21 Estates, Trusts, and Fiduciaries

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New for 2024

- **Annual exclusion for gifts.** For 2024, the annual exclusion amount for gifts is $18,000. See *Annual Exclusion,* page 21-26.
- **Gift tax return—gift splitting election by spouses.** Beginning 2024, a consenting spouse must sign and date a Notice of Consent to be attached to the donor's return instead of signing the donor's Form 709. See *Notice of Consent,* page 21-30.

Common Elections

- Election to treat a revocable trust as part of an estate, page 21-8.
- Election to recognize gain or loss of distributed property, page 21-12.
- Election to treat contributions as paid in prior tax year, page 21-15.
- Election to use 65-day rule for payment to beneficiary, page 21-16.
- Election to allocate estimated tax to beneficiaries, page 21-17.
- QTIP election, page 21-23.
- Portability of the DSUE election, page 21-23.
- Election to use alternate valuation for estate tax, page 21-24.
- Election to split gift with spouse, page 21-30.

Annual Exclusion for Gifts

	2024	2023	2022	2021
Per donee	$18,000	$17,000	$16,000	$15,000
Split gift total (spouses only)	$36,000	$34,000	$32,000	$30,000
Gift to noncitizen spouse	$185,000	$175,000	$164,000	$159,000

Estate and Gift Tax Exclusion, Credit, and Tax Rate

Year of Death	Exclusion*	Credit Against Tax	Maximum Tax Rate
2024	$13,610,000	$5,389,800	40%
2023	$12,920,000	$5,113,800	40%
2022	$12,060,000	$4,769,800	40%
2021	$11,700,000	$4,625,800	40%

* Plus any unused estate/gift DSUE if portability was elected. See *Portability of the deceased spousal unused exclusion (DSUE) election,* page 21-23.

Generation-Skipping Transfer (GST) Tax. The GST exemption is unified with the estate and gift tax exclusion. However, the portability election of the DSUE available for estate and gift tax is not available for the GST tax. See *Generation-Skipping Transfer (GST) Tax,* page 21-22.

2024 Capital Gain and Qualified Dividend Rates

Maximum Rate	0%	15%	20%
Estate or Trust Income	$0 – $3,150	$3,151 – $15,450	$15,451 and over

Net investment income tax. Certain estates or trusts may also be subject to the additional 3.8% net investment income tax. See *Net investment income tax (NIIT),* page 21-13.

2024 Form 1041 Income Tax Rate Schedule

Rev. Proc. 2023-34. If taxable income is:

$ 0	to	3,100	×	10.0%	minus	$ 0.00	=	Tax
3,101	to	11,150	×	24.0%	minus	434.00	=	Tax
11,151	to	15,200	×	35.0%	minus	1,660.50	=	Tax
15,201	and over		×	37.0%	minus	1,964.50	=	Tax

Form 1041—Estates and Trusts Income Tax Return
(See page 21-10)

Tax Year	**Estates.** The first tax year begins at the moment of death. The personal representative selects the year end when filing the first Form 1041. See *Estate Year,* page 21-11. **Trusts.** Trusts must generally use a calendar year. Exceptions apply for grantor, tax-exempt, and charitable trusts.
Filing Requirements	Form 1041 is required if the estate or trust has: • Gross income of $600 or more, • A nonresident alien beneficiary, • A qualified investment in a QOF, or • For trusts only, any taxable income.
Filing Deadline	15th day of the fourth month after the close of the tax year. Calendar year 2024 – April 15, 2025.
Extensions	5½-month automatic extension: Form 7004, *Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns.*
Penalties	Late filing/late payment penalties same as individuals. See *Taxpayer Penalties,* page 15-2. **Schedule K-1.** A $330 penalty applies for each failure to timely issue Schedule K-1 (Form 1041) to a beneficiary.
Exemptions	Estates .... $600 Trusts required to distribute all income currently ... $300 Qualified disability trusts .... $5,050 All other trusts $100
Use 2024 Forms for	2024 calendar year. • Fiscal years beginning in 2024. • Tax years beginning in 2025 if 2025 forms are not available by due date. Incorporate any tax law changes.
Estimated Tax	**Form 1041-ES,** ***Estimated Income Tax for Estates and Trusts.*** Same rules as for individuals. See *Penalty for Underpayment of Estimated Tax,* page 15-4. **Annualized income installment method.** An estate or trust that receives income unevenly during the year may use the annualized income installment method. The period ending dates for calculating estimated tax payments end one month earlier than for individual taxpayers, on 2/28, 4/30, 7/31, and 11/30. See Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts.* **Estates.** Estimated tax payments are not required for an estate of a domestic decedent that had no tax liability for the full 12-month previous tax year or for a decedent's estate for the first two years after the decedent's death. **Trusts.** Estimated tax payments are generally required beginning in the first year. However, payments are not required for a domestic trust that had no tax liability for the full 12-month previous tax year or for the first two years after the decedent's death for a grantor trust that receives the decedent's estate residue by will (if no will is probated, the trust is primarily responsible for paying debts, taxes, and administration expenses). **Estimated tax allocated to beneficiaries.** File Form 1041-T, *Allocation of Estimated Tax Payments to Beneficiaries,* by the 65th day after the close of the tax year, March 6, 2025 (for 2024 calendar year). See *Election to allocate estimated tax to beneficiaries,* page 21-17.
Beneficiaries	Report items from Schedule K-1 (Form 1041) in the year that includes the entity's year end. For example, items for tax year May 1, 2024 through April 30, 2025, are reported in calendar year 2025 for beneficiary.
Election to Treat Revocable Trust as Part of Estate	File Form 8855, *Election to Treat a Qualified Revocable Trust as Part of an Estate,* by the due date (including extension) for the first Form 1041. See *Revocable Trusts at Death,* page 21-7.

Prior Years Form 1041 Income Tax Rate Schedules

2023 Rev. Proc. 2022-38. If taxable income is:

$ 0	to	2,900	×	10.0%	minus	$ 0.00	=	Tax
2,901	to	10,550	×	24.0%	minus	406.00	=	Tax
10,551	to	14,450	×	35.0%	minus	1,566.50	=	Tax
14,451	and over		×	37.0%	minus	1,855.50	=	Tax

2022 (Rev. Proc. 2021-45). If taxable income is:

$ 0	to	2,750	×	10.0%	minus	$ 0.00	=	Tax
2,751	to	9,850	×	24.0%	minus	385.00	=	Tax
9,851	to	13,450	×	35.0%	minus	1,468.50	=	Tax
13,451	and over		×	37.0%	minus	1,737.50	=	Tax

Where to File — Form 1041

Taxpayer is located in:	*Return without payment:*	*Return with payment:*
CT, DE, DC, GA, IL, IN, KY, ME, MD, MA, MI, NH, NJ, NY, NC, OH, PA, RI, SC, TN, VT, VA, WV, WI	Department of the Treasury Internal Revenue Service Kansas City, MO 64999-0048	Department of the Treasury Internal Revenue Service Kansas City, MO 64999-0148
AL, AK, AZ, AR, CA, CO, FL, HI, ID, IA, KS, LA, MN, MS, MO, MT, NE, NV, NM, ND, OK, OR, SD, TX, UT, WA, WY	Department of the Treasury Internal Revenue Service Ogden, UT 84201-0048	Department of the Treasury Internal Revenue Service Ogden, UT 84201-0148
A foreign country or a U.S. territory	Internal Revenue Service P.O. Box 409101 Ogden, UT 84409	Internal Revenue Service P.O. Box 409101 Ogden, UT 84409

State Estate and Inheritance Tax

An estate may deduct (on Form 706) the amount of any estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia. Many states have allowed their estate tax to expire or repealed it, however, some states still tax an estate and/or a beneficiary's inheritance. State estate tax exemption amounts vary from $1 million to over $7 million. Check rules in the decedent's state of domicile and in states where the decedent owned real property.

Inheritance tax. An inheritance tax is a tax on a beneficiary's right to receive property from a decedent. Rates typically vary based on the relationship of the beneficiary to the decedent. That is, closer relatives generally pay at a lower tax rate. Inheritance tax thresholds are generally lower than estate tax thresholds.

Gift tax. Connecticut is the only state to impose a separate gift tax, which applies to amounts that exceed the annual federal exclusion amount. The Connecticut gift tax exemption is unified with its estate tax exemption. Other states may impose estate or inheritance tax on gifts made in contemplation of death or shortly before death.

States with Estate or Inheritance Tax in 2023

Connecticut	Kentucky*	Nebraska*	Rhode Island
District of Columbia	Maine	New Jersey*	Vermont
Hawaii	Maryland**	New York	Washington
Illinois	Massachusetts	Oregon	
Iowa*	Minnesota	Pennsylvania*	

* Inheritance tax only.
** Has both an estate and an inheritance tax.

Check state law. The Iowa inheritance tax began phasing out in 2021 and will be fully repealed as of January 1, 2025.

Form 706 — Estate Tax Return (See page 21-31)

Filing requirements. File Form 706 if the following total more than the estate tax exclusion for the year of death ($13,610,000 for 2024).

- Decedent's gross estate at death.
- Adjusted taxable gifts made by the decedent from 1977 through death.
- Specific exemption (up to $30,000) used for gifts made from September 9, 1976 through December 31, 1976.

File to elect portability. Form 706 must be filed to elect to transfer a decedent's unused estate tax exclusion to his or her surviving spouse. The election must be made on a timely filed Form 706 (including extensions). See *Portability of the deceased spousal unused exclusion (DSUE) election,* page 21-23.

Filing deadline. Generally, nine months after the date of death.

Extension. A 6-month automatic extension is available by filing Form 4768, *Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes.*

Estimated tax. Not required. Tax is generally due nine months after the date of death. A 6-month automatic extension of time to pay estate (and generation-skipping transfer) tax is available by filing Form 4768.

Where to File — Form 706 or 709

U.S. Postal Service:	*Private Delivery Service:*
Department of the Treasury Internal Revenue Service Center Kansas City, MO 64999	Internal Revenue Service 333 W. Pershing Road Kansas City, MO 64108

Estate and Gift Tax

2013 – 2024 Federal Tax Rate Schedule

$ 0	to	10,000	×	18%	minus	$ 0	=	Tax
10,001	to	20,000	×	20%	minus	200	=	Tax
20,001	to	40,000	×	22%	minus	600	=	Tax
40,001	to	60,000	×	24%	minus	1,400	=	Tax
60,001	to	80,000	×	26%	minus	2,600	=	Tax
80,001	to	100,000	×	28%	minus	4,200	=	Tax
100,001	to	150,000	×	30%	minus	6,200	=	Tax
150,001	to	250,000	×	32%	minus	9,200	=	Tax
250,001	to	500,000	×	34%	minus	14,200	=	Tax
500,001	to	750,000	×	37%	minus	29,200	=	Tax
750,001	to	1,000,000	×	39%	minus	44,200	=	Tax
1,000,001	and over		×	40%	minus	54,200	=	Tax

Estate and Gift Tax

2010 – 2012 Federal Tax Rate Schedule

$ 0	to	10,000	×	18%	minus	$ 0	=	Tax
10,001	to	20,000	×	20%	minus	200	=	Tax
20,001	to	40,000	×	22%	minus	600	=	Tax
40,001	to	60,000	×	24%	minus	1,400	=	Tax
60,001	to	80,000	×	26%	minus	2,600	=	Tax
80,001	to	100,000	×	28%	minus	4,200	=	Tax
100,001	to	150,000	×	30%	minus	6,200	=	Tax
150,001	to	250,000	×	32%	minus	9,200	=	Tax
250,001	to	500,000	×	34%	minus	14,200	=	Tax
500,001	and over		×	35%	minus	19,200	=	Tax

Maximum Estate and Gift Tax Rates

2013 – 2024	$1,000,001	and over	40%	minus	$54,200	=	Tax
2010 – 2012	$500,001	and over	35%	minus	$19,200	=	Tax
2007 – 2009	$1,500,001	and over	45%	minus	$119,200	=	Tax
2006	$2,000,001	and over	46%	minus	$139,200	=	Tax
2005	$2,000,001	and over	47%	minus	$159,200	=	Tax
2004	$2,000,001	and over	48%	minus	$179,200	=	Tax
2003	$2,000,001	and over	49%	minus	$199,200	=	Tax

Form 709 — Gift Tax Return (See page 21-25)

2024 Filing deadline. April 15, 2025.

- If donor died during 2024, the executor must file the donor's Form 709 no later than the earlier of the due date (with extension) for filing the donor's estate tax return (Form 706), or April 15, 2025.

Extension. The income tax extension (Form 4868) also extends the deadline for filing Form 709. File Form 8892, *Application for Automatic Extension of Time To File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax,* to make an extension payment of gift tax or to request a filing extension when an income tax extension is not requested.

Estimated tax. Not required. 2024 gift tax is due April 15, 2025.

Form 709 — 2024 Filing Requirements

	Filing Requirements. File Form 709 if the taxpayer gave any of the following in 2024.	**Gifts Reported.** When Form 709 is required, report gifts listed below. Some of these gifts would not require a return to be filed if they were the only gifts made during the year.
Gifts to anyone other than a spouse or charity	• More than $18,000 to any one donee. • A future interest of any value.	• Report all gifts to a donee who received more than $18,000. Do not report any gifts to a donee who received $18,000 or less. • Report all gifts of future interests of any value.
Gifts to charity	• A partial interest in property (i.e., a trust remainder interest).	• Report all gifts to charity if a return is required.
Split gift with spouse, or gift of property held in joint tenancy or tenants by the entirety, or gift of community property	• A split gift with spouse (of any amount). • Gift is considered made one-half by each spouse.	• Each spouse reports one-half of the gift on separate gift tax returns. • Spouses may not file joint gift tax returns. Each individual is responsible for his or her own Form 709. See *Gift Splitting,* page 21-30.
Gift by trust, estate, partnership, or corporation	• More than $18,000 to any one donee. • A future interest of any value.	• Each individual beneficiary, partner, or stockholder must file a gift tax return.
Gifts to U.S. citizen spouse	• A terminable interest of any value other than a life estate with power of appointment.	• Report gifts of terminable interests unless all such gifts qualify as life estates with power of appointment. • Report future interests only if taxpayer gave a reportable interest in the same property to someone else.
Gifts to noncitizen spouse	• More than $185,000. • A future interest of any value. • A terminable interest of more than $18,000 other than a life estate with power of appointment.	Report all gifts to the spouse if he or she received any of the following: • More than $185,000. • A future interest. • A terminable interest of more than $18,000 other than a life estate with power of appointment.

Terminable interests. Defined on page 21-22.

Life estate with power of appointment. Defined on page 21-23.

Future interest. A gift that cannot be immediately used or possessed. See *Present and future interests,* page 21-26.

Death of a Taxpayer—Common Forms and Returns

IRS Form	Title	Instructions	Due Date	Page
Form SS-4	*Application for Employer Identification Number (EIN)*	An executor can obtain an EIN immediately by applying online at: www.irs.gov/businesses/small-businesses-self-employed/apply-for-an-employer-identification-number-ein-online **Fax:** (855) 641-6935 (processing time is four business days). ***Note:*** The processing time for an EIN application by mail is about four weeks.	As soon as possible. The identification number must be included on returns, statements, and other documents.	Page 21-7
Form 56	*Notice Concerning Fiduciary Relationship*	File a separate Form 56 for the fiduciary filing the decedent's final Form 1040 and for the fiduciary of the decedent's estate, even if the same fiduciary is handling both.	As soon as all necessary information is available.	Page 21-7
Form 1040 (Final tax return for year of death)	*U.S. Individual Income Tax Return*	The gross income of a decedent from January 1 until the date of death is reported on the decedent's final tax return.	Generally, April 15 of the year after death.	Page 21-9
Form 1040 (Income tax return for preceding year)	*U.S. Individual Income Tax Return*	If a taxpayer died after the end of the year and before filing a tax return for the previous year, a return must be filed if the decedent meets the filing requirements.	Generally, April 15 of the year of death.	Page 21-9
Form 1310	*Statement of Person Claiming Refund Due a Deceased Taxpayer*	If court-appointed, attaching a copy of court certificate with original Form 1040 is sufficient to claim a refund. If a refund is claimed on an amended return, attach Form 1310 and a copy of the court certificate to Form 1040-X, *Amended U.S. Individual Income Tax Return.*	Submit with Form 1040.	Page 21-9
Form 1041	*U.S. Income Tax Return for Estates and Trusts*	Income received after death by the decedent's estate is reported on Form 1041. Revocable trust income may be treated as part of an estate by election. See *Election to treat a revocable trust as part of an estate,* page 21-8. Filing requirements for estates: • Gross income of $600 or more for the tax year, • A nonresident alien beneficiary, or • The estate held a qualified investment in a qualified opportunity fund (QOF) at any time during the year.	15th day of the 4th month after the end of estate's tax year.	Page 21-10
Form 4810	*Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)*	File to shorten the statute of limitations for tax returns from three years to 18 months.	As soon as possible after filing Form 1040 or Form 1041.	Page 21-7
Form 706	*United States Estate (and Generation-Skipping Transfer) Tax Return*	For decedents dying in 2024, an estate tax return must be filed: • For decedents with a gross estate, plus adjusted taxable gifts and specific exemption, more than $13,610,000. • To elect portability of the deceased spousal unused exclusion (DSUE) amount to the surviving spouse.	9 months after date of decedent's death.	Page 21-31
Form 709	*United States Gift (and Generation-Skipping Transfer) Tax Return*	File Form 709 if the decedent: • Gifted more than the annual exclusion ($18,000 in 2024) to any one donee in year of death. • Failed to file any required prior year gift tax returns.	Earlier of: • Due date (with extensions) for filing decedent's estate tax (Form 706) return, or • Generally, April 15 (or extended due date) of the year after death.	Page 21-25
Form 5495	*Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905*	• The executor of a decedent's estate is discharged from personal liability nine months after receipt of request by the IRS, if no other taxes are due. • The fiduciary of a decedent's trust is discharged from personal liability six months after receipt of request by the IRS, if no other taxes are due.	• Anytime after the filing of Form 1040, Form 1041, or Form 709. • Can attach to Form 706, when filed, or submit during the 3-year period following the date Form 706 is filed.	Page 21-7
Form 4868	*Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*	• File Form 4868 for an automatic 6-month extension of time to file Form 1040 for a decedent. • Also extends time to file Form 709.	File Form 4868 by the original due date for decedent's Form 1040.	Page 21-10
Form 7004	*Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns*	File Form 7004 for an automatic 5½-month extension of time to file Form 1041 for a decedent's estate income tax return.	File Form 7004 by the original due date for estate's Form 1041.	Page 21-10
Form 4768	*Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*	File Form 4768 for an automatic 6-month extension of time to file Form 706 and pay any tax due for a decedent's estate tax return.	File Form 4768 by the original due date for estate's Form 706.	Page 21-31

Estates and Trusts (Form 1041) K-1 Codes

This list identifies the codes used on Schedule K-1 for beneficiaries and provides summarized reporting information for beneficiaries who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040 or 1040-SR and the instructions for your income tax return.

	Report on
1. Interest income	Form 1040 or 1040-SR, line 2b
2a. Ordinary dividends	Form 1040 or 1040-SR, line 3b
2b. Qualified dividends	Form 1040 or 1040-SR, line 3a
3. Net short-term capital gain	Schedule D, line 5
4a. Net long-term capital gain	Schedule D, line 12
4b. 28% rate gain	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
4c. Unrecaptured section 1250 gain	Unrecaptured Section 1250 Gain Worksheet, line 11 (Schedule D instructions)
5. Other portfolio and nonbusiness income	Schedule E, line 33, column (f)
6. Ordinary business income	Schedule E, line 33, column (d) or (f)
7. Net rental real estate income	Schedule E, line 33, column (d) or (f)
8. Other rental income	Schedule E, line 33, column (d) or (f)
9. Directly apportioned deductions	
Code	
A Depreciation	Form 8582; or Schedule E, line 33, column (c) or (e)
B Depletion	Form 8582; or Schedule E, line 33, column (c) or (e)
C Amortization	Form 8582; or Schedule E, line 33, column (c) or (e)
10. Estate tax deduction	Schedule A, line 16
11. Final year deductions	
A Excess deductions – Section 67(e) expenses	Schedule 1 (Form 1040), line 24k (also see the beneficiary's instructions)
B Excess deductions – Non-miscellaneous itemized deductions	See the beneficiary's instructions
C Short-term capital loss carryover	Schedule D, line 5
D Long-term capital loss carryover	Schedule D, line 12; line 5 of the wksht. for Sch. D, line 18; and line 16 of the wksht. for Sch. D, line 19
E Net operating loss carryover — regular tax	Schedule 1 (Form 1040), line 8a
F Net operating loss carryover — minimum tax	Form 6251, line 2f
12. Alternative minimum tax (AMT) items	
A Adjustment for minimum tax purposes	Form 6251, line 2j
B AMT adjustment attributable to qualified dividends	See the beneficiary's instructions and the Instructions for Form 6251
C AMT adjustment attributable to net short-term capital gain	See the beneficiary's instructions and the Instructions for Form 6251
D AMT adjustment attributable to net long-term capital gain	See the beneficiary's instructions and the Instructions for Form 6251
E AMT adjustment attributable to unrecaptured section 1250 gain	See the beneficiary's instructions and the Instructions for Form 6251
F AMT adjustment attributable to 28% rate gain	See the beneficiary's instructions and the Instructions for Form 6251
G Accelerated depreciation	See the beneficiary's instructions and the Instructions for Form 6251
H Depletion	See the beneficiary's instructions and the Instructions for Form 6251
I Amortization	See the beneficiary's instructions and the Instructions for Form 6251
J Exclusion items	2025 Form 8801

13. Credits and credit recapture	
Code	*Report on*
A Credit for estimated taxes	Form 1040 or 1040-SR, line 26
B Credit for backup withholding	Form 1040 or 1040-SR, line 25c
C Low-income housing credit	See the beneficiary's instructions
D Advanced manufacturing production credit	See the beneficiary's instructions
E Clean electricity production credit	See the beneficiary's instructions
F Work opportunity credit	See the beneficiary's instructions
G Credit for small employer health insurance premiums	See the beneficiary's instructions
H Biofuel producer credit	See the beneficiary's instructions
I Credit for increasing research activities	See the beneficiary's instructions
J Renewable electricity production credit	See the beneficiary's instructions
K Empowerment zone employment credit	See the beneficiary's instructions
L Clean fuel production credit	See the beneficiary's instructions
M Orphan drug credit	See the beneficiary's instructions
N Credit for employer-provided childcare facilities and services	See the beneficiary's instructions
O Biodiesel and renewable diesel fuels credit	See the beneficiary's instructions
P Credit to holders of tax credit bonds	See the beneficiary's instructions
Q Credit for employer differential wage payments	See the beneficiary's instructions
R Recapture of credits	See the beneficiary's instructions
S Credit for production from advanced nuclear power facilities	See the beneficiary's instructions
T Zero-emission nuclear power production credit	See the beneficiary's instructions
ZZ Other credits	See the beneficiary's instructions
14. Other information	
A Tax-exempt interest	Form 1040 or 1040-SR, line 2a
B Foreign taxes	Schedule 3 (Form 1040), line 1; or Schedule A, line 6
C Qualified rehabilitation expenditures	See the beneficiary's instructions
D Basis of energy property	See the beneficiary's instructions
E Net investment income	Form 4952, line 4a
F Gross farm and fishing income	Schedule E, line 42
G Foreign trading gross receipts (Section 942(a))	See the Instructions for Form 8873
H Adjustment for section 1411 net investment income or deductions	Form 8960, line 7 (also see the beneficiary's instructions)
I Section 199A information	See the beneficiary's instructions
J Qualifying advanced coal project property and qualifying gasification project property	See the beneficiary's instructions
K Qualifying advanced energy project property	See the beneficiary's instructions
L Advanced manufacturing investment property	See the beneficiary's instructions
M Clean electricity investment credit	See the beneficiary's instructions
ZZ Other information	See the beneficiary's instructions

Note: If you are a beneficiary who does not file a Form 1040 or 1040-SR, see instructions for the type of income tax return you are filing.

Death of Taxpayer

Cross References

- Form 56, *Notice Concerning Fiduciary Relationship*
- Form 4810, *Request for Prompt Assessment Under IRC §6501(d)*
- IRS Pub. 559, *Survivors, Executors, and Administrators*

Related Topics

- Nominee interest and dividends, Tab 3
- Life Insurance, Tab 3
- Inherited IRA, page 13-22

Property Passing at Death

Disposition of property after death depends on the form of ownership of each asset. Some assets may need to be probated (go through a court process) while others pass automatically to new owners. Property ownership rules vary by state law.

Joint assets. Joint tenancies and tenancies by the entirety pass to the surviving joint tenant. Bank accounts in joint tenancy only for convenience and not intended to pass the property to the surviving joint tenant may be probate assets in some states.

Assets with designated beneficiaries. Life insurance policies, annuities, IRAs, and similar assets pass automatically to designated beneficiaries if the beneficiaries are alive when the insured or plan owner dies. Pay-on-death (POD) bank accounts and transfer-on-death (TOD) security registrations also pass assets to beneficiaries. TOD deeds (available in some states) allow real property to pass automatically to a beneficiary without probate.

Trust assets. Property passes to beneficiaries specified in the trust document.

Life estates and remainders. Property passes to the remainder owners at the death of the life tenant. For more information, see *Life estates and remainders,* page 21-28.

Probate assets. Assets that will not pass automatically to new owners at death are subject to state probate rules. These assets pass to the beneficiaries named in the decedent's will or, if none, according to state intestacy law.

Probate Assets	Nonprobate Assets
Pass to beneficiaries named in a will or (if none) according to state law.	*Pass to new owners without probate.*
• Assets owned solely by decedent. • Decedent's share of assets owned as a tenant-in-common. • Assets that name the estate as beneficiary. • Assets with no designated beneficiary or a predeceased beneficiary. • Assets that do not have joint ownership or beneficiaries, such as wages, tax refunds of a single filer, or other refunds.	• Most joint tenancies. • Life insurance, IRAs, retirement plans with living designated beneficiaries. • Bank accounts POD to living designated beneficiaries. • Stock or real property TOD to living designated beneficiaries. • Assets held in trust if the trust instrument provides for distributions at death. • Remainder interests.

Probate

Probate is the court-monitored process for administering the estate of a decedent. The process includes notifying heirs, submitting and validating the will, collecting the decedent's probate assets, paying taxes and creditors, and distributing property to the estate's beneficiaries.

An estate is probated in the decedent's state of domicile at death. If the decedent owned real property outside his or her home state, an ancillary probate proceeding in that state may also be required. Each state has a threshold for probate (generally $10,000 – $100,000). Probate is required if the decedent's probate assets are above the state's threshold. When probate is required, nonprobate assets are not included in the proceeding.

Small estates collection of personal property by affidavit. If the decedent's probate assets are less than the state threshold, no court proceeding is required. The assets can be collected using an affidavit under state procedures for small estates. Typically, the decedent's successors (those entitled to property under the will or state law) complete an affidavit following the form specified by state law. The affidavit is given to anyone in possession of the decedent's assets (banks, brokerages, DMVs, etc.). Ownership of the assets passes directly to successors, who also report any after-death income. For procedures to correct reporting between decedent and successors, see *Nominee interest and dividends,* Tab 3.

Example: Becky died in 2024. Almost all of her assets passed to her boyfriend, Duane, without probate because he was a joint tenant or named as the sole beneficiary. The only asset in Becky's name alone was stock valued at $3,000. Although the stock is a probate asset, no probate is required because its value is less than her state's threshold for probate. Duane is named in Becky's will to receive all her property. He submits an affidavit to the transfer agent, claims and then sells the stock. Duane receives Form 1099-B and reports the sale on his Form 1040.

Wills and Intestacy

A will allows the testator to specify:

- Who receives property at the testator's death.
- Whether beneficiaries receive gifts outright or in trust.
- Who will act as personal representative.
- Who will be the guardian of minor children.

In the absence of a will, these matters are settled by state intestacy law.

Purpose of a will:

- ***Include persons who are not heirs.*** Wills are needed to provide for a person who is not an heir under state law, such as unmarried partners, stepchildren, friends, charities, and in-laws.
- ***Exclude an heir.*** Heirs are the persons who inherit an estate under state law in the absence of a will. A will is needed to prevent an heir from inheriting probate assets.
- ***Minors and disabled adults.*** Trust provisions can be included in a will to delay receipt of an inheritance to a certain age or to allow assets to be used on behalf of an adult who is disabled.
- ***Estate tax planning.*** Married couples can include trust provisions in their wills to reduce estate tax. See *Marital Estate Tax Planning,* page 21-23.

Wills and nonprobate assets. Only probate assets pass according to the terms of a decedent's will. Nonprobate assets pass to the surviving joint tenant or named beneficiary.

Example: Betty's will leaves half her estate to her church and half to her children. Betty changed title to her home and bank accounts to joint tenancy with her children. When Betty died, the only asset in her name alone subject to probate was her car. Her church is entitled to one-half of the value of Betty's car.

Dying intestate (without a will). State intestacy law determines who receives probate property if a decedent dies without a will.

State Intestacy Law Scenarios	
Spouse and children*	• Children always inherit a share, • Children inherit only if they are not children of the surviving spouse, or • Children receive a share if the surviving spouse has any children who are not also children of the decedent.

continued on next page

State Intestacy Law Scenarios continued	
No children	• Surviving spouse receives entire estate, or • Surviving spouse shares estate with decedent's parents.
No spouse and no children	• Parents and siblings share the estate, • Parents inherit the entire estate and siblings inherit only if there is no surviving parent, or • If no parents or descendants of parents, grandparents generally inherit next.
* Most states provide for these individuals first.	

The final beneficiary under intestacy law is the state. Only relations up to a certain degree inherit under each state's laws. After that point, the decedent's property "escheats" to the state. State laws vary, whereas a third cousin thrice removed may inherit in one state, a second cousin may be too remotely related to inherit in another state.

Per stirpes. Intestacy laws generally provide for distribution by representation, also known as per stirpes distribution. The share of any heir who dies before the decedent passes in equal shares to that heir's children.

Example: Nola died at age 103 without a will. Under state law, her property passes to her descendants per stirpes. Nola's children, Kyle and Lloyd, both died before Nola. Nola's six grandchildren inherit her $1 million estate. Kyle's only child receives $500,000. Lloyd's five children each receive $100,000.

Personal Representatives

Under state law, a personal representative is the person appointed by a court to administer an estate. The term includes both executors (appointed when the decedent has a will) and administrators (appointed in the absence of a will). A personal representative nominated in a will has no authority over estate assets until appointed by a court.

Decedent's estate. A decedent's estate is a taxable entity separate from the decedent that comes into existence at the time of the decedent's death. It continues to exist until final distribution of the estate's assets is made to heirs and other beneficiaries.

No court-appointed representative. When there is no probate required and no court-appointed representative, the IRS will allow a "person in charge of the decedent's property" to file the decedent's income tax returns and claim refunds. IRS written guidance does not specify who this person should be. If there is a surviving spouse, he or she usually files a joint final Form 1040 and any other required returns. If there is no surviving spouse, the person who files is commonly:

- The trustee of the decedent's revocable trust,
- The personal representative nominated in the will who would have been appointed if probate was required, or
- A beneficiary receiving nonprobate assets who undertakes the work.

The IRS uses the term "personal representative" to refer to anyone filing for a decedent whether or not court-appointed.

Estate tax. If there is no court-appointed representative, anyone in actual or constructive possession of any property of the decedent is considered an executor and is responsible for filing the estate tax (Form 706) return. In practice, the person filing income tax returns usually also files the estate tax return, if required.

Duties of personal representative. Duties include collecting all of the decedent's property, paying any creditors, and distributing assets to the heirs or other beneficiaries. In addition, the representative is responsible for filing required tax returns and seeing that any taxes owed are properly paid. See *Death of a Taxpayer—Common Forms and Returns* chart, page 21-4.

Tax Returns After Death

If required, the personal representative must file:

Form	Return Type
Form 1040, *U.S. Individual Income Tax Return*	Decedent's final income tax return for year of death.
Form 1041, *U.S. Income Tax Return for Estates and Trusts*	Income tax return for the decedent's estate.
Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*	• Estate tax return. • Portability of the DSUE election for surviving spouse.
Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*	Gift tax return for year of death.
Form 1040, Form 1040-X, Form 709	Returns not filed by decedent for prior years.

Employer identification number (EIN). The personal representative must obtain an EIN for the estate in order to file the estate income tax return (Form 1041), if applicable. A nine-digit EIN is used by estates for tax filing and reporting purposes. An estate with no legal name uses the name of the decedent followed by "Estate." See *Form SS-4,* page 21-4.

Notice of fiduciary relationship. The personal representative must notify the IRS when acting as fiduciary for a decedent's estate. Use Form 56, *Notice Concerning Fiduciary Relationship,* to notify the IRS of the creation, a change in fiduciary, or termination of fiduciary relationship. File separate forms for the decedent and decedent's estate.

Fees received. All personal representatives must include in their gross income any fees paid to them from an estate. Generally, a taxpayer is not in the trade or business of being an executor (for example, the executor of a friend's or relative's estate), and will report these fees as Other Income on line 8z, Schedule 1 (Form 1040), *Additional Income and Adjustments to Income*.

Personal liability. A personal representative of an insolvent estate is personally liable for any unpaid tax if he or she had notice of such tax obligations or did not exercise due care in determining if such obligations existed before distribution of the estate's assets.

Discharge from personal liability. Generally, the IRS has three years after an income, gift, or estate tax return has been filed to assess tax and demand payment of any deficiency. Personal representatives can request a discharge from personal liability after the returns are filed by submitting Form 5495, *Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905.* Generally, personal liability is discharged nine months after the IRS receives Form 5495. Even if the personal representative is discharged from personal liability, the IRS can still assess tax deficiencies to the extent he or she still has the decedent's property.

Prompt assessment. Form 4810, *Request for Prompt Assessment Under Internal Revenue Code Section 6501(d),* can be filed to shorten the statute of limitations for tax returns from three years to 18 months. File Form 4810 separately after the returns are filed. Prompt assessment can be requested for any tax return of the decedent or the decedent's estate, except for the estate tax return (Form 706).

Revocable Trusts at Death

Income from a revocable trust received before death is reported under grantor trust rules, usually on the decedent's Form 1040. Revocable trusts with one grantor become irrevocable at the grantor's death. The trust is then no longer considered a grantor trust. All qualified revocable trusts must obtain a new tax ID number and begin filing trust returns to report after-death income.

Form 1041 must be filed for the trust for the calendar year of death unless an election is made to treat the trust as part of the estate.

Election to treat a revocable trust as part of an estate. An election can be made for a qualified revocable trust (QRT) to be treated as part of an estate (IRC §645). A QRT is a trust, or portion of a trust, treated as owned by a decedent because the decedent had the power to revoke the trust on the date of death.

File Form 8855, *Election To Treat a Qualified Revocable Trust as Part of an Estate,* to make the election. The trust is treated as part of the estate from the date of death until the assets of the estate and trust are distributed or until the day before the second anniversary of death, whichever is earlier. If Form 706 is required, the election period may be longer.

Due date. File Form 8855 by the due date (including extensions) for Form 1041 for the first tax year of the estate (or the filing trust). This deadline applies even if the combined estate and trust do not have sufficient income to be required to file Form 1041.

Executor. If there is an executor of the decedent's estate, the trustee and executor must both sign Form 8855. The executor files Form 1041 for the combined estate and trust using the name and EIN of the estate. Attach the name and EIN of the electing trust. The trust and estate are treated as separate shares for purposes of computing distributable net income (DNI).

No executor. When there is no probate estate, the trustee alone makes the election by filing Form 8855. The trustee files Form 1041 under the name and EIN of the trust. Check the "Decedent's estate" box on Form 1041. The trust is treated as an estate for all income tax rules.

Example: Vincent died on November 16, 2024. All of his assets are in a revocable trust so his estate does not require probate. The trustee decides to make the election and, following rules for estates, chooses the longest first tax year, ending October 31, 2025. Form 1041 is due and the election must be made by February 15, 2026. If the trustee does not make the election, a 2024 calendar year return is due April 15, 2025.

Trusts terminating during the election period. The trustee files a separate Form 1041 using the trust's EIN and checks the final return box. No income, deductions, or credits are reported on the trust return as these items are reported on the related estate's income tax return.

Trusts continuing after the election period. The combined entity files the final Form 1041 for the period ending on the last day of the election period. The combined entity is deemed to have distributed all items of income to a new trust and claims an income distribution deduction for the deemed distribution. The new trust includes the distribution in its income. If returns were filed using the trust's EIN during the election period, the trust must obtain a new EIN. The trust begins filing calendar year returns beginning the day after the election period ends.

An estate that continues after the end of the election period continues to file Form 1041 and does not need a new EIN.

Income in the Year of Death

Cross References

- Form 1040, *U.S. Individual Income Tax Return*
- Form 1041, *U.S. Income Tax Return for Estates and Trusts*
- IRC §691, *Recipients of income in respect of decedents*

Related Topics

- Nominee interest and dividends, Tab 3
- U.S. Savings Bonds, page 6-6

Reporting Income of a Decedent

Before Death	*After Death*
Final Form 1040 Income received by decedent prior to death.	**Estate's Form 1041** • IRD paid to the probate estate. • Income paid on probate assets during administration. • Sale of capital assets by the probate estate.
	Beneficiary's Form 1040 • IRD paid directly to the beneficiary. • Income paid after death on assets received directly from decedent. • Sale of capital assets received from decedent.

Report income actually or constructively received by the decedent before death on his or her final Form 1040. Report IRD and income from assets received after death on the return of the recipient. See *Income in Respect of a Decedent (IRD),* below.

Report income from probate assets on the estate's Form 1041.

Report income from nonprobate assets on the tax return of the beneficiary, surviving joint tenant, or successor who received the asset. For information on probate and nonprobate assets, see *Property Passing at Death,* page 21-6.

Example: Fred died in 2024. His will leaves all of his property to his wife, Ginger. Fred had the following assets.

- House, bank accounts, and vehicles owned jointly with Ginger.
- Brokerage account in Fred's name alone.
- Life insurance and 401(k) that name Ginger as beneficiary.
- IRA that names Fred's adult son, Will, as beneficiary.
- Unpaid wages.

Fred's only probate assets are the brokerage account and unpaid wages. All other assets are paid to a surviving joint tenant or beneficiary and bypass probate. Income is reported as follows.

- All income received before death is reported on Fred's final Form 1040.
- After-death earnings on the brokerage account and the wages paid to the estate are reported on Form 1041. If brokerage assets are sold during probate, the sales are reported on the estate's Form 1041.
- Will reports taxable income from the inherited IRA on his Form 1040 in the year(s) he receives distributions.
- Ginger reports taxable income on all other assets on her Form 1040 in the year(s) she receives the income.

Accrual method decedents. Report income and deductions accrued before death on the final return. Report income and deductions accrued after death on the recipient's return.

Incorrect Forms 1099. Payers may issue Forms 1099 that include income both before and after death. Calculate income from the account statements and correct the reporting as follows.

Form 1099-INT or Form 1099-DIV issued to decedent for estate income. Report the total amount on the decedent's Schedule B (Form 1040), *Interest and Ordinary Dividends.* Subtotal the income. Subtract the estate's income on a separate line, labeled "Form 1041." Enter the estate name and address shown on Form 1041.

Other recipients. If one or more Forms 1099 issued to the decedent includes income belonging to a taxpayer other than the estate, follow procedures for income received as a nominee. See *Nominee interest and dividends,* Tab 3. Do the same for Forms 1099 issued to the estate or beneficiary that include income belonging to the decedent or other taxpayer.

Income in Respect of a Decedent (IRD)

IRD is gross income that the decedent had the right to receive before death that was not paid until after death, including:

- Unpaid wages, commissions, and other compensation.
- Accounts receivable of a sole proprietor.

- IRAs and qualified plans (decedent's taxable balance).
- Earnings portion of a nonqualified annuity.
- Deferred compensation.
- Interest, dividends, rents, and royalties.
- U.S. Savings Bond interest accrued at death and not reported on decedent's tax returns.
- Installment sale payments (decedent's profit percentage).
- Uncollected proceeds of a sale completed before death.

Reporting IRD. IRD is included in the income of the recipient and is taxable in the year received. The character of IRD is the same in the hands of the recipient as it would have been to the decedent. (IRC §691)

See *Reporting Income of a Decedent* chart, page 21-8.

Deductions in respect of decedent. Business expenses, income-producing expenses, interest, and taxes owed at death are deductible when paid by the estate or by a person obligated to pay because he or she acquired property from the decedent.

Estate tax paid on IRD. The taxpayers required to report IRD as income are allowed a deduction if federal estate tax is paid. For the calculation, see *Deduction for Estate Tax Paid on IRD,* page 21-33.

Wages After Death

Wages paid after death are reported as income to the recipient (estate, surviving spouse, or other successor) in box 3, Form 1099-MISC, *Miscellaneous Information.* Wages paid after death are not included in box 1 of the deceased employee's Form W-2 and are not subject to income tax withholding.

FICA and Medicare. Wages paid after death are subject to FICA, FUTA, and Medicare tax if paid in the calendar year of death. The employer withholds FICA and Medicare tax from the payment made to the estate or successor. On the deceased employee's Form W-2, the employer includes the after-death taxes withheld in boxes 4 and 6 and includes the after-death wages in boxes 3 and 5.

U.S. Savings Bonds at Death

Taxpayers can elect to report Series EE and I bond interest annually instead of waiting to report the income at redemption or maturity. See *U.S. Savings Bonds,* page 6-6.

Decedents. The election can be made for a decedent. Accrued interest through the date of death is reported on the decedent's final Form 1040. Interest accrued after death is reported by the estate or other recipient. If the election is not made, all interest before and after death is taxed to the estate or other recipient. Recipients report interest in the year the bonds are redeemed or mature unless they elect to report annually.

Example: Ann died on March 2, 2024. Les is her personal representative. Ann owned the bonds shown below. The $500 bond is payable on death to Ann's nephew, Tom. The other bonds pass to Ann's estate.

Series	*Face*	*Issue*	*March Value*	*March Accrued Interest*	*June Value*	*June Accrued Interest*
EE	$500	11/1997	$586.00	$336.00	$591.60	$341.60
EE	$1,000	05/2002	$1,089.20	$589.20	$1,099.60	$599.60
I	$5,000	02/2008	$9,158.00	$4,158.00	$9,276.00	$4,276.00
Total				$5,083.20		$5,217.20

Ann's 2024 gross income is only $2,000 so Les elects to report the bond interest on her final return.

- **Ann's Form 1040.** Les reports $5,083—interest accrued on all bonds through Ann's death in March.
- **Estate's Form 1041.** Les redeemed the estate's bonds in June 2024. The estate receives Form(s) 1099-INT for accrued interest of $600 on the $1,000 EE bond and $4,276 on the I bond. Les reports $4,876 on Form 1041 and subtracts $4,747 for interest previously reported. Only the $129 earned after Ann's death is taxed to the estate.
- **Tom's Form 1040.** Tom will receive Form 1099-INT for all accrued interest on his $500 EE bond in the year he redeems it. He can subtract $336 on that return for interest reported on his bond on Ann's final Form 1040.

Decedent's Final Form 1040

Cross References

- Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer*
- IRS Pub. 559, *Survivors, Executors, and Administrators*
- IRC §213(c), *Special rule for decedents*

Related Topics

- Filing Requirements, Tab 3
- Life Insurance, Tab 3
- Medical Expenses, page 4-2

Who Files and Signs

1) **Personal representative.** If a court appoints a personal representative, that person files and signs for the decedent. If the return shows a refund, attach a copy of the court certificate showing appointment (usually Letters Testamentary or Letters of Administration). If a refund is claimed on an amended return, attach Form 1310 and a copy of the court certificate. A copy of a will cannot be used in place of a court certificate. If a will is not probated, the representative named in the will has no authority to act for the estate. Follow rules in (3), below.
2) **Surviving spouse.** If there is no court-appointed representative by the due date for the return, a surviving spouse who did not remarry by year-end can file a joint return with the decedent. Enter "Filing as Surviving Spouse" in the space for the decedent's signature.
3) **Person in charge of decedent's property.** If no personal representative will be appointed, and there is no surviving spouse, a person in charge of the decedent's property files the return. Attach Form 1310 to the return to claim a refund. For a discussion of who files as the person in charge of the decedent's property, see *Personal Representatives,* page 21-7.

Court-appointed representatives and persons in charge of the decedent's property sign by writing: "(decedent's name) by (representative's signature), PR."

Filing Requirements—Final Form 1040

A return is required if the decedent meets any of the filing requirements that apply to other taxpayers. See *Filing Requirements,* Tab 3. Decedent's age, marital status, and gross income are determined on the date of death. Filing floors and standard deductions are not reduced because the re-turn covers less than 12 months. A return can be filed to claim withholding, estimated tax payments, and refundable credits.

Age. A higher standard deduction cannot be claimed if the decedent died before reaching age 65 even if the decedent would have been age 65 by year end. A person is considered age 65 on the day before his or her 65th birthday.

Dependent. A decedent who qualified as a dependent of another taxpayer for the part of the year before death can be claimed on that taxpayer's return. A dependent decedent files following rules for dependents.

Joint returns. If a court appoints a personal representative, the personal representative and surviving spouse must agree that a joint return will be filed. If a surviving spouse files a joint return, a court-appointed representative can revoke the election by filing

a separate return for the decedent within one year from the due date of the return (with extensions). A joint return includes the decedent's income and expenses through death and the spouse's income and expenses for the entire year.

Remarried surviving spouse. If the decedent's spouse remarries before the end of the year, the decedent's filing status is Married Filing Separately.

Joint refund check. A surviving spouse can request that a joint refund check be reissued in his or her name alone by filing Form 1310.

Extension of time to file. An automatic 6-month extension of time to file the decedent's final Form 1040 can be requested by filing Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return,* by April 15. No signature or reason for the request is required. An extension of time to file the return does not extend time for payment of any tax due. An individual return extension also automatically extends the time to file a gift tax return, if applicable. See *Gift Tax Return—Form 709,* page 21-25.

Income—Final Form 1040

Only income received by the decedent before death is reported on his or her final income tax return (Form 1040). ***Exceptions:***

- ***U.S. Savings Bonds.*** The person filing for a decedent can elect to include interest accrued through death on the final return. See *U.S. Savings Bonds at Death,* page 21-9.
- ***Medical savings accounts.*** If a decedent's account passes to the estate (because there is no designated beneficiary), report the FMV of the assets in the account(s) as of the date of death on the decedent's final income tax return. Any other beneficiary (including a spouse that is not the designated beneficiary) must include in income the FMV of the assets in the account received on his or her tax return. If the decedent's spouse is the designated beneficiary, the account just becomes that spouse's account.
- ***Coverdell education savings account (ESA).*** If a decedent's account (who was under age 30) passes to the estate, report all earnings on the account on the decedent's final income tax return. Any beneficiary other than the estate must include in income the earnings portion of the distribution received. If the decedent's spouse or other family member is the designated beneficiary, the ESA just becomes that person's ESA.
- ***Accrual-method decedents.*** Include income and deductions accrued before death on the final income tax return.

Self-employment. Self-employment income received before death is reported on Schedules C or F (Form 1040) and is subject to self-employment tax.

Partnership income. The death of a partner closes the partnership's tax year for that partner. Include on the final return the decedent's distributive share of income through the date of death. Self-employment income includes the partner's distributive share through the end of the month of death. Income is considered to be earned ratably over the partnership's tax year.

Example: Ron died on August 10, 2024. He was a member of a partnership that used a calendar year. Ron's estate received his share of partnership income for the remainder of the year. Ron's total distributive share of income for 2024 is $12,000. His self-employment income is $8,000 ($12,000 × 8⁄12 months).

Deductions—Final Form 1040

Only expenses paid by the decedent before death are reported on his or her final income tax return (Form 1040). ***Exceptions:***

- ***Medical expenses paid by estate.*** A decedent's medical expenses paid within one year of death can be deducted on the decedent's income tax return in the year service was provided. Expenses for care in the year of death are claimed on the final return. Expenses for care in earlier years can be claimed on amended returns for any open year. Expenses can be deducted on either Form 1040 or Form 706, but not on both. Expenses can be divided between the returns in any manner. Expenses deducted on Form 1040 that produce no tax benefit because of the 7.5% AGI limitation are not deductible on Form 706. If deductions are claimed on Form 1040, attach two copies of a statement that the expenses have not been claimed as an estate tax deduction, and the estate waives the right to claim the expenses.
- ***Medical expenses paid by spouse or parent.*** A taxpayer who paid expenses for a deceased spouse or dependent before or after death can deduct the expenses in the year paid.
- ***Annuities.*** If the decedent was receiving an annuity, and payments stopped before the decedent's cost was recovered, any remaining investment in the contract is deductible on the final return as an Other Itemized Deduction on line 16, Schedule A (Form 1040).

Funeral expenses. No deduction for funeral expenses can be taken on the decedent's final Form 1040. The expenses may be deductible for estate tax purposes on Form 706. See *Deductions,* page 21-32.

Credits

If the decedent qualifies, credits can be claimed on the final income tax return (Form 1040) even though the return covers less than 12 months. Refundable credits are also refundable on the final return. The Earned Income Credit can be claimed even if the decedent would not have qualified with a full year's income.

Estates and Trusts Income Tax Return—Form 1041

Cross References

- Form 1041, *U.S. Income Tax Return for Estates and Trusts*
- IRC §641–685
- Reg. §1.67-4

Related Topics

- Charitable Contributions, Tab 4
- Capital Gains and Losses (Schedule D), page 6-8
- Rental Income, page 7-3

Filing Requirements—Form 1041

Filing Requirements

	The personal representative or fiduciary must file Form 1041 if:
Estate	• Gross income of $600 or more for the tax year, • Held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, or • A beneficiary who is a nonresident alien.
Trust	• Any taxable income for the tax year, • Gross income of $600 or more (regardless of taxable income), • Held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, or • A beneficiary who is a nonresident alien.

Extension of time to file. An automatic 5½-month extension of time to file Form 1041 can be requested by filing Form 7004, *Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns,* on or before the regular due date of Form 1041. No signature or reason for the request is required. An extension of time to file does not extend time for payment of any tax due.

Estate Year

An estate's first tax year begins the day after death. The personal representative chooses the year by filing the first return. The first year can be any period of 12 months or less that ends on the last day of a month.

Example: Esther died on May 2, 2024. The shortest first year is May 3, 2024 through May 31, 2024. The longest first year is May 3, 2024 through April 30, 2025.

Author's Comment: Although a closing month must be listed on Form SS-4, *Application for Employer Identification Number,* it does not set the estate's tax year. The tax year is chosen when the first Form 1041 is filed. An EIN is needed early in probate, before information needed to choose a tax year is known. Using the longest first year on Form SS-4 avoids IRS notices asking for overdue returns.

Delay in administration. The estate's first year begins at death, whether the probate begins at that time or not.

Example: Lois died on September 5, 2022. Her children applied for probate in May 2024 when they decided to sell her home. The estate is responsible for the tax on income earned on probate assets beginning on September 6, 2022.

Choice of tax year. The choice of tax year may save tax or reduce work (and fees) needed to complete returns. Consider:

- Tax on capital gains is generally paid by the estate except in the final year. Maximum capital gains tax rates apply to estates.
- The estate pays tax on its other income unless distributions are made to beneficiaries, who then report the taxable income.
- Estates reach the highest tax bracket (37%) at taxable income over $15,200 (2024). Estate beneficiaries pay tax at their own marginal rates.
- The first and last years can be short years. The tax year can sometimes be selected to match income with distributions so that taxable income is passed out to the beneficiaries.
- Capital loss does not pass to beneficiaries until the estate ends.
- Estate expenses are deductible only in the tax year paid. Excess deductions may be passed on to beneficiaries in the final year.
- The first tax year can end after all income is received by the estate but before any distributions are made, avoiding Schedules K-1. The estate pays tax on the first year income. Distributions are then made when the estate is under the filing requirement.

Trust Entities

Form 1041 includes checkboxes to indicate the type of entity for which the return is being filed. In some cases, more than one box applies. Determination of entity status is made on an annual basis.

Simple trust. A trust is a simple trust if:

- The trust instrument requires that all income must be distributed currently (i.e., in the year received),
- The trust did not make charitable contributions, and
- The trust did not distribute corpus (principal) in the tax year.

Complex trust. A complex trust is any trust that does not qualify as a simple trust. A trust required to distribute all income currently is complex in years when corpus (principal) is distributed and simple in years when no corpus is distributed. Trusts with charitable beneficiaries and trusts allowed to accumulate income are always complex trusts. (IRC §661)

Grantor-type trust. A grantor trust is a legal trust under state law that is not recognized as a separate tax entity because the grantor retains control. See *Grantor Trusts,* page 21-20.

Note: A trust may be part grantor trust and part other type of trust, for example, simple or complex, or an Electing Small Business Trust (ESBT).

Electing Small Business Trust (ESBT). An ESBT may be a shareholder of an S corporation [IRC §1361(c)(2)(A)(v)]. An ESBT is taxed as two separate trusts. The S portion income is taxed at the highest trust rate with no exemption or income distribution deduction allowed. The S corporation income (whether or not distributed) is not taxed to the beneficiaries. The non-S portion may be taxed under grantor trust rules, if applicable.

Nonresident alien. Generally, beneficiaries of an ESBT include those eligible to hold S corporation stock directly. An ESBT with a nonresident alien beneficiary can be an eligible S corporation shareholder. The regulations provide that if a nonresident alien is a grantor of all or a portion of an ESBT, the grantor portion of the net income of the ESBT must be reallocated to the S portion to ensure the income is not excluded under foreign income rules. [Reg. §1.641(c)-1(b)(ii)]

Qualified Disability Trust (QDT). A QDT is any nongrantor trust established solely for the benefit of an individual under age 65 with a disability. QDTs can include certain trusts containing assets of the beneficiary if amounts remaining in the trust are paid to the state at death and other conditions are met. All QDT beneficiaries must have a disability under Social Security rules for some part of the tax year. A trust can be a QDT even though corpus (principal) can revert to a person without a disability after the trust no longer has beneficiaries with disabilities. A QDT is allowed an exemption ($5,050 in 2024). [IRC §642(b)(2)(C)]

Special needs or supplemental needs trust (SNT). An SNT allows a person with physical or mental disabilities or who is chronically ill to receive income without reducing his or her eligibility for public assistance disability benefits provided by Social Security, Medicare, or Medicaid. An SNT can be a grantor trust, complex trust, or QDT.

Accounting Income

Trust accounting income. Trusts commonly have two types of beneficiaries. Income beneficiaries receive income earned on trust assets. Remainder beneficiaries receive trust assets when the trust ends. Accounting income determines the amount paid to income beneficiaries each year. Categories of income and expenses are assigned to income or corpus (principal). Items assigned to income are used to calculate a trust's accounting income.

Example: Ceil created a trust by will. Her sister Betsy is entitled to all income for life. Interest and dividends are assigned to income, and capital gains are assigned to corpus. Fees are paid equally from income and corpus. In 2024, the trust had the following income and expenses.

	Income and Expenses	*Accounting Income*
Interest	$ 3,000	$ 3,000
Dividends	10,000	10,000
Capital gains	7,000	0
Trustee fees	(2,000)	(1,000)
Tax preparation	(400)	(200)
	$17,600	$11,800

Betsy receives $11,800 as her income distribution for 2024.

The example, above, illustrates a traditional assignment of items to income and corpus. Trust provisions that depart fundamentally from traditional principles are generally not recognized for income tax purposes (e.g., an assignment of interest to corpus).

A trust's accounting income may be specified in the trust document. Allocations not addressed by the trust document are determined by the state law governing the trust. Items such as dividends, interest, and rents are generally allocated to income and proceeds from the sale or exchange of trust assets are generally allocated to corpus (principal).

A trust document may define accounting income as a percentage of trust assets or give the trustee the power to adjust income and corpus. Reasonable allocations of income and corpus made under state law are respected for federal tax purposes. [Reg. §1.643(b)-1]

Percentage of trust assets. An allocation of amounts between income and corpus will be respected if state law provides for a reasonable apportionment between the income and remainder beneficiaries. For example, a state statute providing that income is a unitrust amount of 3-5% of the FMV of the trust assets is a reasonable apportionment.

Authority to adjust. A trustee may make adjustments between corpus (principal) and income if, under traditional rules, the income and remainder beneficiaries are not treated impartially (i.e., not treated in a way that favors one or the other).

Capital gains allocated or distributed to beneficiaries can be included in the income taxed to the beneficiaries [Reg. §1.643(a)-3]. See *Capital gains allocated to beneficiaries,* next column.

Reporting trust accounting income. A simple trust's accounting income is reported on line 9, Form 1041 (Schedule B). A complex trust's accounting income is reported on line 8, Form 1041 (Schedule B). If a complex trust is required to distribute all income, its accounting income is also the amount reported on line 9.

Estate accounting income. The concept of accounting income has little application for many estates. Estates are generally not required to make distributions of income until the end of administration, and most estates have only one set of beneficiaries who receive shares of both income and corpus (principal). Estate accounting income is not reported on Form 1041.

Accounting income rules may determine amounts paid to beneficiaries when a will or state law provides for the payment of income during administration or when assets pass from the probate estate to a trust.

Income—Form 1041

Gross income of an estate or trust is determined in the same manner as gross income for an individual. Gross income is reported on lines 1 through 8, Form 1041.

Business and farm income. If the estate or trust operated a business or farm, income and expenses are reported on Schedule C (Form 1040) or Schedule F (Form 1040). Net profit (or loss) is reported on line 3 or line 6, Form 1041. Ordinary gain or loss from the sale of business property is reported on Form 4797.

Rental income. Income and expenses from rental property are reported on Schedule E (Form 1040), *Supplemental Income and Loss,* and net profit (or loss) is reported on line 5, Form 1041.

Special rule for estates. The rule that allows active participants to deduct up to $25,000 of rental real estate loss from nonpassive income applies to estates for tax years ending before the second anniversary of death. The decedent must have actively participated in the activities before death. The $25,000 offset is reduced by any amount allowed to a surviving spouse for tax years ending in the estate's tax year. Only the decedent's active participation qualifies the estate for the offset. Active participation by the personal representative or spouse does not qualify. [IRC §469(i)(4)]

Author's Comment: Cancellation of debt. Cancellation of debt income (CODI) is considered taxable to an open estate and reported on Form 1041. If the estate is insolvent, it may exclude CODI using Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness.* See *Taxpayer Insolvency,* page 6-29.

Only assets that pass through probate are considered for determining insolvency. An estate with CODI is insolvent if all assets pass directly to beneficiaries. Designated beneficiaries who receive nonprobate assets (life insurance, IRAs) are not liable for paying a decedent's debt.

Exception: If cancelled debt is related to a debt to which a surviving spouse had signature authority, or the spouses lived in a community property state, the surviving spouse must generally report the CODI on his or her own Form 1040, unless an exclusion applies.

Closed estate. If a closed estate receives Form 1099-C, *Cancellation of Debt,* it is considered insolvent (as all assets have been distributed) and no Form 1041 needs to be filed.

Capital Gains and Losses

Report overall gains and losses on Schedule D (Form 1041), *Capital Gains and Losses,* from transactions that are reported on Form 8949, *Sales and Other Dispositions of Capital Assets.* For inherited property, enter "Inherited " as the date acquired. See *2024 Capital Gain and Qualified Dividend Rates,* page 21-1, and *Basis,* page 21-33.

Sale to related taxpayer (IRC §267). Losses are not deductible on sales or exchanges between any of the following related taxpayers.

- Grantor and trustee.
- Trustee and beneficiary.
- Trustees of trusts created by the same grantor.
- Trustee and beneficiary of different trusts created by the same grantor.
- Trustee and corporation in which 50% is owned by the grantor.
- Personal representative and estate beneficiary except to satisfy a bequest of a sum of money.

Gain from the sale or exchange of depreciable property between a trustee or personal representative and a beneficiary is ordinary income. (IRC §1239)

Election to recognize gain or loss of distributed property. Generally, when an estate or trust distributes noncash property to a beneficiary, no gain or loss is recognized. An estate or trust can elect to recognize gain or loss as if the distributed property had been sold to the beneficiary at FMV. The election applies to all distributions by the estate or trust during the tax year and is irrevocable. Losses are not deductible. [IRC §643(e)(3)]

To make the election, complete Schedule D (Form 1041) and check the box next to line 7, *Other Information,* page 3, Form 1041. The distribution deduction is the property's FMV. The beneficiary's basis is the FMV of the property.

Example: Lindsey's estate has property which has appreciated after her death and is expected to be quickly sold upon receipt by her beneficiary, Layla. If the IRC section 643(e)(3) election is made, the estate would recognize the gain and Layla would receive the property with basis of its FMV at the time of distribution. If the property had instead decreased in value during the period of administration, the estate should distribute the asset to Layla rather than sell it so she can realize the loss which will occur upon its sale.

Capital gains allocated to beneficiaries. Capital gains are ordinarily allocated to the estate or trust. Tax on the gains is paid by the entity rather than the beneficiaries. [Reg. §1.643(a)-3]

Exception (final year). Capital gains are allocated to beneficiaries in the final year when all remaining assets are distributed. Gains are included in distributable net income (DNI) and taxed to the beneficiaries. See *Distributable Net Income (DNI),* page 21-16.

Other exceptions. Capital gains are allocated to beneficiaries in the situations described, below. Tax is paid by the beneficiaries rather than the entity. The allocation must be made pursuant to the terms of either the governing instrument and state law or a reasonable and impartial exercise of a discretionary power granted by state law or by the governing instrument and not prohibited by state law.

1) Capital gains are allocated to income. A discretionary power to allocate gains to income under a unitrust law must be exercised

consistently, and the amount allocated to income cannot be more than the unitrust amount less DNI without capital gains.
2) Capital gains are allocated to corpus (principal) but treated consistently by the fiduciary on the trust's books, records, and tax returns as part of a distribution to a beneficiary.
3) Capital gains are allocated to corpus but actually distributed to the beneficiary or used by the fiduciary to determine the amount distributed or required to be distributed to a beneficiary.

Consistent treatment. The trustee chooses the tax treatment in the first year and treats the item the same way in following years.

Example: A trust's accounting income is set under state law as 5% of the trust's FMV at the beginning of each year. In its first year, the trust earns interest and dividends of $10,000 and capital gains of $20,000. The FMV of the trust is $500,000. The trustee distributes $25,000 to the income beneficiaries (5%) and allocates $15,000 of capital gains to the beneficiaries. In future years, the trustee must consistently treat realized capital gains, if any, as distributed to the income beneficiary to the extent that the distribution exceeds ordinary and tax-exempt income.

See Regulation section 1.643(a)-3 for additional examples.

Capital losses. Capital losses are netted against gains at the entity level except for a gain used under item (3), *Other exceptions,* above, in determining the amount distributed or required to be distributed to a beneficiary. Capital losses are allocated to the entity except in the year the estate or trust terminates. If losses are more than gains, the smaller of the net loss, or $3,000, can be deducted on line 4, Form 1041. Losses can be carried forward indefinitely. In the year an estate or trust terminates, any loss that would be carried over to the next year can be distributed to beneficiaries. See *Termination Year,* page 21-15.

Schedule D (Form 1041). Capital gain or loss is allocated between the beneficiaries and the estate in Part III, Schedule D (Form 1041), *Capital Gains and Losses.*

Author's Comment: Sale of decedent's residence. The sale of a decedent's residence results in a capital gain or deductible capital loss if the residence is not used by any beneficiary for personal use. If the residence is used by a beneficiary for personal use, a sale results in a capital gain, but a loss is not deductible. If the estate is the legal owner of the residence, the sale is reported on Form 1041. If legal title transfers directly to beneficiaries, the sale is reported pro rata on each beneficiary's Form 1040. The basis of the residence used to compute gain or loss is the fair market value at the date of death with a holding period of more than one year (long-term).

Net investment income tax (NIIT). Certain estates or trusts may be subject to an additional 3.8% tax on the lesser of:
• The estate's or trust's undistributed net investment income, or
• The excess (if any) of the estate's or trust's AGI over $15,200 (2024).

The NIIT is subject to estimated tax requirements and penalties for underpaying estimated tax. [IRC §1411(a)(2)]

See *Net Investment Income Tax,* page 6-4.

Example #1: The Miller Family Trust pays income and corpus (principal) as needed to its sole beneficiary, Harper, who is single with no other income. In 2024, the trust has dividend and interest income of $180,000 and net capital gain of $200,000. The trust does not make distributions and has an AGI of $380,000. The net investment income subject to the NIIT is $364,800 ($380,000 – $15,200).

Example #2: Assume the same facts as Example #1, except the Miller Family Trust distributes the $180,000 dividend and interest income to Harper. The net investment income subject to the NIIT is $184,800 ($200,000 – $15,200). Harper is not subject to the NIIT on her $180,000 distribution because the threshold for an individual is $200,000.

Tax-Exempt Income

Tax-exempt interest. Tax-exempt interest is interest on state or local bonds that is excluded from gross income under IRC section 103, including exempt-interest dividends.

Deductions. Administrative expenses directly allocable to tax-exempt interest are not deductible. Administrative expenses directly allocable to taxable interest are fully deductible. Administrative expenses not directly allocable to tax-exempt interest or taxable interest are reduced by the amount allocated to tax-exempt interest.

Administrative expenses include attorney fees, fiduciary fees, and other administrative expenses. Other deductions are not reduced for tax-exempt interest.

Allocation of expenses to tax-exempt income can be made based on gross accounting income or using any reasonable method.

Example: A simple trust has the following income, expenses, and accounting income. The trustee fees are paid equally from income and corpus (principal).

	Total Income	*Accounting Income*	*Taxable Income*
Interest and dividends	$ 4,000	$ 4,000	$ 4,000
Rental income	14,000	14,000	14,000
Municipal bond interest	6,000	6,000	0
Capital gains	7,000	0	7,000
Gross	$31,000	$24,000	$25,000
Rental expenses	(9,000)	(9,000)	(9,000)
Trustees fees	(3,000)	(1,500)	(2,250)
Adjusted total income			$13,750

Rental expenses are directly allocable to taxable income and can be deducted in full. Trustee fees allocable to tax-exempt interest are not deductible.

$$\$3{,}000 \text{ trustee fee} \times \frac{\$6{,}000 \text{ tax-exempt interest}}{\$24{,}000 \text{ gross accounting income}} = \$750 \text{ reduction}$$

Line 12 (Form 1041) deduction = $3,000 – $750 = $2,250

Capital gains are included in gross accounting income only if allocated to income. See *Accounting Income,* page 21-11.

Tax-exempt income other than interest. No deductions are allowed for expenses allocable to other types of tax-exempt income, such as life insurance proceeds, death benefits, or compensation for injuries.

Reporting. If the estate has tax-exempt income, answer "Yes" to Question 1, *Other Information,* page 3, Form 1041. Attach an allocation of expenses between tax-exempt and taxable income. Enter amount of tax-exempt interest in box next to Question 1.

Deductions

Deduct expenses allocable to a trade or business or to a rental activity on Schedules C, E, or F (Form 1040). Deduct other expenses on lines 10 through 21, Form 1041. Medical and funeral expenses are not deductible on Form 1041 (only on Form 706).

Income distribution deduction. A deduction is allowed for any income that must be distributed currently and for other amounts that are properly paid, credited, or required to be distributed to beneficiaries. This deduction is limited to the distributable net income (DNI) of the estate or trust. See *Distributable Net Income (DNI),* page 21-16.

Interest. Deductible interest on amounts borrowed by the estate or trust and debts acquired from a decedent include:
• Investment interest limited to net investment income. Attach Form 4952, *Investment Interest Expense Deduction,* when required.
• Qualified residence interest. Interest on debt secured by a residence is deductible if a beneficiary uses the property as a

residence and it would be a qualified residence if owned by the beneficiary. The beneficiary must have a present interest in the estate or trust or an interest in the residue.
- Interest payable under IRC section 6601 on unpaid estate tax attributable to a reversionary or remainder interest during an extension of time for payment.

Nondeductible interest. Personal interest and interest on loans to purchase or carry tax-exempt obligations is not deductible.

Qualified mortgage insurance premiums. The entity's portion of qualified mortgage insurance premiums reported on Form 1098, *Mortgage Interest Statement,* is deductible.

Limited business interest. Deductible business interest expense is limited for certain large taxpayers. See *Business interest limitation,* Tab 5.

Taxes. Deductible taxes (limited to $10,000) include state and local income tax (or sales tax if allowable), real and personal property taxes, including taxes owed by the decedent at death and paid by the estate, and generation-skipping transfer (GST) tax on income distributions.

Nondeductible taxes. Federal income tax, estate, gift and death taxes, federal duties and excise taxes are not deductible.

Estate tax paid on IRD. If IRD is reported on Form 1041, and the estate paid federal estate tax, a deduction is allowed for the estate tax paid on IRD. For the calculation, see *Deduction for Estate Tax Paid on IRD,* page 21-33.

Depreciation. Trusts and estates cannot expense property under Section 179 but are allowed a deduction for depreciation. The deduction is apportioned between the entity and beneficiaries on the basis of entity income allocable to each and separately stated on Schedule K-1 (Form 1041). The depreciable basis for property in an estate is its FMV on the date of death or the alternate valuation date. See *Alternate valuation,* page 21-24.

Exception: If a trustee is required or permitted to maintain a depreciation reserve, the deduction is first allocated to the trust up to the amount of the reserve [Reg. §1.167(h)-1(b)]. Similar rules apply to depletion. [Reg. §1.611-1(c)(4)]

Administrative expenses. Certain expenses for administration of an estate or trust are deductible, including trustee fees, legal and accounting fees, tax preparation, and similar expenses.

Allowable deductions. For tax years 2018 through 2025, administrative expenses subject to the 2% AGI limit (costs commonly incurred by individuals) are not deductible due to the suspension of miscellaneous itemized deductions. Nondeductible expenses include costs incurred in defense of a claim against the estate, the decedent, or the nongrantor trust that are unrelated to the existence, validity, or administration of the estate or trust.

The deduction suspension does not affect the deductibility of expenses under IRC section 67(e). Deductible costs are those that are incurred in connection with the administration of an estate or a nongrantor trust that would not have been incurred if the property were not held in such estate or trust. (Reg. §1.67-4)

Deductible Administrative Expenses (Reg. §1.67-4)

Nondeductible Costs (2% AGI Limit)	Deductible Costs
Ownership costs: • Partnership costs passed through and reportable by partner. • Condominium fees. • Insurance premiums. • Maintenance and lawn services. • Automobile registration and insurance costs.	*Ownership costs:* • Deductions attributable to rents and royalties, and trade or business expenses. • Taxes (limited to $10,000), including: – Property taxes (foreign real property tax not deductible). – State and local income taxes.
Tax preparation fees: • Prior year or other required returns. • Decedent's final gift tax return (Form 709). • Final FBAR (FinCEN Form 114).	*Tax preparation fees:* • Estate and generation-skipping transfer (GST) tax return (Form 706). • Estate or nongrantor trust fiduciary income tax return (Form 1041). • Decedent's final Form 1040.
Investment advisory fees: Most fees for investment advice and related services.	*Investment advisory fees:* Only special, additional charges for advice because it is an estate or trust.
Appraisal fees: Cost of appraisals for purposes commonly incurred by an individual, such as insurance.	*Appraisal fees:* Fees to determine the FMV of the decedent's assets for making distributions or preparing the estate's or trust's tax returns.

continued in next column

Deductible Administrative Expenses (Reg. §1.67-4) continued

Fiduciary fees. Deductible fiduciary fees are those paid or incurred to the fiduciary for administering the estate or trust during the tax year, which include probate court fees and costs, fiduciary bond premiums, legal publication costs of notices to creditors or heirs, the cost of certified copies of the decedent's death certificate, and costs related to fiduciary accounts.

Attorney, accountant, and return preparer fees. Expenses for preparation of fiduciary income tax returns, the decedent's final individual income tax returns, and all estate and generation-skipping transfer tax returns, are deductible. However, expenses for preparing all other tax returns, including gift tax returns, are not deductible.

Bundled fees. Bundled fees must be allocated between the costs commonly or customarily incurred by individuals (nondeductible) and costs that are deductible. If a bundled fee is not computed on an hourly basis, only the portion of that fee attributable to investment advice is not deductible. The remaining portion is deductible. Out-of-pocket expenses billed to the estate or nongrantor trust are treated as separate from the bundled fee and are not subject to allocation.

Estates and nongrantor trusts cannot deduct payments made from the bundled fee to third parties if such payments would not have been deductible if paid directly by the estate or trust. Any reasonable method may be used to allocate a bundled fee, including without limitation the allocation of a portion of a fiduciary commission that is a bundled fee to investment advice.

The reasonable-method standard does not apply to determine the portion of a bundled fee or any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.

Form 706 deductions. Administrative expenses on Form 706 cannot also be deducted on Form 1041. Allocate deductions between the two returns in any way so long as no amount is claimed twice. A deduction can be taken in part on each return. If expenses are claimed on Form 1041, attach two copies of a statement listing the expenses and stating, "These items have not been claimed as deductions for federal estate tax purposes and the estate waives all rights to claim such deductions." The same rule applies to casualty losses incurred during administration of the estate. [IRC §642(g)]

Decedent's accrued expenses. The rules preventing double deduction do not apply to deductions for taxes, interest, business expenses, and other items accrued at the date of death (deductions in respect of a decedent). These expenses can be claimed on both Form 1041 and Form 706.

Example #1: Jo died on April 1, 2025, before picking up her 2024 tax returns. The preparation fee and state income tax due are expenses accrued at the time of death. The estate pays the fee and tax and can deduct them on Form 706 as claims against the estate and on Form 1041.

Example #2: Assume the same facts as Example #1, except Jo died in December 2024. The estate has her returns prepared and pays the state tax due. The preparation fee was not accrued at the time of death. It is an administrative expense deductible on either Form 1041 or Form 706, but not on both. The state tax due was accrued at death and can be deducted on both returns.

Tax-exempt income. Deductions must be reduced if the estate has tax-exempt income. See *Tax-Exempt Income,* page 21-13.

Termination Year

Trusts and estates terminate when the period actually required to perform the ordinary duties of administration ends. [Reg. §1.641(b)-3]

The administration cannot be unduly prolonged. An estate or trust is considered terminated for income tax purposes when all assets have been distributed, except for a reasonable amount set aside in good faith to pay unascertained or contingent liabilities. After termination, beneficiaries report income, deductions, and credits on their individual returns.

Excess deductions on termination. If an estate or trust has deductions in excess of gross income, the excess deductions (excluding the exemption deduction and charitable deduction) are deductible on the beneficiaries' returns.

In the year of termination, all capital gains and losses are allocated to the beneficiaries. Any capital loss that would be carried over to the next year of the estate or trust can be distributed to beneficiaries on termination. The same rule applies to an NOL.

Final year deductions are reported in box 11, Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc*.

Beneficiaries. Excess deductions classified as IRC section 67(e) expenses are reported to beneficiaries on line 11 (Code A), Schedule K-1 (Form 1041), and are deductible as an adjustment to income on line 24k, Schedule 1 (Form 1040), *Additional Income and Adjustments to Income.* Excess non-miscellaneous itemized deductions are reported to beneficiaries on line 11 (Code B), Schedule K-1 (Form 1041), and are deductible as Other Itemized Deductions on line 16, Schedule A (Form 1040), *Itemized Deductions.* See *Administrative expenses,* page 21-14.

Excess deductions are deductible only in the tax year of the beneficiary in which the estate or trust terminates. [Reg. §1.642(h)-2]

Charitable Deductions—Form 1041 (Schedule A)

An estate or trust is allowed an unlimited deduction on Form 1041 for amounts:

• Paid for a charitable purpose,
• Paid pursuant to the terms of the governing instrument,
• Paid from gross income of the estate or trust, and
• Paid during the current tax year.

Deductions are not limited to a percentage of AGI.
Contributions to charities created or organized outside the United States are deductible. [IRC §642(c)]

Paid for a charitable purpose. The same rules that apply to individuals apply to estates and trusts. See *Charitable Contributions,* Tab 4.

Paid pursuant to the governing instrument. The contribution must be specifically provided for in the will or trust document. Voluntary contributions by beneficiaries are not deductible on Form 1041. However, a beneficiary can take a distribution of property from the estate, donate the property, and claim a deduction on his or her personal return.

Example: Lawrence's will passes his entire estate to his children, Myron and Norma. Norma is the personal representative. During administration, Norma donates household property to a charity shop. She also donates $5,000 in Lawrence's name to a charity he supported during life. No deductions are allowed on Form 1041 because Lawrence's will did not authorize the contributions.

Discretion. Contributions subject to a fiduciary's discretion are deductible if made pursuant to the governing instrument.

Example: A trust created by Joe's will pays half of its income to his surviving spouse. The will allows the trustee to distribute the remaining income to Joe's daughter or to a local food shelf. Contributions to the food shelf are deductible.

Paid from gross income. No deduction is allowed if the contribution is not made from gross income of the estate or trust, including contributions made from capital gains and IRD included in gross income. Deductions are allowed for contributions from gross income received in any prior year as long as no deduction was taken in the year the gross income was received.

Example: Bobby's will includes the following provision, "I give my tap shoes and all shares of Disney stock I own at my death to my church." The contributions are not deductible because the property is not gross income. The stock shares earn $500 of taxable dividends during administration. State law requires that income be paid to the recipient of specifically devised property. The contribution of $500 to the church is deductible because the dividends are gross income.

Amounts payable from corpus. No deduction is allowed for amounts that, under the terms of the governing instrument or local law, are payable from estate corpus (principal).

Example: Joe's will gives the sum of $50,000 to the State Fair Foundation and the residue of his estate 50% to his children and 50% to the Humane Society. Joe did not include a provision specifying who should receive income earned during administration. Absent such a provision, state law requires that income earned during probate be paid to the residual beneficiaries. Joe's estate is allowed a deduction for the 50% share of income that will pass to the Humane Society as residual beneficiary. The cash gift to the State Fair Foundation is not deductible because it is payable from corpus (principal).

Source of payment. The terms of the will or trust document determine the source of payment of a contribution. If the instrument requires payment from income, but does not specify the type of income to be used, the contribution is deemed to consist of a proportion of each type of income received by the estate or trust (e.g., interest, dividends, tax-exempt income). The deduction is reduced for the portion paid from tax-exempt income.

Example: Madge's trust provides, "Income shall be paid annually in equal shares to my niece, Sandy, and to the Red Cross." The trust has accounting income of $20,000, including $5,000 of tax-exempt interest. The trust is allowed a deduction for accounting income paid to the Red Cross but must reduce the deduction by 25% for tax-exempt interest.

Paid during the current year. To be deductible, charitable contributions must be paid during the current tax year.

Election to treat contributions as paid in the prior tax year. A contribution can be deducted in the current tax year if it is paid by the end of the next tax year. The election must be made by the due date (including extensions) of the return for the next tax year. For information on how to make the election and the deadline for making the election on an amended return, see the Form 1041 Instructions. [Reg. §1.642(c)-1(b)]

Amounts permanently set aside. Estates are allowed a deduction for amounts of gross income permanently set aside during the tax year for purposes specified in IRC section 170(c) or 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. Most trusts are not allowed this deduction. For testamentary trusts established by wills executed by October 9, 1969 and pooled income funds, see IRC section 642(c) and the related regulations.

Reporting and other requirements. Charitable deductions are calculated on Form 1041 (Schedule A). Deductible contributions from capital gains allocated to income are included in the amount on line 1. Deductible contributions from capital gains allocated to corpus (principal) are reported on line 4.

Form 1041-A. Complex trusts that claim a charitable deduction must also file Form 1041-A, *U.S. Information Return Trust Accumulation of Charitable Amounts.* For exceptions, see Form 1041-A.

Income Distribution Deduction—Form 1041 (Schedule B)

If an estate or trust makes no distributions to beneficiaries for the tax year, the estate or trust pays tax on all of its taxable income. If distributions are made to beneficiaries, some or all of the entity's income may be taxable to the beneficiaries rather than the entity. The income distribution deduction is the amount of income taxed to the beneficiaries. It is the lesser of:

- Distributable net income (DNI) (less tax-exempt interest), or
- Distributions (less tax-exempt income distributed).

The deduction is calculated on Form 1041 (Schedule B). Lines 1 through 7 calculate DNI. Lines 8 through 11 report distributions. Lines 12 through 14 adjust for tax-exempt income.

The estate or trust takes the deduction on line 18, Form 1041, and issues Schedules K-1 (Form 1041) to the beneficiaries, reporting the same amounts of income. The deduction is mandatory. The estate or trust cannot elect to pay tax on amounts distributed to the beneficiaries. (IRC §652 and IRC §662)

Alternative minimum tax. If the estate or trust has an income distribution deduction on line 18 of Form 1041, then Schedule I (Form 1041), *Alternative Minimum Tax—Estates and Trusts,* is required. See *Alternative Minimum Tax—Estates and Trusts,* page 21-20.

Distributable Net Income (DNI)

Generally, DNI is the income considered available for distribution to beneficiaries and is an approximation of the economic benefit received by the beneficiaries. DNI is a tax rule and it limits the amount of income taxed to the beneficiaries but does not determine the amount actually distributed.

Example: A trust instrument allocates dividends to accounting income, capital gains to corpus (principal), and administrative expenses equally to income and corpus. The trust's income and expenses are:

	Income and Expenses	*Accounting Income*	*DNI*
Dividends	$3,000	$3,000	$3,000
Capital gains	4,000	0	0
Expenses	(2,000)	(1,000)	(2,000)
Total	$5,000	$2,000	$1,000

The income beneficiary receives the accounting income of $2,000. The beneficiary's share of taxable income, however, is limited to $1,000.

DNI is calculated on Form 1041 (Schedule B, lines 1 through 7). Generally, the calculation begins with adjusted total income from line 17, page 1, Form 1041.

Tax-exempt interest. Tax-exempt interest is available for distribution and included in DNI. Tax-exempt interest is added to DNI on Form 1041 (Schedule B, line 2), reduced by:

- Administrative expenses allocated to tax-exempt interest.
- Interest expenses allocated to tax-exempt interest.
- Tax-exempt interest allocated to charitable contributions.

Capital gains and losses. Capital gains and losses are generally not included in DNI. Since capital gain or loss is included in the line 17 total that begins the DNI calculation, any gain or loss is factored out of DNI on Form 1041 (Schedule B, line 6). Capital gain is entered as a negative number. Capital loss is entered as a positive number.

A similar adjustment is made if the entity claimed a charitable deduction and any amounts were paid from capital gains. The charitable deduction included in line 17 is factored out of DNI by adding any capital gains given to charity to DNI.

Capital gains allocated to beneficiaries. Since all capital gains and losses are factored out of DNI, capital gains actually allocated to beneficiaries are added back to DNI on Form 1041 (Schedule B, line 3). See *Capital gains allocated to beneficiaries,* page 21-12.

Distributions

A distribution is a payment of cash or a transfer of property to a beneficiary. An in-kind distribution satisfies the beneficiary's right to receive and generally includes any noncash distribution other than:

- A specific bequest (unless it must be distributed in more than three installments),
- Real property, the title to which passes directly to the beneficiary under local law (for example, transfer-on-death deeds).

Specific gifts (IRC §663). A gift or bequest of a specific sum of money, or of specific property, is not included in distributions on Form 1041, if it is:

- Paid in three installments or less, and
- Not required to be paid from income.

Example: Orson's will includes the following provision. "I give the sum of $50,000 and my sled to my cousin, Susan." The gifts to Susan are not included in the estate's distributions on Form 1041, and she receives no taxable income from Orson's estate.

Income required to be distributed currently. Report income required by the governing instrument or local law to be paid to beneficiaries in the year received on Form 1041 (Schedule B, line 9). Include required distributions even if the income was not actually distributed until after the close of the year.

Estates. Line 9 is generally blank for estates because most wills and state probate laws do not require estates to distribute any income in the year received.

Trusts. For a simple trust, the amount reported on line 9 is the trust's accounting income. For a complex trust, line 9 is the portion of accounting income required to be distributed. See *Accounting Income,* page 21-11.

Other amounts distributed. Include all other amounts paid, credited, or required to be distributed to beneficiaries on Form 1041 (Schedule B, line 10), which includes:

- Mandatory and discretionary distributions of corpus (principal).
- Discretionary distributions of income.
- Distributions in kind.
- Estimated tax allocated to beneficiaries on Form 1041-T, *Allocation of Estimated Tax Payments to Beneficiaries.*

Estates. Line 10 generally includes all distributions made during the year except specific gifts.

Trusts. Simple trusts should have no amount on line 10.

Distributions in kind. If an estate distributes property in kind, the estate's deduction is ordinarily the lesser of its basis in the property or the property's FMV when distributed. If the estate elects to recognize gain on the distribution, the deduction is the property's FMV. See *Election to recognize gain or loss of distributed property,* page 21-12.

65-day rule [IRC §663(b) election]. Discretionary distributions are generally deductible only if made during the tax year. To allow the fiduciary time to complete its accountings and make

discretionary distributions, an estate or complex trust may elect to include distributions made during the first 65 days of the following year as distributions for the current year [IRC §663(b)]. Simple trusts do not need to make this election. Required distributions are considered distributed whether or not they are actually made. Make the election by checking the box next to Question 6, *Other Information,* page 3, Form 1041. For the election to be valid, Form 1041 (or statement, if no return is required) must be filed by the return due date (including extensions). The election is irrevocable for the tax year and is only effective for the year of the election.

Schedule K-1 (Form 1041)

The beneficiary's share of income, deductions, and credits from an estate or trust is reported on Schedule K-1 (Form 1041). The beneficiary uses Schedule K-1 (Form 1041) to report these items on his or her tax return. Schedule K-1 (Form 1041) is kept with the beneficiary's records and is not filed with his or her tax return unless backup withholding was reported.

In box 9 and boxes 11 through 14, the fiduciary will identify each item by entering a code. The codes are identified on page 2 of Schedule K-1 (Form 1041). Page 2 also contains summarized reporting information for beneficiaries who file Form 1040. See *Estates and Trusts (Form 1041) K-1 Codes,* page 21-5.

Income. Taxable income reported to all beneficiaries is the amount of the entity's income distribution deduction. If the entity has tax-exempt interest, the beneficiary's share is reported in box 14 (Code A). Beneficiary income on Schedule K-1 (Form 1041) has the same proportion of each type of income as DNI.

Apportioning income to multiple beneficiaries. If the estate or trust has more than one beneficiary, the apportionment of taxable income on Schedule K-1 (Form 1041) depends on the type of distributions received by each beneficiary.

Type of Distributions	
Tier 1	Income required to be distributed currently.
Tier 2	All other amounts paid, credited, or otherwise required to be distributed during the year.

If DNI is less than the income required to be distributed currently, DNI is distributed proportionately to the beneficiaries receiving Tier 1 distributions.

If DNI is more than the amount required to be distributed currently, DNI is first apportioned dollar for dollar to the Tier 1 beneficiaries. Remaining DNI is divided proportionately among beneficiaries receiving Tier 2 distributions.

If all beneficiaries receive the same type of distribution, the income is divided in proportion to their shares. Estate distributions, for example, are almost always Tier 2 distributions. If the estate passes equally to beneficiaries, the Schedule K-1 (Form 1041) items are divided equally among them. However, if one beneficiary receives a 60% share of the estate, and another receives 40%, Schedule K-1 (Form 1041) items are reported 60% to the first beneficiary and 40% to the second.

Ordinary business and rental real estate income. The fiduciary will provide the beneficiary with a separate schedule showing the distributive share of income from each trade or business, net rental real estate, or other rental activity. Any losses may be subject to the passive loss limitations of IRC section 469, which generally limits deducting passive losses from passive activity income only.

Allocation of deductions:

- Deductions directly attributable to a specific class of income are deducted from that income. For example, deduct rental expenses on Schedule E (Form 1040), *Supplemental Income and Loss.*
- Deductions not directly attributable to one class of income may be allocated to any class of income.
- Deductions directly attributable to a class of income in excess of that income may be allocated to another class of income, but:
  - Excess deductions from a passive activity cannot be allocated to income from a nonpassive activity or to portfolio income.
  - Excess deductions attributable to tax-exempt income cannot offset any other class of income.
  - Do not show a negative amount for any class of income.

Directly apportioned deductions. The fiduciary must attach a statement showing depreciation, depletion, and amortization directly apportioned to the beneficiary, if any, for each activity reported in box 5 (other portfolio and nonbusiness income) and boxes 6 through 8 (ordinary business income, net rental real estate income, and other rental income).

Qualified business income deduction (QBID). For tax years 2018 through 2025, individuals, estates, and trusts may be entitled to a deduction of up to 20% of qualified business income (QBI) from a qualified trade or business, plus 20% of the aggregate amount of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. The deduction is subject to multiple limitations. See *Qualified Business Income Deduction (QBID)—IRC §199A,* page 8-15.

If the estate or trust has no DNI for the tax year, QBI and Form W-2 wages are allocated entirely to the entity. The entity's QBID is reported on line 20, Form 1041.

To the extent the estate or trust distributes, or is required to distribute, DNI to a beneficiary, the deduction is determined at the beneficiary level for the portions of QBI, qualified REIT dividends, and qualified PTP items apportioned to the beneficiaries. No amounts are shown on the beneficiary's Schedule K-1 (Form 1041). Instead, a statement is attached to separately identify each beneficiary's allocable share of:

- Qualified items of income, gain, deduction and loss,
- Form W-2 wages,
- Unadjusted basis immediately after acquisition (UBIA) of qualified property,
- Qualified PTP items, and
- Qualified REIT dividends.

The trust or estate must make an initial determination of which items are qualified items of income, gain, deduction, and loss at its level and report to each beneficiary his or her share of all items that may be qualified items at the beneficiary level. The beneficiary must then determine whether each item is includible in QBI. For more information, see the Form 1041 Instructions.

Capital loss carryover. Upon termination of the trust or decedent's estate, the beneficiary succeeding to the property is allowed to deduct any unused short-term or long-term capital loss carryover (IRC §1212). Additionally, a beneficiary may be allowed to deduct any unused net operating loss (NOL) if the carryover would be allowable to the trust or estate in a later tax year but for the termination. The beneficiary's deduction is reported on line 8a, Schedule 1 (Form 1040), *Additional Income and Adjustments to Income.* See *Net Operating Loss (NOL),* page 8-20

Election to allocate estimated tax to beneficiaries. An estate or trust can elect to allocate estimated tax to beneficiaries by filing Form 1041-T, *Allocation of Estimated Tax Payments to Beneficiaries.* The deadline is the 65th day after the close of the tax year, March 6, 2025, for calendar year 2024. An estate may make the election only in its final year. Any portion of estimated tax can be allocated. Form 1041-T can be filed with Form 1041 or filed separately. Failure to file Form 1041-T by the deadline invalidates

continued on page 21-20

Form 1041 Examples

Example #1: Meg is the trustee of Sofia's testamentary trust. All trust income is required to be distributed to Mitch (beneficiary) annually. The trust had the following activity in 2024:

	Income and Expenses	*Accounting Income*	*Taxable Income*
Interest	$3,750	$3,750	$3,750
Municipal bond interest	1,250	1,250	0
Capital loss	(2,000)	0	(2,000)
State tax	(200)	0	(200)
Trustee fee	(800)	(400)	(600)
Totals	$2,000	$4,600	$950
Adjusted total income (line 17)		$950	

See filled out Form 1041, below.

A portion of the trustee fee is allocated to tax-exempt interest and is not deductible:

$$\$800 \text{ expense} \times \frac{\$1{,}250 \text{ tax-exempt interest}}{\$5{,}000 \text{ gross accounting income}} = \$200 \text{ reduction}$$

Meg distributed $4,600 to Mitch and made no other distributions. The trust's income distribution deduction is calculated on Form 1041 (Schedule B) shown below.

Line 2, Schedule B, is tax-exempt interest of $1,250 reduced by the administrative expenses allocated to tax-exempt interest ($200).

The trust can carry over its $2,000 capital loss to 2025.

Schedule K-1 (Form 1041). The income distribution deduction is $2,950. The trust therefore reports taxable income on Mitch's Schedule K-1 (Form 1041) of $2,950. Expenses are allocated as follows:

	Interest	*Tax-Exempt Interest*
Income	$3,750	$1,250
Deductions	(800)	(200)
DNI	$2,950	$1,050

Expenses allocated to tax-exempt income can be deducted only from that income. Mitch's Schedule K-1 (Form 1041), below, reports interest income of $2,950 and tax-exempt interest of $1,050.

Draft as of August 29, 2024

Example #1, above

Form **1041** Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts
Go to *www.irs.gov/Form1041* for instructions and the latest information.
2024 OMB No. 1545-0092

A Check all that apply:
- [ ] Decedent's estate
- [x] Simple trust
- [ ] Complex trust
- [ ] Qualified disability trust
- [ ] ESBT (S portion only)
- [ ] Grantor type trust
- [ ] Bankruptcy estate—Ch. 7
- [ ] Bankruptcy estate—Ch. 11
- [ ] Pooled income fund

For calendar year 2024 or fiscal year beginning , 2024, and ending , 20

Name of estate or trust (If a grantor trust, see the instructions.): Sofia's Testamentary Trust

C Employer identification number: 13-1234567

Name and title of fiduciary

D Date entity created: 2/9/2021

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

E Nonexempt charitable and split-interest trusts, check applicable box(es). See instructions.
- [ ] Described in sec. 4947(a)(1). Check here if not a private foundation [ ]
- [ ] Described in sec. 4947(a)(2)

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

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

F Check applicable boxes: [ ] Initial return [ ] Final return [ ] Amended return [ ] Net operating loss carryback [ ] Change in trust's name [ ] Change in fiduciary [ ] Change in fiduciary's name [ ] Change in fiduciary's address

G Check here if the estate or filing trust made a section 645 election [ ] Trust TIN

Section	Line	Description		Amount
Income	1	Interest income	1	3,750
	2a	Total ordinary dividends	2a	
	b	Qualified dividends allocable to: (1) Beneficiaries ______ (2) Estate or trust ______		
	3	Business income or (loss). Attach Schedule C (Form 1040)	3	
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4	(2,000)
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5	
	6	Farm income or (loss). Attach Schedule F (Form 1040)	6	
	7	Ordinary gain or (loss). Attach Form 4797	7	
	8	Other income. List type and amount	8	
	9	**Total income.** Combine lines 1, 2a, and 3 through 8	9	1,750
Deductions	10	Interest. Check if Form 4952 is attached [ ]	10	
	11	Taxes	11	200
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions 800 (200)	12	600
	13	Charitable deduction (from Schedule A, line 7)	13	
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14	
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a	
	b	Net operating loss deduction. See instructions	15b	
	16	Add lines 10 through 15b	16	800
	17	Adjusted total income or (loss). Subtract line 16 from line 9 — 17: 950		
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	2,950
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20	
	21	Exemption	21	300
	22	Add lines 18 through 21	22	3,250
	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23	(2,300)
ments	24	**Total tax** (from Schedule G, Part I, line 9)	24	
	25	Current year net 965 tax liability paid from Form 965-A, Part II, column (k) (see instructions)	25	

Schedule B — Income Distribution Deduction *Draft as of August 29, 2024*

Line	Description		Amount
1	Adjusted total income. See instructions	1	950
2	Adjusted tax-exempt interest 1,250 (200)	2	1,050
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See instructions	3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1. See instructions	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	2,000
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-	7	4,000
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law — 8:		
9	Income required to be distributed currently	9	4,600
10	Other amounts paid, credited, or otherwise required to be distributed	10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	4,600
12	Enter the amount of tax-exempt income included on line 11	12	1,050
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	3,550
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	2,950
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	2,950

Mitch (Example #1) — Schedule K-1 (Form 1041)

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

Line	Item	Amount	Line	Item	Amount
1	Interest income	2,950	11	Final year deductions	
2a	Ordinary dividends				
2b	Qualified dividends				
3	Net short-term capital gain				
4a	Net long-term capital gain				
4b	28% rate gain		12	Alternative minimum tax adjustment	
4c	Unrecaptured section 1250 gain				
5	Other portfolio and nonbusiness income				
6	Ordinary business income				
7	Net rental real estate income		13	Credits and credit recapture	
8	Other rental income				
9	Directly apportioned deductions				
			14	Other information	A 1,050
10	Estate tax deduction				

Example #2. Sherman is the personal representative and sole beneficiary of his aunt's estate. The estate's income and deductions for its first year are:

Interest	$2,000
Qualified dividends	1,000
IRA distribution	4,500
Property tax	(1,500)
Attorney fees	(1,000)
Adjusted total income (line 17)	$5,000

Sherman made a partial discretionary distribution of estate assets of $30,000 during the year. The estate's income distribution deduction is calculated as follows.

Schedule B **Income Distribution Deduction** *Draft as of August 29, 2024*

1	Adjusted total income. See instructions	1	5,000
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See instructions	3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1. See instructions	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-	7	5,000
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law — 8		
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	30,000
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	30,000
12	Enter the amount of tax-exempt income included on line 11	12	0
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	30,000
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	5,000
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	5,000

The estate's taxable income is:

Adjusted taxable income (line 17)	$5,000
Income distribution deduction	(5,000)
Exemption	(600)
Taxable income	($ 600)

Schedule K-1 (Form 1041). The income distribution deduction is $5,000, the lesser of DNI ($5,000) or distributions ($30,000). Income taxable to the beneficiary and reported on Schedule K-1 (Form 1041) is also $5,000. Property tax and attorney fees are indirect expenses that can be deducted from any type of income. Sherman allocates the first $2,000 of deductions to interest. He skips qualified dividends because of the lower rate and deducts the remaining $500 from other income.

	Interest	*Dividends*	*Other*	*Total*
Income	$2,000	$1,000	$4,500	$7,500
Deductions	(2,000)	(0)	(500)	(2,500)
DNI	$ 0	$1,000	$4,000	$5,000

Income on Schedule K-1 (Form 1041) has the same proportion of each type of income as DNI. The income is reported on Sherman's Schedule K-1 (Form 1041) as $1,000 qualified dividends (lines 2a and 2b) and $4,000 other income (line 5). Sherman's Schedule K-1 (Form 1041) is shown on top, next column.

Example #3. Assume the same facts as Example #2, above, except distributions for the year were only $2,000.

The estate's taxable income is:

Adjusted taxable income (line 17)	$5,000
Income distribution deduction	(2,000)
Exemption	(600)
Taxable income	$2,400

Schedule K-1 (Form 1041). The income distribution deduction is $2,000, the lesser of DNI ($5,000) or distributions ($2,000). Expenses are allocated in the same manner as in Example #2, above.

Income on Schedule K-1 (Form 1041) has the same proportion of each type of income as DNI. Because distributions are less than DNI, the beneficiary income ($2,000) is apportioned as follows:

$$\frac{\$1{,}000 \text{ dividends}}{\$5{,}000 \text{ total DNI}} \times \$2{,}000 \text{ beneficiary income} = \$400 \text{ dividends}$$

$$\frac{\$4{,}000 \text{ IRA}}{\$5{,}000 \text{ total DNI}} \times \$2{,}000 \text{ beneficiary income} = \$1{,}600 \text{ IRA}$$

Sherman's Schedule K-1 (Form 1041), shown on bottom, next column, reports qualified dividends of $400 and other income of $1,600.

Sherman (Example #2) — Schedule K-1 (Form 1041)

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

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

Sherman (Example #3) — Schedule K-1 (Form 1041)

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

1	Interest income	11	Final year deductions
2a	Ordinary dividends 400		
2b	Qualified dividends 400		
3	Net short-term capital gain		
4a	Net long-term capital gain		
4b	28% rate gain	12	Alternative minimum tax adjustment
4c	Unrecaptured section 1250 gain		
5	Other portfolio and nonbusiness income 1,600		
6	Ordinary business income		
7	Net rental real estate income	13	Credits and credit recapture
8	Other rental income		
9	Directly apportioned deductions		
		14	Other information
10	Estate tax deduction		

continued from page 21-17

the election. If Form 1041-T is filed separately, do not attach a copy to Form 1041.

Withholding. Except for backup withholding, withheld income tax cannot be passed through to beneficiaries on either Form 1041-T or Schedule K-1 (Form 1041). The estate or trust must claim a refund on Form 1041.

Separate share rule. If a trust or an estate has more than one beneficiary, and each has a substantially separate and independent share, their shares are treated as separate trusts (or estates) for the sole purpose of determining the amount of DNI allocated to the beneficiaries. The separate share rule prevents income accumulated for one beneficiary from being taxed to a second beneficiary who receives distributions of both income and corpus. [Reg. §1.663(c)-1]

Alternative Minimum Tax— Estates and Trusts

Cross References

- Form 1041, *U.S. Income Tax Return for Estates and Trusts*
- Schedule I (Form 1041), *Alternative Minimum Tax—Estates and Trusts*
- IRC §55, *Alternative minimum tax imposed*

Related Topics

- Alternative Minimum Tax, page 14-2

AMT Exemption Amount for Estates and Trusts

Year	*2024*	*2023*	*2022*	*2021*
AMT exemption*	$29,900	$28,400	$26,500	$25,700
Phaseout begins	$99,700	$94,600	$88,300	$85,650
Complete phaseout	$219,300	$208,200	$194,300	$188,450

* The AMT exemption amount is zero for the S portion of an electing small business trust (ESBT) that is treated as a separate trust.

Alternative Minimum Tax (AMT)

Tax law gives special treatment to certain types of income and allows special deductions and credits for certain types of expenses. The AMT was enacted so taxpayers who benefit from these laws still pay at least a minimum amount of tax. The AMT applies to estates and trusts, as well as individuals. The estate or trust first calculates its tax under the general income tax rules and then AMT is calculated. The estate or trust must pay the higher amount.

2024 AMT Tax Rates for Estates and Trusts

AMT Rate	*AMT Income (AMTI)*
n/a	$0 – $29,900
26%	$29,901 – $232,600
28%	$232,601 or greater

Calculating AMT

The estate's or trust's total adjusted income from Form 1041, *U.S. Income Tax Return for Estates and Trusts,* is reduced by the adjustments made for certain tax preference items and other deductions, which may include some of the following items.

- Interest expense claimed as a deduction.
- Taxes claimed as a deduction.
- Disposition of property.
- Depreciation claimed on certain assets.
- Passive activity losses.
- Minimum tax adjustment from another estate or trust.
- Qualified business income deduction (QBID).

The resulting adjusted alternative minimum taxable income (AMTI) is reduced by the estate's or trust's income distribution deduction and the estate tax deduction. If the resulting total is $29,900 (2024 AMT exemption) or less, the estate or trust is not liable for the AMT. The AMT exemption begins to phase out when the estate's or trust's AMTI exceeds $99,700 (2024). After subtraction of the AMT exemption, AMTI of up to $219,300 is taxed at 26%, and AMTI greater than $219,300 is taxed at 28%.

Schedule I (Form 1041), *Alternative Minimum Tax—Estates and Trusts.* Use Schedule I (Form 1041) to calculate:

- The estate's or trust's alternative minimum taxable income,
- The income distribution deduction on a minimum tax basis, and
- The estate's or trust's alternative minimum tax (AMT).

Note: An ESBT must compute the AMT for the S and non-S portions of the trust on separate Schedules I (Form 1041), which includes only the income, deductions, and credits attributable to that portion.

Certain credits may be limited by any tentative minimum tax calculated on Schedule I (Form 1041), even if there is no AMT liability. If the estate or trust takes a deduction for distributions to beneficiaries, complete Part I and II of Schedule I (Form 1041), even if the estate does not owe any AMT. Allocate the income distribution deduction calculated on a minimum tax basis among the beneficiaries and report each beneficiary's share on Schedule K-1 (Form 1041). Also, show each beneficiary's share of any adjustments or tax preference items for depreciation, depletion, and amortization. See *Schedule K-1 (Form 1041),* page 21-17.

State AMT. Some states have separate AMT requirements for estates and trusts. Check state law for rules.

Grantor Trusts

Cross References

- Form 1041, *U.S. Income Tax Return for Estates and Trusts*
- IRC §671–678
- Reg. §1.671-4

Related Topics

- Form W-9, *Request for Taxpayer Identification Number and Certification,* page 23-5
- Form 1099-MISC, *Miscellaneous Information,* page 23-8

Grantor Trusts

If a grantor retains certain powers over a trust, the grantor is treated as the owner of the trust and taxed on its income. If the grantor has control of a portion of the trust, only that portion is treated as a grantor trust. A trust is treated as a grantor trust in the situations described below.

Reversions. The grantor retains a reversionary interest of more than 5%. ***Exception:*** A reversionary interest that takes effect on the death of a beneficiary before age 21 if the beneficiary is grantor's lineal descendant with a present interest. (IRC §673)

Power to control beneficial enjoyment. The grantor or a nonadverse party has unlimited power to distribute corpus (principal) or income to beneficiaries without the consent of an adverse party. A trust is not a grantor trust if powers are limited, such as:

- Power to distribute corpus if limited by a reasonably definite standard retained by the grantor or given to any other person.
- Power to distribute, apportion, or accumulate income if limited by a reasonably definite standard given to a trustee other than the grantor or spouse.
- Unlimited discretionary power over corpus or income given to an independent trustee who is not a relative or subordinate of the grantor if exercisable without consent of any other person.

Grantor Trust Filing Methods

(See Regulation section 1.671-4 for examples.)

Form 1041:	Optional Method 1:	Optional Method 2:	Optional Method 3:
• Fill in only the entity information. • Do not show dollar amounts. • Do not prepare Schedule K-1 (Form 1041). • Attach statement to Form 1041 reporting name, identifying number, address of grantor, and all items of income, deductions, and credits.	• Obtain Form W-9 from the grantor. • Give the grantor's name and SSN to payers of income so that Forms 1099 are issued to the grantor. • If the grantor is not the trustee, issue a tax statement to the grantor.	• Give payers of income the name and EIN of the trust. • File Forms 1099 annually. • If the grantor is not the trustee, issue a tax statement to the grantor annually.	• Give payers of income the name and EIN of the trust. • File Forms 1099 annually. • Issue tax statements to the grantors annually.

Forms 1099.	Tax statement to grantors:
If the trust is required to file Forms 1099, report all income and gross proceeds paid to the trust. • List the trust as the payer and the grantor as payee. • Report each type of income in the aggregate. For example, report the grantor's total interest from all sources on Form 1099-INT, *Interest Income.* • Report each item of gross proceeds on a separate Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions.*	• Show all items of income, deduction, and credit of the trust. • Provide the grantor with the information necessary to report the items when computing taxable income. • Inform the grantor that the items must be included when computing taxable income and credits on his or her income tax return. • Identify the payers of income (Optional Method 1 only).

A reasonably definite standard is measurable and allows the trustee to be held accountable (e.g., for the beneficiary's health, education, support, and maintenance). (IRC §674)

Certain administrative powers:
- The grantor or a nonadverse party can borrow or purchase trust corpus (principal) for less than adequate consideration.
- A power of administration is exercisable by a nonfiduciary without approval of a fiduciary, including the power to reacquire trust corpus by substituting other property of equivalent value and certain voting rights. (IRC §675)

Revocable trusts. The grantor or a nonadverse party has a power to revoke the trust or return the corpus to the grantor. (IRC §676)

Income for the benefit of grantor. The grantor or a nonadverse party has the power to either distribute income to or for the benefit of the grantor or spouse or apply it to pay premiums on life insurance insuring grantor or spouse. The grantor is taxed on income used to support a beneficiary the grantor is legally obligated to support. Income is not taxed to the grantor merely because income could be used to support a beneficiary. (IRC §677)

Adverse party. An adverse party is a beneficiary with a substantial interest in the trust that would be adversely affected by the exercise or nonexercise of the power. Beneficiaries are generally only adverse to the extent of their interest. If an exercise of a power does not affect that beneficiary's interest, the beneficiary is not an adverse party. A grantor is treated as having any power given to a spouse.

Grantor not owner. A person other than the grantor is treated as owner if that person has the sole power to vest corpus (principal) or income in himself or herself. (IRC §678)

Grantor Trust Filing Methods

Form 1041. Any grantor trust can file Form 1041. If only part of the trust is a grantor trust, prepare Form 1041 and Schedule K-1 (Form 1041) without any items related to the grantor portion and attach a statement reporting the grantor portion.

Optional methods. If the entire trust is a grantor trust, the trustee can choose to file using an optional method instead of filing Form 1041. See *Grantor Trust Filing Methods* chart, above.
- Trusts with one grantor, use either Optional Method 1 or 2.
- Trusts with more than one grantor, use Optional Method 3.

A married couple is treated as one grantor if they file jointly.

Optional Method 1 is the simplest method as the trust is ignored if the grantor is the trustee. Income is reported on the grantor's Form 1040 as if the trust did not exist. Only if the grantor is not the trustee is extra work involved. In that case, the trustee must issue a detailed tax statement annually to the grantor (described in the chart, above).

Under Optional Methods 2 and 3, the trust uses its tax ID number and issues Forms 1099 each year to report income and gross proceeds to the grantors. Tax statements are required if the grantor is not the trustee.

> **Author's Comment:** For trusts that routinely sell stock, Optional Methods 2 and 3 can be more work than filing Form 1041 for the trust, particularly if a statement is also required under the optional method because the grantor is not the trustee.

Optional methods cannot be used by any of the following trusts.
- Trust with a grantor that uses a fiscal year.
- Foreign trusts, trusts with assets outside the United States, or a grantor who is not a U.S. person.
- Common trust funds or qualified subchapter S trusts.
- Trusts with a grantor who is an exempt recipient for information reporting unless another grantor is not exempt, and the trustee treats all grantors as not exempt.

Changing filing methods. A trust can change to an optional method by filing a final Form 1041. Check the final return box and write "Pursuant to Section 1.671-4(g), this is the final Form 1041 for this grantor trust." The trust can use an optional method the following year. See Regulation section 1.671-4(g) for other changes.

Estate and Gift Tax

Cross References
- IRC §2001–2209, *Estate tax*
- IRC §2501–2524, *Gift tax*
- IRC §2601–2663, *Generation-skipping transfer tax*
- Reg. §20.2010-2
- Reg. §20.2031-1
- Reg. §25.2512-1
- Reg. §26.2612-1
- Reg. §301.7701-18

Related Topics
- Charitable Contributions, Tab 4

Estate Tax
At death, all property of the decedent is included in the gross estate for estate tax. Taxable gifts made after 1976 are added to the total. The estate is allowed deductions for funeral expenses, administrative expenses, decedent's debts, and state death taxes. Most property passing to a surviving spouse or charity is also fully deductible. Estate tax is due if the net estate is more than the estate tax exclusion for the year of death ($13,610,000 in 2024). The estate receives a credit for gift tax payable by the donor during life. See *Estate Tax Return—Form 706,* page 21-31.

Example: Henry died in 2024. He had the following assets:

House	$2,675,000
Cabin	950,000
Bank accounts	1,100,000
Brokerage account	4,250,000
Household and personal property	560,000
Vehicles	145,000
IRA rollover account	3,200,000
Total	$12,880,000

Henry gave each of his four children $500,000 when his wife died in 2010. He reported taxable gifts of $1,948,000 ($500,000 minus $13,000 annual exclusion per gift). Henry made no other taxable gifts during his lifetime and paid no gift tax in 2010.

Henry's estate paid funeral and other expenses of $150,000 and state death tax of $300,000. Tax on Henry's estate is calculated as follows:

Total gross estate	$12,880,000
Less allowable expense deductions	(150,000)
Tentative taxable estate	12,730,000
State death tax deduction	(300,000)
Taxable estate	12,430,000
Adjusted taxable gifts made after 1976	1,948,000
Total	14,378,000
Tentative tax	5,697,000
Gift tax payable on gifts after 1976	(0)
Gross estate tax	5,697,000
Allowable credit	(5,389,800)
Estate tax	$307,200

Generation-Skipping Transfer (GST) Tax

The federal estate and gift tax is designed to tax property as it passes from each generation to the next. The GST tax is an additional tax that applies to transfers during life and at death that skip a generation.

Transfers not in trust that qualify for the annual exclusion are excluded from GST tax. Transfers that are not considered gifts for gift tax purposes, such as qualified transfers for tuition and medical care, are not subject to GST tax.

Exemption and tax rate. Each taxpayer has a GST exemption equal to the estate tax exemption ($13,610,000 in 2024). GST tax is set as a flat rate equal to the highest estate tax rate (40% in 2024).

Transfers subject to GST. A GST is one of the following.
- A direct skip is a transfer, made during life or at death, that is subject to gift or estate tax and made to a skip person.
- A taxable termination is the end of a trust's interest in property where the property interest will be transferred to a skip person.
- A taxable distribution is any other distribution made to a skip person.

Skip persons. Skip persons include grandchildren and other relatives two or more generations below the donor. A trust is a skip person if all interests are held by skip persons. (Reg §26.2612-1)

An unrelated person born more than 37½ years after the donor is also considered a skip person. Relatives not descended from the donor's grandparents are considered unrelated. (IRC §2651)

Spouses and former spouses, tax-exempt organizations, and charitable trusts are nonskip persons.

Deceased parent exception. If a child of the donor dies, his or her children are not considered skip persons. They move up a generation assignment and so do their descendants. If a donor has no lineal descendants, the deceased parent exception applies to descendants of nieces and nephews.

See *Gift Tax Return—Form 709,* page 21-25.

✎ **Author's Comment:** In order not to incur the GST tax, a grantor can create a dynasty trust establishing specified distributions to beneficiaries and lasting for generations. By transferring assets (up to the GST exemption limit) into an irrevocable trust, the corpus (principal) of the trust is not subject to gift tax, GST tax, or estate tax with the transfer. Because the beneficiaries lack control over the trust's assets, the assets do not count towards a beneficiary's taxable estate. Income tax applies to the income received by the beneficiaries. Check state law to see which states allow dynasty trusts.

Marital Deduction

An unlimited deduction is allowed for transfers to a spouse during life and for assets passing to a surviving spouse at death. [IRC §2056(a)]

Exceptions:
- Assets passing to a spouse who is not a U.S. citizen.
- Certain terminable interests.

The marital deduction does not exclude assets from tax but rather postpones tax until the death of the second spouse. Assets that pass to a surviving spouse are included in the surviving spouse's estate and taxed at his or her death. Transfers that could allow taxable assets to pass to someone other than the spouse without estate tax generally do not qualify for the marital deduction.

Same-sex married couples. All property included in the gross estate that passes to the surviving same-sex spouse is eligible for the marital deduction. See *Married Taxpayers,* Tab 3.

Restored exclusion amount. A taxpayer who made a transfer to a same-sex spouse before September 16, 2013, that reduced his or her estate tax exclusion because it did not qualify for the marital de-duction, can recalculate the remaining exclusion. (Notice 2017-15)

Any GST exemption amount allocated to a taxable gift to a skip person whose generation assignment was changed is void.

Registered domestic partnerships and civil unions. For federal tax purposes, marriage does not include registered domestic partnerships, civil unions, or other similar formal relationships recognized under state law that are not denominated as marriage.

Noncitizen spouses. Gifts to a spouse who is not a U.S. citizen do not qualify for the marital deduction. [IRC §2056(d)]

A taxpayer is allowed a higher annual exclusion for gifts to a noncitizen spouse ($185,000 in 2024). See *Annual Exclusion,* page 21-26.

Exceptions: Assets passing at death to a noncitizen spouse qualify for the marital deduction if:
- The assets pass to the spouse in a qualified domestic trust, or
- The spouse is a U.S. resident who becomes a U.S. citizen before the due date for Form 706.

If a marital deduction is not allowed, and the surviving spouse's estate is later subject to U.S. estate tax, the surviving spouse's estate receives a credit for tax paid on the first spouse's death. [IRC §2056(d)(3)]

Terminable interests. A terminable interest is one that will end after a period of time or when some contingency occurs or fails to occur (e.g., life estates, annuities, estates for a term of years, or patents). Terminable interests are not deductible if:
- The donor retained or gave an interest in the same property to anyone other than the spouse, and
- Someone other than the spouse may possess or enjoy any part of the property after the spouse's interest ends.

Example: Violet transferred title to her cabin to her daughter, Daisy, and at the same time gave her husband, Bert, a life estate in the cabin. The gift to Bert does not qualify for the marital deduction because it terminates at his death and Daisy will possess the property.

Example: Robin deeded her home into joint tenancy with her new husband, Hawk. Her gift is not a terminable interest. Interests transferred to a spouse as joint tenant or tenant by the entirety are not considered terminable interests if the spouses are the only tenants.

Exceptions: The following terminable interests are deductible.

- An interest conditioned on the spouse's surviving for a limited period if the spouse actually survives.
- Life estate with power of appointment.
- Life insurance or annuity payments held by an insurer with a general power of appointment in the spouse.
- Qualified terminable interest property (QTIP), by election.
- Qualified charitable remainder trust in which the spouse is the only noncharitable beneficiary.

Life estate with power of appointment. If the surviving spouse has a life estate with power of appointment, the value of the entire interest is included in the spouse's gross estate at death. A deduction is allowed if all four requirements are met.

1) The spouse is entitled for life to all income from the entire interest,
2) The income is paid yearly or more often,
3) The spouse has the unlimited power, while he or she is alive or by will, to appoint the entire interest in all circumstances, and
4) No part of the entire interest is subject to another person's power of appointment (except to appoint it to the spouse).

QTIP election. The donor, or the person filing Form 706 of the estate, may elect to deduct a terminable interest if it meets requirements (1), (2), and (4), above, even though it does not meet requirement (3). If the QTIP election is made, the value of the property is included in the gross estate of the surviving spouse under IRC section 2044. Make the election by listing the QTIP property on Form 709 or 706 and claiming the marital deduction.

Automatic QTIP election for annuities. IRC section 2523(f)(6) creates an automatic QTIP election for gifts of joint and survivor annuities if the spouses are the only possible recipients of the annuity prior to the death of the last surviving spouse. The donor spouse can elect out of QTIP treatment by checking the box on line 12, page 3, Form 709.

Marital Estate Tax Planning

Every taxpayer is allowed an estate tax exclusion, therefore, a married couple can potentially shield twice the exclusion amount from estate tax. If the exclusion of the first spouse to die is unused, the couple will potentially pay more in estate tax overall. To maximize the full estate tax exclusion for both, a married couple can create bypass trusts or elect portability of the deceased spousal unused exclusion (DSUE) of the first spouse to die.

Exclusion unused. If a couple has no bypass trusts and does not elect portability, all of a couple's assets pass to the surviving spouse and the couple loses the chance to use the exclusion of the first spouse to die.

Example #1: When Jim died in January 2024, all of his assets passed to his wife, Joyce, as his surviving joint tenant and designated beneficiary. All property passing to Joyce qualified for the marital deduction so his estate paid no estate tax. When Joyce died in December 2024, she owned all of their assets and she had a taxable estate of $28 million. Her estate paid federal estate tax of $5,756,000.

Bypass trusts. Marital estate tax planning typically involves dividing a couple's assets so that each owns assets individually that can be passed to beneficiaries other than the surviving spouse. Because many couples are not comfortable with the idea of giving a substantial amount to children or other beneficiaries when the first of them dies, a bypass trust is commonly named as beneficiary. Assets passing to the irrevocable bypass trust at the first death remain available for the surviving spouse in the event of financial need and are only distributed at the death of the second spouse. Because irrevocable bypass trusts are not included in a surviving spouse's estate, there is no stepped-up basis at his or her death (Rev. Rul. 2023-2).

Example #2: Assume the same facts as Example #1, except that Jim and Joyce had wills that included bypass trusts. They also divided their property so that each of them separately owned half their assets. When Jim died, assets of $13,610,000 (maximum exclusion amount) passed into a bypass trust. His remaining $390,000 in assets passed to Joyce and qualified for the marital deduction. When Joyce died, she had a taxable estate of $14,390,000, including assets she received from Jim. Her estate pays federal estate tax of $312,000.

Example #3: Assume the same facts as Example #2, except that instead of passing assets to a trust, Jim's will passed the same amount outright to the couple's children. The estate tax savings is the same.

Portability of the deceased spousal unused exclusion (DSUE) election. Estates of decedents survived by a spouse may elect to pass any of the decedent's unused estate tax exclusion to the surviving spouse. [IRC §2010(c)(4)]

The surviving spouse can apply the deceased spousal unused exclusion (DSUE) amount received from the estate of his or her last deceased spouse against any tax liability arising from subsequent lifetime gifts and transfers at death.

Note: The DSUE is available for estate and gift tax only and is not available for the generation-skipping transfer (GST) tax.

DSUE amount. The DSUE amount is the lesser of:

- The basic exclusion amount in effect on the date of death of the decedent whose DSUE is being computed, or
- The decedent's applicable exclusion amount less the amount used for the taxable estate of the decedent. The amounts on which gift taxes were paid are excluded from adjusted taxable gifts for the purpose of this computation.

Making the DSUE election. To make the portability election, the executor must file an estate tax return (Form 706) within nine months of the decedent's date of death, or before the 6-month extension period ends. This applies regardless of the size of the gross estate. [Reg. §20.2010-2(a)]

The portability election is irrevocable once the due date of the return (including extension) has passed.

Opting out. The executor of an estate of a decedent with a surviving spouse may opt out of the portability election by checking the box in section A, Part 6, Form 706. Alternatively, if no estate tax return is required, not filing a timely estate tax return will avoid making the portability election.

Extension to elect portability. Estates without a filing requirement and whose executor failed to timely file Form 706 making the portability election may be eligible for an extension if Form 706 is filed on or before the fifth anniversary of the decedent's death. To elect portability under this extension, the top of Form 706 must state "Filed Pursuant to Rev. Proc. 2022-32 to Elect Portability under 2010(c)(5)(A)."

Note: Any estate that is filing Form 706 only to elect portability and did not file timely or within the above extension period may request to make the portability election by showing the estate acted reasonably and in good faith. (Reg. §301.9100-3)

Nonresident surviving spouse. A nonresident surviving spouse who is not a U.S. citizen may not take into account the DSUE amount of a deceased spouse, except to the extent allowed by treaty with his or her country of citizenship. If a non-U.S. citizen surviving spouse becomes a U.S. citizen, he or she is treated as any other U.S. citizen surviving spouse and will have the immediate benefit of the DSUE amount.

Special rule if estate valued under exclusion amount. When electing portability, executors of estates not otherwise required to file Form 706 do not have to report the actual value of certain property qualifying for the marital or charitable deduction, but may estimate the value of those assets and include it in the total value of the gross estate based on a good faith determination of the value of the estate's assets. [Reg. §20.2010-2(a)(7)(ii)]

Example: Wanda died in January 2024. All of her assets passed to her husband, Ralph, except a $300,000 IRA that named Wanda's sister as beneficiary. Wanda's executor filed Form 706 electing portability of her unused exclusion of $13.31 million ($13.61 million minus $300,000) to her surviving spouse. Ralph died in December 2024 with assets of $18 million. His exclusion of $13.61 million plus Wanda's unused exclusion of $13.31 million eliminate his estate tax.

Author's Comment: Portability may reduce the need for bypass trust planning. However, some couples may still want to use a bypass trust.

- Bypass trusts can shield assets from state estate tax.
- A trust allows each spouse to choose beneficiaries. A trust could, for example, pass assets to children from a previous marriage.
- Assets passing to a trust pass from the first spouse to beneficiaries. Appreciation after the first spouse dies is not included in the second spouse's estate. On the flip side, basis is set when the first spouse dies and does not step up at the death of the second spouse.

Charitable Deduction

An unlimited deduction is allowed for most transfers to charity during life and for assets passing to charity at death. Deductible contributions are similar to those allowed for income tax. Contributions to non-governmental organizations outside the U.S. may be deductible. See *Charitable Contributions,* Tab 4. Only certain gifts of partial interests in property, such as remainders and trust shares, are deductible. For details, see IRC sections 2055 and 2522 and related regulations.

Valuation

Form 706. The value of assets reported on Form 706 is generally the fair market value on the date of death (IRC §2031). However, assets may be valued using special-use valuation or alternate valuation, see next column.

Form 709. The value of gifts reported on Form 709 is the fair market value when the gift is complete.

Although the same general valuation rules apply to both gifts and estates, separate regulations govern gifts (IRC §2512 and regulations) and estates (IRC §2031 and regulations).

Fair market value (FMV). The price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. A sale of property in some situations does not set FMV if the item is sold in a market other than the one in which it is commonly sold to the public. Property generally purchased in a retail market is valued at retail price.

Stocks and bonds. The FMV is the average of the high and low selling prices quoted on the valuation date. If the valuation date was not a trading day, average the high and low values on the nearest trading day before and the nearest trading day after. For death on a weekend, average Monday and Friday highs and lows.

The weighted average calculations in the regulations are needed when the valuation date is a trading day but the stock being valued was not traded. See Regulation sections 20.2031-2 and 25.2512-2 for weighted averages and other stock and bond valuations. If only closing selling prices are available, then FMV is the mean between the quoted closing selling price on the valuation date and on the trading day before the valuation date.

Mutual funds. Value mutual funds at the public redemption price (net asset value or NAV) on the valuation date. For death on a weekend or holiday, use the NAV for the day preceding the date of death (e.g., weekend death use Friday's NAV). [Reg. §20.2031-8(b)]

Business interests. Business interests should be appraised for Forms 709 and 706. Factors include net worth, earnings power, dividend paying ability, goodwill, economic outlook specific to the industry, and competition. See IRC section 2031 and Revenue Ruling 59-60. The donor or estate may be able to claim discounts in value due to lack of control and lack of marketability. Discounts in decided court cases have ranged up to 45%.

Annuities, life estates, and remainders. The FMV of a commercial annuity is the amount the issuing company would charge for a comparable annuity (Reg. §20.2031-8). The FMV of other annuities and ordinary life estates and remainders is calculated under Regulation section 20.2031-7.

To determine value, use Table S and the applicable interest rate found at: www.irs.gov/retirement-plans/actuarial-tables.

Example: Julie died in April 2024. Her will leaves a life estate in property valued at $300,000 to her husband, Blake, and the remainder to her niece, Maria. Their interests are valued under Regulation section 20.2032-7 as follows.

- Blake's age at his nearest birthday is 80.
- The applicable federal rate for April 2024 was 5.2% (Rev. Rul. 2024-07 Table 5).
- The Table S (2001CM) factors for age 80 at 5.2% are 0.34378 life estate and 0.65622 remainder.

Blake's life estate is valued at $103,134 ($300,000 × 0.34378).
Maria's remainder is valued at $196,866 ($300,000 × 0.65622).

Author's Comment: The IRS calculation is not the only method for valuing life estates and remainders. A state, for example, may use a higher valuation of the life estate of a nursing home resident. Similarly, parties to a sale may not agree to the IRS method.

Alternate valuation. An executor may elect to value all property included in the estate on the alternate valuation date described, below, instead of on the date of death. (IRC §2032)

- Any property not disposed of within six months is valued on the date six months after death.
- Any property distributed, sold, exchanged, or otherwise disposed of within six months of death is valued on the date it is first disposed of. Assets are not disposed of simply because they pass to a surviving joint tenant or directly to an heir.
- Interests affected by mere lapse of time are valued on the date of death (e.g., life estates, remainders, or patents).
- Interest, dividends, rents, and other earnings received during the alternate valuation period are not added to the gross estate.

Alternate valuation can be elected only if it decreases both:

- The value of the gross estate, and
- The sum of federal estate and GST tax.

If alternate valuation is elected, the basis of property acquired from a decedent is its value on the alternate valuation date. Alternate valuation cannot be used to increase basis when no federal estate tax is due. For more information, see Regulation section 20.2032-1.

Special-use valuation. An executor may elect to value real property used in a family farm or business at its current use rather than at its highest and best use. The real property must be at least 25% of the adjusted gross estate. Real and personal property used in the farm or business must be at least 50%. The total value of property valued under special use valuation may not be decreased from FMV by more than $1,390,000 for decedents dying in 2024. Participation rules apply both before and after death. (IRC §2032A)

Gift Tax Return—Form 709

Cross References

- Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*
- IRC §2501–2524, *Gift Tax*
- IRC §2601–2663, *Generation-Skipping Transfer Tax*

Related Topics

- Imputed Interest on Below-Market Loans, Tab 3
- Basis and Holding Period Rules chart, page 6-3
- Qualified Tuition Programs (QTPs) and Education Savings Accounts (ESAs), page 12-5

Gift Tax

During life, a taxpayer who makes "taxable gifts" in the calendar year is required to file Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return.* Taxable gifts are generally amounts over the annual exclusion ($18,000 in 2024) to anyone other than a spouse or charity. Gift tax is calculated on the running total of taxable gifts made during the donor's lifetime. The current year tax is the difference between gift tax on all gifts from current and prior years and gift tax calculated on gifts from prior years.

Gift tax lifetime exclusion. Each taxpayer is allowed a combined exclusion for lifetime gifts and estate tax ($13,610,000 for 2024). For prior years, see *Estate and Gift Tax Exclusion, Credit, and Tax Rate* chart, page 21-1. No gift tax is owed until the taxpayer exhausts the exclusion by making cumulative taxable gifts of more than the gift and estate tax exclusion. See *Form 709 Gift Tax Return Examples,* page 21-28.

Special rule. For tax years 2018 through 2025, the estate and gift tax exclusion amount has temporarily doubled from $5 million to $10 million, adjusted for inflation. The IRS has issued regulations that provide a special rule that allows an estate to compute its estate tax credit using the higher of the exclusion amount applicable to gifts made during life, or on the date of death. [Reg. §20.2010-1(c)]

Example: During 2024, Karen made taxable gifts of $9 million, sheltered entirely from gift tax by her exclusion amount. If Karen dies in 2026, the credit to be applied in computing her estate tax is based on the $9 million exclusion amount used to compute her gift tax, not the $5 million exclusion amount applicable after 2025.

Gifts Subject to Gift Tax

Gift tax applies to any transfer by gift of real or personal property, made directly or indirectly, in trust, or by any other means. Gifts include transfers of cash, personal property, and payment of debts or expenses for another person. Certain transfers are excluded from gift tax. See *Gift Tax Exclusions,* page 21-26.

A gift is not subject to tax until the gift is complete. A gift is complete when the donor has parted with dominion and control so that he or she has no power to change its disposition. For most assets, the question of whether the donor parted with dominion and control is determined by state law. Gifts are valued on the date completed. See *Valuation,* page 21-24.

Annuities. A taxpayer entitled to an annuity for his or her life alone makes a gift by irrevocably electing to take a smaller annuity that includes a survivorship annuity. A spouse does not make a gift by waiving the right to a survivorship annuity prior to the death of a plan participant.

Below-market sale. Property transferred in part as a sale and in part as a gift is a gift from the seller of the difference between the FMV and the amount realized. The seller's capital gain is the difference between the amount realized and adjusted basis. A loss is not deductible [Reg. §1.1001-1(e)]. The buyer's basis is the greater of the amount paid or gift basis. (Reg. §1.1015-4)

Example: Nadya owns a cabin with a FMV of $200,000 and an adjusted basis of $50,000. She sells the property to her son, Jeremy, for $55,000. Nadya reports a capital gain of $5,000 on Form 1040 and a gift of $145,000 on Form 709. Jeremy's basis is $55,000 (assuming Nadya paid no gift tax on the gift). See *Basis of Gifts,* page 21-34.

Checks. Gifts by check are generally complete when the check is paid by the donor's bank. Some exceptions apply.

- ***Checks to charity.*** A gift is complete on the date the check is unconditionally delivered to the charity if the charity promptly presents the check, and it is actually paid by the donor's bank. In *Estate of Belcher v. Commissioner,* 83 T.C. 227 (1984), checks mailed prior to a decedent's death that cleared her bank after death were considered completed gifts before death.
- ***Checks to noncharity.*** A gift is completed on the date the donee deposits the check in his or her bank if the donor intended a gift, delivery was unconditional, the check was deposited within a reasonable time of issuance, the donor was alive when his or her bank made payment, and the check was honored by the donor's bank when first presented. A gift by check can be completed on an earlier date if under local law the donor has no power to change its disposition. (Rev. Rul. 96-56)

Municipal bonds. Gifts of municipal bonds are subject to gift tax even though income is exempt from income tax.

Stock. A gift is complete when the donor delivers an endorsed certificate to the donee or, if the certificate is delivered to a transfer agent or broker or shares are held in book entry, on the date the stock is transferred on the books of the corporation.

Trusts. A transfer to an irrevocable trust is a completed gift if the donor retains no power over the property. A transfer to a fully revocable trust is not a completed gift. For situations in the middle, where the donor retains some power over the trust but not a right to fully reclaim the assets, the facts in the particular case determine whether a gift has been completed. For examples, see Regulation sections 25.2511-1 and 25.2511-2.

Digital assets. Gift tax applies to transfers of digital assets. Digital assets are any digital representations of value that are recorded on a cryptographically secured distributed ledger or any similar technology. For example, digital assets include non-fungible tokens (NFTs) and virtual currencies, such as cryptocurrencies and stablecoins.

Form 709—digital assets question. A digital assets question must be answered by all taxpayers filing Form 709.

Loans

Debt forgiveness. If an individual makes a loan, and as part of a prearranged plan intends to forgive the debt, the debt is a gift at the time the loan is made. If there is no prearranged plan, the lender makes a gift when the loan is forgiven. If the lender does not enforce the debt when the borrower has resources to pay, a gift is made when the statute of limitations runs out. Cancellation of a debt intended as a gift is not taxable income to the borrower.

Below-market gift loans. If interest on a loan is less than the applicable federal rate (AFR), the foregone interest is a gift from the lender and considered taxable income to the lender.

Exceptions: If the borrower and lender are individuals, and the outstanding amount of all loans between them is:

continued on next page

- ***$10,000 or less.*** Foregone interest is not subject to gift tax and is not included in the lender's income. The loan cannot be used to purchase or carry income-producing assets.
- ***$100,000 or less.*** Foregone interest is not included in the lender's income if the borrower's net investment income for the year is $1,000 or less. If the borrower's investment income is more than $1,000, the interest taxable to the lender is limited to the borrower's net investment income. The primary purpose of the loan cannot be tax avoidance. This exception does not apply to gift tax because foregone interest is a gift from the lender.

A married couple is treated as one individual.

Gift tax. If the loan is to be outstanding for an ascertainable period of time (term loan), the lender makes a gift on the date of the loan of the difference between the amount loaned and the present value of all payments due under the loan. If the loan is payable in full at any time (demand loan), the lender makes a gift each year of the difference between interest charged and interest calculated under the applicable federal rate (AFR).

Income tax. Taxable foregone interest is reported annually for both demand and term loans. For term loans, use demand loan rules but the AFR in effect when the loan was made.

Applicable federal rates (IRC §1274). Find rates at: www.irs.gov/applicable-federal-rates

Joint Tenancies

The creation of a joint tenancy is a completed gift for some assets. For other assets, the gift is not complete until assets are withdrawn by the donee without obligation to account for the proceeds to the donor. If the donor can regain the entire property without the donee's consent, the creation of the joint tenancy is not a completed gift. The question of whether a gift is complete is generally determined by state law. Gifts are complete in most states as listed below.

Creation of a joint tenancy completes the gift for:
- Real property (if deed is recorded or delivered to donee).
- Stocks and mutual funds.
- U.S. Treasury securities other than U.S. Savings Bonds.

Withdrawal of assets from joint tenancy completes the gift for:
- Bank and credit union accounts.
- Brokerage accounts in street name.
- U.S. Savings Bonds. If a purchaser registers bonds with a co-owner, a gift is complete when the bonds are reissued in the co-owner's name alone or when the purchaser allows the co-owner to redeem the bonds and keep the proceeds. The purchaser is responsible for income tax on interest accrued through the date of the gift.

Example: In 2024, Marge changed ownership of her house and bank accounts to joint tenancy with her daughter, Lori. Since Lori is entitled under state law to half the proceeds should the house be sold, Marge has made a completed gift of one-half of the value of the house. The transfer of the bank accounts is not a completed gift because Lori made no withdrawals from the accounts in 2024.

Joint tenancies at death. If the original owner is still a joint tenant at death, the entire property is considered to be acquired from a decedent. Its full value is included in the gross estate for estate tax. If a gift was reported on Form 709 when the joint tenancy was created, the gift is excluded from adjusted taxable gifts reported on line 4, Form 706, and any gift tax paid is credited to the estate. The property receives stepped-up basis (unless acquired from a 2010 decedent whose estate elected modified carryover basis).

Life estates and remainders. The same rules apply when an owner reserves a life estate and transfers the remainder interest. The transfer is a gift. If the original owner is still a life tenant at death, the value of the entire property is included on Form 706. The taxable gift reported on Form 709 is not included on Form 706. The asset receives stepped-up basis (unless acquired from a 2010 decedent whose estate elected modified carryover basis).

Gift Tax Exclusions

The following transfers are specifically excluded from gift tax. The transfers are not reported on Form 709.

Qualified transfers for tuition or medical expenses. Payment must be made directly from the donor to the school or care provider. Payments made to a beneficiary do not qualify even if the payments reimburse the beneficiary for tuition or medical expenses. Payments made to a school or medical provider from a trust do not qualify (Reg. §25.2503-6). The donor and donee do not need to be related. There is no limit on the amount that can be transferred. An annual exclusion gift can also be made to the same beneficiary in the same year. Qualified medical expenses include any unreimbursed expenses that would be deductible medical expenses on Form 1040. Tuition qualifies if paid to a domestic or foreign institution that maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where it carries on its educational activities. Tuition can be for primary, secondary, or higher education and for part-time students. Books, room and board, and other expenses do not qualify. [IRC §2503(e)]

Political organizations. Transfers to political organizations defined in IRC section 527(e)(1) for the use of the organization are excluded from gift tax. [IRC §2501(a)(4)]

Qualified disclaimers (IRC §2518). A disclaimer is the refusal to accept a gift or inheritance. A person disclaiming does not make a gift for gift tax purposes if the disclaimer meets the following requirements.
- It is in writing, irrevocable, and unconditional.
- It is received by the donor, his or her legal representative, or the holder of legal title to the property within nine months of the transfer creating the interest or nine months after the disclaimant's 21st birthday, if later. Generally, this is nine months after a gift is completed or nine months after death.
- The disclaimant did not accept the interest or any of its benefits.
- As a result of the refusal, the interest passes without any direction from the disclaimant to the spouse of the decedent or a person other than the disclaimant.

Example: Emily's will leaves the residue of her estate to Shari, if living, otherwise to Anne. Shari disclaims one month after Emily's death. The residue passes under Emily's will to Anne without any gift tax consequences to Shari.

Annual Exclusion

The first $18,000 given to each recipient during calendar year 2024 is excluded from gift and estate tax. If more than $18,000 is given to one recipient, the amount over $18,000 is a taxable gift. Gifts must be present interests to qualify for the annual exclusion.

Present and future interests. A present interest is an unrestricted right to the immediate use, possession, or enjoyment of property or its income. An annual exclusion is not allowed if these rights will begin at some time in the future. A present interest requires a right to a substantial present economic benefit. A gift in trust is a present interest if the trust will receive income and an ascertainable portion will flow steadily to the beneficiary.

Example #1: Jo transfers securities into an irrevocable trust. Under the terms of the trust, Horace receives all trust income for life, and Sarah receives the securities at Horace's death. Horace has a present interest in the trust. Sarah has a future interest.

Example #2: Assume the same facts as Example #1, page 21-26, except that the trustee has discretion to pay income to Horace or accumulate it in the trust. Horace's interest is not a present interest.

For more examples, see Regulation section 25.2503-3.

Transfers that qualify as present interests.

- ***Transfers for minors.*** A gift to a custodial account or minor's trust is a present interest if: (1) property and income can be used for the minor before age 21, (2) remaining property passes to the minor at age 21, and (3) property will be paid to the minor's estate or to recipients he or she selects under a general power of appointment if the minor dies before age 21.
- ***Crummey powers.*** A Crummey power is a trust provision used to qualify transfers for the annual exclusion. Typically, beneficiaries are given a limited time to withdraw funds transferred to the trust. If beneficiaries receive notice and a reasonable time to exercise the right, the transfers qualify for the annual exclusion even though the beneficiaries never make withdrawals. (*D. Clifford Crummey et. al.,* 9th Cir., June 25, 1968)
- ***Qualified tuition plans.*** Gifts to qualified tuition plans are considered present interests.

5-year gifts to qualified tuition plans. A donor can contribute up to five times the annual exclusion on behalf of an individual and treat the gift as paid equally over five years ($90,000 for 2024). Make the election by checking the box on line B at the top of Form 709 (Schedule A), in the year of contribution. Attach a list of names, amounts contributed per individual, and amounts for which the election is made. Report 20% of the gift on Form 709 (Schedule A) each year. In years 2 through 5, list the calendar year of the return, not the year of the original contribution, as the date of the gift. Form 709 is not required for years 2 through 5 if the donor made no other taxable gifts. If the donor contributed more than $90,000 in 2024, the excess is reported in 2024.

Annual exclusion for noncitizen spouse. For 2024, the first $185,000 given to a spouse who is not a U.S. citizen is excluded from taxable gifts. Gifts must be present interests to qualify. The amount above $18,000 must also be a gift that would qualify for the marital deduction if the spouse was a citizen (i.e., the gift cannot be a nondeductible terminable interest). See *Marital Deduction,* page 21-22.

Noncitizen Spouse Annual Exclusion

Year of Gift	Annual Exclusion	Year of Gift	Annual Exclusion
2024	$185,000	2022	$164,000
2023	$175,000	2021	$159,000

Taxable Gifts

Gift tax rules do not prohibit a donor from making gifts in excess of the annual exclusion. There is no dollar limit on the amount that one person is allowed to give to another. When a donor makes a gift in excess of the annual exclusion, the amount over $18,000 (2024) is considered a "taxable gift."

Consequences of making taxable gifts:

- Donor is required to file a gift tax return (Form 709) for the year.
- Taxable gifts reduce the donor's $13,610,000 (2024) gift and estate tax exclusion. Gift tax is due once the exclusion is exhausted.
- Taxable gifts are added to the donor's taxable estate at death.

Donors with small estates can make gifts over the annual exclusion and pay no gift or estate tax.

Example #1: Kay wants to give her house to her daughter, Mary. The FMV of the house is $250,000. Kay's other assets total $175,000. The only tax consequence to Kay as a result of the gift is the requirement to file a gift tax return. Kay is unlikely to use her full gift tax exclusion and unlikely to pay estate tax at her death. Kay may be subject to the Medicaid 5-year look-back period if she needs nursing home care in the future. See *Medicaid and long-term care,* below.

Think Twice Before Giving

Basis. A disadvantage of making a gift of appreciated property rather than passing the property at death is that the basis of gift property does not step up to FMV at death.

Example #2: In Example #1, previous column, Mary's basis in the house is Kay's basis. Alternatively, if Mary inherited the house from Kay, Mary's basis would step up to FMV on the date of Kay's death. If Mary lives in the house for two years, she could exclude up to $250,000 gain upon its sale.

However, depreciated property is better gifted than inherited. For basis rules and examples, see *Basis of Gifts,* page 21-34.

Example: Bob paid $30,000 for stock that was worth only $20,000 when he died. Dylan inherits the stock and later sells it for $40,000. Dylan's basis is limited to FMV at Bob's death ($20,000). Dylan has a $20,000 capital gain. Now assume that Bob gifted the stock to Dylan when its value was $20,000. Although Dylan's basis for calculating loss is limited to $20,000, Dylan's basis for calculating gain is Bob's basis of $30,000. He has a $10,000 capital gain.

Future appreciation. If a donor anticipates a taxable estate, making a gift can remove future appreciation from the estate. The FMV of the gift is set at the time the gift is made.

Example: Diane gifted her cabin to her son, David, in 2010 when its value was $63,000. She reported a taxable gift of $50,000. Diane died in 2024 when the cabin was worth $280,000. The value of the property is not included in Diane's estate because she did not own the cabin at her death. Only the $50,000 taxable gift is included on Form 706. The disadvantage of the gift is that basis does not step up.

Medicaid and long-term care. Medicaid benefits for nursing home care are generally available only when a person has virtually no assets. Gifts made during the five years before applying for benefits can disqualify a person from receiving benefits for a period of time. Gift tax rules do not apply to Medicaid. There is no permissible amount that can be given to beneficiaries during the 5-year look-back period.

Author's Comment: Medicaid rules are complicated, vary by state, and change frequently. Clients who may require Medicaid, particularly married couples, should consult a lawyer before making gifts. Medicaid rules include protections for a person whose spouse requires nursing home care. Gifts can interfere with those protections.

Gifts of joint tenancies. A joint tenant inherits the joint property at death. Joint tenancies can pass property in ways not intended.

Example: Betty wants to avoid probate and make things easier for her eight children. She transfers her house and bank accounts into joint tenancy with her oldest son, John. Betty knows that John will do the right thing and share her assets with his siblings. At Betty's death, John sells the house and uses the money to pay his creditors.

Joint tenancies can cause problems for the original owner before death. Joint tenants have access to joint funds in a bank account. Joint tenants in real estate are generally entitled to an equal share of sale proceeds and can block a sale by refusing to sell. If a taxpayer transfers his or her principal residence into joint tenancy, the IRC section 121 gain exclusion does not apply to proceeds received by joint tenants who do not live in the home.

Example: After her husband died, Dorothy transferred her home into joint tenancy with her two adult children to avoid probate. Several years have passed, and Dorothy wants to sell her house and move to Florida with a friend. Her daughter and son do not want her to move and refuse to sell their shares of the house.

Life estates and remainders. This form of ownership is similar to joint tenancy and, like joint tenancy, is commonly used to avoid probating real estate. Life estates and remainders are typically created when the original owner deeds property to family members and includes language on the deed reserving a life estate. The original owner has the right to occupy and receive all income from the property until death. The family members who received the remainder interest have the right to full ownership of the property when the original owner dies. The property passes without probate. If the original owner is still a life tenant at death, the property receives stepped-up basis. The gift of the remainder interest is a completed gift in most states. If property is sold prior to the death of the life tenant, those owning the remainder are entitled to a share of the proceeds. Unlike a joint tenancy, the valuation of the respective shares is not a simple division but calculated based on life expectancy and interest rates. For more information on valuation, see *Annuities, life estates, and remainders,* page 21-24.

Form 709 Gift Tax Return Examples

Form 709 Examples — Page 21-28 through Page 21-30

Example #1: In 2024, Loretta gifted her cabin to her daughter, Lynn, when its FMV was $180,000. Loretta's basis was $20,000. Loretta also gave $25,000 to her church and $5,000 to her friend, Tanya.

Loretta is required to file Form 709 to report the gift of the cabin. Because she is required to file to report that gift, the gift to the church is also reported. The gift to Tanya is not reported because Tanya received a gift of a present interest of less than $18,000 (2024 annual exclusion). See *Form 709—2024 Filing Requirements,* page 21-3.

Loretta first completes Form 709 (Schedule A) (shown on page 21-29). She lists reportable gifts in Part 1 and claims exclusions and deductions in Part 4, *Taxable Gift Reconciliation* (shown on page 21-29). Loretta claims two annual exclusions on line 2—one for the gift to Lynn and another for the gift to the church. She claims a charitable deduction on line 7 for the portion of the gift to the church not excluded by the annual exclusion. Her taxable gifts on line 11 total $162,000. Loretta transfers that amount to line 1 on page 1, Form 709 (shown below). The gift tax calculation is shown in the Example 1 column. Loretta pays no gift tax but uses $42,640 of her gift and estate tax applicable credit to exclude tax on her 2024 gifts.

Example #2: Assume the same facts as Example #1, except that Loretta made taxable gifts of $80,000 in calendar year 2000. Form 709 (Schedule A) for current year gifts remains the same.

Form 709 (Schedule B) is required if the taxpayer filed a gift tax return in any prior year. Loretta reports the gift she made in 2000 on Schedule B (shown on page 21-29). If prior gifts total $500,000 or less, the amount of applicable credit actually applied in the prior year is listed in Column C. If prior gifts are more than $500,000, Column C amounts must be recalculated to factor in the current maximum rate of 40%. See Form 709 instructions.

Totals from Form 709 (Schedules A and B) are transferred to page 1, Form 709 (shown below). The gift tax calculation is shown in the Example 2 column:

- ***Line 4.*** Gift tax is first calculated on the total of all taxable gifts from current and prior years. Loretta reports tax of $68,240 on total gifts of $242,000.
- ***Line 5.*** Tax is then calculated on gifts from prior years only. Loretta reports tax of $18,200 on gifts of $80,000.
- ***Line 6.*** The current year tax is the difference between lines 4 and 5—$50,040.
- ***Lines 8–9.*** The applicable credit of $5,389,800 is reduced by $18,200 for credit Loretta used in 2000, leaving a balance of $5,371,600. Loretta pays no gift tax but uses $50,040 of her remaining applicable credit to exclude tax on 2024 gifts.

Draft as of September 12, 2024

Form **709** — Department of the Treasury, Internal Revenue Service

United States Gift (and Generation-Skipping Transfer) Tax Return

Go to *www.irs.gov/Form709* for instructions and the latest information.

(For gifts made during calendar year 2024)

OMB No. 1545-0020 — 2024

Part II Tax Computation

			Example	Example
1	Enter the amount from Schedule A, Part 4, line 11	1	162,000	162,000
2	Enter the amount from Schedule B, line 3	2	0	80,000
3	Total taxable gifts. Add lines 1 and 2	3	162,000	242,000
4	Tax computed on amount on line 3 (see *Table for Computing Gift Tax* in instructions)	4	42,640	68,240
5	Tax computed on amount on line 2 (see *Table for Computing Gift Tax* in instructions)	5	0	18,200
6	Balance. Subtract line 5 from line 4	6	42,640	50,040
7	Applicable credit amount. If donor has DSUE amount from predeceased spouse(s) or Restored Exclusion Amount, enter amount from Schedule C, line 5; otherwise, see instructions	7	5,389,800	5,389,800
8	Enter the applicable credit against tax allowable for all prior periods from Schedule B, line 1, col. (c)	8	0	18,200
9	Balance. Subtract line 8 from line 7. Do not enter less than zero	9	5,389,800	5,371,600
10	Enter 20% (0.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977. See instructions	10		
11	Balance. Subtract line 10 from line 9. Do not enter less than zero	11	5,389,800	5,371,600
12	Applicable credit. Enter the smaller of line 6 or line 11	12	42,640	50,040
13	Credit for foreign gift taxes. See instructions	13		
14	Total credits. Add lines 12 and 13	14	42,640	50,040
15	Balance. Subtract line 14 from line 6. Do not enter less than zero	15	0	0
16	Generation-skipping transfer taxes from Schedule D, Part 3, col. (g), total	16		
17	**Total tax.** Add lines 15 and 16	17		

Form 709 (2024) **For Example #1 and Example #2** *(page 21-28)* *Draft as of September 12, 2024* Page **3**

SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . ☐ Yes ☒ No

B If you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period, check here ☐. See instructions. Attach a statement.

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions.

(a) Item number	(b) Donee's name and address	(c) Relationship to donor (if any)	(d) Description of gift	(e) Donor's adjusted basis of gift	(f) Date of gift	(g) Value at date of gift	(h) For split gifts, enter 1/2 of column (g)	(i) Net transfer (subtract col. (h) from col. (g))	(j) Reserved for future use	(k) Charitable gift	(l) Deductible gift to spouse	(m) 2652(a)(3) election
1	Faith Church,		Cash	25,000	1/9/24	25,000		25,000	☐	☒	☐	☐
	Golden Valley, MN 55400								☐	☐	☐	☐
2	Lynn West,	Daughter	Cabin and Lot–480972	20,000	2/2/24	180,000		180,000	☐	☐	☐	☐
	St. Paul, MN 55100		Legal description and						☐	☐	☐	☐
			appraisal attached						☐	☐	☐	☐

Gifts made by spouse—*complete* ***only*** *if you are splitting gifts with your spouse and spouse also made gifts.*

									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐

Total of Part 1. Add amounts from Part 1, column (i) 205,000

(If more space is needed, attach additional statements.) Form **709** (2024)

Form 709 (2024) **For Example #1 and Example #2** *(page 21-28)* *Draft as of September 12, 2024* Page **6**

SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions) *(continued)*

Part 4—Taxable Gift Reconciliation

1	Total value of gifts of donor. Add totals from column (i) of Parts 1, 2, and 3			1	205,000
2	Total annual exclusions for gifts listed on line 1 (see instructions)			2	36,000
3	Total included amount of gifts. Subtract line 2 from line 1			3	169,000
	Deductions (see instructions)				
4	Gifts of interests to spouse for which a marital deduction will be claimed. Enter the total value of items on Parts 1 and 3 of Schedule A for which the box in column (l) is checked	4			
5	Exclusions attributable to gifts on line 4	5			
6	Marital deduction. Subtract line 5 from line 4	6			
7	Charitable deduction. Enter the total value of items on Parts 1 and 3 of Schedule A for which the box in column (k) is checked, less exclusions	7	7,000		
8	Total deductions. Add lines 6 and 7			8	7,000
9	Subtract line 8 from line 3			9	162,000
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule D, Part 3, col. (g), total)			10	
11	**Taxable gifts.** Add lines 9 and 10. Enter here and on page 1, Part II—Tax Computation, line 1			11	162,000

Form 709 (2024) **For Example #2 only** *(page 21-28)* *Draft as of September 12, 2024* Page **7**

SCHEDULE B Gifts From Prior Periods

If you answered "Yes" on line 18a of page 1, Part I, see the instructions for completing Schedule B. If you answered "No," skip to Part II, Tax Computation on page 1 (or Schedule C or D, if applicable). Complete Schedule A before beginning Schedule B. See instructions for recalculation of the column (c) amounts. Attach calculations.

(a) Calendar year or calendar quarter (see instructions)	(b) Internal Revenue office where prior return was filed	(c) Amount of applicable credit (unified credit) against gift tax for periods after December 31, 1976	(d) Amount of specific exemption for prior periods ending before January 1, 1977	(e) Amount of taxable gifts
2000	Kansas City, MO	18,200	0	80,000

1	Totals for prior periods	1	18,200		80,000
2	Amount, if any, by which total specific exemption, line 1, column (d), is more than $30,000			2	
3	Total amount of taxable gifts for prior periods. Add amount on line 1, column (e), and amount, if any, on line 2. Enter here and on page 1, Part II—Tax Computation, line 2			3	80,000

(If more space is needed, attach additional statements.) Form **709** (2024)

Gift Splitting

Married couples cannot file joint gift tax returns. Each spouse must file a return if he or she meets the filing requirements.

Election. Spouses can elect to split gifts if both spouses agree. If the election is made, all gifts made during the year by either spouse to third parties are considered made one-half by each spouse. Liability for gift tax of both spouses is joint and several.

Example: Sam gave his brother, John, $90,000 from his separate funds. Sam's wife, Janet, agrees to split gifts. Sam and Janet must each file separate gift tax returns (Form 709). Each reports half the gift ($45,000) on Form 709 (Schedule A) as shown below. Sam and Janet each claim an annual exclusion of $18,000 for the gift. Each reports a taxable gift of $27,000 on line 1, Form 709.

Joint gifts. Electing gift splitting is not needed if spouses make a gift of assets they hold as joint tenants, tenants by the entirety, or as community property. Gifts of these assets are considered to be made one-half by each spouse. Spouses elect gift splitting when a gift was made of an asset owned by only one spouse or from funds belonging to one spouse.

Requirements for gift splitting:

- Spouses were married to one another at the time of the gift.
- If divorced or widowed after the gift, they did not remarry in the same year.
- Neither spouse was a nonresident alien at the time of the gift.
- One spouse did not give the other a general power of appointment over the property transferred.

Reporting for gift splitting:

- Check box on line 19, Part I, Form 709, complete Part III, Form 709, and attach Notice of Consent (signed by consenting spouse).
- The Notice of Consent must be signed after the end of the calendar year and either (1) on or before April 15 or (2) on the first gift tax return filed by either spouse for the year. The consent cannot be signed after either spouse receives a notice of deficiency for gift tax for the year. An executor or guardian can sign for a deceased or legally incompetent spouse.
- Mail both gift tax returns in the same envelope.

New for 2024 ***Notice of Consent.*** A consenting spouse is no longer required to sign the return but must sign and date a Notice of Consent to be attached to the donor's return. The Notice of Consent must include a statement that the consenting spouse is electing to treat all gifts made to third parties as having been made one-half by each spouse.

Form 709 for consenting spouse not required. If only one spouse made gifts over $18,000, the consenting spouse is not required to file Form 709 if all gifts were presents interests and:

- Donor spouse did not give more than $36,000 to any one person, and
- Consenting spouse either made no gifts or gave $18,000 or less to other donees.

Form 709 (2024) ***Gift Splitting Example — Sam*** *(see above)* *Draft as of September 12, 2024* Page **3**

SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . X . . . ☐ Yes ☒ No

B If you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period, check here ☐. See instructions. Attach a statement.

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions.

(a) Item number	(b) Donee's name and address	(c) Relationship to donor (if any)	(d) Description of gift	(e) Donor's adjusted basis of gift	(f) Date of gift	(g) Value at date of gift	(h) For split gifts, enter 1/2 of column (g)	(i) Net transfer (subtract col. (h) from col. (g))	(j) Reserved for future use	(k) Charitable gift	(l) Deductible gift to spouse	(m) 2652(a)(3) election
1	John Evening, St. Cloud, MN	Brother	Cash	90,000	3/1/2024	90,000	45,000	45,000	☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
Total of Part 1. Add amounts from Part 1, column (i)								45,000				

(If more space is needed, attach additional statements.) Form **709** (2024)

Form 709 (2024) ***Gift Splitting Example — Janet*** *(see above)* *Draft as of September 12, 2024* Page **3**

SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . X . . . ☐ Yes ☒ No

B If you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period, check here ☐. See instructions. Attach a statement.

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions.

(a) Item number	(b) Donee's name and address	(c) Relationship to donor (if any)	(d) Description of gift	(e) Donor's adjusted basis of gift	(f) Date of gift	(g) Value at date of gift	(h) For split gifts, enter 1/2 of column (g)	(i) Net transfer (subtract col. (h) from col. (g))	(j) Reserved for future use	(k) Charitable gift	(l) Deductible gift to spouse	(m) 2652(a)(3) election
1	John Evening, St. Cloud, MN	Brother-in-law	Cash	90,000	3/1/2024	90,000	45,000	45,000	☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
									☐	☐	☐	☐
Total of Part 1. Add amounts from Part 1, column (i)								45,000				

(If more space is needed, attach additional statements.) Form **709** (2024)

Estate Tax Return—Form 706

Cross References

- Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*
- IRC §2001–2209, *Estate Tax*

Related Topics

- Life Insurance, Tab 3
- Section 403(b) Tax-Sheltered Annuity Plans, page 13-17

Gross Estate

The gross estate includes the value of all the decedent's property, real or personal, tangible or intangible, wherever situated. (IRC §2031)

The gross estate includes property that is part of the probate estate, property held in the decedent's revocable trust, property passing to beneficiaries and surviving joint tenants without probate, and earnings accrued through the date of death that were not paid until after death. The gross estate also includes any gifts that were incomplete on the date of death. See *Gifts Subject to Gift Tax,* page 21-25.

Form 706 filing requirements. See *Form 706—Estate Tax Return,* page 21-3.

Deceased spousal unused exclusion (DSUE). To elect portability of DSUE, fill out Part 6, of a timely filed Form 706. Taxpayers may also use Part 6 to opt out of electing to transfer any DSUE amount to a surviving spouse, calculate the amount of DSUE to be transferred with election, and account for any DSUE received from predeceased spouse(s). See *Portability of the deceased spousal unused exclusion (DSUE) election,* page 21-23.

Extension of time to file and pay. An automatic 6-month extension of time to file Form 706 and pay any estate tax due can be requested by filing Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes,* within nine months after the date of decedent's death.

Asset Schedules

Decedent's assets are reported on Form 706 (Schedules A through I). The schedules are summarized in the chart, next column. See Form 706 Instructions for more details.

- All assets held by the decedent as a joint tenant or tenant by the entirety are reported on Form 706 (Schedule E).
- All assets in decedent's revocable trust are reported on Form 706 (Schedule G).
- Other assets are reported on the schedule for the type of property owned. Community property is also reported on the schedule for the type of property owned. Report the full value and deduct the surviving spouse's community property interest.
- Enter accrued earnings for each asset as a separate, unnumbered line below the asset. For example, enter rent that was due but unpaid at death as an unnumbered entry below the property listed on Form 706 (Schedule A).

See *Valuation,* page 21-24.

Jointly owned property. Unless the surviving joint tenants can prove they provided consideration for their shares, the value of the entire property is included in the gross estate. If property was acquired by the decedent and other joint tenants as a gift or inheritance, the value included in the gross estate is its value divided by the number of tenants. (IRC §2040)

Qualified joint interests. If the decedent and his or her surviving spouse owned property as tenants by the entirety or as joint tenants, and they were the only joint tenants, one-half the value of the property is included in the estate. It does not matter which spouse provided consideration. [IRC §2040(b)]

Exceptions:

- Follow the general rule for joint tenancies created before 1977. Include the full value of the asset unless the surviving spouse can prove he or she provided consideration.
- Joint interests cannot be "qualified joint interests" if the surviving spouse is not a U.S. citizen, unless the surviving spouse is a U.S. resident who becomes a U.S. citizen before the due date for Form 706. [IRC §2056(d)(1) and (4)]

If a gift tax return was filed when the joint tenancy was created, see *Joint tenancies at death,* page 21-26.

Sch.	706 Assets Reported
A	**Real Estate** • Property owned by decedent. • Property decedent had contracted to purchase.
B	**Stocks and Bonds** • Stocks and bonds. • Municipal bonds exempt from income tax. • Mutual funds. • U.S. government bonds and securities.
C	**Mortgages, Notes, and Cash** • List in this order: – Mortgages payable to the decedent. – Promissory notes payable to the decedent. – Contracts by decedent to sell land. – Cash in possession (in purse, wallet, shoe box, etc.). – Cash in banks and other financial organizations.
D	**Insurance on the Decedent's Life** • Include only policies on decedent's life if: – Proceeds are paid to the estate. – Decedent owned the policy at death. – Proceeds are paid to a beneficiary, other than the estate, who is legally required to pay debts or taxes of the estate.
E	**Jointly Owned Property** • Qualified interests between spouses if they are the only tenants. • All other joint tenancies.
F	**Other Miscellaneous Property** • Income tax and other refunds. • Vehicles, household goods, and personal effects. • Debts owed to the decedent other than notes and mortgages. • MSAs and HSAs unless passing to a surviving spouse. • Life insurance policies owned by the decedent insuring the life of another. • QTIP election property made by a predeceased spouse. • Livestock, farm machinery, and crops. • Royalties, partnerships, and unincorporated businesses. • Digital assets, such as virtual currency.
G	**Transfers During Decedent's Life** • Entire value of property subject to a retained interest: – Life estate. – Reversionary interest more than 5% at transfer. – Revocable transfer. Include assets of any type owned by a revocable trust. • Property transferred within three years of death: – Life insurance policies. – Gift tax paid on gifts made within three years of death.
H	**Powers of Appointment** • Value of property for which the decedent possessed a general power of appointment on the date of death.
I	**Annuities** • IRAs, qualified plans, nonqualified annuities, pension plans.

continued on next page

Sch.	706 Deductions
J	**Funeral Expenses** • Expenses ordinarily allowed under applicable local law to be paid from probate assets. **Administrative Expenses—Property Subject to Claims** • Executor/personal representative fees. • Attorney fees. • Interest expense. • Miscellaneous expenses incurred in preserving and distributing the estate, including: – Appraiser and accountant fees. – Certain court costs. – Costs of storing or maintaining assets of the estate. • Expenses for selling assets only if the sale is necessary to: – Pay decedent's debts, the expenses of administration or taxes, or – Preserve the estate or carry out distribution. Taxes, including property taxes, are not deductible administrative expenses. See Form 706 (Schedule K), below. ***No double deduction.*** Administrative expenses cannot be claimed on both Form 706 and Form 1041.
K	**Debts of the Decedent Accrued Before Death** • Federal and state tax on income property includible on an income tax return of the decedent for a period before death. See Regulation section 20.2053-6. • Property tax accrued before death if the tax is an enforceable obligation of the decedent at death under state law. • Unpaid gift tax. • Medical bills if not claimed on decedent's final Form 1040. • Utility bills, credit card debt, and other debt. ***Double deduction allowed.*** Some Form 706 (Schedule K) expenses also qualify as income tax deductions (state tax, business expenses, etc.). These expenses are deductible on both Form 706 and Form 1041 (or other income tax return). **Mortgages and Liens on Property** • Indebtedness secured by a mortgage or other liens on property included in the gross estate.
L	**Net Losses During Administration** • Losses from casualties that occurred during administration and not reimbursed by insurance or otherwise. Do not deduct losses claimed as a deduction on a federal income tax return or depreciation in the value of securities or other property. **Administrative Expenses—Property Not Subject to Claims** Follow rules for Form 706 (Schedule J) administrative expenses.
M	**Bequests to Surviving Spouse – Marital Deduction** • Property that passes from decedent to surviving spouse.
O	**Charitable, Public, and Similar Gifts and Bequests** • Property transferred during life or by will for charitable purposes.
P	**Credit for Foreign Death Taxes** • Allowed only if the decedent was a citizen or resident of the United States. Exceptions apply.
Q	**Credit for Tax on Prior Transfers** • Credit for decedent who received property from an individual who died within 10 years before, or two years after, the decedent, on which estate tax was previously paid.
R	**Generation-Skipping Transfer Tax** • Imposed only on direct skips occurring at death.

Sch.	706 Other Schedules
U	**Qualified Conservation Easement Exclusion** • Include value of land that is subject to a qualified conservation easement.
PC	**Protective Claim for Refund** • Preserves the estate's right to a refund of tax paid on any amount included in the gross estate which would be deductible but has not been paid or otherwise will not meet the requirements until after the limitations period for filing the claim has passed.

Deductions

Total Form 706 (Schedule J) and Form 706 (Schedule K) deductions are limited to:

- The value of property subject to claims included in the gross estate, plus
- The amount paid from property not subject to claims but included in the gross estate. This amount must be paid before the deadline for the estate tax return (including extension).

Funeral expenses. Deductible expenses include any type of expense ordinarily allowed to be paid from probate assets under local law (e.g., mortuary, cremation, cemetery, flowers, luncheon, or clergy). Laws vary by state. Expenses for a tombstone, mausoleum, burial lot for a decedent and family, cemetery care, and transportation of the person accompanying the body are also allowed. (Reg. §20.2053-2)

Administrative expenses. Administrative expenses payable from property subject to claims are deducted on Form 706 (Schedule J). Expenses for administering property not subject to claims are deducted on Form 706 (Schedule L). See *Administrative expenses,* page 21-14.

Executor/personal representative (PR) fees. The amount for executor or PR fees must be allowed under local law and practice. No deduction is allowed if the personal representative waives his or her fee. A gift or bequest in lieu of fees is not deductible.

Attorney fees. Fees incidental to litigation incurred by the beneficiaries are not deductible.

Interest expenses. Expenses incurred after the decedent's death are deductible if they are reasonable, necessary to the administration of the estate, and allowable under local law. Interest on federal estate tax deficiency is deductible.

Property subject to claims. The local law under which the estate is being administered determines which property is subject to claims. Most estates are subject to the laws of the state where the decedent was domiciled at death. Most states have laws that protect certain assets from claims of creditors. If other assets are inadequate to pay the decedent's bills, these protected assets do not need to be used to pay creditor claims. Examples of assets generally not subject to claims are life insurance proceeds and the decedent's homestead. Rules vary by state.

Form 706 (Schedule L). Expenses deductible on Form 706 (Schedule L) are usually expenses incurred in the administration of a revocable trust. This may also include expenses for the collection of other assets or the transfer or clearance of title to other property included in the gross estate but not included in the decedent's probate estate. See Regulation section 20.2053-8 for examples. Expenses must be paid before the deadline for the estate tax return (including extensions).

Form 706 (Schedule PC), ***Protective Claim for Refund.*** Timely filing a protective claim for refund preserves the estate's right to claim a refund of tax paid based on the amount of an unresolved claim or expense that may not become deductible until after the limitation period ends. Form 706 (Schedule PC) cannot be filed separately. If the initial notice of the protective claim for refund is being submitted after Form 706 was filed, use Form 843, *Claim for Refund and Request for Abatement.*

State Death Tax

Estates are allowed an unlimited deduction on line 3b, Part 2, Form 706, for estate, inheritance, legacy, or succession taxes paid as the result of the decedent's death to any state or the District of Columbia. An anticipated amount can be deducted. Tax must be paid within four years (later in certain circumstances). (IRC §2058)

See *State Estate and Inheritance Tax,* page 21-2, for more information.

Deduction for Estate Tax Paid on IRD

Cross References

- Schedule A (Form 1040), *Itemized Deductions*
- Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return* IRC §691,
- *Recipients of income in respect of decedents*

Related Topics

- Other Itemized Deductions, Tab 4

Estates and beneficiaries can claim an income tax deduction for federal estate tax paid on income in respect of a decedent (IRD). [IRC §691(c)]

No deduction is allowed for estate tax paid to a state. For beneficiaries, the deduction is claimed as an Other Itemized Deduction on line 16, Schedule A (Form 1040), *Itemized Deductions.* For estates, the deduction is claimed on line 19, Form 1041. The deduction is claimed in the year(s) IRD is reported as taxable income by the estate or beneficiary.

Example: Polly died on April 13, 2024. Her estate filed Form 706, including the following assets and expenses.

Form 706 Schedule		
A	Houses and lot	$ 6,500,000
A	Condominium	2,260,000
B	Brokerage accounts	3,924,000
C	Bank accounts	1,875,000
C	Accrued interest 4/1 through 4/13	41,000
I	Rollover IRAs	2,400,000
	Total gross estate	$17,000,000
J	Funeral expenses	(15,000)
J	Attorneys' fees	(11,000)
K	State income tax	(2,700)
K	Tax preparation fee for 2023 Form 1040	(1,300)
	Allowable deductions	$ 30,000

IRD is gross income the decedent had a right to receive that was not paid until after death. IRD is included in the gross estate on Form 706 and is also taxable income on either the estate's Form 1041 or a beneficiary's Form 1040. The IRD in Polly's estate is the accrued interest of $41,000 and the IRA of $2,400,000. For other examples of IRD, see *Income in Respect of a Decedent (IRD),* page 21-8.

Deductions in respect of a decedent (DRD) are deductible expenses that were owed by the decedent at death but paid after death. DRDs are deductible on either Form 1041 or the beneficiary's Form 1040 and also deductible on Form 706 as claims against the estate. DRDs in Polly's estate are the state income tax of $2,700 and the tax preparation fee of $1,300.

Taxpayers reporting IRD in income are allowed an income tax deduction for federal estate tax paid on IRD, calculated as follows:

Calculate Net IRD—IRD minus DRDs:

Accrued interest	$ 41,000
IRA	2,400,000
Total IRD	2,441,000
State income tax	(2,700)
Tax preparation fee	(1,300)
Net IRD	$2,437,000

Calculate estate tax without net IRD. The gross estate ($17,000,000) without net IRD ($2,437,000) is $14,563,000. Calculate estate tax on this reduced amount on Form 706. Deductions must be recalculated to take into account the exclusion of net IRD.

	Form 706	*Estate Tax Without Net IRD*
Total gross estate	$17,000,000	$14,563,000
Total allowable deductions	(30,000)	(26,000)
Tentative taxable estate	16,970,000	14,537,000
State death tax deduction (4%)	(678,800)	(581,480)
Taxable estate	$16,291,200	$13,955,520
Gross estate tax	$ 6,462,280	$ 5,528,008
Applicable credit	(5,389,800)	(5,389,800)
Estate tax	$ 1,072,480	$ 138,208

Estate tax attributable to IRD is:

Form 706 estate tax	$ 1,072,480
Less estate tax without IRD	(138,208)
Deductible estate tax on IRD	$ 934,272

The beneficiaries required to report IRD are allowed the deduction. The estate received the bank accounts and reports interest of $41,000 on Form 1041. The deduction is allocated to the estate's IRD as follows:

$$\frac{\$41{,}000 \text{ IRD reported in 2024}}{\$2{,}441{,}000 \text{ Total IRD on Form 706}} \times \$934{,}272 \text{ deduction} = \$15{,}692$$

Polly's daughter, Anna, is the IRA beneficiary. She withdrew $200,000 in 2024. Her deduction is:

$$\frac{\$200{,}000 \text{ IRD reported in 2024}}{\$2{,}441{,}000 \text{ Total IRD on Form 706}} \times \$934{,}272 \text{ deduction} = \$76{,}548$$

The estate has reported all its IRD so the remaining deduction of $842,032 ($934,272 – $92,240) is Anna's. Anna can claim the deduction in future years as she includes her remaining $2,200,000 of IRD in income. She calculates her deduction using the final step, above, substituting current year taxable IRD for the $200,000 amount.

Basis

Cross References

- Form 8971, *Information Regarding Beneficiaries Acquiring Property From a Decedent*
- IRC §1014, *Basis of property acquired from a decedent*
- IRC §1015, *Basis of property acquired by gifts and transfers in trust*

Related Topics

- Basis and Holding Period Rules chart, page 6-3

Basis of Inherited Property

Generally, the basis of property acquired from a decedent is its fair market value (FMV) on the date of death or, if Form 706 was filed, the value of the property on Form 706. The Form 706 value may be different that the FMV if the estate elected alternate valuation or special-use valuation (IRC §1014). See *Alternate valuation* and *Special-use valuation,* page 21-24.

This basis rule is generally referred to as "stepped-up basis" although it applies whether the FMV at death is higher than the decedent's basis (stepped-up basis) or lower than decedent's basis (stepped-down basis). Stepped-up basis applies even if the decedent's estate is not required to file Form 706.

Property acquired from a decedent includes property included in the probate estate, property in the decedent's revocable trust, property passing by beneficiary designation, and other property includible on Form 706. Property acquired from a decedent can include a portion of co-owned property. See *Joint tenancies general rule,* page 21-34.

If only a portion of the property is includible on Form 706, only that portion receives stepped-up basis. For an exception, see *Community property,* page 21-34.

Stepped-up basis does not apply to:

- Annuities, including IRAs and retirement plans. (IRC §72)
- Income in respect of a decedent (IRD).
- Property in a foreign holding company if the date of death was before January 1, 2005.
- Appreciated property acquired by the decedent as a gift within one year of death if property passes back to original donor or his or her spouse. Basis is decedent's adjusted basis.
- Conservation easements.
- 2010 estates that elected modified carryover basis.
- Irrevocable trusts not included in decedent's gross estate. (Rev. Rul. 2023-2)

Basis substantiation. An executor of an estate required to file Form 706 must also separately file Form 8971, *Information Regarding Beneficiaries Acquiring Property From a Decedent,* and provide each beneficiary with that beneficiary's Form 8971 (Schedule A). Schedule A identifies the value of each property interest received as reported on Form 706. Form 8971 is not required if the gross estate plus adjusted taxable gifts is less than the exclusion amount or if Form 706 is filed solely to elect portability of the DSUE.

Form 8971 is due 30 days after the date on which Form 706 (including extensions) is required to be filed, or is actually filed.

Depreciation. The depreciable basis for inherited property (such as rental real estate) is its FMV on the date of death or the alternate valuation date if elected by the estate. Any prior cost basis or depreciation previously taken by the decedent is irrelevant.

Example: Lauren inherited her father's rental property in 2024. He originally paid $100,000 and had claimed $30,000 in depreciation prior to his date of death. His adjusted basis was $70,000. At the time of death, the property's FMV was $250,000, which is Lauren's basis in the inherited property. If Lauren continues to rent the property, she must claim depreciation using $250,000 as her basis.

Joint tenancies general rule. Generally, unless the surviving joint tenants can prove they provided consideration for their shares, the entire value of property held in joint tenancy is included on Form 706 and receives stepped-up basis.

Example: Ann moved her assets into a joint brokerage account with her son so he could inherit without probate. Since Ann provided all consideration, the value of the entire account is included on Form 706, and all assets receive stepped-up basis. If Ann's son had died before Ann, the account would not have been included on his Form 706, and the basis of the assets would not change at his death.

Qualified joint tenancies. If assets are owned by both spouses, one-half of their value is included on Form 706 at the death of the first spouse and that half receives stepped-up basis. It does not matter which spouse provided consideration for the asset. If there are any joint tenants other than the spouses, the general rule applies to the asset.

Exception: Follow the general rule for joint tenancies created before 1977.

Example #1: Ann owned a cabin when she married Roger in 1970. She transferred ownership to herself and Roger as joint tenants in 1975. Ann died in 2024. The entire value of the cabin is included on Ann's Form 706 and receives stepped-up basis.

Example #2: Assume the same facts as Example #1, above, except Roger and Ann married in 1980 and she transferred ownership in 1980. One-half of the value of the cabin is included on Ann's Form 706 and receives stepped-up basis.

Community property. The decedent's share of community property is included on Form 706 and receives stepped-up basis. The surviving spouse's one-half share of community property also receives stepped-up basis if at least one-half of the whole community interest is includible on Form 706. The interest must be defined as a community interest under state law. Joint tenancies in community property states may not qualify.

Life estates and remainder interests. If decedent owned entire property and gifted a remainder interest, the value of the entire property is included on Form 706 and receives stepped-up basis.

Example: Marge deeded her home to her children after her spouse died in 2006. She reserved a life estate in the property which gave her the right to occupy the property until her death. Her children will inherit the home without probate. The entire value of the home is included in Marge's Form 706 and receives stepped-up basis.

Tenancies in common. Tenants in common do not have the right to inherit property at the death of another tenant in common. The decedent's portion is a probate asset that passes by will or to the decedent's heirs. The decedent's portion is included on Form 706 and receives stepped-up basis. The basis of other tenants does not change.

Holding period. Assets acquired from a decedent are considered to be held for more than one year (long-term) even if sold within a year of death. List "Inherited" as the date acquired on Form 8949, *Sales and Other Dispositions of Capital Assets.*

Basis of Gifts

Basis of property received as a gift is the donor's adjusted basis at the time of the gift (IRC §1015). ***Exceptions:***

- **Gift of property that has decreased in value.** If the donor's adjusted basis was higher than the FMV at the time of the gift, the recipient's basis for calculating loss is the FMV at the time of the gift.

Example: Phyllis purchased stock for $15,000 and gave it to Terry when its FMV was $10,000. Terry's basis depends on the price received when she sells the stock.

- Sale for $20,000. Terry's basis for gain is $15,000.
- Sale for $8,000. Terry's basis for loss is $10,000.
- Sale for $12,000. When property is sold for less than the donor's basis, but more than FMV at the time of the gift, there is no gain or loss. Basis for gain is $15,000 so the sale for $12,000 produces no gain. Basis for loss is $10,000 so the sale for $12,000 produces no loss.

- **Gift tax paid.** Basis is increased for gift tax paid on appreciation. Basis is not increased for gift tax calculated on Form 709 that is offset by the donor's gift tax credit. Gifts made prior to 1977 are increased by gift tax paid on the entire gift (not just appreciation) up to FMV at the time of the gift.

Example: In 2024, Mark gave land valued at $100,000 to his daughter, Heidi. Mark reports a taxable gift of $82,000 on Form 709 ($100,000 – $18,000 annual exclusion). Mark exhausted his gift tax applicable credit prior to 2024 and pays gift tax of $32,800. Heidi's basis is Mark's basis of $70,000, plus gift tax of $12,000.

$100,000 FMV of gift – $70,000 Donor's basis = $30,000 Appreciation

$$\underset{\text{Gift tax paid}}{\$32{,}800} \times \frac{\$30{,}000\ \text{Appreciation}}{\$82{,}000\ \text{Taxable gift}} = \underset{\text{on appreciation}}{\$12{,}000\ \text{Gift tax}}$$

Adjustments. Gift basis is adjusted for increases and decreases during the time the property is held by the recipient. For example, a recipient's expenses for adding a deck to a house received as a gift increases his or her basis.

Holding period. The recipient's holding period also includes the donor's holding period. [IRC §1223(2)]

~ End ~