000 cash and land with a fair market value of $28,000 and a basis of $22,000. Martha held the land for investment purposes. She does not choose to reduce the fair market value of the land by the appreciation in value. Martha also gave $5,000 cash to a private foundation to which the 30% limit applies.

The $2,000 cash donated to the church is considered first and is fully deductible. Her contribution to the private foundation is considered next. Because her contributions to 50% limit organizations ($2,000 + $28,000) are more than $25,000 (50% of $50,000), her contribution to the private foundation is not deductible for the year. It can be carried over to later years. The gift of land is considered next. Martha’s deduction for the land is limited to $15,000 (30% × $50,000). The unused part of the gift of land ($13,000) can be carried over. For this year, Martha’s deduction is limited to $17,000 ($2,000 + $15,000).

g. Capital Gain Property Election

An individual may choose the 50% limit for gifts of capital gain property to 50% limit organizations instead of the 30% limit that would otherwise apply. If an individual makes this choice, he or she must reduce the fair market value of the property contributed by the appreciation in value that would have been long-term capital gain if the property had been sold.

This choice applies to all capital gain property contributed to 50% limit organizations during a tax year. It also applies to carryovers of this kind of contribution from an earlier tax year.

An individual must make the choice on his or her original return or on an amended return filed by the due date for filing the original return.

Example.

In the previous example, if Martha chose to have the 50% limit apply to the land (the 30% capital gain property) given to her church, she must reduce the fair market value of the property by the appreciation in value. Therefore, the amount of her charitable contribution for the land would be its basis to her of $22,000. Martha adds this amount to the $2,000 cash contributed to the church. She can now deduct $1,000 of the amount
donated to the private foundation because her contributions to 50% limit organizations ($2,000 + $22,000) are $1,000 less than the 50%-of-adjusted-gross-income limit. Her total deduction for the year is $25,000 ($2,000 cash to her church, $22,000 for property donated to her church, and $1,000 cash to the private foundation). Martha can carry over to later years the part of her contribution to the private foundation that she could not deduct ($4,000).

h. Carryovers

An individual can carry over his or her contributions that he or she is not able to deduct in the current year because they exceed his or her adjusted-gross-income limits. The individual can deduct the excess in each of the next 5 years until it is used up, but not beyond that time. The individual's total contributions deduction for the year to which he or she carries his or her contributions cannot exceed 50% of his or her adjusted gross income for that year.

Contributions an individual carries over are subject to the same percentage limits in the year to which they are carried. For example, contributions subject to the 20% limit in the year in which they are made are 20% limit contributions in the year to which they are carried.

For each category of contributions, an individual can deduct carryover contributions only after deducting all allowable contributions in that category for the current year. If an individual has carryovers from two or more prior years, he or she must use the carryover from the earlier year first.

Also note that a carryover of a contribution to a 50% limit organization must be used before contributions in the current year to organizations other than 50% limit organizations.

G. VALUING AN ESTATE

As a general rule, every asset included in a decedent's gross estate is valued at its fair market value. The personal representative can choose from the following valuation dates:

- The decedent's date of death; or
- The value six months later (known as the alternate valuation date).

The alternative valuation date election is allowed only if it lowers the individual's tax liability. Whatever date is selected, it is irrevocable and will apply to all assets in the estate.

If the 6-months-after-death date applies, all of the decedent's assets must be valued on that date. Furthermore, if property is sold, distributed, exchanged, or disposed of during the 6-month period, it is valued on the date of the distribution, sale, etc., rather than the alternative valuation date.
Family farmland and closely-held family business interests can be valued at less than their highest-and-best use. A separate discussion on family businesses is discussed in Chapter 4.

It is important that the decedent’s personal representative accurately value the estate. Otherwise, underpayment penalties described below apply.

H. U.S. CITIZENS OR RESIDENTS; NONRESIDENT NONCITIZENS

An executor must file Form 706 for the estates of decedents who were either U.S. citizens or U.S. residents at the time of death. For estate tax purposes, a resident is someone who had a domicile in the United States at the time of death. A person acquires a domicile by living in a place for even a brief period of time, as long as the person had no intention of moving from that place.

An executor must file Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States, for the estates of nonresident alien decedents (decedents who were neither U.S. citizens nor residents at the time of death).

I. PAYING ESTATE TAXES

The estate and Generation Skipping Taxes (GST) taxes are due within nine months after the date of the decedent's death unless an extension of time for payment has been granted, or unless an executor has properly elected under § 6166 to pay in installments, or under § 6163 to postpone the part of the tax attributable to a reversionary or remainder interest.

J. PENALTIES

1. Late Filing and Late Payment

Internal Revenue Code § 6651 provides for penalties for both late filing and for late payment unless there is reasonable cause for the delay. The law also provides for penalties for willful attempts to evade payment of tax. The late filing penalty will not be imposed if the taxpayer can show that the failure to file a timely return is due to reasonable cause.

2. Valuation Understatement

Internal Revenue Code § 6662 provides a 20% penalty for the underpayment of estate tax that exceeds $5,000 when the underpayment is attributable to valuation understatements. A valuation understatement occurs when the value of property reported on Form 706 is 50% (65% for returns filed after August 17, 2006) or less of the actual value of the property.

This penalty increases to 40% if there is a gross valuation understatement. A gross valuation understatement occurs if any property on the return is valued at 25% (40% for returns filed after August 17, 2006) or less of the value determined to be correct.

These penalties also apply to late filing, late payment, and underpayment of GST taxes.
III. Gift Tax

The gift tax applies to the transfer by gift of any property. An individual makes a gift if he or she gives property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If an individual sells something at less than its full value or if he or she makes an interest-free or reduced interest loan, he or she may be making a gift.

Example 1.

*Lisa’s granddaughter, Katie, is going away to college and needs a car to come home on the weekends. Lisa buys Katie a Volkswagen Bug. This is clearly a gift.*

Example 2.

*Rob’s cousin, Mark, is trying to open a new business detailing cars. Rob has always felt that Mark did not get as much financial support from their grandparents as he did so he wants to help his cousin out. He tells Mark that he will “loan” him $50,000 to open his business, but that the money does not need to be paid back until the business becomes successful. Although Rob is calling this payment a “loan,” it appears more like a gift since there is no apparent expectation of repayment.*

Even if tax applies to a gift or estate, it may be eliminated by the unified credit, discussed below.

A. GENERAL RULE

The general rule is that any gift is a taxable gift. However, there are many exceptions to this rule. Generally, the following gifts are not taxable gifts:

- Gifts that are not more than the annual exclusion for the calendar year;
- Tuition or medical expenses a taxpayer pays for someone (the educational and medical exclusions);
- Gifts to an individual’s spouse;
- Gifts to a political organization for its use; and
- Gifts to qualified charities (a deduction is available for these amounts).

B. ANNUAL EXCLUSION

A separate annual exclusion applies to each person to whom an individual makes a gift. For 2011, the annual exclusion is $13,000. Therefore, during 2011 an individual generally can give up to $13,000 each to any number of people and none of the gifts would have been taxable.
1. **Married Couples**

If an individual is married, both he or she and his or her spouse can separately give up to $13,000 to the same person in the same year without making a taxable gift. If one of the two gives more than $13,000 to a person, the gift splitting rules discussed below apply. Gifts to individuals are not deductible on the donor's income tax returns.

2. **Inflation Adjustment**

After 2011, the $13,000 annual exclusion will continue to be indexed in $1,000 increments due to annual CPI cost-of-living adjustments. See the instructions for Form 709 for the amount of the annual exclusion for the year the gift is made.

**Example 1.**

*In 2011, Wanda gives her niece a cash gift of $8,000. It is her only gift to her this year. The gift is not a taxable gift because it is not more than the $13,000 annual exclusion.*

**Example 2.**

*Martin pays the $15,000 college tuition of his friend. Because the payment qualifies for the educational exclusion, the gift is not a taxable gift.*

**Example 3.**

*In 2011, Ken gives $25,000 to his 25-year-old daughter. The first $13,000 of his gift is not subject to the gift tax because of the annual exclusion. The remaining $12,000 is a taxable gift. As explained later under Applying the Unified Credit to Gift Tax, Ken may not have to pay the gift tax on the remaining $12,000. However, he does have to file a gift tax return.*

3. **Gift Splitting**

If an individual and his spouse make a gift to a third party, the gift can be considered as made one-half by the individual and one-half by his spouse. This is known as *gift splitting*. Both spouses must consent (agree) to split the gift. If such consent is given, each spouse can take the annual exclusion for his or her part of the gift. In 2011, for example, gift splitting allowed married couples to give up to $26,000 to a person without making a taxable gift.

If a couple does decide to split a gift, they must file a gift tax return showing that there was an agreement to split the gift.
Example.

John and his wife, Marsha, agree to split the gifts that they made during 2011. John gives his son, George, $21,000, and Marsha gives her daughter, Gina, $18,000. Although each gift is more than the annual exclusion ($13,000), by gift splitting they can make these gifts without making a taxable gift.

John’s gift to George is treated as one-half ($10,500) from John and one-half ($10,500) from Marsha. Marsha’s gift to Gina is also treated as one-half ($9,000) from Marsha and one-half ($9,000) from John. In each case, because one-half of the split gift is not more than the annual exclusion, it is not a taxable gift. However, each of them must file a gift tax return.

4. No Limit on Number of Gift Recipients

An individual is free to give away as many gifts as he or she wants. In theory, a rich man could dispose of his entire estate by giving thousands of people a gift that falls under the annual exclusion level.

Example.

Walt, who knows that he is dying, decides to dispose of his entire $985,000 cash estate by making gifts to his many family members and friends. Assuming the applicable annual exclusion in the year he wishes to make the gifts is $13,000, Walt can make a gift of $13,000 to 75 different people and $10,000 to one person and avoid any gift tax liability. In so doing, he will be disposing of his entire $985,000 in a single year.

C. APPLICATION OF THE UNIFIED CREDIT

A credit is an amount that eliminates or reduces tax. The unified credit applies to both the gift tax and the estate tax. You must subtract the unified credit from any gift tax that you owe. Any unified credit you use against your gift tax in one year reduces the amount of credit that you can use against your gift tax in a later year. The total amount used against your gift tax reduces the credit available to use against your estate tax.

Example.

In 2010, Lori gives her niece, Mary, a cash gift of $8,000. It is her only gift to her this year. Lori pays the $15,000 college tuition of her friend, David. Lori gave her 25-year-old daughter, Lisa, $25,000. She also gives her 27-year-old son, Ken, $25,000. Before 2010, Lori had never given a taxable gift. She applies the exclusions to the gift tax and the unified credit as follows:

1. Apply the educational exclusion. Payment of tuition expenses is not subject to the gift tax. Therefore, the gift to David is not a taxable gift.
2. Apply the annual exclusion. The first $13,000 Lori gives someone during 2010 is not a taxable gift. Therefore, her $8,000 gift to Mary, the first $13,000 of her gift to Lisa, and the first $13,000 of her gift to Ken are not taxable gifts.

3. Apply the unified credit. The gift tax on $24,000 ($12,000 remaining from her gift to Lisa plus $12,000 remaining from her gift to Ken) is $4,680. Lori subtracts the $4,680 from her unified credit of $345,800 for 2010. The unified credit that she can use against the gift tax in a later year is $341,120.

Lori does not have to pay any gift tax for 2010. However, she does have to file Form 709.

D. GIFTS EXEMPT FROM TAX

Regardless of the identity of the recipient or the purpose of the gift (i.e., to help pay for a car or to take a Caribbean cruise), any gift which falls under the annual exclusion limit is exempt from tax. There are other categories that provide a larger exemption.

1. Educational and Medical Expenses

In addition to the $13,000 annual Gift Tax exclusion, there is a 100% exclusion when an individual makes direct payments for someone’s medical bills or tuition expenses. Both the medical and educational exclusions are allowed without regard to the relationship – so the recipient need not be a close relative or dependent. The payments must be made directly to the medical care provider or the educational institution. Payments to the recipient cancel the tax benefit. Room and board, supplies, books and other fees do not qualify.

A qualifying educational organization is one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students.

Medical care includes expenses for diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or for transportation. It also includes medical insurance.

2. Gifts to a Spouse

Transfers between spouses are 100% deductible for gift tax purposes. This is known as the "unlimited Gift Tax marital deduction". However, the value of the gift, whether it was for a future or present interest, must be included in the giver's gross estate on death in order for the deduction to apply. If the gross estate does not include the transfers to the spouse, no marital deduction applies.

This gift exclusion only applies to gifts to a U.S. citizen spouse. An individual can give away $134,000 in 2010 ($136,000 in 2011) tax-free to a spouse who is not a U.S. citizen.
3. **Charitable Contributions**

Individuals can give any amount – no matter how large – to a qualified charity completely tax-free. For example, if Martin owns real estate that he gifts outright to a charity, no gift tax is due. The value of what Martin transferred is included in the gross estate after his death, but it is 100% subtracted before the tax rates are applied. This issue is discussed in more detail above in the section on estate taxes.

**E. VALUING GIFTS**

An important component in determining the applicability of a gift tax is the value of the gift. If someone makes a gift of $15,000 in cash, valuation is obviously not an issue. Valuation questions arise with other types of property, such as real property, stocks and collectibles.

**Example.**

*Michael makes a gift to his nephew of 1,000 shares of stock in XYZ Corporation. Michael purchased the shares two years ago at $5 per share. On the day he makes the gift, the stock is trading at $15 per share. Is the value of the gift $5,000 (the amount Michael paid for the stock) or $15,000 (the current value of the stock at the time the gift is executed)? The IRS considers the value of the gift to be its fair market value at the time the gift is made. This means that the value of this gift is $15,000, above the applicable annual exclusion of $13,000. The gift will still, however, come under Michael’s lifetime umbrella exclusion and he will therefore not currently have to pay tax on the gift. Upon Michael’s death, the total amount of his lifetime gifts will be calculated and subtracted from his unified credit applicable in the year of his death.*
Table 1-2. Determining Whether Gift Is Subject to Gift Tax

The following table is intended to help the reader determine whether a gift is subject to gift tax or not.

<table>
<thead>
<tr>
<th>Type of Gift</th>
<th>Whether It Is Subject to Gift Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Father gives 10 gifts of $2,000 each to his son during calendar year.</td>
<td>Yes. Total of gifts during year exceed annual exclusion level.</td>
</tr>
<tr>
<td>Mother gifts her remainder interest in her mother’s life estate to her daughter.</td>
<td>Yes. Future interests are always subject to gift tax, regardless of value.</td>
</tr>
<tr>
<td>Husband gives his wife a $25,000 diamond ring to celebrate their silver wedding anniversary.</td>
<td>No. Gift to spouse is exempt regardless of value.</td>
</tr>
<tr>
<td>Uncle pays the $15,000 annual tuition for his nephew to attend a private university.</td>
<td>No. Educational expenses are normally exempt.</td>
</tr>
<tr>
<td>Grandmother pays $20,000 for surgery for grandson who does not have medical insurance.</td>
<td>No. Medical expenses are normally exempt.</td>
</tr>
<tr>
<td>Husband and wife jointly donate $1,000,000 to cancer research at the UCLA medical center.</td>
<td>No. Gift is made to a charitable organization.</td>
</tr>
</tbody>
</table>

F. FILING A GIFT TAX RETURN

As with the income tax return, Gift Tax returns (Form 709) are due on April 15 of the year following the year in which the taxpayer made the gift. The Gift Tax (if any) is due at the time of filing the return.

1. Return Required

An individual must file a gift tax return on Form 709 if any of the following apply:

- The individual gave gifts that are more than the annual exclusion for the year to someone (other than his or her spouse);
- The individual and his or her spouse are splitting a gift (discussed above);
- The individual gave someone (other than his or her spouse) a gift that he or she cannot actually possess, enjoy, or receive income from until some time in the future; or
- The individual gave his or her spouse an interest in property that will be ended by some future event.
2. Return Not Required

An individual is not required to file a gift tax return to report gifts to (or for the use of) political organizations and gifts made by paying someone's tuition or medical expenses. An individual also does not need to report the following deductible gifts made to charities:

- The individual's entire interest in property, if no other interest has been transferred for less than adequate consideration or for other than a charitable use; or
- A qualified conservation contribution that is a restriction (granted forever) on the use of real property.

IV. Generation Skipping Tax

A. APPLICATION AND RATIONALE

The generation skipping tax sounds complicated, but in reality it is a simple concept intended to prevent families from avoiding estate taxes.

Example.

Roger is an 85-year-old widower with one son and five grandchildren. Roger’s son, Jason, is 62-years-old and is suffering from advanced prostate cancer. He is also financially secure. If Roger leaves his property to his son, it will likely soon pass to his grandchildren. If this happens, it may be subject to estate taxes when it is passes to Jason and then again when Jason dies and leaves the estate to his own children. In order to avoid the potential of double taxation, Roger elects to “skip” his son’s generation and leave his estate directly to his grandchildren. While the idea may seem sound, the generation skipping tax could kick in and eliminate his planned tax savings.

The generation skipping tax (hereinafter referred to as “GST”) can apply outside of familial situations as well. It may be due if a beneficiary of a gift or estate is 37.5 years younger than the donor or deceased.

1. Assignment to Generations

A GST tax is due when a transfer of assets is made to a "skip person." A skip person is determined by looking at the generation assignments applicable for family and non-family members.

a. Family Members

Generally, the GST tax will be imposed when the assets are transferred to a family member two or more generations below the decedent or person making the gift. The family member must be a lineal descendant of the transferor's, or his or her spouse's, grandparents. For example, a grand-nephew, grandson or spouse's grand-nephew would all be classified as two generations below the transferor.
The law does not distinguish between persons who are whole-blood, half-blood or adopted relatives.

Regardless of the age difference between spouses, they are always considered to be of the same generation.

b. Predeceased Generation in a Direct Skip

This rule allows someone from a lower generation to be pushed into a higher generation if he or she was predeceased by someone from that higher generation.

Example.

Lucy leaves her property in trust to her son for his life, and upon her son’s death, to her grandson. If her son dies before Lucy, the property that passes to her grandson will not be considered to have skipped a generation.

A living descendant who dies no later than 90 days after the subject transfer is treated as having predeceased the transferor to the extent that either the governing instrument or applicable local law provides that such individual shall be treated as predeceasing the transferor.

In most cases, a living descendant is not treated as a predeceased child solely by reason of applicable local law; e.g., an individual is not treated as a predeceased child solely because state law treats an individual executing a disclaimer as having predeceased the transferor of the disclaimed property.

Example 1.

Thomas establishes an irrevocable trust providing that trust income is to be paid to Thomas’ grandchild, Sam, for 5 years. At the end of the 5-year period, the trust is to terminate and the principal is to be distributed to Sam. Thomas's child, Charles, a parent of Sam, is deceased at the time Thomas establishes the trust. Therefore, Sam is treated as a child of Thomas rather than as a grandchild. As a result, Sam is not a skip person, and the initial transfer to the trust is not a direct skip. Similarly, distributions to Sam during the term of the trust and at the termination of the trust will not be GSTs.

Example 2.

The facts are the same as in Example 1, except the trust income is to be paid to Thomas’s spouse, Sylvia, during the first two years of the trust. Since Sylvia has an interest in the trust, the trust is not a skip person and the transfer by Thomas is not a direct skip. Since the transfer is not a direct skip, the predeceased ancestor rule does not apply and Sam is not treated as the child of Thomas. A taxable termination occurs at the expiration of Sylvia’s interest.
c. Non-Family Situations

Non-family members are assigned to the same generation if the individual making the gift and the recipient are within 12½ years of each other in age. A beneficiary with an age difference from the person making the gift of between 12½ and 37½ years is assigned to the second generation. Any transfer of property between individuals with an age difference of more than 37½ years is subject to GST tax. Individuals with an age difference of more than 37½ years are assigned to generations in 25-year increments.

B. EXEMPTIONS

1. Life Time Exemption

Individuals may avoid the impact of the GST through their applicable life time exemption. The exemption is $5,000,000 for 2010. Application of the exemption can have a profound tax savings affect on an estate.

Example.

Lorraine plans to gift $1.12 million to a trust to provide income to her son and grandchildren. She allocates all of her GST exemption to the transfer. Because all of Lorraine’s property placed in the trust is permanently exempt from GST tax, neither the principal in the trust nor proceeds paid to her son or grandchildren will be subject to tax. If, on the other hand, Lorraine had not used her GST exemption and her son were to die, the $1.12 million that would pass to her grandchildren would be subject to the GST. Assuming a tax rate of 45%, that would reduce the value of the estate to $616,000.

2. Gifts

Gifts given outright that qualify for the applicable gift tax exclusion are shielded from the GST tax as are education and medical expenses.

3. Allocation of Exemption

The exemption may be allocated to the transferred property at any time before an estate tax return becomes due. Once the allocation election is made, the decision is irrevocable.

4. Unused Exemption

Unused GST credit is automatically allocated to direct skip transfers made during the life of a decedent unless the person elects otherwise on a gift tax return. In addition, the exemption will be deemed allocated to any trust that involves an "indirect skip" during the decedent’s lifetime.

Any portion of the exemption that remains unallocated upon the death of the decedent is first allocated to any direct skips that occurs at his or her death (e.g., a bequest to a grandchild), and then to trusts from which a taxable distribution or taxable termination may occur by virtue of the individual's death. A generation-skipping trust may undergo a "qualified severance" under which it would be split into exempt and non-exempt trusts.
C. TAX RATE

Due to the 2010 Tax Relief Act, signed into law by the President on December 18, 2010, the GST exemption amount is set at $5,000,000 (and a 35% tax rate) for 2011 and 2012. For deaths occurring in 2010, the GST exemption is also $5,000,000, but the tax rate is zero percent. Prior to 2010, the exemption amount was the same as the estate tax exemption amount.

Table 1-3. Generation Skipping Tax Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>46%</td>
</tr>
<tr>
<td>2007-2009</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>0%</td>
</tr>
<tr>
<td>2011</td>
<td>35%</td>
</tr>
<tr>
<td>2012</td>
<td>35%</td>
</tr>
</tbody>
</table>

1. Tax Rate Is Flat

Unlike the graduated tax rates used for the estate and gift taxes, the GST tax is a flat rate tax.

2. State Tax Credit

The federal GST tax permits a credit for any GST taxes paid to a state. The credit may only be claimed if:

- The transfer is not a direct skip; and
- The GST occurs at the same time and as a result of the death of an individual.

The amount allowed as a credit must not surpass 5% of the amount of the federal GST tax imposed.

The Economic Growth and Tax Relief Reconciliation Act of 2001 eliminates the federal credit for state GST taxes paid for the years 2005-2009. The federal credit is scheduled to be reinstated in 2011 when the federal GST returns.

3. Deductions

In some cases, deductions are available to reduce the liability of the GST tax. The type of transfer determines whether a deduction applies. The transferor of a taxable termination may claim a deduction for administration expenses, indebtedness and taxes. Taxable distributions may be reduced by the expenses of determination, collection, or refund of a tax. Direct skips, on the other hand, are not eligible for any deductions.
D. PAYMENT OF TAX

The party responsible for payment of the GST tax depends upon the type of generation skipping transfer. The following table identifies which individual must pay the GST tax.

Table 1-4. Payment of Generation Skipping Tax

<table>
<thead>
<tr>
<th>Type of Transfer</th>
<th>Party Responsible for Paying Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Termination</td>
<td>Trustee</td>
</tr>
<tr>
<td>Taxable Distribution</td>
<td>Transferee</td>
</tr>
<tr>
<td>Direct Skip (Trust)</td>
<td>Trustee</td>
</tr>
<tr>
<td>Direct Skip (Outright Transfer)</td>
<td>Transferor</td>
</tr>
</tbody>
</table>

1. Taxable Termination

A "taxable termination" occurs upon the termination of an interest in property held in trust (by death, lapse of time, release of power, or otherwise) if:

- Immediately after the termination a skip person has an interest in such property; or

- At any time after the termination, a distribution may be made from the trust to a skip person.

A common example of a taxable termination occurs when a decedent places assets in a trust, with income payable for life to a child, and the remainder to a grandchild. Normally, the child's life estate interest would not be taxable at death. However, the GST tax treats the termination of the child's interest at death as a "taxable termination," i.e. a taxable transfer to the grandchild, triggering the tax.

Example 1.

Allan establishes an irrevocable trust under which the income is to be paid to his child, Chris, for life. On the death of Chris, the trust principal is to be paid to Allan’s grandchild, Alex. Since Chris has an interest in the trust, the trust is not a skip person and the transfer to the trust is not a direct skip. If Chris dies survived by Alex, a taxable termination occurs at Chris's death because Chris's interest in the trust terminates and thereafter the trust property is held by a skip person who occupies a lower generation than Chris.
Example 2.

Allan establishes an irrevocable trust for the benefit of his child, Chris, grandchild, Alex, and Allan's great-grandchild, Lisa. Under the terms of the trust, income and principal may be distributed to any or all of the living beneficiaries at the discretion of the trustee. Upon the death of the second beneficiary to die, the trust principal is to be paid to the survivor. Chris dies first. A taxable termination occurs at that time because, immediately after Chris's interest terminates, all interests in the trust are held by skip persons (Alex and Lisa).

2. Taxable Distribution

A "taxable distribution" is a distribution from a trust to a "skip person" that is not classified as a taxable termination or a direct skip.

3. Direct Skip

A direct skip is a transfer to a skip person that is subject to Federal estate or gift tax. If property is transferred to a trust, the transfer is a direct skip only if the trust is a skip person. Only one direct skip occurs when a single transfer of property skips two or more generations.

Example 1.

Ted gratuitously conveys Blackacre to Ted's grandchild. Because the transfer is a transfer to a skip person of property subject to Federal gift tax, it is a direct skip.

Example 2.

Ted gratuitously conveys Blackacre to Ted's great-grandchild. The transfer is a direct skip. Only one GST tax is imposed on the direct skip although two generations are skipped by the transfer.

With the exception of an outright direct skip, the GST tax return must be filed before the fifteenth day of the fourth month in the year following the taxable year of the transfer. In the case of an outright direct skip transfer, a return must be filed on or before the date for filing the gift or estate tax return.

E. GENERATION SKIPPING TRUST

A common estate-planning tool to avoid the GST is the establishment of a so-called generation-skipping trust. This type of trust can be established either during the life time of the trustor or upon his or her death. If it is established while the trustor is still alive, all or part of the GST exemption will be allocated to the trust on the trustor’s gift tax return. If the trust is not established until the trustor dies, the executor of the estate will allocate the exemption on the final tax return of the decedent.
Whether the trust is established during the trustor’s lifetime or at death, the assets of the trust will also be subject to gift or estate taxes. Therefore, the tax consequences of when the trust is established must be compared. If the trust is established with a lifetime gift, the total transfer tax cost to the trustor is the gift tax and the GST tax. If the transfer takes place at death, the total transfer tax is the estimated estate tax on the decedent’s estate (assuming the decedent made no lifetime gifts) plus the GST tax.

Many people also choose to use life insurance to fund a generation-skipping trust. The GST exclusion is applied to the premium rather than the benefit paid upon death. This leaves more of the GST exemption to apply to other assets.

V. State Death Taxes

A. STATES DEATH TAXES: INHERITANCE, ESTATE AND GIFT TAXES

For some people, state taxes are also an issue in estate planning. States levy one of two types of death taxes: inheritance and estate (states also levy gift taxes). Inheritance taxes are imposed on the person receiving the devise, while estate taxes are levied on the estate of the deceased person before assets are distributed to heirs.

As of January 2011, a handful of states impose some sort of inheritance or “death tax” on estates. These are:

- Indiana;
- Iowa;
- Kentucky;
- Maryland;
- Nebraska;
- New Jersey;
- Ohio;
- Pennsylvania;
- Tennessee; and
- Washington.
1. **Inheritance Tax**

Inheritance taxes are normally imposed at graduated rates based upon the amount of the devise and upon the relationship between the deceased and the beneficiary.

Several types of exemptions are typically allowed under the inheritance tax:

- Personal exemptions based on the relationship of the giver and receiver (the most common one is for a surviving spouse);
- Exemptions of a specified amount allowed the entire estate;
- Exemptions for property on which a tax already has been paid;
- Exemptions for bequests to charitable, religious or educational institutions; and
- Exemptions for particular types of property.

The personal exemption is usually the most important for state estate tax purposes. There is normally a greater exemption for gifts given to close relatives than to more distant relatives or non-relatives.

Rates also vary significantly between states. In Indiana, for example, lineal descendants are taxed at rates varying from 1 percent on inheritances of up to $25,000 to 10 percent on amounts of $1.5 million or more. In Pennsylvania, they are taxed at a 4.5 percent rate and non-relatives are taxed at a 15 percent rate, regardless of the amount of inheritance.

2. **Estate Taxes**

Estate taxes are also imposed at graduated rates based upon the value of the estate. Unlike the inheritance tax, the rates generally are imposed on the estate as a whole and do not vary based upon the relationship of the beneficiary to the donor.

3. **Gift Tax**

The rates imposed and the exemptions allowed under state gift tax laws are similar to rates and exemptions under the inheritance tax. In the case of a gift tax, however, it is the donor rather than the beneficiary who is liable for payment of the tax.

**B. STATE DEATH TAX CREDIT**

When the federal estate tax was enacted, so too was a provision that provided a state death tax credit. Individuals have historically been entitled to a credit against the federal tax for death taxes paid to a state. Under the Federal Estate Tax Act of 1926, the maximum credit is 80 percent. This credit is commonly referred to as a "pick-up" tax. The total tax liability for the beneficiaries does not increase and all states currently impose this tax up to the allowable federal credit.
One of the many components of The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) phased out the state death tax credit allowed against the federal estate tax in 25% increments between 2002 and 2005. The repeal of the credit was intended to increase revenues to the federal government.

Prior to the enactment of EGTRRA in 2001, 38 states and the District of Columbia used a pick-up tax in which the state death tax was an amount equal to the maximum amount of state death tax credit allowed under federal law.

In five states (New York, North Carolina, Oregon, Virginia and Washington), the state pick-up tax was tied to the federal estate tax as of a particular date prior to the enactment of EGTRRA. In the remaining cases, the state pick-up tax was tied to the federal code on an automatic or rolling basis, meaning that the pick-up tax would phase-out in these states unless the state enacted legislation to the contrary.

The remaining 12 states – Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, New Hampshire, New Jersey, Ohio, Oklahoma, Pennsylvania and Tennessee – also coordinated their death taxes (a stand-alone inheritance or estate tax) with the state death tax credit. In these states, the state death tax credit acted as a minimum tax for the stand-alone tax (i.e., the estate was liable for the greater of the death tax credit or the separately computed state tax) or as a supplemental state death tax (i.e., an amount equal to the allowable death tax credit was owed in addition to a state-computed liability).

Of these twelve states, all except Kansas were tied to the federal code on an automatic or rolling basis prior to the enactment of EGTRRA. In addition, Ohio takes the position that its incorporation of the state death tax credit into its estate tax is not affected by the passage of EGTRRA.

Table 1-5. Death Taxes by State and Type – (January 2011)

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CHAPTER 1 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following years has the lowest estate tax rate according to current law:
   a) 2001-2006
   b) 2007-2009
   c) 2012
   d) 2013-2015

2. Most estates are subject to the estate tax.
   a) true
   b) false

3. In 2010, the amount of a decedent’s estate excluded from estate tax was $5.0 million.
   a) true
   b) false

4. Debts the decedent owed at the time of death are not included when calculating a decedent’s taxable estate.
   a) true
   b) false

5. For tax purposes, how are assets in a decedent’s estate valued:
   a) the lesser of their fair market value at the time of death or the time they were acquired
   b) their fair market value at the time of death
   c) their fair market value six months after the decedent’s death
   d) either b or c above

6. Estate taxes are generally due:
   a) three months after the death of the decedent
   b) six months after the death of the decedent
   c) nine months after the death of the decedent
   d) 18 months after the death of the decedent
7. Direct payments for someone’s medical expenses or educational tuition are exempt from federal gift tax.

   a) true
   b) false

8. Which of the following would be subject to a gift tax:
   
   a) a father gives 10 gifts of $2,000 each to his son during the calendar year
   b) a husband gives his wife a $25,000 diamond ring
   c) an uncle pays the $15,000 annual tuition for his nephew to attend a private university
   d) a grandmother pays $20,000 for her grandson’s surgery

9. The federal Generation Skipping Tax never applies to gifts made to non-family members.

   a) true
   b) false

10. In addition to federal estate taxes, all states impose their own so-called “death tax.”

   a) true
   b) false
CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1.  **A:** Incorrect. This year range contained the highest rates (55% to 46%) and the lowest asset exclusion levels.

   **B:** Incorrect. The exclusion from income increased to $3.5 million in 2009, but during this period, it is still not the most advantageous rate.

   **C:** Correct. Per the 2010 Tax Act, 2010-2012 contains the lowest estate tax rates for the periods noted.

   **D:** Incorrect. Congress has not currently set the estate tax rate for these years.

   (See page 1-1 of the course material.)

2.  **A:** True is incorrect. Only about 2% of all estates are subject to the estate tax.

   **B:** False is correct. Even if the estate tax applies, it may be eliminated by the Unified Credit.

   (See page 1-2 of the course material.)

3.  **A:** True is correct. Federal law provides an exclusion from estate tax for a certain part of a decedent’s estate. The amount is different depending on the year in which the decedent dies. For decedents who die in 2010, the first $5.0 million of their estate will be excluded from federal estate taxes.

   **B:** False is incorrect. Under current law, the first $5.0 million of an estate for decedent’s dying in 2010 will be excluded.

   (See page 1-4 of the course material.)

4.  **A:** True is correct. A decedent’s taxable estate is his or her gross estate less any allowable deductions. Allowable deductions include debts the decedent owed at the time of death.

   **B:** False is incorrect. Debts the decedent owed at the time of death are deducted from a decedent’s gross estate in order to calculate the value of the estate subject to tax.

   (See page 1-5 of the course material.)
5. A: Incorrect. The value at the time of acquisition is not relevant.
   
   B: Incorrect. This is one choice the personal representative has.
   
   C: Incorrect. This is an alternative method the personal representative has. This alternative valuation is allowed only if it lowers the individual’s tax liability. Whatever date is selected, it is irrevocable and will apply to all assets in the estate.
   
   D: Correct. The personal representative can elect either B or C for purposes of valuing the assets of the estate.
   
   (See pages 1-14 to 1-15 of the course material.)

6. A: Incorrect. The general time allowed is longer.
   
   B: Incorrect. The general time allowed is longer.
   
   C: Correct. Both estate and generation skipping taxes, where applicable, are due nine months after the decedent’s death barring an extension.
   
   D: Incorrect. A shorter period of time is allowed, absent an extension.
   
   (See page 1-15 of the course material.)

7. A: True is correct. Payments for medical and educational expenses are not subject to gift tax regardless of the relationship between the donor and the recipient so long as the payments are made directly to the medical care provider or the educational institution.
   
   B: False is incorrect. Educational and medical expense payments are normally excluded from federal gift tax.
   
   (See page 1-19 of the course material.)

8. A: Correct. Gifts totaling more than $13,000 (in 2010) to one donee exceed the annual gift exclusion level.
   
   B: Incorrect. Gifts to a spouse are exempt from the gift tax, regardless of value.
   
   C: Incorrect. Gifts made directly to a university for annual tuition are generally exempt.
   
   D: Incorrect. Gifts made directly to medical care providers for medical treatment are normally exempt.
   
   (See page 1-22 of the course material.)
9. A: True is incorrect. Under some circumstances, gifts to non-family members will trigger application of the Generation Skipping Tax.

**B: False is correct.** When determining the applicability of the Generation Skipping Tax, non-family members are assigned to the same generation if the individual making the gift and the recipient are within 12½ years of each other in age. A beneficiary with an age difference to the person making the gift of between 12½ and 37½ years is assigned to the second generation. Individuals with an age difference of more than 37½ years are assigned to generations in 25-year increments.

(See page 1-23 of the course material.)

10. A: True is incorrect. Most states do not impose their own death taxes.

**B: False is correct.** Currently only 10 states impose their own death taxes on decedent’s estates.

(See page 1-27 of the course material.)
Chapter 2: Decedent’s Final Tax Return

I. Final Return for Decedent

The personal representative of a decedent must file a decedent’s final income tax return (Form 1040) for the year of death, plus any returns not filed for preceding years. A surviving spouse, under certain circumstances, may have to file the returns for the decedent.

If an individual died after the close of the tax year, but before the return for that year was filed, the return for the year just closed will not be the final return. The return for that year will be a regular return and the personal representative must file it.

Example.


A. FILING REQUIREMENTS

The gross income, age, and filing status of a decedent generally determine whether a return must be filed. Gross income usually is all income received by an individual in the form of money, goods, property, and services that is not tax-exempt. It includes gross receipts from self-employment. In general, filing status depends on whether the decedent was considered single or married at the time of death.

1. Refunds

A return should be filed to obtain a refund if tax was withheld from salaries, wages, pensions, or annuities, or if estimated tax was paid, even if a return is not required to be filed. Also, the decedent may be entitled to other credits that result in a refund.

Generally, a person who is filing a return for a decedent and claiming a refund must file Form 1310 with the return. However, if the person claiming the refund is a surviving spouse filing a joint return with the decedent, or a court-appointed or certified personal representative filing an original return for the decedent, Form 1310 is not needed. The personal representative must attach to the return a copy of the court certificate showing that he or she was appointed the personal representative.

If the personal representative is filing a claim for refund on Form 1040X, Amended U.S. Individual Income Tax Return, or Form 843, Claim for Refund and Request for Abatement, and the court certificate has already been filed with the IRS, attach Form 1310 and write Certificate Previously Filed at the bottom of the form.
Example.

Mr. Green died before filing his tax return. Alan was appointed the personal representative for Mr. Green's estate, and files his Form 1040 showing a refund due. Alan does not need Form 1310 to claim the refund if he attaches a copy of the court certificate showing he was appointed the personal representative.

2. Nonresident Alien

If the decedent was a nonresident alien who would have had to file Form 1040NR, U.S. Nonresident Alien Income Tax Return, the personal representative must file that form for the decedent's final tax year.

3. Joint Return

Generally, the personal representative and the surviving spouse can file a joint return for the decedent and the surviving spouse. However, the surviving spouse alone can file the joint return if no personal representative has been appointed before the due date for filing the final joint return for the year of death. This also applies to the return for the preceding year if the decedent died after the close of the preceding tax year but before the due date for filing that return. The income of the decedent that was included on his or her return for the year up to the date of death and the income of the surviving spouse for the entire year must be included in the final joint return.

A final joint return with the decedent cannot be filed if the surviving spouse remarried before the end of the year of the decedent's death. The filing status of the decedent in this instance is married filing separate.

4. Personal Representative May Revoke Joint Return Election

A court-appointed personal representative may revoke an election to file a joint return that was previously made by the surviving spouse alone. This is done by filing a separate return for the decedent within one year from the due date of the return (including any extensions). The joint return made by the surviving spouse will then be regarded as the separate return of that spouse by excluding the decedent's items and recalculating the tax liability.

B. INCOME TO INCLUDE

The decedent's income included on the final return is generally determined as if the person were still alive except that the taxable period is usually shorter because it ends on the date of death. The method of accounting regularly used by the decedent before death also determines the income that must be included on the final return.
1. Accounting Methods

a. Cash Method

If the decedent accounted for income under the cash method, only those items actually or constructively received before death are included in the final return. Interest from coupons on the decedent's bonds are considered constructively received by the decedent if the coupons matured in the decedent's final tax year, but had not been cashed. Include the interest in the final return.

Generally, a dividend was constructively received if it was available for use by the decedent without restriction. If the corporation customarily mailed its dividend checks, the dividend was included when received. If the individual died between the time the dividend was declared and the time it was received in the mail, the decedent did not constructively receive it before death and the dividend should not be included in the final return.

b. Accrual Method

Generally, under an accrual method of accounting, income is reported when earned. If the decedent used an accrual method, only the income items normally accrued before death are included in the final return.

2. Partnership Income

The death of a partner closes the partnership's tax year for that partner. Generally, it does not close the partnership’s tax year for the remaining partners. The decedent's distributive share of partnership items must be figured as if the partnership's tax year ended on the date the partner died. To avoid an interim closing of the partnership books, the partners can agree to estimate the decedent's distributive share by prorating the amounts the partner would have included for the entire partnership tax year.

On the decedent's final return, the decedent's distributive share of partnership items should be included for the following periods:

- The partnership's tax year that ended within or with the decedent's final tax year (the year ending on the date of death); and

- The period, if any, from the end of the partnership's tax year above to the decedent's date of death.

Example.

Mary Smith was a partner in XYZ partnership and reported her income on a tax year ending December 31. The partnership uses a tax year ending June 30. Mary died August 31, 2009, and her estate established its tax year through August 31.
The distributive share of partnership items based on the decedent's partnership interest is reported as follows.

- **Final Return for the Decedent** – January 1 through August 31, 2009, includes XYZ partnership items from (a) the partnership tax year ending June 30, 2009, and (b) the partnership tax year beginning July 1, 2009, and ending August 31, 2009 (the date of death);


3. **S Corporation Income**

   If the decedent was a shareholder in an S corporation, the final return should include the decedent's share of the S corporation's items of income, loss, deduction, and credit for the following periods:

   1) The corporation's tax year that ended within or with the decedent's final tax year (the year ending on the date of death); and

   2) The period, if any, from the end of the corporation's tax year in (1) to the decedent's date of death.

4. **Self-Employment Income**

   Self-employment income actually or constructively received or accrued, should be included depending on the decedent's accounting method. For self-employment tax purposes only, the decedent's self-employment income will include the decedent's distributive share of a partnership's income or loss through the end of the month in which death occurred. For this purpose, the partnership's income or loss is considered to be earned ratably over the partnership's tax year.

5. **Community Income**

   If the decedent was married and was domiciled in a community property state, half of the income received and half of the expenses paid during the decedent's tax year by either the decedent or spouse may be considered to be the income and expenses of the other.

6. **Interest and Dividend Income (Forms 1099)**

   A Form 1099 should be received for the decedent reporting interest and dividends earned before death and included on the decedent's final return. A separate Form 1099 should show the interest and dividends earned after the date of the decedent's death and paid to the estate or other recipient that must include those amounts on its return.
C. REPORTING ISSUES

1. Archer MSA

The treatment of an Archer MSA or a Medicare Advantage MSA, at the death of the account holder, depends on who acquires the interest in the account. If the decedent's estate acquires the interest, the fair market value of the assets in the account on the date of death is included in income on the decedent's final return. The estate tax deduction does not apply to this amount.

2. Coverdell Education Savings Account (ESA)

Generally, the balance in a Coverdell ESA must be distributed within 30 days after the individual for whom the account was established reaches age 30, or dies, whichever is earlier. The treatment of the Coverdell ESA at the death of an individual under age 30 depends on who acquires the interest in the account. If the decedent's estate acquires the interest, the earnings on the account must be included on the final income tax return of the decedent. The estate tax deduction, discussed later, does not apply to this amount.

The age 30 limitation does not apply if the individual for whom the account was established or the beneficiary that acquires the account is an individual with special needs. This includes an individual who, because of a physical, mental, or emotional condition (including learning disability), requires additional time to complete his or her education.

3. Accelerated Death Benefits

Accelerated death benefits are amounts received under a life insurance contract before the death of the insured individual. These benefits also include amounts received on the sale or assignment of the contract to a viatical settlement provider.

Generally, if the decedent received accelerated death benefits either on his or her own life or on the life of another person, those benefits are not included in the decedent's income. This exclusion applies only if the insured was a terminally or chronically ill individual.

D. EXEMPTIONS AND DEDUCTIONS

Generally, the rules for exemptions and deductions allowed to an individual also apply to the decedent's final income tax return. Show on the final return deductible items the decedent paid (or accrued, if the decedent reported deductions on an accrual method) before death. This section contains a detailed discussion of medical expenses because, under certain conditions, the tax treatment can be different for the medical expenses of the decedent.
1. **Exemptions**

A personal representative can claim the decedent's personal exemption on the final income tax return. If the decedent was another person's dependent (for example, a parent's), the personal exemption cannot be claimed on the decedent's final return.

2. **Standard Deduction**

If a personal representative does not itemize deductions on the final return, the full amount of the appropriate standard deduction is allowed regardless of the date of death.

3. **Medical Expenses**

Medical expenses paid before death by the decedent are deductible, subject to limits, on the final income tax return if deductions are itemized. This includes expenses for the decedent, as well as for the decedent's spouse and dependents.

Qualified medical expenses are not deductible if paid with a tax-free distribution from an Archer MSA.

**a. Election for decedent's expenses.** Medical expenses that were not paid before death are liabilities of the estate and are shown on the federal estate tax return (Form 706). However, if medical expenses for the decedent are paid out of the estate during the 1-year period beginning with the day after death, the personal representative can elect to treat all or part of the expenses as paid by the decedent at the time they were incurred.

If this election is made, the personal representative can claim all or part of the expenses on the decedent's income tax return, if deductions are itemized, rather than on the federal estate tax return (Form 706). He or she can deduct expenses incurred in the year of death on the final income tax return. An amended return (Form 1040X) should be filed for medical expenses incurred in an earlier year, unless the statutory period for filing a claim for that year has expired.

The amount that can be deducted on the income tax return is the amount above 7.5% of adjusted gross income. The amounts not deductible because of this percentage cannot be claimed on the federal estate tax return.

**b. Making the election.** A personal representative makes the election by attaching a statement, in duplicate, to the decedent's income tax return or amended return. The statement must state that the decedent has not claimed the amount as an estate tax deduction, and that the estate waives the right to claim the amount as a deduction. This election applies only to expenses incurred for the decedent, not to expenses incurred to provide medical care for dependents.
Example.

Richard Brown used the cash method of accounting and filed his income tax return on a calendar year basis. Mr. Brown died on June 1, 2010, after incurring $800 in medical expenses. Of that amount, $500 was incurred in 2009 and $300 was incurred in 2010. Richard itemized his deductions when he filed his 2009 income tax return. The personal representative of the estate paid the entire $800 liability in August 2010.

The personal representative may file an amended return (Form 1040X) for 2009 claiming the $500 medical expense as a deduction, subject to the 7.5% limit. The $300 of expenses incurred in 2010 can be deducted on the final income tax return if deductions are itemized, subject to the 7.5% limit. The personal representative must file a statement in duplicate with each return stating that these amounts have not been claimed on the federal estate tax return (Form 706), and waiving the right to claim such a deduction on Form 706 in the future.

c. Medical expenses not paid by estate. If an individual paid medical expenses for his or her deceased spouse or dependent, he or she can claim the expenses on his or her own tax return for the year in which they were paid, whether they are paid before or after the decedent's death. If the decedent was a child of divorced or separated parents, the medical expenses can usually be claimed by both the custodial and non-custodial parent to the extent paid by that parent during the year.

d. Insurance reimbursements. Insurance reimbursements of previously deducted medical expenses due a decedent at the time of death and later received by the decedent's estate are included in the income tax return of the estate (Form 1041) for the year the reimbursements are received. The reimbursements are also included in the decedent's gross estate.

4. Deduction for Losses

A decedent's net operating loss deduction from a prior year and any capital losses (including capital loss carryovers) can be deducted only on the decedent's final income tax return. A net operating loss on the decedent's final income tax return can be carried back to prior years. A personal representative cannot deduct any unused net operating loss or capital loss on the estate's income tax return.

a. At-risk loss limits. Special at-risk rules apply to most activities that are engaged in as a trade or business or for the production of income. These rules limit the amount of deductible loss to the amount for which the individual was considered at risk in the activity. An individual generally will be considered at risk to the extent of the money and the adjusted basis of property that he or she contributed to the activity and certain amounts the individual borrowed for use in the activity.

An individual will be considered at risk for amounts borrowed only if he or she was personally liable for the repayment or if the amounts borrowed were secured by property other than that used in the activity. The individual is not considered at risk for borrowed amounts if the lender has an interest in the activity or if the lender is related to a person who has an interest in the activity.
b. Passive activity rules. A passive activity is any trade or business activity in which the taxpayer does not materially participate. Rental activities are passive activities regardless of the taxpayer's participation, unless the taxpayer meets certain eligibility requirements.

Individuals, estates, and trusts can offset passive activity losses only against passive activity income. Passive activity losses or credits that are not allowed in one tax year can be carried forward to the next year.

If a passive activity interest is transferred because a taxpayer dies, the accumulated unused passive activity losses are allowed as a deduction against the decedent's income in the year of death. Losses are allowed only to the extent they are greater than the excess of the transferee's (recipient of the interest transferred) basis in the property over the decedent's adjusted basis in the property immediately before death. The portion of the loss that is equal to the excess is not allowed as a deduction for any tax year.

E. CREDITS, OTHER TAXES AND PAYMENTS

This section includes brief discussions of some of the tax credits, types of taxes that may be owed, income tax withheld, and estimated tax payments that are reported on the final return of a decedent.

1. Credits

A personal representative can claim on the final income tax return any tax credits that applied to the decedent before death. Some of these credits are:

a. Earned income credit. If the decedent was an eligible individual, a personal representative can claim the earned income credit on the decedent's final return even though the return covers less than 12 months. If the allowable credit is more than the tax liability for the year, the excess is refunded.

b. Credit for the elderly or the disabled. This credit is allowable on a decedent's final income tax return if the decedent was age 65 or older or had retired before the end of the tax year on permanent and total disability.

c. Child tax credit. If the decedent had a qualifying child, a personal representative may be able to claim the child tax credit on the decedent's final return even though the return covers less than 12 months. The personal representative may also be able to claim the additional child tax credit and get a refund if the credit is more than the decedent's liability.

d. General business tax credit. The general business credit available to a taxpayer is limited. Any credit arising in a tax year beginning before 1998 that has not been used up can be carried forward for up to 15 years. Any unused credit arising in a tax year beginning after 1997 has a 1-year carryback and a 20-year carryforward period.

After the carryforward period, a deduction may be allowed for any unused business credit. If the taxpayer dies before the end of the carryforward period, the deduction generally is allowed in the year of death.
2. **Other Taxes**

Taxes other than income tax that may be owed on the final return of a decedent include self-employment tax and alternative minimum tax, which are reported on Form 1040.

**a. Self-employment tax.** Self-employment tax may be owed on the final return if either of the following applied to the decedent in the year of death:

1. Net earnings from self-employment (excluding income described in (2)) were $400 or more; and
2. Wages from services performed as a church employee were $108.28 or more.

**b. Alternative minimum tax (AMT).** The tax laws give special treatment to some kinds of income and allow special deductions and credits for some kinds of expenses. The alternative minimum tax (AMT) was enacted so that certain taxpayers who benefit from these laws still pay at least a minimum amount of tax. In general, the AMT is the excess of the tentative minimum tax over the regular tax shown on the return.

**F. PAYMENT OF TAXES**

The income tax withheld from the decedent's salary, wages, pensions, or annuities, and the amount paid as estimated tax, for example, are credits (advance payments of tax) that a personal representative must claim on the final return.

The final income tax return is due at the same time the decedent's return would have been due had death not occurred. A final return for a decedent who was a calendar year taxpayer is generally due on April 15 following the year of death, regardless of when during that year death occurred. However, when the due date falls on a Saturday, Sunday, or legal holiday, the return is filed timely if filed by the next business day.

The tax return must be prepared on a form for the year of death regardless of when during the year death occurred.
CHAPTER 2 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. If an individual dies after the close of the tax year, but before the return for that year was filed, the return for the year just closed will not be the final return.
   a) true
   b) false

2. Under what circumstances is a surviving spouse prohibited from filing a joint return with his or her deceased spouse for the year the spouse died:
   a) under no circumstances
   b) if the surviving spouse remarried before the end of the year in which the decedent died
   c) if there is a personal representative involved
   d) if the estate is valued at over $1 million

3. If the decedent accounted for income under the cash method of accounting, only those items normally accrued before death should be included in his or her final tax return.
   a) true
   b) false

4. Which of the following is generally not included in income on a decedent’s final return:
   a) the decedent’s distributive share of partnership items for the partnership’s tax year that ended within the decedent’s final tax year
   b) the decedent’s share of an S corporation’s items of income, loss, deduction, and credit for the corporation’s tax year that ended within or with the decedent’s final tax year
   c) self-employment income actually or constructively received for a cash method taxpayer
   d) accelerated death benefits received by the decedent prior to his or her death
5. A personal representative can claim on the final income tax return any tax credits that applied to the decedent before death.
   a) true
   b) false

6. When is a decedent's final income tax return due:
   a) at the same time it would have been due had the decedent not died
   b) within six months of the decedent's death
   c) within 12 months of the decedent's death
   d) within six months of the close of probate
CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: True is correct.** The return for that year will be a regular return.

   **B: False is incorrect.** The final return will be filed for the period after the close of the prior year up to the decedent's death.

   (See page 2-1 of the course material.)

2. **A: Incorrect.** This is not true. It is prohibited in cases where the surviving spouse remarried during the same year he or she became a widow or a widower.

   **B: Correct.** This bars the surviving spouse from filing a joint return with his or her deceased spouse.

   **C: Incorrect.** This does not bar a joint filing.

   **D: Incorrect.** There is no income limit involved in the status of a filer.

   (See page 2-2 of the course material.)

3. **A: True is incorrect.** This applies to the accrual method, not the cash method of accounting.

   **B: False is correct.** If the decedent accounted for income under the cash method, only those items actually or constructively received before death are included in the final return.

   (See page 2-3 of the course material.)

4. **A: Incorrect.** The decedent's distributive share of partnership items should be included for the partnership's tax year that ended within or with the decedent's final tax year and the period, if any, from the end of the partnership's tax year to the decedent's date of death.

   **B: incorrect.** If the decedent was a shareholder in an S corporation, the final return should include these items.

   **C: Incorrect.** For self-employment tax purposes only, the decedent’s self-employment income will include the decedent's distributive share of a partnership’s income or loss through the end of the month in which death occurred.

   **D: Correct.** This exclusion only applies if the insured was a terminally or chronically ill individual.

   (See pages 2-3 to 2-5 of the course material.)
5. **A: True is correct.** If a decedent would have been eligible for a tax credit had he or she lived, the personal representative can claim such credit or credits on the decedent’s final tax return.

B: False is incorrect. The personal representative can claim any credits the decedent would have been entitled to, including the earned income credit, a credit for the elderly or disabled, the child tax credit or general business credit.

(See page 2-8 of the course material.)

6. **A: Correct.** This means that for a calendar year taxpayer, his or her return is due on April 15 following the year in which he or she died. This is true regardless of when during the year he or she actually died.

B: Incorrect. This is not the rule.

C: Incorrect. The time period is not based on the decedent’s actual date of death.

D: Incorrect. The timing of probate does not affect the filing timelines for the decedent’s final tax return.

(See page 2-9 of the course material.)
Chapter 3: Tax Benefits for Survivors

I. Introduction

Survivors can qualify for certain benefits when filing their own income tax returns, including the following:

- A surviving spouse can file a joint return for the year of death and may qualify for special tax rates for the following two years;
- If the decedent qualified as a taxpayer’s dependent for the part of the year before death, a survivor can claim the exemption for the dependent on their tax return, regardless of when death occurred during the year; or
- If the decedent was the survivor’s qualifying child, the survivor may be able to claim the child tax credit or the earned income credit.

A. QUALIFYING WIDOWS AND WIDowers

If a survivor’s spouse dies within the two tax years preceding the year for which their return is being filed, the survivor may be eligible to claim the filing status of qualifying widow(er) with dependent child and qualify to use the Married filing jointly tax rates.

1. Requirements

Generally, a widow or widower can qualify for this special benefit if they meet all of the following requirements:

- They were entitled to file a joint return with their spouse for the year of death - whether or not they actually filed jointly;
- They did not remarry before the end of the current tax year;
- They have a child, stepchild, or foster child who qualifies as their dependent for the tax year; and
- They provide more than half the cost of maintaining their home, which is the principal residence of that child for the entire year except for temporary absences.

Example.

William Burns’ wife died in 2008. Mr. Burns has not remarried and continued throughout 2009 and 2010 to maintain a home for himself and his dependent child. For 2008, he was entitled to file a joint return for himself and his deceased wife. For 2009 and 2010, he qualifies to file as a qualifying widow(er) with dependent child. For later years, he may qualify to file as a head of household.
The last year an individual can file jointly with, or claim an exemption for, his or her deceased spouse is the year of death.

If an individual is the surviving spouse and a personal representative is handling the estate for the decedent, he or she should coordinate filing his or her return for the year of death with this personal representative.

B. INCOME IN RESPECT OF THE DECEDEDENT

All income that the decedent would have received had death not occurred, that was not properly includible on the final return, is income in respect of the decedent. This exclusion does not apply to certain income.

Income in respect of a decedent must be included in the income of one of the following:

- The decedent's estate, if the estate receives it;
- The beneficiary, if the right to income is passed directly to the beneficiary and the beneficiary receives it; or
- Any person to whom the estate properly distributes the right to receive it.

If a taxpayer is required to include income in respect of the decedent in his or her income, he or she may be able to claim a deduction for the estate tax paid on that income.

**Example 1.**

Frank Johnson owned and operated an apple orchard. He used the cash method of accounting. He sold and delivered 1,000 bushels of apples to a canning factory for $2,000, but did not receive payment before his death. The proceeds from the sale are income in respect of the decedent. When the estate was settled, payment had not been made and the estate transferred the right to the payment to his widow. When Frank's widow collects the $2,000, she must include that amount in her return. It is not reported on the final return of the decedent or on the return of the estate.

**Example 2.**

Assume the same facts as in Example 1, except that Frank used the accrual method of accounting. The amount accrued from the sale of the apples would be included on his final return. Neither the estate nor the widow would realize income in respect of the decedent when the money is later paid.

**Example 3.**

On February 1, George High, a cash method taxpayer, sold his tractor for $3,000, payable March 1 of the same year. His adjusted basis in the tractor was $2,000. Mr. High died on February 15, before receiving payment. The gain to be reported as income in respect of the decedent is
the $1,000 difference between the decedent's basis in the property and the sale proceeds. In other words, the income in respect of the decedent is the gain the decedent would have realized had he lived.

Example 4.

Cathy O'Neil was entitled to a large salary payment at the date of her death. The amount was to be paid in five annual installments. The estate, after collecting two installments, distributed the right to the remaining installments to Nora, the beneficiary. The payments are income in respect of the decedent. None of the payments were includible on Cathy's final return. The estate must include in its income the two installments it received, and Nora must include in her income each of the three installments as she receives them.

Example 5.

Clair inherited the right to receive renewal commissions on life insurance sold by her father before his death. She inherited the right from her mother, who acquired it by bequest from her father. Clair’s mother died before she received all the commissions she had the right to receive, so Clair received the rest. The commissions are income in respect of the decedent. None of these commissions were includible in her father’s final return. The commissions received by Clair’s mother were included in her income. The commissions Clair received are not includible in her mother’s income, even on her final return. Clair must include them in her income.

1. Character of Income

The character of the income received in respect of a decedent is the same as it would be to the decedent if he or she were alive. If the income would have been a capital gain to the decedent, it will be a capital gain to the beneficiary.

2. Transfer of Right to Income

If a beneficiary transfers his or her right to income in respect of a decedent, the beneficiary must include in his or her income the greater of:

- The amount he or she received for the right, or
- The fair market value of the right he or she transferred.

If a beneficiary makes a gift of such a right, he or she must include in his or her income the fair market value of the right at the time of the gift. If the right to income from an installment obligation is transferred, the amount he or she must include in income is reduced by the basis of the obligation.

A transfer for this purpose includes a sale, exchange, or other disposition, the satisfaction of an installment obligation at other than face value, or the cancellation of an installment obligation.
3. **Installment Obligations**

If the decedent had sold property using the installment method and a beneficiary collects payments on an installment obligation he or she acquired from the decedent, the beneficiary will use the same gross profit percentage the decedent used to figure the part of each payment that represents profit. The beneficiary should include in his or her income the same profit the decedent would have included had death not occurred.

4. **Transfer to Obligor**

A transfer of a right to income, discussed earlier, has occurred if the decedent (seller) had sold property using the installment method and the installment obligation is transferred to the obligor (buyer or person legally obligated to pay the installments). A transfer also occurs if the obligation is canceled either at death or by the estate or person receiving the obligation from the decedent. An obligation that becomes unenforceable is treated as having been canceled.

If such a transfer occurs, the amount included in the income of the transferor (the estate or beneficiary) is the greater of the amount received or the fair market value of the installment obligation at the time of transfer, reduced by the basis of the obligation. The basis of the obligation is the decedent's basis, adjusted for all installment payments received after the decedent's death and before the transfer.

If the decedent and obligor were related persons, the fair market value of the obligation cannot be less than its face value.

C. **SPECIFIC TYPES OF INCOME IN RESPECT OF A DECEDED**

This section explains and provides examples of some specific types of income in respect of a decedent.

1. **Wages**

The entire amount of wages or other employee compensation earned by the decedent but unpaid at the time of death is income in respect of the decedent. The income is not reduced by any amounts withheld by the employer. If the income is $600 or more, the employer should report it in box 3 of Form 1099-MISC and give the recipient a copy of the form or a similar statement.

Wages paid as income in respect of a decedent are not subject to federal income tax withholding. However, if paid during the calendar year of death, they are subject to withholding for social security and Medicare taxes. These taxes should be included on the decedent's Form W-2 with the taxes withheld before death. These wages are not included in box 1 of Form W-2.

Wages paid as income in respect of a decedent after the year of death generally are not subject to withholding for any federal taxes.
2. Farm Income

A farmer's growing crops and livestock at the date of death normally would not give rise to income in respect of a decedent or income to be included in the final return. However, when a cash method farmer receives rent in the form of crop shares or livestock and owns the crop shares or livestock at the time of death, the rent is income in respect of a decedent and is reported in the year in which the crop shares or livestock are sold or otherwise disposed of. The same treatment applies to crop shares or livestock the decedent had a right to receive as rent at the time of death for economic activities that occurred before death.

If the individual died during a rental period, only the proceeds from the portion of the rental period ending with death are income in respect of a decedent. The proceeds from the portion of the rental period from the day after death to the end of the rental period are income to the estate. Cash rent or crop shares and livestock received as rent and reduced to cash by the decedent are includible in the final return even though the rental period did not end until after death.

Example.

Alonzo Roberts, who used the cash method of accounting, leased part of his farm for a 1-year period beginning March 1. The rental was one-third of the crop, payable in cash when the crop share is sold at the direction of Roberts. Roberts died on June 30 and was alive during 122 days of the rental period. Seven months later, Roberts' personal representative ordered the crop to be sold and was paid $1,500. Of the $1,500, 122/365, or $501, is income in respect of a decedent. The balance of the $1,500 received by the estate, $999, is income to the estate.

3. Partnership Income

If the partner who died had been receiving payments representing a distributive share or guaranteed payment in liquidation of the partner's interest in a partnership, the remaining payments made to the estate or other successor in interest are income in respect of the decedent. The estate or the successor receiving the payments must include them in income when received. Similarly, the estate or other successor in interest receives income in respect of a decedent if amounts are paid by a third person in exchange for the successor's right to the future payments.

4. U.S. Savings Bonds Acquired from Decedent

If series EE or series I U.S. savings bonds that were owned by a cash method individual who had chosen to report the interest each year (or by an accrual method individual) are transferred because of death, the increase in value of the bonds (interest earned) in the year of death up to the date of death must be reported on the decedent's final return. The transferee (estate or beneficiary) reports on its return only the interest earned after the date of death.

The redemption values of U.S. savings bonds generally are available from local banks, savings and loan institutions, or the Federal Reserve Bank.
If the bonds transferred because of death were owned by a cash method individual who had not chosen to report the interest each year and had purchased the bonds entirely with personal funds, interest earned before death must be reported in one of the following ways:

1. The person (executor, administrator, etc.) who must file the final income tax return of the decedent can elect to include in it all of the interest earned on the bonds before the decedent's death. The transferee (estate or beneficiary) then includes in its return only the interest earned after the date of death.

2. If the election in (1), above, was not made, the interest earned to the date of death is income in respect of the decedent and is not included in the decedent's final return. In this case, all of the interest earned before and after the decedent's death is income to the transferee (estate or beneficiary). A transferee who uses the cash method of accounting and who has not chosen to report the interest annually may defer reporting any of it until the bonds are cashed or the date of maturity, whichever is earlier. In the year the interest is reported, the transferee may claim a deduction for any federal estate tax paid that arose because of the part of interest (if any) included in the decedent's estate.

Example 1.

Will’s uncle, a cash method taxpayer, died and left him a $1,000 series EE bond. He had bought the bond for $500 and had not chosen to report the increase in value each year. At the date of death, interest of $94 had accrued on the bond, and its value of $594 at date of death was included in Will’s uncle’s estate. Will’s uncle’s personal representative did not choose to include the $94 accrued interest in the decedent's final income tax return. Will is a cash method taxpayer and does not choose to report the increase in value each year as it is earned. Assuming he cashes it when it reaches maturity value of $1,000, Will would report $500 interest income (the difference between maturity value of $1,000 and the original cost of $500) in that year.

Will is also entitled to claim, in that year, a deduction for any federal estate tax resulting from the inclusion in his uncle's estate of the $94 increase in value.

Example 2.

If, in Example 1, the personal representative had chosen to include the $94 interest earned on the bond before death in the final income tax return of Will’s uncle, he would report $406 ($500 - $94) as interest when he cashed the bond at maturity. This $406 represents the interest earned after his uncle's death and was not included in his estate, so no deduction for federal estate tax is allowable for this amount.
Example 3.

Will's uncle died owning series HH bonds that he acquired in exchange for series EE bonds. Will was the beneficiary on these bonds. His uncle used the cash method of accounting and had not chosen to report the increase in redemption price of the series EE bonds each year as it accrued. His uncle's personal representative made no election to include any interest earned before death in the decedent's final return. Will's income in respect of the decedent is the sum of the unreported increase in value of the series EE bonds, which constituted part of the amount paid for series HH bonds, and the interest, if any, payable on the series HH bonds but not received as of the date of the decedent's death.

5. Interest Accrued on U.S. Treasury Bonds

The interest accrued on U.S. Treasury bonds owned by a cash method taxpayer and redeemable for the payment of federal estate taxes that was not received as of the date of the individual's death is income in respect of the decedent. This interest is not included in the decedent's final income tax return. The estate will treat such interest as taxable income in the tax year received if it chooses to redeem the U.S. Treasury bonds to pay federal estate taxes.

If the person entitled to the bonds (by bequest, devise, or inheritance, or because of the death of the individual) receives them, that person will treat the accrued interest as taxable income in the year the interest is received. Interest that accrues on the U.S. Treasury bonds after the owner's death does not represent income in respect of the decedent. The interest, however, is taxable income and must be included in the income of the respective recipients.

6. Interest Accrued on Savings Certificates

The interest accrued on savings certificates (redeemable after death without forfeiture of interest) that is for the period from the date of the last interest payment and ending with the date of the decedent's death, but not received as of that date, is income in respect of a decedent. Interest for a period after the decedent's death that becomes payable on the certificates after death is not income in respect of a decedent, but is taxable income includible in the income of the respective recipients.

7. Inherited IRAs

If a beneficiary receives a lump-sum distribution from a traditional IRA he or she inherited, all or some of it may be taxable. The distribution is taxable in the year received as income in respect of a decedent up to the decedent's taxable balance. This is the decedent's balance at the time of death, including unrealized appreciation and income accrued to date of death, minus any basis (nondeductible contributions). Amounts distributed that are more than the decedent's entire IRA balance (includes taxable and nontaxable amounts) at the time of death are the income of the beneficiary.
If the beneficiary of a traditional IRA is the decedent's surviving spouse who properly rolls over the distribution into another traditional IRA, the distribution is not currently taxed. A surviving spouse also can roll over tax free the taxable part of the distribution into a qualified plan, section 403 annuity, or section 457 plan.

Example 1.

At the time of his death, Greg owned a traditional IRA. All of the contributions by Greg to the IRA had been deductible contributions. Greg's nephew, Mark, was the sole beneficiary of the IRA. The entire balance of the IRA, including income accruing before and after Greg's death, was distributed to Mark in a lump sum. Mark must include the total amount received in his income. The portion of the lump-sum distribution that equals the amount of the balance in the IRA at Greg's death, including the income earned before death, is income in respect of the decedent. Mark may take a deduction for any federal estate taxes that were paid on that portion.

Example 2.

Assume the same facts as in Example 1, except that some of Greg's contributions to the IRA had been nondeductible contributions. To determine the amount to include in income, Mark must subtract the total nondeductible contributions made by Greg from the total amount received (including the income that was earned in the IRA both before and after Greg's death). Income in respect of the decedent is the total amount included in income less the income earned after Greg's death.

8. Roth IRAs

Qualified distributions from a Roth IRA are not subject to tax. A distribution made to a beneficiary or to the Roth IRA owner's estate on or after the date of death is a qualified distribution if it is made after the 5-tax-year period beginning with the first tax year in which a contribution was made to any Roth IRA of the owner.

Generally, the entire interest in the Roth IRA must be distributed by the end of the fifth calendar year after the year of the owner's death unless the interest is payable to a designated beneficiary over his or her life or life expectancy. If paid as an annuity, the distributions must begin before the end of the calendar year following the year of death. If the sole beneficiary is the decedent's spouse, the spouse can delay the distributions until the decedent would have reached age 70½ or can treat the Roth IRA as his or her own Roth IRA.

Part of any distribution to a beneficiary that is not a qualified distribution may be includible in the beneficiary's income. Generally, the part includible is the earnings in the Roth IRA. Earnings attributable to the period ending with the decedent's date of death are income in respect of the decedent. Additional earnings are the income of the beneficiary.
9. **Coverdell Education Savings Account (ESA)**

Generally, the balance in a Coverdell ESA must be distributed within 30 days after the individual for whom the account was established reaches age 30 or dies, whichever is earlier. The treatment of the Coverdell ESA at the death of an individual under age 30 depends on who acquires the interest in the account.

The age 30 limitation does not apply if the individual for whom the account was established or the beneficiary that acquires the account is an individual with special needs. This includes an individual who, because of a physical, mental, or emotional condition (including learning disability), requires additional time to complete his or her education.

If the decedent's spouse or other family member is the designated beneficiary of the decedent's account, the Coverdell ESA becomes that person's Coverdell ESA.

Any other beneficiary (including a spouse or family member who is not the designated beneficiary) must include in income the earnings portion of the distribution. Any balance remaining at the close of the 30-day period is deemed to be distributed at that time. The amount included in income is reduced by any qualified education expenses of the decedent that are paid by the beneficiary within one year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse or family member.

10. **Archer MSA**

The treatment of an Archer MSA or a Medicare Advantage MSA, at the death of the account holder depends on who acquires the interest in the account. If the decedent's spouse is the designated beneficiary of the account, the account becomes that spouse's Archer MSA.

Any other beneficiary (including a spouse that is not the designated beneficiary) must include in income the fair market value of the assets in the account on the decedent's date of death. This amount must be reported for the beneficiary's tax year that includes the decedent's date of death. The amount included in income is reduced by any qualified medical expenses for the decedent that are paid by the beneficiary within one year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse.

D. **DEDUCTIONS IN RESPECT OF THE DECEDENT**

Items such as business expenses, income-producing expenses, interest, and taxes, for which the decedent was liable but that are not properly allowable as deductions on the decedent's final income tax return will be allowed as a deduction to one of the following when paid:

- The estate; or
- The person who acquired an interest in the decedent's property (subject to such obligations) because of the decedent's death, if the estate was not liable for the obligation.
Similar treatment is given to the foreign tax credit. A beneficiary who must pay a foreign tax on income in respect of a decedent will be entitled to claim the foreign tax credit.

1. **Depletion**

The deduction for percentage depletion is allowable only to the person (estate or beneficiary) who receives income in respect of the decedent to which the deduction relates, whether or not that person receives the property from which the income is derived. An heir who (because of the decedent's death) receives income as a result of the sale of units of mineral by the decedent (who used the cash method) will be entitled to the depletion allowance for that income. If the decedent had not figured the deduction on the basis of percentage depletion, any depletion deduction to which the decedent was entitled at the time of death would be allowable on the decedent's final return, and no depletion deduction in respect of the decedent would be allowed to anyone else.

2. **Estate Tax Deduction**

Income that a decedent had a right to receive is included in the decedent's gross estate and is subject to estate tax. This income in respect of a decedent is also taxed when received by the recipient (estate or beneficiary). However, an income tax deduction is allowed to the recipient for the estate tax paid on the income.

The deduction for estate tax can be claimed only for the same tax year in which the income in respect of the decedent must be included in the recipient's income. (This also is true for income in respect of a prior decedent.)

Individuals can claim this deduction only as an itemized deduction, on line 28 of Schedule A (Form 1040). This deduction is not subject to the 2% limit on miscellaneous itemized deductions. Estates can claim the deduction on the line provided for the deduction on Form 1041. For the alternative minimum tax computation, the deduction is not included in the itemized deductions that are an adjustment to taxable income.

If the income in respect of the decedent is capital gain income, the individual must reduce the gain, but not below zero, by any deduction for estate tax paid on such gain. This applies in figuring the following:

- The maximum tax on net capital gain.
- The 50% exclusion for gain on small business stock.
- The limitation on capital losses.

3. **Computation**

To figure a recipient's estate tax deduction, determine –

- The estate tax that qualifies for the deduction, and
- The recipient's part of the deductible tax.
4. **Deductible Estate Tax**

The estate tax is the tax on the taxable estate, reduced by any credits allowed. The estate tax qualifying for the deduction is the part of the net value of all the items in the estate that represents income in respect of the decedent. *Net value* is the excess of the items of income in respect of the decedent over the items of expenses in respect of the decedent. The deductible estate tax is the difference between the actual estate tax and the estate tax determined without including net value.

**Example.**

*Jack used the cash method of accounting. At the time of his death, he was entitled to receive $12,000 from clients for his services and he had accrued bond interest of $8,000, for a total income in respect of the decedent of $20,000. He also owed $5,000 for business expenses for which his estate is liable. The income and expenses are reported on Jack's estate tax return.*

*The tax on Jack's estate is $9,460 after credits. The net value of the items included as income in respect of the decedent is $15,000 ($20,000 – $5,000). The estate tax determined without including the $15,000 in the taxable estate is $4,840, after credits. The estate tax that qualifies for the deduction is $4,620 ($9,460 – $4,840).*

Figure the recipient's part of the deductible estate tax by dividing the estate tax value of the items of income in respect of the decedent included in the recipient's income (the numerator) by the total value of all items included in the estate that represents income in respect of the decedent (the denominator). If the amount included in the recipient's income is less than the estate tax value of the item, use the lesser amount in the numerator.

The estate tax deduction allowed an estate is figured in the same manner as just discussed. However, any income in respect of a decedent received by the estate during the tax year is reduced by any such income that is properly paid, credited, or required to be distributed by the estate to a beneficiary. The beneficiary would include such distributed income in respect of a decedent for figuring the beneficiary's deduction.

For the estate tax deduction, an annuity received by a surviving annuitant under a joint and survivor annuity contract is considered income in respect of a decedent. The deceased annuitant must have died after the annuity starting date. A special computation must be made to figure the estate tax deduction for the surviving annuitant.
CHAPTER 3 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following is not a benefit of a survivor when filing his or her own income tax return:
   a) a surviving spouse can file a joint return for the year of death and the following two years
   b) if the decedent was the survivor's qualifying child, the survivor may be able to claim the child tax credit or the earned income credit
   c) a surviving spouse may qualify for special tax rates for the following two years
   d) if a decedent qualified as a taxpayer's dependent for the part of the year before death, a survivor can claim the exemption for the dependent on his or her tax return, regardless of when death occurred during the year

2. Income in respect of decedent must be included in the decedent's final income tax return.
   a) true
   b) false

3. The character of the income received in respect of a decedent is the same as it would be to the decedent if he or she were alive.
   a) true
   b) false

4. Which of the following is true regarding wage income in respect of the decedent:
   a) the wages earned by the decedent should be reduced by amounts withheld by the employer
   b) the employer should report such wages on Form 1099-MISC if the income is $600 or more
   c) wages paid as income in respect of a decedent are subject to federal income tax withholding
   d) all of the above

5. The tax treatment of inherited traditional IRAs and Roth IRAs is identical.
   a) true
   b) false
6. Which of the following items will be allowed as a deduction to the estate or the person who acquired an interest in the decedent’s property because of the decedent's death:

a) business expenses
b) income-producing expenses
c) interest
d) all of the above
CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: Correct.** The joint return can only be filed for the year of death.
   
   B: Incorrect. This is a benefit available to a surviving qualifying child.
   
   C: Incorrect. This is a benefit available to a surviving spouse.
   
   D: Incorrect. This is a benefit available to a surviving dependent of the taxpayer.
   
   (See page 3-1 of the course material.)

2. A: True is incorrect. Income in respect of the decedent is all income that the decedent would have received had death not occurred, that was not properly includible on the final return.
   
   **B: False is correct.** Income in respect of the decedent must be included in the income of either the decedent’s estate (if the estate receives it), the beneficiary (if the right to income passed directly to the beneficiary and the beneficiary receives it), or any person to whom the estate properly distributes the right to receive it.
   
   (See page 3-2 of the course material.)

3. **A: True is correct.** If the income would have been a capital gain to the decedent, it will be a capital gain to the beneficiary.
   
   B: False is incorrect. Income received in respect of the decedent maintains the same character as it would have had if the decedent were still alive.
   
   (See page 3-3 of the course material.)

4. A: Incorrect. The entire amount of the wages earned by the decedent is income in respect of the decedent.
   
   **B: Correct.** The recipient of the wages should be given a copy of the form or a similar statement.
   
   C: Incorrect. These wages are not subject to federal income tax withholding, but if paid during the calendar year of death, they are subject to social security and Medicare tax withholding.
   
   D: Incorrect. Only one of the responses is true.
   
   (See page 3-4 of the course material.)
5. A: True is incorrect. The tax treatment differs because of the difference of the deductibility of the contributions to a traditional and Roth IRA.

B: False is correct. Qualified distributions from a Roth IRA are not subject to tax. A lump-sum distribution from a traditional IRA may or may not be taxable.

(See pages 3-7 to 3-8 of the course material.)

6. A: Incorrect. If these business expenses were not properly allowable as deductions on the decedent’s final income tax return, they will be allowed as a deduction when paid to the estate or the person acquiring the interest. However, this is not the best answer.

B: Incorrect. If these income-producing expenses were not properly allowable as deductions on the decedent’s final income tax return, they will be allowed as a deduction when paid to the estate or the person acquiring the interest. However, this is not the best answer.

C: Incorrect. If interest was not properly allowable as a deduction on the decedent’s final income tax return, it will be allowed as a deduction when paid to the estate or the person acquiring the interest. However, this is not the best answer.

D: Correct. All of the responses will be allowable deductions when paid to the estate or the person who acquired an interest in the decedent’s property.

(See page 3-9 of the course material.)
Chapter 4: Estate Planning Issues for Small and Family Businesses

I. Introduction: The Importance of Planning Ahead

A main concern of many small business owners considering an estate plan is how to dispose of the business. If members of the owner’s family are not interested in carrying on the business, this may be less of a concern. If, on the other hand, at least some of the members of the owner’s family want to maintain the business following the owner’s death, serious attention has to be paid to the best way of transferring the business while limiting tax liabilities. In some cases, there are tax breaks for owners of small and family businesses, especially farms. In other cases, careful attention to the choice of entity can help smooth the transition when the owner dies.

Example 1.

Donald is the sole proprietor of a restaurant, Donald’s Diner. He is married and has two adult children. He has no will. If he dies, all of his property will be distributed according to the laws of intestate succession in his state of domicile. This will likely mean that one-half of his estate will go to his surviving spouse and one-half to his two children in equal amounts. Given the difficulty in splitting the assets of the restaurant, the only way the business can continue is if all three heirs decide to restructure and continue operation. If the children are not interested in the business but his wife would have wanted to continue, he could have drafted a will leaving the restaurant exclusively to her. He also could have structured the business as a corporation, giving controlling shares to his wife and minority shares to his children. This would have allowed his wife to manage the enterprise but provide some support for his children. In any event, Donald should have considered all of these options early on to ease the transition at his death.

Example 2.

Craig and Mike are brothers. After completing law school, the brothers became partners in a law firm. Although business at first was slow, the practice began to build. Both Craig and Mike married and started a family. Craig’s wife, Emily, stays at home with their three young children. Mike’s wife Kim works as the firm’s office manager. The brothers have a written partnership agreement that specifies that in the event one of the partners dies, the other partner will “buy out” the deceased’s partners interest based on a formula that provides the surviving spouse with a significant amount of income. On his way to work one morning, Mike was involved in an automobile accident and killed. Based on their written partnership agreement, Craig will buy Mike’s interest in the partnership. The money to pay for his interest will come from a life insurance policy which the brothers had each taken out naming the other brother as beneficiary. This was done to ensure that in the event one of the brothers died, the surviving brother would have enough cash to “buy out” the other’s interest.
and thereby provide needed income for the deceased partner’s family. Due to good planning, the business will be able to continue and the family of the deceased will be provided for. Kim may or may not choose to continue working as office manager for the firm.

The two examples above illustrate how good planning can make the difference between a smooth transition and the end of a business when someone unexpectedly dies.

Today, there are more choices than ever in selecting the appropriate business entity. Historically, there were three choices: the sole proprietorship, the partnership and the corporation. Now there are a number of hybrids that combine various characteristics of each traditional entity, such as the limited liability company which combines the limited liability of a corporation with the flexibility and tax advantages of a partnership. As of 1997, all states offer limited liability companies as an option for most types of businesses. Other recent options include the limited liability partnership. State law plays an important role in determining the best entity. State law governs many important aspects of business entities, both tax and non-tax.

II. Choice of Entity: Ease of Passing Business Interests Upon Death

The process of estate planning should begin as soon as a business is started. This is because the choice of entity selected by the organizer or organizers of the business, i.e. whether to form a partnership or a corporation, has a profound effect on the ease of transferring interests in that business at a future date.

A. SOLE PROPRIETORSHIP

A sole proprietorship is an unincorporated business that is owned by one individual. It is the simplest form of business organization to start and maintain. The business has no separate legal existence apart from the owner. Its liabilities are the personal liabilities of the owner. The income and losses of the business are included on the owner’s personal tax return. An individual’s sole proprietorship is therefore treated no differently than his or her other property: if it is not disposed of through a will or other will substitute such as a trust, the assets of the business will pass to the decedent’s heirs according to the laws of intestate succession.

This type of business structure – or lack thereof – presents the greatest dilemma in estate planning. Assume a proprietor has three sons, each of whom is interested in the business. How can the sole proprietor divide the assets of the business? If the assets are divided, will the business be able to survive the proprietor’s death?

Given the limitations of a sole proprietorship, an individual who would like to see the business continue after his or her death is encouraged to consider a more formal business structure that can simplify the process of transferring its assets to an heir.
B. PARTNERSHIP

1. General Partnership

Next to a sole proprietorship, a partnership is the easiest type of business structure to start and maintain. For a simple general partnership, an agreement between the partners is also what is required to begin. In the case of other types of partnerships such as limited partnerships or limited liability partnerships, more formalities and restrictions are involved.

Partners normally retain the right to transfer their interest in receiving the profits of the partnership but are limited in their ability to transfer the partnership interest as a whole. An individual with a partnership interest in a business needs to be careful that the partnership agreement provides for his or her right to transfer his or her interest upon death, if so desired.

Another common possibility is for the partnership agreement to give the surviving partner or partners the option of buying out the interests of a deceased partner, as was the case in Example 2, above. This gives the survivors financial support and ends their involvement in the business. Otherwise, the normal course of events is for the partnership to be dissolved. This is particularly true with professional partnerships such as accountants, doctors and lawyers where a non-professional is not legally entitled to become a partner in the business.

2. Limited Partnership

A limited partnership is comprised of one or more "general" partners and one or more "limited" partners. The general partner or partners are responsible for managing the partnership and, like partners in a general partnership, are jointly and severally liable for all partnership debts and obligations. The general partner or partners need not be a natural person; a corporation, for example, may serve as the general partner.

Limited partners are typically passive investors who are not involved in management of the partnership and who, as a result, are generally not personally liable for the debts and obligations of the partnership beyond their capital contributions.

While not involved in day-to-day operations of the enterprise, limited partners are entitled to receive information, including an accounting, regarding the partnership and likewise have a right to inspect various partnership records.

Limited partners who become involved in management of the partnership or involved in other ways, including being employed by the partnership, risk losing their limited liability status. As with limited liability companies, discussed later in this chapter, a limited partnership may have different classes of partners as set forth in a partnership agreement.

The flexibility of the limited partnership can be especially useful with family businesses, where only one family member is directly involved in management of the business but the others receive income from the business. The issue of the Family Limited Partnership is discussed in more detail below.
3. Limited Liability Partnership

A recent hybrid of the limited partnership, a limited liability partnership must be registered as a limited liability partnership under the laws of the state of organization. Every state has its own technical requirements for formation, which normally include the appointment of an agent for receipt of service of process.

All of the partners in a limited liability partnership are normally entitled to limited liability status for the acts or omissions of the partnership – though not generally for his or her own acts or omissions. Again, state law varies considerably on this topic.

Many states reserve limited liability partnership status for certain professional associations, for example, attorneys and certified public accountants.

C. LIMITED LIABILITY COMPANY

Limited liability companies combine the qualities of a partnership with those of a corporation. Owners, referred to as “members,” have limited liability like shareholders of a corporation but can elect the pass-through taxation normally afforded to partners. It is a relatively recent and very popular creation of business entity.

Although recognized by the IRS for tax purposes, limited liability companies are purely creatures of state law. A limited liability company is an entity formed by following the procedures required in the state of operation.

The document that governs a limited liability company is its operating agreement, which contains provisions governing everything from daily operation to transfers of interest. If a member has an heir that is interested in taking over after the member’s death, the member should ensure that the operating agreement allows such a transfer.

Because the members of a limited liability company have tremendous flexibility in structuring their operating agreement, they can have mechanisms in place for surviving members to “buy out” the interests of a member who unexpectedly dies. A limited liability company operating agreement can also limit the ability of a member to transfer their interest without the consent of the other members. This can be helpful in ensuring that a business remains in the hands of a small group of people.

D. CORPORATION

1. C Corporation

Most corporations are what are referred to as C corporations. One of the most desirable characteristics of corporate form is often the ease of transferability of interests. Absent a contrary provision in the articles of incorporation or bylaws, the holder of shares of a corporation is normally free to transfer that interest to any other third party.

It is also fairly common for closely-held corporations, those owned by a small group of people, to include rights of first refusal in the event a shareholder decides to sell.

As a separate legal entity, a corporation may operate indefinitely. The death of a shareholder does not affect the legal status of a corporation.
2. S Corporation

Originally created in 1958, an S corporation combines the limited liability of a classic C corporation with tax treatment similar to a partnership. S corporations are treated as corporations under state law. For purposes of federal income tax, however, S corporations are treated as partnerships. This means that the income, deductions, and tax credits of an S corporation flow through to shareholders; income is taxed at the shareholder level and not at the corporate level.

State taxation of S corporations varies. Some states, for example, treat an S corporation as a C corporation and therefore impose an income or franchise tax.

The shareholders of a C corporation must “elect” to become an S corporation. There are a number of important restrictions placed on S corporations, including a cap on the number of shareholders (currently 100) and a requirement that there be only one class of stock. Failure to comply with the many IRS requirements will cause an S corporation to lose its status.

A corporation will not be eligible to be an S corporation if:

- It is not a domestic corporation;
- It has more than 100 shareholders;
- It has as a shareholder a person other than an individual, an estate, or certain trusts and tax-exempt organizations;
- It has a nonresident alien as a shareholder;
- It has more than one class of stock; or
- It is an "ineligible" corporation as defined in federal law.

Because of the tax benefits and the restrictions on the number of owners, many family businesses that elect to incorporate also elect S corporation status. The limited liability status of the owners protects the assets of the individual and their families who are involved in the business, limits their tax liability while they are alive and provides for easy transition after death.

**E. FAMILY LIMITED PARTNERSHIP**

1. Reducing Estate Tax Liability

Family Limited Partnerships are a somewhat controversial tool designed to reduce the value of an individual’s estate (for estate tax purposes) while allowing the individual to maintain control of investments and assets of the partnership during his or her lifetime.
Family Limited Partnerships are set up much like traditional limited partnerships. There are at least two parties involved: the general partner, who controls the trust, and one or more limited partners, who have a share in the profits but no right to manage or control the enterprise. Individuals can also use their estate tax credit to place assets in the partnership.

Over time, the general partner can use his or her annual gift exclusion to give away limited partner shares to chosen heirs. The general partner can maintain control while maintaining as little as a 1 percent ownership interest in the enterprise.

If the general partner wants to retire, he or she can use his or her interest as a source of income by imposing a management fee on the partnership. The other partners can run the day-to-day operation of the business and retain most of the income. In the meantime, the limited partners are limited in their right to transfer their interests in the business. When the general partner dies, his small interest can be disposed of through a testamentary devise.

2. IRS Skeptical

Given the many advantages the family limited partnership offers, the IRS has traditionally been suspicious of this business form as an estate planning tool. A recent challenge came in a case involving the estate of a Texas woman, Ruth Kimbell. Following her death, the IRS imposed substantial taxes on the estate. Kimbell's executor appealed the IRS's determination.

Facts.

The decedent, Ruth Kimbell, died in 1998 at the age of 96. In the years prior to her death, the Decedent transferred a large portion of her estate in a series of transactions to three entities. In 1991, Mrs. Kimbell created the R.A. Kimbell Living Trust, which was a revocable living trust administered by Mrs. Kimbell and her son as co-trustees.

In January 1998, the Trust, David Kimbell and his wife formed a limited liability company, the R.A. Kimbell Management Co., L.L.C. (the "LLC"). The Trust contributed $20,000 for a 50% interest. David Kimbell and his wife each contributed $10,000 for 25% interests each. David Kimbell was the sole manager of the LLC.

Later in January 1998, the Trust and the LLC formed the R.A. Kimbell Property Co., Ltd., a limited partnership under Texas law (the "Partnership"). The Trust contributed approximately $2.5 million in cash, oil and gas working interests and royalty interests, securities, notes and other assets for a 99% pro-rata limited partner interest. The oil and gas properties were a continuation of an oil and gas business that the Decedent's late husband had founded in the 1920's. The LLC contributed approximately $25,000 in cash for a 1% pro-rata general partner interest. At inception, approximately 15% of the assets of the Partnership were oil and gas working (11%) and royalty (4%) interests.
As a result of these transfers, the decedent, through the Trust and the LLC, owned 99.5% of the Partnership. David Kimbell managed Mrs. Kimbell’s business interest before and after the creation of the LLC and the Partnership. Not all of Mrs. Kimbell’s assets were conveyed to the LLC and the Partnership. She retained over $450,000 in assets outside of the LLC and the Partnership for her personal expenses. The primary focus of this appeal is on this transfer from the LLC and the Trust to the Partnership. Because of Mrs. Kimbell’s control of the Trust assets, the transfer by the Trust is viewed as a transfer by Mrs. Kimbell.

Under the stated terms of the Partnership Agreement, the purposes of the Partnership were to "increase Family wealth; establish a method by which annual gifts can be made without fractionalizing Family Assets; continue the ownership and collective operation of Family Assets and restrict the right of non-Family members to acquire interests in Family Assets; provide protection to Family Assets from claims of future creditors against Family members; prevent transfer of a Family member's interest in the Partnership as a result of a failed marriage; provide flexibility and continuity in business planning for the Family not available through trusts, corporations or other business entities; facilitate the administration and reduce the cost associated with the disability or probate of the estate of Family members; provide the Family's knowledge of and communication about Family Assets; provide resolution of any disputes which may arise among the Family in order to preserve Family harmony and avoid the expense and problems of litigation; and consolidate fractional interests in Family Assets." The term of the Partnership was 40 years.

The LLC, as general partner, managed the Partnership and had exclusive authority to make distributions. The Partnership Agreement provided that the general partner owed no fiduciary duty to the Partnership or to any Partner but owed a duty of loyalty and a duty of care to the Partnership. The Trust, as limited partner, had no right to withdraw from the Partnership or receive a return of contributions until the Partnership was terminated, which could occur only by unanimous consent of the partners. The Partnership Agreement provided that 70% in interest of the limited partners had the right to remove the general partner. A majority in interest of the limited partners had the right to elect a new general partner.

In a case decided in May, 2004, the U.S. Court of Appeals for Fifth Circuit held that the decedent’s transfer of mostly oil and gas working interest and royalty assets to a limited partnership managed by her son was a bona fide sale, and thus not subject to recapture for estate tax purposes. Although the decedent’s inter vivos transaction was motivated solely by tax planning with no business or corporate purpose, the court said this does not prevent the sale from being "bona fide," and thus is not subject to the recapture rule.

The district court had ruled that as a matter of law family members can not enter into a bona fide transaction and that a transfer of assets in return for a pro rata partnership interest is not a transfer for full and adequate consideration. Upholding this ruling would have dealt a severe blow to the use of family partnerships.
The estate filed its federal estate tax return in December 1998. At the time of Mrs. Kimbell's death, the value of the Partnership assets was approximately $2.4 million. On the return, the estate claimed a 49% discount on the value of Mrs. Kimbell's interest in the Partnership and her interest in the LLC for lack of control and lack of marketability of the partnership interest. It reported her 99% interest in the Partnership as having a fair market value of approximately $1.2 million and her 50% interest in the LLC as having a fair market value of approximately $17,000.

The IRS audited the estate. It found that the value of the assets transferred to the Partnership and the LLC, rather than Mrs. Kimbell's interest in these entities, was includible in the gross estate under § 2036(a) of the Internal Revenue Code and increased the tax due accordingly. The estate paid the additional tax and then filed for a refund, claiming that the IRS overvalued Mrs. Kimbell's interests in the Partnership and the LLC.

Whether the assets Mrs. Kimbell transferred to the Partnership must be recaptured into her estate for estate tax purposes depends on the application of Internal Revenue Code § 2036(a), which provides:

(a) General rule. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death--

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

The statute recognizes that some assets transferred prior to death must be recaptured into the estate, the court said. By recapturing these transfers into the estate, the code prevents the circumvention of federal estate tax by the use of inter vivos transactions which do not remove the lifetime enjoyment of property purportedly transferred by a decedent.

There are two exceptions to the statute: (1) a bona fide transfer for full and adequate consideration; or (2) if the decedent did not retain either possession of the transferred property or the right to designate who could possess the transferred property.

According to Treasury Regulations, a transaction is a bona fide sale if it is made in good faith. The court also found that the partnership was created for a genuine business purpose, namely preserving the family business, and that the transfer of assets by the decedent to the partnership was the result of a bona fide sale.

The proper focus therefore on whether a transfer to a partnership is for adequate and full consideration, according to the court, is:

- Whether the interests credited to each of the partners was proportionate to the fair market value of the assets each partner contributed to the partnership;
Whether the assets contributed by each partner to the partnership were properly credited to the respective capital accounts of the partners; and

Whether on termination or dissolution of the partnership the partners were entitled to distributions from the partnership in amounts equal to their respective capital accounts.

Anyone contemplating the use of a Family Limited Partnership should ensure that he or she consider these issues carefully and review any more recent court decisions or IRS rulings.

III. Deferring Estate Tax Payments

Under Internal Revenue Code § 6166, the executor of certain estates can elect to defer estate taxes over a period of 14 years. If an executor takes advantage of this option, the estate is liable for interest only for the first five years, after which it must make annual installment payments of interest and principal for no more than 10 years until the debt is paid in full. The election is available where the estate of the decedent consists largely of an interest in a closely held business.

Pursuant to IRC § 6166, the value of the business interest must be at least 35 percent of the value of the decedent’s gross estate for the deferment to apply.

The statute defines a “closely held business” as any of the following:

- An interest as a proprietor in a trade or business carried on as a proprietorship;
- An interest as a partner in a partnership carrying on a trade or business, if:
  - 20 percent or more of the total capital interest in such partnership is included in determining the gross estate of the decedent; or
  - Such partnership had 45 or fewer partners.
- Stock in a corporation carrying on a trade or business if:
  - 20 percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent; or
  - Such corporation had 45 or fewer shareholders.

In determining whether the business interest qualifies, the IRS will examine the status of the business immediately prior to the decedent’s death.

There is no limit on the amount of tax that may be deferred under this provision, but only the first $1,000,000 in value qualifies for a special interest rate of two percent. The $1,000,000 limit will periodically be indexed for inflation. The inflation adjusted limit for 2011, for example, was $1,360,000.
IV. Special Rules for Family Farms and Other Small Businesses

Over the years, the impact of federal estate and gift taxes on the ability to transfer the farm business to the next generation has been a major concern among farmers. Congressional concern that federal estate and gift taxes might force the liquidation of some family farms has resulted in the enactment of a number of special provisions for farmers and other small business owners.

These provisions include the special use valuation of farmland and the installment payment of estate taxes.

The installment payment provision allows estate taxes to be paid over a 14-year period. The interest rate on the taxes due on the first $1,360,000 (2011) of taxable value of a farm or closely-held business is 2 percent.

For those estates eligible for the special use valuation, the amount a married couple can transfer to their heirs without incurring any federal estate or gift taxes can easily exceed $4 million. As a result, despite the increase in farm size and the appreciation in land value, currently only about 4 percent of all farm estates actually owe any federal estate and gift taxes. Many of those that do owe taxes are eligible to pay them in installments at reduced interest rates under the installment payment provision.

A. SPECIAL USE VALUATION OF SECTION 2032A

In general, the value of property for estate tax purposes is the fair market value at the date of death. However, if certain conditions are satisfied, the estate’s real property devoted to farming (or other closely held business) use may be valued at its use value as a farm (or other closely held business) rather than at its fair market value. Under Section 2032A, the total value of the property may not be decreased from FMV by more than $1,000,000 for decedents dying in 2010.

1. Qualifications

To qualify for this use value, all of the following conditions must be met:

1. The decedent was a U.S. citizen or resident at the time of death;

2. The real property is located in the United States;

3. At the decedent’s death, the real property was used by the decedent or a family member for farming or in a trade or business, or was rented for such use by either the surviving spouse or a lineal descendant of the decedent to a family member on a net cash basis;

4. The real property was acquired from or passed from the decedent to a qualified heir of the decedent;

5. The real property was owned and used in a qualified manner by the decedent or a member of the decedent’s family during 5 of the 8 years before the decedent’s death;
6. There was material participation by the decedent or a member of the decedent's family during 5 of the 8 years before the decedent's death; and

7. The qualified property meets the following percentage requirements:
   a) At least 50% of the adjusted value of the gross estate must consist of the adjusted value of real or personal property that was being used as a farm or in a closely held business and that was acquired from, or passed from, the decedent to a qualified heir of the decedent, and
   b) At least 25% of the adjusted value of the gross estate must consist of the adjusted value of qualified farm or closely held business real property.

For this purpose, adjusted value is the value of property determined without regard to its special-use value. The value is reduced for unpaid mortgages on the property or any indebtedness against the property, if the full value of the decedent's interest in the property (not reduced by such mortgage or indebtedness) is included in the value of the gross estate. The adjusted value of the qualified real and personal property used in different businesses may be combined to meet the 50% and 25% requirements.

2. Method of Valuation

The method used to value farmland for use-value purposes is to divide the 5-year average annual gross cash or share rental for comparable land in the area, minus state and local real estate taxes, by an average of the annual effective interest rate for all new Federal Land Bank (FLB) loans for the year of death.

For most farms, the use-valuation law can reduce the value of the real property portion of qualifying estates by 40 to 70 percent, with the largest reductions occurring for farmland which has residential or commercial development potential.

3. Recapture

All or a portion of the estate tax benefits obtained under the special-use valuation provision are recaptured if the property is sold to a nonfamily member or if the property ceases to be used for farming or other closely held business purpose within 10 years of the decedent’s death.

B. INSTALLMENT PAYMENTS

A second special provision for farmers (and other small business owners) is aimed at the liquidity problem that these businesses can face as a result of having a large portion of the estate in land and other relatively illiquid business assets. Federal estate and gift taxes generally must be paid within 9 months of the date of death. However, when at least 35 percent of an estate’s value is a farm or closely held business, estate taxes may be paid over an additional 14-year period with only interest due for the first 5 years.

This provision, combined with the increase in the amount of property that can be transferred tax free, has greatly reduced the liquidity problem that some farm heirs might otherwise experience as a result of federal estate taxes.
C. EXCLUSION FOR LAND SUBJECT TO CONSERVATION EASEMENT

In addition to the targeted provisions, farmers and other landowners will be the primary beneficiaries of an exclusion for land subject to a conservation easement. Since 1981, a deduction has been allowed for Federal income and estate and gift tax purposes for a contribution of a qualified real property interest to a charity or other qualifying organization exclusively for conservation purposes.

**Update:** The Pension Protection Act of 2006 significantly increased the deduction for donations of conservation easements in 2006 and 2007. For those two years, the deduction was increased from 30% of AGI to 50% for individuals. Individuals were allowed to carryover any qualified conservation contributions that exceed the 50% limitation for up to 15 years.

If the donor is a qualified farmer or rancher, the deduction can be as much as 100% of the excess of the taxpayer's AGI over the amount of all other allowable charitable contributions.

In order to qualify for the 100% limitation, the conservation easement must provide that the property remain available for agricultural production.

The farm bill passed in the summer of 2008 expanded these federal income tax incentives so that they apply to all conservation easements donated in 2008 and 2009.

As of January 1, 2010, the enhanced tax incentive for donations of conservation easements expired.

A “qualifying real property interest” means a perpetual restriction or easement on the use of real property. A “conservation purpose” is defined as (1) the preservation of land for the general public's outdoor recreation or education, (2) the preservation of a natural habitat, (3) the preservation of open space for the scenic enjoyment of the general public or in furtherance of a governmental conservation policy, or (4) the preservation of historically important land or certified historic structures.

Beginning in 1998, in addition to the reduction in value for the conservation easement, up to 40 percent of the value of the land in an estate subject to a qualified conservation easement and located within 25 miles of a metropolitan area, a national park, or wilderness area, or within 10 miles of an Urban National Forest can be excluded for federal estate tax purposes.

The land must have been owned by the decedent or a member of the decedent’s family for at least 3 years prior to the date of death, and the donation must have been made by the decedent or his family. The exclusion is based on the value of the property after the conservation easement is placed, but does not include any retained development rights to use the land for any commercial purpose except farming. If the value of the conservation easement is less than 30 percent of the value of the land for purposes of the exclusion then the exclusion percentage is reduced 2 percentage points for each percentage point below 30 percent. The maximum exclusion was increased to $500,000 in 2002 and thereafter.
The exclusion provides an additional incentive to donate a conservation easement within the designated areas. The exclusion is especially attractive for farmers who own land near urban areas where the difference between the value of land for farm purposes and for development purposes can be significant.

However, given the increased unified credit and the availability of special-use valuation, the number of landowners subject to the federal estate tax who would benefit from the additional exclusion is relatively small. Geographic targeting of conservation easements has also limited the pool of potential donors.

D. OTHER TAX BENEFITS

Farmers also benefit from general tax provisions available to all taxpayers and from tax provisions specifically designed for farmers. Examples of special tax treatments for farmers include cash accounting, farm income averaging, depreciation, the current deductibility of certain capital costs, capital gains treatment for certain assets used in farming, and the ability to deduct certain farm losses.

These and other provisions reduce the farm income tax base, and generally accrue to those with higher incomes – large farms with high farm income and very small farms with high levels of off-farm income. Such incentives have encouraged greater investment in productive capacity than would have been warranted without tax incentives, and has affected farmland prices, organizational structure and farm profitability.
CHAPTER 4 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. When should a business owner begin thinking about estate planning:
   a) when the owner is starting to think about retirement
   b) as soon as the business is started
   c) only when family members express an interest in taking over the business
   d) never; he or she should focus on running the business and let the survivors worry about it after he or she dies

2. What is the simplest type of business entity to start and operate:
   a) general partnership
   b) sole proprietorship
   c) limited partnership
   d) corporation

3. A limited partnership must be comprised of:
   a) at least one general and one limited partner
   b) at least two limited partners
   c) at least two general partners
   d) at least two general and two limited partners

4. The limited liability status of the owners of an S corporation provides for easy transition after death.
   a) true
   b) false

5. According to Treasury Regulations, a transaction is a bona fide sale if it is made:
   a) at fair market value
   b) in good faith
   c) in a timely manner
   d) in cash
6. Pursuant to IRC § 6166, the value of the business interest must be ______ of the value of the decedent’s gross estate for the deferment of estate tax payments to apply.

   a) at least 35%
   b) at least 50%
   c) no more than 50%
   d) no more than 35%

7. In general, the value of property for estate tax purposes is the fair market value at the date of death.

   a) true
   b) false

8. Federal estate and gift taxes must always be paid within nine months of the date of death.

   a) true
   b) false
CHAPTER 4 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. This is generally too late to consider tax and other implications of transferring a business and its assets.

B: Correct. The consideration of estate planning should be part of the discussion at the beginning, including selecting the type of entity to create to operate the business.

C: Incorrect. This is often too late.

D: Incorrect. This is shortsighted and wrong. There are many things that have to be done up front to preserve the assets of the business and family.

(See page 4-2 of the course material.)

2. A: Incorrect. The general partnership is relatively simple to start and maintain, especially compared to a corporation. However, there is one that is even easier.

B: Correct. There are literally no formalities and no forms other than a business license. In addition, there is no separate tax return required, as the income goes on the owner's personal return.

C: Incorrect. This requires registration with the state and separate tax returns.

D: Incorrect. This is the most complicated type of entity, although it has its advantages.

(See page 4-2 of the course material.)

3. A: Correct. A limited partnership must have at least one general and one limited partner, although more of either or both is permissible.

B: Incorrect. Only one limited partner is required.

C: Incorrect. Only one general partner is required.

D: Incorrect. Only one limited and one general partner are required to form a limited partnership.

(See page 4-3 of the course material.)
4. **A: True is correct.** Because of the tax benefits and the restrictions on the number of owners, many family businesses that elect to incorporate also elect S corporation status.

   B: False is incorrect. The limited liability status of the owners protects the assets of the individual and his or her families who are involved in the business, limits their tax liability while they are alive, and provides for easy transition after death.

   (See page 4-5 of the course material.)

5. A: Incorrect. The primary factor is not the amount.

   **B: Correct.** To determine if a transaction is a bona fide sale, the transfer must be made in good faith.

   C: Incorrect. Timing is not the determinative factor.

   D: Incorrect. The form of payment is not the determinative factor.

   (See page 4-8 of the course material.)

6. **A: Correct.** Under IRC § 6166, the executor of certain estates can elect to defer estate taxes over a period of 14 years. The election is available where the estate of the decedent consists largely of an interest in a closely held business if the value of the business interest is at least 35 percent of the value of the decedent’s gross estate.

   B: Incorrect. The value of the business interest must be 35 percent of the value of the decedent’s gross estate, not 50 percent.

   C: Incorrect. This is not the proper limit.

   D: Incorrect. This is not the proper limit.

   (See page 4-9 of the course material.)

7. **A: True is correct.** However, if certain conditions are satisfied, the estate’s real property devoted to farming use may be valued at its use value as a farm rather than at its fair market value.

   B: False is incorrect. To qualify for special use valuation, several conditions must be met.

   (See pages 4-10 to 4-11 of the course material.)
8. A: True is incorrect. If at least 35 percent of an estate’s value is a farm or closely held business, estate taxes may be paid over an additional 14-year period with only interest due for the first five years.

B: False is correct. The provision for deferment of estate tax payments, along with the increase in the amount of property that can be transferred tax free, has greatly reduced the liquidity problem that some farm heirs might otherwise experience as a result of the federal estate taxes.

(See page 4-11 of the course material.)
Appendix A:

IRS Form 706 and Instructions

Note: As of the date of printing, the Form 706 for 2010 was still unavailable. We have included the 2009 Form 706 for your reference.
# United States Estate (and Generation-Skipping Transfer) Tax Return

**Form 706**  
(Rev. September 2009)

**Department of the Treasury**  
Internal Revenue Service

**Estate of a citizen or resident of the United States (see separate instructions).**


---

### Part 1—Decedent and Executor

<table>
<thead>
<tr>
<th>1a</th>
<th>Decedent’s first name and middle initial (and maiden name, if any)</th>
<th>1b</th>
<th>Decedent’s last name</th>
<th>2</th>
<th>Decedent’s Social Security No.</th>
</tr>
</thead>
</table>

| 3a | County, state, and ZIP code, or foreign country, of legal residence (domicile) at time of death | 3b | Year domicile established | 4 | Date of birth | 5 | Date of death |

<table>
<thead>
<tr>
<th>6a</th>
<th>Name of executor (see page 5 of the instructions)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>6b</th>
<th>Executor’s address (number and street including apartment or suite no.; city, town, or post office; state; and ZIP code) and phone no.</th>
</tr>
</thead>
</table>

### Part 2—Tax Computation

<table>
<thead>
<tr>
<th>1</th>
<th>Total gross estate less exclusion (from Part 5—Recapitulation, page 3, item 12)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>2</th>
<th>Tentative total allowable deductions (from Part 5—Recapitulation, page 3, Item 22)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>3a</th>
<th>Tentative taxable estate (before state death tax deduction) (subtract line 2 from line 1)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>b</th>
<th>State death tax deduction</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>c</th>
<th>Taxable estate (subtract line 3b from line 3a)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>4</th>
<th>Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent’s gross estate (section 2001(b)))</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>5</th>
<th>Add lines 3c and 4</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>6</th>
<th>Tentative tax on the amount on line 5 from Table A on page 4 of the instructions</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>7</th>
<th>Total gift tax paid or payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent’s spouse for such spouse’s share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent’s gross estate (see instructions)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>8</th>
<th>Gross estate tax (subtract line 7 from line 6)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>9</th>
<th>Maximum unified credit (applicable credit amount) against estate tax</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>10</th>
<th>Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed $6,000. See page 6 of the instructions.)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>11</th>
<th>Allowable unified credit (applicable credit amount) (subtract line 10 from line 9)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>12</th>
<th>Subtract line 11 from line 8 (but do not enter less than zero)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>13</th>
<th>Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>14</th>
<th>Credit for tax on prior transfers (from Schedule Q)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>15</th>
<th>Total credits (add lines 13 and 14)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>16</th>
<th>Net estate tax (subtract line 15 from line 12)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>17</th>
<th>Generation-skipping transfer (GST) taxes payable (from Schedule R, Part 2, line 10)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>18</th>
<th>Total transfer taxes (add lines 16 and 17)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>19</th>
<th>Prior payments. Explain in an attached statement</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>20</th>
<th>Balance due (or overpayment) (subtract line 19 from line 18)</th>
</tr>
</thead>
</table>

---

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 the executor is based on all information of which preparer has any knowledge.

---

### Sign Here

**Signature of executor**  
Date

**Signature of executor**  
Date

### Paid Preparer’s Use Only

**Preparer’s signature**  
Date  
Check if self-employed  
Preparer’s SSN or PTIN  
EIN  
Phone no. ( )

---

For Privacy Act and Paperwork Reduction Act Notice, see page 30 of the separate instructions for this form.
**Estate of:**

<table>
<thead>
<tr>
<th>Decedent’s Social Security Number</th>
</tr>
</thead>
</table>

### Part 3—Elections by the Executor

**Please check the “Yes” or “No” box for each question (see instructions beginning on page 7).**

**Note.** Some of these elections may require the posting of bonds or liens.

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Do you elect alternate valuation?</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>2. Do you elect special-use valuation?</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>If “Yes,” you must complete and attach Schedule A-1.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Do you elect to pay the taxes in installments as described in section 6166?</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>If “Yes,” you must attach the additional information described on pages 10 through 12 of the instructions.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Note.</strong> By electing section 6166, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6324A lien.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Do you elect to postpone the part of the taxes attributable to a reversionary or remainder interest as described in section 6163?</td>
<td></td>
<td>4</td>
</tr>
</tbody>
</table>

### Part 4—General Information

**Note.** Please attach the necessary supplemental documents. You must attach the death certificate.

(see instructions on page 12)

Authorization to receive confidential tax information under Regs. sec. 601.504(b)(2)(i); to act as the estate’s representative before the IRS; and to make written or oral presentations on behalf of the estate if return prepared by an attorney, accountant, or enrolled agent for the executor:

<table>
<thead>
<tr>
<th>Name of representative (print or type)</th>
<th>State</th>
<th>Address (number, street, and room or suite no., city, state, and ZIP code)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

I declare that I am the [ ] attorney/ [ ] certified public accountant/ [ ] enrolled agent (you must check the applicable box) for the executor. I am not under suspension or disbarment from practice before the Internal Revenue Service and am qualified to practice in the state shown above.

<table>
<thead>
<tr>
<th>Signature</th>
<th>CAF number</th>
<th>Date</th>
<th>Telephone number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. Death certificate number and issuing authority (attach a copy of the death certificate to this return).

2. Decedent’s business or occupation. If retired, check here ▶ [ ] and state decedent’s former business or occupation.

3. Marital status of the decedent at time of death:
   - [ ] Married
   - [ ] Widow or widower—Name, SSN, and date of death of deceased spouse ▶ [ ]
   - [ ] Single
   - [ ] Legally separated
   - [ ] Divorced—Date divorce decree became final ▶ [ ]

4. a. Surviving spouse’s name
   b. Social security number
   c. Amount received (see page 12 of the instructions)

5. Individuals (other than the surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule O) (see instructions).

<table>
<thead>
<tr>
<th>Name of individual, trust, or estate receiving $5,000 or more</th>
<th>Identifying number</th>
<th>Relationship to decedent</th>
<th>Amount (see instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

All unascertainable beneficiaries and those who receive less than $5,000 ▶ [ ]

### Total

Please check the “Yes” or “No” box for each question.

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Does the gross estate contain any section 2044 property (qualified terminable interest property (QTIP) from a prior gift or estate) (see page 12 of the instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7a. Have federal gift tax returns ever been filed?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If “Yes,” please attach copies of the returns, if available, and furnish the following information:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7b. Period(s) covered</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7c. Internal Revenue office(s) where filed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8a. Was there any insurance on the decedent’s life that is not included on the return as part of the gross estate?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8b. Did the decedent own any insurance on the life of another that is not included in the gross estate?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Part 4—General Information (continued)

If you answer “Yes” to any of questions 9–16, you must attach additional information as described in the instructions.  

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>9 Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which (a) one or more of the other joint tenants was someone other than the decedent’s spouse, and (b) less than the full value of the property is included on the return as part of the gross estate? If “Yes,” you must complete and attach Schedule E.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10a Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), an unincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b If “Yes,” was the value of any interest owned (from above) discounted on this estate tax return? If “Yes,” see the instructions for Schedule F on page 20 for reporting the total accumulated or effective discounts taken on Schedule F or G.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Did the decedent make any transfer described in section 2035, 2036, 2037, or 2038 (see the instructions for Schedule G beginning on page 15 of the separate instructions)? If “Yes,” you must complete and attach Schedule G.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12a Were there in existence at the time of the decedent’s death any trusts created by the decedent during his or her lifetime?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b Were there in existence at the time of the decedent’s death any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c Was the decedent receiving income from a trust created after October 22, 1986, by a parent or grandparent?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>d If “Yes,” was there a GST taxable termination (under section 2612) upon the death of the decedent?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>e Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in question 12a or 12b?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If “Yes,” provide the EIN number to this transferred/sold item.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Did the decedent ever possess, exercise, or release any general power of appointment? If “Yes,” you must complete and attach Schedule H.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Did the decedent have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Was the decedent, immediately before death, receiving an annuity described in the “General” paragraph of the instructions for Schedule I or a private annuity? If “Yes,” you must complete and attach Schedule I.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a pre-deceased spouse under section 2056(b)(7) and which is not reported on this return? If “Yes,” attach an explanation.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Part 5—Recapitulation

<table>
<thead>
<tr>
<th>Item number</th>
<th>Gross estate</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Schedule A—Real Estate</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Schedule B—Stocks and Bonds</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Schedule C—Mortgages, Notes, and Cash</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Schedule D—Insurance on the Decedent’s Life (attach Form(s) 712)</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance)</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance)</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Schedule G—Transfers During Decedent’s Life (at. Form(s) 712 for life insurance)</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Schedule H—Powers of Appointment</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Schedule I—Annuities</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Total gross estate (add items 1 through 9)</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Schedule U—Qualified Conservation Easement Exclusion</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Total gross estate less exclusion (subtract item 11 from item 10). Enter here and on line 1 of Part 2—Tax Computation</td>
<td>12</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item number</th>
<th>Deductions</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims</td>
<td>13</td>
</tr>
<tr>
<td>14</td>
<td>Schedule K—Debts of the Decedent</td>
<td>14</td>
</tr>
<tr>
<td>15</td>
<td>Schedule K—Mortgages and Liens</td>
<td>15</td>
</tr>
<tr>
<td>16</td>
<td>Total of items 13 through 15</td>
<td>16</td>
</tr>
<tr>
<td>17</td>
<td>Allowable amount of deductions from item 16 (see the instructions for item 17 of the Recapitulation)</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>Schedule L—Net Losses During Administration</td>
<td>18</td>
</tr>
<tr>
<td>19</td>
<td>Schedule L—Expenses Incurred in Administering Property Not Subject to Claims</td>
<td>19</td>
</tr>
<tr>
<td>20</td>
<td>Schedule M—Bequests, etc., to Surviving Spouse</td>
<td>20</td>
</tr>
<tr>
<td>21</td>
<td>Schedule O—Charitable, Public, and Similar Gifts and Bequests</td>
<td>21</td>
</tr>
<tr>
<td>22</td>
<td>Tentative total allowable deductions (add items 17 through 21). Enter here and on line 2 of the Tax Computation</td>
<td>22</td>
</tr>
</tbody>
</table>
SCHEDULE A—Real Estate

- For jointly owned property that must be disclosed on Schedule E, see the instructions on the reverse side of Schedule E.
- Real estate that is part of a sole proprietorship should be shown on Schedule F.
- Real estate that is included in the gross estate under section 2035, 2036, 2037, or 2038 should be shown on Schedule G.
- Real estate that is included in the gross estate under section 2041 should be shown on Schedule H.
- If you elect section 2032A valuation, you must complete Schedule A and Schedule A-1.

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules or additional sheets attached to this schedule . . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 1.) . . . . . . . .

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(See the instructions on the reverse side.)
Instructions for Schedule A—Real Estate

If the total gross estate contains any real estate, you must complete Schedule A and file it with the return. On Schedule A, list real estate the decedent owned or had contracted to purchase. Number each parcel in the left-hand column.

Describe the real estate in enough detail so that the IRS can easily locate it for inspection and valuation. For each parcel of real estate, report the area and, if the parcel is improved, describe the improvements. For city or town property, report the street and number, ward, subdivision, block and lot, etc. For rural property, report the township, range, landmarks, etc.

If any item of real estate is subject to a mortgage for which the decedent’s estate is liable, that is, if the indebtedness may be charged against other property of the estate that is not subject to that mortgage, or if the decedent was personally liable for that mortgage, you must report the full value of the property in the value column. Enter the amount of the mortgage under “Description” on this schedule. The unpaid amount of the mortgage may be deducted on Schedule K.

If the decedent’s estate is not liable for the amount of the mortgage, report only the value of the equity of redemption (or value of the property less the indebtedness) in the value column as part of the gross estate. Do not enter any amount less than zero. Do not deduct the amount of indebtedness on Schedule K.

Also list on Schedule A real property the decedent contracted to purchase. Report the full value of the property and not the equity in the value column. Deduct the unpaid part of the purchase price on Schedule K.

Report the value of real estate without reducing it for homestead or other exemption, or the value of dower, curtesy, or a statutory estate created instead of dower or curtesy.

Explain how the reported values were determined and attach copies of any appraisals.

Schedule A Examples

In this example, alternate valuation is not adopted; the date of death is January 1, 2009.

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>House and lot, 1921 William Street NW, Washington, DC (lot 6, square 481). Rent of $8,100 due at end of each quarter, February 1, May 1, August 1, and November 1. Value based on appraisal, copy of which is attached</td>
<td></td>
<td></td>
<td>$550,000</td>
</tr>
<tr>
<td></td>
<td>Rent due on item 1 for quarter ending November 1, 2008, but not collected at date of death</td>
<td></td>
<td></td>
<td>8,100</td>
</tr>
<tr>
<td></td>
<td>Rent accrued on item 1 for November and December 2008</td>
<td></td>
<td></td>
<td>5,400</td>
</tr>
<tr>
<td>2</td>
<td>House and lot, 304 Jefferson Street, Alexandria, VA (lot 18, square 40). Rent of $1,800 payable monthly. Value based on appraisal, copy of which is attached</td>
<td></td>
<td>375,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rent due on item 2 for December 2008, but not collected at date of death</td>
<td></td>
<td></td>
<td>1,800</td>
</tr>
</tbody>
</table>

In this example, alternate valuation is adopted; the date of death is January 1, 2009.

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>House and lot, 1921 William Street NW, Washington, DC (lot 6, square 481). Rent of $8,100 due at end of each quarter, February 1, May 1, August 1, and November 1. Value based on appraisal, copy of which is attached. Not disposed of within 6 months following death</td>
<td>7/1/09</td>
<td>$535,000</td>
<td>$550,000</td>
</tr>
<tr>
<td></td>
<td>Rent due on item 1 for quarter ending November 1, 2008, but not collected until February 1, 2009</td>
<td>2/1/09</td>
<td>8,100</td>
<td>8,100</td>
</tr>
<tr>
<td></td>
<td>Rent accrued on item 1 for November and December 2008, collected on February 1, 2009</td>
<td>2/1/09</td>
<td>5,400</td>
<td>5,400</td>
</tr>
<tr>
<td>2</td>
<td>House and lot, 304 Jefferson Street, Alexandria, VA (lot 18, square 40). Rent of $1,800 payable monthly. Value based on appraisal, copy of which is attached. Property exchanged for farm on May 1, 2009</td>
<td>5/1/09</td>
<td>369,000</td>
<td>375,000</td>
</tr>
<tr>
<td></td>
<td>Rent due on item 2 for December 2008, but not collected until February 1, 2009</td>
<td>2/1/09</td>
<td>1,800</td>
<td>1,800</td>
</tr>
</tbody>
</table>
Instructions for Schedule A-1. Section 2032A Valuation

The election to value certain farmland and closely held business property at its special-use value is made by checking “Yes” on Form 706, Part 3—Elections by the Executor, line 2. Schedule A-1 is used to report the additional information that must be submitted to support this election. In order to make a valid election, you must complete Schedule A-1 and attach all of the required statements and appraisals.

For definitions and additional information concerning special-use valuation, see section 2032A and the related regulations.

Part 1. Type of Election

Estate and GST tax elections. If you elect special-use valuation for the estate tax, you must also elect special-use valuation for the GST tax and vice versa.

You must value each specific property interest at the same value for GST tax purposes that you value it at for estate tax purposes.

Protective election. To make the protective election described in the separate instructions for Part 3—Elections by the Executor, line 2, you must check this box, enter the decedent’s name and social security number in the spaces provided at the top of Schedule A-1, and complete Part 2. Notice of Election, line 1 and lines 3 and 4, column A. For purposes of the protective election, list on line 3 all of the real property that passes to the qualified heirs even though some of the property will be shown on line 2 when the additional notice of election is subsequently filed. You need not complete columns B through D of lines 3 and 4. You need not complete any other line entries on Schedule A-1. Completing Schedule A-1 as described above constitutes a Notice of Protective Election as described in Regulations section 20.2032A-8(b).

Part 2. Notice of Election

Line 10. Because the special-use valuation election creates a potential tax liability for the recapture tax of section 2032A(c), you must list each person who receives an interest in the specially valued property on Schedule A-1. If there are more than eight persons who receive interests, use an additional sheet that follows the format of line 10. In the columns “Fair market value” and “Special-use value,” you should enter the total respective values of all the specially valued property interests received by each person.

GST Tax Savings

To compute the additional GST tax due upon disposition (or cessation of qualified use) of the property, each “skip person” (as defined in the instructions to Schedule R) who receives an interest in the specially valued property must know the total GST tax savings on all of the interests in specially valued property received. This GST tax savings is the difference between the total GST tax that was imposed on all of the interests in specially valued property received by the skip person valued at their special-use value and the total GST tax that would have been imposed on the same interests received by the skip person had they been valued at their fair market value (FMV).

Because the GST tax depends on the executor’s allocation of the GST exemption and the grandchild exclusion, the skip person who receives the interests is unable to compute this GST tax savings. Therefore, for each skip person who receives an interest in specially valued property, you must attach worksheets showing the total GST tax savings attributable to all of that person’s interests in specially valued property.

How to compute the GST tax savings. Before computing each skip person’s GST tax savings, you must complete Schedules R and R-1 for the entire estate (using the special-use values).

For each skip person, you must complete two Schedules R (Parts 2 and 3 only) as worksheets, one showing the interests in specially valued property received by the skip person at their special-use value and one showing the same interests at their FMV.

If the skip person received interests in specially valued property that were shown on Schedule R-1, show these interests on the Schedule R, Parts 2 and 3 worksheets, as appropriate. Do not use Schedule R-1 as a worksheet.

Completing the special-use value worksheets. On Schedule R, Parts 2 and 3, lines 2 through 4 and 6, enter -0-.

Completing the fair market value worksheets.

- Schedule R, Parts 2 and 3, lines 2 and 3, fixed taxes and other charges. If valuing the interests at their FMV (instead of special-use value) causes any of these taxes and charges to increase, enter the increased amount (only) on these lines and attach an explanation of the increase. Otherwise, enter -0-.

- Schedule R, Parts 2 and 3, line 6—GST exemption allocation. If you completed Schedule R, Part 1, line 10, enter on line 6 the amount shown for the skip person on the line 10 special-use allocation schedule you attached to Schedule R. If you did not complete Schedule R, Part 1, line 10, enter -0- on line 6.

Total GST tax savings. For each skip person, subtract the tax amount on line 10, Part 2 of the special-use value worksheet from the tax amount on line 10, Part 2 of the fair market value worksheet. This difference is the skip person’s total GST tax savings.

Part 3. Agreement to Special Valuation Under Section 2032A

The agreement to special valuation by persons with an interest in property is required under section 2032A(a)(1)(B) and (d)(2) and must be signed by all parties who have any interest in the property being valued based on its qualified use as of the date of the decedent’s death.

An interest in property is an interest that, as of the date of the decedent’s death, can be asserted under applicable local law so as to affect the disposition of the specially valued property by the estate. Any person who at the decedent’s death has any such interest in the property, whether present or future, or vested or contingent, must enter into the agreement. Included are owners of remainder and executory interests; the holders of general or special powers of appointment; beneficiaries of a gift over in default of exercise of any such power; joint tenants and holders of similar undivided interests when the decedent held only a joint or undivided interest in the property or when only an undivided interest is specially valued; and trustees of trusts and representatives of other entities holding title to, or holding any interests in the property. An heir who has the power under local law to caveat (challenge) a will and thereby affect disposition of the property is not, however, considered to be a person with an interest in property under section 2032A solely by reason of that right. Likewise, creditors of an estate are not such persons solely by reason of their status as creditors.

If any person required to enter into the agreement desires that an agent act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, or due to death before the election under section 2032A is timely exercised, a representative authorized by local law to bind the person in an agreement of this nature may sign the agreement on his or her behalf.

The Internal Revenue Service will contact the agent designated in the agreement on all matters relating to continued qualification under section 2032A of the specially valued real property and on all matters relating to the special lien arising under section 6324B. It is the duty of the agent as attorney-in-fact for the parties with interests in the specially valued property to furnish the IRS with any requested information and to notify the IRS of any disposition or cessation of qualified use of any part of the property.
Checklist for Section 2032A Election

If you are going to make the special-use valuation election on Schedule A-1, please use this checklist to ensure that you are providing everything necessary to make a valid election.

To have a valid special-use valuation election under section 2032A, you must file, in addition to the federal estate tax return, (a) a notice of election (Schedule A-1, Part 2), and (b) a fully executed agreement (Schedule A-1, Part 3). You must include certain information in the notice of election. To ensure that the notice of election includes all of the information required for a valid election, use the following checklist. The checklist is for your use only. Do not file it with the return.

1. Does the notice of election include the decedent’s name and social security number as they appear on the estate tax return?
2. Does the notice of election include the relevant qualified use of the property to be specially valued?
3. Does the notice of election describe the items of real property shown on the estate tax return that are to be specially valued and identify the property by the Form 706 schedule and item number?
4. Does the notice of election include the FMV of the real property to be specially valued and also include its value based on the qualified use (determined without the adjustments provided in section 2032A(b)(3)(B))?
5. Does the notice of election include the adjusted value (as defined in section 2032A(b)(3)(B)) of (a) all real property that both passes from the decedent and is used in a qualified use, without regard to whether it is to be specially valued, and (b) all real property to be specially valued?
6. Does the notice of election include (a) the items of personal property shown on the estate tax return that pass from the decedent to a qualified heir and that are used in qualified use and (b) the total value of such personal property adjusted under section 2032A(b)(3)(B)?
7. Does the notice of election include the adjusted value of the gross estate? (See section 2032A(b)(3)(A).)
8. Does the notice of election include the method used to determine the special-use value?
9. Does the notice of election include copies of written appraisals of the FMV of the real property?
10. Does the notice of election include a statement that the decedent and/or a member of his or her family has owned all of the specially valued property for at least 5 years of the 8 years immediately preceding the date of the decedent’s death?
11. Does the notice of election include a statement as to whether there were any periods during the 8-year period preceding the decedent’s date of death during which the decedent or a member of his or her family did not (a) own the property to be specially valued, (b) use it in a qualified use, or (c) materially participate in the operation of the farm or other business? (See section 2032A(e)(6).)
12. Does the notice of election include, for each item of specially valued property, the name of every person taking an interest in that item of specially valued property and the following information about each such person: (a) the person’s address, (b) the person’s taxpayer identification number, (c) the person’s relationship to the decedent, and (d) the value of the property interest passing to that person based on both FMV and qualified use?
13. Does the notice of election include affidavits describing the activities constituting material participation and the identity of the material participants?
14. Does the notice of election include a legal description of each item of specially valued property? (In the case of an election made for qualified woodlands, the information included in the notice of election must include the reason for entitlement to the Woodlands election.)

Any election made under section 2032A will not be valid unless a properly executed agreement (Schedule A-1, Part 3) is filed with the estate tax return. To ensure that the agreement satisfies the requirements for a valid election, use the following checklist.

1. Has the agreement been signed by each qualified heir having an interest in the property being specially valued?
2. Has every qualified heir expressed consent to personal liability under section 2032A(c) in the event of an early disposition or early cessation of qualified use?
3. Is the agreement that is actually signed by the qualified heirs in a form that is binding on all of the qualified heirs having an interest in the specially valued property?
4. Does the agreement designate an agent to act for the parties to the agreement in all dealings with the IRS on matters arising under section 2032A?
5. Has the agreement been signed by the designated agent and does it give the address of the agent?
SCHEDULE A-1—Section 2032A Valuation

Part 1. Type of Election (Before making an election, see the checklist on page 7.):

- Protective election (Regulations section 20.2032A-8(b)). Complete Part 2, line 1, and column A of lines 3 and 4. (see instructions)
- Regular election. Complete all of Part 2 (including line 11, if applicable) and Part 3. (see instructions)

Before completing Schedule A-1, see the checklist on page 7 for the information and documents that must be included to make a valid election.

The election is not valid unless the agreement (that is, Part 3. Agreement to Special Valuation Under Section 2032A):

- Is signed by each qualified heir with an interest in the specially valued property and
- Is attached to this return when it is filed.

Part 2. Notice of Election (Regulations section 20.2032A-8(a)(3))

Note. All real property entered on lines 2 and 3 must also be entered on Schedules A, E, F, G, or H, as applicable.

1. Qualified use—check one ▶
   - Farm used for farming, or
   - Trade or business other than farming

2. Real property used in a qualified use, passing to qualified heirs, and to be specially valued on this Form 706.

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule and item number from Form 706</td>
<td>Full value (without section 2032A(b)(3)(B) adjustment)</td>
<td>Adjusted value (with section 2032A(b)(3)(B) adjustment)</td>
<td>Value based on qualified use (without section 2032A(b)(3)(B) adjustment)</td>
</tr>
</tbody>
</table>

Totals

Attach a legal description of all property listed on line 2.

Attach copies of appraisals showing the column B values for all property listed on line 2.

3. Real property used in a qualified use, passing to qualified heirs, but not specially valued on this Form 706.

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule and item number from Form 706</td>
<td>Full value (without section 2032A(b)(3)(B) adjustment)</td>
<td>Adjusted value (with section 2032A(b)(3)(B) adjustment)</td>
<td>Value based on qualified use (without section 2032A(b)(3)(B) adjustment)</td>
</tr>
</tbody>
</table>

Totals

If you checked “Regular election,” you must attach copies of appraisals showing the column B values for all property listed on line 3.

(continued on next page)
4 Personal property used in a qualified use and passing to qualified heirs.

<table>
<thead>
<tr>
<th>A</th>
<th>B (continued)</th>
<th>A (continued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule and item number from Form 706</td>
<td>Adjusted value (with section 2032A(b)(3)(B) adjustment)</td>
<td>Schedule and item number from Form 706</td>
</tr>
</tbody>
</table>

"Subtotal" from Col. B, below left

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total adjusted value</td>
<td></td>
</tr>
</tbody>
</table>

5 Enter the value of the total gross estate as adjusted under section 2032A(b)(3)(A). ☐ Yes ☐ No

6 Attach a description of the method used to determine the special value based on qualified use.

7 Did the decedent and/or a member of his or her family own all property listed on line 2 for at least 5 of the 8 years immediately preceding the date of the decedent’s death? ☐ Yes ☐ No

8 Were there any periods during the 8-year period preceding the date of the decedent’s death during which the decedent or a member of his or her family:
   a Did not own the property listed on line 2? ☐ Yes No
   b Did not use the property listed on line 2 in a qualified use? ☐ Yes No
   c Did not materially participate in the operation of the farm or other business within the meaning of section 2032A(e)(6)? ☐ Yes No

If “Yes” to any of the above, you must attach a statement listing the periods. If applicable, describe whether the exceptions of sections 2032A(b)(4) or (5) are met.

9 Attach affidavits describing the activities constituting material participation and the identity and relationship to the decedent of the material participants.

10 Persons holding interests. Enter the requested information for each party who received any interest in the specially valued property. (Each of the qualified heirs receiving an interest in the property must sign the agreement, and the agreement must be filed with this return.)

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td></td>
</tr>
<tr>
<td>E</td>
<td></td>
</tr>
<tr>
<td>F</td>
<td></td>
</tr>
<tr>
<td>G</td>
<td></td>
</tr>
<tr>
<td>H</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Identifying number</th>
<th>Relationship to decedent</th>
<th>Fair market value</th>
<th>Special-use value</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>G</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

You must attach a computation of the GST tax savings attributable to direct skips for each person listed above who is a skip person. (see instructions)

11 Woodlands election. Check here ☐ if you wish to make a Woodlands election as described in section 2032A(e)(13). Enter the schedule and item numbers from Form 706 of the property for which you are making this election ☐ ____________________________

You must attach a statement explaining why you are entitled to make this election. The IRS may issue regulations that require more information to substantiate this election. You will be notified by the IRS if you must supply further information.
Part 3. Agreement to Special Valuation Under Section 2032A

The undersigned agree and consent to the application of subsection (c) of section 2032A of the Code with respect to all the property described on Form 706, Schedule A-1, Part 2, line 2, attached to this agreement. More specifically, the undersigned heirs expressly agree and consent to personal liability under subsection (c) of 2032A for the additional estate and GST taxes imposed by that subsection with respect to their respective interests in the above-described property in the event of certain early dispositions of the property or early cessation of the qualified use of the property. It is understood that if a qualified heir disposes of any interest in qualified real property to any member of his or her family, such member may thereafter be treated as the qualified heir with respect to such interest upon filing a Form 706-A, United States Additional Estate Tax Return, and a new agreement.

The undersigned interested parties who are not qualified heirs consent to the collection of any additional estate and GST taxes imposed under section 2032A(c) of the Code from the specially valued property.

If there is a disposition of any interest which passes, or has passed to him or her, or if there is a cessation of the qualified use of any specially valued property which passes or passed to him or her, each of the undersigned heirs agrees to file a Form 706-A, and pay any additional estate and GST taxes due within 6 months of the disposition or cessation.

It is understood by all interested parties that this agreement is a condition precedent to the election of special-use valuation under section 2032A of the Code and must be executed by every interested party even though that person may not have received the estate (or GST) tax benefits or be in possession of such property.

Each of the undersigned understands that by making this election, a lien will be created and recorded pursuant to section 6324B of the Code on the property referred to in this agreement for the adjusted tax differences with respect to the estate as defined in section 2032A(c)(2)(C).

As the interested parties, the undersigned designate the following individual as their agent for all dealings with the Internal Revenue Service concerning the continued qualification of the specially valued property under section 2032A of the Code and on all issues regarding the special lien under section 6324B. The agent is authorized to act for the parties with respect to all dealings with the Service on matters affecting the qualified real property described earlier. This includes the authorization:

- To receive confidential information on all matters relating to continued qualification under section 2032A of the specially valued real property and on all matters relating to the special lien arising under section 6324B;
- To furnish the Internal Revenue Service with any requested information concerning the property;
- To notify the Internal Revenue Service of any disposition or cessation of qualified use of any part of the property;
- To receive, but not to endorse and collect, checks in payment of any refund of Internal Revenue taxes, penalties, or interest;
- To execute waivers (including offers of waivers) of restrictions on assessment or collection of deficiencies in tax and waivers of notice of disallowance of a claim for credit or refund; and
- To execute closing agreements under section 7121.

(continued on next page)
### Part 3. Agreement to Special Valuation Under Section 2032A (continued)

<table>
<thead>
<tr>
<th>Estate of:</th>
<th>Decedent’s Social Security Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Other acts (specify)</td>
<td></td>
</tr>
</tbody>
</table>

By signing this agreement, the agent agrees to provide the Internal Revenue Service with any requested information concerning this property and to notify the Internal Revenue Service of any disposition or cessation of the qualified use of any part of this property.

<table>
<thead>
<tr>
<th>Name of Agent</th>
<th>Signature</th>
<th>Address</th>
</tr>
</thead>
</table>

The property to which this agreement relates is listed in Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and in the Notice of Election, along with its fair market value according to section 2031 of the Code and its special-use value according to section 2032A. The name, address, social security number, and interest (including the value) of each of the undersigned in this property are as set forth in the attached Notice of Election.

IN WITNESS WHEREOF, the undersigned have hereunto set their hands at ________________________________ day of ____________________.

SIGNATURES OF EACH OF THE QUALIFIED HEIRS:

<table>
<thead>
<tr>
<th>Signature of qualified heir</th>
<th>Signature of qualified heir</th>
</tr>
</thead>
<tbody>
<tr>
<td>Signature of qualified heir</td>
<td>Signature of qualified heir</td>
</tr>
<tr>
<td>Signature of qualified heir</td>
<td>Signature of qualified heir</td>
</tr>
<tr>
<td>Signature of qualified heir</td>
<td>Signature of qualified heir</td>
</tr>
<tr>
<td>Signature of qualified heir</td>
<td>Signature of qualified heir</td>
</tr>
<tr>
<td>Signature of qualified heir</td>
<td>Signature of qualified heir</td>
</tr>
</tbody>
</table>

Signatures of other interested parties

<table>
<thead>
<tr>
<th>Signature of other interested parties</th>
<th>Signature of other interested parties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Signature of other interested parties</td>
<td>Signature of other interested parties</td>
</tr>
</tbody>
</table>
# SCHEDULE B—Stocks and Bonds

(For jointly owned property that must be disclosed on Schedule E, see the instructions for Schedule E.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description, including face amount of bonds or number of shares and par value for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN</th>
<th>Unit value</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CUSIP number or EIN, where applicable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule . . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 2.) . . . . . . .

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(To the instructions to Schedule B are in the separate instructions.)
**SCHEDULE C—Mortgages, Notes, and Cash**
(For jointly owned property that must be disclosed on Schedule E, see the instructions for Schedule E.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 3.) . . . . .

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)
(See the instructions on the reverse side.)
Instructions for Schedule C—
Mortgages, Notes, and Cash

Complete Schedule C and file it with your return if the total gross estate contains any:

- Mortgages,
- Notes, or
- Cash.

List on Schedule C:

- Mortgages and notes payable to the decedent at the time of death.
- Cash the decedent had at the date of death.

Do not list on Schedule C:

- Mortgages and notes payable by the decedent. (If these are deductible, list them on Schedule K.)

List the items on Schedule C in the following order:

1. Mortgages;
2. Promissory notes;
3. Contracts by decedent to sell land;
4. Cash in possession; and
5. Cash in banks, savings and loan associations, and other types of financial organizations.

What to enter in the “Description” column:

For mortgages, list:

- Face value,
- Unpaid balance,
- Date of mortgage,
- Name of maker,
- Property mortgaged,
- Date of maturity,
- Interest rate, and
- Interest date.

Example to enter in “Description” column:

“Bond and mortgage of $50,000, unpaid balance: $17,000; dated: January 1, 1992; John Doe to Richard Roe; premises: 22 Clinton Street, Newark, NJ; due: January 1, 2012; interest payable at 10% a year—January 1 and July 1.”

For promissory notes, list in the same way as mortgages.

For contracts by the decedent to sell land, list:

- Name of purchaser,
- Contract date,
- Property description,
- Sale price,
- Initial payment,
- Amounts of installment payment,
- Unpaid balance of principal, and
- Interest rate.

For cash in possession, list such cash separately from bank deposits.

For cash in banks, savings and loan associations, and other types of financial organizations, list:

- Name and address of each financial organization,
- Amount in each account,
- Serial or account number,
- Nature of account—checking, savings, time deposit, etc., and
- Unpaid interest accrued from date of last interest payment to the date of death.

Note. If you obtain statements from the financial organizations, keep them for IRS inspection.
<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 4.) . . . . . . . .

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(See the instructions on the reverse side.)
Instructions for Schedule D—Insurance on the Decedent’s Life

If you are required to file Form 706 and there was any insurance on the decedent’s life, whether or not included in the gross estate, you must complete Schedule D and file it with the return.

Insurance you must include on Schedule D. Under section 2042, you must include in the gross estate:

- Insurance on the decedent’s life receivable by or for the benefit of the estate; and
- Insurance on the decedent’s life receivable by beneficiaries other than the estate, as described below.

The term “insurance” refers to life insurance of every description, including death benefits paid by fraternal beneficiary societies operating under the lodge system, and death benefits paid under no-fault automobile insurance policies if the no-fault insurer was unconditionally bound to pay the benefit in the event of the insured’s death.

Insurance in favor of the estate. Include on Schedule D the full amount of the proceeds of insurance on the life of the decedent receivable by the executor or otherwise payable to or for the benefit of the estate. Insurance in favor of the estate includes insurance used to pay the estate tax, and any other taxes, debts, or charges that are enforceable against the estate. The manner in which the policy is drawn is immaterial as long as there is an obligation, legally binding on the beneficiary, to use the proceeds to pay taxes, debts, or charges. You must include the full amount even though the premiums or other consideration may have been paid by a person other than the decedent.

Insurance receivable by beneficiaries other than the estate. Include on Schedule D the proceeds of all insurance on the life of the decedent not receivable by or for the benefit of the decedent’s estate if the decedent possessed at death any of the incidents of ownership, exercisable either alone or in conjunction with any person.

Incidents of ownership in a policy include:

- The right of the insured or estate to its economic benefits;
- The power to change the beneficiary;
- The power to surrender or cancel the policy;
- The power to assign the policy or to revoke an assignment;
- The power to pledge the policy for a loan;
- The power to obtain from the insurer a loan against the surrender value of the policy; and
- A reversionary interest if the value of the reversionary interest was more than 5% of the value of the policy immediately before the decedent died. (An interest in an insurance policy is considered a reversionary interest if, for example, the proceeds become payable to the insured’s estate or payable as the insured directs if the beneficiary dies before the insured.)

Life insurance not includible in the gross estate under section 2042 may be includible under some other section of the Code. For example, a life insurance policy could be transferred by the decedent in such a way that it would be includible in the gross estate under section 2036, 2037, or 2038. See the instructions to Schedule G for a description of these sections.

Completing the Schedule

You must list every policy of insurance on the life of the decedent, whether or not it is included in the gross estate.

Under “Description,” list:

- The name of the insurance company, and
- The number of the policy.

For every policy of life insurance listed on the schedule, you must request a statement on Form 712, Life Insurance Statement, from the company that issued the policy. Attach the Form 712 to the back of Schedule D.

If the policy proceeds are paid in one sum, enter the net proceeds received (from Form 712, line 24) in the value (and alternate value) columns of Schedule D. If the policy proceeds are not paid in one sum, enter the value of the proceeds as of the date of the decedent’s death (from Form 712, line 25).

If part or all of the policy proceeds are not included in the gross estate, you must explain why they were not included.
**Estate of:**

**SCHEDULE E—Jointly Owned Property**

(If you elect section 2032A valuation, you must complete Schedule E and Schedule A-1.)

**PART 1. Qualified Joint Interests—Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))**

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

[CUSIP number or EIN, where applicable]

<table>
<thead>
<tr>
<th>1a Totals</th>
<th>1a</th>
</tr>
</thead>
<tbody>
<tr>
<td>1b Amounts included in gross estate (one-half of line 1a)</td>
<td>1b</td>
</tr>
</tbody>
</table>

**PART 2. All Other Joint Interests**

2a State the name and address of each surviving co-tenant. If there are more than three surviving co-tenants, list the additional co-tenants on an attached sheet.

<table>
<thead>
<tr>
<th>Name</th>
<th>Address (number and street, city, state, and ZIP code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td></td>
</tr>
<tr>
<td>B.</td>
<td></td>
</tr>
<tr>
<td>C.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item number</th>
<th>Enter letter for co-tenant</th>
<th>Description (including alternate valuation date if any). For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN</th>
<th>Percentage includible</th>
<th>Includible alternate value</th>
<th>Includible value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

[CUSIP number or EIN, where applicable]

<table>
<thead>
<tr>
<th>2b Total other joint interests</th>
<th>2b</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 Total includible joint interests (add lines 1b and 2b). Also enter on Part 5—Recapitulation, page 3, at item 5.</td>
<td>3</td>
</tr>
</tbody>
</table>

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(See the instructions on the reverse side.)
Instructions for Schedule E—Jointly Owned Property

If you are required to file Form 706, you must complete Schedule E and file it with the return if the decedent owned any joint property at the time of death, whether or not the decedent’s interest is includible in the gross estate.

Enter on this schedule all property of whatever kind or character, whether real estate, personal property, or bank accounts, in which the decedent held at the time of death an interest either as a joint tenant with right to survivorship or as a tenant by the entirety.

Do not list on this schedule property that the decedent held as a tenant in common, but report the value of the interest on Schedule A if real estate, or on the appropriate schedule if personal property. Similarly, community property held by the decedent and spouse should be reported on the appropriate Schedules A through I. The decedent’s interest in a partnership should not be entered on this schedule unless the partnership interest itself is jointly owned. Solely owned partnership interests should be reported on Schedule F, “Other Miscellaneous Property Not Reportable Under Any Other Schedule.”

Part 1. Qualified joint interests held by decedent and spouse. Under section 2040(b)(2), a joint interest is a qualified joint interest if the decedent and the surviving spouse held the interest as:

- Tenants by the entirety, or
- Joint tenants with right of survivorship if the decedent and the decedent’s spouse are the only joint tenants.

Interests that meet either of the two requirements above should be entered in Part 1. Joint interests that do not meet either of the two requirements above should be entered in Part 2.

Under “Description,” describe the property as required in the instructions for Schedules A, B, C, and F for the type of property involved. For example, jointly held stocks and bonds should be described using the rules given in the instructions to Schedule B.

Under “Alternate value” and “Value at date of death,” enter the full value of the property.

Note. You cannot claim the special treatment under section 2040(b) for property held jointly by a decedent and a surviving spouse who is not a U.S. citizen. You must report these joint interests on Part 2 of Schedule E, not Part 1.

Part 2. All other joint interests. All joint interests that were not entered in Part 1 must be entered in Part 2.

For each item of property, enter the appropriate letter A, B, C, etc., from line 2a to indicate the name and address of the surviving co-tenant.

Under “Description,” describe the property as required in the instructions for Schedules A, B, C, and F for the type of property involved.

In the “Percentage includible” column, enter the percentage of the total value of the property that you intend to include in the gross estate.

Generally, you must include the full value of the jointly owned property in the gross estate. However, the full value should not be included if you can show that a part of the property originally belonged to the other tenant or tenants and was never received or acquired by the other tenant or tenants from the decedent for less than adequate and full consideration in money or money’s worth, or unless you can show that any part of the property was acquired with consideration originally belonging to the surviving joint tenant or tenants. In this case, you may exclude from the value of the property an amount proportionate to the consideration furnished by the other tenant or tenants. Relinquishing or promising to relinquish dower, curtesy, or statutory estate created instead of dower or curtesy, or other marital rights in the decedent’s property or estate is not consideration in money or money’s worth. See the Schedule A instructions for the value to show for real property that is subject to a mortgage.

If the property was acquired by the decedent and another person or persons by gift, bequest, devise, or inheritance as joint tenants, and their interests are not otherwise specified by law, include only that part of the value of the property that is figured by dividing the full value of the property by the number of joint tenants.

If you believe that less than the full value of the entire property is includible in the gross estate for tax purposes, you must establish the right to include the smaller value by attaching proof of the extent, origin, and nature of the decedent’s interest and the interest(s) of the decedent’s co-tenant or co-tenants.

In the “Includible alternate value” and “Includible value at date of death” columns, you should enter only the values that you believe are includible in the gross estate.
SCHEDULE F—Other Miscellaneous Property Not Reportable Under Any Other Schedule

(For jointly owned property that must be disclosed on Schedule E, see the instructions for Schedule E.)

(If you elect section 2032A valuation, you must complete Schedule F and Schedule A-1.)

1. Did the decedent at the time of death own any works of art or items with collectible value in excess of $3,000 or any collections whose artistic or collectible value combined at date of death exceeded $10,000?  

   Yes  No

   If “Yes,” submit full details on this schedule and attach appraisals.

2. Has the decedent’s estate, spouse, or any other person received (or will receive) any bonus or award as a result of the decedent’s employment or death?  

   Yes  No

   If “Yes,” submit full details on this schedule.

3. Did the decedent at the time of death have, or have access to, a safe deposit box?  

   Yes  No

   If “Yes,” state location, and if held in joint names of decedent and another, state name and relationship of joint depositor.

   If any of the contents of the safe deposit box are omitted from the schedules in this return, explain fully why omitted.

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CUSIP number or EIN, where applicable</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule ____________________________

TOTAL. (Also enter on Part 5—Recapitulation, page 3, at item 6.) ____________________________

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)
(See the instructions on the reverse side.)
Instructions for Schedule F—Other Miscellaneous Property

You must complete Schedule F and file it with the return.

On Schedule F, list all items that must be included in the gross estate that are not reported on any other schedule, including:

- Debts due the decedent (other than notes and mortgages included on Schedule C);
- Interests in business;
- Any interest in an Archer medical savings account (MSA) or health savings account (HSA), unless such interest passes to the surviving spouse; and
- Insurance on the life of another (obtain and attach Form 712, Life Insurance Statement, for each policy).

Note (for single premium or paid-up policies). In certain situations, for example, where the surrender value of the policy exceeds its replacement cost, the true economic value of the policy will be greater than the amount shown on line 59 of Form 712. In these situations, you should report the full economic value of the policy on Schedule F. See Rev. Rul. 78-137, 1978-1 C.B. 280 for details.

- Section 2044 property (see Decedent Who Was a Surviving Spouse below);
- Claims (including the value of the decedent's interest in a claim for refund of income taxes or the amount of the refund actually received);
- Rights;
- Royalties;
- Leaseholds;
- Judgments;
- Reversionary or remainder interests;
- Shares in trust funds (attach a copy of the trust instrument);
- Household goods and personal effects, including wearing apparel;
- Farm products and growing crops;
- Livestock;
- Farm machinery; and
- Automobiles.

Interests. If the decedent owned any interest in a partnership or unincorporated business, attach a statement of assets and liabilities for the valuation date and for the 5 years before the valuation date. Also, attach statements of the net earnings for the same 5 years. Be sure to include the EIN of the entity. You must account for goodwill in the valuation. In general, furnish the same information and follow the methods used to value close corporations. See the valuation. In general, furnish the same information and follow the methods used to value close corporations. See Rev. Rul. 78-137, 1978-1 C.B. 280 for details.

- Section 2044 property (see Decedent Who Was a Surviving Spouse below);
- Claims (including the value of the decedent's interest in a claim for refund of income taxes or the amount of the refund actually received);
- Rights;
- Royalties;
- Leaseholds;
- Judgments;
- Reversionary or remainder interests;
- Shares in trust funds (attach a copy of the trust instrument);
- Household goods and personal effects, including wearing apparel;
- Farm products and growing crops;
- Livestock;
- Farm machinery; and
- Automobiles.

Interests. If the decedent owned any interest in a partnership or unincorporated business, attach a statement of assets and liabilities for the valuation date and for the 5 years before the valuation date. Also, attach statements of the net earnings for the same 5 years. Be sure to include the EIN of the entity. You must account for goodwill in the valuation. In general, furnish the same information and follow the methods used to value close corporations. See the instructions for Schedule B.

- Section 2044 property (see Decedent Who Was a Surviving Spouse below);
- Claims (including the value of the decedent's interest in a claim for refund of income taxes or the amount of the refund actually received);
- Rights;
- Royalties;
- Leaseholds;
- Judgments;
- Reversionary or remainder interests;
- Shares in trust funds (attach a copy of the trust instrument);
- Household goods and personal effects, including wearing apparel;
- Farm products and growing crops;
- Livestock;
- Farm machinery; and
- Automobiles.

Valuation discounts. If you answered “Yes” to line 10b for any interest in miscellaneous property not reportable under any other schedule owned by the decedent at the time of death, attach a statement that lists the item number from Schedule F and identifies the total accumulated discount taken (that is, XX.XX%) on such interest.

If you answered “Yes” to line 10b for an interest in a limited liability company owned by the decedent at the time of death, attach a statement that lists the item number from Schedule F and identifies the effective discount taken on such interest.

Example of effective discount:

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>Pro-rata value of limited liability company</td>
<td>$100.00</td>
</tr>
<tr>
<td>b</td>
<td>Minus: 10% discounts for lack of control</td>
<td>$10.00</td>
</tr>
<tr>
<td>c</td>
<td>Marketable minority interest value (as if freely traded minority interest value)</td>
<td>$90.00</td>
</tr>
<tr>
<td>d</td>
<td>Minus: 15% discount for lack of marketability</td>
<td>$13.50</td>
</tr>
<tr>
<td>e</td>
<td>Non-marketable minority interest value</td>
<td>$76.50</td>
</tr>
</tbody>
</table>

Calculation of effective discount:

\[
\text{Effective discount} = \frac{\text{Total Accumulated Discount}}{\text{Total Value}} = \frac{(100.00 - 23.50)}{100.00} = 23.50\%
\]

Note. The amount of discounts are based on the factors pertaining to a specific interest and those discounts shown in the example are for demonstration purposes only.

If you answered “Yes” to line 10b for any transfer described in (1) through (5) on pages 15 and 16 of the separate Form 706 instructions (and made by the decedent), attach a statement to Schedule G which lists the item number from that schedule and identifies the total accumulated discount taken (that is, XX.XX%) on such transfer(s).

Line 1. If the decedent owned at the date of death works of art or items with collectible value (for example, jewelry, furs, silverware, books, statuary, vases, oriental rugs, coin or stamp collections), check the “Yes” box on line 1 and provide full details. If any one work of art or item with collectible value is valued at more than $3,000, or any collection of similar articles is valued at more than $10,000, attach an appraisal by an expert under oath and the required statement regarding the appraiser’s qualifications (see Regulations section 20.2031-6(b)).

Decedent Who Was a Surviving Spouse

If the decedent was a surviving spouse, he or she may have received qualified terminable interest property (QTIP) from the predeceased spouse for which the marital deduction was elected either on the predeceased spouse’s estate tax return or on a gift tax return, Form 709. The election was available for gifts made and decedents dying after December 31, 1981. List such property on Schedule F.

If this election was made and the surviving spouse retained his or her interest in the QTIP property at death, the full value of the QTIP property is includible in his or her estate, even though the qualifying income interest terminated at death. It is valued as of the date of the surviving spouse’s death, or alternate valuation date, if applicable. Do not reduce the value by any annual exclusion that may have applied to the transfer creating the interest.

The value of such property included in the surviving spouse’s gross estate is treated as passing from the surviving spouse. It therefore qualifies for the charitable and marital deductions on the surviving spouse’s estate tax return if it meets the other requirements for those deductions.

For additional details, see Regulations section 20.2044-1.
**SCHEDULE G—Transfers During Decedent’s Life**

(If you elect section 2032A valuation, you must complete Schedule G and Schedule A-1.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Gift tax paid or payable by the decedent or the estate for all gifts made by the decedent or his or her spouse within 3 years before the decedent’s death (section 2035(b))</td>
<td>X X X X X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. 1</td>
<td>Transfers includible under section 2035(a), 2036, 2037, or 2038:</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 7.) . . . . . .

**SCHEDULE H—Powers of Appointment**

(Include “5 and 5 lapsing” powers (section 2041(b)(2)) held by the decedent.)

(If you elect section 2032A valuation, you must complete Schedule H and Schedule A-1.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule . .

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 8.) . . . . . .

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(The instructions to Schedules G and H are in the separate instructions.)
**SCHEDULE I—Annuities**

**Note.** Generally, no exclusion is allowed for the estates of decedents dying after December 31, 1984 (see page 17 of the instructions).

**A** Are you excluding from the decedent’s gross estate the value of a lump-sum distribution described in section 2039(f)(2) (as in effect before its repeal by the Deficit Reduction Act of 1984)?

If “Yes,” you must attach the information required by the instructions.

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description, show the entire value of the annuity before any exclusions</th>
<th>Alternate valuation date</th>
<th>Includible alternate value</th>
<th>Includible value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule.

TOTAL. (Also enter on Part 5—Recapitulation, page 3, at item 9.)
SCHEDULE J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims

Note. Do not list on this schedule expenses of administering property not subject to claims. For those expenses, see the instructions for Schedule L.

If executors’ commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for federal income tax purposes. They are allowable as an income tax deduction on Form 1041 if a waiver is filed to waive the deduction on Form 706 (see the Form 1041 instructions).

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Expense amount</th>
<th>Total amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Funeral expenses:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Total funeral expenses</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

 B. Administration expenses:

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description</th>
<th>Expense amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Executors’ commissions—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Attorney fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Accountant fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Miscellaneous expenses:</td>
<td></td>
</tr>
</tbody>
</table>

Total miscellaneous expenses from continuation schedules (or additional sheets) attached to this schedule:  

Total miscellaneous expenses:  

TOTAL. (Also enter on Part 5—Recapitulation, page 3, at item 13.)  

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)  

(See the instructions on the reverse side.)
Instructions for Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims

General. You must complete and file Schedule J if you claim a deduction on item 13 of Part 5—Recapitulation.

On Schedule J, itemize funeral expenses and expenses incurred in administering property subject to claims. List the names and addresses of persons to whom the expenses are payable and describe the nature of the expense. **Do not list expenses incurred in administering property not subject to claims on this schedule. List them on Schedule L instead.**

The deduction is limited to the amount paid for these expenses that is allowable under local law but may not exceed:

1. The value of property subject to claims included in the gross estate, plus
2. The amount paid out of property included in the gross estate but not subject to claims. This amount must actually be paid by the due date of the estate tax return.

The applicable local law under which the estate is being administered determines which property is and is not subject to claims. If under local law a particular property interest included in the gross estate would bear the burden for the payment of the expenses, then the property is considered property subject to claims.

Unlike certain claims against the estate for debts of the decedent (see the instructions for Schedule K in the separate instructions), you cannot deduct expenses incurred in administering property subject to claims on both the estate tax return and the estate's income tax return. If you choose to deduct them on the estate tax return, you cannot deduct them on a Form 1041 filed for the estate. Funeral expenses are only deductible on the estate tax return.

Funeral expenses. Itemize funeral expenses on line A. Deduct from the expenses any amounts that were reimbursed, such as death benefits payable by the Social Security Administration and the Veterans Administration.

Executors’ commissions. When you file the return, you may deduct commissions that have actually been paid to you or that you expect will be paid. You may not deduct commissions if none will be collected. If the amount of the commissions has not been fixed by decree of the proper court, the deduction will be allowed on the final examination of the return, provided that:

- The Estate and Gift Tax Territory Manager is reasonably satisfied that the commissions claimed will be paid;
- The amount entered as a deduction is within the amount allowable by the laws of the jurisdiction where the estate is being administered; and
- It is in accordance with the usually accepted practice in that jurisdiction for estates of similar size and character.

If you have not been paid the commissions claimed at the time of the final examination of the return, you must support the amount you deducted with an affidavit or statement signed under the penalties of perjury that the amount has been agreed upon and will be paid.

You may not deduct a bequest or devise made to you instead of commissions. If, however, the decedent fixed by will the compensation payable to you for services to be rendered in the administration of the estate, you may deduct this amount to the extent it is not more than the compensation allowable by the local law or practice.

Do not deduct on this schedule amounts paid as trustees’ commissions whether received by you acting in the capacity of a trustee or by a separate trustee. If such amounts were paid in administering property not subject to claims, deduct them on Schedule L.

**Note.** Executors’ commissions are taxable income to the executors. Therefore, be sure to include them as income on your individual income tax return.

Attorney fees. Enter the amount of attorney fees that have actually been paid or that you reasonably expect to be paid. If on the final examination of the return, the fees claimed have not been awarded by the proper court and paid, the deduction will be allowed provided the Estate and Gift Tax Territory Manager is reasonably satisfied that the amount claimed will be paid and that it does not exceed a reasonable payment for the services performed, taking into account the size and character of the estate and the local law and practice. If the fees claimed have not been paid at the time of final examination of the return, the amount deducted must be supported by an affidavit, or statement signed under the penalties of perjury, by the executor or the attorney stating that the amount has been agreed upon and will be paid.

Do not deduct attorney fees incidental to litigation incurred by the beneficiaries. These expenses are charged against the beneficiaries personally and are not administration expenses authorized by the Code.

Interest expense. Interest expenses incurred after the decedent’s death are generally allowed as a deduction if they are reasonable, necessary to the administration of the estate, and allowable under local law.

Interest incurred as the result of a federal estate tax deficiency is a deductible administrative expense. Penalties are not deductible even if they are allowable under local law.

**Note.** If you elect to pay the tax in installments under section 6166, you may not deduct the interest payable on the installments.

Miscellaneous expenses. Miscellaneous administration expenses necessarily incurred in preserving and distributing the estate are deductible. These expenses include appraiser’s and accountant’s fees, certain court costs, and costs of storing or maintaining assets of the estate.

The expenses of selling assets are deductible only if the sale is necessary to pay the decedent’s debts, the expenses of administration, or taxes, or to preserve the estate or carry out distribution.
<table>
<thead>
<tr>
<th>Item number</th>
<th>Debts of the Decedent—Creditor and nature of claim, and allowable death taxes</th>
<th>Amount unpaid to date</th>
<th>Amount in contest</th>
<th>Amount claimed as a deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule...

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 14.)...

<table>
<thead>
<tr>
<th>Item number</th>
<th>Mortgages and Liens—Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule...

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 15.)...

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(The instructions to Schedule K are in the separate instructions.)
# SCHEDULE L—Net Losses During Administration and Expenses Incurred in Administering Property Not Subject to Claims

<table>
<thead>
<tr>
<th>Item number</th>
<th>Net losses during administration (Note. Do not deduct losses claimed on a federal income tax return.)</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 18.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Expenses incurred in administering property not subject to claims. (Indicate whether estimated, agreed upon, or paid.)</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule

**TOTAL.** (Also enter on Part 5—Recapitulation, page 3, at item 19.)

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

Schedule L—Page 26

(The instructions to Schedule L are in the separate instructions.)
**SCHEDULE M—Bequests, etc., to Surviving Spouse**

**Election To Deduct Qualified Terminable Interest Property Under Section 2056(b)(7).** If a trust (or other property) meets the requirements of qualified terminable interest property under section 2056(b)(7), and

a. The trust or other property is listed on Schedule M and

b. The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule M, then unless the executor specifically identifies the trust (all or a fractional portion or percentage) or other property to be excluded from the election, the executor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2056(b)(7).

If less than the entire value of the trust (or other property) that the executor has included in the gross estate is entered as a deduction on Schedule M, the executor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule M. The denominator is equal to the total value of the trust (or other property).

**Election To Deduct Qualified Domestic Trust Property Under Section 2056A.** If a trust meets the requirements of a qualified domestic trust under section 2056A(a) and this return is filed no later than 1 year after the time prescribed by law (including extensions) for filing the return, and

a. The entire value of a trust or trust property is listed on Schedule M and

b. The entire value of the trust or trust property is entered as a deduction on Schedule M, then unless the executor specifically identifies the trust to be excluded from the election, the executor shall be deemed to have made an election to have the entire trust treated as qualified domestic trust property.

---

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description of property interests passing to surviving spouse. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1 QTIP property:</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>B1 All other property:</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule

<table>
<thead>
<tr>
<th>4 Total amount of property interests listed on Schedule M</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>5a Federal estate taxes payable out of property interests listed on Schedule M</td>
<td>5a</td>
</tr>
<tr>
<td>b Other death taxes payable out of property interests listed on Schedule M</td>
<td>5b</td>
</tr>
<tr>
<td>c Federal and state GST taxes payable out of property interests listed on Schedule M</td>
<td>5c</td>
</tr>
<tr>
<td>d Add items 5a, 5b, and 5c</td>
<td>5d</td>
</tr>
<tr>
<td>6 Net amount of property interests listed on Schedule M (subtract 5d from 4). Also enter on Part 5—Recapitulation, page 3, at item 20.</td>
<td>6</td>
</tr>
</tbody>
</table>

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(See the instructions on the reverse side.)

Schedule M—Page 27
Instructions for Schedule M—Bequests, etc., to Surviving Spouse (Marital Deduction)

General
You must complete Schedule M and file it with the return if you claim a deduction on Part 5—Recapitulation, item 20.

The marital deduction is authorized by section 2056 for certain property interests that pass from the decedent to the surviving spouse. You may claim the deduction only for property interests that are included in the decedent’s gross estate (Schedules A through I).

Note. The marital deduction is generally not allowed if the surviving spouse is not a U.S. citizen. The marital deduction is allowed for property passing to such a surviving spouse in a qualified domestic trust (QDOT) or if such property is transferred or irrevocably assigned to such a trust before the estate tax return is filed. The executor must elect QDOT status on this return. See the instructions that follow, on pages 29 and 30, for details on the election.

Property Interests That You May List on Schedule M
Generally, you may list on Schedule M all property interests that pass from the decedent to the surviving spouse and are included in the gross estate. However, you should not list any nondeductible terminable interests (described below) on Schedule M unless you are making a QTIP election. The property for which you make this election must be included on Schedule M. See Qualified terminable interest property on the following page.

For the rules on common disaster and survival for a limited period, see section 2056(b)(3).

You may list on Schedule M only those interests that the surviving spouse takes:
1. As the decedent’s legatee, devisee, heir, or donee;
2. As the decedent’s surviving tenant by the entirety or joint tenant;
3. As an appointee under the decedent’s exercise of a power or as a taker in default at the decedent’s nonexercise of a power;
4. As a beneficiary of insurance on the decedent’s life;
5. As the surviving spouse taking under dower or curtesy (or similar statutory interest); and
6. As a transferee of a transfer made by the decedent at any time.

Property Interests That You May Not List on Schedule M
You should not list on Schedule M:
1. The value of any property that does not pass from the decedent to the surviving spouse;
2. Property interests that are not included in the decedent’s gross estate;
3. The full value of a property interest for which a deduction was claimed on Schedules J through L. The value of the property interest should be reduced by the deductions claimed with respect to it;
4. The full value of a property interest that passes to the surviving spouse subject to a mortgage or other encumbrance or an obligation of the surviving spouse. Include on Schedule M only the net value of the interest after reducing it by the amount of the mortgage or other debt;
5. Nondeductible terminable interests (described below); or
6. Any property interest disclaimed by the surviving spouse.

Terminable Interests
Certain interests in property passing from a decedent to a surviving spouse are referred to as terminable interests. These are interests that will terminate or fail after the passage of time, or on the occurrence or nonoccurrence of some contingency. Examples are: life estates, annuities, estates for terms of years, and patents.

The ownership of a bond, note, or other contractual obligation, which when discharged would not have the effect of an annuity for life or for a term, is not considered a terminable interest.

Nondeductible terminable interests. A terminable interest is nondeductible. Unless you are making a QTIP election, a terminable interest should not be entered on Schedule M if:
1. Another interest in the same property passed from the decedent to some other person for less than adequate and full consideration in money or money’s worth; and
2. By reason of its passing, the other person or that person’s heirs may enjoy part of the property after the termination of the surviving spouse’s interest.

This rule applies even though the interest that passes from the decedent to a person other than the surviving spouse is not included in the gross estate, and regardless of when the interest passes. The rule also applies regardless of whether the surviving spouse’s interest and the other person’s interest pass from the decedent at the same time.

Property interests that are considered to pass to a person other than the surviving spouse are any property interest that: (a) passes under a decedent’s will or intestacy; (b) was transferred by a decedent during life; or (c) is held by or passed on to any person as a decedent’s joint tenant, as appointee under a decedent’s exercise of a power, as taker in default at a decedent’s release or nonexercise of a power, or as a beneficiary of insurance on the decedent’s life.

For example, a decedent devised real property to his wife for life, with remainder to his children. The life interest that passed to the wife does not qualify for the marital deduction because it will terminate at her death and the children will thereafter possess or enjoy the property.

However, if the decedent purchased a joint and survivor annuity for himself and his wife who survived him, the value of the survivor’s annuity, to the extent that it is included in the gross estate, qualifies for the marital deduction because

Examples of Listing of Property Interests on Schedule M

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description of property interests passing to surviving spouse. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>All other property: One-half the value of a house and lot, 256 South West Street, held by decedent and surviving spouse as joint tenants with right of survivorship under deed dated July 15, 1975 (Schedule E, Part I, item 1)</td>
<td>$182,500</td>
</tr>
<tr>
<td>B2</td>
<td>Proceeds of Metropolitan Life Insurance Company policy No. 104729, payable in one sum to surviving spouse (Schedule D, item 3)</td>
<td>200,000</td>
</tr>
<tr>
<td>B3</td>
<td>Cash bequest under Paragraph Six of will</td>
<td>100,000</td>
</tr>
</tbody>
</table>
even though the interest will terminate on the wife’s death, no one else will possess or enjoy any part of the property.

The marital deduction is not allowed for an interest that the decedent directed the executor or a trustee to convert, after death, into a terminable interest for the surviving spouse. The marital deduction is not allowed for such an interest even if there was no interest in the property passing to another person and even if the terminable interest would otherwise have been deductible under the exceptions described below for life estate and life insurance and annuity payments with powers of appointment. For more information, see Regulations sections 20.2056(b)-1(f) and 20.2056(b)-1(g), Example (7).

If any property interest passing from the decedent to the surviving spouse may be paid or otherwise satisfied out of any of a group of assets, the value of the property interest is, for the entry on Schedule M, reduced by the value of any asset or assets that, if passing from the decedent to the surviving spouse, would be nondeductible terminable interests. Examples of property interests that may be paid or otherwise satisfied out of any of a group of assets are a bequest of the residue of the decedent’s estate, or of a share of the residue, and a cash legacy payable out of the general estate.

**Example.** A decedent bequeathed $100,000 to the surviving spouse. The general estate includes a term for years (valued at $10,000 in determining the value of the gross estate) in an office building, which interest was retained by the decedent under a deed of the building by gift to a son. Accordingly, the value of the specific bequest entered on Schedule M is $90,000.

**Life estate with power of appointment in the surviving spouse.** A property interest, whether or not in trust, will be treated as passing to the surviving spouse, and will not be treated as a nondeductible terminable interest if: (a) the surviving spouse is entitled for life to all of the income from the entire interest; (b) the income is payable annually or at more frequent intervals; (c) the surviving spouse has the power, exercisable in favor of the surviving spouse or the estate of the surviving spouse, to appoint the entire interest; (d) the power is exercisable by the surviving spouse alone and (whether exercisable by will or during life) is exercisable by the surviving spouse in all events; and (e) no part of the entire interest is subject to a power in any other person to appoint any part to any person other than the surviving spouse.

**Life insurance, endowment, or annuity payments, with power of appointment in surviving spouse.** A property interest consisting of the entire proceeds under a life insurance, endowment, or annuity contract is treated as passing from the decedent to the surviving spouse, and will not be treated as a nondeductible terminable interest if: (a) the surviving spouse is entitled to receive the proceeds in installments, or is entitled to interest on them, with all amounts payable during the life of the spouse, payable only to the surviving spouse; (b) the installment or interest payments are payable annually, or more frequently, beginning not later than 13 months after the decedent’s death; (c) the surviving spouse has the power, exercisable in favor of the surviving spouse or of the estate of the surviving spouse, to appoint all amounts payable under the contract; (d) the power is exercisable by the surviving spouse alone and (whether exercisable by will or during life) is exercisable by the surviving spouse in all events; and (e) no part of the amount payable under the contract is subject to a power in any other person to appoint any part to any person other than the surviving spouse. If these five conditions are satisfied only for a specific portion of the proceeds, see the section 2056(b) regulations to determine the amount of the marital deduction.

**Charitable remainder trusts.** An interest in a charitable remainder trust will not be treated as a nondeductible terminable interest if:

1. The interest in the trust passes from the decedent to the surviving spouse, and
2. The surviving spouse is the only beneficiary of the trust other than charitable organizations described in section 170(c).

A **charitable remainder trust** is either a charitable remainder annuity trust or a charitable remainder unitrust. (See section 664 for descriptions of these trusts.)

**Election To Deduct Qualified Terminable Interests (QTIP)**

You may elect to claim a marital deduction for qualified terminable interest property or property interests. You make the QTIP election simply by listing the qualified terminable interest property on Schedule M and deducting its value. You are presumed to have made the QTIP election if you list the property and deduct its value on Schedule M. If you make this election, the surviving spouse’s gross estate will include the value of the qualified terminable interest property. See the instructions for Part 4—General Information, line 6, for more details. **The election is irrevocable.**

If you file a Form 706 in which you do not make this election, you may not file an amended return to make the election unless you file the amended return on or before the due date for filing the original Form 706.

The effect of the election is that the property (interest) will be treated as passing to the surviving spouse and will not be treated as a nondeductible terminable interest. All of the other marital deduction requirements must still be satisfied before you may make this election. For example, you may not make this election for property or property interests that are not included in the decedent’s gross estate.

**Qualified terminable interest property.** Qualified terminable interest property is property (a) that passes from the decedent, and (b) in which the surviving spouse has a qualifying income interest for life.

The surviving spouse has a **qualifying income interest for life** if the surviving spouse is entitled to all of the income from the property payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and during the surviving spouse’s lifetime no person has a power to appoint any part of the property to any person other than the surviving spouse. An annuity is treated as an income interest regardless of whether the property from which the annuity is payable can be separately identified.

Amendments to Regulations sections 20.2044-1, 20.2056(b)-7, and 20.2056(b)-10 clarify that an interest in property is eligible for QTIP treatment if the income interest is contingent upon the executor’s election even if that portion of the property for which no election is made will pass to or for the benefit of beneficiaries other than the surviving spouse.

The QTIP election may be made for all or any part of qualified terminable interest property. A partial election must relate to a fractional or percentile share of the property so that the elective part will reflect its proportionate share of the increase or decline in the whole of the property when applying section 2044 or 2519. Thus, if the interest of the surviving spouse in a trust (or other property in which the spouse has a qualified life estate) is qualified terminable...
interest property, you may make an election for a part of the trust (or other property) only if the election relates to a defined fraction or percentage of the entire trust (or other property). The fraction or percentage may be defined by means of a formula.

Qualified Domestic Trust Election (QDOT)
The marital deduction is allowed for transfers to a surviving spouse who is not a U.S. citizen only if the property passes to the surviving spouse in a qualified domestic trust (QDOT) or if such property is transferred or irrevocably assigned to a QDOT before the decedent’s estate tax return is filed.

A QDOT is any trust:
1. That requires at least one trustee to be either an individual who is a citizen of the United States or a domestic corporation;
2. That requires that no distribution of corpus from the trust can be made unless such a trustee has the right to withhold from the distribution the tax imposed on the QDOT;
3. That meets the requirements of any applicable regulations; and
4. For which the executor has made an election on the estate tax return of the decedent.

Note. For trusts created by an instrument executed before November 5, 1990, paragraphs 1 and 2 above will be treated as met if the trust instrument requires that all trustees be individuals who are citizens of the United States or domestic corporations.

You make the QDOT election simply by listing the qualified domestic trust or the entire value of the trust property on Schedule M and deducting its value. You are presumed to have made the QDOT election if you list the trust or trust property and deduct its value on Schedule M. Once made, the election is irrevocable.

If an election is made to deduct qualified domestic trust property under section 2056A(d), provide the following information for each qualified domestic trust on an attachment to this schedule:
1. The name and address of every trustee;
2. A description of each transfer passing from the decedent that is the source of the property to be placed in trust; and
3. The employer identification number (EIN) for the trust.

The election must be made for all of the trust property. For purposes of computing the value of the trust at the time of death, the court-ordered changes to the trust are made.

The determination of whether a trust qualifies as a QDOT will be made as of the date the decedent’s estate tax return is filed. If, however, judicial proceedings are brought before the Form 706’s due date (including extensions) to have the trust revised to meet the QDOT requirements, then the determination will not be made until the court-ordered changes to the trust are made.

Line 1
If property passes to the surviving spouse as the result of a qualified disclaimer, check “Yes” and attach a copy of the written disclaimer required by section 2518(b).

Line 3
Section 2056(b)(7) creates an automatic QTIP election for certain joint and survivor annuities that are includible in the estate under section 2039. To qualify, only the surviving spouse can have the right to receive payments before the death of the surviving spouse.

The executor can elect out of QTIP treatment, however, by checking the “Yes” box on line 3. Once made, the election is irrevocable. If there is more than one such joint and survivor annuity, you are not required to make the election for all of them.

If you make the election out of QTIP treatment by checking “Yes” on line 3, you cannot deduct the amount of the annuity on Schedule M. If you do not make the election out, you must list the joint and survivor annuities on Schedule M.

Listing Property Interests on Schedule M
List each property interest included in the gross estate that passes from the decedent to the surviving spouse and for which a marital deduction is claimed. This includes otherwise nondeductible terminable interest property for which you are making a QTIP election. Number each item in sequence and describe each item in detail. Describe the instrument (including any clause or paragraph number) or provision of law under which each item passed to the surviving spouse. If possible, show where each item appears (number and schedule) on Schedules A through I.

In listing otherwise nondeductible property for which you are making a QTIP election, unless you specifically identify a fractional portion of the trust or other property as not subject to the election, the election will be considered made for all of the trust or other property.

Enter the value of each interest before taking into account the federal estate tax or any other death tax. The valuation dates used in determining the value of the gross estate apply also on Schedule M.

If Schedule M includes a bequest of the residue or a part of the residue of the decedent’s estate, attach a copy of the computation showing how the value of the residue was determined. Include a statement showing:

- The value of all property that is included in the decedent’s gross estate (Schedules A through I) but is not a part of the decedent’s probate estate, such as lifetime transfers, jointly owned property that passed to the survivor on decedent’s death, and the insurance payable to specific beneficiaries;
- The values of all specific and general legacies or devises, with reference to the applicable clause or paragraph of the decedent’s will or codicil. (If legacies are made to each member of a class, for example, $1,000 to each of decedent’s employees, only the number in each class and the total value of property received by them need be furnished);
- The date of birth of all persons, the length of whose lives may affect the value of the residuary interest passing to the surviving spouse; and
- Any other important information such as that relating to any claim to any part of the estate not arising under the will.

Lines 5a, 5b, and 5c. The total of the values listed on Schedule M must be reduced by the amount of the federal estate tax, the federal GST tax, and the amount of state or other death and GST taxes paid out of the property interest involved. If you enter an amount for state or other death or GST taxes on line 5b or 5c, identify the taxes and attach your computation of them.

Attachments. If you list property interests passing by the decedent’s will on Schedule M, attach a certified copy of the order admitting the will to probate. If, when you file the return, the court of probate jurisdiction has entered any decree interpreting the will or any of its provisions affecting any of the interests listed on Schedule M, or has entered any order of distribution, attach a copy of the decree or order. In addition, the IRS may request other evidence to support the marital deduction claimed.
**SCHEDULE O—Charitable, Public, and Similar Gifts and Bequests**

1a If the transfer was made by will, has any action been instituted to have interpreted or to contest the will or any of its provisions affecting the charitable deductions claimed in this schedule? ......................................................... Yes  No

If “Yes,” full details must be submitted with this schedule.

b According to the information and belief of the person or persons filing this return, is any such action planned? If “Yes,” full details must be submitted with this schedule.

2 Did any property pass to charity as the result of a qualified disclaimer? ......................................................... Yes  No

If “Yes,” attach a copy of the written disclaimer required by section 2518(b).

<table>
<thead>
<tr>
<th>Item number</th>
<th>Name and address of beneficiary</th>
<th>Character of institution</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total from continuation schedules (or additional sheets) attached to this schedule .........................................................

3  Total  ......................................................... 3

4a Federal estate tax payable out of property interests listed above  ......................................................... 4a

b Other death taxes payable out of property interests listed above  ......................................................... 4b

c Federal and state GST taxes payable out of property interests listed above  4c

d Add items 4a, 4b, and 4c  ......................................................... 4d

5 Net value of property interests listed above (subtract 4d from 3). Also enter on Part 5—Recapitulation, page 3, at item 21  ......................................................... 5

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

(The instructions to Schedule O are in the separate instructions.)
### SCHEDULE P—Credit for Foreign Death Taxes

List all foreign countries to which death taxes have been paid and for which a credit is claimed on this return.

If a credit is claimed for death taxes paid to more than one foreign country, compute the credit for taxes paid to one country on this sheet and attach a separate copy of Schedule P for each of the other countries.

The credit computed on this sheet is for the death taxes paid to

(Name of country)

Credit is computed under the

(Insert title of treaty or “statute”)

Citizenship (nationality) of decedent at time of death

(All amounts and values must be entered in United States money.)

<table>
<thead>
<tr>
<th>Item</th>
<th>Transferor</th>
<th>Total A, B, &amp; C</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total of estate, inheritance, legacy, and succession taxes imposed in the country named above attributable to property situated in that country, subjected to these taxes, and included in the gross estate (as defined by statute)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Value of the gross estate (adjusted, if necessary, according to the instructions for item 2)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Value of property situated in that country, subjected to death taxes imposed in that country, and included in the gross estate (adjusted, if necessary, according to the instructions for item 3)</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Tax imposed by section 2001 reduced by the total credits claimed under sections 2010 and 2012 (see instructions)</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Amount of federal estate tax attributable to property specified at item 3. (Divide item 3 by item 2 and multiply the result by item 4.)</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Credit for death taxes imposed in the country named above (the smaller of item 1 or item 5). Also enter on line 13 of Part 2—Tax Computation</td>
<td></td>
</tr>
</tbody>
</table>

### SCHEDULE Q—Credit for Tax on Prior Transfers

#### Part 1. Transferor Information

<table>
<thead>
<tr>
<th>Name of transferor</th>
<th>Social security number</th>
<th>IRS office where estate tax return was filed</th>
<th>Date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Check here □ if section 2013(f) (special valuation of farm, etc., real property) adjustments to the computation of the credit were made (see page 23 of the instructions).

#### Part 2. Computation of Credit (see instructions on page 23)

<table>
<thead>
<tr>
<th>Item</th>
<th>Transferor</th>
<th>Total A, B, &amp; C</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Transferee’s tax as apportioned (from worksheet, (line 7 ÷ line 8) x line 35 for each column)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Transferor’s tax (from each column of worksheet, line 20)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Maximum amount before percentage requirement (for each column, enter amount from line 1 or 2, whichever is smaller)</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Percentage allowed (each column) (see instructions)</td>
<td>%</td>
</tr>
<tr>
<td>5</td>
<td>Credit allowable (line 3 x line 4 for each column)</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>TOTAL credit allowable (add columns A, B, and C of line 5). Enter here and on line 14 of Part 2—Tax Computation</td>
<td></td>
</tr>
</tbody>
</table>

Schedules P and Q—Page 32

(The instructions to Schedules P and Q are in the separate instructions.)
### Part 1. GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) (Special QTIP) Election

You no longer need to check a box to make a section 2652(a)(3) (special QTIP) election. If you list qualifying property in Part 1, line 9 below, you will be considered to have made this election. See page 26 of the separate instructions for details.

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Maximum allowable GST exemption</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Total GST exemption allocated by the decedent against decedent’s lifetime transfers</td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Total GST exemption allocated by the executor, using Form 709, against decedent’s lifetime transfers</td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>GST exemption allocated on line 6 of Schedule R, Part 2</td>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>GST exemption allocated on line 6 of Schedule R, Part 3</td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Total GST exemption allocated on line 4 of Schedule(s) R-1</td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>Total GST exemption allocated to <em>inter vivos</em> transfers and direct skips (add lines 2–6)</td>
<td></td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>8</td>
<td>GST exemption available to allocate to trusts and section 2032A interests (subtract line 7 from line 1)</td>
<td></td>
<td></td>
<td>8</td>
</tr>
</tbody>
</table>

### Allocation of GST exemption to trusts (as defined for GST tax purposes):

<table>
<thead>
<tr>
<th>A</th>
<th></th>
<th>B</th>
<th></th>
<th>C</th>
<th></th>
<th>D</th>
<th></th>
<th>E</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of trust</td>
<td>Trust’s EIN (if any)</td>
<td>GST exemption allocated on lines 2–6, above (see instructions)</td>
<td>Additional GST exemption allocated (see instructions)</td>
<td>Trust’s inclusion ratio (optional—see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>9D</td>
<td>Total. May not exceed line 8, above</td>
<td></td>
<td></td>
<td>9D</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>GST exemption available to allocate to section 2032A interests received by individual beneficiaries (subtract line 9D from line 8). You must attach special-use allocation schedule (see instructions).</td>
</tr>
</tbody>
</table>

(The instructions to Schedule R are in the separate instructions.)
Part 2. Direct Skips Where the Property Interests Transferred Bear the GST Tax on the Direct Skips

<table>
<thead>
<tr>
<th>Name of skip person</th>
<th>Description of property interest transferred</th>
<th>Estate tax value</th>
</tr>
</thead>
</table>

1 Total estate tax values of all property interests listed above
2 Estate taxes, state death taxes, and other charges borne by the property interests listed above
3 GST taxes borne by the property interests listed above but imposed on direct skips other than those shown on this Part 2 (see instructions)
4 Total fixed taxes and other charges (add lines 2 and 3)
5 Total tentative maximum direct skips (subtract line 4 from line 1)
6 GST exemption allocated
7 Subtract line 6 from line 5
8 GST tax due (divide line 7 by 3.222222)
9 Enter the amount from line 8 of Schedule R, Part 3
10 Total GST taxes payable by the estate (add lines 8 and 9)
### Part 3. Direct Skips Where the Property Interests Transferred Do Not Bear the GST Tax on the Direct Skips

<table>
<thead>
<tr>
<th>Name of skip person</th>
<th>Description of property interest transferred</th>
<th>Estate tax value</th>
</tr>
</thead>
</table>

1. Total estate tax values of all property interests listed above
2. Estate taxes, state death taxes, and other charges borne by the property interests listed above
3. GST taxes borne by the property interests listed above but imposed on direct skips other than those shown on this Part 3 (see instructions)
4. Total fixed taxes and other charges (add lines 2 and 3)
5. Total tentative maximum direct skips (subtract line 4 from line 1)
6. GST exemption allocated
7. Subtract line 6 from line 5
8. GST tax due (multiply line 7 by .45). Enter here and on Schedule R, Part 2, line 9
## Part 1. Computation of the GST Tax on the Direct Skip

<table>
<thead>
<tr>
<th>Description of property interests subject to the direct skip</th>
<th>Estate tax value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Total estate tax value of all property interests listed above</td>
<td>1</td>
</tr>
<tr>
<td>2 Estate taxes, state death taxes, and other charges borne by the property interests listed above</td>
<td>2</td>
</tr>
<tr>
<td>3 Tentative maximum direct skip from trust (subtract line 2 from line 1)</td>
<td>3</td>
</tr>
<tr>
<td>4 GST exemption allocated</td>
<td>4</td>
</tr>
<tr>
<td>5 Subtract line 4 from line 3</td>
<td>5</td>
</tr>
<tr>
<td>6 GST tax due from fiduciary (divide line 5 by 3.222222). (See instructions if property will not bear the GST tax.)</td>
<td>6</td>
</tr>
</tbody>
</table>

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.

Signature(s) of executor(s)  

Date

Signature of fiduciary or officer representing fiduciary  

Date
Instructions for the Trustee

Introduction
Schedule R-1 (Form 706) serves as a payment voucher for the Generation-Skipping Transfer (GST) tax imposed on a direct skip from a trust, which you, the trustee of the trust, must pay. The executor completes the Schedule R-1 (Form 706) and gives you two copies. File one copy and keep one for your records.

How to pay
You can pay by check or money order.

- Make it payable to the “United States Treasury.”
- Make the check or money order for the amount on line 6 of Schedule R-1.
- Write “GST Tax” and the trust’s EIN on the check or money order.

Signature
You must sign the Schedule R-1 in the space provided.

What to mail
Mail your check or money order and the copy of Schedule R-1 that you signed.

Where to mail
Mail to the Department of the Treasury, Internal Revenue Service Center, Cincinnati, OH 45999.

When to pay
The GST tax is due and payable 9 months after the decedent’s date of death (shown on the Schedule R-1). You will owe interest on any GST tax not paid by that date.

Automatic extension
You have an automatic extension of time to file Schedule R-1 and pay the GST tax. The automatic extension allows you to file and pay by 2 months after the due date (with extensions) for filing the decedent’s Schedule R (shown on the Schedule R-1).

- If you pay the GST tax under the automatic extension, you will be charged interest (but no penalties).

Additional information
For more information, see section 2603(a)(2) and the Instructions for Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.
Part 1. Election

**Note.** The executor is deemed to have made the election under section 2031(c)(6) if he or she files Schedule U and excludes any qualifying conservation easements from the gross estate.

Part 2. General Qualifications

1. Describe the land subject to the qualified conservation easement (see separate instructions) ...........................................

2. Did the decedent or a member of the decedent’s family own the land described above during the 3-year period ending on the date of the decedent’s death? ☐ Yes ☐ No

3. Describe the conservation easement with regard to which the exclusion is being claimed (see separate instructions).

Part 3. Computation of Exclusion

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>Estate tax value of the land subject to the qualified conservation easement (see separate instructions)</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Date of death value of any easements granted prior to decedent’s death and included on line 10 below (see instructions)</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Add lines 4 and 5.</td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>Value of retained development rights on the land (see instructions)</td>
<td>7</td>
</tr>
<tr>
<td>8</td>
<td>Subtract line 7 from line 6.</td>
<td>8</td>
</tr>
<tr>
<td>9</td>
<td>Multiply line 8 by 30% (.30)</td>
<td>9</td>
</tr>
<tr>
<td>10</td>
<td>Value of qualified conservation easement for which the exclusion is being claimed (see instructions)</td>
<td>10</td>
</tr>
</tbody>
</table>

**Note.** If line 10 is less than line 9, continue with line 11. If line 10 is equal to or more than line 9, skip lines 11 through 13, enter ".40" on line 14, and complete the schedule.

| 11| Divide line 10 by line 8. Figure to 3 decimal places (for example, ".123") | 11 |

**Note.** If line 11 is equal to or less than .100, stop here; the estate does not qualify for the conservation easement exclusion.

| 12| Subtract line 11 from .300. Enter the answer in hundredths by rounding any thousandths up to the next higher hundredth (that is, .030 = .03, but .031 = .04) | 12 |
| 13| Multiply line 12 by 2.                                            | 13 |
| 14| Subtract line 13 from .40.                                        | 14 |
| 15| Deduction under section 2055(f) for the conservation easement (see separate instructions) | 15 |
| 16| Amount of indebtedness on the land (see separate instructions)    | 16 |

| 17| Total reductions in value (add lines 7, 15, and 16)               | 17 |
| 18| Net value of land (subtract line 17 from line 4)                  | 18 |
| 19| Multiply line 18 by line 14.                                      | 19 |
| 20| Enter the smaller of line 19 or the exclusion limitation (see instructions). Also enter this amount on item 11, Part 5—Recapitulation, page 3 | 20 |
### CONTINUATION SCHEDULE

**Continuation of Schedule**

(Enter letter of schedule you are continuing.)

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description, For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.</th>
<th>Unit value (Sch. B, E, or G only)</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death or amount deductible</th>
</tr>
</thead>
</table>

**TOTAL.** (Carry forward to main schedule.)

See the instructions on the reverse side.
Instructions for Continuation Schedule

When you need to list more assets or deductions than you have room for on one of the main schedules, use the Continuation Schedule on page 39. It provides a uniform format for listing additional assets from Schedules A through I and additional deductions from Schedules J, K, L, M, and O.

Please keep the following points in mind:
● Use a separate Continuation Schedule for each main schedule you are continuing. Do not combine assets or deductions from different schedules on one Continuation Schedule.
● Make copies of the blank schedule before completing it if you expect to need more than one.
● Use as many Continuation Schedules as needed to list all the assets or deductions.
● Enter the letter of the schedule you are continuing in the space at the top of the Continuation Schedule.
● Use the Unit value column only if continuing Schedule B, E, or G. For all other schedules, use this space to continue the description.
● Carry the total from the Continuation Schedules forward to the appropriate line on the main schedule.

<table>
<thead>
<tr>
<th>If continuing</th>
<th>Report</th>
<th>Where on Continuation Schedule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule E, Pt. 2</td>
<td>Percentage includible</td>
<td>Alternate valuation date</td>
</tr>
<tr>
<td>Schedule K</td>
<td>Amount unpaid to date</td>
<td>Alternate valuation date</td>
</tr>
<tr>
<td>Schedule K</td>
<td>Amount in contest</td>
<td>Alternate value</td>
</tr>
<tr>
<td>Schedules J, L, M</td>
<td>Description of deduction continuation</td>
<td>Alternate valuation date and Alternate value</td>
</tr>
<tr>
<td>Schedule O</td>
<td>Character of institution</td>
<td>Alternate valuation date and Alternate value</td>
</tr>
<tr>
<td>Schedule O</td>
<td>Amount of each deduction</td>
<td>Amount deductible</td>
</tr>
</tbody>
</table>
Instructions for Form 706

(Rev. September 2009)

For decedents dying after December 31, 2008, and before January 1, 2010

United States Estate (and Generation-Skipping Transfer) Tax Return

Section references are to the Internal Revenue Code unless otherwise noted.

Prior Revisions of Form 706

For Decedents Dying Use of Form 706

<table>
<thead>
<tr>
<th>After Dated</th>
<th>Before Dated</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 1998</td>
<td>January 1, 2001</td>
</tr>
<tr>
<td>December 31, 2000</td>
<td>January 1, 2002</td>
</tr>
<tr>
<td>December 31, 2001</td>
<td>January 1, 2003</td>
</tr>
<tr>
<td>December 31, 2002</td>
<td>January 1, 2004</td>
</tr>
<tr>
<td>December 31, 2003</td>
<td>January 1, 2005</td>
</tr>
<tr>
<td>December 31, 2004</td>
<td>January 1, 2006</td>
</tr>
<tr>
<td>December 31, 2005</td>
<td>January 1, 2007</td>
</tr>
<tr>
<td>December 31, 2006</td>
<td>January 1, 2008</td>
</tr>
<tr>
<td>December 31, 2007</td>
<td>January 1, 2009</td>
</tr>
</tbody>
</table>

Contents of Form 706

<table>
<thead>
<tr>
<th>Schedule</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>B—Stocks and Bonds</td>
<td>13</td>
</tr>
<tr>
<td>C—Mortgages, Notes, and Cash</td>
<td>15</td>
</tr>
<tr>
<td>D—Insurance on the Decedent's Life</td>
<td>15</td>
</tr>
<tr>
<td>E—Jointly Owned Property</td>
<td>15</td>
</tr>
<tr>
<td>F—Miscellaneous Property</td>
<td>15</td>
</tr>
<tr>
<td>G—Transfers During Decedent's Life</td>
<td>15</td>
</tr>
<tr>
<td>H—Powers of Appointment</td>
<td>16</td>
</tr>
<tr>
<td>I—Annuities</td>
<td>17</td>
</tr>
<tr>
<td>J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims</td>
<td>19</td>
</tr>
<tr>
<td>K—Debts of the Decedent and Mortgages and Liens</td>
<td>19</td>
</tr>
<tr>
<td>L—Net Losses During Administration and Expenses Incurred in Administering Property Not Subject to Claims</td>
<td>21</td>
</tr>
<tr>
<td>M—Bequests, etc., to Surviving Spouse</td>
<td>21</td>
</tr>
<tr>
<td>O—Charitable, Public, and Similar Gifts and Bequests</td>
<td>21</td>
</tr>
<tr>
<td>P—Credit for Foreign Death Taxes</td>
<td>21</td>
</tr>
<tr>
<td>Q—Credit for Tax on Prior Transfers</td>
<td>22</td>
</tr>
<tr>
<td>R and R-1—Generation-Skipping Transfer Tax</td>
<td>24</td>
</tr>
<tr>
<td>U—Qualified Conservation Easement</td>
<td>28</td>
</tr>
<tr>
<td>Exclusion</td>
<td>28</td>
</tr>
<tr>
<td>Continuation Schedule</td>
<td>29</td>
</tr>
<tr>
<td>Privacy Act and Paperwork</td>
<td>30</td>
</tr>
<tr>
<td>Reduction Act</td>
<td>31</td>
</tr>
<tr>
<td>Worksheet for Schedule Q</td>
<td>32</td>
</tr>
<tr>
<td>Index</td>
<td>32</td>
</tr>
<tr>
<td>Checklist</td>
<td>33</td>
</tr>
</tbody>
</table>

* For Schedules A, A-1, C, D, E, F, J, and M, see instructions in the Form 706 itself.

What's New

- Use this revision of Form 706 only for the estates of decedents dying in calendar year 2009.
- The applicable exclusion amount for estates of decedents dying in calendar year 2008 is $3,500,000.
- Various dollar amounts and limitations relevant to Form 706 are indexed for inflation. For decedents dying in 2009, the following amounts have increased:
  a. The ceiling on special-use valuation is $1,000,000.
  b. The amount used in computing the 2% portion of estate tax payable in installments is $1,330,000.
- The IRS will publish amounts for future years in annual revenue procedures.

Reminders

In 2008, we added a worksheet to help executors figure how much of the estate tax may be paid in installments under section 6166. See Determine how much of the estate tax may be paid in installments under section 6166 on page 11 for details.

General Instructions

Purpose of Form

The executor of a decedent’s estate uses Form 706 to figure the estate tax imposed by Chapter 11 of the Internal Revenue Code. This tax is levied on the entire taxable estate and not just on the share received by a particular beneficiary. Form 706 is also used to compute the generation-skipping transfer (GST) tax imposed by Chapter 13 on direct skips (transfers to skip persons of interests in property included in the decedent’s gross estate).

Which Estates Must File

For decedents dying in 2009, Form 706 must be filed by the executor for the estate of every U.S. citizen or resident whose gross estate, plus adjusted taxable gifts and specific exemption, is more than $3,500,000.

To determine whether you must file a return for the estate, add:
1. The adjusted taxable gifts (under section 2001(b)) made by the decedent after December 31, 1976; and
2. The total specific exemption allowed under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) for gifts made by the decedent after September 8, 1976; and
3. The decedent’s gross estate valued at the date of death.

Gross Estate

The gross estate includes all property in which the decedent had an interest (including real property outside the United States). It also includes:
• Certain transfers made during the decedent’s life without an adequate and full consideration in money or money’s worth,
• Annuities,
• The includible portion of joint estates with right of survivorship (see the instructions on the back of Schedule E),
• The includible portion of tenancies by the entirety (see the instructions on the back of Schedule E),
• Certain life insurance proceeds (even though payable to beneficiaries other than the estate) (see the instructions on the back of Schedule D),
• Property over which the decedent possessed a general power of appointment,
• Dower or curtesy (or statutory estate) of the surviving spouse, and
• Community property to the extent of the decedent's interest as defined by applicable law.

For more specific information, see the instructions for Schedules A through I.

U. S. Citizens or Residents; Nonresident Noncitizens

File Form 706 for the estates of decedents who were either U.S. citizens or U.S. residents at the time of death. For estate tax purposes, a resident is someone who had a domicile in the United States at the time of death. A person acquires a domicile by living in a place for even a brief period of time, as long as the person had no intention of moving from that place.

File Form 706-NA, U.S. Estate (and Generation-Skipping Transfer) Tax Return, if the estates of nonresident alien decedents (decedents who were neither U.S. citizens nor U.S. residents at the time of death).

Residents of U. S. Possessions

All references to citizens of the United States are subject to the provisions of sections 2208 and 2209, relating to decedents who were U.S. citizens and residents of a U.S. possession on the date of death. If such a decedent became a U.S. citizen only because of his or her connection with a possession, then the decedent is considered a nonresident alien decedent for estate tax purposes, and you should file Form 706-NA. If such a decedent became a U.S. citizen wholly independently of his or her connection with a possession, then the decedent is considered a U.S. citizen for estate tax purposes, and you should file Form 706.

Executor

The term “executor” means the executor, personal representative, or administrator of the decedent’s estate.

If none of these is appointed, qualified, and acting in the United States, every person in actual or constructive possession of any property of the decedent is considered an executor and must file a return.

When To File

You must file Form 706 to report estate and/or GST tax within 9 months after the date of the decedent’s death unless you receive an extension of time to file. Use Form 4768, Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes, to apply for an automatic—3-month extension of time to file.

Private delivery services. You can use certain private delivery services designated by the IRS to meet the “timely mailing as timely filing/paying” rule for tax returns and payments.

These private delivery services include only the following:
• DHL Express (DHL): DHL Same Day Service,
• FedEx Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, FedEx International First,

The private delivery service can tell you how to get written proof of the mailing date.

Where To File

File Form 706 at the following address:
Department of the Treasury Internal Revenue Service Center Cincinnati, OH 45999

Paying the Tax

The estate and GST taxes are due within 9 months after the date of the decedent’s death unless an extension of time for payment has been granted, or unless you have been granted an election under section 6166 to pay in installments, or under section 6163 to postpone the part of the tax attributable to a reversionary or remainder interest. These elections are made by checking lines 3 and 4 (respectively) of Part 3—Elections by the Executor, and attaching the required statements.

If the tax paid with the return is different from the balance due as figured on the return, explain the difference in an attached statement. If you have made prior payments to the IRS, attach a statement to Form 706 including these facts.

Paying by check. Make the check payable to the “United States Treasury.” Please write the decedent’s name, social security number (SSN), and “Form 706” on the check to assist us in posting it to the proper account.

Signature and Verification

If there is more than one executor, all listed executors are responsible for the return. However, it is sufficient for only one of the co-executors to sign the return.

All executors are responsible for the return as filed and are liable for penalties provided for erroneous or false returns.

If two or more persons are liable for filing the return, they should all join together in filing one complete return. However, if they are unable to join in making one complete return, each is required to file a return disclosing all the information the person has in the case, including the name of every person holding an interest in the property and a full description of the property. If the appointed, qualified, and acting executor is unable to make a complete return, then every person holding an interest in the property must, on notice from the IRS, make a return regarding that interest.

The executor who files the return must, in every case, sign the declaration on page 1 under penalties of perjury.

Generally, anyone who is paid to prepare the return must sign the return in the space provided and fill in the “Paid Preparer’s Use Only” area. See section 7701(a)(36)(B) for exceptions.

In addition to signing and completing the required information, the paid preparer must give a copy of the completed return to the executor.

Note. A paid preparer may sign original or amended returns by rubber stamp, mechanical device, or computer software program.

Amending Form 706

If you find that you must change something on a return that has already been filed, you should:
• File another Form 706;
• Enter "Supplemental Information" across the top of page 1 of the form; and
• Attach a copy of pages 1, 2, and 3 of the original Form 706 that has already been filed.

If you have already been notified that the return has been selected for examination, you should provide the additional information directly to the office conducting the examination.

Supplemental Documents
Note. You must attach the death certificate to the return.

If the decedent was a citizen or resident and died testate, attach a certified copy of the will to the return. If you cannot obtain a certified copy, attach a copy of the will and an explanation of why it is not certified. Other supplemental documents may be required as explained below. Examples include Forms 712, Life Insurance Statement; 709, United States Gift (and Generation-Skipping Transfer) Tax Return; and 706-CE, Certificate of Payment of Foreign Death Tax; trust and power of appointment instruments; death certificate; and state certification of payment of death taxes. If you do not file these documents with the return, the processing of the return will be delayed.

If the decedent was a U.S. citizen but not a resident of the United States, you must attach the following documents to the return:
1. A copy of the inventory of property and the schedule of liabilities, claims against the estate, and expenses of administration filed with the foreign court of probate jurisdiction, certified by a proper official of the court;
2. A copy of the return filed under the foreign inheritance, estate, legacy, succession tax, or other death tax act, certified by a proper official of the foreign tax department, if the estate is subject to such a foreign tax; and
3. If the decedent died testate, a certified copy of the will.

Rounding Off to Whole Dollars
You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

Penalties
Late filing and late payment. Section 6651 provides for penalties for both late filing and late payment unless there is reasonable cause for the delay. The law also provides for penalties for willful attempts to evade payment of tax. The late filing penalty will not be imposed if the taxpayer can show that the failure to file a timely return is due to reasonable cause. Executors filing late (after the due date, including extensions) should attach an explanation to the return to show reasonable cause.

Valuation understatement. Section 6662 provides a 20% penalty for the underpayment of estate tax that exceeds $5,000 when the underpayment is attributable to valuation understatement. A valuation understatement occurs when the value of property reported on Form 706 is 65% or less of the actual value of the property.

This penalty increases to 40% if there is a gross valuation understatement. A gross valuation understatement occurs if any property on the return is valued at 40% or less of the value determined to be correct.

These penalties also apply to late filing, late payment, and underpayment of GST taxes.

Return preparer. Estate tax return preparers, who prepare any return or claim for refund which reflects an understatement of tax liability due to willful or reckless conduct, are subject to a penalty of $5,000 or 50% of the income derived (or income to be derived), whichever is greater, for the preparation of each such return. See section 6694, the regulations thereunder, and Ann. 2009-15, 2009-11 I.R.B. 687 for more information.

Obtaining Forms and Publications To File or Use Internet. You can access the IRS website 24 hours a day, 7 days a week at www.irs.gov to:
• Download forms, instructions, and publications;
• Order IRS products online;
• Research your tax questions online;
• Search publications online by topic or keyword; and
• Sign up to receive local and national tax news by email.

DVD of tax products. You can order Publication 1796, IRS Tax Products DVD, and obtain:
• Current-year forms, instructions, and publications;
• Prior-year forms, instructions, and publications;
• Tax Map: an electronic research tool and finding aid;
• Tax Law frequently asked questions; and
• Tax Topics from the IRS telephone response system.

• Internal Revenue Code – Title 26
• Fill-in, print, and save features for most tax forms
• Internal Revenue Bulletins
• Toll-free and email technical support.
• The DVD is released twice during the year.

— The first release will ship the beginning of January 2010.
— The final release will ship the beginning of March 2010.

Purchase the DVD from National Technical Information Service (NTIS) at www.irs.gov/od/or for $30 (no handling fee) or call 1-877-233-6767 toll free to purchase the DVD for $30 (plus a $6 handling fee). The price is discounted to $25 for orders placed prior to December 1, 2009.

Other forms that may be required.
• Form SS-5, Application for Social Security Card.
• Form 706-CE, Certificate of Payment of Foreign Death Tax.
• Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return. Estate of nonresident not a citizen of the United States.
• Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.
• Form 712, Life Insurance Statement.
• Form 2848, Power of Attorney and Declaration of Representative.
• Form 4768, Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes
• Form 4808, Computation of Credit for Gift Tax.
• Form 8821, Tax Information Authorization.
• Form 8822, Change of Address.

Additional Information. The following publications may assist you in learning about and preparing Form 706:
• Publication 559, Survivors, Executors, and Administrators.
• Publication 910, Guide to Free Tax Services.
• Publication 950, Introduction to Estate and Gift Taxes.

Note. For information about release of nonresident U.S. citizen decedents’ assets using transfer certificates under Regulation 20.6325-1, write to: Internal Revenue Service Cincinnati, OH, 45999 Step 824G

Specific Instructions
You must file the first three pages of Form 706 and all required schedules. File Schedules A through I, as appropriate, to support the entries in items 1 through 9 of Part 5—Recapitulation.
IF... THEN ...

you enter zero on any item of the Recapitulation, you need not file the schedule (except for Schedule F) referred to on that item.

you claim an exclusion on item 11, complete and attach Schedule U.

you claim any deductions on items 13 through 21 of the Recapitulation, support the claimed deductions.

you claim the credits for foreign death taxes or tax on prior transfers, complete and attach the appropriate schedules to Schedule P or Q.

there is not enough space on a schedule to list all the items, attach a Continuation Schedule (or additional sheets of the same size) to the back of the schedule; (see the Form 706 package for the Continuation Schedule); photocopy the blank schedule before completing it, if you will need more than one copy.

Also consider the following:

• Form 706 has 40 numbered pages. The pages are perforated so that you can remove them for copying and filing.

Worksheet TG—Taxable Gifts Reconciliation

(To be used for lines 4 and 7 of the Tax Computation)

<table>
<thead>
<tr>
<th>Gifts made after June 6, 1972 and before 1977</th>
<th>Total taxable gifts for period (see Note)</th>
<th>Taxable amount included in col. b for gifts included in the gross estate</th>
<th>Taxable amount included in col. b for gifts that qualify for “special treatment of split gifts” described on page 6</th>
<th>Gift tax paid by decedent on gifts in col. d</th>
<th>Gift tax paid by decedent’s spouse on gifts in col. c</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. Calendar year or calendar quarter</td>
<td>b.</td>
<td>c.</td>
<td>d.</td>
<td>e.</td>
</tr>
<tr>
<td>1. Total taxable gifts made before 1977</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Gifts made after 1976

| Gifts made after 1976 | | | | | | |
| 2. Totals for gifts made after 1976 | | | | | | |

Line 4 Worksheet—Adjusted Taxable Gifts Made After 1976

1. Taxable gifts made after 1976. Enter the amount from line 2, column b, Worksheet TG...
2. Taxable gifts made after 1976 reportable on Schedule G. Enter the amount from line 2, column c, Worksheet TG...
3. Taxable gifts made after 1976 that qualify for “special treatment.” Enter the amount from line 2, column d, Worksheet TG...
4. Add lines 2 and 3...
5. Adjusted taxable gifts. Subtract line 4 from line 1. Enter here and on line 4 of the Tax Computation of Form 706...
Line 7 Worksheet—Gift Tax on Gifts Made After 1976

<table>
<thead>
<tr>
<th>Column</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Calendar year or calendar quarter</td>
</tr>
<tr>
<td>b.</td>
<td>Total taxable gifts for prior periods (from Form 709, Part 2, Tax Computation, line 2)</td>
</tr>
<tr>
<td>c.</td>
<td>Taxable gifts for this period (from Form 709, Part 2, Tax Computation, line 1) (see below)</td>
</tr>
<tr>
<td>d.</td>
<td>Tax payable using Table A (see above)</td>
</tr>
<tr>
<td>e.</td>
<td>Unused unified credit (applicable credit amount) for this period (see below)</td>
</tr>
<tr>
<td>f.</td>
<td>Tax payable for this period (subtract col. e from col. d)</td>
</tr>
</tbody>
</table>

1. Total gift taxes payable on gifts made after 1976 (combine the amounts in column f) ............................... 1
2. Gift taxes paid by the decedent on gifts that qualify for “special treatment.” Enter the amount from line 2, column e, Worksheet TG .............................................................. 2
3. Subtract line 2 from line 1 .................................................................................................................. 3
4. Gift tax paid by decedent’s spouse on split gifts included on Schedule G. Enter the amount from line 2, column f, Worksheet TG ................................................................................. 4
5. Add lines 3 and 4. Enter here and on line 7 of the Tax Computation of Form 706 ............................................. 5

Columns b and c. In addition to gifts reported on Form 709, you must include in these columns any taxable gifts in excess of the annual exclusion that were not reported on Form 709.

Column d. To figure the “tax payable” for this column, you must use Table A in these instructions, as it applies to the year of the decedent’s death rather than to the year the gifts were actually made. To compute the entry for column d, you should figure the “tax payable” on the amount in column b and subtract it from the “tax payable” on the amounts in columns b and c added together. Enter the difference in column d.

“Tax payable” as used here is a hypothetical amount and does not necessarily reflect tax actually paid. Figure “tax payable” only on gifts made after 1976. Do not include any tax paid or payable on gifts made before 1977. However, if the decedent made taxable gifts before January 1, 1977, a special computation is required. The amount of gift tax payable (line 7) should be determined by applying the unified rate schedule, in effect at date of death, to the cumulative lifetime taxable transfers made both before January 1, 1977, and after December 31, 1976, and then subtracting the taxes payable on the lifetime transfers made before December 31, 1976.

To calculate the tax, enter the amount for the appropriate year from column c of the worksheet on line 1 of the Tax Computation of the Form 709. Enter the amount from column b on line 2 of the Tax Computation. Complete the Tax Computation through the tax due before any reduction for the unified credit (applicable credit amount) and enter that amount in column d, above.

Column e. To figure the unused unified credit (applicable credit amount), use the unified credit (applicable credit amount) in effect for the year the gift was made. This amount should be on line 12 of the Tax Computation of the Form 709 filed for the gift.
Line 3b. State Death Tax Deduction

The estates of decedents dying after December 31, 2004, will be allowed a deduction for state death taxes, instead of a credit. The state death tax credit is repealed, effective January 1, 2005.

You may take a deduction on line 3b for estate, inheritance, legacy, or succession taxes paid as the result of the decedent’s death to any state or the District of Columbia. You may claim an anticipated amount of deduction and figure the federal estate tax on the return before the state death taxes have been paid. However, the deduction cannot be finally allowed unless you pay the state death taxes and claim the deduction within 4 years after the return is filed, or later (see section 2058(b)) if:
• A petition is filed with the Tax Court of the United States.
• You have an extension of time to pay.
• You file a claim for refund or credit of an overpayment which extends the deadline for claiming the deduction.

Note. The deduction is not subject to dollar limits.

If you make a section 6166 election to pay the federal estate tax in installments and make a similar election to pay the state death tax in installments, see section 2058(b) for exceptions and periods of limitation.

If you transfer property other than cash to the state in payment of state inheritance taxes, the amount you may claim as a deduction is the lesser of the state inheritance tax liability discharged or the fair market value (FMV) of the property on the date of the transfer. For more information on the application of such transfers, see the principles discussed in Rev. Rul. 86-117, 1986-2 C.B. 157, prior to the repeal of section 2011.

You should send the following evidence to the IRS:
1. Certificate of the proper officer of the taxing state, or the District of Columbia, showing the:
   a. Total amount of tax imposed (before adding interest and penalties and before allowing discount).
   b. Amount of discount allowed.
   c. Amount of penalties and interest imposed or charged.
   d. Total amount actually paid in cash, and
   e. Date of payment.
2. Any additional proof the IRS specifically requests.

You should file the evidence requested above with the return if possible. Otherwise, send it as soon after you file the return as possible.

Line 6

To figure the tentative tax on the amount on line 5, use Table A on page 4 and put the result on this line.

Lines 4 and 7

Three worksheets are provided to help you compute the entries for these lines. You need not file these workhouses with your return but should keep them for your records. Worksheet TG—Taxable Gifts Reconciliation, on page 4, allows you to reconcile the decedent’s lifetime taxable gifts to compute totals that will be used for the Line 4 Worksheet on page 4 and the Line 7 Worksheet on page 5.

You must get all of the decedent’s gift tax returns (Form 709) before you complete Worksheet TG—Taxable Gifts Reconciliation. The amounts you will enter on Worksheet TG can usually be derived from these returns as filed. However, if any of the returns were audited by the IRS, you should use the amounts that were finally determined as a result of the audits.

In addition, you must include in column b of Worksheet TG any gifts in excess of the annual exclusion made by the decedent (or on behalf of the decedent under a power of attorney) but for which no Forms 709 were filed. You must make a reasonable inquiry as to the existence of any such gifts. The annual exclusion for 1977 through 1981 was $3,000 per donee per year, $10,000 for years 1981 through 2001, $11,000 for years 2002 through 2005, and $12,000 for years 2006 through 2008. For calendar year 2009 the annual exclusion was $13,000 per donee.

Note. In figuring the line 7 amount, do not include any tax paid or payable on gifts made before 1977. The line 7 amount is a hypothetical figure used to calculate the estate tax.

Special treatment of split gifts.

These special rules apply only if:
• The decedent’s spouse predeceased the decedent;
• The decedent’s spouse made gifts that were “split” with the decedent under the rules of section 2513;
• The decedent was the “consenting spouse” for those split gifts, as that term is used on Form 709; and
• The split gifts were included in the decedent’s spouse’s gross estate under section 2035.

If all four conditions above are met, do not include these gifts on line 4 of the Tax Computation and do not include the gift taxes payable on these gifts on line 7 of the Tax Computation. These adjustments are incorporated into the worksheets.

Line 9. Maximum Unified Credit (applicable credit amount)

The applicable credit amount (formerly the unified credit) is $1,455,800 for the estates of decedents dying in 2009. The amount of the credit cannot exceed the amount of estate tax imposed.

Line 10. Adjustment to Unified Credit (applicable credit amount)

If the decedent made gifts (including gifts made by the decedent’s spouse and treated as made by the decedent by reason of gift splitting) after September 8, 1976, and before January 1, 1977, for which the decedent claimed a specific exemption, the unified credit (applicable credit amount) on this estate tax return must be reduced by entering 20% of the specific exemption claimed for these gifts.

Note. The specific exemption was allowed by section 2521 for gifts made before January 1, 1977.

If the decedent did not make any gifts between September 8, 1976, and January 1, 1977, or if the decedent made gifts during that period but did not claim the specific exemption, enter zero.

Line 15. Total Credits

Generally, line 15 is used to report the total of credit for foreign death taxes (line 13) and credit for tax on prior transfers (line 14).

However, you may also use line 15 to report credit taken for federal gift taxes imposed by Chapter 12 of the Code, and the corresponding provisions of prior laws, on certain transfers the decedent made before January 1, 1977, that are included in the gross estate. The credit cannot be more than the amount figured by the following formula:

\[
\text{Value of gross estate tax minus (the sum of the state death taxes and unified credit)} \times \text{Value of included gift}
\]

\[
\text{Value of gross estate tax minus (the sum of the deductions for charitable, public, and similar gifts and bequests and marital deduction)}
\]

When taking the credit for pre-1977 federal gift taxes:
• Include the credit in the amount on line 15 and
• Identify and enter the amount of the credit you are taking on the dotted line to the left of the entry space for line 15 on page 1 of Form 706 with a notation, “section 2012 credit.”

For more information, see the regulations under section 2012. This computation may be made using Form 4808. Attach a copy of a completed Form 4808 (not a copy of Form 4808-EZ).

Part Instructions
The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.

Form 4808 or the computation of the credit. Also, attach all available copies of Form 706 filed by the decedent to help verify the amounts entered on lines 4 and 7, and the amount of credit taken (on line 15) for pre-1977 federal gift taxes.

Canadian marital credit. In addition to using line 15 to report credit for federal gift taxes on pre-1977 gifts, you may also use line 15 to claim the Canadian marital credit, where applicable.

When taking the marital credit under the 1995 Canadian income tax treaty protocol:
1. Include the credit on the amount on line 15 and
2. Identify and enter the amount of the credit you are taking on the dotted line to the left of the entry space for line 15 on page 1 of Form 706 with a notation, “Canadian marital credit.”

Also, attach a statement to the return that refers to the treaty, waives QDOT rights, and shows the computation of the marital credit. See the 1995 Canadian income tax treaty protocol for details on computing the credit.

Part 3—Elections by the Executor (Page 2 of Form 706)

Line 1. Alternate Valuation

See the example on page 14 showing the use of Schedule B where the alternate valuation is adopted.

Unless you elect at the time you file the return to adopt alternate valuation as authorized by section 2032, you must value all property included in the gross estate on the date of the decedent’s death. Alternate valuation cannot be applied to only a part of the property.

You may elect special-use valuation without a Schedule B election. The property included in the gross estate on the date of the decedent’s death. Alternate valuation cannot be applied to only a part of the property.

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Part Instructions

-7-
Line 2. Special-Use Valuation of Section 2032A

In general. Under section 2032A, you may elect to value certain farm and closely held business real property at its farm or business use value rather than its fair market value (FMV). You may elect both special-use valuation and alternate valuation.

To elect this valuation, you must check “Yes” on line 2 and complete and attach Schedule A-1 and its required additional statements. You must file Schedule A-1 and its required attachments with Form 706 for this election to be valid. You may make the election on a late-filed return so long as it is the first return filed.

The total value of the property valued under section 2032A may not be decreased from FMV by more than $1,000,000 for decedents dying in 2009.

Real property may qualify for the section 2032A election if:

1. The decedent was a U.S. citizen or resident at the time of death;
2. The property is located in the United States;
3. At the decedent’s death, the real property was used by the decedent or a family member for farming or in a trade or business, or was rented for such use by either the surviving spouse or a lineal descendant of the decedent to a family member on a net cash basis;
4. The real property was acquired from or passed from the decedent to a qualified heir of the decedent;
5. The real property was owned and used in a qualified manner by the decedent or a member of the decedent’s family during 5 of the 8 years before the decedent’s death;
6. There was material participation by the decedent or a member of the decedent’s family during 5 of the 8 years before the decedent’s death; and
7. The qualified property meets the following percentage requirements:
   a. At least 50% of the adjusted value of the property must consist of the adjusted value of real or personal property that was being used as a farm or in a closely held business and that was acquired from, or passed from, the decedent to a qualified heir of the decedent, and
   b. At least 25% of the adjusted value of the gross estate must consist of the adjusted value of qualified farm or closely held business real property.

For this purpose, adjusted value is the value of property determined without regard to its special-use value. The value is reduced for unpaid mortgages on the property or any indebtedness against the property, if the full value of the decedent’s interest in the property (not reduced by such mortgage or indebtedness) is included in the value of the gross estate. The adjusted value of the qualified real and personal property used in different businesses may be combined to meet the 50% and 25% requirements.

Qualified Real Property

Qualified use. The term “qualified use” means the use of the property as a farm for farming purposes or the use of property in a trade or business other than farming. Trade or business applies only to the active conduct of a business. It does not apply to passive investment activities or the mere passive rental of property to a person other than a member of the decedent’s family. Also, no trade or business is present in the case of activities not engaged in for profit.

Ownership. To qualify as special-use property, the decedent or a member of the decedent’s family must have owned and used the property in a qualified use for 5 of the last 8 years before the decedent’s death. Ownership may be direct or indirect through a corporation, a partnership, or a trust.

If the ownership is indirect, the business must qualify as a closely held business under section 6166. The ownership, when combined with periods of direct ownership, must meet the requirements of section 6166 on the date of the decedent’s death and for a period of time that equals at least 5 of the 8 years preceding death.

If the property was leased by the decedent to a closely held business, it qualifies as long as the business entity to which it was rented was a closely held business. You must notify the IRS of the date on the date of the decedent’s death and for sufficient time to meet the “5 in 8 years” test explained above.

Structures and other real property improvements. Qualified real property includes residential buildings and other structures and real property improvements regularly occupied or used by the owner or lessee to operate the farm or business. A farm residence which the decedent had occupied is considered to have been occupied for the purpose of operating the farm even when a family member and not the decedent was the person materially participating in the operation of the farm.

Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

Elements of value such as mineral rights that are not related to the farm or business use are not eligible for special-use valuation.

Property acquired from the decedent. Property is considered to have been acquired from or to have passed from the decedent if one of the following applies:

• The property is considered to have been acquired from or to have passed from the decedent under section 1014(b) (relating to basis of property acquired from a decedent);
• The property is acquired by any person from the estate; or
• The property is acquired by any person from a trust, to the extent the property is includible in the gross estate.

Qualified heir. A person is a “qualified heir” of property if he or she is a member of the decedent’s family and acquired or received the property from the decedent. If a qualified heir disposes of any interest in qualified real property to any member of his or her family, that person will then be treated as the qualified heir for that interest.

The term “member of the family” includes only:

• An ancestor (parent, grandparent, etc.) of the individual;
• The spouse of the individual;
• The lineal descendant (child, stepchild, grandchild, etc.) of the individual, the individual’s spouse, or a parent of the individual; or
• The spouse, widow, or widower of any lineal descendant described above.

A legally adopted child of an individual is treated as a child of that individual by blood.

Material Participation

To elect special-use valuation, either the decedent or a member of his or her family must have materially participated in the operation of the farm or other business for at least 5 of the 8 years ending on the date of the decedent’s death. The existence of material participation is a factual determination, but passively collecting rents, salaries, draws, dividends, or other income from the farm or other business does not constitute material participation. Neither does merely advancing capital and reviewing a crop plan and financial reports each season or business year.

In determining whether the required participation has occurred, disregard brief periods (that is, 30 days or less) during which there was no material participation, as long as such periods were both preceded and followed by substantial periods (more than 120 days) during which there was uninterrupted material participation.

Retirement or disability. If, on the date of death, the time period for material participation could not be met because the decedent had retired or was disabled, a substitute period may apply. The decedent must have retired on social security or been disabled for a continuous period ending with death. A person is disabled for this purpose if he or she was mentally or physically

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Valuing a real property interest in closely held business.

The substitute time period for material participation for these decedents is a period totaling at least 5 years out of the 8-year period that ended on the earlier of:

- The date the decedent began receiving social security benefits or
- The date the decedent became disabled.

Surviving spouse. A surviving spouse who received qualified real property from the predeceased spouse is considered to have materially participated if he or she was engaged in the active management of the farm or other business. If the surviving spouse died within 8 years of the first spouse’s death, you may add the period of material participation of the predeceased spouse to the period of active management by the surviving spouse to determine if the surviving spouse’s estate qualifies for special-use valuation. To qualify for this, the property must have been eligible for special-use valuation in the predeceased spouse’s estate, though it does not have to have been elected by that estate.

For additional details regarding material participation, see Regulations section 20.2032A-3(e).

Valuation Methods

The primary method of valuing special-use value property that is used for farming purposes is the annual gross cash rental method. If comparable gross cash rentals are not available, you can substitute comparable average annual net share rentals, or if neither of these are available, or if you so elect, you can use the method for valuing real property in a closely held business.

Average annual gross cash rental.

Generally, the special-use value of property that is used for farming purposes is determined as follows:

1. Subtract the average annual state and local real estate taxes on actual tracts of comparable real property from the average annual gross cash rental for that comparable property and
2. Divide the result in (1) by the average annual effective interest rate charged for all new Federal Land Bank loans.

The computation of each average annual amount is based on the 5 most recent calendar years ending before the date of the decedent’s death. See Effective interest rate below.

Gross cash rental. Generally, gross cash rental is the total amount of cash received in a calendar year for the use of actual tracts of comparable farm real property in the same locality as the property being specially valued. You may not use:

- Appraisals or other statements regarding rental value or areawide averages of rentals, or
- Rents that are paid wholly or partly in-kind, or
- Rent that is paid in-kind and amount of rent may not be based on production.

The rental must have resulted from an arm’s-length transaction. Also, the amount of rent is not reduced by the amount of any expenses or liabilities associated with the farm operation or the lease.

Comparable property. Comparable property must be situated in the same locality as the specially valued property as defined by generally accepted real property valuation rules. The determination of comparability is based on all the facts and circumstances. It is often necessary to value land in segments where there are different uses or land characteristics included in the specially valued land.

The following list contains some of the factors considered in determining comparability:

- Similarity of soil;
- Whether the crops grown would deplete the soil in a similar manner;
- Types of soil conservation techniques that have been practiced on the two properties;
- Whether the two properties are subject to flooding;
- Slope of the land;
- For livestock operations, the carrying capacity of the land;
- For timbered land, whether the timber is comparable;
- Whether the property as a whole is unified or segmented. If segmented, the availability of the means necessary for movement among the different sections;
- Number, types, and conditions of all buildings and other fixed improvements located on the properties and their location as it affects efficient management, use, and value of the property; and
- Availability and type of transportation facilities in terms of costs and of proximity of the properties to local markets.

You must specifically identify on the return the property being used as comparable property. Use the type of descriptions used to list real property on Schedule A.


Net share rental. You may use average annual net share rental from comparable land only if there is no comparable land from which average annual gross cash rental can be determined. Net share rental is the difference between the gross value of produce received by the lessor from the comparable land and the cash operating expenses (other than real estate taxes) of growing the produce that, under the lease, are paid by the lessor. The production of the produce must be the business purpose of the farming operation. For this purpose, produce includes livestock.

The gross value of the produce is generally the gross amount received if the produce was disposed of in an arm’s-length transaction within the period established by the Department of Agriculture for its price support program. Otherwise, the value is the weighted average price for which the produce sold on the closest national or regional commodities market. The value is figured for the date or dates on which the lessor receives the produce (or constructively received) the produce.

Valuing a real property interest in closely held business. Use this method to determine the special-use valuation for qualifying real property used in a trade or business other than farming. You may also use this method for qualifying farm property if there is no comparable land or if you elect to use it. Under this method, the following factors are considered:

- The capitalization of income that the property can be expected to yield for farming or for closely held business purposes over a reasonable period of time with prudent management and traditional cropping patterns for the area, taking into account soil capacity, terrain configuration, and similar factors;
- The capitalization of the fair rental value of the land for farming or for closely held business purposes;
- The assessed land values in a state that provides a differential or use value assessment law for farmland or closely held business;
- Comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in land value or price; and
- Any other factor that fairly values the farm or closely held business value of the property.

Making the Election

Include the words “section 2032A valuation” in the Description column of any Form 706 schedule if section 2032A property is included in the deceased’s gross estate.

An election under section 2032A need not include all the property in an estate that is eligible for special-use valuation, but sufficient property to satisfy the threshold requirements of section 2032A(b)(1)(B) must be specially valued under the election.

The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.
If joint or undivided interests (that is, interests as joint tenants or tenants in common) in the same property are received from a decedent by qualified heirs, an election for one heir’s joint or undivided interest need not include any other heir’s interest in the same property if the electing heir’s interest plus other property to be specially valued satisfies the requirements of section 2032A(b)(1)(B).

If successive interests (that is, life estates and remainder interests) are created by a decedent in or with respect to an otherwise qualified property, an election under section 2032A is available only for that property (or part) in which qualified heirs of the decedent receive all of the successive interests, and such an election must include the interests of all of those heirs.

For example, if a surviving spouse receives a life estate in otherwise qualified property and the spouse’s brother receives a remainder interest (in fee, no part of the property may be valued under a section 2032A election.

Where successive interests in specially valued property are created, remainder interests are treated as being received by qualified heirs only if the remainder interests are not contingent on surviving a nonfamily member or are not subject to divestment in favor of a nonfamily member.

Protective Election
You may make a protective election to specially value qualified real property. Under this election, whether or not you may ultimately use special-use valuation, the election depends upon values as finally determined (or agreed to following examination of the return) meeting the requirements of section 2032A.

To make a protective election, check “Yes” on line 2 and complete Schedule A-1 according to its instructions for “Protective election.”

If you make a protective election, you should complete this Form 706 by valuing all property at its FMV. Do not use special-use valuation. Usually, this will result in higher estate and GST tax that is attributable to the death.

The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.

Line 3. Section 6166 Interest Payments
If the gross estate includes an interest in a closely held business, you may be able to elect to pay part of the estate tax in installments under section 6166.

The maximum amount that can be paid in installments is that part of the estate tax that is attributable to the closely held business; see Determining how much of the estate tax may be paid in installments section 6166 on page 11. In general, that amount is the amount of tax that bears the same ratio to the total estate tax that the value of the closely held business included in the gross estate bears to the adjusted gross estate.

Bond or lien. The IRS may require that an estate furnish a surety bond when granting the installment payment election. In the alternative, the executor may consent to elect the special lien provisions of section 6324A, in lieu of the bond. The IRS will contact you regarding the specifics of furnishing the bond or electing the special lien. The IRS may make this determination on a case-by-case basis, and you may be asked to provide additional information.

If you elect the lien provisions, section 6324A requires that the lien be placed on property having a value equal to the total deferred tax plus 4 years of interest. The property must be expected to survive the deferral period, and does not necessarily have to be property of the estate. In addition, all of the persons having an interest in the designated property must consent to the creation of this lien on the property pledged.

Percentage requirements. To qualify for installment payments, the value of the interest in the closely held business that is included in the gross estate must be more than 35% of the adjusted gross estate (i.e., gross estate less expenses, indebtedness, taxes, and losses—Schedules J, K, and L of Form 706 (do not include any portion of the state death tax deduction)).

Interests in two or more closely held businesses are treated as an interest in a single business if at least 20% of the total value of each business is included in the gross estate. For this purpose, include any interest held by the surviving spouse in a business held jointly with the decedent as community property or as joint tenants, tenants by the entirety, or tenants in common.

Value. The value used for meeting the percentage requirements is the same value used for determining the gross estate. Therefore, if the estate is valued under alternate valuation or special-use valuation, you must use those values to meet the percentage requirements.

Transfers before death. Generally, gifts made before death are not included in the gross estate. However, the estate must meet the 35% requirement by both including in and excluding from the gross estate any gifts made by the decedent in the 3-year period ending on the date of death.

Passive assets. In determining the value of a closely held business and whether the 35% requirement is met, do not include the value of any passive assets held by the business. A passive asset is an asset not used in carrying on a trade or business. Any asset used in a qualifying lending and financing business is treated as an asset used in carrying on a trade or business; see section 6166(b)(10) for details. Stock in another corporation is a passive asset unless the stock is treated as held by the decedent because of the election to treat holding company stock as business company stock; see Holding company stock below.

If a corporation owns at least 20% in value of the voting stock of another corporation, or the other corporation had no more than 45 shareholders and at least 80% of the value of the assets of each corporation is attributable to assets used in carrying on a trade or business, then these corporations will be treated as a single corporation, and the stock will not be treated as a passive asset. Stock held in the other corporation is not taken into account in determining the 80% requirement.

Interest in closely held business. For purposes of the installment payment election, an “interest in a closely held business” means:

- Ownership of a trade or business carried on as a proprietorship,
- An interest as a partner in a partnership carrying on a trade or business if 20% or more of the total capital interest was included in the gross estate of the decedent or the partnership had no more than 45 partners, or
- Stock in a corporation carrying on a trade or business if 20% or more in value of the stock is owned by the shareholders, and the corporation is included in the gross estate of the decedent or the corporation had no more than 45 shareholders.

The partnership or corporation must be carrying on a trade or business at
### Line 3 Worksheet—Adjusted Gross Estate

1. What is the value of the decedent's interest in the closely held business(es) included in the gross estate (less value of passive assets, as mentioned in section 6166(b)(9))? 
2. What is the value of the gross estate (Form 706, page 3, Part 5, line 12)? 
3. Subtract line 3 from line 2 to calculate the adjusted gross estate. 
4. Divide line 1 by line 2 to calculate the percentage of the gross estate. 
5. Multiply line 5 by the amount on line 16 of Form 706, page 1, Part 2. This is the maximum amount of estate tax that may be paid in installments under section 6166. (Certain GST taxes may be deferred as well; see section 6166(e) for more information.) 

If the executor makes this election, the first installment payment is due when the estate tax return is filed. The 5-year deferral for payment of the tax, as discussed below under *Time for payment*, does not apply. In addition, the 2% interest rate, discussed below under *Interest computation*, will not apply. Also, if the business company stock is readily tradable, as explained above, the tax must be paid in five installments.

### Interest computation

A special interest rate applies to installment payments. For decedents dying in 2009, the interest rate is 2% on the lesser of:

- $598,500 or
- The amount of the estate tax that is attributable to the closely held business and that is payable in installments.

The 2% portion is an amount equal to the amount of the tentative estate tax (on $1,000,000 plus the applicable exclusion amount in effect) minus the applicable credit amount in effect. However, if the amount of estate tax extended under section 6166 is less than the amount computed above, the 2% portion is the lesser amount.

### Inflation adjustment

The $1,000,000 amount used to calculate the 2% portion is indexed for inflation for the estates of decedents dying in a calendar year after 1998. For an estate of a decedent dying in calendar year 2009, the dollar amount used to determine the 2% portion of the estate tax payable in installments under section 6166 is $1,330,000.

### Computation

Interest on the portion of the tax in excess of the 2% portion is figured at 45% of the annual rate of interest on underpayments. This rate is based on the federal short-term rate and is announced quarterly by the IRS in the Internal Revenue Bulletin.

If you elect installment payments and the estate tax due is more than the maximum amount to which the 2% interest rate applies, each installment payment is deemed to comprise both tax subject to the 2% rate and tax subject to 45% of the regular underpayment rate. The amount of each installment that is subject to the 2% rate is the same as the percentage of total tax payable in installments that is subject to the 2% rate.
make a protective election, you must attach a notice of protective election as described in Regulations section 20.6166-1(d). Regulation section 20.6166-1(b) requires that the notice of election is made by attaching to a timely filed estate tax return the following information:

- The decedent’s name and taxpayer identification number as they appear on the estate tax return;
- The amount of tax that is to be paid in installments;
- The date selected for payment of the first installment;
- The number of annual installments, including first installment, in which the tax is to be paid;
- The properties shown on the estate tax return that are the closely held business interest (identified by schedule and item number); and
- The facts that formed the basis for the executor’s conclusion that the estate qualifies for payment of the estate tax in installments.

You may also elect to pay certain GST taxes in installments. See section 6166(i).

### Line 4. Reversionary or Remainder Interests

For details of this election, see section 6163 and the related regulations.

### Part 4—General Information (Pages 2 and 3 of Form 706)

#### Authorization

Completing the authorization on page 2 of Form 706 will authorize one attorney, accountant, or enrolled agent to represent the estate and receive confidential tax information, but will not authorize the representative to enter into closing agreements for the estate.

**Note.** If you wish to represent the estate, you must complete and sign the authorization.

If you wish to authorize persons other than attorneys, accountants, and enrolled agents, or if you wish to authorize more than one person to receive confidential information or represent the estate, you must complete and attach Form 2848. You must also complete and attach Form 2848 if you wish to authorize someone to enter into closing agreements for the estate. Filing a completed Form 2848 with this return may expedite processing of the Form 706.

If you wish only to authorize someone to inspect and/or receive confidential tax information (but not to represent you before the IRS), complete and file Form 8821.

### Line 4

Complete line 4 whether or not there is a surviving spouse and whether or not the surviving spouse received any benefits from the estate. If there was no surviving spouse on the date of decedent’s death, enter “None” in line 4a and leave lines 4b and 4c blank. The value entered in line 4c need not be exact. See the instructions for “Amount” under line 5 below.

### Line 5

#### Name.

Enter the name of each individual, trust, or estate that received (or will receive) benefits of $5,000 or more from the estate directly as an heir, next-of-kin, devisee, or legatee; or indirectly (for example, as beneficiary of an annuity or insurance policy, shareholder of a corporation, or partner of a partnership that is an heir, etc.).

#### Identifying number.

Enter the SSN of each individual beneficiary listed. If the number is unknown, or the individual has no number, please indicate “unknown” or “none.” For trusts and other estates, enter the EIN.

#### Relationship.

For each individual beneficiary, enter the relationship (if known) to the decedent by reason of blood, marriage, or adoption. For trust or estate beneficiaries, indicate “TRUST” or “ESTATE.”

#### Amount.

Enter the amount actually distributed (or to be distributed) to each beneficiary including transfers during the decedent’s life from Schedule G required to be included in the gross estate. The value to be entered need not be exact. A reasonable estimate is sufficient. For example, where precise values cannot readily be determined, as with certain future interests, a reasonable approximation should be entered. The total of these distributions should approximate the amount of gross estate reduced by funeral and administrative expenses, debts and mortgages, bequests to surviving spouse, charitable bequests, and any federal and state estate and GST taxes paid (or payable) relating to the benefits received by the beneficiaries listed on lines 4 and 5.

All distributions of less than $5,000 to specific beneficiaries may be included with distributions to unascertainable beneficiaries on the line provided.

### Line 6. Section 2044 Property

If you answered “Yes,” these assets must be shown on Schedule F.

Section 2044 property is property for which a previous section 2056(b)(7) election (QTIP election) has been made, or for which a similar gift tax election (section 2523) has been made. For more information, see the instructions on the back of Schedule F.

### Line 8. Insurance Not Included in the Gross Estate

If you answered “Yes” to either 8a or 8b, you must complete and attach Schedule D and attach a Form 712 to each policy and an explanation of why the policy or its proceeds are not includible in the gross estate.

### Line 10. Partnership Interests and Stock in Close Corporations

If you answered “Yes” on line 10a, you must include full details for partnerships (including family limited partnerships), unincorporated businesses, and limited liability companies on Schedule F (Schedule E if the partnership interest is jointly owned). You must also include full details for fractional interests in real estate on Schedule A, and full details for stock of inactive or close corporations on Schedule B.

### Part 5—Recapitulation (Page 3 of Form 706)

#### Gross Estate

- **Items 1 through 10.** You must make an entry in each of items 1 through 9.

If the gross estate does not contain any assets of the type specified by a given item, enter zero for that item.

- **Entering zero for any of items 1 through 9 is a statement by the executor, made**
under penalties of perjury, that the gross estate does not contain any includible assets covered by that item. Do not enter any amounts in the "Alternate value" column unless you elected alternate valuation on line 1 of Part 3—Elections by the Executor on page 2 of the Form 706.

Which schedules to attach for items 1 through 9. You must attach:
- Schedules F to the return and answer its questions even if you report no assets on it;
- Schedules A, B, and C if the gross estate includes any (1) Real Estate, (2) Stocks and Bonds, or (3) Mortgages, Notes, and Cash, respectively;
- Schedule D if the gross estate includes any life insurance or if you answered “Yes” to question 8a of Part 4—General Information;
- Schedule E if the gross estate contains any jointly owned property or if you answered “Yes” to question 9 of Part 4;
- Schedule G if the decedent made any of the lifetime transfers to be listed or if you answered “Yes” to question 11 or 12a of Part 4;
- Schedule H if you answered “Yes” to question 13 of Part 4; and
- Schedule I if you answered “Yes” to question 15 of Part 4.

Exclusion

Item 11. Conservation easement exclusion. You must complete and attach Schedule U (along with any required attachments) to claim the exclusion on this line.

Deductions

Items 13 through 21. You must attach the appropriate schedules for the deductions you claim.

Item 17. If item 16 is less than or equal to the value (at the time of the decedent’s death) of the property subject to claims, enter the amount from item 16 on item 17.

If the amount on item 16 is more than the value of the property subject to claims, enter the greater of:
- The value of the property subject to claims or
- The amount actually paid at the time the return is filed.

In no event should you enter more on item 17 than the amount on item 16. See section 2053 and the related regulations for more information.

Schedule A—Real Estate

See the reverse side of Schedule A on Form 706.

Schedule A-1—Section 2032A Valuation

See Schedule A-1 on Form 706.

Schedule B—Stocks and Bonds

Before completing Schedule B, read the examples showing use of Schedule B where the alternate valuation is not adopted (see below) and adopted (see below).

If the total gross estate contains any stocks or bonds, you must complete Schedule B and file it with the return.

On Schedule B, list the stocks and bonds included in the decedent’s gross estate. Number each item in the left-hand column.

Note. Bonds that are exempt from federal income tax are not exempt from estate tax unless specifically exempted by an estate tax provision of the Code. Therefore, you should list these bonds on Schedule B.

Public housing bonds includible in the gross estate must be included at their full value.

If you paid any estate, inheritance, legacy, or succession tax to a foreign country on any stocks or bonds included in this schedule, group those stocks and bonds together and label them "Subjected to Foreign Death Taxes."

List interest and dividends on each stock or bond separately. Indicate as a separate item dividends that have not been collected at death, but which are payable to the decedent or the estate because the decedent was a stockholder of record on the date of death. However, if the stock is being traded on an exchange and is selling ex-dividend on the date of the decedent’s death, do not include the amount of the dividend as a separate item. Instead, add it to the ex-dividend quotation in determining the FMV of the stock on the date of the decedent’s death. Dividends declared on shares of stock before the death of the decedent but payable to stockholders of record on a date after the decedent’s death are not includible in the gross estate for federal estate tax purposes.

Description

Stocks. For stocks, indicate:
- Number of shares;
- Whether common or preferred;
- Issue;
- Par value where needed for identification;
- Price per share;
- Exact name of corporation;
- Principal exchange upon which sold, if listed on an exchange; and

Example showing use of Schedule B where the alternate valuation is not adopted; date of death, January 1, 2009

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description, including face amount of bonds or number of shares and par value where needed for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN.</th>
<th>Unit value</th>
<th>Alternate valuation date</th>
<th>Alternate value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$60,000-Arkansas Railroad Co. first mortgage 4%, 20-year bonds, due 2011. Interest payable quarterly on Feb. 1, May 1, Aug. 1, and Nov. 1; <strong>N.Y. Exchange</strong></td>
<td>XXXXXXXXXX</td>
<td>100</td>
<td>$60,000</td>
</tr>
<tr>
<td></td>
<td>Interest coupons attached to bonds, item 1, due and payable on Nov. 1, 2008, but not cashed at date of death .</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Interest accrued on item 1, from Nov. 1, 2008, to Jan. 1, 2009 .</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2</td>
<td>500 shares Public Service Corp., common; <strong>N.Y. Exchange</strong></td>
<td>XXXXXXXXXX</td>
<td>110</td>
<td>55,000</td>
</tr>
<tr>
<td></td>
<td>Dividend on item 2 of $2 per share declared Dec. 10, 2008, payable on Jan. 9, 2009, to holders of record on Dec. 30, 2008 .</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
### Example showing use of Schedule B where the alternate valuation is adopted; date of death, January 1, 2009

<table>
<thead>
<tr>
<th>Item number</th>
<th>Description, including face amount of bonds or number of shares and par value where needed for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN.</th>
<th>Unit value</th>
<th>Alternate valuation date</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$60,000-Arkansas Railroad Co. first mortgage 4%, 20-year bonds, due 2011. Interest payable quarterly on Feb. 1, May 1, Aug. 1, and Nov. 1; N.Y. Exchange.</td>
<td>100</td>
<td>4/1/09</td>
<td>29,700</td>
<td>$60,000</td>
</tr>
<tr>
<td></td>
<td>$30,000 of item 1 distributed to legatees on Apr. 1, 2009.</td>
<td>99</td>
<td>5/1/09</td>
<td>29,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$30,000 of item 1 sold by executor on May 1, 2009.</td>
<td>98</td>
<td>2/2/09</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest coupons attached to bonds, item 1, due and payable on Nov. 1, 2008, but not cashed at date of death. Cashed by executor on Feb. 2, 2009.</td>
<td>-</td>
<td></td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>500 shares Public Service Corp., common; N.Y. Exchange</td>
<td>110</td>
<td>7/1/09</td>
<td>55,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Not disposed of within 6 months following death.</td>
<td>90</td>
<td>1/9/09</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dividend on item 2 of $2 per share declared Dec. 10, 2008, paid on Jan. 9, 2009, to holders of record on Dec. 30, 2008</td>
<td>-</td>
<td></td>
<td>1,000</td>
<td></td>
</tr>
</tbody>
</table>

- Nine-digit CUSIP number (defined below).

**Bonds.** For bonds, indicate:
- Quantity and denomination;
- Name of obligor;
- Date of maturity;
- Interest rate;
- Interest due date;
- Principal exchange, if listed on an exchange; and
- Nine-digit CUSIP number.

If the gross estate includes any interest in a trust, partnership, or closely held entity, provide the employer identification number (EIN) of the entity in the description column on Schedules B, E, F, G, M, and O, where applicable. You must also provide the EIN of the estate (if any) in the description column on the above-noted schedules, where applicable.

The CUSIP (Committee on Uniform Security Identification Procedure) number is a nine-digit number that is assigned to all stocks and bonds traded on major exchanges and many unlisted securities. Usually, the CUSIP number is printed on the face of the stock certificate. If the CUSIP number is not printed on the certificate, it may be obtained through the company's transfer agent.

**Valuation**

List the FMV of the stocks or bonds. The FMV of a stock or bond (whether listed or unlisted) is the mean between the highest and lowest selling prices quoted on the valuation date. If only the closing selling prices are available, then the FMV is the mean between the quoted closing selling prices on the valuation date and on the trading day before the valuation date.

If there were no sales on the valuation date, figure the FMV as follows.

1. Find the mean between the highest and lowest selling prices on the nearest trading date before and the nearest trading date after the valuation date. Both trading dates must be reasonably close to the valuation date.
2. Prorate the difference between the mean prices to the valuation date.
3. Add or subtract (whichever applies) the prorated part of the difference to or from the mean price figured for the nearest trading date before the valuation date.

If no actual sales were made reasonably close to the valuation date, make the same computation using the mean between the bona fide bid andasked prices instead of sales prices. If actual sales prices or bona fide bid and asked prices are available within a reasonable period of time before the valuation date but not after the valuation date, or vice versa, use the mean between the highest and lowest sales prices or bid and asked prices as the FMV.

For example, assume that sales of stock nearest the valuation date (June 15) occurred 2 trading days before (June 13) and 3 trading days after (June 18). On those days, the mean sale prices per share were $10 and $15, respectively. Therefore, the price of $12 is considered the FMV of a share of stock on the valuation date. If, however, on June 13 and 18, the mean sale prices per share were $15 and $10, respectively, the FMV of a share of stock on the valuation date is $13.

If only closing prices for bonds are available, see Regulations section 20.2031-2(b).

Apply the rules in the section 2031 regulations to determine the value of inactive stock and stock in close corporations. Send with the schedule complete financial and other data used to determine value, including balance sheets (particularly the one nearest to the valuation date) and statements of the net earnings or operating results and dividends paid for each of the 5 years immediately before the valuation date.

Securities reported as of no value, of nominal value, or obsolete should be listed last. Include the address of the company and the state and date of the incorporation. Attach copies of correspondence or statements used to determine the "no value."

If the security was listed on more than one stock exchange, use either the record of the exchange where the security is principally traded or the composite listing of combined exchanges, if available, in a publication of general circulation. In valuing listed stocks and bonds, you should carefully check accurate records to obtain values for the applicable valuation date.

If you get quotations from brokers, or evidence of the sale of securities from the officers of the issuing companies, attach to the schedule copies of the letters furnishing these quotations or evidence of sale.
Schedule C—Mortgages, Notes, and Cash
See the reverse side of Schedule C on Form 706.

Schedule D—Insurance on the Decedent’s Life
See the reverse side of Schedule D on Form 706.

Schedule E—Jointly Owned Property
See the reverse side of Schedule E on Form 706.

Schedule F—Other Miscellaneous Property
See the reverse side of Schedule F on Form 706.

Schedule G—Transfers During Decedent’s Life
Complete Schedule G and file it with the return if the decedent made any of the transfers described in (1) through (5) beginning below through page 16, or if you answered “Yes” to question 11 or 12a of Part 4—General Information.

Report the following types of transfers on this schedule.

1. Certain gift taxes (section 2035(b)). Enter at Item A of Schedule G the total value of the gift taxes that were paid by the decedent or the estate on gifts made by the decedent or the decedent’s spouse within 3 years of death.

The date of the gift, not the date of payment of the gift tax, determines whether a gift tax paid is included in the gross estate under this rule. Therefore, you should carefully examine the Forms 706 filed by the decedent and the decedent’s spouse to determine what part of the total gift taxes reported on them was attributable to gifts made within 3 years of death.

For example, if the decedent died on July 10, 2005, you should examine gift tax returns for 2009, 2008, 2007, and 2006. However, the gift taxes on the 2006 return that are attributable to gifts made on or before July 10, 2006, are not included in the gross estate.

Attach an explanation of how you computed the includible gift taxes if you do not include in the gross estate the entire gift taxes shown on any Form 706 filed for gifts made within 3 years of death. Also attach copies of any pertinent gift tax returns filed by the decedent’s spouse for gifts made within 3 years of death.

2. Other transfers within 3 years of death (section 2035(a)). These transfers include only the following:
   • Any transfer by the decedent with respect to a life insurance policy within 3 years of death;
   • Any transfer within 3 years of death of a retained section 2036 life estate, section 2037 reversionary interest, or section 2038 power to revoke, etc., if the property subject to the life estate, interest, or power would have been included in the gross estate had the decedent continued to possess the life estate, interest, or power until death.

These transfers are reported on Schedule G, regardless of whether a gift tax return was required to be filed for them when they were made. However, the amount includible and the information required to be shown for the transfers are determined:
   • For insurance on the life of the decedent the using the instructions to Schedule F (attach Forms 712);
   • For insurance on the life of another using the instructions to Schedule F (attach Forms 712); and
   • For sections 2036, 2037, and 2038 transfers, using paragraphs (3), (4), and (5) of these instructions.

3. Transfers with retained life estate (section 2036). These transfers are by the decedent in which the decedent retained an interest in the transferred property. The transfer can be in trust or otherwise, but excludes any transfer made by the decedent, the decedent’s spouse, or any other person, to designate the persons who shall receive the income from, or possess or enjoy, the property.

Retained annuity, unitrust, and other income interests in trusts. If a decedent transferred property into a trust and retained or reserved the right to use such property, or the right to an annuity, unitrust, or other interest in such trust for the property decedent so transferred for decedent’s life, any period not ascertainable without reference to the decedent’s death, or for a period that does not, in fact, end before the decedent’s death, then the decedent’s right to use the property or the retained annuity, unitrust, or other interest (whether payable from income or principal) is the retention of the possession or enjoyment of the property for the right to the income from, the property for purposes of section 2036. See Regulations section 20.2036-1(c)(2).

Retained voting rights. Transfers with a retained life estate also include transfers of stock in a controlled corporation after June 22, 1976, if the decedent retained or acquired voting rights in the stock. If the decedent retained direct or indirect voting rights in a controlled corporation, the decedent is considered to have retained enjoyment of the transferred property. A corporation is a controlled corporation if the decedent owned (actually or constructively) or had the right (either alone or with any other person) to vote at least 20% of the total combined voting power of all classes of stock. See section 2036(b). If these voting rights ceased or were relinquished within 3 years of the decedent’s death, the corporate interests are included in the gross estate as if the decedent had actually retained the voting rights until death.

The amount includible in the gross estate is the value of the transferred property at the time of the decedent’s death if the transfer was made directly to the property or left to the property. If the property included an interest or right to only a part of the transferred property, the amount includible in the gross estate is a corresponding part of the entire value of the property.

A retained life estate does not have to be legally enforceable. What matters is that a substantial economic benefit was retained. For example, if a mother transferred title to her home to her daughter but with the informal understanding that she was to continue living there until her death, the value of the home would be includible in the mother’s estate even if the agreement would not have been legally enforceable.

4. Transfers taking effect at death (section 2037). A transfer that takes effect at the decedent’s death is one under which possession or enjoyment can be obtained only by surviving the decedent. A transfer is not treated as one that takes effect at the decedent’s death unless the decedent retained a reversionary interest (defined below) in the property that immediately before the decedent’s death had a value of more
than 5% of the value of the transferred property. If the transfer was made before October 8, 1949, the reversionary interest must have arisen by the express terms of the instrument of transfer.

A reversionary interest is generally any right under which the transferred property will or may be returned to the decedent or the decedent’s estate. It also may be created by modifying the transferred property may become subject to a power of disposition by the decedent. It does not matter if the right arises by the express terms of the instrument of transfer or by operation of law. For this purpose, reversionary interest does not include the possibility that the income alone from the property may return to the decedent or become subject to the decedent’s power of disposition.

5. Revocable transfers (section 2038). The gross estate includes the value of transferred property in which the enjoyment of the transferred property was subject at decedent’s death to any change through the exercise of a power to alter, amend, revoke, or terminate. A decedent’s power to change the beneficiaries and to hasten or increase any beneficiary’s enjoyment of the property are examples of this. It does not matter whether the power was reserved at the time of the transfer, whether it arose by operation of law, or whether it was later created or conferred. The rule applies regardless of the source from which the power was acquired, and regardless of whether the power was exercisable by the decedent alone or with any person (and regardless of whether that person had a substantial adverse interest in the transferred property).

The capacity in which the decedent could use a power has no bearing. If the decedent gave property in trust and was the trustee with the power to revoke the trust, the property would be included in his or her gross estate. For transfers of additional property, an irrevocable trust after October 28, 1979, the transferred property is includible if the decedent reserved the power to remove the trustee at will and appoint another trustee.

If the decedent relinquished within 3 years of death any of the includible powers described above, figure the gross estate as if the decedent had actually retained the powers until death.

Only the part of the transferred property that is subject to the decedent’s power is included in the gross estate.

For more detailed information on which transfers are includible in the gross estate, see the Estate Tax Regulations.

Special Valuation Rules for Certain Lifetime Transfers

Sections 2701 through 2704 provide rules for valuing certain transfers to family members.

Section 2701 deals with the transfer of an interest in a corporation or partnership while retaining certain distribution rights, or a liquidation, put, call or similar right.

Section 2702 deals with the transfer of an interest in a trust while retaining any interest other than a qualified interest. In general, a qualified interest is a right to receive certain distributions from the trust at least annually, or a noncontingent remainder interest if all of the other interests in the trust are distribution rights specified in section 2702.

Section 2703 provides rules for the valuation of property transferred to a family member but subject to an option, agreement, or other right to acquire or use the property at less than FMV. It also applies to transfers subject to restrictions on the right to sell or use the property.

Finally, section 2704 provides that in certain cases, the lapse of a voting or liquidation right in a family-owned corporation or partnership will result in a deemed transfer.

These rules have potential consequences for the valuation of property in an estate. If the decedent (or any member of his or her family) involved in any such transactions, see sections 2701 through 2704 and the related regulations for additional details.

How To Complete Schedule G

All transfers (other than outright transfers not in trust and bona fide sales) made by the decedent at any time during life must be reported on Schedule G, regardless of whether you believe the transfers are subject to tax. If the decedent made any transfers not described in the instructions beginning on page 15, the transfers should not be shown on Schedule G. Instead, attach a statement describing these transfers by listing:

- The date of the transfer,
- The amount or value of the transferred property, and
- The type of transfer.

Complete the schedule for each transfer that is included in the gross estate under sections 2035(a), 2036, 2037, and 2038 as described in the Instructions for Schedule G beginning on page 15.

In the “Item number” column, number each transfer consecutively beginning with “1.” In the “Description” column, list the name of the transferee and the date of the transfer, and give a complete description of the property. Transfers included in the gross estate should be valued on the date of the decedent’s death or, if alternate valuation is adopted, according to section 2032.

If only part of the property transferred meets the terms of section 2035(a), 2036, 2037, or 2038, then only the part of the value of the property should be included in the value of the gross estate. If the transferee makes additions or improvements to the property, the increased value of the property at the valuation date should not be included on Schedule G. However, if only a part of the value of the property is included, enter the value of the whole under the column headed “Description” and explain what part was included.

Attachments. If a transfer, by trust or otherwise, was made by a written instrument, attach a copy of the instrument to Schedule G. If the copy of the instrument is of public record, it should be certified; if not of public record, the copy should be verified.

Schedule H—Powers of Appointment

Complete Schedule H and file it with the return if you answered “Yes” to question 13 of Part 4—General Information.

On Schedule H, include in the gross estate:

- The value of property for which the decedent possessed a general power of appointment (defined below) on the date of his or her death and
- The value of property for which the decedent possessed a general power of appointment that he or she exercised or released before death by disposing of it in such a way that if it were a transfer of property owned by the decedent, the property would be includible in the decedent’s gross estate as a transfer with a retained life estate, a transfer taking effect at death, or a revocable transfer.

With the above exceptions, property subject to a power of appointment is not includible in the gross estate if the decedent released the power completely and the decedent held no interest in or control over the property.

If the failure to exercise a general power of appointment results in a lapse of the power, the lapse is treated as a release only to the extent that the value of the property that could have been appointed by the exercise of the lapsed power is more than the greater of $5,000 or 5% of the total value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could have been satisfied.
Powers of Appointment
A power of appointment determines who will own or enjoy the property subject to the power and when they will own or enjoy it. The power must be created by someone other than the decedent. It does not include a power created or held on property transferred by the decedent.

A power of appointment includes all powers which are, in substance and effect, powers of appointment regardless of how they are identified and regardless of local property laws. For example, if a settlor transfers property in trust for the life of his wife, with a power in the wife to appropriate or consume the principal of the trust, the wife has a power of appointment.

Some powers do not in themselves constitute a power of appointment. For example, a power created only to administer provisions of a trust that cannot substantially affect the beneficial enjoyment of the trust property or income is not a power of appointment. A power to manage, invest, or control assets, or to allocate receipts and disbursements, when exercised only in a fiduciary capacity, is not a power of appointment.

General power of appointment. A general power of appointment is a power that is exercisable in favor of the decedent, the decedent’s estate, the decedent’s creditors, or the creditors of the decedent’s estate.

1. A power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent.
2. A power exercisable by the decedent only in conjunction with:
   a. the creator of the power or
   b. a person who has a substantial interest in the property subject to the power and adverse to the exercise of the power in favor of the decedent.

A part of a power is considered a general power of appointment if the power:
1. May only be exercised by the decedent in conjunction with another person and
2. Is also exercisable in favor of the other person (in addition to being exercisable in favor of the decedent, the decedent’s creditors, the decedent’s estate, or the creditors of the decedent’s estate).

The part to include in the gross estate as a general power of appointment is figured by dividing the value of the property by the number of persons (including the decedent) in favor of whom the power is exercisable.

Date power was created. Generally, a power of appointment created by will is considered created on the date of the testator’s death.

A power of appointment created by an inter vivos instrument is considered created on the date the instrument takes effect. If the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first.

Attachments
If the decedent ever possessed a power of appointment, attach a certified or verified copy of the instrument granting the power and a certified or verified copy of any instrument by which the power was exercised or released. You must file these copies even if you contend that the power was not a general power of appointment, and that the property is not otherwise includible in the gross estate.

Schedule I—Annuities
You must complete Schedule I and file it with the return if you answered “Yes” to question 15 of Part 4—General Information.

Enter on Schedule I every annuity that meets all of the conditions under General, below, and every annuity described in paragraphs (a) through (h) of Annuities Under Approved Plans on page 18, even if the annuities are wholly or partially excluded from the gross estate.

For a discussion regarding the QTIP treatment of certain joint and survivor annuities, see the Form 706 itself, Schedule M, line 3 instructions.

General
In general, you must include in the gross estate all or part of the value of any annuity that meets the following requirements:

- It is receivable by a beneficiary following the death of the decedent and by reason of surviving the decedent.
- The annuity is under a contract or agreement entered into after March 3, 1921;
- The annuity was payable to the decedent (or the decedent possessed the right to receive the annuity) either alone or in conjunction with another, for the decedent’s life or for any period not ascertainable without reference to the decedent’s death or for any period that did not in fact end before the decedent’s death; and
- The contract or agreement is not a policy of insurance on the life of the decedent.

These rules apply to all types of annuities, including pension plans, individual retirement arrangements, purchased commercial annuities, and private annuities.

Note. A private annuity is an annuity issued from a party not engaged in the business of writing annuity contracts, typically a junior generation family member or a family trust.

An annuity contract that provides periodic payments to a person for life and ceases at the person’s death is not includible in the gross estate. Social security benefits are not includible in the gross estate even if the surviving spouse receives benefits.

An annuity or other payment that is not includible in the decedent’s or the surviving spouse’s gross estate is also not includible in the gross estate of any other transferee, even if the transfer was made after death.

Part Includible
If the decedent contributed only part of the purchase price of the contract or agreement, include in the gross estate only that part of the value of the annuity receivable by the surviving beneficiary that the decedent’s contribution to the purchase price of the annuity or agreement bears to the total purchase price.

For example, if the value of the survivor’s annuity was $20,000 and the decedent had contributed three-fourths of the purchase price of the contract, the amount includible is $15,000 (74 × $20,000).

Except as provided under Annuities Under Approved Plans on page 18, contributions made by the decedent’s employer to the purchase price of the contract or agreement are considered made by the decedent if they were made by the employer because of the decedent’s employment. For more information, see section 2039.

Definitions
Annuity. The term “annuity” includes one or more payments extending over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic.

Examples. The following are examples of contracts (but not necessarily the only forms of contracts) for annuities that must be included in the gross estate.

1. A contract under which the decedent immediately before death was receiving or was entitled to receive, for the duration of life, an annuity with payments to continue after death to a designated beneficiary, if surviving the decedent.
2. A contract under which the decedent immediately before death was receiving or was entitled to receive, together with another person, an annuity payable to the decedent and the other person for their joint lives, with payments to continue to the survivor following the death of either.

3. A contract or agreement entered into by the decedent and employer under which the decedent immediately before death and following retirement was receiving, or was entitled to receive, an annuity payable to the decedent for life and after the decedent’s death to a designated beneficiary, if surviving the decedent, whether the payments after the decedent’s death are fixed by the contract or subject to an option or election exercised or exercisable by the decedent. However, see Annuities Under Approved Plans below.

4. A contract or agreement entered into by the decedent and the decedent’s employer under which at the decedent’s death, before retirement, or before the expiration of a stated period of time, an annuity was payable to a designated beneficiary, if surviving the decedent. However, see Annuities Under Approved Plans below.

5. A contract or agreement under which the decedent immediately before death was receiving, or was entitled to receive, an annuity for a stated period of time, with the annuity to continue to a designated beneficiary, surviving the decedent, upon the decedent’s death and before the expiration of that period of time.

6. An annuity contract or other arrangement providing for a series of substantially equal periodic payments to be made to a beneficiary for life or over a period of at least 30 months after the date of the decedent’s death under an individual retirement account, annuity, or bond as described in section 2039(e) (before its repeal by P.L. 98-369).

Payable to the decedent. An annuity or other payment was payable to the decedent if, at the time of death, the decedent had the right to receive an annuity or other payment immediately before death, the decedent had an enforceable right to receive payments at some time in the future, whether or not at the time of death the decedent had a present right to receive payments.

Annuities Under Approved Plans

The following rules relate to whether part or all of an otherwise includible annuity may be excluded. These rules have been repealed and apply only if the decedent is either:

- On December 31, 1984, was both a participant in the plan and in pay status (for example, had received at least one benefit payment on or before December 31, 1984) and had irrevocably elected the form of the benefit before July 18, 1984.
- Had separated from service before January 1, 1985, and did not change the form of benefit before death.

The amount excluded cannot exceed $100,000 unless either of the following conditions is met:

- On December 31, 1982, the decedent was both a participant in the plan and in pay status (for example, had received at least one benefit payment on or before December 31, 1982) and the decedent irrevocably elected the form of the benefit before January 1, 1983.
- The decedent separated from service before January 1, 1983, and did not change the form of benefit before death.

Approved Plans

Approved plans may be separated into two categories:

- Pension, profit-sharing, stock bonus, and other similar plans and
- Individual retirement arrangements (IRAs), and retirement bonds.

Different exclusion rules apply to the two categories of plans.

Pension, etc., plans.

The following plans are approved plans for the exclusion rules:

- an employee’s trust (or under a plan with a similar plan to one described in section 403(a); or
- a retirement annuity contract purchased (but not by an employer that is an organization referred to in section 706(b)(1)[(ii)(A)(ii) or (vii)], or that is a religious organization (other than a trust), and that is exempt from tax under section 501(a); or
- a bond purchase plan described in section 403(b) (before its repeal by P.L. 98-369, effective for obligations issued after December 31, 1983).

Exclusion rules for pension, etc., plans.

If an annuity under an “approved plan” described in (a) through (e) above is receivable by a beneficiary other than the executor and the decedent made no contributions under the plan toward the cost, no part of the value of the annuity, subject to the $100,000 limitation (if applicable), is includible in the gross estate.

If the decedent made a contribution under a plan described in (a) through (e) above toward the cost, include in the gross estate on this schedule that portion of the amount of the annuity which the amount of the decedent’s contribution under the plan bears to the total amount of all contributions under the plan. The remaining value of the annuity is excludable from the gross estate subject to the $100,000 limitation (if applicable). For the rules to determine whether the decedent made contributions to the plan, see Regulations section 20.2039.

IRAs and retirement bonds.

The following plans are approved plans for the exclusion rules:

f. An individual retirement account described in section 408(a),

g. An individual retirement annuity described in section 408(b), or

h. A retirement bond described in section 409(a) (before its repeal by P.L. 98-369).

Exclusion rules for IRAs and retirement bonds.

These plans are approved plans only if they provide for a series of substantially equal periodic payments made to a beneficiary for life, or over a period of at least 36 months after the date of the decedent’s death.

Subject to the $100,000 limitation, if applicable, an annuity under a “plan” described in (f) through (h) above is receivable by a beneficiary other than the executor, the entire value of the annuity is excludable from the gross estate even if the decedent made a contribution under the plan.

However, if any payment to or for an account or annuity described in paragraphs (f), (g), or (h) above was not allowable as an income tax deduction under section 219 (and was not a rollover contribution), the amount not allowable as a deduction under section 219 and not a rollover contribution bears to the total amount paid to or for such account or annuity. For more information, see Regulations section 20.2039-5.

Rules applicable to all approved plans.

The following rules apply to all approved plans described in paragraphs (a) through (h) above.
If any part of an annuity under a "plan" described in (a) through (h) above is receivable by the executor, it is generally includible in the gross estate on this schedule to the extent that it is receivable by the executor in that capacity. In general, the annuity is receivable by the executor if it is to be paid to the executor or if there is an agreement (expressed or implied) that it will be applied by the beneficiary for the benefit of the estate (such as in discharge of the estate’s liability for death taxes or debts of the decedent, etc.) or that its distribution will be governed to any extent by the terms of the decedent’s will or the laws of descent and distribution.

If data available to you does not indicate whether the plan satisfies the requirements of section 401(a), 403(a), 408(a), 408(b), or 409(a), you may obtain that information from the IRS where the employer’s principal place of business is located.

Line A. Lump Sum Distribution Election

Note. The following rules have been repealed and apply only if the decedent:

1. On December 31, 1984, was both a participant in the plan and in pay status (for example, had received at least one benefit payment on or before December 31, 1984) and had irrevocably elected the form of benefit before July 18, 1984, or
2. Had separated from service before January 1, 1985, and did not change the form of benefit before death.

Generally, the entire amount of any lump sum distribution is included in the decedent’s gross estate. However, under this special rule, all or part of a lump sum distribution from an approved plan will be excluded if the lump sum distribution is included in the recipient’s income for income tax purposes.

If the decedent was born before 1936, the recipient may be eligible to elect special "10-year averaging" rules (under repealed section 402(e)) and capital gain treatment (under repealed section 402(a)(2)) in computing the income tax on the distribution. For more information, see Pub. 575, Pension and Annuity Income. If this option is available, the estate tax exclusion cannot be claimed unless the recipient elects to forego the "10-year averaging" and capital gain treatment in computing the income tax on the distribution. The recipient elects to forego this treatment by treating the distribution as taxable on his or her income tax return as described in Regulations section 20.2039-4(d). The election is irrevocable.

The amount excluded from the gross estate is the portion attributable to the employer contributions. The portion, if any, attributable to the employee-decedent’s contributions is always includible. Also, you may not compute the gross estate in accordance with this election unless you check “Yes” on line A and attach the name, address, and identifying number of the recipients of the lump sum distributions. See Regulations section 20.2039-4.

How To Complete Schedule I

In describing an annuity, give the name and address of the grantor of the annuity. Specify if the annuity is under an approved plan.

Schedule J—Funeral Expenses and Expenses Incurred in Administering Property

Subject to Claims

See the reverse side of Schedule J on Form 706.

Schedule K—Debts of the Decedent and Mortgages and Liens

You must complete and attach Schedule K if you claimed deductions on either item 14 or item 15 of Part 5 — Recapitulation.

Income vs. estate tax deduction. Taxes, interest, and business expenses accrued at the date of the decedent’s death are deductible both on Schedule K and as deductions in respect of the decedent on the income tax return of the estate.

If you choose to deduct medical expenses of the decedent only on the estate tax return, they are fully deductible as claims against the estate. If, however, they are claimed on the decedent’s final income tax return under section 213(c), they may not also be claimed on the estate tax return. In this case, you also may not deduct on the estate tax return any amounts that were not deductible on the income tax return because of the percentage limitations.

Debts of the Decedent

List under “Debts of the Decedent” only valid debts the decedent owed at the time of death. List any indebtedness secured by a mortgage or other lien on property of the gross estate under the heading “Mortgages and Liens.” If the amount of the debt is disputed or the subject of litigation, deduct only the amount the estate concedes to be a valid claim. Enter the amount in contest in the column provided.

Generally, if the claim against the estate is based on a promise or agreement, the deduction is limited to the extent that the liability was contracted before the date and for an adequate and full consideration in money or money’s worth. However, any enforceable claim based on a promise or agreement of the decedent to make a contribution or gift (such as a pledge or a subscription) to or for the use of a charitable, public, religious, or educational organization is deductible to the extent that the deduction would be allowed as a bequest under the statute that applies.

Schedule K

Certain claims of a former spouse against the estate based on the relinquishment of marital rights are
Net Losses During Administration

You may deduct only those losses from thefts, fires, storms, shipwrecks, or other casualties that occurred during the settlement of the estate. You may deduct only the amount not reimbursed by insurance or otherwise.

Describe in detail the loss sustained and the cause. If you received insurance or other compensation for the loss, state the amount collected. Identify the property to which you are claiming the loss by indicating the particular schedule and item number where the property is included in the gross estate.

If you elect alternate valuation, do not deduct the amount by which you reduced the value of an item to include it in the gross estate.

Do not deduct losses claimed as a deduction on a federal income tax return or depreciation in the value of securities or other property.

Expenses Incurred in Administering Property Not Subject to Claims

You may deduct expenses incurred in administering property that is included in the gross estate but that is not subject to claims. You may only deduct these expenses if they were paid before the section 6501 period of limitations for assessment expired.

The expenses deductible on this schedule are usually expenses incurred in the administration of a trust established by the decedent before death. They may also be incurred in the collection of other assets or the transfer of title to other property included in the decedent’s gross estate for estate tax purposes, but not included in the decedent’s probate estate.

The expenses deductible on this schedule are limited to those that are the result of settling the decedent’s interest in the property or of vesting good title to the property in the beneficiaries. Expenses incurred on behalf of the transferees (except those described above) are not deductible. Examples of deductible and nondeductible expenses are provided in Regulations section 20.2053-8.

List the names and addresses of the persons to whom each expense was payable and the nature of the expense. Identify the property for which the expense was incurred by indicating the schedule and item number where the property is included in the gross estate. If you do not know the exact amount of the expense, you may deduct an estimate, provided that the amount may be verified with reasonable certainty and will be paid before the period of...
limitations for assessment (referred to above) expires. Keep all vouchers and receipts for inspection by the IRS.

Schedule M—Bequests, etc., to Surviving Spouse
(Marital Deduction)
See the Form 706 itself for these instructions.

Schedule O—Charitable, Public, and Similar Gifts
and Bequests

General
You must complete Schedule O and file it with the return if you claim a deduction on item 21 of Part 5—Recapitulation.

You can claim the charitable deduction allowed under section 2055 for the value of property in the decedent’s gross estate that was transferred by the decedent during life or by will to or for the use of any of the following:

• The United States, a state, a political subdivision of a state, or the District of Columbia, for exclusively public purposes;
• Any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment, unless the organization is a qualified amateur sports organization) and the prevention of cruelty to children and animals, as long as no part of the net earnings benefits any private individual and no substantial activity is undertaken to carry on propaganda, or otherwise attempt to influence legislation or participate in any political campaign on behalf of any candidate for public office;
• A trustee or a fraternal society, order or association operating under the lodging system, if the transferred property is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, and no substantial activity is undertaken to carry on propaganda or otherwise attempt to influence legislation, or participate in any political campaign on behalf of any candidate for public office;
• Any veterans organization incorporated by an Act of Congress or any of its departments, local chapters, or posts, for which none of the net earnings benefits any private individual; or
• A foreign government or its political subdivision when the use of such property is limited exclusively to charitable purposes.

For this purpose, certain Indian tribal governments are treated as states and transfers to them qualify as deductible charitable contributions. See Rev. Proc. 2008-55, 2008-39 I.R.B. 768, as modified and supplemented by subsequent Revenue Rulings and procedures, for a list of qualifying Indian tribal governments.

You may also claim a charitable contribution deduction for a qualifying conservation easement granted after the decedent’s death under the provisions of section 2031(c)(9).

The charitable deduction is allowed for amounts that are transferred to charitable organizations as a result of either a qualified disclaimer (see Line 2. Qualified Disclaimer below) or the complete termination of a power to consume, invade, or appropriate property for the benefit of an individual. It does not matter whether termination occurs because of the death of the individual or in any other way. The termination must occur within the period of time (including extensions) for filing the decedent’s estate tax return and before the power has been exercised.

The deduction is limited to the amount actually available for charitable uses. Therefore, if under the terms of a will or the provisions of local law, or for any other reason, the federal estate tax, the federal GST tax, or any other estate, GST, succession, legacy, or inheritance tax is payable in whole or in part out of any bequest, legacy, or devise that would otherwise be allowed as a charitable deduction, the amount you may deduct is the amount of the bequest, legacy, or devise reduced by the total amount of the taxes.

If you elected to make installment payments of the estate tax, and the interest is payable out of property transferred to charity, you must reduce the charitable deduction by an estimate of the maximum amount of interest that will be paid on the deferred tax.

For split-interest trusts (or pooled income funds), enter in the “Amount” column the amount treated as passing to the charity. Do not enter the entire amount that passes to the trust (fund).

If you are deducting the value of the residue or a part of the residue passing to charity under the decedent’s will, attach a copy of the computation showing how you determined the value, including any Schedule for the taxes described above.

Also include:

• A statement that shows the values of all specific and general legacies or devises for both charitable and noncharitable uses. For each legacy or devise, indicate the paragraph or section of the decedent’s will or codicil that applies. If legacies are made to each member of a class (for example, $1,000 to each of the decedent’s employees), show only the number of each class and the total value of property they received;
• The date of birth of all life tenants or annuitants, the length of whose lives may affect the value of the interest passing to charity under the decedent’s will;
• A statement showing the value of all property that is included in the decedent’s gross estate but does not pass under the will, such as transfers, jointly owned property that passed to the survivor on decedent’s death, and insurance payable to specific beneficiaries; and
• Any other important information such as that relating to any claim, not arising under the will, to any part of the estate (that is, a spouse claiming dower or curtesy, or similar rights).

Line 2. Qualified Disclaimer
The charitable deduction is allowed for amounts that are transferred to charitable organizations as a result of a qualified disclaimer. To be a qualified disclaimer, a refusal to accept an interest in property must meet the conditions of section 2518. These are explained in Regulations sections 25.2518-1 through 25.2518-3. If property passes to a charitable beneficiary as a result of a qualified disclaimer, check the “Yes” box on line 2 and attach a copy of the written disclaimer required by section 2518(b).

Attachments
If the charitable transfer was made by will, attach a certified copy of the order admitting the will to probate, in addition to the copy of the will. If the charitable transfer was made by any other written instrument, attach a copy. If the instrument is of record, the copy should be certified; if not, the copy should be verified.

Value
The valuations dates used in determining the value of the gross estate apply also on Schedule O.

Schedule P—Credit for Foreign Death Taxes

General
If you claim a credit on line 13 of Part 2—Tax Computation, you must complete Schedule P and file it with the return. You must attach Form(s) 706-CE to support any credit you claim.

If the foreign government refuses to certify Form 706-CE, you must file it directly with the IRS as instructed on the Form 706-CE. See Form 706-CE.
for instructions on how to complete the form and for a description of the items that must be attached to the form when the foreign government refuses to certify it.

The credit for foreign death taxes is allowable only if the decedent was a citizen or resident of the United States. However, see section 2053(d) and the related regulations for exceptions and limitations if the executor has elected, in certain cases, to deduct these taxes from the value of the gross estate. For a resident, not a citizen, who was a citizen or subject of a foreign country for which the President has issued a proclamation under section 2014(h), the credit is allowable only if the country of which the decedent was a national allows a similar credit to decedents who were U.S. citizens residing in that country.

The credit is authorized either by statute or by treaty. If a credit is authorized by a treaty, whichever of the following is the most beneficial to the estate is allowed:

- The credit computed under the treaty;
- The credit computed under the statute; or
- The credit computed under the treaty, plus the credit computed under the statute for death taxes paid to each political subdivision or possession of the treaty country that are not directly or indirectly creditable under the treaty.

Under the statute, the credit is authorized for all death taxes (national and local) imposed in the foreign country. Whether local taxes are the basis for a credit under a treaty depends upon the provisions of the particular treaty.

If a credit for death taxes paid in more than one foreign country is allowable, a separate computation of the credit must be made for each foreign country. The copies of Schedule P on which the additional computations are made should be attached to the copy of Schedule P provided in the return.

The total credit allowable in respect to any property, whether subjected to tax by one or more than one foreign country, is limited to the amount of the federal estate tax attributable to the property. The anticipated amount of the credit may be computed on the return, but the credit cannot finally be allowed until the foreign tax has been paid and a Form 706-CE evidencing payment is filed. Section 2014(g) provides that for credits for foreign death taxes, each U.S. possession is deemed a foreign country.

Convert death taxes paid to the foreign country into U.S. dollars by using the rate of exchange in effect at the time each payment of foreign tax is made.

If a credit is claimed for any foreign death tax that is later recovered, see Regulations section 20.2016-1 for the notice required within 30 days.

Limitation Period

The credit for foreign death taxes is limited to those taxes that were actually paid and for which a credit was claimed within the later of the 4 years after the filing of the estate tax return, or before the date of expiration of any extension of time for payment of the federal estate tax, or 60 days after a final decision of the Tax Court on a timely filed petition for a redetermination of a deficiency.

Credit Under the Statute

For the credit allowed by the statute, the question of whether particular property is situated in the foreign country imposing the tax is determined by the same principles that would apply in determining whether similar property of a nonresident not a U.S. citizen is situated within the United States for purposes of the federal estate tax. See the instructions for Form 706-NA.

Computation of Credit Under the Statute

Item 1. Enter the amount of the estate, inheritance, legacy, and succession taxes paid to the foreign country and its possessions or political subdivisions, attributable to property that is:

- Situated in that country,
- Subjected to these taxes, and
- Included in the gross estate.

The amount entered at item 1 should not include any tax paid to the foreign country for property not situated in that country and should not include any tax paid to the foreign country for property not included in the gross estate. If only a part of the property subjected to foreign taxes is both situated in the foreign country and included in the gross estate, it will be necessary to determine the portion of the taxes attributable to that part of the property. Also, attach the computation of the amount entered at item 1.

Item 2. Enter the value of the gross estate, less the total of the deductions on items 20 and 21 of Part 5—Recapitulation.

Item 3. Enter the value of the property situated in the foreign country that is subjected to the foreign taxes and included in the gross estate, less those portions of the deductions taken on Schedules M and O that are attributable to the property.

Item 4. Subtract any credit claimed on line 15 for federal gift taxes on pre-1977 gifts (section 2012) from line 12 of Part 2—Tax Computation, and enter the balance at item 4 of Schedule P.

Credit Under Treaties

If you are reporting any items on this return based on the provisions of a death tax treaty, you may have to attach a statement to this return disclosing the return position that is treaty based. See Regulations section 201.6114-1 for details.

In general. If the provisions of a treaty apply to the estate of a U.S. citizen or resident, a credit is authorized for payment of the foreign death tax or taxes specified in the treaty. Treaties with death tax conventions are in effect with the following countries: Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Switzerland, and the United Kingdom.

A credit claimed under a treaty is in general computed on Schedule P in the same manner as the credit is computed under the statute with the following principal exceptions:

- The situs rules contained in the treaty apply in determining whether property was situated in the foreign country;
- The credit may be allowed only for payment of the death tax or taxes specified in the treaty (but see the instructions above for credit under the statute for death taxes paid to each political subdivision or possession of the treaty country that are not directly or indirectly creditable under the treaty);
- If specifically provided, the credit is proportionately shared for the tax applicable to property situated outside both countries, or that was deemed in some instances situated within both countries; and
- The amount entered at item 4 of Schedule P is the amount shown on line 12 of Part 2—Tax Computation, less the total of the credits claimed for federal gift taxes on pre-1977 gifts (section 2012) and for tax on prior transfers (line 14 of Part 2—Tax Computation). (If a credit is claimed for tax on prior transfers, it will be necessary to complete Schedule Q before completing Schedule P.) For examples of computation of credits under the treaties, see the applicable regulations.

Computation of credit in cases when property is situated outside both countries or deemed situated within both countries. See the appropriate treaty for details.

Schedule Q—Credit for Tax on Prior Transfers

General
You must complete Schedule Q and file it with the return if you claim a credit on Part 2—Tax Computation, line 14.

The term "transferee" means the decedent for whose estate this return is
filed. If the transferee received property from a transferor who died within 10 years before, or 2 years after, the transferor, a credit is allowable on this return for all or part of the federal estate tax paid by the transferor’s estate for the transfer. There is no requirement that the property be identified in the estate of the transferee or that it exist on the date of the transferee’s death. It is sufficient for the allowance of the credit that the transfer of the property was subjected to federal estate tax in the estate of the transferor and that the specified period of time has not elapsed. A credit may be allowed for property received as the result of the exercise or nonexercise of a power of appointment when the property is included in the gross estate of the donee of the power.

If the transferee was the transferor’s surviving spouse, no credit is allowed for property received from the transferor to the extent that a marital deduction was allowed to the transferor’s estate for the property. There is no credit for tax on prior transfers for federal gift taxes paid in connection with the transfer of the property to the transferee.

If you are claiming a credit for tax on prior transfers on Form 706-NA, you should first complete and attach Part 5—Recapitulation from Form 706 before computing the credit on Schedule Q from Form 706.

Section 2056(d)(3) contains specific rules for allowing a credit for certain transfers to a spouse who was not a U.S. citizen where the property passed outright to the spouse, or to a qualified domestic trust.

The term “property” includes any interest (legal or equitable) of which the transferee received the beneficial ownership. The transferee is considered the beneficial owner of property over which the transferee received a general power of appointment. Property does not include interests to which the transferee received only a bare legal title, such as that of a trustee. Neither does it include an interest in property over which the transferee received a power of appointment that is not a general power of appointment. In addition to interests in which the transferee received the complete ownership, the credit may be allowed for annuities, life estates, terms for years, remainder interests (whether contingent or vested), and any other interest that is less than the complete ownership of the property, to the extent that the transferee became the beneficial owner of the interest.

Maximum Amount of the Credit
The maximum amount of the credit is the smaller of:
1. The amount of the estate tax of the transferor’s estate attributable to the transferred property or
2. The amount by which:
   a. An estate tax on the transferor’s estate determined without the credit for tax on prior transfers exceeds
   b. An estate tax on the transferor’s estate determined by excluding from the gross estate the net value of the transfer.

If credit for a particular foreign death tax may be taken under either the statute or a death duty convention, and on this return the credit actually is taken under the convention, then no credit for that foreign death tax may be taken into consideration in computing estate tax (a) or estate tax (b), above.

Percent Allowable
Where transferee predeceased the transferor. If no more than 2 years elapsed between the dates of death, the credit allowed is 100% of the maximum amount. If more than 2 years elapsed between the dates of death, no credit is allowed.

Where transferor predeceased the transferee. The percent of the maximum amount that is allowed as a credit depends on the number of years that elapsed between dates of death. It is determined using the following table:

<table>
<thead>
<tr>
<th>Period of Time Exceeding</th>
<th>Not Exceeding</th>
<th>Percent Allowable</th>
</tr>
</thead>
<tbody>
<tr>
<td>- - - - - - 2 years</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>2 years</td>
<td>80</td>
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<tr>
<td>4 years</td>
<td>60</td>
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<tr>
<td>6 years</td>
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<tr>
<td>8 years</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>10 years</td>
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<td></td>
</tr>
</tbody>
</table>

How To Compute the Credit
A worksheet for Schedule Q is provided on page 31 of these instructions to allow you to compute the limits before completing Schedule Q. Transfer the appropriate amounts from the worksheet to Schedule Q as indicated on the schedule. You do not need to file the worksheet with your Form 706, but you should keep it for your records.

Cases involving transfers from two or more transferors. Part I of the worksheet and Schedule Q enable you to compute the credit for as many as three transfers. The number of transfers is irrelevant to Part II of the worksheet. If you are computing the credit for more than three transfers, use more than one worksheet and Schedule Q, Part I, and combine the totals for the appropriate lines.

Section 2032A additional tax. If the transferor's estate elected special-use valuation and the additional estate tax of section 2032A(c) was imposed at any time up to 2 years after the death of the decedent for whom you are filing this return, check the box on Schedule Q. On lines 1 and 9 of the worksheet, include the property subject to the additional estate tax at its FMV rather than its special-use value. On line 10 of the worksheet, include the additional estate tax paid as a federal estate tax paid.

How To Complete the Schedule Q Worksheet
Most of the information to complete Part I of the worksheet should be obtained from the transferor's Form 706.

Line 5. Enter on line 5 the applicable marital deduction claimed for the transferor’s estate (from the transferor’s Form 706).

Lines 10 through 18. Enter on these lines the appropriate taxes paid by the transferor’s estate.

If the transferor’s estate elected to pay the federal estate tax in installments, enter on line 10 only the total of the installments that have actually been paid at the time you file this Form 706. See Rev. Rul. 83-15, 1983-1 C.B. 224, for more details. Do not include as estate tax any tax attributable to section 4980A, before its repeal by the Taxpayer Relief Act of 1997.

Line 21. Add lines 11 (allowable unified credit) and 13 (foreign death taxes credit) of Part 2—Tax Computation to the amount of any credit taken (on line 15) for federal gift taxes on pre-1977 gifts (section 2012). Subtract this total from Part 2—Tax Computation, line 8. Enter the result on line 21 of the worksheet.

Line 26. If you computed the marital deduction using the unlimited marital deduction in effect for decedents dying after 1981, for purposes of determining the marital deduction for the reduced gross estate, see Rev. Rul. 90-2, 1990-1 C.B. 169. To determine the “reduced adjusted gross estate,” subtract the amount on line 25 of the Schedule Q Worksheet from the amount on line 24 of the worksheet. If community property is included in the amount on line 24 of the worksheet, compute the reduced adjusted gross estate using the rules of Regulations section 20.2056(c)-2 and Rev. Rul. 76-311, 1976-2 C.B. 261.
Schedules R and R-1—Generation-Skipping Transfer Tax

Introduction and Overview
Schedule R is used to compute the generation-skipping transfer (GST) tax that is payable by the estate. Schedule R-1 (Form 706) is used to compute the GST tax that is payable by certain trusts that are includible in the gross estate.

The GST tax that is to be reported on Form 706 is imposed only on "direct skips occurring at death." Unlike the estate tax, which is imposed on the value of the entire taxable estate regardless of who receives it, the GST tax is imposed only on the value of interests in property, wherever located, that actually pass to certain transferees, who are referred to as "skip persons."

For purposes of Form 706, the property interests transferred must be includible in the gross estate before they are subject to the GST tax. Therefore, the first step in computing the GST tax liability is to determine the property interests includible in the gross estate by completing Schedules A through I of Form 706.

The second step is to determine who the skip persons are. To do this, assign each transferee to a generation and determine whether each transferee is a "natural person" or a "trust" for GST purposes.

The third step is to determine which skip persons are transferees of "interests in property." If the skip person is a natural person, anything transferred is an interest in property. If the skip person is a trust, make this determination using the rules under Interest in property below. These first three steps are described in detail under the main heading, Dividing Direct Skips Between Schedules R and R-1 on page 25.

The fourth step is to determine whether to enter the transfer on Schedule R or on Schedule R-1. See the rules under the main heading, Dividing Direct Skips Between Schedules R and R-1 on page 25.

The fifth step is to complete Schedules R and R-1 using the How To Complete instructions beginning on page 26, for each schedule.

Determining Which Transfers Are Direct Skips

Effective dates. The rules below apply only for the purpose of determining if a transfer is a direct skip that should be reported on Schedule R or R-1 of Form 706.

In general. The GST tax is effective for the estates of decedents dying after October 22, 1986.

Invocable trusts. The GST tax will not apply to any transfer under a trust that was irrevocable on September 25, 1986, but only to the extent that the transfer was not made out of corpus added to the trust after September 25, 1985. An addition to the corpus after that date will cause a proportionate part of future income and appreciation to be subject to the GST tax. For more information, see Regulations section 26.2601-1(b)(1)(i).

Mental disability. If, on October 22, 1986, the decedent was under a mental disability to change the disposition of his or her property and did not regain the competence to dispose of property before death, the GST tax will not apply to any property included in the gross estate (other than property transferred on behalf of the decedent during life and after October 21, 1986). The GST tax will also not apply to any transfer under a trust to the extent that the trust consists of property included in the gross estate (other than property transferred on behalf of the decedent during life and after October 21, 1986).

The term "mental disability" means the decedent's mental incompetence to execute an instrument governing the disposition of his or her property, whether or not there has been an adjudication of incompetence and whether or not there has been an appointment of any other person charged with the care of the person or property of the transferor.

If the decedent had been adjudged mentally incompetent, a copy of the judgment or decree must be filed with this return.

If the decedent had not been adjudged mentally incompetent, the executor must file with the return a certification from a qualified physician stating that in his opinion the decedent had been mentally incompetent at all times on and after October 22, 1986, and that the decedent had not regained the competence to modify or revoke the terms of the trust or will prior to his death or a statement as to why no such certification may be obtained from a physician.

Direct skip. The GST tax reported on Form 706 and Schedule R-1 (Form 706) is imposed only on direct skips. For purposes of Form 706, a direct skip is a transfer that is:

Subject to the estate tax,
Of an interest in property, and
To a skip person.

All three requirements must be met before the transfer is subject to the GST tax. A transfer is subject to the estate tax if you are required to list it on any of Schedules A through I of Form 706. To determine if a transfer is of an interest in property and to a skip person (as defined above) transferred to the transferee is a natural person or a trust as defined below.

Trust. For purposes of the GST tax, a trust includes not only an explicit trust (as defined in Special rule for trusts other than explicit trusts beginning on page 26), but also any other transfers to the trust (or any estate) which, although not explicitly a trust, has substantially the same effect as a trust. For example, a trust includes life estates with remaindermen, terms for years, and insurance and annuity contracts.

Substantially separate and independent shares of different beneficiaries in a trust are treated as separate trusts.

Interest in property. If a transfer is made to a natural person, it is always considered a transfer of an interest in property for purposes of the GST tax.

If a transfer is made to a trust, a person will have an interest in the property transferred to the trust if that person either has a present right to receive income or corpus from the trust (such as an income interest for life) or is a permissible current recipient of income or corpus from the trust (that is, may receive income or corpus at the discretion of the trustee).

Skip person. A transferee who is a natural person is a skip person if that transferee is assigned to a generation that is two or more generations below the generation assignment of the decedent. See Determining the generation of a transferee below.

A transferee who is a trust is a skip person if all the interests in the property (as defined above) transferred to the trust by the decedent are held by skip persons. Thus, whenever a non-skip person has an interest in a trust, the trust will not be a skip person even though a skip person also has an interest in the trust.

A trust will also be a skip person if there are no interests in the property transferred to the trust by any person, and future distributions or terminations from the trust can be made only to skip persons.

Non-skip person. A non-skip person is any transferee who is not a skip person.

Determining the generation of a transferee. Generally, a generation is determined along family lines as follows.

1. Where the beneficiary is a lineal descendant of a grandparent of the decedent (that is, the decedent’s cousin, niece, nephew, etc.), the number of generations between the decedent and the beneficiary is determined by subtracting the number of generations between the
grandparent and the decedent from the number of generations between the
grandparent and the beneficiary.

2. Where the beneficiary is a lineal
descendant of a grandparent of a
spouse (or former spouse) of the
decedent, the number of generations
between the decedent and the
beneficiary is determined by subtracting
the number of generations between the
grandparent and the spouse (or former
spouse) from the number of

generations between the grandparent and the
beneficiary. The number of generations
between the grandparent and the
beneficiary is subject to gift or estate tax, 2. The will bequeaths $100,000 to
the number of generations between the
decedent's grandchild. This transfer

is subject to gift or estate tax, 2. The will bequeaths $100,000 to

grandparent and the beneficiary. assignment, the individual is treated as
is a direct skip that is not made in trust

or (4) above is assigned to a generation
based on his or her birth date, as follows:

a. A person who was born not more
than 12½ years after the decedent is in
the decedent's generation.

b. A person born more than 12½
years, but not more than 37½ years,
after the decedent is in the first
generation younger than the decedent.

c. A similar rule applies for a new
generation every 25 years.

If more than one of the rules for
assigning generations applies to a
transferee, that transferee is generally
assigned to the youngest of the

generations that would apply.

If an estate, trust, partnership,
corporation, or other entity (other than
certain charitable organizations and

trusts described in sections 511(a)(2)
and 511(b)(2)) is a transferee, then
each person who indirectly receives the

property interests through the entity is
treated as a transferee and is assigned
to a generation as explained in the

above rules. However, this look-through
rule does not apply for the purpose of
determining whether a transfer to a

trust is a direct skip.

Generation assignment where
Intervening parent is deceased.
A special rule may apply in the case
of the death of a parent of the transferee.

For terminations, distributions, and

transfers after December 31, 1997, the
existing rule that applied to

grandchildren of the decedent has been
extended to apply to other lineal
descendants.

If property is transferred to an
individual who is a descendant of a
parent of the transferee, and that

individual's parent (who is a lineal
descendant of the parent of the

transferee) is deceased at the time the
transfer is subject to gift or estate tax,
then for purposes of generation
assignment, the individual is treated as
if he or she is a member of the

generation that is one generation below
the lower of:

• The transferor's generation or
• The generation assignment of the
youngest living ancestor of the
individual, who is also a descendant
of the parent of the transferor.

The same rules apply to the
generation assignment of any
descendant of the individual.

If any transfer of property to a trust
would have been a direct skip except
for this generation assignment rule, then
the transferor applies transfers from
the trust attributable to such
property.

Ninety-day rule. For purposes of
determining if an individual's parent is
deceased at the time of a testamentary
transfer, an individual's parent who dies
no later than 90 days after a transfer
occurring by reason of the death of the

transferor is treated as having
predeceased the transferor. The 90-day
rule applies to transfers occurring on or
after July 18, 2005. See Regulations
section 26.2651-1, for more information.

Charitable organizations.
Charitable organizations and trusts

described in sections 511(a)(2) and
511(b)(2) are assigned to the
decedent’s generation. Transfers to
such organizations are therefore not
subject to the GST tax.

Charitable remainder trusts.
Transfers to or in the form of charitable
remainder annuity trusts, charitable
remainder unitrusts, and pooled
income funds are not considered made to

skip persons, and, therefore, are not direct
skips even if all of the life beneficiaries

are skip persons.

Estate tax value. Estate tax value is
determined by subtracting the GST
on direct skips from a trust (as
defined for GST tax purposes on page
24) is to be paid by the trustee and not
by the estate. Schedule R-1 serves as
a notification from the executor to the

trustee that a GST tax is due.

Examples. The rules above can be
illustrated by the following examples:

1. Under the will, the decedent's
daughter for her life with the remainder

passing to her children. This transfer
is made to a "trust" even though there is
no explicit trust instrument. The interest
in the property transferred (the present
right to use the house) is transferred to a
non-skip person (the decedent's
daughter). Therefore, the trust is not a
skip person because there is an
interest in the transferred property that
is held by a non-skip person. The

transfer is not a direct skip.

2. The will bequeaths $100,000 to

the decedent's grandson. This transfer
is a direct skip that is not made in trust
and should be shown on Schedule R.

3. The will establishes a trust that is
required to accumulate income for 10
years and then pay its income to the
decedent's grandchildren for the rest of
their lives and, upon their deaths,
distribute the corpus to the decedent's
great-grandchildren. Because the trust
has no current beneficiaries, there are
no present interests in the property

transferred to the trust. All of the
persons to whom the trust can make
future distributions (including
distributions upon the termination
of interests in property held in trust) are
skip persons (for example, the
decedent's grandchildren and
great-grandchildren). Therefore, the

trust itself is a skip person and you

should show the transfer on

Schedule R.

4. The will establishes a trust that is
to pay all of its income to the
decedent’s grandchildren for 10 years. At
two-thirds interest is held in the
corpus is to be distributed to the
decedent's grandchildren. All of the present
interests in this trust are held by skip persons.

Therefore, the trust is a skip person
and you should show this transfer on
Schedule R. You should show the

estate tax value of all the property
transferred to the trust even though the

trust has some ultimate beneficiaries

who are non-skip persons.

Dividing Direct Skips

Between Schedules R and

-25-

R-1

Report all generation-skipping

transfers on Schedule R unless

the rules below specifically

provide that they are to be reported on

Schedule R-1.

Under section 2603(a)(2), the GST
tax on direct skips from a trust (as
defined for GST tax purposes on page
24) is to be paid by the trustee and not
by the estate. Schedule R-1 serves as
a notification from the executor to the

trustee that a GST tax is due.

For a direct skip to be reportable on

Schedule R-1, the trust must be

indelible in the decedent's gross

estate.

If the decedent was the surviving
spouse life beneficiary of a marital
deduction power of appointment (or
QTIP) trust created by the decedent’s
spouse, then transfers caused by
reason of the decedent’s death from

that trust to skip persons are direct

skips required to be reported on

Schedule R-1.

If a direct skip is made "from a trust"
under these rules, it is reportable on

the type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.
Schedule R-1 even if it is also made “to a trust” rather than to an individual.

Similarly, if property in a trust (as defined for GST tax purposes on page 24) is included in the decedent’s gross estate under section 2035, 2036, 2037, 2038, 2039, 2041, or 2042 and such property is, by reason of the decedent’s death, transferred to skip persons, the transfers are direct skips required to be reported, not on Schedule R-1.

Special rule for trusts other than explicit trusts. An explicit trust is a trust as defined in Regulations section 201.7701-4(d) as “an arrangement created by a will or by an inter vivos declaration whereby beneficiaries take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.” Direct skips from explicit trusts are required to be reported on Schedule R-1 regardless of their size unless the executor is also a trustee (see Executor as trustee on page 26).

For transfers made through 1998, the GST exemption was $1 million. The amount of the exemption for 2000 is $3,500,000. The exemption amounts for 1999 through 2008 are as follows:

<table>
<thead>
<tr>
<th>Year of transfer</th>
<th>GST exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>1,010,000</td>
</tr>
<tr>
<td>2000</td>
<td>1,030,000</td>
</tr>
<tr>
<td>2001</td>
<td>1,060,000</td>
</tr>
<tr>
<td>2002</td>
<td>1,100,000</td>
</tr>
<tr>
<td>2003</td>
<td>1,120,000</td>
</tr>
<tr>
<td>2004 and 2005</td>
<td>1,500,000</td>
</tr>
<tr>
<td>2006, 2007, and 2008</td>
<td>2,000,000</td>
</tr>
</tbody>
</table>

The amount of each increase can only be allocated to transfers made (or appreciation that occurred) during or after the year of the increase. The following example shows the application of this rule:

**Example.** In 2003, G made a direct skip of $1,120,000 and applied her full $1,120,000 of GST exemption to the transfer. G made a $450,000 taxable direct skip in 2004 and another of $90,000 in 2006. For 2004, G can only apply $380,000 of exemption ($380,000 inflation adjustment from 2004) to the $450,000 transfer in 2004. For 2006, G can apply $90,000 of exemption to the 2006 transfer, but nothing to the transfer made in 2004. At the end of 2006, G would have $410,000 of unused exemption that she could apply to future transfers (or appreciation) starting in 2007.

Special QTIP election. In the case of property for which a marital deduction is allowed to the decedent’s estate under section 2056(b)(7) (QTIP election), section 2652(a)(3) allows you to treat such property for purposes of the GST tax as if the election to be treated as qualified terminable interest property had not been made.

The 2652(a)(3) election must include the value of all property in the trust for which a QTIP election was allowed under section 2056(b)(7).

If a section 2652(a)(3) election is made, then the decedent will, for GST tax purposes, be treated as the transferor of all the property in the trust for which a marital deduction was allowed to the decedent’s estate under section 2056(b)(7). In this case, the executor of the decedent’s estate may allocate part or all of the decedent’s GST exemption to the transferor of all property in the trust. You must use the IRS Form 4563 to make this election. You will generally need to allocate all of the decedent’s GST exemption to the transferor of all property in the trust for which a marital deduction was allowed to the decedent’s estate under section 2056(b)(7).
skip occurring at the decedent’s death, and then to trusts as to which the decedent is the transferor. If you wish to avoid the application of the deemed allocation rules, you should enter on line 9 every trust (except certain trusts entered on Schedule R-1, as described below) to which you wish to allocate any part of the decedent’s GST exemption. Unless you enter a trust on line 9, the unused GST exemption will be allocated to it under the deemed allocation rules.

If a trust is entered on Schedule R-1, the amount you entered on line 4 of Schedule R-1 serves as a Notice of Allocation and you need not enter the trust on line 9 unless you wish to allocate more than the Schedule R-1, line 4 amount to the trust. However, you must enter the trust on line 9 if you wish to allocate any of the unused GST exemption amount to it. Such an additional allocation would not ordinarily be appropriate in the case of a trust entered on Schedule R-1 when the trust property passes outright (rather than to another trust) at the decedent’s death. However, where section 2032A property is involved, it may be appropriate to allocate additional exemption amounts to the property. See the instructions for line 10 below.

To avoid application of the deemed allocation rules, Form 706 and Schedule R should be filed to allocate the exemption to trusts that may later have taxable terminations or distributions under section 2612 even if the form is not required to be filed to report estate or GST tax.

Line 9, column C. Enter the GST exemption included on lines 2 through 6 of Part 1 of Schedule R, and discussed above, that was allocated to the trust.

Line 9, column D. Allocate the amount on line 8 of Part 1 of Schedule R in line 9, column D. This amount may be allocated to transfers into trusts that are not otherwise reported on Form 706. For example, the line 8 amount may be allocated to an inter vivos trust established by the decedent during his or her lifetime and not included in the gross estate. This allocation is made by identifying the trust on line 9 and making an allocation to it using column D. If the trust is not included in the gross estate, value the trust as of the date of death. You should inform the trustee of each trust listed on line 9 of the total GST exemption you allocated to the trust. The trustee will need this information to compute the GST tax on future distributions and terminations.

Line 9, column E. Trust’s inclusion ratio. The trustee must know the trust’s inclusion ratio to figure the trust’s GST tax for future distributions and terminations. You are not required to inform the trustee of the inclusion ratio and may not have enough information to compute it. Therefore, you are not required to make an entry in column E. However, column E and the worksheet below are provided to assist you in computing the inclusion ratio for the trustee if you wish to do so.

You should inform the trustee of the amount of the GST exemption allocated to the trust. Line 9, columns C and D may be used to compute this amount for each trust.

Note. This worksheet will compute an accurate inclusion ratio only if the decedent was the only settlor of the trust. You should use a separate worksheet for each trust (or separate share of a trust that is treated as a separate trust).

WORKSHEET (inclusion ratio for trust):

1. Total estate and gift tax value of all of the property interests that passed to the trust .
2. Estate taxes, state death taxes, and other charges actually recovered from the trust .
3. GST taxes imposed on direct skips to skip persons other than this trust and borne by the property transferred to this trust .
4. GST taxes actually recovered from this trust (from Schedule R, Part 2, line 8 or Schedule R-1, line 6) .
5. Subtract line 4 from line 3 .
6. Divide line 5 by line 2 .
7. Add columns C and D of line 9 .
8. Divide line 7 by line 6 .
9. Trust’s inclusion ratio. Subtract line 8 from 1.000 .

Line 10. Special-use allocation. For skip persons who receive an interest in section 2032A special-use property, you may allocate more GST exemption than the direct skip amount to reduce the additional GST tax that would be due when the interest is later disposed of or qualified use ceases. See Schedule A-1 of this Form 706 for more details about this additional GST tax.

Enter on line 10 the total additional GST exemption available to allocate to all skip persons who received any interest in section 2032A property. Attach a special-use allocation schedule listing each such skip person and the amount of the GST exemption allocated to that person.

If you do not allocate the GST exemption, it will be automatically allocated under the deemed allocation at death rules. To the extent any amount is not so allocated, it will be automatically allocated to the earliest disposition or cessation that is subject to the GST tax. Under certain circumstances, post-death events may cause the decedent to be treated as a transferor for purposes of Chapter 13.

Line 10 may be used to set aside an exemption amount for such an event. You must attach a schedule listing each such event and the amount of exemption allocated to that event.

Parts 2 and 3
Use Part 2 to compute the GST tax on transfers in which the property interests transferred are to bear the GST tax on the transfers. Use Part 3 to report the GST tax on transfers in which the property interests transferred do not bear the GST tax on the transfers.

Section 2603(b) requires that unless the governing document provides otherwise, the GST tax is to be charged to the property constituting the transfer. Therefore, you will usually enter all of the direct skips on Part 2.

You may enter a transfer on Part 3 only if the will or trust instrument directs, by specific reference, that the GST tax is not to be paid from the transferred property interests.

Part 2, Line 3. Enter zero on this line unless the will or trust instrument specifies that the GST taxes will be paid by property other than that constituting the transfer (as described above). Enter on line 3 the total of the GST taxes shown on Part 3 and Schedule(s) R-1 that are payable out of the property interests shown on Part 2, line 1.

Part 2, Line 6. Do not enter more than the amount on line 5. Additional allocations may be made using Part 3.

Part 3, Line 3. See the instructions to Part 2, line 3 above. Enter only the total of the GST taxes shown on Schedule(s) R-1 that are payable out of the property interests shown on Part 3, line 1.

Part 3, Line 6. See the instructions to Part 2, line 6 above.

How To Complete Schedule R-1
Filing due date. Enter the due date of Schedule R, Form 706. You must send the copies of Schedule R-1 to the fiduciary by this date.

Line 4. Do not enter more than the amount on line 3. If you wish to allocate an additional GST exemption, you must use Schedule R, Part 1. Making an entry on line 4 constitutes a Notice of Allocation of the decedent’s GST exemption to the trust.

Line 6. If the property interests entered on line 1 will not bear the GST tax, multiply line 6 by 45% (.45).

Signature. The executor(s) must sign Schedule R-1 in the same manner as Form 706. See Signature and Verification on page 2. Filing Schedule R-1. Attach to Form 706 one copy of each Schedule R-1.
that you prepare. Send two copies of each Schedule R-1 to the fiduciary.

Schedule U—Qualified Conservation Easement Exclusion

If at the time of the contribution of the conservation easement, the value of the easement, the value of the land subject to the easement, or the value of any retained development right was different than the applicable percentage of the land value, you must complete a separate computation in addition to completing Schedule U.

Use a copy of Schedule U as a worksheet for this separate computation. Complete lines 4 through 14 of the worksheet Schedule U. However, the value you use on lines 4, 5, 7, and 10 of the worksheet is the value for these items as of the date of the contribution of the easement, not the estate tax value. If the date of contribution and the estate tax values are the same, you do not need to do a separate computation.

After completing the worksheet, enter the amount from line 14 of the worksheet on line 14 of Schedule U. Finish completing Schedule U by entering amounts on lines 4, 7, and 15 through 20, following the instructions below for those lines. At the top of Schedule U, enter “worksheet attached.” Attach the worksheet to the return.

Under section 2031(c), you may elect to exclude a portion of the value of land that is subject to a qualified conservation easement. You make the election by filing Schedule U with all of the required information and excluding the applicable value of the land that is subject to the easement on Part 5—Recapitulation, page 3, at item 11. To elect the exclusion, you must include on Schedule A, B, E, F, G, or H, as appropriate, the decedent’s interest in the land that is subject to the exclusion. You must make the election on a timely filed Form 706, including extensions.

The exclusion is the lesser of:

- The applicable percentage of the value of land (after certain reductions) subject to a qualified conservation easement or
- $500,000.

Once made, the election is irrevocable.

General Requirements

Qualified Land

Land may qualify for the exclusion if all of the following requirements are met.

- The decedent or a member of the decedent’s family must have owned the land for the 3-year period ending on the date of the decedent’s death.
- No later than the date the election is made, a qualified conservation easement on the land has been made by the decedent, a member of the decedent’s family, the executor of the decedent’s estate, or the trustee of a trust that holds the land.
- The land is located in the United States or one of its possessions.

Member of Family

Members of the decedent’s family include the decedent’s spouse; ancestors; lineal descendants of the decedent; the decedent’s spouse’s, and of the parents of the decedent; and the spouse of any lineal descendant. A legally adopted child of an individual is considered a child of the individual by blood.

Indirect Ownership of Land

The qualified conservation easement exclusion applies if the land is owned indirectly through a partnership, corporation, or trust. If the decedent owned (directly or indirectly) at least 30% of the entity, the rules on determining ownership of an entity, see Ownership rules below.

Ownership rules. An interest in property owned, directly or indirectly, by or for a corporation, partnership, or trust is considered proportionately owned by or for the entity’s shareholders, partners, or beneficiaries. A person is the beneficiary of a trust only if he or she has a present interest in the trust. For additional information, see the ownership rules in section 2057(e)(3) (before its repeal by P.L. 107-16).

Qualified Conservation Easement

A qualified conservation easement is one that would qualify as a qualified conservation contribution under section 170(h). It must be a contribution:

- Of a qualified real property interest,
- To a qualified organization, and
- Exclusively for conservation purposes.

Qualified real property interest. The term “qualified real property interest” means any of the following:

- The entire interest of the donor, other than a qualified mineral interest;
- A remainder interest; or
- A restriction granted in perpetuity on the use that may be made of the real property. The restriction must include a prohibition on more than a de minimis use for commercial recreational activity.

Qualified organization. A qualified organization includes:

- The United States, a possession of the United States, a state (or the District of Columbia), or a political subdivision of them, as long as the gift is for exclusively public purposes;
- A domestic entity that meets the general requirements for qualifying as a charity under section 170(c)(2) and that generally receives a substantial amount of its support from a government unit or from the general public; or
- Any entity that qualifies under section 170(h)(3)(B).

Conservation purpose. The term “conservation purpose” means:

- The preservation of land areas for outdoor recreation by, or the education of, the public;
- The protection of a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; or
- The preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public, or under a clearly delineated federal, state, or local conservation policy and will yield a significant public benefit.

Specific Instructions

Line 1

If the land is reported as one or more item numbers on a Form 706 schedule, simply list the schedule and item numbers. If the land subject to the easement comprises only part of an item, however, list the schedule and item number and describe the part subject to the easement. See the instructions for Schedule A—Real estate, for information on how to describe the land.

Line 3

Using the general rules for describing real estate, provide enough information so the IRS can value the easement. Report the estate tax value even if the exclusion was granted by the decedent or someone other than the decedent. Give the date the easement was granted and by whom it was granted.

Line 4

Enter on this line the gross value at which the land was reported on the applicable asset schedule on this Form 706. Do not reduce the value by the amount of any mortgage outstanding. Report the estate tax value even if the easement was granted by the decedent (or someone other than the decedent) prior to the decedent’s death.

Note. If the value of the land reported on line 4 was different at the time the easement was contributed than that reported on Form 706, see the Caution at the beginning of the Schedule U instructions.

Line 5

The amount on line 5 should be the date of death value of any qualifying conservation easements granted prior to the decedent’s death, whether granted by the decedent or someone other than the decedent, for which the exclusion is being elected.
Note. If the value of the easement reported on line 5 was different at the time the easement was contributed than at the date of death, see the Caution at the beginning of the Schedule U Instructions.

Line 7
You must reduce the land value by the value of any development rights retained by the donor in the conveyance of the easement. A development right is any right to use the land for any commercial purpose that is not subordinate to and directly supportive of the use of the land as a farm for farming purposes.

Note. If the value of the retained development rights reported on line 7 was different at the time the easement was contributed than at the date of death, see the Caution at the beginning of the Schedule U Instructions.

You do not have to make this reduction if everyone with an interest in the land (regardless of whether in possession) agrees to permanently extinguish the retained development right. The agreement must be filed with this return and must include the following information and terms:

1. A statement that the agreement is made under section 2031(c)(5);
2. A list of all persons in being holding an interest in the land that is subject to the qualified conservation easement. Include each person’s name, address, tax identifying number, relationship to the decedent, and a description of their interest;
3. The items of real property shown on the estate tax return that are subject to the qualified conservation easement (identified by schedule and item number);
4. A description of the retained development right that is to be extinguished;
5. A clear statement of consent that is binding on all parties under applicable local law:
   a. To take whatever action is necessary to permanently extinguish the retained development rights listed in the agreement and
   b. To be personally liable for additional taxes under section 2031(c)(5)(C) if this agreement is not implemented by the earlier of:
      • The date that is 2 years after the date of the decedent’s death or
      • The date of sale of the land subject to the qualified conservation easement;
6. A statement that in the event this agreement is not timely implemented, that they will report the additional tax on whatever return is required by the IRS and will file the return and pay the additional tax by the last day of the 6th month following the applicable date described above.

All parties to the agreement must sign the agreement.

For an example of an agreement containing some of the same terms, see Schedule A-1 (Form 706).

Line 10
Enter the total value of the qualified conservation easements on which the exclusion is based. This could include easements granted by the decedent (or someone other than the decedent) prior to the decedent’s death, easements granted by the decedent that take effect after death, easements granted by the executor after the decedent’s death, or some combination of these.

Use the value of the easement as of the date of death, even if the easement was granted prior to the date of death. But, if the value of the easement was different at the time the easement was contributed than at the date of death, see the Caution at the beginning of the Schedule U Instructions.

Explain how this value was determined and attach copies of any appraisals. Normally, the appropriate way to value a conservation easement is to determine the FMV of the land before and after the granting of the easement, with the difference being the value of the easement.

You must reduce the reported value of the easement by the amount of any consideration received for the easement. If the date of death value of the easement is different from the value at the time the consideration was received, you must reduce the value of the easement by the same proportion that the consideration received bears to the value of the easement at the time it was granted. For example, assume the value of the easement at the time it was granted was $100,000 and $10,000 was received in consideration for the easement. If the easement was worth $150,000 at the date of death, you must reduce the value of the easement by $15,000 ($10,000/$100,000 x $150,000) and report the value of the easement on line 10 as $135,000.

Line 15
If a charitable contribution deduction for this land has been taken on Schedule Q, enter the amount of the deduction here. If the easement was granted after the decedent’s death, a contribution deduction may be taken on Schedule Q, if it otherwise qualifies, as long as no income tax deduction was or will be claimed for the contribution by any person or entity.

Line 16
You must reduce the value of the land by the amount of any acquisition indebtedness on the land at the date of the decedent’s death. Acquisition indebtedness includes the unpaid amount of:
• Any indebtedness incurred by the donor in acquiring the property;
• Any indebtedness incurred before the acquisition if the indebtedness would not have been incurred but for the acquisition;
• Any indebtedness incurred after the acquisition if the indebtedness would not have been incurred but for the acquisition and the incidence of the indebtedness was reasonably foreseeable at the time of the acquisition; and
• The extension, renewal, or refinancing of acquisition indebtedness.

Continuation Schedule
See instructions for Continuation Schedule on Form 706 itself.
Instructions for Form 706

The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. Subtitle B and section 6109, and the regulations require you to provide this information.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential as required by section 6103. However, section 6103 allows or requires the Internal Revenue Service to disclose information from this form in certain circumstances. For example, we may disclose information to the Department of Justice for civil or criminal litigation, and to cities, states, the District of Columbia, and U.S. commonwealths or possessions for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism. Failure to provide this information, or providing false information, may subject you to penalties.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

<table>
<thead>
<tr>
<th>Form</th>
<th>Recordkeeping</th>
<th>Learning about the law or the form</th>
<th>Preparing the form</th>
<th>Copying, assembling, and sending the form to the IRS</th>
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</thead>
<tbody>
<tr>
<td>706</td>
<td>1 hr., 25 min.</td>
<td>1 hr., 50 min.</td>
<td>3 hr., 42 min.</td>
<td>48 min.</td>
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<td>Schedule A</td>
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<td>12 min.</td>
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<tr>
<td>Schedule A-1</td>
<td>31 min.</td>
<td>1 hr., 15 min.</td>
<td>13 min.</td>
<td>20 min.</td>
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<tr>
<td>Schedule B</td>
<td>6 min.</td>
<td>6 min.</td>
<td>36 min.</td>
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<tr>
<td>Schedule C</td>
<td>8 min.</td>
<td>8 min.</td>
<td>20 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Schedule D</td>
<td>21 min.</td>
<td>12 min.</td>
<td>20 min.</td>
<td>20 min.</td>
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<tr>
<td>Schedule E</td>
<td>6 min.</td>
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<td>13 min.</td>
<td>20 min.</td>
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<tr>
<td>Schedule F</td>
<td>19 min.</td>
<td>15 min.</td>
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<td>Schedule G</td>
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<td>Schedule H</td>
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<td>Schedule I</td>
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<td>9 min.</td>
<td>15 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Schedule J</td>
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<td>6 min.</td>
<td>15 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Schedule K</td>
<td>6 min.</td>
<td>9 min.</td>
<td>16 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Schedule L</td>
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<td>4 min.</td>
<td>15 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Schedule M</td>
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<td>34 min.</td>
<td>25 min.</td>
<td>20 min.</td>
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<tr>
<td>Schedule O</td>
<td>12 min.</td>
<td>12 min.</td>
<td>21 min.</td>
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</tr>
<tr>
<td>Schedule P</td>
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<td>15 min.</td>
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<td>20 min.</td>
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<td>Schedule Q</td>
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<td>16 min.</td>
<td>20 min.</td>
</tr>
<tr>
<td>Worksheet for Schedule Q</td>
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<td>6 min.</td>
<td>6 min.</td>
<td>1 hr., 10 min.</td>
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<tr>
<td>Schedule R</td>
<td>46 min.</td>
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<td>Schedule R-1</td>
<td>26 min.</td>
<td>26 min.</td>
<td>29 min.</td>
<td>20 min.</td>
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<tr>
<td>Schedule U</td>
<td>19 min.</td>
<td>19 min.</td>
<td>13 min.</td>
<td>20 min.</td>
</tr>
</tbody>
</table>

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave, NW, IR-6526, Washington, DC 20224. Do not send the tax form to this address. Instead, see Where To File on page 2.
# Worksheet for Schedule Q—Credit for Tax on Prior Transfers

## Part I: Transferor's tax on prior transfers

<table>
<thead>
<tr>
<th>Item</th>
<th>Transferor (From Schedule Q)</th>
<th>Total for all transfers (line 8 only)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Gross value of prior transfer to this transferee</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Death taxes payable from prior transfer</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Encumbrances allocable to prior transfer</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Obligations allocable to prior transfer</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Marital deduction applicable to line 1 above, as shown on transferor's Form 706</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>TOTAL, Add lines 2, 3, 4, and 5</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Net value of transfers. Subtract line 6 from line 1</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Net value of transfers. Add columns A, B, and C of line 7</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Transferor's taxable estate</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Federal estate tax paid</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>State death taxes paid</td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>Foreign death taxes paid</td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>Other death taxes paid</td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td>TOTAL taxes paid. Add lines 10, 11, 12, and 13</td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>Value of transferor's estate. Subtract line 14 from line 9</td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Net federal estate tax paid on transferor's estate</td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Credit for gift tax paid on transferor's estate with respect to pre-1977 gifts (section 2012)</td>
<td></td>
</tr>
<tr>
<td>18.</td>
<td>Credit allowed transferor's estate for tax on prior transfers from prior transferor(s) who died within 10 years before date of decedent</td>
<td></td>
</tr>
<tr>
<td>19.</td>
<td>Tax on transferor's estate. Add lines 16, 17, and 18</td>
<td></td>
</tr>
<tr>
<td>20.</td>
<td>Transferor's tax on prior transfers ((line 7 × line 19) of respective estates)</td>
<td></td>
</tr>
</tbody>
</table>

## Part II: Transferee's tax on prior transfers

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>21.</td>
<td>Transferee's actual tax before allowance of credit for prior transfers (see instructions)</td>
</tr>
<tr>
<td>22.</td>
<td>Total gross estate of transferee from line 1 of the Tax Computation, page 1, Form 706</td>
</tr>
<tr>
<td>23.</td>
<td>Net value of all transfers from line 8 of this worksheet</td>
</tr>
<tr>
<td>24.</td>
<td>Transferee's reduced gross estate. Subtract line 23 from line 22</td>
</tr>
<tr>
<td>25.</td>
<td>Total debts and deductions (not including marital and charitable deductions) (line 3b of Part 2—Tax Computation, page 1 and items 17, 18, and 19 of the Recapitulation, page 3, Form 706)</td>
</tr>
<tr>
<td>26.</td>
<td>Marital deduction from item 20, Recapitulation, page 3, Form 706 (see instructions)</td>
</tr>
<tr>
<td>27.</td>
<td>Charitable bequests from item 21, Recapitulation, page 3, Form 706</td>
</tr>
<tr>
<td>28.</td>
<td>Charitable deduction proportion ([ line 23 – (line 22 – line 25)] × line 27)</td>
</tr>
<tr>
<td>29.</td>
<td>Reduced charitable deduction. Subtract line 28 from line 27</td>
</tr>
<tr>
<td>30.</td>
<td>Transferee's deduction as adjusted. Add lines 25, 26, and 29</td>
</tr>
<tr>
<td>31.</td>
<td>(a) Transferee's reduced taxable estate. Subtract line 30 from line 24</td>
</tr>
<tr>
<td></td>
<td>(b) Adjusted taxable gifts</td>
</tr>
<tr>
<td></td>
<td>(c) Total reduced taxable estate. Add lines 31(a) and 31(b)</td>
</tr>
<tr>
<td>32.</td>
<td>Tentative tax on reduced taxable estate</td>
</tr>
<tr>
<td>33.</td>
<td>(a) Post-1916 gift taxes paid</td>
</tr>
<tr>
<td></td>
<td>(b) Unified credit (applicable credit amount)</td>
</tr>
<tr>
<td></td>
<td>(c) Section 2012 gift tax credit</td>
</tr>
<tr>
<td></td>
<td>(d) Section 2014 foreign death tax credit</td>
</tr>
<tr>
<td></td>
<td>(e) Total credits. Add lines 33(a) through 33(d)</td>
</tr>
<tr>
<td>34.</td>
<td>Net tax on reduced taxable estate. Subtract line 33(e) from line 32</td>
</tr>
<tr>
<td>35.</td>
<td>Transferee's tax on prior transfers. Subtract line 34 from line 21</td>
</tr>
</tbody>
</table>
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Checklist for Completing Form 706

To ensure a complete return, review the following checklist before filing Form 706.

Attachments . . .

☐ Death certificate—you must attach.
☐ Certified copy of the will—if decedent died testate, you must attach. If not certified, explain why.
☐ Appraisals—attach any appraisals used to value property included on the return.
☐ Copies of all trust documents where the decedent was a grantor or a beneficiary.
☐ Form 2848 or 8821, if applicable.
☐ Copy of any Form(s) 709 filed by the decedent.
☐ Form 712, if filing Schedule D.
☐ Form 706-CE, if claiming a foreign death tax credit.
☐ Explanation of reasonable cause for late filing, if applicable.

Have you . . .

☐ Signed the return at the bottom of page 1?
☐ Had the preparer sign, if applicable?
☐ Obtained the signature of your authorized representative on Part 4, page 2?
☐ Entered a Total on all schedules filed?
☐ Made an entry on every line of the Recapitulation, even if it is a zero?
☐ Included the CUSIP number for all stocks and bonds?
☐ Included the EIN of trusts, partnerships, or closely held entities and the EIN of the estate?
☐ Included the first 3 pages of the return and all required schedules?
☐ Completed Schedule F? It must be filed with all returns.
☐ Completed Part 4, line 4, on page 2, if there is a surviving spouse?
☐ Completed and attached Schedule D to report insurance on the life of the decedent, even if its value is not included in the estate?
☐ Included any QTIP property received from a pre-deceased spouse?
☐ Entered the decedent’s name, SSN, and “Form 706” on your check or money order?
Appendix B:

IRS Form 1041 U.S. Income Tax Return for Estates and Trusts and Instructions
Form 1041

U.S. Income Tax Return for Estates and Trusts

For calendar year 2010 or fiscal year beginning , 2010, and ending , 20 .

A Type of entity (see instr.):
- Decedent’s estate
- Simple trust
- Complex trust
- Qualified disability trust
- ESBT (S portion only)
- Grantor type trust
- Bankruptcy estate-Ch. 7
- Bankruptcy estate-Ch. 11
- Pooled income fund

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

C Employer identification number

D Date entity created

E Nonexempt charitable and split-interest trusts, check applicable boxes (see page 16 of the instr.):
- Described in section 4947(a)(1)
- Not a private foundation
- Described in section 4947(a)(2)

F Check applicable boxes:
- Initial return
- Final return
- Amended return
- Change in fiduciary's name
- Change in fiduciary’s address

G Check here if the estate or filing trust made a section 645 election . . . . . . . . . .

---

### Income

1. Interest income
2a. Total ordinary dividends
3. Qualified dividends allocable to:
   - (1) Beneficiaries
   - (2) Estate or trust
4. Business income or (loss). Attach Schedule C or C-EZ (Form 1040)
5. Capital gain or (loss). Attach Schedule D (Form 1041)
6. Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)
7. Farm income or (loss). Attach Schedule F (Form 1040)
8. Ordinary gain or (loss). Attach Form 4797
9. Other income. List type and amount

### Deductions

10. Add lines 1 through 9
11. Interest. Check if Form 4952 is attached
12. Taxes
13. Charitable deduction (from Schedule A, line 7)
14. Attorney, accountant, and return preparer fees
15a. Other deductions not subject to the 2% floor (attach schedule)
15b. Allowable miscellaneous itemized deductions subject to the 2% floor
16. Add lines 10 through 15b
17. Adjusted total income or (loss). Subtract line 16 from line 9
18. Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)
19. Estate tax deduction including certain generation-skipping taxes (attach computation)
20. Exemption
21. Add lines 18 through 20
22. Taxable income. Subtract line 21 from line 17. If a loss, see page 23 of the instructions
23. Total tax (from Schedule G, line 7)
24. Payments: a 2010 estimated tax payments and amount applied from 2009 return
   - Estimated tax payments allocated to beneficiaries (from Form 1041-T)
   - Subtract line 24b from line 24a
   - Tax paid with Form 7004 (see page 24 of the instructions)
   - Federal income tax withheld. If any is from Form(s) 1099, check
24e. Other payments: f Form 2439, g Form 4136; Total
25. Total payments. Add lines 24c through 24e, and 24h
26. Estimated tax penalty (see page 24 of the instructions)
27. Tax due. If line 25 is smaller than the total of lines 23 and 26, enter amount owed
28. Overpayment. If line 25 is larger than the total of lines 23 and 26, enter amount overpaid
29. Amount of line 28 to be: a Credited to 2011 estimated tax
   - b Refunded

### Sign Here

Signature of fiduciary or officer representing fiduciary
Date
EIN of fiduciary if a financial institution

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.
### Form 1041 (2010)

#### Schedule A  Charitable Deduction

Do not complete for a simple trust or a pooled income fund.

<table>
<thead>
<tr>
<th></th>
<th>Amounts paid or permanently set aside for charitable purposes from gross income (see page 25)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Tax-exempt income allocable to charitable contributions (see page 25 of the instructions)</td>
</tr>
<tr>
<td>3</td>
<td>Subtract line 2 from line 1</td>
</tr>
<tr>
<td>4</td>
<td>Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes</td>
</tr>
<tr>
<td>5</td>
<td>Add lines 3 and 4</td>
</tr>
<tr>
<td>6</td>
<td>Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes (see page 25 of the instructions)</td>
</tr>
<tr>
<td>7</td>
<td><strong>Charitable deduction.</strong> Subtract line 6 from line 5. Enter here and on page 1, line 13</td>
</tr>
</tbody>
</table>

#### Schedule B  Income Distribution Deduction

<p>| | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Adjusted total income (see page 25 of the instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Adjusted tax-exempt interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Total net gain from Schedule D (Form 1041), line 15, column (1) (see page 26 of the instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Capital gains for the tax year included on Schedule A, line 1 (see page 26 of the instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>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</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td><strong>Distributable net income.</strong> Combine lines 1 through 6. If zero or less, enter -0-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Income required to be distributed currently</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Other amounts paid, credited, or otherwise required to be distributed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Total distributions. Add lines 9 and 10. If greater than line 8, see page 26 of the instructions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Enter the amount of tax-exempt income included on line 11</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Tentative income distribution deduction. Subtract line 12 from line 11</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td><strong>Income distribution deduction.</strong> Enter the smaller of line 13 or line 14 here and on page 1, line 18</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Schedule G  Tax Computation (see page 27 of the instructions)

<p>| | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tax: a Tax on taxable income (see page 27 of the instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>b Tax on lump-sum distributions. Attach Form 4972</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>c Alternative minimum tax (from Schedule I (Form 1041), line 56)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>d Total. Add lines 1a through 1c</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2a</td>
<td>Foreign tax credit. Attach Form 1116</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2b</td>
<td>General business credit. Attach Form 3800</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2c</td>
<td>Credit for prior year minimum tax. Attach Form 8801</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2d</td>
<td>Bond credits. Attach Form 8912</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td><strong>Total credits.</strong> Add lines 2a through 2d</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Subtract line 3 from line 1d. If zero or less, enter -0-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Recapture taxes. Check if from: □ Form 4255 □ Form 8611</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Household employment taxes. Attach Schedule H (Form 1040)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td><strong>Total tax.</strong> Add lines 4 through 6. Enter here and on page 1, line 23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Other Information

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>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 ▶ $</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>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?</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>At any time during calendar year 2010, 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 page 29 of the instructions for exceptions and filing requirements for Form TD F 90-22.1. If “Yes,” enter the name of the foreign country ▶</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>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 page 29 of the instructions</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If “Yes,” see page 29 for required attachment</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>If this is an estate or a complex trust making the section 663(b) election, check here (see page 29) ▶</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here (see page 29) ▶</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>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 ▶</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Are any present or future trust beneficiaries skip persons? See page 29 of the instructions</td>
<td></td>
</tr>
</tbody>
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Form 1041 (2010)
Income Tax Return for Estates and Trusts

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What's New

• For tax years beginning in 2010, the requirement to file a return for a bankruptcy estate applies only if gross income is at least $9,350.
• For 2010, qualified disability trusts can claim an exemption of up to $3,650. The exemption is no longer phased out.
• The election to deduct state and local sales taxes instead of state and local income taxes has been extended through tax year 2011 by Public Law (P.L.) 111-312, Act section 722.
• P.L. 111-312, Act section 301 repealed the modified carryover basis rules for property acquired from a decedent who died in 2010 unless the executor of such decedent's estate makes the special election under Act section 301(c). If the Act section 301(c) election is not made, the basis rules of section 1014 apply (generally, FMV at the date of death). See Pub. 4895, Tax Treatment of Property Acquired From a Decedent Dying in 2010, for more information.
• New for 2010 is Form 1041-V, Payment Voucher. The form is used to include information about your remittance of the balance due on Form 1041. Use of Form 1041-V is optional but we encourage you to use it if your payment is made by check or money order.
• If an amended return is filed for an NOL carryback, write “NOL Carryback” at the top of the page. See Amended Return on page 16 for complete information.

Reminder

• Review a copy of the trust instrument (including any amendments) or the will, if any, before preparing an estate's or trust's return.

Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Unresolved Tax Issues

If you have attempted to deal with an IRS problem unsuccessfully, you should contact the Taxpayer Advocate. The Taxpayer Advocate independently represents the estate's or trust's interests and concerns within the IRS by protecting its rights and resolving problems that have not been fixed through normal channels.

While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that the estate's or trust's case is given a complete and impartial review.

The estate's or trust's assigned personal advocate will listen to its point of view and will work with the estate or trust to address its concerns. The estate or trust can expect the advocate to provide:
• An impartial and independent look at your problem,
You can order type trust. See page 11 for special rules are foreign trusts. Funds may flow from Pub. 1796, IRS Tax Products DVD, and for grantor trusts. one trust to another trust by way of rental agreements, fees for services, or trust's assets. Such a trust is a grantor trusts, purport to involve charities, or trusts and estate taxes. These promised benefits may include reduction or elimination of income subject to tax; deductions for personal expenses paid by the trust; depreciation deductions of an owner's personal residence and furnishings; a stepped-up basis for property transferred to the trust; the reduction or elimination of self-employment taxes; and the reduction or elimination of gift and estate taxes. These promised benefits are inconsistent with the tax rules applicable to trust arrangements. Abusive trust arrangements often use trusts to hide the true ownership of assets and income or to disguise the substance of transactions. These arrangements frequently involve more than one trust, each holding different assets of the taxpayer (for example, the taxpayer's business, business equipment, home, automobile, etc.). Some trusts may hold interests in other trusts, purport to involve charities, or are foreign trusts. Funds may flow from one trust to another trust by way of rental agreements, fees for services, purchase agreements, and distributions. Some of the abusive trust arrangements that have been identified include unincorporated business trusts (or organizations), equipment or service

- Timely acknowledgment, The name and phone number of the individual assigned to its case, Updates on progress, Timeframes for action, Speedy resolution, and Courteous service.

When contacting the Taxpayer Advocate, you should provide the following information:

- The estate's or trust's name, address, and employer identification number (EIN).
- The name and telephone number of an authorized contact person and the hours he or she can be reached.
- The type of tax return and year(s) involved.
- A detailed description of the problem.
- Previous attempts to solve the problem and the office that had been contacted.
- A description of the hardship the estate or trust is facing and supporting documentation (if applicable).

You can contact a Taxpayer Advocate as follows:

- Call the Taxpayer Advocate's toll-free number: 1-877-777-4778.
- Call, write, or fax the Taxpayer Advocate office in its area (see Pub. 1546, Taxpayer Advocate Service, Your Voice At The IRS, for addresses and phone numbers).
- TTY/TDD help is available by calling 1-800-829-4059.
- Visit the website at www.irs.gov/advocate.

How To Get Forms and Publications

Internet. You can access the IRS website 24 hours a day, 7 days a week at IRS.gov to:

- Download forms, instructions, and publications;
- Order IRS products online;
- Research your tax questions online;
- Search publications online by topic or keyword;
- Use the online Internal Revenue Code, Regulations, or other official guidance;
- View Internal Revenue Bulletins (IRBs) published in the last few years; and
- Sign up to receive local and national tax news by email.

DVD for tax products. You can order Pub. 1796, IRS Tax Products DVD, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax Law frequently asked questions.

- Tax Topics from the IRS telephone response system.
- Internal Revenue Code - Title 26 of the U.S. Code.
- Fill-in, print, and save features for most tax forms
- Internal Revenue Bulletins.
- Toll-free and email technical support.

The DVD is released twice during the year. The first release will ship the beginning of January 2011. The final release will ship the beginning of March 2011.

Purchase the DVD from National Technical Information Service at www.irs.gov/cdorders for $30 (no handling fee) or call 1-877-233-6767 toll free to buy the DVD for $30 (plus a $6 handling fee).

By phone and in person. You can order forms and publications by calling 1-800-TAX-FORM (1-800-829-3676). You can also get most forms and publications at your local IRS office.

General Instructions

Purpose of Form

The fiduciary of a domestic decedent's estate, trust, or bankruptcy estate uses Form 1041 to report:

- The income, deductions, gains, losses, etc. of the estate or trust;
- The income that is either accumulated or held for future distribution or distributed currently to the beneficiaries;
- Any income tax liability of the estate or trust; and
- Employment taxes on wages paid to household employees.

Income Taxation of Trusts and Decedents’ Estates

A trust or a decedent’s estate is a separate legal entity for federal tax purposes. A decedent’s estate comes into existence at the time of death of an individual. A trust may be created during an individual's life (inter vivos) or at the time of his or her death under a will (testamentary). If the trust instrument contains certain provisions, then the person creating the trust (the grantor) is treated as the owner of the trust's assets. Such a trust is a grantor type trust. See page 11 for special rules for grantor trusts.

A trust or decedent's estate figures its gross income in much the same manner as an individual. Most deductions and credits allowed to individuals are also allowed to estates and trusts. However, there is one major distinction. A trust or decedent's estate is allowed an income distribution deduction for distributions to beneficiaries. To figure this deduction, the fiduciary must complete Schedule B. The income distribution deduction determines the amount of any distributions taxed to the beneficiaries.

For this reason, a trust or decedent's estate sometimes is referred to as a “passthrough” entity. The beneficiary, and not the trust or decedent's estate, pays income tax on his or her distributive share of income. Schedule K-1 (Form 1041) is used to notify the beneficiaries of the amounts to be included on their income tax returns.

Before preparing Form 1041, the fiduciary must figure the accounting income of the estate or trust under the will or trust instrument and applicable local law to determine the amount, if any, of income that is required to be distributed, because the income distribution deduction is based, in part, on that amount.

Abusive Trust Arrangements

Certain trust arrangements purport to reduce or eliminate federal taxes in ways that are not permitted under the law. Abusive trust arrangements are frequently involved with more than one trust, each holding different assets of the taxpayer (for example, the taxpayer's business, business equipment, home, automobile, etc.). Some trusts may hold interests in other trusts, purport to involve charities, or are foreign trusts. Funds may flow from one trust to another trust by way of rental agreements, fees for services, purchase agreements, and distributions. Some of the abusive trust arrangements that have been identified include unincorporated business trusts (or organizations), equipment or service
trusts, family residence trusts, charitable trusts, and final trusts. In each of these trusts, the original owner of the assets nominally subject to the trust effectively retains the authority to cause financial benefits of the trust to be directly or indirectly returned or made available to the owner. For example, the trustee may be the promoter, a relative, or a friend of the owner who simply carries out the directions of the owner whether or not permitted by the terms of the trust.

When trusts are used for legitimate business, family, or estate planning purposes, either the trust, the beneficiary, or the transferor to the trust will pay the tax on income generated by the trust property. Trusts cannot be used to transform a taxpayer's personal, living, or educational expenses into deductible items, and cannot seek to avoid tax liability by ignoring either the true ownership of income and assets or the true substance of transactions. Therefore, the tax results promised by the promoters of abusive trust arrangements are not allowable under the law, and the participants in and promoters of these arrangements may be subject to civil or criminal penalties in appropriate cases.

For more details, including the legal principles that control the proper tax treatment of these abusive trusts arrangements, see Notice 97-24, 1997-1 C.B. 409.

For additional information about abusive tax arrangements, visit the IRS website at IRS.gov and type in the keyword “Scams” in the search box.

**Definitions**

**Beneficiary.** A beneficiary includes an heir, a legatee, or a devisee.  

**Decedent’s estate.** The decedent’s estate is an entity that is formed at the time of an individual’s death and generally is charged with gathering the estate’s assets, paying the decedent’s debts and expenses, and distributing the remaining assets. Generally, the estate consists of all the property, real or personal, tangible or intangible, wherever situated, that the decedent owned an interest in at death.  

**Distributable net income (DNI).** The income distribution deduction allowable to estates and trusts for amounts paid, credited, or required to be distributed to beneficiaries is limited to DNI. This amount, which is figured on Schedule B, line 7, is also used to determine how much of an amount paid, credited, or required to be distributed to a beneficiary will be includible in his or her gross income.

**Income, deductions, and credits in respect of a decedent.**

**Income.** When completing Form 1041, you must take into account any items that are income in respect of a decedent (IRD).

In general, IRD is income that a decedent was entitled to receive but that was not properly includible in the decedent’s final income tax return under the decedent’s method of accounting.

IRD includes:
- All income of a decedent who reported his or her income on the cash method of accounting,
- Income accrued solely because of the decedent’s death in the case of a decedent who reported his or her income on the accrual method of accounting, and
- Income to which the decedent had a contingent claim at the time of his or her death.

Some examples of IRD for a decedent who kept his or her books on the cash method are:
- Deferred salary payments that are payable to the decedent’s estate,
- Uncollected interest on U.S. savings bonds,
- Proceeds from the completed sale of farm produce, and
- The portion of a lump-sum distribution to the beneficiary of a decedent’s IRA that equals the balance in the IRA at the time of the owner’s death. This includes unrealized appreciation and income accrued to that date, less the aggregate amount of the owner’s nondeductible contributions to the IRA. Such amounts are included in the beneficiary’s gross income in the tax year that the distribution is received.

The IRD has the same character it would have had if the decedent had lived and received such amount.

**Deductions and credits.** The following deductions and credits, when paid by the decedent’s estate, are allowed on Form 1041 even though they were not allowable on the decedent’s final income tax return.
- Business expenses deductible under section 162.
- Interest deductible under section 163.
- Taxes deductible under section 164.
- Investment expenses described in section 212 (in excess of 2% of adjusted gross income (AGI)).
- Percentage depletion allowed under section 611.
- Foreign tax credit.

For more information, see section 691 or IRD in Pub. 559, Survivors, Executors, and Administrators.

**Income required to be distributed currently.** Income required to be distributed currently is income that is required under the terms of the governing instrument and applicable local law to be distributed in the year it is received. The fiduciary must be under a duty to distribute the income currently, even if the actual distribution is not made until after the close of the trust’s tax year. See Regulations section 1.651(a)-2.

**Fiduciary.** A fiduciary is a trustee of a trust, or an executor, executrix, administrator, administratrix, personal representative, or person in possession of property of a decedent’s estate.

**Note.** Any reference in these instructions to “you” means the fiduciary of the estate or trust.

**Trust.** A trust is an arrangement created either by a will or by an inter vivos declaration by which trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.

**Revocable living trust.** A revocable living trust is an arrangement created by a written agreement or declaration during the life of an individual and can be changed or ended at any time during the individual’s life. A revocable living trust is generally created to manage and distribute property. Many people use this type of trust instead of (or in addition to) a will.

Because this type of trust is revocable, it is treated as a grantor type trust for tax purposes. See Grantor Type Trusts later for special filing instructions that apply to grantor type trusts.

**Tip.** Be sure to read Optional Filing Methods for Certain Grantor Type Trusts. Generally, most people that have revocable living trusts will be able to use Optional Method 1. This method is the easiest and least burdensome way to meet your obligations.

**Who Must File**

**Decedent’s Estate**

The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic estate that has:

1. Gross income for the tax year of $600 or more,
2. A beneficiary who is a nonresident alien.

An estate is a domestic estate if it is not a foreign estate. A foreign estate is one the income of which is from sources outside the United States that is not effectively connected with the conduct of a U.S. trade or business and
is not includible in gross income. If you are the fiduciary of a foreign estate, file Form 1040NR, U.S. Nonresident Alien Income Tax Return, instead of Form 1041.

**Trust**

The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic trust taxable under section 641 that has:

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

Two or more trusts are treated as one trust if such trusts have substantially the same grantor(s) and substantially the same primary beneficiaries and a principal purpose of such trusts is avoidance of tax. This provision applies only to that portion of the trust that is attributable to contributions to corpus made after March 1, 1984.

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

See Regulations section 301.7701-7 for more information on the court and control tests.

Also treated as a domestic trust is a trust (other than a trust treated as wholly owned by the grantor) that:
- Was in existence on August 20, 1996,
- Was treated as a domestic trust on August 19, 1996, and
- Elected to continue to be treated as a domestic trust.

A trust that is not a domestic trust is treated as a foreign trust. If you are the trustee of a foreign trust, file Form 1040NR instead of Form 1041. Also, 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.

If a domestic trust becomes a foreign trust, it is treated under section 684 as having transferred all of its assets to a foreign trust, except to the extent a grantor or another person is treated as the owner of the trust when the trust becomes a foreign trust.

**Grantor Type Trusts**

If all or any portion of a trust is a grantor type trust, then that trust or portion of a trust must follow the special reporting requirements discussed on page 11, under Special Reporting Instructions. See Grantor Type Trust on page 15 for more details on what makes a trust a grantor type trust.

**Qualified subchapter S trusts (QSSTs)**

QSSTs must follow the special reporting requirements for these trusts discussed on page 11.

**Special Rule for Certain Revocable Trusts**

Section 645 provides that if both the executor (if any) of an estate (the related estate) and the trustee of a qualified revocable trust (QRT) elect the treatment in section 645, the trust must be treated and taxed as part of the related estate during the election period. This election may be made by a QRT even if no executor is appointed for the related estate.

In general, Form 8855, Election To Treat a Qualified Revocable Trust as Part of an Estate, must be filed by the due date for Form 1041 for the first tax year of the related estate. This applies even if the combined related estate and electing trust do not have sufficient income to be required to file Form 1041. However, if the estate is granted an extension of time to file Form 1041 for its first tax year, the due date for Form 8855 is the extended due date.

Once made, the election is irrevocable.

**Qualified revocable trusts.** In general, a QRT is any trust (or part of a trust) that, on the day the decedent died, was treated as owned by the decedent because the decedent held the power to revoke the trust as described in section 676. An electing trust is a QRT for which a section 645 election has been made.

**Election period.** The election period is the period of time during which an electing trust is treated as part of its related estate.

The election period begins on the date of the decedent’s death and terminates on the earlier of:
- The day on which the electing trust and related estate, if any, distribute all of their assets, or
- The day before the applicable date. To determine the applicable date, first determine whether Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, is required to be filed as a result of the decedent’s death. If no Form 706 is required to be filed, the applicable date is 2 years after the date of the decedent’s death. If Form 706 is required, the applicable date is the later of 2 years after the date of the decedent’s death or 6 months after the final determination of liability for estate tax. For additional information, see Regulations section 1.645-1(f).

**Taxpayer identification number (TIN).** All QRTs must obtain a new TIN following the death of the decedent whether or not a section 645 election is made. (Use Form W-9, Request for Taxpayer Identification Number and Certification, to notify payers of the new TIN.)

If there is an executor. The following rules apply to filing Form 1041 while the election is in effect.
- The executor of the related estate is responsible for filing Form 1041 for the estate and all electing trusts. The return is filed under the name and TIN of the related estate. Be sure to check the Decedent’s estate box at the top of Form 1041. The executor continues to file Form 1041 during the election period even if the estate distributes all of its assets before the end of the election period.
- The Form 1041 includes all items of income, deduction, and credit for the estate and all electing trusts.
- The executor must attach a statement to Form 1041 providing the following information for each electing trust: (a) the name of the electing trust, (b) the TIN of the electing trust, and (c) the name and address of the trustee of the electing trust.
- The related estate and the electing trust are treated as separate shares for purposes of computing DNI and applying distribution provisions. Also, each of those shares can contain two or more separate shares. For more information, see Separate share rule on page 25 and Regulations section 1.645-1(e)(2)(iii).
- The executor is responsible for insuring that the estate’s share of the combined tax obligation is paid.

For additional information, including treatment of transfers between shares and charitable contribution deductions, see Regulations section 1.645-1(e).
If there is no executor. If no executor has been appointed for the related estate, the trustee of the electing trust files Form 1041 as if it was an estate. File using the TIN that the QRT obtained after the death of the decedent. The trustee can choose a fiscal year as the trust’s tax year during the election period. Be sure to check the Decedent’s estate box at the top of page 1 during the election period. The electing trust is entitled to a single $600 personal exemption on returns filed for the election period.

If there is more than one electing trust, the trusts must appoint one trustee as the filing trustee. Form 1041 is filed under the name and TIN of the filing trustee’s trust. A statement providing the same information regarding the electing trusts (except the filing trust) that is listed under if there is an executor above must be attached to these Forms 1041. All electing trusts must choose the same tax year.

If there is more than one electing trust, the filing trustee is responsible for ensuring that the filing trust’s share of the combined tax liability is paid.

For additional information on filing requirements when there is no executor, including application of the separate share rule, see Regulations section 1.645-1(e). For information on the requirements when an executor is appointed after an election is made and the executor does not agree to the election, see below.

Responsibilities of the trustee when there is an executor (or there is no executor and the trustee is not the filing trustee). When there is an executor (or there is no executor and the trustee is not the filing trustee), the trustee of an electing trust is responsible for the following during the election period.

- To timely provide the executor with all the trust information necessary to file a complete, accurate, and timely Form 1041.
- To ensure that the electing trust’s share of the combined tax liability is paid.

The trustee does not file a Form 1041 during the election period (except for a final return if the trust terminates during the election period as explained later).

Procedures for completing Form 1041 for the year in which the election terminates.

If there is an executor. If there is an executor, the Form 1041 filed under the name and TIN of the related estate for the tax year in which the election terminates includes (a) the items of income, deduction, and credit for the related estate for its entire tax year, and (b) the income, deductions, and credits for the electing trust for the period that ends with the last day of the election period. If the estate will not continue after the close of the tax year, indicate that this Form 1041 is a final return.

At the end of the last day of the election period, the combined entity is deemed to distribute the share comprising the electing trust to a new trust. All items of income, including net capital gains that are attributable to the share comprising the electing trust are included in the calculation of DNI of the electing trust and treated as distributed. The distribution rules of sections 661 and 662 apply to this deemed distribution. The combined entity is entitled to an income distribution deduction for this deemed distribution, and the “new” trust must include its share of the distribution in its income. See Regulations sections 1.645-1(e)(2)(iii) and 1.645-1(h) for more information.

If the electing trust continues in existence after the termination of the election period, the trustee must file Form 1041 under the name and TIN of the trust, using the calendar year as its accounting period, if it is otherwise required to file.

If there is no executor. If there is no executor, the following rules apply to filing Form 1041 for the tax year in which the election period ends:

- The tax year of the electing trust closes on the last day of the election period, and the Form 1041 filed for that tax year includes all items of income, deduction, and credit for the electing trust for the period beginning with the first day of the tax year and ending with the last day of the election period.
- The deemed distribution rules discussed above apply.
- Check the box to indicate that this Form 1041 is a final return.
- If the filing trust continues after the termination of the election period, the trustee must obtain a new TIN. If the trust meets the filing requirements, the trustee must file a Form 1041 under the new TIN for the period beginning with the day after the close of the election period and, in general, ending December 31 of that year.

Responsibilities of the trustee when there is an executor (or there is no executor and the trustee is not the filing trustee). In addition to the requirements listed above under this heading, the trustee is responsible for the following.

- If the trust will not continue after the close of the election period, the trustee must file a Form 1041 under the name and TIN of the trust. Complete the entity information and items A, C, D, and F. Indicate in item F that this is a final return. Do not report any items of income, deduction, or credit.
- If the trust will continue after the close of the election period, the trustee must file a Form 1041 for the trust for the tax year beginning the day after the close of the election period and, in general, ending December 31 of that year. Use the TIN obtained after the decedent’s death. Follow the general rules for completing the return.

Special filing instructions. When the election is not made by the due date of the QRT’s Form 1041.

If the section 645 election has not been made by the time the QRT’s first income tax return would be due for the tax year beginning with the decedent’s death, but the trustee and executor (if any) have decided to make a section 645 election, then the QRT is not required to file a Form 1041 for the short tax year beginning with the decedent’s death and ending on December 31 of that year. However, if a valid election is not subsequently made, the QRT may be subject to penalties and interest for failure to file and failure to pay.

If the QRT files a Form 1041 for this short period, and a valid section 645 election is subsequently made, then the QRT must file an amended Form 1041 for the electing trust, excluding all items of income, deduction, and credit of the electing trust. These amounts are then included on the first Form 1041 filed by the executor for the related estate (or the filing trustee for the electing trust filing as an estate).

Later appointed executor. If an executor for the related estate is not appointed until after the trust has made a valid section 645 election, the executor must agree to the trustee’s election and they must file a revised Form 8855 within 90 days of the appointment of the executor. If the executor does not agree to the election, the election terminates as of the date of appointment of the executor.

If the executor agrees to the election, the trustee must amend any Form 1041 filed under the name and TIN of the electing trust for the period beginning with the decedent’s death. The amended returns are still filed under the name and TIN of the electing trust, and they must include the items of income, deduction, and credit for the related estate for the periods covered by the returns. Also, attach a statement to the amended Forms 1041 identifying the name and TIN of the related estate, and the name and address of the executor. Check the Final return box on the amended return for the tax year that ends with the appointment of the executor. Except for this amended return, all returns filed for the combined...
entity after the appointment of the executor must be filed under the name and TIN of the related estate.

If the election terminates as the result of a later appointed executor, the executor of the related estate must file Forms 1041 under the name and TIN of the related estate for all tax years of the related estate beginning with the decedent's death. The electing trust's election period and tax year terminate the day before the appointment of the executor. The trustee is not required to amend any of the returns filed by the electing trust for the period prior to the appointment of the executor. The trust must file a final Form 1041 following the instructions above for completing Form 1041 in the year in which the election terminates and there is no executor.

**Termination of the trust during the election period.** If an electing trust terminates during the election period, the trustee of that trust must file a final Form 1041 by completing the entity information (using the trust's EIN), checking the Final return box, and signing and dating the form. Do not report items of income, deduction, and credit. These items are reported on the related estate's return.

### Alaska Native Settlement Trusts

The trustee of an Alaska Native Settlement Trust may elect the special tax treatment for the trust and its beneficiaries provided for in section 646. The election must be made by the due date (including extensions) for filing the trust's tax return for its first tax year ending after June 7, 2001. Do not use Form 1041. Use Form 1041-N, U.S. Income Tax Return for Electing Alaska Native Settlement Trusts, to make the election. Additionally, Form 1041-N is the trust's income tax return and satisfies the section 6039H information reporting requirement for the trust.

### Bankruptcy Estate

The bankruptcy trustee or debtor-in-possession must file Form 1041 for the estate of an individual involved in bankruptcy proceedings under chapter 7 or 11 of title 11 of the United States Code if the estate has gross income for the tax year of $9,350 or more. See Bankruptcy Estates on page 13 for details.

### Charitable Remainder Trusts

A section 664 charitable remainder trust (CRT) does not file Form 1041. Instead, a CRT files Form 5227, Split-Interest Trust Information Return. If the CRT has any unrelated business taxable income, it also must file Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code.

### Common Trust Funds
Do not file Form 1041 for a common trust fund maintained by a bank. Instead, the fund may use Form 1065, U.S. Return of Partnership Income, for its return. For more details, see section 584 and Regulations section 1.6032-1.

### Electing Small Business Trusts

Elections by small business trusts file Form 1041. However, see page 12 for a discussion of the special reporting requirements for these trusts.

### Pooled Income Funds

Pooled income funds file Form 1041. See page 12 for the special reporting requirements for these trusts. Additionally, pooled income funds must file Form 5227, Split-Interest Trust Information Return.

### Qualified Funeral Trusts

Trustees of pre-paid funeral trusts who elect treatment under section 685 file Form 1041-QFT, U.S. Income Tax Return for Qualified Funeral Trusts. All other pre-paid funeral trusts, see Grandor Type Trusts on page 11 for Form 1041 reporting requirements.

### Qualified Settlement Funds

The trustee of a designated or qualified settlement fund (QSF) generally must file Form 1120-SF, U.S. Income Tax Return for Settlement Funds, instead of Form 1041.

### Special election.

If a QSF has only one transferee, the transferee may elect to treat the QSF as a grantor-type trust.

To make the grantor trust election, the transferee must attach an election statement to a timely filed Form 1041, including extensions, that the administrator files for the QSF for the tax year in which the settlement fund is established. If Form 1041 is not filed because Optional Method 1 or 2 was chosen, attach the election statement to a timely filed income tax return, including extensions, of the transferee for the tax year in which the settlement fund is established.

### Transition rule.

A transferee can make a grantor trust election for a QSF that was established by February 3, 2006, if the applicable period for filing an amended return has not expired for both the QSF’s first tax year and all later tax years and the same tax years of the transferor. A grantor trust election under this paragraph requires that the returns of the QSF and the transferee for all affected tax years are consistent with the grantor trust election. This requirement may be satisfied by timely filed original returns or amended returns filed before the applicable period of limitations expires. For information about QSFs established by the U.S. Government by February 3, 2006, see Regulations section 1.468B-5(c)(3).

### Election statement.

The election statement may be made separately or, if filed with Form 1041, on the attachment described under Grantor Type Trusts. At the top of the election statement, write “Section 1.468B-1(k) Election” and include the transferee's:

- Name,
- Address,
- TIN, and
- A statement that he or she will treat the qualified settlement fund as a grantor type trust.

### Widely Held Fixed Investment Trust (WHFITs)

Trustees and middlemen of WHFITs do not file Form 1041. Instead, they report all items of gross income and proceeds on the appropriate Form 1099. For more details, see Regulations section 1.671-5(e).

### Electronic Filing

Qualified fiduciaries or transmitters may be able to file Form 1041 and related schedules electronically. If you wish to do this, you must file Form 8633, Application to Participate in the IRS e-file Program. If you file Form 1041 electronically, you may now sign the return electronically by using a personal identification number (PIN). If you do not sign the electronically filed return by using a PIN, you must file Form 1099-S, IRS e-file Signature Authorization for Form 1041, for details.

When To File
For calendar year estates and trusts, file Form 1041 and Schedule(s) K-1 on or before April 18, 2011. For fiscal year estates and trusts, file Form 1041 by the 15th day of the 4th month following the close of the tax year. If the due date falls on a Saturday, Sunday, or legal holiday, file on the next business day. For example, an estate that has a tax year that ends on June 30, 2011, must file Form 1041 by October 17, 2011.

Private Delivery Services
You can use certain private delivery services designated by the IRS to meet the “timely mailing as timely filing/paying” rule for tax returns and payments. These private delivery services include only the following.
• The private delivery service can tell you how to get written proof of the mailing date.

Extension of Time To File
If more time is needed to file the estate or trust return, use Form 7004 to apply for an automatic 5-month extension of time to file.

Period Covered
File the 2010 return for calendar year 2010 and fiscal years beginning in 2010 and ending in 2011. If the return is for a fiscal year or a short tax year (less than 12 months), fill in the tax year space at the top of the form.

The 2010 Form 1041 may also be used for a tax year beginning in 2011 if:
1. The estate or trust has a tax year of less than 12 months that begins and ends in 2011, and
2. The 2011 Form 1041 is not available by the time the estate or trust is required to file its tax return. However, the estate or trust must show its 2011 tax year on the 2010 Form 1041 and incorporate any tax law changes that are effective for tax years beginning after December 31, 2010.

Who Must Sign
Fiduciary
The fiduciary, or an authorized representative, must sign Form 1041. If there are joint fiduciaries, only one is required to sign the return.

A financial institution that submitted estimated tax payments for trusts for which it is the trustee must enter its EIN in the space provided for the EIN of the fiduciary. Do not enter the EIN of the trust. For this purpose, a financial institution is one that maintains a Treasury Tax and Loan (TT&L) account. If you are an attorney or other individual functioning in a fiduciary capacity, leave this space blank. Do not enter your individual social security number (SSN). If you, as fiduciary, fill in Form 1041, leave the Paid Preparer space blank. If someone prepares this return and does not charge you, that person should not sign the return.

Paid Preparer
Generally, anyone who is paid to prepare a tax return must sign the return and fill in the other blanks in the Paid Preparer Use Only area of the return.

The person required to sign the return must:
• Complete the required preparer information,
• Sign it in the space provided for the preparer’s signature (a facsimile signature is acceptable), and
• Give you a copy of the return for your records.

Anyone who is paid to prepare the estate’s or trust’s return must enter their PTIN in the Paid Preparer Use Only section. The PTIN entered must have been issued after August 2010. For information, see Form W-12, IRS Paid Preparer Tax Information Number (PTIN) Application.

Paid Preparer Authorization
If the fiduciary wants to allow the IRS to discuss the estate’s or trust’s 2010 tax return with the paid preparer who signed it, check the “Yes” box in the signature area of the return. This authorization applies only to the individual whose signature appears in the Paid Preparer Use Only area of the estate’s or trust’s return. It does not
apply to the firm, if any, shown in that section.

If the “Yes” box is checked, the fiduciary is authorizing the IRS to call the paid preparer to answer any questions that may arise during the processing of the estate’s or trust’s return. The fiduciary is also authorizing the paid preparer to:

• Give the IRS any information that is missing from the estate’s or trust’s return.
• Call the IRS for information about the processing of the estate’s or trust’s return or the status of its refund or payment(s), and
• Respond to certain IRS notices that the fiduciary has shared with the preparer about math errors, offsets, and return preparation. The notices will not be sent to the preparer.

The fiduciary is not authorizing the paid preparer to receive any refund check, bind the estate or trust to anything (including any additional tax liability), or otherwise represent the estate or trust before the IRS.

The authorization will automatically end no later than the due date (without regard to extensions) for filing the estate’s or trust’s 2010 tax return. If the fiduciary wants to expand the paid preparer’s authorization or revoke the authorization before it ends, see Pub. 947, Practice Before the IRS and Power of Attorney.

**Accounting Methods**

Figure taxable income using the method of accounting regularly used in keeping the estate’s or trust’s books and records. Generally, permissible methods include the cash method, the accrual method, or any other method authorized by the Internal Revenue Code. In all cases, the method used must clearly reflect income.

Generally, the estate or trust may change its accounting method (for income as a whole or for any material item) only by getting consent on Form 3115, Application for Change in Accounting Method. For more information, see Pub. 538, Accounting Periods and Methods.

**Accounting Periods**

For a decedent’s estate, the moment of death determines the end of the decedent’s tax year and the beginning of the estate’s tax year. As executor or administrator, you choose the estate’s tax period when you file its first income tax return. The estate’s first tax year may be any period of 12 months or less that ends on the last day of a month. If you select the last day of any month other than December, you are adopting a fiscal tax year.

To change the accounting period of an estate, use Form 1128, Application To Adopt, Change, or Retain a Tax Year.

Generally, a trust must adopt a calendar year. The following trusts are exempt from this requirement:

• A trust that is exempt from tax under section 501(a);
• A charitable trust described in section 4947(a)(1); and
• A trust that is treated as wholly owned by a grantor under the rules of sections 671 through 679.

**Rounding Off to Whole Dollars**

You may round off cents to whole dollars on the estate’s or trust’s return and schedules. If you do round to whole dollars, you must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar. For example, $1.39 becomes $1 and $2.50 becomes $3.

If you have to add two or more amounts to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

**Estimated Tax**

Generally, an estate or trust must pay estimated income tax for 2011 if it expects to owe, after subtracting any withholding and credits, at least $1,000 in tax, and it expects the withholding and credits to be less than the smaller of:

1. 90% of the tax shown on the 2011 tax return, or
2. 100% of the tax shown on the 2010 tax return (110% of that amount if the estate’s or trust’s adjusted gross income on that return is more than $150,000, and less than 1½ of gross income for 2010 or 2011 is from farming or fishing).

However, if a return was not filed for 2010 or that return did not cover a full 12 months, item 2 does not apply.

For this purpose, include household employment taxes in the tax shown on the tax return, but only if either of the following is true:

• The estate or trust will have federal income tax withheld for 2011 (see the instructions on page 24 for line 24e), or
• The estate or trust would be required to make estimated tax payments for 2011 even if it did not include household employment taxes when figuring estimated tax.

**Exceptions**

Estimated tax payments are not required from:

1. An estate of a domestic decedent or a domestic trust that had no tax liability for the full 12-month 2010 tax year;
2. A decedent’s estate for any tax year ending before the date that is 2 years after the decedent’s death; or
3. A trust that was treated as owned by the decedent if the trust will receive the residue of the decedent’s estate under the will (or if no will is admitted to probate, the trust primarily responsible for paying debts, taxes, and expenses of administration) for any tax year ending before the date that is 2 years after the decedent’s death.

For more information, see Form 1041-ES, Estimated Income Tax for Estates and Trusts.

**Electronic Deposits**

The IRS has issued T.D. 9507. Beginning in 2011, you must deposit all depository taxes (such as estimated taxes of certain trusts, excise tax, etc.) electronically using the Electronic Federal Tax Payment System (EFTPS).

A financial institution that maintains a TT&L account, and acts as a fiduciary for at least 200 taxable trusts that are required to pay estimated tax, is required to deposit the estimated tax payments electronically using EFTPS.

A fiduciary that is not required to make electronic deposits of estimated tax on behalf of a trust, or the fiduciary of an estate, may voluntarily participate in EFTPS. To enroll in or get more information about EFTPS, visit the EFTPS website at www.eftps.gov or call 1-800-555-4477. Also, see Pub. 966, The Secure Way To Pay Your Federal Taxes.

**Depositing on time.** For deposits made using EFTPS to be on time, you must initiate the deposit by 8:00 p.m. Eastern time the day before the date the deposit is due. If you use a third party to make deposits on behalf of the trust (or estate), the third party may have a different cut-off time.

**Section 643(g) Election**

Fiduciaries of trusts that pay estimated tax may elect under section 643(g) to have any portion of their estimated tax payments allocated to any of the beneficiaries.

The fiduciary of a decedent’s estate may make a section 643(g) election only for the final year of the estate.

You make the election by filing Form 1041-T, Allocation of Estimated Tax Payments to Beneficiaries, by the 65th day after the close of the estate’s or trust’s tax year. Then, you include that amount on the Schedule K-1 (Form 1041) for the beneficiary(ies) for whom you elected it.
Failure to make a timely election will result in the estimated tax payments not being transferred to the beneficiary(ies) even if you entered the amount you wanted transferred on Schedule K-1.

See the instructions for line 24b on page 24 for more details.

**Interest and Penalties**

**Interest**

Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted.

Interest is also charged on penalties imposed for failure to file, negligence, fraud, substantial understatement of tax, and reportable transactions. Interest is charged on the penalty from the due date of the return (including extensions). The interest charge is figured at a rate determined under section 6621.

**Late Filing of Return**

The law provides a penalty of 5% of the tax due for each month, or part of a month, for which a return is not filed up to a maximum of 25% of the tax due (15% for each month, or part of a month, up to a maximum of 75% if the failure to file is fraudulent). If the return is more than 60 days late, the minimum penalty is the smaller of $135 or the tax due. The penalty will not be imposed if you can show that the failure to file on time was due to reasonable cause. If the failure is due to reasonable cause, attach an explanation to the return.

**Late Payment of Tax**

Generally, the penalty for not paying tax when due is 1/2 of 1% of the unpaid amount for each month or part of a month it remains unpaid. The maximum penalty is 25% of the unpaid amount. The penalty applies to any unpaid tax on the return. Any penalty is in addition to interest charges on late payments.

**TIP**

If you include interest on either of these penalties with your payment, identify and enter these amounts in the bottom margin of Form 1041, page 1. Do not include the interest or penalty amount in the balance of tax due on line 27.

**Failure To Provide Information Timely**

You must provide Schedule K-1 (Form 1041), on or before the day you are required to file Form 1041, to each beneficiary who receives a distribution of property or an allocation of an item of the estate.

**Underpaid Estimated Tax**

If the fiduciary underpaid estimated tax, use Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, to figure any penalty. Enter the amount of any penalty on Form 1041, line 26.

**Trust Fund Recovery Penalty**

This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid. These taxes are generally reported on Forms 720, 941, 943, 944, or 945. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, or paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the instructions for Form 720, Pub. 15 (Circular E), Employer's Tax Guide, or Pub. 51 (Circular A), Agricultural Employer's Tax Guide, for more details, including the definition of responsible persons.

**Other Penalties**

Other penalties can be imposed for negligence, substantial understatement of tax, and fraud. See Pub. 17, Your Federal Income Tax, for details on these penalties.

**Other Forms That May Be Required**

Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements.

Form 56, Notice Concerning Fiduciary Relationship. You must notify the IRS of the creation or termination of a fiduciary relationship. You may use Form 56 to provide this notice to the IRS.

Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, or Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States.

Form 706-GS(D-1), Notification of Distribution From a Generation-Skipping Trust.

Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.

Form 720, Quarterly Federal Excise Tax Return. Use Form 720 to report environmental excise taxes, communications and air transportation taxes, fuel taxes, luxury tax on passenger vehicles, manufacturers' taxes, ship passenger tax, and certain other excise taxes.

**Caution.** See Trust Fund Recovery Penalty earlier.

Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. Use this form to report certain information required under section 6038B.

Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. The estate or trust may be liable for FUTA tax and may have to file Form 940 if it paid wages of $1,500 or more in any calendar quarter during the calendar year (or the preceding calendar year) or one or more employees worked for the estate or trust for some part of a day in any 20 different weeks during the calendar year (or the preceding calendar year).

Form 941, Employer’s QUARTERLY Federal Tax Return. Employers must file this form quarterly to report income tax withheld on wages and employer and employee social security and Medicare taxes. Certain small employers must file Form 944, Employer's ANNUAL Federal Tax Return, instead of Form 941. For more information, see the instructions for Form 944. Agricultural employers must file Form 943, Employer's Annual Federal Tax Return for Agricultural Employees, instead of Form 941, to report income tax withheld and employer and employee social security and Medicare taxes on farmworkers.

**Caution.** See Trust Fund Recovery Penalty earlier.

Form 945, Annual Return of Withheld Federal Income Tax. Use this form to report income tax withheld from nonpayroll payments, including pensions, annuities, IRAs, gambling winnings, and backup withholding.
Caution. See Trust Fund Recovery Penalty earlier.


Form 1040NR, U.S. Nonresident Alien Income Tax Return.


Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the United States that is not effectively connected with a U.S. trade or business. For more information, see sections 1441 and 1442, and Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.

Forms 1099-A, B, INT, LTC, MISC, OID, Q, R, S, and SA. You may have to file these information returns to report acquisitions or abandonments of secured property; proceeds from broker and barter exchange transactions; interest payments; payments of long-term care and accelerated death benefits; miscellaneous income payments; original issue discount; distributions from Coverdell ESAs; distributions from pensions, annuities, retirement or profit-sharing plans, IRAs (including SEPs, SIMPLEs, Roth IRAs, Roth Conversions, and IRA recharacterizations), insurance contracts, etc.; proceeds from real estate transactions; and distributions from an HSA, Archer MSA, or Medicare Advantage MSA. Also, use certain of these returns to report amounts received as a nominee on behalf of another person, except amounts reported to beneficiaries on Schedule K-1 (Form 1041).

Form 8275, Disclosure Statement. File Form 8275 to disclose items or positions, except those contrary to a regulation, that are not otherwise adequately disclosed on a tax return. The disclosure is made to avoid parts of the accuracy-related penalty imposed for disregard of rules or substantial understatement of tax. Form 8275 is also used for disclosures relating to preparer penalties for understatements due to unrealistic positions or disregard of rules.

Form 8275-R, Regulation Disclosure Statement, is used to disclose any item on a tax return for which a position has been taken that is contrary to Treasury regulations.

Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests, and Form 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests. Use these forms to report and transmit withheld tax on the sale of U.S. real property by a foreign person. Also, use these forms to report and transmit withheld tax from amounts distributed to a foreign beneficiary from a “U.S. real property interest account” that a domestic estate or trust is required to establish under Regulations section 1.1445-5(c)(1)(iii).

Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than $10,000 in cash or foreign currency in one transaction (or a series of related transactions).

Form 8855, Election To Treat a Qualified Revocable Trust as Part of an Estate. This election allows a qualified revocable trust to be treated and taxed (for income tax purposes) as part of its related estate during the election period.

Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. The estate or trust may have to file Form 8865 if it:

1. Controlled a foreign partnership (that is, owned more than a 50% direct or indirect interest in a foreign partnership);
2. Owned at least a 10% direct or indirect interest in a foreign partnership while U.S. persons controlled that partnership;
3. Had an acquisition, disposition, or change in proportional interest in a foreign partnership that:
   a. Increased its direct interest to at least 10%;
   b. Reduced its direct interest of at least 10% to less than 10%; or
   c. Changed its direct interest by at least a 10% interest.
4. Contributed property to a foreign partnership in exchange for a partnership interest if:
   a. Immediately after the contribution, the estate or trust owned, directly or indirectly, at least a 10% interest in the foreign partnership or
   b. The fair market value (FMV) of the property the estate or trust contributed to the foreign partnership, for a partnership interest, when added to other contributions of property made to the foreign partnership during the preceding 12-month period, exceeds $100,000.

Also, the estate or trust may have to file Form 8865 to report certain disposions by a foreign partnership of property it previously contributed to that foreign partnership if it was a partner at the time of the disposition.

For more details, including penalties for failing to file Form 8865, see Form 8865 and its separate instructions.

Form 8886, Reportable Transaction Disclosure Statement. Use Form 8886 to disclose information for each reportable transaction in which the trust participated, directly or indirectly. Form 8886 must be filed for each tax year that the federal income tax liability of the estate or trust is affected by its participation in the transaction. The estate or trust may have to pay a penalty if it has a requirement to file Form 8886 but you fail to file it. The following are reportable transactions:

- Any transaction that is the same as or substantially similar to tax avoidance transactions identified by the IRS as listed transactions.
- Any transaction offered under conditions of confidentiality and for which the estate or trust paid a minimum fee (confidential transaction).
- Any transaction for which the estate or trust or a related party has contractual protection against disallowance of the tax benefits (transaction with contractual protection).
- Any transaction resulting in a loss of at least $2 million in any single year or $4 million in any combination of years ($50,000 in any single year if the loss is generated by a section 988 transaction) (loss transactions).
- Any transaction substantially similar to one of the types of transactions identified by the IRS as a transaction of interest.

See the Instructions for Form 8886 for more details and exceptions.

Form 8918, Material Advisor Disclosure Statement. Material advisors who provide material aid, assistance, or advice on organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and who directly or indirectly receive or expect to receive a minimum fee, must use Form 8918 to disclose any reportable transaction under Regulations section 301.6111-3. For more information, see Form 8918 and its instructions.

Form 8939, Allocation of Increase in Basis for Property Received From a Decedent. File this form to allocate additional basis for property acquired from a decedent who died in 2010.
Additional Information

The following publications may assist you in preparing Form 1041:
- Pub. 550, Investment Income and Expenses,
- Pub. 559, Survivors, Executors, and Administrators,
- Pub. 590, Individual Retirement Arrangements (IRAs), and
- Pub. 4895, Tax Treatment of Property Acquired From a Decedent Dying in 2010.

Assembly and Attachments

Assemble any schedules, forms, and attachments behind Form 1041 in the following order:
1. Schedule I (Form 1041);
2. Schedule D (Form 1041);
3. Form 4952;
4. Schedule H (Form 1040);
5. Form 3800;
6. Form 4136;
7. Form 8855;
8. All other schedules and forms; and
9. All attachments.

Attachments

If you need more space on the forms or schedules, attach separate sheets. Use the same size and format as on the printed forms. But show the totals on the printed forms.

Attach these separate sheets after all the schedules and forms. Enter the estate’s or trust’s EIN on each sheet.

Do not file a copy of the decedent’s will or the trust instrument unless the IRS requests it.

Special Reporting Instructions

Grantor type trusts, the S portion of electing small business trusts (ESBTs), and bankruptcy estates all have reporting requirements that are significantly different than other Subchapter J trusts and decedent’s estates. Additionally, grantor type trusts have optional filing methods available. Pooled income funds have many similar reporting requirements that other Subchapter J trusts (other than grantor type trusts and electing small business trusts) have but there are some very important differences. These reporting differences and optional filing methods are discussed below by entity.

Grantor Type Trusts

A trust is a grantor trust if the grantor retains certain powers or ownership benefits. This can also apply to only a portion of a trust. See Grantor Type Trust on page 15 for details on what makes a trust a grantor trust.

In general, a grantor trust is ignored for income tax purposes and all of the income, deductions, etc., are treated as belonging directly to the grantor. This also applies to any portion of a trust that is treated as a grantor trust.

The following instructions apply only to grantor type trusts that are not using an optional filing method.

How to report.

If the entire trust is a grantor trust, fill in only the entity portion of Form 1041. Do not show any dollar amounts on the form itself; show dollar amounts only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment.

If only part of the trust is treated as a grantor trust, report on Form 1041 only the part of the income, deductions, etc., that is taxable to the trust. The amounts that are taxable directly to the grantor are shown only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment. However, Schedule K-1 is used to reflect any income distributed from the portion of the trust that is not taxable directly to the grantor or owner.

The fiduciary must give the grantor (owner) of the trust a copy of the attachment.

Attachment. On the attachment, show:
- The name, identifying number, and address of the person(s) to whom the income is taxable;
- The income of the trust that is taxable to the grantor or another person under sections 671 through 678. Report the income in the same detail as it would be reported on the grantor’s return had it been received directly by the grantor; and
- Any deductions or credits that apply to this income. Report these deductions and credits in the same detail as they would be reported on the grantor’s return had they been received directly by the grantor.

The income taxable to the grantor or another person under sections 671 through 678 and the deductions and credits that apply to that income must be reported by that person on their own income tax return.

Example. The John Doe Trust is a grantor type trust. During the year, the trust sold 100 shares of ABC stock for $1,010 in which it had a basis of $10 and 200 shares of XYZ stock for $10 in which it had a $1,020 basis.

The trust does not report these transactions on Form 1041. Instead, a schedule is attached to the Form 1041 showing each stock transaction separately and in the same detail as John Doe (grantor and owner) will need to report these transactions on his Schedule D (Form 1040). The trust does not net the capital gains and losses, nor does it issue a Schedule K-1 (Form 1041) showing a $10 long-term capital loss.

QSSTS. Income allocated to S corporation stock held by the trust is treated as owned by the income beneficiary of the portion of the trust that owns the stock. Report this income following the rules discussed above for grantor type trusts. A QSST cannot elect any of the optional filing methods discussed below.

However, the trust, and not the income beneficiary, is treated as the owner of the S corporation stock for figuring and attributing the tax results of a disposition of the stock. For example, if the disposition is a sale, the QSST election as to the stock sold and any gain or loss recognized on the sale will be that of the trust. For more information on QSSTS, see Regulations section 1.1361-1(j).

Optional Filing Methods for Certain Grantor Type Trusts

Generally, if a trust is treated as owned by one grantor or other person, the trustee may choose Optional Method 1 or Optional Method 2 as the trust’s method of reporting instead of filing Form 1041. A husband and wife will be treated as one grantor for purposes of all the schedules and forms. Enter the address of the person(s) to whom the estate’s or trust’s EIN on each sheet.

Optional Method 1

If the entire trust is a grantor trust, fill in only the entity portion of Form 1041. Do not show any dollar amounts on the form itself; show dollar amounts only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment.

Optional Method 2

If only part of the trust is treated as a grantor trust, report on Form 1041 only the part of the income, deductions, etc., that is taxable to the trust. The amounts that are taxable directly to the grantor are shown only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment. However, Schedule K-1 is used to reflect any income distributed from the portion of the trust that is not taxable directly to the grantor or owner.

The fiduciary must give the grantor (owner) of the trust a copy of the attachment.

Attachment. On the attachment, show:
- The name, identifying number, and address of the person(s) to whom the income is taxable;
- The income of the trust that is taxable to the grantor or another person under sections 671 through 678. Report the income in the same detail as it would be reported on the grantor’s return had it been received directly by the grantor; and
- Any deductions or credits that apply to this income. Report these deductions and credits in the same detail as they would be reported on the grantor’s return had they been received directly by the grantor.

The income taxable to the grantor or another person under sections 671 through 678 and the deductions and credits that apply to that income must be reported by that person on their own income tax return.

Example. The John Doe Trust is a grantor type trust. During the year, the trust sold 100 shares of ABC stock for $1,010 in which it had a basis of $10 and 200 shares of XYZ stock for $10 in which it had a $1,020 basis.

The trust does not report these transactions on Form 1041. Instead, a schedule is attached to the Form 1041 showing each stock transaction separately and in the same detail as John Doe (grantor and owner) will need to report these transactions on his Schedule D (Form 1040). The trust does not net the capital gains and losses, nor does it issue a Schedule K-1 (Form 1041) showing a $10 long-term capital loss.

QSSTS. Income allocated to S corporation stock held by the trust is treated as owned by the income beneficiary of the portion of the trust that owns the stock. Report this income following the rules discussed above for grantor type trusts. A QSST cannot elect any of the optional filing methods discussed below.

However, the trust, and not the income beneficiary, is treated as the owner of the S corporation stock for figuring and attributing the tax results of a disposition of the stock. For example, if the disposition is a sale, the QSST election as to the stock sold and any gain or loss recognized on the sale will be that of the trust. For more information on QSSTS, see Regulations section 1.1361-1(j).

Optional Filing Methods for Certain Grantor Type Trusts

Generally, if a trust is treated as owned by one grantor or other person, the trustee may choose Optional Method 1 or Optional Method 2 as the trust’s method of reporting instead of filing Form 1041. A husband and wife will be treated as one grantor for purposes of all the schedules and forms. Enter the address of the person(s) to whom the estate’s or trust’s EIN on each sheet.

Optional Method 1

If the entire trust is a grantor trust, fill in only the entity portion of Form 1041. Do not show any dollar amounts on the form itself; show dollar amounts only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment.

Optional Method 2

If only part of the trust is treated as a grantor trust, report on Form 1041 only the part of the income, deductions, etc., that is taxable to the trust. The amounts that are taxable directly to the grantor are shown only on an attachment to the form. Do not use Schedule K-1 (Form 1041) as the attachment. However, Schedule K-1 is used to reflect any income distributed from the portion of the trust that is not taxable directly to the grantor or owner.

The fiduciary must give the grantor (owner) of the trust a copy of the attachment.

Attachment. On the attachment, show:
- The name, identifying number, and address of the person(s) to whom the income is taxable;
- The income of the trust that is taxable to the grantor or another person under sections 671 through 678. Report the income in the same detail as it would be reported on the grantor’s return had it been received directly by the grantor; and
- Any deductions or credits that apply to this income. Report these deductions and credits in the same detail as they would be reported on the grantor’s return had they been received directly by the grantor.

The income taxable to the grantor or another person under sections 671 through 678 and the deductions and credits that apply to that income must be reported by that person on their own income tax return.

Example. The John Doe Trust is a grantor type trust. During the year, the trust sold 100 shares of ABC stock for $1,010 in which it had a basis of $10 and 200 shares of XYZ stock for $10 in which it had a $1,020 basis.

The trust does not report these transactions on Form 1041. Instead, a schedule is attached to the Form 1041 showing each stock transaction separately and in the same detail as John Doe (grantor and owner) will need to report these transactions on his Schedule D (Form 1040). The trust does not net the capital gains and losses, nor does it issue a Schedule K-1 (Form 1041) showing a $10 long-term capital loss.

QSSTS. Income allocated to S corporation stock held by the trust is treated as owned by the income beneficiary of the portion of the trust that owns the stock. Report this income following the rules discussed above for grantor type trusts. A QSST cannot elect any of the optional filing methods discussed below.

However, the trust, and not the income beneficiary, is treated as the owner of the S corporation stock for figuring and attributing the tax results of a disposition of the stock. For example, if the disposition is a sale, the QSST election as to the stock sold and any gain or loss recognized on the sale will be that of the trust. For more information on QSSTS, see Regulations section 1.1361-1(j).
persons, one of which is not a U.S. person.
• A trust all of which is treated as owned by one or more grantors or other persons if at least one grantor or other person is an exempt recipient for information reporting purposes, unless at least one grantor or other person is not an exempt recipient and the trustee reports without treating any of the grantors or other persons as exempt recipients.

Optional Method 1. For a trust treated as owned by one grantor or by one other person, the trustee must give all payers of income during the tax year the name and TIN of the grantor or other person treated as the owner of the trust and the address of the trust. This method may be used only if the owner of the trust provides the trustee with a signed Form W-9, Request for Taxpayer Identification Number and Certification. In addition, unless the grantor or other person treated as owner of the trust is the trustee or a co-trustee of the trust, the trustee must give the grantor or other person treated as owner of the trust a statement that:
• Shows all items of income, deduction, and credit of the trust;
• Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and
• Informs the grantor or other person treated as owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return.

Optional Method 2. For a trust treated as owned by two or more grantors or other persons, the trustee must give all payers of income during the tax year the name, address, and TIN of the trust. The trustee also must file with the IRS the appropriate Forms 1099 to report the income or gross proceeds paid to the trust by all payers during the tax year attributable to the part of the trust treated as owned by each grantor, or other person, showing the trust as the payer and each 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. The due date for any Forms 1099 required to be filed with the IRS by a trustee under this method is February 28, 2011 (March 31, 2011, if filed electronically).

In addition, the trustee must give each grantor or other person treated as owner of the trust a statement that:
• Shows all items of income, deduction, and credit of the trust attributable to the part of the trust treated as owned by the grantor or other person;
• Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and
• Informs the grantor or other person treated as owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return.

TIP
Grantor trusts that have not applied for an EIN and are going to file under Optional Method 1 do not need an EIN for the trust as long as they continue to report under that method.

Optional Method 3. For a trust treated as owned by two or more grantors or other persons, the trustee must give all payers of income during the tax year the name, address, and TIN of the trust. The trustee also must file with the IRS the appropriate Forms 1099 to report the income or gross proceeds paid to the trust by all payers during the tax year attributable to the part of the trust treated as owned by each grantor, or other person, showing the trust as the payer and each 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. The due date for any Forms 1099 required to be filed with the IRS by a trustee under this method is February 28, 2011 (March 31, 2011, if filed electronically).

In addition, the trustee must give each grantor or other person treated as owner of the trust a statement that:
• Shows all items of income, deduction, and credit of the trust attributable to the part of the trust treated as owned by the grantor or other person;
• Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and
• Informs the grantor or other person treated as owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return.

Changing filing methods. A trustee who previously had filed Form 1041 can change to one of the optional methods by filing a final Form 1041 for the tax year that immediately precedes the first tax year for which the trustee elects to report under one of the optional methods. On the front of the final Form 1041, the trustee must write “Pursuant to section 1.671-4(g), this is the final Form 1041 for this grantor trust,” and check the Final return box in item F.

For more details on changing reporting methods, including changes from one optional method to another, see Regulations section 1.671-4(g).

Backup withholding. The following grantor trusts are treated as payors for purposes of backup withholding.

1. A trust established after 1995, all of which is owned by two or more grantors (treating spouses filing a joint return as one grantor).

2. A trust with 10 or more grantors established after 1983 but before 1996.

The trustee must withhold 28% of reportable payments made to any grantor who is subject to backup withholding.

For more information, see section 3406 and its regulations.

Pooled Income Funds
If you are filing for a pooled income fund, attach a statement to support the following:
• The calculation of the yearly rate of return,
• The computation of the deduction for distributions to the beneficiaries, and
• The computation of any charitable deduction.

See section 642 and the regulations thereunder for more information.

You do not have to complete Schedules A or B of Form 1041.

Also, you must file Form 5227, Split-Interest Trust Information Return, for the pooled income fund. However, if all amounts were transferred to trust before May 27, 1969, or if an amount was transferred to the trust after May 26, 1969, for which no deduction was allowed under any of the sections listed under section 4947(a)(2), then Form 5227 does not have to be filed.

Note. Form 1041-A is no longer filed by pooled income funds.

Electing Small Business Trusts (ESBTs)
Special rules apply when figuring the tax on the S portion of an ESBT. The S portion of an ESBT is the portion of the trust that consists of stock in one or more S corporations and is not treated as a grantor type trust. The tax on the S portion:
• Must be figured separately from the tax on the remainder of the ESBT (if any) and attached to the return,
• Is entered to the left of the Schedule G, line 7, entry space preceded by “Sec. 641(c),” and
• Is included in the total tax on Schedule G, line 7.
The tax on the remainder (non-S portion) of the ESBT is figured in the normal manner on Form 1041.

Tax computation attachment. Attach to the return the tax computation for the S portion of the ESBT.

To compute the tax on the S portion:

- Treat that portion of the ESBT as if it were a separate trust;
- Include only the income, losses, deductions, and credits allocated to the ESBT as an S corporation shareholder and gain or loss from the disposition of S corporation stock;
- Aggregate items of income, losses, deductions, and credits allocated to the ESBT as an S corporation shareholder if the S portion of the ESBT has stock in more than one S corporation;
- Deduct state and local income taxes and administrative expenses directly related to the S portion or allocated to the S portion if the allocation is reasonable in light of all the circumstances;
- Deduct interest expense paid or accrued on indebtedness incurred to acquire stock in an S corporation;
- Do not claim a deduction for capital losses in excess of capital gains;
- Do not claim an income distribution deduction or an exemption amount;
- Do not claim an exemption amount in figuring the AMT; and
- Do not use the tax rate schedule to figure the tax. The tax is 35% of the S portion’s taxable income except in figuring the maximum tax on qualified dividends and capital gains.

For additional information, see Regulations section 1.641(c)-1.

Other information. When figuring the tax and DNI on the remaining (non-S) portion of the trust, disregard the S corporation items.

Do not apportion to the beneficiaries any of the S corporation items.

If the ESBT consists entirely of stock in one or more S corporations, do not make any entries on lines 1-22 of page 1. Instead:

- Complete the entity portion;
- Follow the instructions above for figuring the tax on the S corporation items;
- Carry the tax from line 7 of Schedule G to line 23 on page 1; and
- Complete the rest of the return.

The grantor portion (if any) of an ESBT will follow the rules discussed under Grantor Type Trusts on page 11.

Bankruptcy Estates

The bankruptcy estate that is created when an individual debtor files a petition under either chapter 7 or 11 of title 11 of the U.S. Code is treated as a separate taxable entity. The bankruptcy estate is administered by a trustee or a debtor-in-possession. If the case is later dismissed by the bankruptcy court, the individual debtor is treated as if the bankruptcy petition had never been filed.

A separate taxable entity is not created if a partnership or corporation files a petition under any chapter of title 11 of the U.S. Code.

Who Must File

Every trustee (or debtor-in-possession) for an individual’s bankruptcy estate under chapter 7 or 11 of title 11 of the U.S. Code must file a return if the bankruptcy estate has gross income of $9,350 or more for tax years beginning in 2010.

Failure to do so may result in an estimated Request for Administrative Expenses being filed by the IRS in the bankruptcy proceeding or a motion to compel filing of the return.

The filing of a tax return for the bankruptcy estate does not relieve the individual debtor(s) of his, her, or their individual tax obligations.

EIN

Every bankruptcy estate of an individual required to file a return must have its own EIN. The SSN of the individual debtor cannot be used as the EIN for the bankruptcy estate.

Accounting Period

A bankruptcy estate is allowed to have a fiscal year. However, this period cannot be longer than 12 months.

When To File

File Form 1041 on or before the 15th day of the 4th month following the close of the tax year. Use Form 7004 to apply for an extension of time to file.

Disclosure of Return Information

Under section 6103(e)(5), tax returns of individual debtors who have filed for bankruptcy under chapters 7 or 11 of title 11 are, upon written request, open to inspection by or disclosure to the trustee.

The returns subject to disclosure to the trustee are those for the year the bankruptcy begins and prior years. Use Form 4506, Request for Copy of Tax Return, to request copies of the individual debtor’s tax returns.

If the bankruptcy case was not voluntary, disclosure cannot be made before the bankruptcy court has entered an order for relief, unless the court rules that the disclosure is needed for determining whether relief should be ordered.

Transfer of Tax Attributes From the Individual Debtor to the Bankruptcy Estate

The bankruptcy estate succeeds to the following tax attributes of the individual debtor:

1. Net operating loss (NOL) carryovers;
2. Charitable contribution carryovers;
3. Recovery of tax benefit items;
4. Credit carryovers;
5. Capital loss carryovers;
6. Basis, holding period, and character of assets;
7. Method of accounting;
8. Unused passive activity losses;
9. Unused passive activity credits; and
10. Unused section 465 losses.

Income, Deductions, and Credits

Under section 1398(c), the taxable income of the bankruptcy estate generally is figured in the same manner as that of an individual. The gross income of the bankruptcy estate includes any income included in property of the estate as defined in title 11, sections 541 and 1115. Section 1115 was added to title 11 of the U.S. Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Section 1115 of title 11 of the U.S. Code expands the definition of property of the estate in chapter 11 cases filed by individuals after October 16, 2005, and in chapter 11 cases begun by creditors against an individual debtor (involuntary cases) after that date. Under section 1115 of title 11 of the U.S. Code, property of the bankruptcy estate includes (a) earnings from services performed by the debtor after the beginning of the case (both wages and self-employment income) and before the case is closed, dismissed, or converted to a case under a different chapter and (b) property described in section 541 of title 11 of the U.S. Code and income earned therefrom that the debtor acquires after the beginning of the case and before the case is closed, dismissed, or converted. If section 1115 of title 11 of the U.S. Code applies, the bankruptcy estate’s gross income includes, as described above, (a) the debtor’s earnings from services performed after the beginning of the case and (b) the income from property acquired after the beginning of the case.

The income from property owned by the debtor when the case began is also included in the bankruptcy estate’s gross income. However, if this property is exempted from the bankruptcy estate
or is abandoned by the trustee or debtor-in-possession, the income from the property is not included in the bankruptcy estate’s gross income. Also included in income is gain from the sale of the bankruptcy estate’s property. To figure gain, the trustee or debtor-in-possession must determine the correct basis of the property.

To determine whether any amount paid or incurred by the bankruptcy estate is allowable as a deduction or credit, or is treated as wages for employment tax purposes, treat the amount as if it were paid or incurred by the individual debtor in the same trade or business or other activity the debtor engaged in before the bankruptcy proceedings began.

**Administrative expenses.** The bankruptcy estate is allowed a deduction for any administrative expenses allowed under section 503 of title 11 of the U.S. Code, and any fee or charge assessed under chapter 123 of title 28 of the U.S. Code, to the extent not disallowed under an Internal Revenue Code provision (for example, section 263, 265, or 275).

**Administrative expense loss.** When figuring an NOL, nonbusiness deductions (including administrative expenses) are limited under section 172(d)(4) to the bankruptcy estate’s nonbusiness income. The excess nonbusiness deductions are an administrative expense loss that may be carried back to each of the 3 preceding tax years and forward to each of the 7 succeeding tax years of the bankruptcy estate. The amount of an administrative expense loss that may be carried to any tax year is determined after the NOL deductions allowed for that year. An administrative expense loss is allowed only to the bankruptcy estate and cannot be carried to any tax year of the individual debtor.

**Carryback of NOLs and credits.** If the bankruptcy estate incurs an NOL (apart from losses carried forward to the estate from the individual debtor), it can carry back its NOLs not only to previous tax years of the bankruptcy estate, but also to tax years of the individual debtor prior to the year in which the bankruptcy proceedings began. Excess credits, such as the foreign tax credit, also may be carried back to pre-bankruptcy years of the individual debtor.

**Exemption.** For tax years beginning in 2010, a bankruptcy estate is allowed a personal exemption of $3,650.

**Standard deduction.** For tax years beginning in 2010, a bankruptcy estate that does not itemize deductions is allowed a standard deduction of $5,700.

**Discharge of indebtedness.** In a title 11 case, gross income does not include amounts that normally would be included in gross income resulting from the discharge of indebtedness. However, any amounts excluded from gross income must be applied to reduce certain tax attributes in a certain order. Attach Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), to show the reduction of tax attributes.

**Tax Rate Schedule**

Figure the tax for the bankruptcy estate using the tax rate schedule below. Enter the tax on Form 1040, line 44.

<table>
<thead>
<tr>
<th>If taxable income is:</th>
<th>The tax is:</th>
<th>Of the amount over:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over $0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>$0-$8,375</td>
<td>$0.10</td>
<td>$837.50</td>
</tr>
<tr>
<td>$8,375-$34,000</td>
<td>$837.50</td>
<td>$837.50</td>
</tr>
<tr>
<td>$34,000-$68,650</td>
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<td>$68,650</td>
</tr>
<tr>
<td>$68,650-$104,625</td>
<td>$34,000</td>
<td>$104,625</td>
</tr>
<tr>
<td>$104,625-$186,825</td>
<td>$34,000</td>
<td>$186,825</td>
</tr>
<tr>
<td>$186,825</td>
<td>$0</td>
<td>$186,825</td>
</tr>
</tbody>
</table>


**Special Filing Instructions for Bankruptcy Estates**

Use Form 1041 only as a transmittal for Form 1040. In the top margin of Form 1040 write “Attachment to Form 1041. DO NOT DETACH.” Attach Form 1040 to Form 1041. Complete only the identification area at the top of Form 1041. Enter the name of the individual debtor in the following format: “John Q. Public Bankruptcy Estate.” Beneath, enter the name of the trustee in the following format: “Avery Snow, Trustee.” In item D, enter the date the petition was filed or the date of conversion to a chapter 7 or 11 case.

Enter on Form 1041, line 23, the total tax from line 60 of Form 1040. Complete lines 24 through 29 of Form 1041, and sign and date it.

In a chapter 11 case filed after October 16, 2005, the bankruptcy estate’s gross income may be affected by section 1115 of title 11 of the U.S. Code. See Income, Deductions, and Credits earlier. The debtor may receive a Form W-2, 1099-INT, 1099-DIV, or 1099-MISC or other information return reporting wages or other income to the debtor for the entire year, even though some or all of this income is includible in the bankruptcy estate’s gross income under section 1115 of title 11 of the U.S. Code. If this happens, the income reported to the debtor on the Form W-2 or 1099, or other information return (and the withheld income tax shown on these forms) must be reasonably allocated between the debtor and the bankruptcy estate. The debtor-in-possession (or the chapter 11 trustee, if one was appointed) must attach a schedule that shows (a) all the income reported on the Form W-2, Form 1099, or other information return, (b) the portion of this income includible in the bankruptcy estate’s gross income, and (c) all the withheld income tax, if any, and the portion of withheld tax reasonably allocated to the bankruptcy estate. Also, the debtor-in-possession (or the chapter 11 trustee, if one was appointed) must attach a copy of the Form W-2, if any, issued to the debtor for the tax year if the Form W-2 reports wages to the debtor and some or all of the wages are includible in the bankruptcy estate’s gross income because of section 1115 of title 11 of the U.S. Code. For more details, including acceptable allocation methods, see Notice 2006-83, 2006-40 I.R.B. 956, available at www.irs.gov/irb/2006-40_IRB/ar12.html.
Specific Instructions

Name of Estate or Trust
Copy the exact name of the estate or trust from the Form SS-4, Application for Employer Identification Number, that you used to apply for the EIN. If the name of the trust was changed during the tax year for which you are filing, enter the trust's new name and check the Change in Trust's Name box in item F.

If a grantor type trust (discussed later), write the name, identification number, and address of the grantor(s) or other owner(s) in parentheses after the name of the trust.

Name and Title of Fiduciary
Enter the name and title of the fiduciary. If the name entered is different than the name on the prior year's return, see Change in Fiduciary's Name and Change in Fiduciary on page 17.

Address
Include the suite, room, or other unit number after the street address. If the post office does not deliver mail to the street address and the fiduciary has a P.O. box, show the box number instead.

If you want a third party (such as an accountant or an attorney) to receive mail for the estate or trust, enter on the street address line "C/O" followed by the third party's name and street address or P.O. box.

If the estate or trust has had a change of address (including a change to an "in care of" name and address) and did not file Form 8822, Change of Address, check the Change in Fiduciary's address box in item F.

If the estate or trust has a change of mailing address (including a new "in care of" name and address) after filing its return, file Form 8822 to notify the IRS of the change.

A. Type of Entity
Check the appropriate box that describes the entity for which you are filing the return.

In some cases, more than one box is checked. For example, if only a portion of a trust is a grantor type trust or if only a portion of an electing small business trust is the S portion, then more than one box is checked.

Note: Determination of entity status is made on an annual basis.

There are special reporting requirements for grantor type trusts, pooled income funds, electing small business trusts, and bankruptcy estates. See Special Reporting Instructions on page 11.

Decedent's Estate
An estate of a deceased person is a taxable entity separate from the decedent. It generally continues to exist until the final distribution of the assets of the estate is made to the heirs and other beneficiaries. The income earned from the property of the estate during the period of administration or settlement must be accounted for and reported by the estate.

Simple Trust
A trust may qualify as a simple trust if:
1. The trust instrument requires that all income must be distributed currently; and
2. The trust instrument does not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes; and
3. The trust does not distribute amounts allocated to the corpus of the trust.

Complex Trust
A complex trust is any trust that does not qualify as a simple trust as explained above.

Qualified Disability Trust
A qualified disability trust is any nongrantor trust:
1. Described in 42 U.S.C. 1396p(c)(2)(B)(iv) and established solely for the benefit of an individual under 65 years of age who is disabled, and
2. All the beneficiaries of which are determined by the Commissioner of Social Security to have been disabled for some part of the tax year within the meaning of 42 U.S.C. 1382c(a)(3).

A trust will not fail to meet item 2 above just because the trust's corpus may revert to a person who is not disabled after the trust ceases to have any disabled beneficiaries.

ESBT (S Portion Only)
The S portion of an ESBT 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. See page 12 of the instructions for more information about an ESBT.

Grantor Type Trust
A grantor type trust is 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.

Generally, for transfers made in trust after March 1, 1986, the grantor is treated as the owner of any portion of a trust in which he or she has a reversionary interest in either the income or corpus therefrom, if, as of the inception of that portion of the trust, the value of the reversionary interest is more than 5% of the value of that portion. Also, the grantor is treated as holding any power or interest that was held by either the grantor’s spouse at the time that the power or interest was created or who became the grantor’s spouse after the creation of that power or interest. See Grantor Type Trusts on page 11 for more information.

Pre-need funeral trusts. The purchasers of pre-need funeral services are the grantors and the owners of pre-need funeral trusts established under state laws. See Rev. Rul. 87-127, 1987-2 C.B. 156. However, the trustees of pre-need funeral trusts can elect to file the return and pay the tax for qualified funeral trusts. For more information, see Form 1041-QFT, U.S. Income Tax Return for Qualified Funeral Trusts.

Nonqualified deferred compensation plans. Taxpayers may adopt and maintain grantor trusts in connection with nonqualified deferred compensation plans (sometimes referred to as “rabbi trusts”). Rev. Proc. 92-64, 1992-2 C.B. 422, provides a “model grantor trust” for use in rabbi trust arrangements. The procedure also provides guidance for requesting rulings on the plans that use these trusts.

QSSTs. The beneficiary of a qualified subchapter S trust is treated as the substantial owner of that portion of the trust which consists of stock in an S corporation for which an election under section 1361(d)(2) has been made. See QSSTs on page 11.

Bankruptcy Estate
A chapter 7 or 11 bankruptcy estate is a separate and distinct taxable entity from the individual debtor for federal income tax purposes. See Bankruptcy Estates on page 13.

For more information, see section 1398 and Pub. 908, Bankruptcy Tax Guide.

Pooled Income Fund
A pooled income fund is a split-interest trust with a remainder interest for a public charity and a life income interest retained by the donor or for another person. The property is held in a pool with other pooled income fund property and does not include any tax-exempt securities. The income for a retained
life interest is figured using the yearly rate of return earned by the trust. See section 642(c) and the related regulations for more information.

B. Number of Schedules K-1 Attached
Every trust or decedent’s estate claiming an income distribution deduction on page 1, line 18, must enter the number of Schedules K-1 (Form 1041) that are attached to Form 1041.

C. Employer Identification Number
Every estate or trust that is required to file Form 1041 must have an EIN. An EIN may be applied for:
- Online by clicking on the EIN link at www.irs.gov/businesses/small. The EIN is issued immediately once the application information is validated.
- By telephone at 1-800-829-4933 from 7:00 a.m. to 10:00 p.m. in the fiduciary’s local time zone. Assistance provided to callers from Alaska and Hawaii will be based on the hours of operation in the Pacific time zone.
- By mailing or faxing Form SS-4, Application for Employer Identification Number, to the address provided online.

If the estate or trust has not received its EIN by the time the return is due, write “Applied for” and the date you applied in the space for the EIN. For more details, see Pub. 583, Starting a Business and Keeping Records.

D. Date Entity Created
Enter the date the trust was created, or, if a decedent’s estate, the date of the decedent’s death.

E. Nonexempt Charitable and Split-Interest Trusts
Section 4947(a)(1) Trust
Check this box if the trust is a nonexempt charitable trust within the meaning of section 4947(a)(1).

A nonexempt charitable trust is a trust:
- That is not exempt from tax under section 501(a);
- In which all of the unexpired interests are devoted to one or more charitable purposes described in section 170(c)(2)(B); and
- For which a deduction was allowed under section 170 (for individual taxpayers) or similar Code section for personal holding companies, foreign personal holding companies, or estates or trusts (including a deduction for estate or gift tax purposes).

Nonexempt charitable trust treated as a private foundation. If a nonexempt charitable trust is treated as though it were a private foundation under section 509, then the fiduciary must file Form 990-PF, Return of Private Foundation, in addition to Form 1041.

If a nonexempt charitable trust is treated as though it were a private foundation, and it has no taxable income under Subtitle A, it may check the box on Form 990-PF, Part VII-A, line 15 and enter the tax-exempt interest received or accrued during the year on that line, instead of filing Form 1041 to meet its section 6012 filing requirement for that tax year.

Excise taxes. If a nonexempt charitable trust is treated as a private foundation, then it is subject to the same excise taxes under chapters 41 and 42 that a private foundation is subject to. If the nonexempt charitable trust is liable for any of these taxes (except the section 4940 tax), then it reports these taxes on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. Taxes paid by the trust on Form 4720 or on Form 990-PF (the section 4940 tax) cannot be taken as a deduction on Form 1041.

Not a Private Foundation
Check this box if the nonexempt charitable trust (section 4947(a)(1)) is not treated as a private foundation under section 509. For more information, see Regulations section 53.4947-1.

Other returns that must be filed. If a nonexempt charitable trust is not treated as though it were a private foundation, the fiduciary must file Form 990, Return of Organization Exempt From Income Tax, or Form 990-EZ, Short Form Return of Organization Exempt from Income Tax, in addition to Form 1041, if the trust meets the filing requirements for either of those forms.

If a nonexempt charitable trust is not treated as though it were a private foundation, and it has no taxable income under Subtitle A, it may answer “Yes” on Form 990, Part V, line 12a and enter the tax-exempt interest received or accrued during the year on Form 990, Part V, line 12b instead of filing Form 1041 to meet its section 6012 filing requirement for that tax year (or if Form 990-EZ is filed instead of Form 990, you may check the box on Form 990-EZ, line 43 and enter the tax-exempt interest received or accrued during the year on that line).

Section 4947(a)(2) Trust
Check this box if the trust is a split-interest trust described in section 4947(a)(2).

A split-interest trust is a trust that:
- Is not exempt from tax under section 501(a);
- Has some unexpired interests that are devoted to purposes other than religious, charitable, or similar purposes described in section 170(c)(2)(B); and
- Has amounts transferred in trust after May 26, 1969, for which a deduction was allowed under section 170 (for individual taxpayers) or similar Code sections for personal holding companies, foreign personal holding companies, or estates or trusts (including a deduction for estate or gift tax purposes).
Amended Schedule K-1 (Form 1041). If the amended return results in a change to income, or a change in distribution of any income or other information provided to a beneficiary, an amended Schedule K-1 (Form 1041) must also be filed with the amended Form 1041 and given to each beneficiary. Check the “Amended K-1” box at the top of the amended Schedule K-1.

Final Return
Check this box if this is a final return because the estate or trust has terminated. Also, check the “Final K-1” box at the top of Schedule K-1.

If, on the final return, there are excess deductions, an unused capital loss carryover, or an NOL carryover, see the instructions for Schedule K-1, box 11, on page 34.

Change in Trust’s Name
If the name of the trust has changed from the name shown on the prior year’s return (or Form SS-4 if this is the first return being filed), be sure to check this box.

Change in Fiduciary
If a different fiduciary enters his or her name on the line for Name and title of fiduciary than was shown on the prior year’s return (or Form SS-4 if this is the first return being filed) and you did not file a Form 8822, be sure to check this box. If there is a change in the fiduciary whose address is used as the mailing address for the estate or trust after the return is filed, use Form 8822 to notify the IRS.

Change in Fiduciary’s Name
If the fiduciary changed his or her name from the name that he or she entered on the prior year’s return (or Form SS-4 if this is the first return being filed), be sure to check this box.

Change in Fiduciary’s Address
If the same fiduciary who filed the prior year’s return (or Form SS-4 if this is the first return being filed) files the current year’s return and changed the address on the return (including a change to an “in care of” name and address), and did not report the change on Form 8822, check this box.

If the address shown on Form 1041 changes after you file the form (including a change to an “in care of” name and address), file Form 8822 to notify the IRS of the change.

G. Section 645 Election
If a section 645 election was made by the fiduciary of a qualified trust, the fiduciary may elect to report the income from the trust on Schedule B (Form 1040A or 1040), line 1 the total interest shown on Form 1099-INT. Under the last entry on line 1, subtotal all the information reported on line 1. Below the subtotal, write “Form 1041” and the name and address shown on Form 1041 for the decedent’s estate. Also, show the part of the interest reported on Form 1041 and subtract it from the subtotal.

Line 2a—Total Ordinary Dividends
Report the estate’s or trust’s share of all ordinary dividends received during the tax year.

For the year of the decedent’s death, Forms 1099-DIV issued in the decedent’s name may include dividends earned after the date of death that should be reported on the income tax return of the decedent’s estate. When preparing the decedent’s final income tax return, report on Schedule B (Form 1040A or 1040), line 5 the ordinary dividends shown on Form 1099-DIV. Under the last entry on line 5, subtotal all the dividends reported on line 5. Below the subtotal, write “Form 1041” and the name and address shown on Form 1041 for the decedent’s estate. Also, show the part of the ordinary dividends reported on Form 1041 and subtract it from the subtotal.

Line 2b—Qualified Dividends
Enter the beneficiary’s allocable share of qualified dividends on line 2b(1) and enter the estate’s or trust’s allocable share on line 2b(2).

If the estate or trust received qualified dividends that were derived from IRD, you must reduce the amount on line 2b(2) by the portion of the estate tax deduction claimed on Form 1041, page 1, line 19, that is attributable to those qualified dividends. Do not reduce the amounts on line 2b by any other allocable expenses.

Note. The beneficiary’s share (as figured above) may differ from the amount entered on line 2b of Schedule K-1 (Form 1041).

Qualified dividends. Qualified dividends are eligible for a lower tax rate than other ordinary income. Generally, these dividends are reported to the estate or trust in box 1b of Form(s) 1099-DIV. See Pub. 550 for...
the definition of qualified dividends if the estate or trust received dividends not reported on Form 1099-DIV.

**Exception.** Some dividends may be reported to the estate or trust as in box 1b of Form 1099-DIV but are not qualified dividends. These include:
- Dividends on any share of stock that the estate or trust held for less than 61 days during the 121-day period that began 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the purchaser of a stock is not entitled to receive the next dividend payment. When counting the number of days the stock was held, include the day the estate or trust disposed of the stock but not the day it acquired the stock. However, you cannot count certain days during which the estate’s or trust’s risk of loss was diminished. See Pub. 550 for more details.
- Dividends attributable to periods totaling more than 366 days that the estate or trust disposed of a stock but not the day it acquired the stock. However, you cannot count certain days during which the estate’s or trust’s risk of loss was diminished. See Pub. 550 for more details.

**TIP**
If you have an entry on line 2b(2), be sure you use Schedule D (Form 1041), the Schedule D Tax Worksheet, or the Qualified Dividends Tax Worksheet, whichever applies, to figure the estate’s or trust’s tax. Figuring the estate’s or trust’s tax liability in this manner will usually result in a lower tax.

**Line 3—Business Income or (Loss)**
If the estate operated a business, report the income and expenses on Schedule C (Form 1040), Profit or Loss From Business; or Schedule C-EZ (Form 1040), Net Profit From Business. Enter the net profit or (loss) from Schedule C (or Schedule C-EZ) on line 3.

**Line 4—Capital Gain or (Loss)**
Enter the gain from Schedule D (Form 1041), Part III, line 15, column (3) or the loss from Part IV, line 16.

**CAUTION**
Do not substitute Schedule D (Form 1040) for Schedule D (Form 1041).

**Line 5—Rents, Royalties, Partnerships, Other Estates and Trusts, etc.**
Use Schedule E (Form 1040), Supplemental Income and Loss, to report the estate’s or trust’s share of income or (losses) from rents, royalties, partnerships, S corporations, other estates and trusts, and REMICs. Also use Schedule E (Form 1040) to report farm rental income and expenses based on crops or livestock produced by a tenant. Enter the net profit or (loss) from Schedule E on line 5. See the instructions for Schedule E (Form 1040) for reporting requirements.

If the estate or trust received a Schedule K-1 from a partnership, S corporation, or other flow-through entity, use the corresponding lines on Form 1041 to report the interest, dividends, capital gains, etc., from the flow-through entity.

**Line 6—Farm Income or (Loss)**
If the estate or trust operated a farm, use Schedule F (Form 1040), Profit or Loss From Farming, to report farm income and expenses. Enter the net profit or (loss) from Schedule F on line 6.

If an estate or trust has farm rental income and expenses based on crops or livestock produced by a tenant, report the income and expenses on Schedule E (Form 1040). Do not use Form 4835 or Schedule F (Form 1040) to report such income and expenses and do not include the net profit or (loss) from such income and expenses on line 6.

**Line 7—Ordinary Gain or (Loss)**
Enter from line 17, Form 4797, Sales of Business Property, the ordinary gain or loss from the sale or exchange of property other than capital assets and also from involuntary conversions (other than casualty or theft).

**Line 8—Other Income**
Enter other items of income not included on lines 1, 2a, and 3 through 7. List the type and amount on an attached schedule if the estate or trust has more than one item.

**Items to be reported on line 8 include:**
- Unpaid compensation received by the decedent’s estate that is IRD, and
- Any part of a total distribution shown on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., that is treated as ordinary income. For more information, see the separate instructions for Form 4972, Tax on Lump-Sum Distributions.

**Deductions**

**Depreciation, Depletion, and Amortization**
A trust or decedent’s estate is allowed a deduction for depreciation, depletion, and amortization only to the extent the deductions are not apportioned to the beneficiaries. An estate or trust is not allowed to make an election under section 179 to expense depreciable business assets.

The estate’s or trust’s share of depreciation, depletion, and amortization is generally reported on the appropriate lines of Schedule C (or C-EZ), E, or F (Form 1040), the net income or loss from which is shown on lines 3, 5, or 6 of Form 1041. If the deduction is not related to a specific business or activity, then report it on line 15a.

**Depreciation.** For a decedent’s estate, the depreciation deduction is apportioned between the estate and the heirs, legatees, and devisees on the basis of the estate’s income allocable to each.

For a trust, the depreciation deduction is apportioned between the income beneficiaries and the trust on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a depreciation reserve. If the trustee is required to maintain a reserve, the deduction is first allocated to the trust, up to the amount of the reserve. Any excess is allocated among the income beneficiaries and the trust in the same manner as the trust’s accounting income. See Regulations section 1.167(h)-1(b).

**Depletion.** For mineral or timber property held by a decedent’s estate, the depletion deduction is apportioned between the estate and the heirs, legatees, and devisees on the basis of the estate’s income from such property allocable to each.

For mineral or timber property held in trust, the depletion deduction is apportioned between the income...
beneficiaries and the trust based on the trust income from such property allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depletion. If the trustee is required to maintain a reserve, the deduction is first allocated to the trust, up to the amount of the reserve. Any excess is allocated among the beneficiaries and the trust in the same manner as the trust's accounting income. See Regulations section 1.611-1(c)(4).

**Amortization.** The deduction for amortization is apportioned between an estate or trust and its beneficiaries under the same principles used to apportion the deductions for depreciation and depletion.

The deduction for the amortization of reforestation expenditures under section 194 is allowed only to an estate.

**Allocable share from a passthrough entity.** Depreciation, depletion, and amortization received from a passthrough entity on a Schedule K-1 is apportioned and reported in the same manner as discussed above. A section 179 expense received from a passthrough entity on a Schedule K-1 is not deductible by the estate or trust.

**Allocation of Deductions for Tax-Exempt Income**

Generally, no deduction that would otherwise be allowable is allowed for any expense (whether for business or for the production of income) that is allocable to tax-exempt income. Examples of tax-exempt income include:

- Certain death benefits (section 101),
- Interest on state or local bonds (section 103),
- Compensation for injuries or sickness (section 104), and
- Income from discharge of indebtedness in a title 11 case (section 108).

**Exception.** State income taxes and business expenses that are allocable to tax-exempt interest are deductible.

Expenses that are directly allocable to tax-exempt income are allocable only to tax-exempt income. A reasonable proportion of expenses indirectly allocable to both tax-exempt income and other income must be allocated to each class of income.

**Deductions That May Be Allowable for Estate Tax Purposes**

Administration expenses and casualty and theft losses deductible on Form 706 may be deducted, to the extent otherwise deductible for income tax purposes, on Form 1041 if the fiduciary files a statement waiving the right to deduct the expenses and losses on Form 706. The statement must be filed before the expiration of the statutory period of limitations for the tax year, the deduction is claimed. See Pub. 559 for more information.

**Accrued Expenses**

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that: (a) all events have occurred that determine the liability; and (b) the amount of the liability can be figured with reasonable accuracy. However, all the events that establish liability are treated as occurring only when economic performance takes place. There are exceptions for recurring items. See section 461(h).

**Limitations on Deductions**

**At-Risk Loss Limitations**

Generally, the amount the estate or trust has “at-risk” limits the loss it can deduct for any tax year. Use Form 6198, At-Risk Limitations, to figure the deductible loss for the year and file it with Form 1041. For more information, see Pub. 925, Passive Activity and At-Risk Rules.

**Passive Activity Loss and Credit Limitations**

**In general.** Section 469 and the regulations thereunder generally limit losses from passive activities to the amount of income derived from all passive activities. Similarly, credits from passive activities are generally limited to the tax attributable to such activities. These limitations are first applied at the estate or trust level.

Generally, an activity is a passive activity if it involves the conduct of any trade or business, and the taxpayer does not materially participate in the activity. Passive activities do not include working interests in oil and gas properties. See section 469(c)(3).

**Note.** Material participation standards for estates and trusts have not been established by regulations.

For a grantor trust, material participation is determined at the grantor level.

If the estate or trust distributes an interest in a passive activity, the basis of the property immediately before the distribution is increased by the passive activity losses allocable to the interest, and such losses cannot be deducted. See section 469(j)(12).

**TIP**

Losses from passive activities are first subject to the at-risk rules. When the losses are deductible under the at-risk rules, the passive activity rules then apply.

**Rental activities.** Generally, rental activities are passive activities, whether or not the taxpayer materially participates. However, certain taxpayers who materially participate in real property trades or businesses are not subject to the passive activity limitations on losses from rental real estate activities in which they materially participate. For more details, see section 469(c)(7).

For tax years of an estate ending less than 2 years after the decedent’s date of death, up to $25,000 of deductions and deduction equivalents of credits from rental real estate activities in which the decedent actively participated are allowed. Any excess losses or credits are suspended for the year and carried forward.

**Portfolio income.** Portfolio income is not treated as income from a passive activity, and passive losses and credits generally may not be applied to offset it. Portfolio income generally includes interest, dividends, royalties, and income from annuities. Portfolio income of an estate or trust must be accounted for separately.

**Forms to file.** See Form 8582, Passive Activity Loss Limitations, to figure the amount of losses allowed from passive activities. See Form 8582-CR, Passive Activity Credit Limitations, to figure the amount of credit allowed for the current year.

**Transactions Between Related Taxpayers**

Under section 267, a trust that uses the accrual method of accounting may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. For this purpose, a related party includes:

1. A grantor and a fiduciary of any trust;
2. A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
3. A fiduciary of a trust and a beneficiary of such trust.
4. A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
5. A fiduciary of a trust and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; and
6. An executor of an estate and a beneficiary of that estate, except for a sale or exchange to satisfy a pecuniary
Line 10—Interest

Enter the amount of interest (subject to limitations) paid or incurred by the estate or trust on amounts borrowed by the estate or trust, or on debt acquired by the estate or trust (for example, outstanding obligations from the decedent) that is not claimed elsewhere on the return.

If the proceeds of a loan were used for more than one purpose (for example, to purchase a portfolio investment and to acquire an interest in a passive activity), the fiduciary must make an interest allocation according to the rules in Temporary Regulations section 1.163-8T.

Do not include interest paid on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from income tax.

Personal interest is not deductible. Examples of personal interest include interest paid on:

- Revolving charge accounts used to purchase personal use property;
- Personal notes for money borrowed from a bank, credit union, or other person;
- Installment loans on personal use property; and
- Underpayments of federal, state, or local income taxes.

Interest that is paid or incurred on indebtedness allocable to a trade or business (including a rental activity) should be deducted on the appropriate line of Schedule C (or C-EZ), E, or F (Form 1040), the net income or loss from which is shown on line 3, 5, or 6 of Form 1041.

Types of interest to include on line 10 are:

1. Any investment interest (subject to limitations — see below);
2. Any qualified residence interest (see later); and
3. Any interest payable under section 6601 on any unpaid portion of the estate tax attributable to the value of a reversionary or remainder interest in property for the period during which an extension of time for payment of such tax is in effect.

Investment interest. Generally, investment interest is interest (including amortizable bond premium on taxable bonds acquired after October 22, 1986, but before January 1, 1988) that is paid or incurred on indebtedness that is properly allocable to property held for investment. Interest interest does not include any qualified residence interest, or interest that is taken into account under section 469 in figuring income or loss from a passive activity.

Generally, net investment income is the excess of investment income over investment expenses. Investment expenses are those expenses (other than interest) allowable after application of the 2% floor on miscellaneous itemized deductions.

The amount of the investment interest deduction may be limited. Use Form 4952, Investment Interest Expense Deduction, to figure the allowable investment interest deduction.

If you must complete Form 4952, check the box on line 10 of Form 1041 and attach Form 4952. Then, add the deductible investment interest to the other types of deductible interest and enter the total on line 10.

Qualified residence interest. Interest paid or incurred by an estate or trust on indebtedness secured by a qualified residence of a beneficiary of an estate or trust is treated as qualified residence interest if the residence would be a qualified residence (that is, the principal residence or the secondary residence selected by the beneficiary) if owned by the beneficiary. The beneficiary must have a present interest in the estate or trust or an interest in the residuary of the estate or trust. See Pub. 936, Home Mortgage Interest Deduction, for an explanation of the general rules for deducting home mortgage interest.

See section 163(h)(3) for a definition of qualified residence interest and for limitations on indebtedness.

Qualified mortgage insurance premiums. Enter (on the worksheet below) the qualified mortgage insurance premiums paid under a mortgage insurance contract issued after December 31, 2006, in connection with qualified residence acquisition debt that was secured by a principal or secondary residence. See Prepaid mortgage insurance below if the estate or trust paid any premiums allocable after 2010. If at least one other person was liable for and paid the premiums in connection with the loan, and the premiums were reported on Form 1098, include the estate’s or trust’s share of the 2010 premiums on the worksheet below.

Qualified mortgage insurance is mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1998 as in effect on December 20, 2006).

Qualified mortgage insurance is provided by the Department of Veterans Affairs and the Rural Housing Service is commonly

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Qualified Mortgage Insurance Premiums Deduction Worksheet

Keep for Your Records

| 1. Enter the total premiums the estate or trust paid in 2010 for qualified mortgage insurance for a contract issued after December 31, 2006. | 1. |
| 2. Enter the estate’s or trust’s AGI. | 2. |
| 3. Enter $100,000. | 3. |
| 4. Is the amount on line 2 more than the amount on line 3? | 4. |
| □ No. | 5. Divide line 4 by $10,000. Enter the result as a decimal. If the result is 1.0 or more, enter 1.0 |
| □ Yes. Subtract line 3 from line 2. If the result is not a multiple of $1,000, increase it to the next multiple of $1,000. For example, increase $425 to $1,000, increase $2,025 to $3,000, etc. |
| □ No. | 6. Multiply line 1 by line 5. |
| □ Yes. | 7. Qualified mortgage insurance premiums deduction. Subtract line 6 from line 1. Enter the result here and include the amount on Form 1041, line 10. |
known as a funding fee and guarantee fee, respectively. These fees can be deducted fully in 2010 if the mortgage insurance contract was issued in 2010. Contact the mortgage insurance issuer to determine the deductible amount if it is not included in box 4 of Form 1098.

**Prepaid Mortgage Insurance.** If the estate or trust paid mortgage insurance premiums allocable to periods after the end of its tax year, such premiums must be allocated over the shorter of:
- The stated term of the mortgage, or
- 84 months, beginning with the month the insurance was obtained.

The premiums are treated as paid in the year to which they are allocated. If the mortgage is satisfied before its term, no deduction is allowed for the unamortized balance. See Pub. 936 for details. These allocation rules do not apply to qualified mortgage insurance provided by the Department of Veterans Affairs or the Rural Housing Service.

**Limit on the Amount that is Deductible.** The estate or trust cannot deduct mortgage insurance premiums if the estate’s or trust’s AGI is more than $109,000. If the estate’s or trust’s AGI is more than $100,000, its deduction is limited and you must use the worksheet below to figure the deduction. See How to figure AGI for estates and trusts on page 22 for information on figuring AGI.

**Line 11—Taxes**
Enter any deductible taxes paid or incurred during the tax year that are not deductible elsewhere on Form 1041. Deductible taxes include the following:
- State and local income taxes. You can deduct state and local income taxes unless you elect to deduct state and local general sales taxes. You cannot deduct both.
- State and local general sales taxes. You can elect to deduct state and local general sales taxes instead of state and local income taxes. Generally, you can elect to deduct the actual state and local general sales taxes (including compensating use taxes) you paid in 2010 if the tax rate was the same as the general sales tax rate. However, taxes paid on food, clothing, medical supplies, and motor vehicles are deductible as a general sales tax even if the tax rate was less than the general sales tax rate. Sales taxes on motor vehicles are also deductible as a general sales tax if the tax rate was more than the general sales tax rate, but the tax is deductible only up to the amount of tax that would have been imposed at the general sales tax rate. Motor vehicles include cars, motorcycles, motor homes, recreational vehicles, sport utility vehicles, trucks, vans, and off-road vehicles. Also include any state and local general sales taxes paid for a leased motor vehicle. Do not include sales taxes paid on items used in a trade or business. An estate or trust cannot use the Optional Sales Tax Tables for individuals in Pub. 600, State and Local General Sales Taxes, to figure its deduction.
- State, local, and foreign real property taxes.
- State and local personal property taxes.
- Foreign or U.S. possession income taxes. You may want to take a credit for the tax instead of a deduction. See the instructions for Schedule G, line 2a, on page 27 for more details.
- The generation-skipping transfer (GST) tax imposed on income distributions.

**Line 12—Fiduciary Fees**
Enter the deductible fees paid or incurred to the fiduciary for administering the estate or trust during the tax year.

**TIP** Fiduciary fees deducted on Form 706 cannot be deducted on Form 1041.

**Line 15a—Other Deductions Not Subject to the 2% Floor**
Attach your own schedule, listing by type and amount all allowable deductions that are not deductible elsewhere on Form 1041.

Do not include any losses on worthless bonds and similar obligations and nonbusiness bad debts. Report these losses on Schedule D (Form 1041).

Do not deduct medical or funeral expenses on Form 1041. Medical expenses of the decedent paid by the estate may be deductible on the decedent’s income tax return for the year incurred. See section 213(c). Funeral expenses are deductible only on Form 706.

The following are examples of deductions that are reported on line 15a.

**Bond Premium(s).** For taxable bonds acquired before October 23, 1986, if the fiduciary elected to amortize the premium, report the amortization on this line. You cannot deduct the amortization for tax-exempt bonds. If you made the election to amortize the premium, the basis in the taxable bond must be reduced by the amount of amortization.

For tax-exempt bonds, you cannot deduct the premium that is amortized. Although the premium cannot be deducted, you must amortize the premium and reduce the estate’s or trust’s basis in the tax-exempt bond by the amount of premium amortized. In the case of a premium on a tax-exempt bond, or if the fiduciary has made an election to amortize the premium on a taxable bond, the basis in the bond must be reduced by the amount of amortization.

For more information, see section 171 and Pub. 550.

If you claim a bond premium deduction for the estate or trust, figure the deduction on a separate sheet and attach it to Form 1041.

**Casualty and Theft Losses.** Use Form 4684, Casualties and Thefts, to figure any deductible casualty and theft losses.

**Domestic Production Activities Deduction.** The estate or trust may be able to deduct up to 9% of its share of qualified production activities income (QPAI) from the following activities.

1. Construction performed in the United States.
2. Engineering or architectural services performed in the United States for construction projects in the United States.
3. Any lease, rental, license, sale, exchange, or other disposition of:
   - a. Tangible personal property, computer software, and sound recordings that the estate or trust manufactured, produced, grew, or extracted in whole or in significant part within the United States;
   - b. Any qualified film the estate or trust produced; or
   - c. Electricity, natural gas, or potable water the estate or trust produced in the United States.

In certain cases, the United States includes the Commonwealth of Puerto Rico.

The deduction does not apply to income derived from:
- The sale of food and beverages the estate or trust prepared at a retail establishment;
- Property the estate or trust leased, licensed, or rented for use by any related person; or
- The transmission or distribution of electricity, natural gas, or potable water.

The deduction cannot exceed 9% of modified AGI or 50% of certain Form W-2 wages. QPAI, as well as Form W-2 wages, must be apportioned between the trust or estate and its beneficiaries. For more details, see Form 8903, Domestic Production Activities Deduction, and its separate instructions.
Special rule for oil-related QPAI. If the estate or trust has oil-related QPAI, the domestic production activities deduction is reduced by 3% of the smallest of:
- Oil-related QPAI,
- QPAI, or
- Modified AGI.

See Form 8903 for details.

Net operating loss deduction (NOLD). An estate or trust is allowed the NOLD under section 172.

If you claim an NOLD for the estate or trust, figure the deduction on a separate sheet and attach it to this return.

Estate’s or trust’s share of amortization, depreciation, and depletion not claimed elsewhere. If you cannot deduct the estate’s or trust’s apportioned share of amortization, depreciation, and depletion as rent or royalty expenses on Schedule E (Form 1040), or as business or farm expenses on Schedule C, C-EZ, or F (Form 1040), itemize the estate’s or trust’s apportioned share of the deductions on an attached sheet and include them on line 15a. Itemize each beneficiary’s apportioned share of the deductions and report them in the appropriate box of Schedule K-1 (Form 1041).

Line 15b—Allowable Miscellaneous Itemized Deductions Subject to the 2% Floor

Miscellaneous itemized deductions are deductible only to the extent that the aggregate amount of such deductions exceeds 2% of AGI.

Among the miscellaneous itemized deductions that must be included on line 15b are expenses for the production or collection of income under section 212, such as investment advisory fees, subscriptions to investment advisory publications, and the cost of safe deposit boxes.

Miscellaneous itemized deductions do not include deductions for:
- Interest under section 163,
- Taxes under section 164,
- The amortization of bond premium under section 171,
- Estate taxes attributable to IRD under section 691(c), or
- Expenses paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in the estate or trust.

How to figure AGI for estates and trusts. You figure AGI by subtracting the following from total income on line 9 of page 1:

1. The administration costs of the estate or trust (the total of lines 12, 14, and 15a to the extent they are costs incurred in the administration of the estate or trust) that would not have been incurred if the property were not held by the estate or trust;
2. The income distribution deduction (line 18);
3. The amount of the exemption (line 20);
4. The domestic production activities deduction claimed on line 15a; and
5. The NOLD claimed on line 15a.

For those estates and trusts whose income distribution deduction is limited to the actual distribution, and not the DNI (that is, the income distribution deduction is less than the DNI), when computing the AGI, use the amount of the actual distribution.

For those estates and trusts whose income distribution deduction is limited to the DNI (that is, the actual distribution exceeds the DNI), the DNI must be figured taking into account the allowable miscellaneous itemized deductions (AMID) after application of the 2% floor. In this situation there are two unknown amounts: (a) the AMID and (b) the DNI.

Computing line 15b. To compute line 15b, use the equation below:

\[
\text{AMID} = \text{Total miscellaneous itemized deductions} - (0.02(\text{AGI}))
\]

The following example illustrates how algebraic equations can be used to solve for these unknown amounts.

**Example.** The Malcolm Smith Trust, a complex trust, earned $20,000 of dividend income, $20,000 of capital gains, and a fully deductible $5,000 loss from XYZ partnership (chargeable to corpus) in 2010. The trust instrument provides that capital gains are added to corpus. Fifty percent of the fiduciary fees are allocated to income and 50% to corpus. The trust claimed a $2,000 deduction on line 12 of Form 1041. The trust incurred $1,500 of miscellaneous itemized deductions (chargeable to income), which are subject to the 2% floor. There are no other deductions. The trustee made a discretionary distribution of the accounting income of $17,500 to the trust’s sole beneficiary.

Because the actual distribution can reasonably be expected to exceed the DNI, the trust must figure the DNI, taking into account the allowable miscellaneous itemized deductions, to determine the amount to enter on line 15b.

The trust also claims an exemption of $100 on line 20.

Using the facts in this example:

\[
\text{AMID} = 1,500 - (0.02(\text{AGI}))
\]

In all situations, use the following equation to compute the AGI:

\[
\text{AGI} = (\text{line 9}) - (\text{the total of lines 12, 14, and 15a to the extent they are costs incurred in the administration of the estate or trust that would not have been incurred if the property were not held by the estate or trust}) - (\text{line 18}) - (\text{line 20}).
\]

**Note.** There are no other deductions claimed by the trust on line 15a that are deductible in arriving at AGI.

Figuring AGI in this example, we get:

\[
\text{AGI} = 35,000 - 2,000 - \text{DNI} - 100
\]

Since the value of line 18 is not known because it is limited to the DNI, you are left with the following:

\[
\text{AGI} = 32,900 - \text{DNI}
\]

Substitute the value of AGI in the equation:

\[
\text{AMID} = 1,500 - (0.02(32,900 - \text{DNI}))
\]

The equation cannot be solved until the value of DNI is known. The DNI can be expressed in terms of the AMID. To do this, compute the DNI using the known values. In this example, the DNI is equal to the total income of the trust (less any capital gains allocated to corpus or plus any capital loss from line 4); less total deductions from line 16 (excluding any miscellaneous itemized deductions); less the AMID.

Thus, DNI = (line 9) - (line 15, column (2) of Schedule D (Form 1041)) - (line 16) - (AMID)

Substitute the known values:

\[
\text{DNI} = 35,000 - 20,000 - 2,000 - \text{AMID}
\]

\[
\text{DNI} = 13,000 - \text{AMID}
\]

Substitute the value of DNI in the equation to solve for AMID:

\[
\text{AMID} = 1,500 - (0.02(32,900 - (13,000 - \text{AMID})))
\]

\[
\text{AMID} = 1,500 - (0.02(32,900 - 13,000 + \text{AMID}))
\]

\[
\text{AMID} = 1,500 - (658 - 260 + 0.02\text{AMID})
\]

\[
\text{AMID} = 1,102 - 0.02\text{AMID}
\]

\[
1.02\text{AMID} = 1,102
\]

\[
\text{AMID} = 1,080
\]

\[
\text{DNI} = 11,920 \text{ (i.e., 13,000 - 1,080)}
\]

\[
\text{AGI} = 20,980 \text{ (i.e., 32,900 - 11,920)}
\]

**Note.** The income distribution deduction is equal to the smaller of the distribution ($17,500) or the DNI ($11,920).

Enter the value of AMID on line 15b (the DNI should equal line 7 of Schedule B) and complete the rest of
Form 1041 according to the instructions.

If the 2% floor is more than the deductions subject to the 2% floor, no deductions are allowed.

**Line 18—Income Distribution Deduction**

If the estate or trust was required to distribute income currently or if it paid, credited, or was required to distribute any other amounts to beneficiaries during the tax year, complete Schedule B to determine the estate’s or trust’s income distribution deduction. However, if you are filing for a pooled income fund, do not complete Schedule B. Instead, attach a statement to support the computation of the income distribution deduction. See Pooled Income Funds on page 12 for more information.

If the estate or trust claims an income distribution deduction, complete and attach:

- Part I (through line 26) and Part II of Schedule I (Form 1041) to refigure the deduction on a minimum tax basis, and
- Schedule K-1 (Form 1041) for each beneficiary to which a distribution was made or required to be made.

**Cemetery perpetual care fund.** On line 18, deduct the amount, not more than $5 per gravesite, paid for maintenance of cemetery property. To the right of the entry space for line 18, enter the number of gravesites. Also write “Section 642(i) trust” in parentheses after the trust’s name at the top of Form 1041. You do not have to complete Schedules B of Form 1041 and K-1 (Form 1041).

Do not enter less than zero on line 18.

**Line 19—Estate Tax Deduction (Including Certain Generation-Skipping Transfer Taxes)**

If the estate or trust includes IRD in its gross income, and such amount was included in the decedent’s gross estate for estate tax purposes, the estate or trust is allowed to deduct in the same tax year that the income is included that portion of the estate tax imposed on the decedent’s estate that is attributable to the inclusion of the IRD in the decedent’s estate. For an example of the computation, see Regulations section 1.691(c)-1 and Pub. 559.

If any amount properly paid, credited, or required to be distributed by an estate or trust to a beneficiary consists of IRD received by the estate or trust, do not include such amounts in determining the estate tax deduction for the estate or trust. Figure the deduction on a separate sheet. Attach the sheet to your return.

If you claim a deduction for estate tax attributable to qualified dividends or capital gains, you may have to adjust the amount on Form 1041, page 1, line 2b(2), or Schedule D (Form 1041), line 18.

Also, a deduction is allowed for the GST tax imposed as a result of a taxable termination or a direct skip occurring as a result of the death of the transferor. See section 691(c)(3). Enter the estate’s or trust’s share of these deductions on line 19.

**Line 20—Exemption**

**Decedents’ estates.** A decedent’s estate is allowed a $600 exemption.

**Trusts required to distribute all income currently.** A trust whose governing instrument requires that all income be distributed currently is allowed a $300 exemption, even if it distributed amounts other than income during the tax year.

**Qualified disability trusts.** A qualified disability trust is allowed a $3,650 exemption. The exemption is not phased out for the 2010 tax year, regardless of adjusted gross income.

A qualified disability trust is any trust:

1. Described in 42 U.S.C. 1396p(c)(2)(B)(iv) and established solely for the benefit of an individual under 65 years of age who is disabled, and
2. All of the beneficiaries of which are determined by the Commissioner of Social Security to have been disabled for some part of the tax year within the meaning of 42 U.S.C. 1382(c)(a)(3).

A trust will not fail to meet item 2 above just because the trust’s corpus may revert to a person who is not disabled after the trust ceases to have any disabled beneficiaries.

**All other trusts.** A trust not described above is allowed a $100 exemption.

**Tax and Payments**

**Line 22—Taxable Income**

**Minimum taxable income.** Line 22 cannot be less than the larger of:

- The inversion gain of the estate or trust, as figured under section 7874, if the estate or trust is an expatriated entity or a partner in an expatriated entity, or
- The sum of the excess inclusions of the estate or trust from Schedule Q (Form 1066), line 2c.

**NOL.** If line 22 (figured without regard to the minimum taxable income rule stated above) is a loss, the estate or trust may have an NOL. Do not include the deductions claimed on lines 13, 18, and 20 when figuring the amount of the NOL.

Generally, an NOL may be carried back to the prior 2 tax years. The 2-year carryback period does not apply to the portion of an NOL attributable to an eligible loss; a farming loss; a qualified disaster; GO Zone, or disaster recovery assistance loss; or a specified liability loss. An estate or trust may also elect to carry an NOL forward only, instead of first carrying it back. For more information, see the Instructions for Form 1045, Application for Tentative Refund.

Complete Schedule A of Form 1045 to figure the amount of the NOL that is available for carryback or carryover. Use Form 1045 or file an amended return to apply for a refund based on an NOL carryback. For more details, see Pub. 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts.

On the termination of the estate or trust, any unused NOL carryover that would be allowable to the estate or trust in a later tax year, but for the termination, is allowed to the beneficiaries succeeding to the property of the estate or trust. See the instructions for Schedule K-1 (Form 1041), box 11, codes D and E on page 34.

**Excess deductions on termination.**

If the estate or trust has for its final year deductions (excluding the charitable deduction and exemption) in excess of its gross income, the excess is allowed as an itemized deduction to the beneficiaries succeeding to the property of the estate or trust.

In general, an unused NOL carryover that is allowed to beneficiaries (as explained above) cannot also be treated as an excess deduction. However, if the final year of the estate or trust is also the last year of the NOL carryover period, the NOL carryover not absorbed in that tax year by the estate or trust is included as an excess deduction. See the instructions for Schedule K-1 (Form 1041), box 11, code A on page 34.

**Line 24a—2010 Estimated Tax Payments and Amount Applied From 2009 Return**

Enter the amount of any estimated tax payment you made with Form 1041-ES for 2010 plus the amount of any overpayment from the 2009 return that was applied to the 2010 estimated tax.

If the estate or trust is the beneficiary of another trust and received a payment of estimated tax that was credited to the trust (as reflected on the
Schedule K-1 issued to the trust, then report this amount separately with the notation "section 643(g)" in the space next to line 24a and include this amount in the amount entered on line 24a.

Do not include on Form 1041 estimated tax paid by an individual before death. Instead, include those payments on the decedent's final income tax return.

**Line 24b—Estimated Tax Payments Allocated to Beneficiaries**

The trustee (or executor, for the final year of the estate) may elect under section 643(g) to have any portion of its estimated tax treated as a payment of estimated tax made by a beneficiary or beneficiaries. The election is made on Form 1041-T, Allocation of Estimated Tax Payments to Beneficiaries, which must be filed by the 65th day after the close of the trust's tax year. Form 1041-T shows the amounts to be allocated to each beneficiary. This amount is reported on the beneficiary's Schedule K-1 (Form 1041), box 13, using code A.

Attach Form 1041-T to your return only if you have not yet filed it; however, attaching Form 1041-T to Form 1041 does not extend the due date for filing Form 1041-T. If you have already filed Form 1041-T, do not attach a copy to your return.

*Failure to file Form 1041-T by the due date (March 7, 2011, for calendar year estates and trusts) will result in an invalid election. An invalid election will require the filing of amended Schedules K-1 for each beneficiary who was allocated a payment of estimated tax.*

**Line 24d—Tax Paid With Form 7004**

If you filed Form 7004 to request an extension of time to file Form 1041, enter the amount that you paid with the extension request.

**Line 24e—Federal Income Tax Withheld**

Use line 24e to claim a credit for any federal income tax withheld (and not repaid) by: (a) an employer on wages and salaries of a decedent received by the decedent's estate; (b) a payer of certain gambling winnings (for example, state lottery winnings); or (c) a payer of distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, insurance contracts, etc., received by a decedent's estate or trust. Attach a copy of Form W-2, Form W-2G, or Form 1099-R to the front of the return.

Except for backup withholding (as explained below), withheld income tax can not be passed through to beneficiaries on either Schedule K-1 or Form 1041-T.

**Backup withholding.** If the estate or trust received a 2010 Form 1099 showing federal income tax withheld (that is, backup withholding) on interest income, dividends, or other income, check the box and include the amount withheld on income retained by the estate or trust in the total for line 24e.

Report on Schedule K-1 (Form 1041), box 13, using code B, any credit for backup withholding on income distributed to the beneficiary.

**Line 24f—Credit for Tax Paid on Undistributed Capital Gains**

Attach Copy B of Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains.

**Line 24g—Credit for Federal Tax on Fuels**

Enter any credit for federal excise taxes paid on fuels that are ultimately used for nontaxable purposes (for example, an off-highway business use). Attach Form 4136, Credit for Federal Tax Paid on Fuels. See Pub. 510, Excise Taxes, for more information.

**Line 26—Estimated Tax Penalty**

If line 27 is at least $1,000 and more than 10% of the tax shown on Form 1041, or the estate or trust underpaid its 2010 estimated tax liability for any payment period, it may owe a penalty. See Form 2210 to determine whether the estate or trust owes a penalty and to figure the amount of the penalty.

*Note.* The penalty may be waived under certain conditions. See Pub. 505, Tax Withholding and Estimated Tax, for details.

**Line 27—Tax Due**

You must pay the tax in full when the return is filed. You may pay by check or money order or by credit or debit card. Also, you may pay by EFTPS. For more information about EFTPS, see Electronic Deposits on page 8.

**To pay by check or money order.**

- Make it payable to “United States Treasury,”
- Make sure the name of the estate or trust appears on the payment,
- Write the estate’s or trust’s EIN and “2010 Form 1041” on the payment,
- Consider completing the 2010 Form 1041-V, and

**Enclose, but do not attach, the payment (and Form 1041-V, if completed) with Form 1041.**

**To pay by credit or debit card.**

For information on paying your taxes electronically, including by credit or debit card, go to www.irs.gov/e-pay.

**Line 29a—Credited to 2011 Estimated Tax**

Enter the amount from line 28 that you want applied to the estate’s or trust’s 2011 estimated tax.

**Schedule A—Charitable Deduction**

**General Instructions**

Generally, any part of the gross income of an estate or trust (other than a simple trust) that, under the terms of the will or governing instrument, is paid (or treated as paid) during the tax year for a charitable purpose specified in section 170(c) is allowed as a deduction to the estate or trust. It is not necessary that the charitable organization be created or organized in the United States.

A pooled income fund or a section 4947(a)(1) nonexempt charitable trust treated as a private foundation must attach a separate sheet to Form 1041 instead of using Schedule A of Form 1041 to figure the charitable deduction.

**Additional return to be filed by trusts.** Trusts, other than split-interest trusts or nonexempt charitable trusts, that claim a charitable deduction also file Form 1041-A unless the trust is required to distribute currently to the beneficiaries all the income for the year determined under section 643(b) and related regulations.

Pooled income funds and charitable lead trusts also file Form 5227. See Form 5227 for information about any exceptions.

**Election to treat contributions as paid in the prior tax year.** The fiduciary of an estate or trust may elect to treat as paid during the tax year any amount of gross income received during that tax year or any prior tax year that was paid in the next tax year for a charitable purpose.

For example, if a calendar year estate or trust makes a qualified charitable contribution on February 7, 2011, from income earned in 2010 or prior, the fiduciary can elect to treat the contribution as paid in 2010. To make the election, the fiduciary must file a statement with Form 1041 for the tax year in which the contribution is treated as paid. This statement must include:
1. The name and address of the fiduciary;
2. The name of the estate or trust;
3. An indication that the fiduciary is making an election under section 642(c)(1) for contributions treated as paid during such tax year;
4. The name and address of each organization to which any such contribution is paid; and
5. The amount of each contribution and date of actual payment or, if applicable, the total amount of contributions paid to each organization during the next tax year, to be treated as paid in the prior tax year.

The election must be filed by the due date (including extensions) for Form 1041 for the next tax year. If the original return was filed on time, you may make the election on an amended return filed no later than 6 months after the due date of the return (excluding extensions). Write “Filed pursuant to section 301.9100-2” at the top of the amended return and file it at the same address you used for your original return.

For more information about the charitable deduction, see section 642(c) and related regulations.

Specific Instructions

Line 1—Amounts Paid or Permanently Set Aside for Charitable Purposes From Gross Income

Enter amounts that were paid for a charitable purpose out of the estate’s or trust’s gross income, including any capital gains paid during the tax year from gross income received in a prior tax year, but only if no deduction was allowed for any prior tax year for these amounts.

Estates, and certain trusts, may claim a deduction for amounts permanently set aside for a charitable purpose from gross income. Such amounts must be permanently set aside during the tax year to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit.

For a trust to qualify, the trust may not be a simple trust, and the set aside must not be required by the terms of a trust instrument that was created on or before October 9, 1969.

Further, the trust instrument must provide for an irrevocable remainder interest to be transferred to or for the use of an organization described in section 170(c); or the trust must have been created by a grantor who was at all times after October 9, 1969, under a mental disability to change the terms of the trust.

Also, certain testamentary trusts that were established by a will that was executed on or before October 9, 1969, may qualify. See Regulations section 1.642(c)-2(b).

Do not include any capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes. Instead, enter these amounts on line 4.

Line 2—Tax-Exempt Income Allocable to Charitable Contributions

Any estate or trust that pays or sets aside any part of its income for a charitable purpose must reduce the deduction by the portion allocable to any tax-exempt income. If the governing instrument specifically provides as to the source from which amounts are paid, permanently set aside, or to be used for charitable purposes, the specific provisions control. In all other cases, determine the amount of tax-exempt income allocable to charitable contributions by multiplying line 1 by a fraction, the numerator of which is the total tax-exempt income of the estate or trust, and the denominator of which is the gross income of the estate or trust. Do not include in the denominator any losses allocated to corpus.

Line 4—Capital Gains for the Tax Year Allocated to Corpus and Paid or Permanently Set Aside for Charitable Purposes

Enter the total of all capital gains for the tax year that are:
• Allocated to corpus, and
• Paid or permanently set aside for charitable purposes.

Line 6—Section 1202 Exclusion Allocable to Capital Gains Paid or Permanently Set Aside for Charitable Purposes

If the exclusion of gain from the sale or exchange of qualified small business (QSB) stock was claimed, enter the part of the gain included on Schedule A, lines 1 and 4, that was excluded under section 1202.

Schedule B—Income Distribution Deduction

General Instructions

If the estate or trust was required to distribute income currently or if it paid, credited, or was required to distribute any other amounts to beneficiaries during the tax year, complete Schedule B to determine the estate’s or trust’s income distribution deduction.

Note. Use Schedule I (Form 1041) to compute the DNI and income distribution deduction on a minimum tax basis.

Pooled income funds. Do not complete Schedule B for these funds. Instead, attach a separate statement to support the computation of the income distribution deduction. See Pooled Income Funds on page 12 for more information.

Separate share rule. If a single trust or an estate has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts or estates for the sole purpose of determining the DNI allocable to the respective beneficiaries.

If the separate share rule applies, figure the DNI allocable to each beneficiary on a separate sheet and attach the sheet to this return. Any deduction or loss that is applicable solely to one separate share of the trust or estate is not available to any other share of the same trust or estate.

For more information, see section 663(c) and related regulations.

Withholding of tax on foreign persons. The fiduciary may be liable for withholding tax on distributions to beneficiaries who are foreign persons. For more information, see Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Entities, and Forms 1042 and 1042-S.

Specific Instructions

Line 1—Adjusted Total Income

Generally, enter on line 1, Schedule B, the amount from line 17 on page 1 of Form 1041. However, if both line 4 and line 17 on page 1 of Form 1041 are losses, enter on line 1, Schedule B, the smaller of those losses. If line 4 is zero or a gain and line 17 is a loss, enter zero on line 1, Schedule B.

If you are filing for a simple trust, subtract from adjusted total income any extraordinary dividends or taxable stock dividends included on page 1, line 2, and determined under the governing instrument and applicable local law to be allocable to corpus.

Line 2—Adjusted Tax-Exempt Interest

To figure the adjusted tax-exempt interest:

Step 1. Add tax-exempt interest income on line 2 of Schedule A, any
expenses allowable under section 212 allocable to tax-exempt interest, and any interest expense allocable to tax-exempt interest.

**Step 2.** Subtract the Step 1 total from the amount of tax-exempt interest (including exempt-interest dividends) received.

Section 212 expenses that are directly allocable to tax-exempt interest are allocated only to tax-exempt interest. A reasonable proportion of section 212 expenses that are indirectly allocable to both tax-exempt interest and other income must be allocated to each class of income.

Figure the interest expense allocable to tax-exempt interest according to the guidelines in Rev. Proc. 72-18, 1972-1 C.B. 740.

See Regulations sections 1.643(a)-5 and 1.265-1 for more information.

**Line 3**

Include all capital gains, whether or not distributed, that are attributable to income under the governing instrument or local law. For example, if the trustee distributed 50% of the current year’s capital gains to the income beneficiaries (and reflects this amount in column (1), line 15 of Schedule D (Form 1041)), but under the governing instrument all capital gains are attributable to income, then include 100% of the capital gains on line 3. If the amount on Schedule D (Form 1041), line 15, column (1) is a net loss, enter zero.

If the exclusion of gain from the sale or exchange of QSBS stock was claimed, do not reduce the gain on line 3 by any amount excluded under section 1202.

**Line 5**

In figuring the amount of long-term and short-term capital gain for the tax year included on Schedule A, line 1, the specific provisions of the governing instrument control if the instrument specifically provides as to the source from which amounts are paid, permanently set aside, or to be used for charitable purposes.

In all other cases, determine the amount to enter by multiplying line 1 of Schedule A by a fraction, the numerator of which is the amount of net capital gains that are included in the accounting income of the estate or trust (that is, not allocated to corpus) and are distributed to charities, and the denominator of which is all items of income (including the amount of such net capital gains) included in the DNI.

Reduce the amount on line 5 by any allocable section 1202 exclusion.

**Line 8—Accounting Income**

If you are filing for a decedent’s estate or a simple trust, skip this line. If you are filing for a complex trust, enter the income for the tax year determined under the terms of the governing instrument and applicable local law. Do not include extraordinary dividends or taxable stock dividends determined under the governing instrument and applicable local law to be allocable to corpus.

**Lines 9 and 10**

Do not include any:
- Amounts deducted on prior year’s return that were required to be distributed in the prior year;
- Amount that is properly paid or credited as a gift or bequest of a specific amount of money or specific property. (To qualify as a gift or bequest, the amount must be paid in three or fewer installments.) An amount that can be paid or credited only from income is not considered a gift or bequest; or
- Amount paid or permanently set aside for charitable purposes or otherwise qualifying for the charitable deduction.

**Line 9—Income Required To Be Distributed Currently**

Line 9 is to be completed by all simple trusts as well as complex trusts and decedent’s estates that are required to distribute income currently, whether it is distributed or not. The determination of whether trust income is required to be distributed currently depends on the terms of the governing instrument and the applicable local law.

The line 9 distributions are referred to as first tier distributions and are deductible by the estate or trust to the extent of the DNI. The beneficiary includes such amounts in his or her income to the extent of his or her proportionate share of the DNI.

**Line 11—Total Distributions**

If line 11 is more than line 8, and you are filing for a complex trust that has previously accumulated income, see the instructions on page 29 to see if you must complete Schedule J (Form 1041).

**Line 12—Adjustment for Tax-Exempt Income**

In figuring the income distribution deduction, the estate or trust is not allowed a deduction for any item of the DNI that is not included in the gross income of the estate or trust. Thus, for purposes of figuring the allowable income distribution deduction, the DNI (line 7) is figured without regard to any tax-exempt interest.

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 11), and the DNI (line 7) is less than or equal to line 11, then enter on line 12 the amount from line 2.

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 11), and the DNI is more than line 11 (that is, the estate or trust made a distribution that is less than the DNI), then figure the adjustment by multiplying line 2 by a fraction, the numerator of which is the total distributions (line 11), and the
denominator of which is the DNI (line 7). Enter the result on line 12.

If line 11 includes tax-exempt income other than tax-exempt interest, figure line 12 by subtracting the total of the following from tax-exempt income included on line 11:
1. The charitable contribution deduction allocable to such tax-exempt income, and
2. Expenses allocable to tax-exempt income.

Expenses that are directly allocable to tax-exempt income are allocated only to tax-exempt income. A reasonable proportion of expenses indirectly allocable to both tax-exempt income and other income must be allocated to each class of income.

Table: 2010 Tax Rate Schedule

<table>
<thead>
<tr>
<th>If taxable income is:</th>
<th>Over —</th>
<th>But not over —</th>
<th>Its tax is:</th>
<th>Of the amount over —</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$2,300</td>
<td>15%</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>2,300</td>
<td>5,350</td>
<td>$345.00 + 25%</td>
<td>2,300</td>
<td></td>
</tr>
<tr>
<td>5,350</td>
<td>8,200</td>
<td>$1,107.50 + 28%</td>
<td>5,350</td>
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</tr>
<tr>
<td>8,200</td>
<td>11,200</td>
<td>$1,905.50 + 33%</td>
<td>8,200</td>
<td></td>
</tr>
<tr>
<td>11,200</td>
<td>----</td>
<td>$2,895.50 + 35%</td>
<td>11,200</td>
<td></td>
</tr>
</tbody>
</table>

Schedule D (Form 1041) and Schedule D Tax Worksheet. Use Part V of Schedule D (Form 1041) or the Schedule D Tax Worksheet, whichever is applicable, to figure the estate’s or trust’s tax if the estate or trust files Schedule D (Form 1041) and has:
- A net capital gain and any taxable income, or
- Qualified dividends on line 2b(2) of Form 1041 and any taxable income.

Qualified Dividends Tax Worksheet.
If you do not have to complete Part I or Part II of Schedule D and the estate or trust has an amount entered on line 2b(2) of Form 1041 and any taxable income (line 22), then figure the estate’s or trust’s tax using the worksheet below and enter the tax on line 1a.

Note. You must reduce the amount you enter on line 2b(2) of Form 1041 by the portion of the section 691(c) deduction claimed on line 19 of Form 1041 if the estate or trust received qualified dividends that were IRD.

Line 1c—AMT. Attach Schedule I (Form 1041) if:
- The estate or trust must complete Schedule B.
- The estate or trust claims a credit on line 2b, 2c, or 2d of Schedule G.
- The estate’s or trust’s share of alternative minimum taxable income (line 29 of Schedule I (Form 1041)) exceeds $22,500.

Enter the amount from line 56 of Schedule I (Form 1041) on line 1c.

Line 2a—Foreign Tax Credit
Attach Form 1116, Foreign Tax Credit (Individual, Estate, or Trust), if you elect to claim credit for income or profits taxes paid or accrued to a foreign country or a U.S. possession. The estate or trust may claim credit for that part of the foreign taxes not allocable to the beneficiaries (including charitable beneficiaries). Enter the estate’s or trust’s share of the credit on line 2a. See Pub. 514, Foreign Tax Credit for Individuals, for details.

Line 2b—General Business Credit

Keep for Your Records

Caution: Do not use this worksheet if the estate or trust must complete Schedule D (Form 1041).

<table>
<thead>
<tr>
<th>Caution: Do not use this worksheet if the estate or trust must complete Schedule D (Form 1041).</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enter the amount from Form 1041, line 22 ................................. 1. __________________</td>
</tr>
<tr>
<td>2. Enter the amount from Form 1041, line 2b(2) ............................... 2. __________________</td>
</tr>
<tr>
<td>3. If you are claiming investment interest expense on Form 4952, enter the amount from line 4g; otherwise enter 0. ........ 3. __________________</td>
</tr>
<tr>
<td>4. Subtract line 3 from line 2. If zero or less, enter 0. ........................ 4. __________________</td>
</tr>
<tr>
<td>5. Subtract line 4 from line 1. If zero or less, enter 0. ........................ 5. __________________</td>
</tr>
<tr>
<td>6. Enter the smaller of the amount on line 1 or $2,300 ....................... 6. __________________</td>
</tr>
<tr>
<td>7. Is the amount on line 5 equal to or more than the amount on line 6?</td>
</tr>
<tr>
<td>☐ Yes.</td>
</tr>
<tr>
<td>☐ No.</td>
</tr>
<tr>
<td>8. Subtract line 7 from line 6 .................................................. 8. __________________</td>
</tr>
<tr>
<td>9. Are the amounts on lines 4 and 8 the same? ............................... 9. __________________</td>
</tr>
<tr>
<td>☐ Yes.</td>
</tr>
<tr>
<td>☐ No.</td>
</tr>
<tr>
<td>10. Enter the amount from line 8 (if line 8 is blank, enter 0). ........... 10. __________________</td>
</tr>
<tr>
<td>11. Subtract line 10 from line 9 .................................................. 11. __________________</td>
</tr>
<tr>
<td>12. Multiply line 11 by 15% (.15) .................................................. 12. __________________</td>
</tr>
<tr>
<td>13. Figure the tax on the amount on line 5. Use the 2010 Tax Rate Schedule 13. __________________</td>
</tr>
<tr>
<td>14. Add lines 12 and 13 ................................................................. 14. __________________</td>
</tr>
<tr>
<td>15. Figure the tax on the amount on line 1. Use the 2010 Tax Rate Schedule 15. __________________</td>
</tr>
<tr>
<td>16. Tax on all taxable income. Enter the smaller of line 14 or line 15 here and on Sch. G, line 1a .... 16. __________________</td>
</tr>
</tbody>
</table>
are apportioned on the basis of the income allocable to the estate or trust and the beneficiaries.

Enter on line 2b the estate's or trust's total general business credit allowed for the current year from Form 3800. The estate or trust must file Form 3800 to claim any of the general business credits. If the estate's or trust's only source of credits listed in Part I for Form 3800 is from passthrough entities, you may not be required to complete the source credit form. See the Instructions for Form 3800 for more information.

**Line 2c—Credit for Prior Year Minimum Tax**

An estate or trust that paid AMT in a previous year may be eligible for a minimum tax credit in 2010. See Form 8801, Credit for Prior Year Minimum Tax—Individuals, Estates, and Trusts.

**Line 2d—Bond Credits**

Complete and attach Form 8912, Credit to Holders of Tax Credit Bonds, if the estate or trust claims a credit for holding a tax credit bond. Also, be sure to include the credit in interest income.

**Line 3—Total Credits**

To claim a credit allowable to the estate or trust other than the credits entered on lines 2a through 2d, include the allowable credit in the total for line 3. Complete and attach the appropriate form and write the form number and amount of the allowable credit on the dotted line to the left of the entry space.

**Line 5—Recapture Taxes**

**Recapture of investment credit.** If the estate or trust disposed of investment credit property or changed its use before the end of the recapture period, see Form 4255, Recapture of Investment Credit, to figure the recapture tax allocable to the estate or trust. Include the tax on line 5 and write “ICR” on the dotted line to the left of the entry space.

**Recapture of low-income housing credit.** If the estate or trust disposed of property (or there was a reduction in the qualified basis of the property) on which the low-income housing credit was claimed, see Form 8611, Recapture of Low-Income Housing Credit, to figure any recapture tax allocable to the estate or trust. Include the tax on line 5 and write “LIHCR” on the dotted line to the left of the entry space.

**Recapture of qualified electric vehicle credit.** If the estate or trust claimed the qualified electric vehicle credit in a prior tax year for a vehicle that ceased to qualify for the credit, part or all of the credit may have to be recaptured. See Regulations 1.30-1(b) for details. If the estate or trust owes any recapture tax, include it on line 5 and write “QEVCR” on the dotted line to the left of the entry space.

**Recapture of the Indian employment credit.** Generally, if the estate or trust terminates a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year by reason of wages paid or incurred to that employee must be recaptured. See Form 8845 for details. If the estate or trust owes any recapture tax, include it on line 5 and write “IECR” on the dotted line to the left of the entry space.

**Recapture of the new markets credit.** If the estate or trust owes any new markets recapture tax, include it on line 5 and write “NMCR” on the dotted line to the left of the entry space. For more information, including how to figure the recapture amount, see section 45D(g).

**Recapture of the credit for employer-provided child care facilities.** If the facility ceased to operate as a qualified child care facility or there was a change in ownership, part or all of the credit may have to be recaptured. See Form 8882 for details. If the estate or trust owes any recapture tax, include it on line 5 and write “ECCFR” on the dotted line to the left of the entry space.

**Recapture of the alternative motor vehicle credit.** See section 30B(h)(8) for details. Include the tax on line 5 and write “AMVCR” on the dotted line to the left of the entry space.

**Recapture of the alternative fuel vehicle refueling property credit.** See section 30C(e)(5) for details. Include the tax on line 5 and write “ARPCR” on the dotted line to the left of the entry space.

**Line 6—Household Employment Taxes**

If any of the following apply, get Schedule H (Form 1040), Household Employment Taxes, and its instructions, to see if the estate or trust owes these taxes.

1. The estate or trust paid any one household employee cash wages of $1,700 or more in 2010. Cash wages include wages paid by checks, money orders, etc. When figuring the amount of cash wages paid, combine cash wages paid by the estate or trust with cash wages paid to the household employee in the same calendar year by the household of the decedent or beneficiary for whom the administrator, executor, or trustee of the estate or trust is acting.

2. The estate or trust withheld federal income tax during 2010 at the request of any household employee.

3. The estate or trust paid total cash wages of $1,000 or more in any calendar quarter of 2009 or 2010 to household employees.

**Note.** See Amended Schedule H (Form 1040) under F. Initial Return, Amended Return, etc., earlier for information on filing an amended Schedule H (Form 1040) for a Form 1041.

**Line 7—Total Tax**

Tax on ESBTs. Attach the tax computation to the return. To the left of the line 7 entry space, write “Sec. 641(c)” and the amount of tax on the S corporation items. Include this amount in the total tax on line 7.

To Electing Small Business Trusts (ESBTs) on page 12 for the special tax computation rules that apply to the portion of an ESBT consisting of stock in one or more S corporations.

Interest on deferred tax attributable to installment sales of certain timeshares and residential lots and certain nondealer real property installment obligations. If an obligation arising from the disposition of real property to which section 453(l) or 453A applies is outstanding at the close of the year, the estate or trust must include the interest due under section 453(l)(3)(B) or 453A(c), whichever is applicable, in the amount to be entered on line 7 of Schedule G, Form 1041, with the notation “Section 453(l) interest” or “Section 453A(c) interest,” whichever is applicable. Attach a schedule showing the computation.

Form 4970, Tax on Accumulation Distribution of Trusts. Include on this line any tax due on an accumulation distribution from a trust. To the left of the entry space, write “Form From Form 4970” and the amount of the tax.

Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. Include the interest due under the look-back method of section 460(b)(2). To the left of the entry space, write “From Form 8697” and the amount of interest due.

Form 8866, Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method. Include the interest due under the look-back method of section 167(g)(2). To the left of the entry space, write “From Form 8866” and the amount of interest due.

Interest on deferral of gain from certain constructive ownership transactions. Include the interest due under section 1260(b) on any deferral
of gain from certain constructive ownership transactions. To the left of the entry space, write "1260(b)" and the amount of interest due.

**Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.** If the estate or trust fails to receive the minimum distribution under section 4974, use Form 5329 to pay the excise tax. To the left of the entry space, write “Form 5329” and the amount of the tax.

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**Other Information**

**Question 1**

If the estate or trust received tax-exempt income, figure the allocation of expenses between tax-exempt and taxable income on a separate sheet and attach it to the return. Enter only the deductible amounts on the return. Do not figure the allocation on the return itself. For more information, see the instructions for Allocation for Deductions for Tax-Exempt Income on page 19.

Report the amount of tax-exempt interest income received or accrued in the space provided below Question 1.

Also, include any exempt-interest dividends the estate or trust received as a shareholder in a mutual fund or other regulated investment company.

**Question 2**

All salaries, wages, and other compensation for personal services must be included on the return of the person who earned the income, even if the income was irrevocably assigned to a trust by a contract assignment or similar arrangement.

The grantor or person creating the trust is considered the owner if he or she keeps "beneficial enjoyment" of or substantial control over the trust property. The trust's income, deductions, and credits are allocable to the owner.

If you checked "Yes" for Question 2, see Special Reporting Instructions on page 11.

**Question 3**

Check the "Yes" box and enter the name of the foreign country if either 1 or 2 below applies.

1. The estate or trust owns more than 50% of the stock in any corporation that owns one or more foreign bank accounts.
2. At any time during the year the estate or trust had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country.

**Exception.** Check "No" if either of the following applies to the estate or trust:

- The combined value of the accounts was $10,000 or less during the whole year, or
- The accounts were with a U.S. military banking facility operated by a U.S. financial institution.

Get Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, to see if the estate or trust is considered to have an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country. You can get Form TD F 90-22.1 from the IRS website at [www.irs.gov/pub/irs-pdf/f90221.pdf](http://www.irs.gov/pub/irs-pdf/f90221.pdf).

If you checked "Yes" for Question 3, file Form TD F 90-22.1 by June 30, 2011, with the Department of the Treasury at the address shown on the form. Form TD F 90-22.1 is not a tax return, so do not file it with Form 1041.

If you are required to file Form TD F 90-22.1 but do not, you may have to pay a penalty of up to $10,000 (more in some cases).

**Question 4**

The estate or trust may be required to report gifts and transfers to foreign persons.

- Accumulation Distribution for Certain Complex Trusts

**General Instructions**

Use Schedule J (Form 1041) to report an accumulation distribution for a domestic complex trust that was:

- Previously treated at any time as a foreign trust (unless an exception is provided in future regulations), or
- Created before March 1, 1984, unless that trust would not be aggregated with other trusts under the rules of section 643(f) if that section applied to the trust.

An accumulation distribution is the excess of amounts properly paid, credited, or required to be distributed (other than income required to be distributed currently) over the DNI of the trust reduced by income required to be distributed currently. To have an accumulation distribution, the distribution must exceed the accounting income of the trust.
Specific Instructions

Part I—Accumulation Distribution in 2010

Line 1—Distribution Under Section 661(a)(2)
Enter the amount from Form 1041, Schedule B, line 10, for 2010. This is the amount properly paid, credited, or required to be distributed other than the amount of income for the current tax year required to be distributed currently.

Line 2—DNI
Enter the amount from Form 1041, Schedule B, line 7, for 2010. This is the amount of DNI for the current tax year determined under section 643(a).

Line 3—Distribution Under Section 661(a)(1)
Enter the amount from Form 1041, Schedule B, line 9, for 2010. This is the amount of income for the current tax year required to be distributed currently.

Line 5—Accumulation Distribution
If line 11 of Form 1041, Schedule B, is more than line 8 of Form 1041, Schedule B, complete the rest of Schedule J and file it with Form 1041, unless the trust has no previously accumulated income.

Generally, amounts accumulated before a beneficiary reaches age 21 may be excluded by the beneficiary. See sections 665 and 667(c) for exceptions relating to multiple trusts. The trustee reports to the IRS the total amount of the accumulation distribution before any reduction for income accumulated before the beneficiary reaches age 21. If the multiple trust rules do not apply, the beneficiary claims the exclusion when filing Form 4970, as you may not be aware that the beneficiary may be a beneficiary of other trusts with other trustees.

For examples of accumulation distributions that include payments from one trust to another trust, and amounts distributed for a dependent’s support, see Regulations section 1.665(b)-1A.

Part II—Ordinary Income Accumulation Distribution
Enter the applicable year at the top of each column for each throwback year.

Line 6—DNI for Earlier Years
Enter the applicable amounts as follows:

<table>
<thead>
<tr>
<th>Throwback year(s)</th>
<th>Amount from line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 - 1977</td>
<td>Form 1041, Schedule C, line 5</td>
</tr>
<tr>
<td>1978 - 1979</td>
<td>Form 1041, line 58</td>
</tr>
<tr>
<td>1980</td>
<td>Form 1041, line 61</td>
</tr>
<tr>
<td>1981 - 1982</td>
<td>Form 1041, line 60</td>
</tr>
</tbody>
</table>

1983 - 1996 . . . . Form 1041, Schedule B, line 9
1997 - 2009 . . . . Form 1041, Schedule B, line 7

For information about throwback years, see the instructions for line 13. For purposes of line 6, in figuring the DNI of the trust for a throwback year, subtract any estate tax deduction for IRD if the income is includable in figuring the DNI of the trust for that year.

Line 7—Distributions Made During Earlier Years
Enter the applicable amounts as follows:

<table>
<thead>
<tr>
<th>Throwback year(s)</th>
<th>Amount from line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 - 1977</td>
<td>Form 1041, Schedule C, line 8</td>
</tr>
<tr>
<td>1978</td>
<td>Form 1041, line 64</td>
</tr>
<tr>
<td>1979</td>
<td>Form 1041, line 65</td>
</tr>
<tr>
<td>1980</td>
<td>Form 1041, line 64</td>
</tr>
<tr>
<td>1981 - 1982</td>
<td>Form 1041, line 62</td>
</tr>
<tr>
<td>1983 - 1996</td>
<td>Form 1041, Schedule B, line 13</td>
</tr>
<tr>
<td>1997 - 2009</td>
<td>Form 1041, Schedule B, line 11</td>
</tr>
</tbody>
</table>

Line 11—Prior Accumulation Distribution Thrown Back to Any Throwback Year
Enter the amount of prior accumulation distributions thrown back to the throwback years. Do not enter distributions excluded under section 663(a)(1) for gifts, bequests, etc.

Line 13—Throwback Years
Allocate the amount on line 5 that is an accumulation distribution to the earliest applicable year first, but do not allocate more than the amount on line 12 for any throwback year. An accumulation distribution is thrown back first to the earliest preceding tax year in which the trust received income. Then, it is thrown back beginning with the next earliest tax year to any remaining preceding tax years of the trust. The portion of the accumulation distribution allocated to the earliest preceding tax year is the amount of the DNI of the trust for that year. The portion of the accumulation distribution allocated to any remaining preceding tax year is the amount by which the accumulation distribution is larger than the total of the UNI for all earlier preceding tax years.

A tax year of a trust during which the trust was a simple trust for the entire year is not a preceding tax year unless (a) during that year the trust received outside income, or (b) the trustee did not distribute all of the trust’s income that was required to be distributed currently for that year. In this case, UNI for that year must not be more than the greater of the outside income or income not distributed during that year.

The term “outside income” means amounts that are included in the DNI of the trust for that year but that are not “income” of the trust as defined in Regulations section 1.643(b)-1. Some examples of outside income are: (a) income taxable to the trust under section 691; (b) unrealized accounts receivable that were assigned to the trust; and (c) distributions from another trust that include the DNI or UNI of the other trust.

Line 16—Tax-Exempt Interest Included on Line 13
For each throwback year, divide line 15 by line 6 and multiply the result by the following:

<table>
<thead>
<tr>
<th>Throwback year(s)</th>
<th>Amount from line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 - 1977</td>
<td>Form 1041, Schedule C, line 2(a)</td>
</tr>
<tr>
<td>1978</td>
<td>Form 1041, line 58(a)</td>
</tr>
<tr>
<td>1980</td>
<td>Form 1041, line 57(a)</td>
</tr>
<tr>
<td>1981 - 1982</td>
<td>Form 1041, line 55(a)</td>
</tr>
<tr>
<td>1983 - 2009</td>
<td>Form 1041, Schedule B, line 2</td>
</tr>
</tbody>
</table>

Part III—Taxes Imposed on Undistributed Net Income
For the regular tax computation, if there is a capital gain, complete lines 18 through 25 for each throwback year. If the trustee elected the alternative tax on capital gains, complete lines 21 through 31 instead of lines 18 through 25 for each applicable year. If there is no capital gain for any year, or there is a capital loss for every year, enter on line 9 the amount of the tax for each year identified in the instruction for line 18 and do not complete Part III. If the trust received an accumulation distribution from another trust, see Regulations section 1.665(b)-1A.

Note. The alternative tax on capital gains was repealed for tax years beginning after December 31, 1978. The maximum rate on net capital gain for 1981, 1987, and 1991 through 2009 is not an alternative tax for this purpose.

Line 18—Regular Tax
Enter the applicable amounts as follows:

<table>
<thead>
<tr>
<th>Throwback year(s)</th>
<th>Amount from line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 - 1976</td>
<td>Form 1041, page 1, line 24</td>
</tr>
<tr>
<td>1977</td>
<td>Form 1041, page 1, line 26</td>
</tr>
<tr>
<td>1978 - 1979</td>
<td>Form 1041, line 27</td>
</tr>
<tr>
<td>1980 - 1984</td>
<td>Form 1041, line 26c</td>
</tr>
<tr>
<td>1985 - 1986</td>
<td>Form 1041, line 25c</td>
</tr>
<tr>
<td>1987</td>
<td>Form 1041, line 22c</td>
</tr>
<tr>
<td>1988 - 2009</td>
<td>Form 1041, Schedule G, line 1a</td>
</tr>
</tbody>
</table>

Line 19—Trust’s Share of Net Short-Term Gain
For each throwback year, enter the smaller of the capital gain from the two lines indicated. If there is a capital loss or a zero on either or both of the two lines indicated, enter zero on line 19.

<table>
<thead>
<tr>
<th>Throwback year(s)</th>
<th>Amount from line</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 - 1970</td>
<td>Schedule D, line 10, column 2, or</td>
</tr>
</tbody>
</table>
Schedule K-1 (Form 1041)—Beneficiary’s Share of Income, Deductions, Credits, etc.

General Instructions
Use Schedule K-1 (Form 1041) to report the beneficiary’s share of income, deductions, and credits from a trust or a decedent’s estate.

Who Must File
The fiduciary (or one of the joint fiduciaries) must file Schedule K-1. A copy of each beneficiary’s Schedule K-1 is attached to the Form 1041 filed with the IRS, and each beneficiary is given a copy of his or her respective Schedule K-1. One copy of each Schedule K-1 must be retained for the fiduciary’s records.

Beneficiary’s Identifying Number
As a payer of income, you are required to request and provide a proper identifying number for each recipient of income. Enter the beneficiary’s number on the respective Schedule K-1 when you file Form 1041. Individuals and business recipients are responsible for giving you their TINs upon request. You may use Form W-9 to request the beneficiary’s identifying number.

Penalty. You may be charged a $50 penalty for each failure to provide a required TIN, unless reasonable cause is established for not providing it. Explain any reasonable cause in a signed affidavit and attach it to this return.

Substitute Forms
You do not need IRS approval to use a substitute Schedule K-1 if it is an exact copy of the IRS schedule. The boxes must use the same numbers and titles and must be in the same order and format as on the comparable IRS Schedule K-1. The substitute schedule must include the OMB number and the 6-digit form ID code in the upper right-hand corner of the schedule.

You must provide each beneficiary with the Instructions for Beneficiary Filing Form 1040 or other prepared specific instructions for each item reported on the beneficiary’s Schedule K-1.
Inclusion of Amounts in Beneficiaries' Income

Simple trust. The beneficiary of a simple trust must include in his or her gross income the amount of the income required to be distributed currently, whether or not distributed, or if the income required to be distributed currently to all beneficiaries exceeds the DNI, his or her proportionate share of the DNI. The determination of whether trust income is required to be distributed currently depends on the terms of the trust instrument and applicable local law. See Regulations section 1.652(c)-4 for a comprehensive example.

Estates and complex trusts. The beneficiary of a decedent’s estate or complex trust must include in his or her gross income the sum of:

1. The amount of the income required to be distributed currently, or if the income required to be distributed currently to all beneficiaries exceeds the DNI, (figured without taking into account the charitable deduction), his or her proportionate share of the DNI (as so figured), and
2. All other amounts properly paid, credited, or required to be distributed, or if the sum of the income required to be distributed currently and other amounts properly paid, credited, or required to be distributed to all beneficiaries exceeds the DNI, his or her proportionate share of the excess of DNI over the income required to be distributed currently.

See Regulations section 1.662(c)-4 for a comprehensive example.

For complex trusts that have more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of DNI allocable to the respective beneficiaries. A similar rule applies to treat substantially separate and independent shares of different beneficiaries of an estate as separate estates. For examples of the application of the separate share rule, see the regulations under section 663(c).

Gifts and bequests. Do not include in the beneficiary’s income any gifts or bequests of a specific sum of money or of specific property under the terms of the governing instrument that are paid or credited in three installments or less.

Amounts that can be paid or credited only from income of the estate or trust do not qualify as a gift or bequest of a specific sum of money.

Past years. Do not include in the beneficiary’s income any amounts deducted on Form 1041 for an earlier year that were credited or required to be distributed in that earlier year.

Character of income. The beneficiary’s income is considered to have the same proportion of each class of items entering into the computation of DNI that the total of each class has to the DNI (for example, half dividends and half interest if the income of the estate or trust is half dividends and half interest).

Allocation of deductions. Generally, items of deduction that enter into the computation of DNI are allocated among the items of income to the extent such allocation is not inconsistent with the rules set out in section 469 and its regulations, relating to passive activity loss limitations, in the following order.

First, all deductions directly attributable to a specific class of income are deducted from that income. For example, rental expenses, to the extent allowable, are deducted from rental income.

Second, deductions that are not directly attributable to a specific class of income generally may be allocated to any class of income, as long as a reasonable portion is allocated to any tax-exempt income. Deductions considered not directly attributable to a specific class of income under this rule include fiduciary fees, safe deposit box rental charges, and state income and personal property taxes. The charitable deduction, however, must be ratably apportioned among each class of income included in DNI.

Finally, any excess deductions that are directly attributable to a class of income may be allocated to another class of income. However, in no case can excess deductions from a passive activity be allocated to income from a nonpassive activity, or to portfolio income earned by the estate or trust. Excess deductions attributable to tax-exempt income cannot offset any other class of income.

In no case can deductions be allocated to an item of income that is not included in the computation of DNI, or attributable to corpus.

You cannot show any negative amounts for any class of income shown in boxes 1 through 8 of Schedule K-1. However, for the final year of the estate or trust, certain deductions or losses can be passed through to the beneficiary(ies). See the instructions for box 11 for more information on these deductions and losses. Also, the beneficiary’s share of depreciation and depletion is apportioned separately. These deductions may be allocated to the beneficiary(ies) in amounts greater than his or her income. See Depreciation, Depletion, and Amortization on page 18 and Rev. Rul. 74-530, 1974-2 C.B. 188.

Beneficiary’s Tax Year

The beneficiary’s income from the estate or trust must be included in the beneficiary’s tax year during which the tax year of the estate or trust ends. See Pub. 559 for more information, including the effect of the death of a beneficiary during the tax year of the estate or trust.

General Reporting Information

If the return is for a fiscal year or a short tax year, fill in the tax year space at the top of each Schedule K-1. On each Schedule K-1, enter the information about the estate or trust and the beneficiary in Parts I and II (items A through H). In Part III, enter the beneficiary’s share of each item of income, deduction, credit, and any other information the beneficiary needs to file his or her income tax return.

Codes. In box 9 and boxes 11 through 14, identify each item by entering a code in the column to the left of the entry space for the dollar amount. These codes are identified in these instructions and on the back of the Schedule K-1.

Attached statements. Enter an asterisk (*) after the code, if any, in the column to the left of the dollar amount entry space for each item for which you have attached a statement providing additional information. For those informational items that cannot be reported as a single dollar amount, enter the code and asterisk in the left-hand column and enter “STMT” in the entry space to the right to indicate that the information is provided on an attached statement. More than one attached statement can be placed on the same sheet of paper and should be identified in alphanumeric order by box number followed by the letter code (if any). For example: “Box 9, Code A—Depreciation” (followed by the information the beneficiary needs).

Too few entry spaces on Schedule K-1? If the estate or trust has more coded items than the number of spaces in box 9 or boxes 11 through 14, do not enter a code or dollar amount in the last entry space of the box. In the last entry space, enter an asterisk in the left column and enter “STMT” in the entry space to the right. Report the additional items on an attached statement and provide the box number, code, description, and dollar amount or information for each additional item. For example: “Box 13, Code H—Alcohol and Cellulosic Biofuels Fuel Credit—$500.00.”
Boxes 4a through 4c—Net Long-Term Capital Gain
Enter the beneficiary's share of the net long-term capital gain from Schedule D (Form 1041), lines 14a through 14c, column (1), minus allocable deductions.

Do not enter a loss in boxes 4a through 4c. If, for the final year of the estate or trust, there is a capital loss carryover, enter in box 11, using code C, the beneficiary's share of the long-term capital loss carryover. If the beneficiary is a corporation, see the instructions for box 3.) See section 642(h) and related regulations for more information.

Gains or losses from the complete or partial disposition of a rental, rental real estate, or trade or business activity that is a passive activity must be shown on an attachment to Schedule K-1.

Note. An estate or trust cannot make an election under section 179 to expense certain depreciable business assets.

Boxes 6 through 8—Ordinary Business Income, Rental Real Estate, and Other Rental Income
Enter the beneficiary's share of trade or business, rental real estate, and other rental income, minus allocable deductions (other than directly apportionable deductions). To assist the beneficiary in figuring any applicable passive activity loss limitations, also attach a separate schedule showing the beneficiary's share of income derived from each trade or business, rental real estate, and other rental activity.

Box 9—Directly Apportioned Deductions

The limitations on passive activity losses and credits under section 469 apply to estates and trusts. Estates and trusts that distribute income to beneficiaries are allowed to apportion depreciation, depletion, and amortization deductions to the beneficiaries. These deductions are referred to as “directly apportionable deductions.”

Rules for treating a beneficiary's income and directly apportionable deductions from an estate or trust and other rules for applying the passive loss and credit limitations to beneficiaries of estates and trusts have not yet been issued.

Any directly apportionable deduction, such as depreciation, is treated by the beneficiary as having been incurred in the same activity as incurred by the estate or trust. However, the character of such deduction may be determined as if the beneficiary incurred the deduction directly.

To assist the beneficiary in figuring any applicable passive activity loss limitations, also attach a separate schedule showing the beneficiary's share of directly apportionable deductions derived from each trade or business, rental real estate, and other rental activity.

Enter the beneficiary's share of directly apportionable deductions using codes A through C.

Depreciation (code A). Enter the beneficiary's share of the depreciation deductions directly apportioned to each activity reported in boxes 5 through 8. See the instructions on page 18 for a discussion of how the depreciation deduction is apportioned between the beneficiaries and the estate or trust. Report any AMT adjustment or tax preference item attributable to depreciation separately in box 12, using code G.

Note. An estate or trust cannot make an election under section 179 to expense certain depreciable business assets.

Depletion (code B). Enter the beneficiary's share of the depletion deduction under section 611 directly apportioned to each activity reported in boxes 5 through 8. See the instructions on page 18 for a discussion of how the depletion deduction is apportioned between the beneficiaries and the estate or trust. Report any tax preference item attributable to depletion separately in box 12, using code H.

Amortization (code C). Itemize the beneficiary's share of the amortization deductions directly apportioned to each activity reported in boxes 5 through 8. Apportion the amortization deductions between the estate or trust and the beneficiaries in the same way that the depreciation and depletion deductions are divided. Report any AMT adjustment attributable to amortization separately in box 12, using code I.

Box 10—Estate Tax Deduction (Including Certain Generation-Skipping Transfer Taxes)

If the distribution deduction consists of any IRD, and the estate or trust was allowed a deduction under section 691(c) for the estate tax paid attributable to such income (see the
line 19 instructions on page 23), then the beneficiary is allowed an estate tax deduction in proportion to his or her share of the distribution that consists of such income. For an example of the computation, see Regulations section 1.691(c)-2. Figure the computation on a separate sheet and attach it to the return.

Box 11, Code A—Excess Deductions on Termination
If this is the final return of the estate or trust, and there are excess deductions on termination (see the instructions for line 22 on page 23), enter the beneficiary’s share of the excess deductions in box 11, using code A. Figure the deductions on a separate sheet and attach it to the return.

Excess deductions on termination occur only during the last tax year of the trust or decedent’s estate when the total deductions (excluding the charitable deduction and exemption) are greater than the gross income during that tax year.

Generally, a deduction based on an NOL carryover is not available to a beneficiary as an excess deduction. However, if the last tax year of the estate or trust is also the last year in which an NOL carryover may be taken (see section 172(b)), the NOL carryover is considered an excess deduction on the termination of the estate or trust to the extent it is not absorbed by the estate or trust during its final tax year. For more information, see Regulations section 1.642(h)-4 for a discussion of the allocation of the carryover among the beneficiaries.

Only the beneficiary of an estate or trust that succeeds to its property is allowed to deduct that entity’s excess deductions on termination. A beneficiary who does not have enough income in that year to absorb the entire deduction may not carry the balance over to any succeeding year. An individual beneficiary must be able to itemize deductions in order to claim the excess deductions in determining taxable income.

Box 11, Codes B and C—Unused Capital Loss Carryover
Upon termination of the trust or decedent’s estate, the beneficiary succeeding to its property is allowed to deduct any unused capital loss carryover under section 1212. If the estate or trust incurs capital losses in the final year, use the Capital Loss Carryover Worksheet in the Instructions for Schedule D (Form 1041) to figure the amount of capital loss carryover to be allocated to the beneficiary.

Box 11, Codes D and E—NOL Carryover
Upon termination of a trust or decedent’s estate, a beneficiary succeeding to its property is allowed to deduct any unused NOL (and any ATNOL) carryover for regular and AMT purposes if the carryover would be allowable to the estate or trust in a later tax year but for the termination. Enter in box 11, using codes D and E, the unused carryover amounts.

Box 12—AMT Items
Adjustment for minimum tax purposes (code A). Enter the beneficiary’s share of the adjustment for minimum tax purposes.

To figure the adjustment, subtract the beneficiary’s share of the income distribution deduction figured on Schedule B, line 15, from the beneficiary’s share of the income distribution deduction on a minimum tax basis figured on Schedule I (Form 1041), line 44. The difference is the beneficiary’s share of the adjustment for minimum tax purposes.

Note. Schedule B, line 15 equals the sum of all Schedule K-1s, box 1, 2a, 3, 4a, 5, 6, 7, and 8.

AMT adjustment attributable to qualified dividends, net short-term capital gains, or net long-term capital gains (codes B through D). If any part of the amount reported in box 12, code A, is attributable to qualified dividends (code B), net short-term capital gain (code C), or net long-term capital gain (code D), enter that part using the applicable code.

AMT adjustment attributable to unreaptured section 1250 gain or 28% rate gain (codes E and F). Enter the beneficiary’s distributive share of any AMT adjustments to the unreaptured section 1250 gain (code E) or 28% rate gain (code F), whichever is applicable, in box 12.

Accelerated depreciation, depletion, and amortization (codes G through I). Enter any adjustments or tax preference items attributable to depreciation, depletion, or amortization that were directly apportioned to the beneficiary. For property placed in service before 1987, report separately the accelerated depreciation of real and leased personal property.

Exclusion items (code J). Enter the beneficiary’s share of the adjustment for minimum tax purposes from Schedule K-1, box 12, code A, that is attributable to exclusion items (Schedule I (Form 1041), lines 2 through 6 and 8).

Box 13—Credits and Credit Recapture
Enter each beneficiary’s share of the credits and credit recapture using the applicable codes. Listed below are the credits that can be allocated to the beneficiary(ies). Attach a statement if additional information must be provided to the beneficiary as explained below.

- Credit for estimated taxes (code A) — Payment of estimated tax to be credited to the beneficiary (section 643(g)).

See the instructions for line 24b on page 24 before you make an entry to allocate any estimated tax payments to a beneficiary. If the fiduciary does not make a valid election, then the IRS will disallow the estimated tax payment that is reported on Schedule K-1 and claimed on the beneficiary’s return.

- Credit for backup withholding (code B).

- The low-income housing credit (code C). Attach a statement that shows the beneficiary’s share of the amount, if any, entered on line 6 of Form 8586 with instructions to report that amount on line 4 of Form 8586 or line 1d of Form 3800 if the beneficiary’s only source for the credit is a pass-through entity. Also, show the beneficiary’s share of the amount, if any, entered on line 19 of Form 8586 with instructions to report that amount on line 11 of Form 8586.

- Rehabilitation credit and energy credit (code D). Attach a statement that shows the beneficiary’s apportioned share of basis, expenditures, and other information that is necessary for the beneficiary to complete Form 3468, Investment Credit, for the rehabilitation credit and the energy credit. See the Instructions for Form 3468 for more information.

- Other qualifying investment credit (code E). Attach a statement that shows the beneficiary’s apportioned share of qualified investment and other information that is necessary for the beneficiary to complete Form 3468 for the qualifying advanced coal project credit, qualifying gasification project credit, and qualifying advanced energy project credit. See the Instructions for Form 3468 for more information.

- Work opportunity credit (code F).

- Credit for small employer health insurance premiums (code G).

- Alcohol and cellulosic biofuel fuels credit (code H). If the credit includes the small ethanol producer credit, attach a statement that shows the beneficiary’s share of the small ethanol producer credit, the number of gallons claimed for the small ethanol producer credit, and the estate’s or trust’s productive capacity for alcohol.
• Credit for increasing research activities (code I).
• Renewable electricity, refined coal, and Indian coal production credit (code J). Attach a statement that shows the amount of the credit the beneficiary must report on line 9 and line 29 of Form 8835; in case the beneficiary is required to file that form in addition to Form 3800.
• Empowerment zone and renewal community employment credit (code K).
• Indian employment credit (code L).
• Orphan drug credit (code M).
• Credit for employer provided child care and facilities (code N).
• Biodiesel and renewable diesel fuels credit (code O). If the credit includes the small agri-biodiesel credit, attach a statement that shows the beneficiary's share of the small agri-biodiesel credit, the number of gallons claimed for the small agri-biodiesel credit, and the estate's or trust's productive capacity for agri-biodiesel.
• Nonconventional source fuel credit (code P).
• Credit to holders of tax credit bonds (code Q).
• Agricultural chemicals security credit (code R).
• Energy efficient appliance credit (code S).
• Credit for employer differential wage payments (code T).
• Recapture of credits (code U). On an attached statement to Schedule K-1, provide any information the beneficiary will need to report recapture of credits.

Box 14—Other Information
Enter the dollar amounts and applicable codes for the items listed under Other Information.

Domestic production activities information. The estate or trust allocates QPAI (whether positive or negative) and Form W-2 wages based on the relative proportion of the estate's or trust's DNI that is distributed or required to be distributed to the beneficiary. If the estate or trust has no DNI for the tax year, QPAI and Form W-2 wages are allocated entirely to the estate or trust.

Qualified production activities income (code C). Enter the beneficiary's share, if any, of the estate's or trust's QPAI from all activities. The QPAI will be less than zero if the cost of goods sold and deductions allocated and apportioned to domestic production gross receipts (DPGR) is more than the estate's or trust's DPGR. If any of the QPAI is oil-related QPAI, attach a statement that shows the amount of oil-related QPAI. See Form 8903, Domestic Production Activities Deduction, and its instructions for more details.

Form W-2 wages (code D). Use code D to report the beneficiary's share, if any, of Form W-2 wages. Do not enter more than 9% of the beneficiary's share, if any, of the estate's or trust's QPAI. See Form 8903 and its instructions for more details.

Foreign trading gross receipts (code G). Enter the beneficiary's share, if any, of foreign trading gross receipts. See Form 8873, Extraterritorial Income Exclusion, for more information.

Other information (code H). List on a separate sheet the tax information the beneficiary will need to complete his or her return that is not entered elsewhere on Schedule K-1.

For example, if the estate or trust participates in a transaction that must be disclosed on Form 8886 (see page 10), both the estate or trust and its beneficiaries may be required to file Form 8886. The estate or trust must determine if any of its beneficiaries are required to disclose the transaction and provide those beneficiaries with information they will need to file Form 8886. This determination is based on the category(ies) under which a transaction qualified for disclosure. See the instructions for Form 8886 for details.

Income tax withheld on wages cannot be distributed to the beneficiary.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

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<td>Recordkeeping</td>
<td>38 hr., 58 min.</td>
<td>26 hr., 33 min.</td>
<td>17 hr., 42 min.</td>
<td>11 hr., 00 min.</td>
<td>6 hr., 27 min.</td>
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<td>16 hr., 11 min.</td>
<td>4 hr., 5 min.</td>
<td>4 hr., 22 min.</td>
<td>1 hr., 27 min.</td>
<td>35 min.</td>
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<tr>
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<td>30 hr., 34 min.</td>
<td>5 hr., 37 min.</td>
<td>4 hr., 51 min.</td>
<td>2 hr., 37 min.</td>
<td>43 min.</td>
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<td>3 hr., 45 min.</td>
<td>51 min.</td>
<td>- - -</td>
<td>16 min.</td>
<td>- - -</td>
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If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave, NW, IR-6526, Washington, DC 20224. Do not send the tax form to this address. Instead, see Where To File on page 7.
Instructions for Form 1041 and Schedules A, B, G, J, and K-1

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-- A --

**Adjusted Gross Estate**: Calculated by deducting estate settlement costs from the gross estate, also known as the taxable estate.

**Administrator**: The person appointed by the court to manage your estate when you die without leaving a will. Since they are court appointed, they are required to post a bond as security. They have the same duties as an executor. In some states, the position is called “personal representative.”

**Annual Exclusion**: The amount of property the IRS allows a person to gift to another person during a calendar year before a gift tax is assessed and/or a gift tax return must be filed. The amount is increased periodically.

-- D --

**Death Tax**: Also known as estate tax, is levied on a decedent’s estate.

**Decedent**: An individual who has died.

-- E --

**Estate**: The assets owned by a decedent at the time of his or her death are referred to as the estate.

**Estate Planning**: The process by which an individual determines how to divide his or her assets upon death or during their lifetime in anticipation of death.

**Estate Taxes**: Taxes imposed on the “privilege” of transferring property by reason of death. Estate tax is most commonly used in reference to the tax imposed by the federal government rather than the state government. Estate taxes are intended to raise revenue for the government and break up a family’s wealth, so that the nation’s wealth does not concentrate in the hands of a few families.

-- G --

**General Partnership**: A partnership that has only general partners and no limited partners. Each partner is liable for all partnership debts, and there is no limited liability.

**Generation Skipping Transfer (GST)**: A transfer of property, usually in trust, that is designed to provide benefits for beneficiaries who are two or more generations younger than the generation of the grantor.
**Generation-Skipping Transfer (GST) Tax:** A separate 55% flat rate federal transfer tax in addition to the gift and estate taxes imposed on transfers to persons two or more generations below the transferor; each transferor has $1,000,000 of inflation-indexed exemption from the GST tax.

**Gift:** Literally, a gratuitous transfer of something of value from the owner to another person. To be a valid gift there must be intent, actual transfer to the donee or recipient of the gift and acceptance.

**Gift Taxes:** Taxes levied by the federal government on gifts. Gift taxes and estate taxes have been “merged” into a single tax called the “unified tax.”

**Gross Estate:** The total value of all property owned by a decedent at the time of his or her death.

**Income in Respect of a Decedent (IRD):** Income earned by a decedent or income to which the decedent had a right prior to death, but which was not properly includible in his or her gross income prior to death.

**Partnership:** A type of unincorporated business organization in which multiple individuals, called general partners, manage the business and are equally liable for its debts.

**Personal Representative:** An executor, administrator, or anyone else who is in charge of a decedent’s property.

**Split Gift:** Each spouse is entitled to give any individual $12,000 in a calendar year without tax consequences. If a married couple tries to give more than $12,000 to an individual, they must file a gift tax form declaring that the gift is split between them.

**Spouse:** Legal term for a married person, either a husband or wife.

**Surviving Spouse:** The husband or wife that lives after the death of his or her spouse.

**Taxable Estate:** The portion of an estate that is subject to federal estate taxes or state death taxes. Technically, all of an estate is subject to federal estate taxes, but because of the unified credit, only estates with a value over the exemption equivalent amount actually have to pay any estate taxes.
-- U --

**Unified Credit:** A tax credit is given to each person by the IRS to be used during his or her life or after his or her death. The tax credit equals the amount of tax (gift or estate) which is assessed on the exemption equivalent value of property. It is considered the “unified” credit because it applies to both gift taxes and estate taxes.

-- W --

**Widow's Allowance:** The amount allowed by court order to be paid a decedent’s widow and family from estate assets under administration.
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