

Instructions for Form 1041 and Schedules A, B, D, G, I, J, and K-1

U.S. Income Tax Return for Estates and Trusts

Section references are to the Internal Revenue Code unless otherwise noted.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

| | Form 1041 | Schedule D | Schedule J | Schedule K-1 |
|---|-----------------|-----------------|-----------------|----------------|
| Recordkeeping | 46 hr., 38 min. | 23 hr., 41 min. | 39 hr., 28 min. | 8 hr., 51 min. |
| Learning about the law or the form | 18 hr., 54 min. | 2 hr., 9 min. | 1 hr., 12 min. | 1 hr., 17 min. |
| Preparing the form | 35 hr., 23 min. | 2 hr., 34 min. | 1 hr., 53 min. | 1 hr., 29 min. |
| Copying, assembling, and sending the form to the IRS | 4 hr., 17 min. | | | |

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the tax form to this address. Instead, see **Where To File** on page 4.

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Changes To Note

The Taxpayer Relief Act of 1997 (the Act) made several changes that affect estates and trusts. Some of the changes are highlighted below.

- The Act generally reduced the tax rates that apply to net capital gain for sales, exchanges, and conversions of assets (including installment payments received) after May 6, 1997. Schedule D, Schedule I, and Schedule K-1 have been revised to reflect the new tax rates and reporting of capital gains. For more details, see the instructions for Schedule D beginning on page 24.
- For estates of decedents dying after August 5, 1997, certain revocable trusts may be treated as part of the estate if the executor of the estate and the trustee of the trust elect such treatment. For more details, see page 3.
- For tax years beginning after August 5, 1997, the section 663(b) election to treat any amount paid or credited to a beneficiary within 65 days following the close of the tax year as being paid or credited on the last day of that year has been extended to decedents' estates.
- For estates of decedents dying after August 5, 1997, the rule that treats substantially separate and independent shares of different beneficiaries as separate trusts when figuring distributable net income has been extended to decedents' estates.
- For tax years beginning after August 5, 1997, an executor of an estate and a beneficiary of that estate generally are treated as related persons for purposes of sections 267 and 1239.
- For tax years ending after August 5, 1997, special rules apply to the taxation

of qualified funeral trusts for trustees that elect these rules. For details, see new **Form 1041-QFT**, U.S. Income Tax Return for Qualified Funeral Trusts.

- Employers that pay wages to long-term family assistance recipients may qualify for the welfare-to-work credit. This new credit is based on wages paid to qualified individuals who begin work after December 31, 1997, and is figured on **Form 8861**, Welfare-to-Work Credit.

Other changes that affect estates and trusts are as follows:

- A new definition of "domestic trust" applies for tax years beginning after 1996. For details, see **Who Must File** on page 3.

- For tax years beginning after 1996, the Small Business Job Protection Act of 1996 permitted a new type of trust, an electing small business trust (ESBT), to be a shareholder in an S corporation. An ESBT is an eligible trust that has made an election in accordance with Notice 97-12, 1997-3 I.R.B. 11, and that does not have as a beneficiary any person other than an individual, an estate, or a charity that holds a contingent remainder interest. The tax on the portion of the ESBT consisting of stock in 1 or more S corporations is figured separately from the tax on the remainder of the ESBT. Also, other special rules apply when figuring the tax. For more details, see the instructions on page 18 for Schedule G, line 8.

- For tax years beginning in 1997, the requirement to file a return for a bankruptcy estate applies only if gross income is at least \$6,100.

See **Pub. 553**, Highlights of 1997 Tax Changes, for more information.

Unresolved Tax Problems

The Problem Resolution Program is for taxpayers that have been unable to resolve their problems with the IRS. If the estate or trust has a tax problem it cannot clear up through normal channels, write to the estate's or trust's local IRS District Director, or call the local IRS office and ask for Problem Resolution assistance. Persons who have access to TTY/TDD equipment may call 1-800-829-4059 to ask for help from Problem Resolution. This office cannot change the tax law or technical decisions. But it can help clear up problems that resulted from previous contacts.

How To Get Forms and Publications

Personal Computer

Visit the IRS's Internet Web Site at **www.irs.ustreas.gov** to get:

- Forms and instructions
- Publications
- IRS press releases and fact sheets
You can also reach us using:
- Telnet at **iris.irs.ustreas.gov**

- File Transfer Protocol at **ftp.irs.ustreas.gov**

- Direct Dial (by modem). Dial direct to the Internal Revenue Information Services (IRIS) by calling **703-321-8020** using your modem. IRIS is an on-line information service on FedWorld.

CD-ROM

A CD-ROM containing over 2,000 tax products (including many prior year forms) can be purchased from the Government Printing Office (GPO). To order the CD-ROM, call the Superintendent of Documents at **202-512-1800**, or go through GPO's Internet Web Site (**www.access.gpo.gov/su_docs**).

Phone and in Person

To order forms and publications, call **1-800-TAX-FORM (1-800-829-3676)** between 7:30 a.m. and 5:30 p.m. on weekdays. You can also get most forms and publications at your local IRS office.

General Instructions

Purpose of Form

The fiduciary of a domestic decedent's estate, trust, or bankruptcy estate uses Form 1041 to report: **(a)** the income, deductions, gains, losses, etc. of the estate or trust; **(b)** the income that is either accumulated or held for future distribution or distributed currently to the beneficiaries; **(c)** any income tax liability of the estate or trust; and **(d)** employment taxes on wages paid to household employees.

Income Taxation of Trusts and Decedents' Estates

A trust (except a grantor type trust) or a decedent's estate is a separate legal entity for Federal tax purposes. A decedent's estate comes into existence at the time of death of an individual. A trust may be created during an individual's life (inter vivos) or at the time of his or her death under a will (testamentary). If the trust instrument contains certain provisions, then the person creating the trust (the grantor) is treated as the owner of the trust's assets. Such a trust is a grantor type trust.

A trust or decedent's estate figures its gross income in much the same manner as an individual. Most deductions and credits allowed to individuals are also allowed to estates and trusts. However, there is one major distinction. A trust or decedent's estate is allowed an income distribution deduction for distributions to beneficiaries. To figure this deduction, the fiduciary must complete Schedule B. The income distribution deduction determines the amount of any distributions taxed to the beneficiaries.

For this reason, a trust or decedent's estate sometimes is referred to as a "pass-through" entity. The beneficiary,

and not the trust or decedent's estate, pays income tax on his or her distributive share of income. Schedule K-1 (Form 1041) is used to notify the beneficiaries of the amounts to be included on their income tax returns.

Before preparing Form 1041, the fiduciary must figure the accounting income of the estate or trust under the will or trust instrument and applicable local law to determine the amount, if any, of income that is required to be distributed, because the income distribution deduction is based, in part, on that amount.

Abusive Trust Arrangements

Certain trust arrangements purport to reduce or eliminate Federal taxes in ways that are not permitted under the law. Abusive trust arrangements typically are promoted by the promise of tax benefits with no meaningful change in the taxpayer's control over or benefit from the taxpayer's income or assets. The promised benefits may include reduction or elimination of income subject to tax; deductions for personal expenses paid by the trust; depreciation deductions of an owner's personal residence and furnishings; a stepped-up basis for property transferred to the trust; the reduction or elimination of self-employment taxes; and the reduction or elimination of gift and estate taxes. These promised benefits are inconsistent with the tax rules applicable to abusive trust arrangements.

Abusive trust arrangements often use trusts to hide the true ownership of assets and income or to disguise the substance of transactions. These arrangements frequently involve more than one trust, each holding different assets of the taxpayer (e.g., the taxpayer's business, business equipment, home, automobile, etc.). Some trusts may hold interests in other trusts, purport to involve charities, or are foreign trusts. Funds may flow from one trust to another trust by way of rental agreements, fees for services, purchase agreements, and distributions.

Some of the abusive trust arrangements that have been identified include unincorporated business trusts (or organizations), equipment or service trusts, family residence trusts, charitable trusts, and final trusts. In each of these trusts, the original owner of the assets that are nominally subject to the trust effectively retains the authority to cause financial benefits of the trust to be directly or indirectly returned or made available to the owner. For example, the trustee may be the promoter, or a relative or friend of the owner who simply carries out the directions of the owner whether or not permitted by the terms of the trust.

When trusts are used for legitimate business, family, or estate planning purposes, either the trust, the beneficiary, or the transferor to the trust will pay the tax on income generated by the trust property. Trusts cannot be used to

transform a taxpayer's personal, living, or educational expenses into deductible items, and will not seek to avoid tax liability by ignoring either the true ownership of income and assets or the true substance of transactions. Therefore, the tax results promised by the promoters of abusive trust arrangements are not allowable under the law and the participants in and promoters of these arrangements may be subject to civil or criminal penalties in appropriate cases.

For more details, including the legal principles that control the proper tax treatment of these abusive trust arrangements, see Notice 97-24, 1997-16 I.R.B. 6.

Definitions

Beneficiary

A beneficiary includes an heir, a legatee, or a devisee.

Distributable Net Income (DNI)

The income distribution deduction allowable to estates and trusts for amounts paid, credited, or required to be distributed to beneficiaries is limited to distributable net income (DNI). This amount, which is figured on Schedule B, line 7, is also used to determine how much of an amount paid, credited, or required to be distributed to a beneficiary will be includible in his or her gross income.

Income, Deductions, and Credits in Respect of a Decedent

Income. When completing Form 1041, you must take into account any items that are income in respect of a decedent (IRD).

In general, income in respect of a decedent is income that a decedent was entitled to receive but that was not properly includible in the decedent's final income tax return under the decedent's method of accounting.

IRD includes:

- All accrued income of a decedent who reported his or her income on the cash method of accounting;
- Income accrued solely because of the decedent's death in the case of a decedent who reported his or her income on the accrual method of accounting; and
- Income to which the decedent had a contingent claim at the time of his or her death.

Some examples of IRD of a decedent who kept his or her books on the cash method are:

- Deferred salary payments that are payable to the decedent's estate.
- Uncollected interest on U.S. savings bonds.
- Proceeds from the completed sale of farm produce.
- The portion of a lump sum distribution to the beneficiary of a decedent's IRA that equals the balance in the IRA at the time

of the owner's death. This includes unrealized appreciation and income accrued to that date, less the aggregate amount of the owner's nondeductible contributions to the IRA. Such amounts are included in the beneficiary's gross income in the tax year that the distribution is received.

The IRD has the same character it would have had if the decedent lived and received such amount.

Deductions and credits. The following deductions and credits, when paid by the decedent's estate, are allowed on Form 1041 even though they were not allowable on the decedent's final income tax return:

- Business expenses deductible under section 162.
- Interest deductible under section 163.
- Taxes deductible under section 164.
- Investment expenses described in section 212 (in excess of 2% of AGI).
- Percentage depletion allowed under section 611.
- Foreign tax credit.

For more information, see section 691.

Income Required To Be Distributed Currently

Income required to be distributed currently is income that is required under the terms of the governing instrument and applicable local law to be distributed in the year it is received. The fiduciary must be under a duty to distribute the income currently, even if the actual distribution is not made until after the close of the trust's tax year. See Regulations section 1.651(a)-2.

Fiduciary

A fiduciary is a trustee of a trust; or an executor, executrix, administrator, administratrix, personal representative, or person in possession of property of a decedent's estate.

Note: *Any reference in these instructions to "you" means the fiduciary of the estate or trust.*

Trust

A trust is an arrangement created either by a will or by an inter vivos declaration by which trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.

Who Must File

Decedent's Estate

The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic estate that has:

- **1.** Gross income for the tax year of \$600 or more, or
- **2.** A beneficiary who is a nonresident alien.

An estate is a **domestic estate** if it is **not** a foreign estate. A **foreign estate** is one the income of which, from sources

outside the United States that is not effectively connected with the conduct of a U.S. trade or business, is not includible in gross income. If you are the fiduciary of a foreign estate, file **Form 1040NR**, U.S. Nonresident Alien Income Tax Return, instead of Form 1041.

Trust

The fiduciary (or one of the joint fiduciaries) must file Form 1041 for a domestic trust taxable under section 641 that has:

- **1.** Any taxable income for the tax year, or
- **2.** Gross income of \$600 or more (regardless of taxable income), or
- **3.** A beneficiary who is a nonresident alien.

Two or more trusts are treated as one trust if such trusts have substantially the same grantor(s) and substantially the same primary beneficiary(ies), and a principal purpose of such trusts is avoidance of tax. This provision applies only to that portion of the trust that is attributable to contributions to corpus made after March 1, 1984.

A trust is a **domestic trust** if:

- A U.S. court is able to exercise primary supervision over the administration of the trust, and
- One or more U.S. persons have the authority to control all substantial decisions of the trust.

A trust that is not a domestic trust is treated as a foreign trust. If you are the fiduciary of a foreign trust, file Form 1040NR instead of Form 1041. The above definition of a domestic trust generally applies to tax years beginning after 1996. However, a trust in existence on August 20, 1996, that was treated as a domestic trust under prior law, may continue to file as a domestic trust for tax years beginning after 1996, if the trust meets the conditions in Notice 96-65, 1996-2 C.B. 232.

If a domestic trust becomes a foreign trust, it is treated under section 684 as having transferred all of its assets to a foreign trust, except to the extent a grantor or another person is treated as the owner of the trust when the trust becomes a foreign trust.

Special Rule for Certain Revocable Trusts

For the estates of decedents dying after August 5, 1997, new section 646 provides that the executor of an estate **and** the trustee of a qualified revocable trust can elect to treat the trust as part of the estate instead of filing a separate Form 1041 for the trust. The election applies to all tax years of the estate ending after the date of the decedent's death and before the applicable date, as defined below. Once made, the election is irrevocable.

Qualified revocable trusts. A qualified revocable trust for this purpose is any trust or portion of a trust that is treated under section 676, because of a power in

the grantor of the trust, as owned by the decedent whose estate is making the election. For this purpose, a power does not include any power in the grantor that is treated as held by the grantor because it is held by his or her spouse.

Applicable date. The applicable date is either:

- If the estate is required to file a Federal estate tax return, the date that is 6 months after the date of the final determination of the Federal estate tax liability, or
- If the estate is not required to file a Federal estate tax return, the date that is 2 years after the date of the decedent's death.

Making the election. The election must be made no later than the due date, including extensions, for filing the Form 1041 of the estate for its first tax year.

At the time these instructions were printed, rules for making the election had not been issued.

Bankruptcy Estate

The bankruptcy trustee or debtor-in-possession must file Form 1041 for the estate of an individual involved in bankruptcy proceedings under chapter 7 or 11 of title 11 of the United States Code if the estate has gross income for the tax year of \$6,100 or more. See **Of Special Interest To Bankruptcy Trustees and Debtors-in-Possession** on page 7 for other details.

Qualified Settlement Funds

The trustee of a designated or qualified settlement fund must file **Form 1120-SF**, U.S. Income Tax Return for Settlement Funds, rather than Form 1041. See Regulations section 1.468B-5.

Electronic and Magnetic Media Filing

Qualified fiduciaries or transmitters may be able to file Form 1041 and related schedules electronically or on magnetic media. Tax return data may be filed electronically using telephone lines or on magnetic media using magnetic tape or floppy diskette.

If you wish to do this, you must file **Form 9041**, Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns. If you file Form 1041 electronically or on magnetic media, you must also file **Form 8453-F**, U.S. Estate or Trust Income Tax Declaration and Signature for Electronic and Magnetic Media Filing. For more details, get **Pub. 1437**, Procedures for Electronic and Magnetic Media Filing of U.S. Income Tax Returns for Estates and Trusts, Form 1041 for 1997, and **Pub. 1438**, File Specifications, Validation Criteria, and Record Layouts for Electronic and Magnetic Media Filing of Estate and Trust Returns, Form 1041. To order these forms and publications, or for more information on electronic and magnetic media filing of Form 1041, call the Magnetic Media

Unit at the Philadelphia Service Center at (215) 516-7533 (not a toll-free number), or write to:

Internal Revenue Service Center
Attention: Magnetic Media Unit-DP 115
11601 Roosevelt Blvd.
Philadelphia, PA 19154

When To File

For calendar year estates and trusts, file Form 1041 and Schedules K-1 on or before April 15, 1998. For fiscal year estates and trusts, file Form 1041 by the 15th day of the 4th month following the close of the tax year. If the due date falls on a Saturday, Sunday, or legal holiday, file on the next business day. For example, an estate that has a tax year that ends on June 30, 1998, must file Form 1041 by October 15, 1998.

Private Delivery Services

You can use certain private delivery services designated by the IRS to meet the "timely mailing as timely filing/paying" rule for tax returns and payments. The IRS publishes a list of the designated private delivery services in September of each year. The list published in September 1997 includes only the following:

- Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, Second Day Service.
- DHL Worldwide Express (DHL): DHL "Same Day" Service, DHL USA Overnight.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day.
- United Parcel Service (UPS): UPS Next Day Air, Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M.

The private delivery service can tell you how to get written proof of the mailing date.

Extension of Time To File

Estates. Use **Form 2758**, Application for Extension of Time To File Certain Excise, Income, Information, and Other Returns, to apply for an extension of time to file.

Trusts. Use **Form 8736**, Application for Automatic Extension of Time To File U.S. Return for a Partnership, REMIC, or for Certain Trusts, to request an automatic 3-month extension of time to file.

If more time is needed, file **Form 8800**, Application for Additional Extension of Time To File U.S. Return for a Partnership, REMIC, or for Certain Trusts, for an additional extension of up to 3 months. To obtain this additional extension of time to file, you must show reasonable cause for the additional time you are requesting. Form 8800 must be filed by the extended due date for Form 1041.

Period Covered

File the 1997 return for calendar year 1997 and fiscal years beginning in 1997

and ending in 1998. If the return is for a fiscal year or a short tax year, fill in the tax year space at the top of the form.

The 1997 Form 1041 may also be used for a tax year beginning in 1998 if:

- **y1.** The estate or trust has a tax year of less than 12 months that begins and ends in 1998; and
- **y2.** The 1998 Form 1041 is not available by the time the estate or trust is required to file its tax return. However, the estate or trust must show its 1998 tax year on the 1997 Form 1041 and incorporate any tax law changes that are effective for tax years beginning after December 31, 1997.

Where To File

For all estates and trusts, except charitable and split-interest trusts and pooled income funds:

| If you are located in | Please mail to the following Internal Revenue Service Center |
|---|--|
| ▼ | ▼ |
| New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester) | Holtsville, NY 00501 |
| New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont | Andover, MA 05501 |
| Florida, Georgia, South Carolina | Atlanta, GA 39901 |
| Indiana, Kentucky, Michigan, Ohio, West Virginia | Cincinnati, OH 45999 |
| Kansas, New Mexico, Oklahoma, Texas | Austin, TX 73301 |
| Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming | Ogden, UT 84201 |
| California (all other counties), Hawaii | Fresno, CA 93888 |
| Illinois, Iowa, Minnesota, Missouri, Wisconsin | Kansas City, MO 64999 |
| Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee | Memphis, TN 37501 |
| Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, any U.S. possession, or foreign country | Philadelphia, PA 19255 |

For a charitable or split-interest trust described in section 4947(a) and a pooled income fund defined in section 642(c)(5):

| If you are located in | Please mail to the following Internal Revenue Service Center |
|---|--|
| ▼ | ▼ |
| Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee | Atlanta, GA 39901 |
| Arizona, Colorado, Kansas, New Mexico, Oklahoma, Texas, Utah, Wyoming | Austin, TX 73301 |
| Indiana, Kentucky, Michigan, Ohio, West Virginia | Cincinnati, OH 45999 |
| Alaska, California, Hawaii, Idaho, Nevada, Oregon, Washington | Fresno, CA 93888 |
| Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont | Holtsville, NY 00501 |
| Illinois, Iowa, Minnesota, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wisconsin | Kansas City, MO 64999 |
| Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia, any U.S. possession, or foreign country | Philadelphia, PA 19255 |

Who Must Sign

Fiduciary

The fiduciary, or an authorized representative, must sign Form 1041.

A financial institution that submitted estimated tax payments for trusts for which it is the trustee must enter its EIN in the space provided for the EIN of the fiduciary. Do not enter the EIN of the trust. For this purpose, a financial institution is one that maintains a Treasury Tax and Loan account. If you are an attorney or other individual functioning in a fiduciary capacity, leave this space blank. DO NOT enter your individual social security number (SSN).

If you, as fiduciary, fill in Form 1041, leave the Paid Preparer's space blank. If someone prepares this return and does not charge you, that person should not sign the return.

Paid Preparer

Generally, anyone who is paid to prepare a tax return must sign the return and fill in the other blanks in the Paid Preparer's Use Only area of the return.

The person required to sign the return must complete the required preparer information and:

- Sign it in the space provided for the preparer's signature. A facsimile signature is acceptable if certain conditions are met. See Regulations section 1.6695-1(b)(4)(iv) for details.
- Give you a copy of the return in addition to the copy to be filed with the IRS.

Accounting Methods

Figure taxable income using the method of accounting regularly used in keeping

the estate's or trust's books and records. Generally, permissible methods include the cash method, the accrual method, or any other method authorized by the Internal Revenue Code. In all cases, the method used must clearly reflect income.

Generally, the estate or trust may change its accounting method (for income as a whole or for any material item) only by getting consent on **Form 3115, Application for Change in Accounting Method**. For more information, see **Pub. 538, Accounting Periods and Methods**.

Accounting Periods

For a decedent's estate, the moment of death determines the end of the decedent's tax year and the beginning of the estate's tax year. As executor or administrator, you choose the estate's tax period when you file its first income tax return. The estate's first tax year may be any period of 12 months or less that ends on the last day of a month. If you select the last day of any month other than December, you are adopting a fiscal tax year.

To change the accounting period of an estate, get **Form 1128, Application To Adopt, Change, or Retain a Tax Year**.

Generally, a trust must adopt a calendar year. The following trusts are exempt from this requirement:

- A trust that is exempt from tax under section 501(a);
- A charitable trust described in section 4947(a)(1); and
- A trust that is treated as wholly owned by a grantor under the rules of sections 671 through 679.

Rounding Off to Whole Dollars

You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop amounts less than 50 cents and increase any amounts from 50 to 99 cents to the next dollar.

Estimated Tax

Generally, an estate or trust must pay estimated income tax for 1998 if it expects to owe, after subtracting any withholding and credits, at least \$1,000 in tax, and it expects the withholding and credits to be less than the smaller of:

- 90% of the tax shown on the 1998 tax return, or
- 100% of the tax shown on the 1997 tax return

However, if a return was not filed for 1997 or that return did not cover a full 12 months, item 2 does not apply.

For this purpose, include household employment taxes in the tax shown on the tax return, but **only if either** of the following is true:

- The estate or trust will have Federal income tax withheld for 1998 (see the instructions on page 15 for line 25e), or

- The estate or trust would be required to make estimated tax payments for 1998 even if it **did not** include household employment taxes when figuring estimated tax.

Exceptions

Estimated tax payments are not required from:

- **y1.** An estate of a domestic decedent or a domestic trust that had no tax liability for the full 12-month 1997 tax year;
- **y2.** A decedent's estate for any tax year ending before the date that is 2 years after the decedent's death; or
- **y3.** A trust that was treated as owned by the decedent if the trust will receive the residue of the decedent's estate under the will (or if no will is admitted to probate, the trust primarily responsible for paying debts, taxes, and expenses of administration) for any tax year ending before the date that is 2 years after the decedent's death.

For more information, see **Form 1041-ES, Estimated Income Tax for Estates and Trusts**.

Section 643(g) Election

Fiduciaries of trusts that pay estimated tax may elect under section 643(g) to have any portion of their estimated tax payments allocated to any of the beneficiaries.

The fiduciary of a decedent's estate may make a section 643(g) election only for the final year of the estate.

See the instructions for line 25b for more details.

Interest and Penalties

Interest

Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted.

Interest is also charged on the failure-to-file penalty, the accuracy-related penalty, and the fraud penalty. The interest charge is figured at a rate determined under section 6621.

Late Filing of Return

The law provides a penalty of 5% a month, or part of a month, up to a maximum of 25%, for each month the return is not filed. The penalty is imposed on the net amount due. If the return is more than 60 days late, the minimum penalty is the smaller of \$100 or the tax due. The penalty will not be imposed if you can show that the failure to file on time was due to reasonable cause. If the failure is due to reasonable cause, attach an explanation to the return.

Late Payment of Tax

Generally, the penalty for not paying tax when due is $\frac{1}{2}$ of 1% of the unpaid amount for each month or part of a month it remains unpaid. The maximum penalty is 25% of the unpaid amount. The penalty is imposed on the net amount due. Any

penalty is in addition to interest charges on late payments.

Note: *If you include interest or either of these penalties with your payment, identify and enter these amounts in the bottom margin of Form 1041, page 1. Do not include the interest or penalty amount in the balance of tax due on line 28.*

Failure To Provide Information Timely

You must provide Schedule K-1 (Form 1041), on or before the day you are required to file Form 1041, to each beneficiary who receives a distribution of property or an allocation of an item of the estate.

For each failure to provide Schedule K-1 to a beneficiary when due and each failure to include on Schedule K-1 all the information required to be shown (or the inclusion of incorrect information), a \$50 penalty may be imposed with regard to each Schedule K-1 for which a failure occurs. The maximum penalty is \$100,000 for all such failures during a calendar year. If the requirement to report information is intentionally disregarded, each \$50 penalty is increased to \$100 or, if greater, 10% of the aggregate amount of items required to be reported, and the \$100,000 maximum does not apply.

The penalty will not be imposed if the fiduciary can show that not providing information timely was due to reasonable cause and not due to willful neglect.

Underpaid Estimated Tax

If the fiduciary underpaid estimated tax, use **Form 2210**, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, to figure any penalty. Enter the amount of any penalty on line 27, Form 1041.

Trust Fund Recovery Penalty

This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid to the IRS. These taxes are generally reported on Forms 720, 941, 943, or 945. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been **responsible** for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the instructions for Form 720, **Pub. 15 (Circular E)**, Employer's Tax Guide, or **Pub. 51 (Circular A)**, Agricultural Employer's Tax Guide, for more details, including the definition of responsible persons.

Other Penalties

Other penalties can be imposed for negligence, substantial understatement of tax, and fraud. See **Pub. 17**, Your Federal Income Tax, for details on these penalties.

Other Forms That May Be Required

Forms W-2 and W-3, Wage and Tax Statement; and Transmittal of Wage and Tax Statements.

Form 56, Notice Concerning Fiduciary Relationship.

Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return; or **Form 706-NA**, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States.

Form 706-GS(D), Generation-Skipping Transfer Tax Return For Distributions.

Form 706-GS(D-1), Notification of Distribution From a Generation-Skipping Trust.

Form 706-GS(T), Generation-Skipping Transfer Tax Return for Terminations.

Form 720, Quarterly Federal Excise Tax Return. Use Form 720 to report environmental excise taxes, communications and air transportation taxes, fuel taxes, luxury tax on passenger vehicles, manufacturers' taxes, ship passenger tax, and certain other excise taxes.

Caution: See *Trust Fund Recovery Penalty* on page 5.

Form 940 or **Form 940-EZ**, Employer's Annual Federal Unemployment (FUTA) Tax Return. The estate or trust may be liable for FUTA tax and may have to file Form 940 or 940-EZ if it paid wages of \$1,500 or more in any calendar quarter during the calendar year (or the preceding calendar year) or one or more employees worked for the estate or trust for some part of a day in any 20 different weeks during the calendar year (or the preceding calendar year).

Form 941, Employer's Quarterly Federal Tax Return. Employers must file this form quarterly to report income tax withheld on wages and employer and employee social security and Medicare taxes. Agricultural employers must file **Form 943**, Employer's Annual Tax Return for Agricultural Employees, instead of Form 941, to report income tax withheld and employer and employee social security and Medicare taxes on farmworkers.

Caution: See *Trust Fund Recovery Penalty* on page 5.

Form 945, Annual Return of Withheld Federal Income Tax. Use this form to report income tax withheld from nonpayroll payments, including pensions, annuities, IRAs, gambling winnings, and backup withholding.

Caution: See *Trust Fund Recovery Penalty* on page 5.

Form 1040, U.S. Individual Income Tax Return.

Form 1040NR, U.S. Nonresident Alien Income Tax Return.

Form 1041-A, U.S. Information Return—Trust Accumulation of Charitable Amounts.

Forms 1042 and 1042-S, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the United States that is not effectively connected with a U.S. trade or business. For more information, see sections 1441 and 1442, and **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

Forms 1099-A, B, INT, LTC, MISC, MSA, OID, R, and S. You may have to file these information returns to report acquisitions or abandonments of secured property; proceeds from broker and barter exchange transactions; interest payments; payments of long-term care and accelerated death benefits; miscellaneous income payments; distributions from a medical savings account; original issue discount; distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, insurance contracts, etc.; and proceeds from real estate transactions.

Also, use certain of these returns to report amounts received as a nominee on behalf of another person, except amounts reported to beneficiaries on Schedule K-1 (Form 1041).

Form 8275, Disclosure Statement. File Form 8275 to disclose items or positions, except those contrary to a regulation, that are not otherwise adequately disclosed on a tax return. The disclosure is made to avoid parts of the accuracy-related penalty imposed for disregard of rules or substantial understatement of tax. Form 8275 is also used for disclosures relating to preparer penalties for understatements due to unrealistic positions or disregard of rules.

Form 8275-R, Regulation Disclosure Statement, is used to disclose any item on a tax return for which a position has been taken that is contrary to Treasury regulations.

Forms 8288 and 8288-A, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests; and Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests. Use these forms to report and transmit withheld tax on the sale of U.S. real property by a foreign person. Also, use these forms to report and transmit tax withheld from amounts distributed to a foreign beneficiary from a "U.S. real property interest account" that a domestic estate or trust is required to establish under Regulations section 1.1445-5(c)(1)(iii).

Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than \$10,000 in cash or foreign currency in one

transaction (or a series of related transactions).

Attachments

If you need more space on the forms or schedules, attach separate sheets. Use the same size and format as on the printed forms. **But show the totals on the printed forms.**

Attach these separate sheets after all the schedules and forms. Enter the estate's or trust's EIN on each sheet.

Do not file a copy of the decedent's will or the trust instrument unless the IRS requests it.

Additional Information

The following publications may assist you in preparing Form 1041.

Pub. 550, Investment Income and Expenses; and

Pub. 559, Survivors, Executors, and Administrators.

Of Special Interest to Bankruptcy Trustees and Debtors-in-Possession

Taxation of Bankruptcy Estates of an Individual

A bankruptcy estate is a separate taxable entity created when an individual debtor files a petition under either chapter 7 or 11 of title 11 of the U.S. Code. The estate is administered by a trustee or a debtor-in-possession. If the case is later dismissed by the bankruptcy court, the debtor is treated as if the bankruptcy petition had never been filed. This provision does NOT apply to partnerships or corporations.

Who Must File

Every trustee (or debtor-in-possession) for an individual's bankruptcy estate under chapter 7 or 11 of title 11 of the U.S. Code must file a return if the bankruptcy estate has gross income of \$6,100 or more for tax years beginning in 1997.

Failure to do so may result in an estimated Request for Administrative Expenses being filed by the IRS in the bankruptcy proceeding or a motion to compel filing of the return.

Important: *The filing of a tax return for the bankruptcy estate does not relieve the individual debtor of his or her (or their) individual tax obligations.*

Employer Identification Number

Every bankruptcy estate of an individual required to file a return must have its own employer identification number (EIN). The

social security number (SSN) of the individual debtor cannot be used as the EIN for the bankruptcy estate.

Accounting Period

A bankruptcy estate is allowed to have a fiscal year. The period can be no longer than 12 months.

When To File

File Form 1041 on or before the 15th day of the 4th month following the close of the tax year. Use Form 2758 to apply for an extension of time to file.

Disclosure of Return Information

Under section 6103(e)(5), tax returns of individual debtors who have filed for bankruptcy under chapters 7 or 11 of title 11 are, upon written request, open to inspection by or disclosure to the trustee.

The returns subject to disclosure to the trustee are those for the year the bankruptcy begins and prior years. Use **Form 4506**, Request for Copy or Transcript of Tax Form, to request copies of the individual debtor's tax returns.

If the bankruptcy case was not voluntary, disclosure cannot be made before the bankruptcy court has entered an order for relief, unless the court rules that the disclosure is needed for determining whether relief should be ordered.

Transfer of Tax Attributes From the Individual Debtor to the Bankruptcy Estate

The bankruptcy estate succeeds to the following tax attributes of the individual debtor:

- **1.** Net operating loss (NOL) carryovers;
- **2.** Charitable contributions carryovers;
- **3.** Recovery of tax benefit items;
- **4.** Credit carryovers;
- **5.** Capital loss carryovers;
- **6.** Basis, holding period, and character of assets;
- **7.** Method of accounting;
- **8.** Unused passive activity losses;
- **9.** Unused passive activity credits; and
- **10.** Unused section 465 losses.

Income, Deductions, and Credits

Under section 1398(c), the taxable income of the bankruptcy estate generally is figured in the same manner as an individual. The gross income of the bankruptcy estate includes any income included in property of the estate as defined in Bankruptcy Code section 541. Also included is gain from the sale of property. To figure gain, the trustee or debtor-in-possession must determine the correct basis of the property.

To determine whether any amount paid or incurred by the bankruptcy estate is allowable as a deduction or credit, or is treated as wages for employment tax purposes, treat the amount as if it were paid or incurred by the individual debtor in the same trade or business or other activity the debtor engaged in before the bankruptcy proceedings began.

Administrative expenses. The bankruptcy estate is allowed a deduction for any administrative expense allowed under section 503 of title 11 of the U.S. Code, and any fee or charge assessed under chapter 123 of title 28 of the U.S. Code, to the extent not disallowed under an Internal Revenue Code provision (e.g., section 263, 265, or 275).

Administrative expense loss. When figuring a net operating loss, nonbusiness deductions (including administrative expenses) are limited under section 172(d)(4) to the bankruptcy estate's nonbusiness income. The excess nonbusiness deductions are an administrative expense loss that may be carried back to each of the 3 preceding tax years and forward to each of the 7 succeeding tax years of the bankruptcy estate. The amount of an administrative expense loss that may be carried to any tax year is determined after the net operating loss deductions allowed for that year. An administrative expense loss is allowed only to the bankruptcy estate and cannot be carried to any tax year of the individual debtor.

Carryback of net operating losses and credits. If the bankruptcy estate itself incurs a net operating loss (apart from losses carried forward to the estate from the individual debtor), it can carry back its net operating losses not only to previous tax years of the bankruptcy estate, but also to tax years of the individual debtor prior to the year in which the bankruptcy proceedings began. Excess credits, such as the foreign tax credit, also may be carried back to pre-bankruptcy years of the individual debtor.

Exemption. For tax years beginning in 1997, a bankruptcy estate is allowed a personal exemption of \$2,650.

Standard deduction. For tax years beginning in 1997, a bankruptcy estate that does not itemize deductions is allowed a standard deduction of \$3,450.

Discharge of indebtedness. In a title 11 case, gross income does not include amounts that normally would be included in gross income resulting from the discharge of indebtedness. However, any amounts excluded from gross income must be applied to reduce certain tax attributes in a certain order. Attach **Form 982**, Reduction of Tax Attributes Due to Discharge of Indebtedness, to show the reduction of tax attributes.

Tax Rate Schedule

Figure the tax for the bankruptcy estate using the tax rate schedule shown below. Enter the tax on Form 1040, line 39.

If taxable income is:

| Over— | But not over— | The tax is: | Of the amount over— |
|---------|---------------|-------------------|---------------------|
| \$0 | \$20,600 | 15% | \$0 |
| 20,600 | 49,800 | \$3,090.00 + 28% | 20,600 |
| 49,800 | 75,875 | 11,266.00 + 31% | 49,800 |
| 75,875 | 135,525 | 19,349.25 + 36% | 75,875 |
| 135,525 | ----- | 40,823.25 + 39.6% | 135,525 |

Prompt Determination of Tax Liability

To request a prompt determination of the tax liability of the bankruptcy estate, the trustee or debtor-in-possession must file a written application for the determination with the IRS District Director for the district in which the bankruptcy case is pending. The application must be submitted in duplicate and executed under the penalties of perjury. The trustee or debtor-in-possession must submit with the application an **exact copy** of the return (or returns) filed by the trustee with the IRS for a completed tax period, and a statement of the name and location of the office where the return was filed. The envelope should be marked, "Personal Attention of the Special Procedures Function (Bankruptcy Section). DO NOT OPEN IN MAILROOM."

The IRS will notify the trustee or debtor-in-possession within 60 days from receipt of the application whether the return filed by the trustee or debtor-in-possession has been selected for examination or has been accepted as filed. If the return is selected for examination, it will be examined as soon as possible. The IRS will notify the trustee or debtor-in-possession of any tax due within 180 days from receipt of the application or within any additional time permitted by the bankruptcy court.

See Rev. Proc. 81-17, 1981-1 C.B. 688.

Special Filing Instructions for Bankruptcy Estates

Use Form 1041 only as a transmittal for Form 1040. In the top margin of Form 1040 write "Attachment to Form 1041. DO NOT DETACH." Attach Form 1040 to Form 1041. Complete only the identification area at the top of Form 1041. Enter the name of the individual debtor in the following format: "John Q. Public Bankruptcy Estate." Beneath, enter the name of the trustee in the following format: "Avery Snow, Trustee." In item D, enter the date the petition was filed or the date of conversion to a chapter 7 or 11 case.

Enter on Form 1041, line 24, any tax due from line 53 of Form 1040. Complete lines 25 through 30 of Form 1041, and sign and date it.

Specific Instructions

Name of Estate or Trust

Copy the exact name of the estate or trust from the **Form SS-4**, Application for Employer Identification Number, that you used to apply for the employer identification number (EIN).

If a grantor type trust (discussed below), write the name, identification number, and address of the grantor(s) or other owner(s) in parentheses after the name of the trust.

Address

Include the suite, room, or other unit number after the street address.

If the Post Office does not deliver mail to the street address and the fiduciary has a P.O. box, show the box number instead of the street address.

If you change your address after filing Form 1041, use **Form 8822**, Change of Address, to notify the IRS.

A. Type of Entity

Check the appropriate box that describes the entity for which you are filing the return.

Note: *There are special filing requirements for grantor type trusts and bankruptcy estates (discussed below).*

Decedent's Estate

An estate of a deceased person is a taxable entity separate from the decedent. It generally continues to exist until the final distribution of the assets of the estate is made to the heirs and other beneficiaries. The income earned from the property of the estate during the period of administration or settlement must be accounted for and reported by the estate.

Simple Trust

A trust may qualify as a simple trust if:

1. The trust instrument requires that all income must be distributed currently;
2. The trust instrument does not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes; and
3. The trust does not distribute amounts allocated to the corpus of the trust.

Complex Trust

A complex trust is any trust that does not qualify as a simple trust as explained above.

Grantor Type Trust

A grantor type trust is a legal trust under applicable state law that is not recognized as a separate taxable entity for income tax purposes because the grantor or other substantial owners have not relinquished

complete dominion and control over the trust.

Generally, for transfers made in trust after March 1, 1986, the grantor is treated as the owner of any portion of a trust in which he or she has a reversionary interest in either the income or corpus therefrom, if, as of the inception of that portion of the trust, the value of the reversionary interest is more than 5% of the value of that portion. Also, the grantor is treated as holding any power or interest that was held by either the grantor's spouse at the time that the power or interest was created or who became the grantor's spouse after the creation of that power or interest.

Caution: *The following instructions apply only to grantor type trusts that are not using an optional filing method, explained later.*

Report on Form 1041 **only** the part of the income that is taxable to the trust. Do not report on Form 1041 the income that is taxable to the grantor or another person. Instead, attach a separate sheet to report:

- The income of the trust that is taxable to the grantor or another person under sections 671 through 678;
- The name, identifying number, and address of the person(s) to whom the income is taxable; and
- Any deductions or credits applied to this income.

The income taxable to the grantor or another person under sections 671 through 678 and the deductions and credits applied to the income must be reported by that person on his or her own income tax return.

Mortgage pools. The trustee of a mortgage pool, such as the Federal National Mortgage Association, collects principal and interest payments on each mortgage and makes distributions to the certificate holders. Each pool is considered a grantor type trust, and each certificate holder is treated as the owner of an undivided interest in the entire trust under the grantor trust rules. Certificate holders must report their proportionate share of the mortgage interest and other items of income on their individual tax returns.

Pre-need funeral trusts. The purchasers of pre-need funeral services are the grantors and the owners of pre-need funeral trusts established under state laws. See Rev. Rul. 87-127, 1987-2 C.B. 156. However, for tax years ending after August 5, 1997, the trustees of pre-need funeral trusts can elect to file the return and pay the tax for qualified funeral trusts. For more information, see new **Form 1041-QFT**, U.S. Income Tax Return for Qualified Funeral Trusts.

Nonqualified deferred compensation plans. Taxpayers may adopt and maintain grantor trusts in connection with nonqualified deferred compensation plans (sometimes referred to as "rabbi trusts"). Rev. Proc. 92-64, 1992-2 C.B. 422,

provides a “model grantor trust” for use in rabbi trust arrangements. The procedure also provides guidance for requesting rulings on the plans that use these trusts.

Optional Filing Methods for Certain Grantor Type Trusts

Generally, for a trust all of which is treated as owned by one or more grantors or other persons, the trustee may use one of the following 3 optional methods to report instead of filing Form 1041.

Method 1. For a trust treated as owned by one grantor or by one other person, the trustee must give all payers of income during the tax year the name and taxpayer identification number (TIN) of the grantor or other person treated as the owner of the trust and the address of the trust. This method may be used only if the owner of the trust provides the trustee with a signed **Form W-9**, Request for Taxpayer Identification Number and Certification. In addition, unless the grantor or other person treated as owner of the trust is the trustee or a co-trustee of the trust, the trustee must give the grantor or other person treated as owner of the trust a statement that:

- Shows all items of income, deduction, and credit of the trust;
- Identifies the payer of each item of income;
- Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and
- Informs the grantor or other person treated as the owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return.

Important: *Grantor trusts that have not applied for an EIN and are going to file under **Method 1** do not need an EIN for the trust as long as they continue to report under that method.*

Method 2. For a trust treated as owned by one grantor or by one other person, the trustee must give all payers of income during the tax year the name, address, and TIN of the trust. The trustee also must file with the IRS the appropriate Forms 1099 to report the income or gross proceeds paid to the trust during the tax year that shows the trust as the payer and the grantor or other person treated as owner as the payee. The trustee must report each type of income in the aggregate and each item of gross proceeds separately. The due date for any Forms 1099 required to be filed with the IRS by a trustee under this method is March 2, 1998.

In addition, unless the grantor or other person treated as owner of the trust is the trustee or a co-trustee of the trust, the trustee must give the grantor or other person treated as owner of the trust a statement that:

- Shows all items of income, deduction, and credit of the trust;

- Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and

- Informs the grantor or other person treated as the owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return. This statement satisfies the requirement to give the recipient copies of the Forms 1099 filed by the trustee.

Method 3. For a trust treated as owned by two or more grantors or other persons, the trustee must give all payers of income during the tax year the name, address, and TIN of the trust. The trustee also must file with the IRS the appropriate Forms 1099 to report the income or gross proceeds paid to the trust by all payers during the tax year attributable to the part of the trust treated as owned by each grantor or other person, showing the trust as the payer and each grantor or other person treated as owner of the trust as the payee. The trustee must report each type of income in the aggregate and each item of gross proceeds separately. The due date for any Forms 1099 required to be filed with the IRS by a trustee under this method is March 2, 1998.

In addition, the trustee must give each grantor or other person treated as owner of the trust a statement that:

- Shows all items of income, deduction, and credit of the trust attributable to the part of the trust treated as owned by the grantor or other person;
- Explains how the grantor or other person treated as owner of the trust takes those items into account when figuring the grantor's or other person's taxable income or tax; and

- Informs the grantor or other person treated as the owner of the trust that those items must be included when figuring taxable income and credits on his or her income tax return. This statement satisfies the requirement to give the recipient copies of the Forms 1099 filed by the trustee.

Exceptions. The following trusts cannot report using the optional filing methods:

• **1.** A common trust fund (as defined in section 584(a)).

• **2.** A foreign trust or a trust that has any of its assets located outside the United States.

• **3.** A qualified subchapter S trust (as defined in section 1361(d)(3)).

• **4.** A trust all of which is treated as owned by one grantor or one other person whose tax year is other than a calendar year.

• **5.** A trust all of which is treated as owned by one or more grantors or other persons, one of which is not a U.S. person.

• **6.** A trust all of which is treated as owned by one or more grantors or other persons if at least one grantor or other person is an exempt recipient for

information reporting purposes, unless at least one grantor or other person is not an exempt recipient and the trustee reports without treating any of the grantors or other persons as exempt recipients.

Changing filing methods. A trustee who previously had filed Form 1041 can change to one of the optional methods by filing a final Form 1041 for the tax year that immediately precedes the first tax year for which the trustee elects to report under one of the optional methods. On the front of the final Form 1041, the trustee must write “Pursuant to section 1.671-4(g), this is the final Form 1041 for this grantor trust,” and check the “Final return” box in item F.

For more details on changing reporting methods, including changes from one optional method to another, see Regulations section 1.671-4(g).

Backup withholding. Generally, a grantor trust is considered a payor of reportable payments received by the trust for purposes of backup withholding. If the trust has 10 or fewer grantors, a reportable payment made to the trust is treated as a reportable payment of the same kind made to the grantors on the date the trust received the payment. If the trust has more than 10 grantors, a reportable payment made to the trust is treated as a payment of the same kind made by the trust to each grantor in an amount equal to the distribution made to each grantor on the date the grantor is paid or credited. The trustee must withhold 31% of reportable payments made to any grantor who is subject to backup withholding. For more information, see section 3406 and Temporary Regulations section 35a.9999-2, Q&A 20.

Bankruptcy Estate

A chapter 7 or 11 bankruptcy estate is a separate and distinct taxable entity from the individual debtor for Federal income tax purposes. See **Of Special Interest to Bankruptcy Trustees and Debtors-in-Possession** on page 7.

For more information, see section 1398 and **Pub. 908**, Bankruptcy Tax Guide.

Pooled Income Fund

A pooled income fund is a split-interest trust with a remainder interest for a public charity and a life income interest retained by the donor or for another person. The property is held in a pool with other pooled income fund property and does not include any tax-exempt securities. The income for a retained life interest is figured using the yearly rate of return earned by the trust. See section 642(c) and the related regulations for more information.

If you are filing for a pooled income fund, attach a statement to support the following:

- The calculation of the yearly rate of return.
- The computation of the deduction for distributions to the beneficiaries.

- The computation of any charitable deduction.

You do not have to complete Schedules A or B of Form 1041.

If the fund has accumulations of income, file Form 1041-A unless the fund is required to distribute all of its net income to beneficiaries currently.

You must also file **Form 5227**, Split-Interest Trust Information Return, for the pooled income fund.

B. Number of Schedules K-1 Attached

Every trust or decedent's estate claiming an income distribution deduction on page 1, line 18, must enter the number of Schedules K-1 (Form 1041) that are attached to Form 1041.

C. Employer Identification Number

Every estate or trust that is required to file Form 1041 must have an EIN. To apply for one, use Form SS-4. Form SS-4 has information on how to apply for an EIN by mail or by telephone. If the estate or trust has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. See **Pub. 583**, Starting a Business and Keeping Records, for more information.

If you are filing a return for a mortgage pool, such as one created under the mortgage-backed security programs administered by the Federal National Mortgage Association ("Fannie Mae") or the Government National Mortgage Association ("Ginnie Mae"), the EIN stays with the pool if that pool is traded from one financial institution to another.

D. Date Entity Created

Enter the date the trust was created, or, if a decedent's estate, the date of the decedent's death.

E. Nonexempt Charitable and Split-Interest Trusts

Section 4947(a)(1) Trust

Check this box if the trust is a nonexempt charitable trust within the meaning of section 4947(a)(1). A nonexempt charitable trust is a trust that is not exempt from tax under section 501(a); all of the unexpired interests are devoted to one or more charitable purposes described in section 170(c)(2)(B); and for which a deduction was allowed under section 170 (for individual taxpayers) or similar Code section for personal holding companies, foreign personal holding companies, or estates or trusts (including a deduction for estate or gift tax purposes).

Not a Private Foundation

Check this box if the charitable trust is not treated as a private foundation under section 509. For more information, see Regulations section 53.4947-1.

If a nonexempt charitable trust is not treated as though it were a private foundation, the fiduciary must file, in addition to Form 1041, **Form 990** (or **Form 990-EZ**), Return of Organization Exempt From Income Tax, and **Schedule A (Form 990)**, Organization Exempt Under Section 501(c)(3), if the trust's gross receipts are normally more than \$25,000.

If a nonexempt charitable trust is not treated as though it were a private foundation, and it has no taxable income under Subtitle A, it can file either Form 990 or Form 990-EZ instead of Form 1041 to meet its section 6012 filing requirement.

Section 4947(a)(2) Trust

Check this box if the trust is a split-interest trust described in section 4947(a)(2). A split-interest trust is a trust that is not exempt from tax under section 501(a); has some unexpired interests that are devoted to purposes other than religious, charitable, or similar purposes described in section 170(c)(2)(B); and has amounts transferred in trust after May 26, 1969, for which a deduction was allowed under section 170 (for individual taxpayers) or similar Code section for personal holding companies, foreign personal holding companies, or estates or trusts (including a deduction for estate or gift tax purposes).

The fiduciary of a split-interest trust must also file Form 5227 (for amounts transferred in trust after May 26, 1969); and Form 1041-A if the trust's governing instrument does not require that all of the trust's income be distributed currently.

If a split-interest trust has any unrelated business taxable income, however, it must file Form 1041 to report all of its income and to pay any tax due.

Nonexempt Charitable Trust Treated as a Private Foundation

If a nonexempt charitable trust is treated as though it were a private foundation under section 509, then the fiduciary must file **Form 990-PF**, Return of Private Foundation, in addition to Form 1041.

If a nonexempt charitable trust is subject to any of the private foundation excise taxes, then it must also file **Form 4720**, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code. None of the private foundation taxes paid by the trust can be taken as a deduction on Form 1041.

If a nonexempt charitable trust is treated as though it were a private foundation, and it has no taxable income under Subtitle A, it may file Form 990-PF

instead of Form 1041 to meet its section 6012 filing requirement.

F. Initial Return, Amended Return, Final Return; or Change in Fiduciary's Name or Address

Amended Return

If you are filing an amended Form 1041, check the "Amended return" box. Complete the entire return, correct the appropriate lines with the new information, and refigure the estate's or trust's tax liability. If the total tax on line 24 is larger on the amended return than on the original return, you generally should pay the difference with the amended return. However, you should adjust this amount if there is any increase or decrease in the total payments shown on line 26.

On an attached sheet explain the reason for the amendments and identify the lines and amounts being changed on the amended return.

If the amended return results in a change to income, or a change in distribution of any income or other information provided to a beneficiary, an amended Schedule K-1 (Form 1041) must also be filed with the amended Form 1041 and given to each beneficiary. Check the "Amended K-1" box at the top of the amended Schedule K-1.

Final Return

Check this box if this is a final return because the estate or trust has terminated. Also, check the "Final K-1" box at the top of Schedule K-1.

If, on the final return, there are excess deductions, an unused capital loss carryover, or a net operating loss carryover, see the instructions for Schedule K-1, lines 13a through 13e, on page 31.

G. Pooled Mortgage Account

If you bought a pooled mortgage account during the year, and still have that pool at the end of the tax year, check the "Bought" box and enter the date of purchase. If you sold a pooled mortgage account that was purchased during this, or a previous, tax year, check the "Sold" box and enter the date of sale. If you neither bought nor sold a pooled mortgage account, skip this item.

Income

Special Rule for Blind Trust

If you are reporting income from a qualified blind trust (under the Ethics in Government Act of 1978), do not identify the payer of any income to the trust but complete the rest of the return as provided in the instructions. Also write "Blind Trust" at the top of page 1.

Line 1—Interest Income

Report the estate's or trust's share of all taxable interest income that was received during the tax year. Examples of taxable interest include interest from:

- Accounts (including certificates of deposit and money market accounts) with banks, credit unions, and thrifts.
- Notes, loans, and mortgages.
- U.S. Treasury bills, notes, and bonds.
- U.S. savings bonds.
- Original issue discount.
- Income received as a regular interest holder of a real estate mortgage investment conduit (REMIC).

For taxable bonds acquired after 1987, amortizable bond premium is treated as an offset to the interest income instead of as a separate interest deduction. See Pub. 550.

For the year of the decedent's death, Forms 1099-INT issued in the decedent's name may include interest income earned after the date of death that should be reported on the income tax return of the decedent's estate. When preparing the decedent's final income tax return, report on line 1 of Schedule B (Form 1040) or Schedule 1 (Form 1040A) the total interest shown on Form 1099-INT. Under the last entry on line 1, subtotal all the interest reported on line 1. Below the subtotal, write "Form 1041" and the name and address shown on Form 1041 for the decedent's estate. Also, show the part of the interest reported on Form 1041 and subtract it from the subtotal.

Line 2—Dividends

Report the estate's or trust's share of all ordinary dividends received during the tax year.

For the year of the decedent's death, Forms 1099-DIV issued in the decedent's name may include dividends earned after the date of death that should be reported on the income tax return of the decedent's estate. When preparing the decedent's final income tax return, report on line 5 of Schedule B (Form 1040) or Schedule 1 (Form 1040A) the total dividends shown on Form 1099-DIV. Under the last entry on line 5, subtotal all the dividends reported on line 5. Below the subtotal, write "Form 1041" and the name and address shown on Form 1041 for the decedent's estate. Also, show the part of the dividends reported on Form 1041 and subtract it from the subtotal.

Note: Report capital gain distributions on Schedule D (Form 1041), line 9.

Line 3—Business Income or (Loss)

If the estate or trust operated a business, report the income and expenses on **Schedule C (Form 1040)**, Profit or Loss From Business (or **Schedule C-EZ (Form 1040)**, Net Profit From Business). Enter the net profit or (loss) from Schedule C (or Schedule C-EZ) on line 3.

Line 4—Capital Gain or (Loss)

Enter the gain from Schedule D (Form 1041), Part III, line 16, column (3); or the loss from Part IV, line 17.

Note: Do not substitute Schedule D (Form 1040) for Schedule D (Form 1041).

Line 5—Rents, Royalties, Partnerships, Other Estates and Trusts, etc.

Use **Schedule E (Form 1040)**, Supplemental Income and Loss, to report the estate's or trust's share of income or (losses) from rents, royalties, partnerships, S corporations, other estates and trusts, and REMICs. Enter the net profit or (loss) from Schedule E on line 5. See the instructions for Schedule E (Form 1040) for reporting requirements.

If the estate or trust received a Schedule K-1 from a partnership, S corporation, or other flow-through entity, use the corresponding lines on Form 1041 to report the interest, dividends, capital gains, etc., from the flow-through entity.

Line 6—Farm Income or (Loss)

If the estate or trust operated a farm, use **Schedule F (Form 1040)**, Profit or Loss From Farming, to report farm income and expenses. Enter the net profit or (loss) from Schedule F on line 6.

Line 7—Ordinary Gain or (Loss)

Enter from line 18, **Form 4797**, Sales of Business Property, the ordinary gain or loss from the sale or exchange of property other than capital assets and also from involuntary conversions (other than casualty or theft).

Line 8—Other Income

Enter other items of income not included on lines 1 through 7. List the type and amount on an attached schedule if the estate or trust has more than one item.

Items to be reported on line 8 include:

- Unpaid compensation received by the decedent's estate that is income in respect of a decedent.
- Any part of a total distribution shown on **Form 1099-R**, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., that is treated as ordinary income. For more information, see the separate instructions for **Form 4972**, Tax on Lump-Sum Distributions.

Deductions

Depreciation, Depletion, and Amortization

A trust or decedent's estate is allowed a deduction for depreciation, depletion, and amortization only to the extent the deductions are not apportioned to the beneficiaries. An estate or trust is not allowed to make an election under section 179 to expense certain tangible property.

The estate's or trust's share of depreciation, depletion, and amortization should be reported on the appropriate lines of Schedule C (or C-EZ), E, or F (Form 1040), the net income or loss from which is shown on line 3, 5, or 6 of Form 1041. If the deduction is not related to a specific business or activity, then report it on line 15a.

Depreciation. For a decedent's estate, the depreciation deduction is apportioned between the estate and the heirs, legatees, and devisees on the basis of the estate's income allocable to each.

For a trust, the depreciation deduction is apportioned between the income beneficiaries and the trust on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a depreciation reserve. If the trustee is required to maintain a reserve, the deduction is first allocated to the trust, up to the amount of the reserve. Any excess is allocated among the beneficiaries in the same manner as the trust's accounting income. See Regulations section 1.167(h)-1(b).

Depletion. For mineral or timber property held by a decedent's estate, the depletion deduction is apportioned between the estate and the heirs, legatees, and devisees on the basis of the estate's income from such property allocable to each.

For mineral or timber property held in trust, the depletion deduction is apportioned between the income beneficiaries and the trust based on the trust income from such property allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depletion. If the trustee is required to maintain a reserve, the deduction is first allocated to the trust, up to the amount of the reserve. Any excess is allocated among the beneficiaries in the same manner as the trust's accounting income. See Regulations section 1.611-1(c)(4).

Amortization. The deduction for amortization is apportioned between an estate or trust and its beneficiaries under the same principles for apportioning the deductions for depreciation and depletion.

The deduction for the amortization of reforestation expenditures under section 194 is allowed only to an estate.

Allocation of Deductions for Tax-Exempt Income

Generally, no deduction that would otherwise be allowable is allowed for any expense (whether for business or for the production of income) that is allocable to tax-exempt income. Examples of tax-exempt income include:

- Certain death benefits (section 101);
- Interest on state or local bonds (section 103);
- Compensation for injuries or sickness (section 104); and

- Income from discharge of indebtedness in a title 11 case (section 108).

Exception. State income taxes and business expenses that are allocable to tax-exempt interest are deductible.

Expenses that are directly allocable to tax-exempt income are allocated only to tax-exempt income. A reasonable proportion of expenses indirectly allocable to both tax-exempt income and other income must be allocated to each class of income.

Deductions That May Be Allowable for Estate Tax Purposes

Administration expenses and casualty and theft losses deductible on Form 706 may be deducted, to the extent otherwise deductible for income tax purposes, on Form 1041 if the fiduciary files a statement waiving the right to deduct the expenses and losses on Form 706. The statement must be filed before the expiration of the statutory period of limitations for the tax year the deduction is claimed. See Pub. 559 for more information.

Accrued Expenses

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that: **(a)** all events have occurred that determine the liability; and **(b)** the amount of the liability can be figured with reasonable accuracy. However, all the events that establish liability are treated as occurring only when economic performance takes place. There are exceptions for recurring items. See section 461(h).

Limitations on Deductions

At-Risk Loss Limitations

Generally, the amount the estate or trust has “at risk” limits the loss it can deduct for any tax year. Use **Form 6198**, At-Risk Limitations, to figure the deductible loss for the year and file it with Form 1041. For more information, see **Pub. 925**, Passive Activity and At-Risk Rules.

Passive Activity Loss and Credit Limitations

In general. Section 469 and the regulations thereunder generally limit losses from passive activities to the amount of income derived from all passive activities. Similarly, credits from passive activities are generally limited to the tax attributable to such activities. These limitations are first applied at the estate or trust level.

Generally, an activity is a passive activity if it involves the conduct of any trade or business, and the taxpayer does not materially participate in the activity. Passive activities do not include working interests in oil and gas properties. See section 469(c)(3).

Note: *Material participation standards for estates and trusts had not been established by regulations at the time these instructions went to print.*

For a grantor trust, material participation is determined at the grantor level.

If the estate or trust distributes an interest in a passive activity, the basis of the property immediately before the distribution is increased by the passive activity losses allocable to the interest, and such losses cannot be deducted. See section 469(j)(12).

Note: *Losses from passive activities are first subject to the at-risk rules. When the losses are deductible under the at-risk rules, the passive activity rules then apply.*

Rental activities. Generally, rental activities are passive activities, whether or not the taxpayer materially participates. However, certain taxpayers who materially participate in real property trades or businesses are not subject to the passive activity limitations on losses from rental real estate activities in which they materially participate. For more details, see section 469(c)(7).

For tax years of an estate ending less than 2 years after the decedent's date of death, up to \$25,000 of deductions and deduction equivalents of credits from rental real estate activities in which the decedent actively participated are allowed. Any excess losses and/or credits are suspended for the year and carried forward.

Portfolio income. Portfolio income is not treated as income from a passive activity, and passive losses and credits generally may not be applied to offset it. Portfolio income generally includes interest, dividends, royalties, and income from annuities. Portfolio income of an estate or trust must be accounted for separately.

Forms to file. See **Form 8582**, Passive Activity Loss Limitations, to figure the amount of losses allowed from passive activities. See **Form 8582-CR**, Passive Activity Credit Limitations, to figure the amount of credit allowed for the current year.

Transactions Between Related Taxpayers

Under section 267, a trust that uses the accrual method of accounting may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. For this purpose, a related party includes:

- ÿ1. A grantor and a fiduciary of any trust;
- ÿ2. A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
- ÿ3. A fiduciary of a trust and a beneficiary of such trust;
- ÿ4. A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

ÿ5. A fiduciary of a trust and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; and

ÿ6. For tax years beginning after August 5, 1997, an executor of an estate and a beneficiary of that estate, except for a sale or exchange to satisfy a pecuniary bequest (i.e., a bequest of a sum of money).

Line 10—Interest

Enter the amount of interest (subject to limitations) paid or incurred by the estate or trust on amounts borrowed by the estate or trust, or on debt acquired by the estate or trust (e.g., outstanding obligations from the decedent) that is not claimed elsewhere on the return.

If the proceeds of a loan were used for more than one purpose (e.g., to purchase a portfolio investment and to acquire an interest in a passive activity), the fiduciary must make an interest allocation according to the rules in Temporary Regulations section 1.163-8T.

Do not include interest paid on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from income tax.

Personal interest is not deductible. Examples of personal interest include interest paid on:

- Revolving charge accounts.
- Personal notes for money borrowed from a bank, credit union, or other person.
- Installment loans on personal use property.
- Underpayments of Federal, state, or local income taxes.

Interest that is paid or incurred on indebtedness allocable to a trade or business (including a rental activity) should be deducted on the appropriate line of Schedule C (or C-EZ), E, or F (Form 1040), the net income or loss from which is shown on line 3, 5, or 6 of Form 1041.

Types of interest to include on line 10 are:

- ÿ1. Any investment interest (subject to limitations—see below);
- ÿ2. Any qualified residence interest (see page 13); and
- ÿ3. Any interest payable under section 6601 on any unpaid portion of the estate tax attributable to the value of a reversionary or remainder interest in property, or an interest in a closely held business for the period during which an extension of time for payment of such tax is in effect.

Investment interest. Generally, investment interest is interest (including amortizable bond premium on taxable bonds acquired after October 22, 1986, but before January 1, 1988) that is paid or incurred on indebtedness that is properly allocable to property held for investment. Investment interest does not include any qualified residence interest,

or interest that is taken into account under section 469 in figuring income or loss from a passive activity.

Generally, net investment income is the excess of investment income over investment expenses. Investment expenses are those expenses (other than interest) allowable after application of the 2% floor on miscellaneous itemized deductions.

The amount of the investment interest deduction may be limited. Use **Form 4952**, Investment Interest Expense Deduction, to figure the allowable investment interest deduction.

If you must complete Form 4952, check the box on line 10 and attach Form 4952. Then, add the deductible investment interest to the other types of deductible interest and enter the total on line 10.

Qualified residence interest. Interest paid or incurred by an estate or trust on indebtedness secured by a qualified residence of a beneficiary of an estate or trust is treated as qualified residence interest if the residence would be a qualified residence (i.e., the principal residence or the second residence selected by the beneficiary) if owned by the beneficiary. The beneficiary must have a present interest in the estate or trust or an interest in the residuary of the estate or trust. See **Pub. 936**, Home Mortgage Interest Deduction, for an explanation of the general rules for deducting home mortgage interest.

See section 163(h)(3) for a definition of qualified residence interest and for limitations on indebtedness.

Line 11—Taxes

Enter any deductible taxes paid or incurred during the tax year that are not deductible elsewhere on Form 1041.

Deductible taxes include:

- State and local income or real property taxes.
- The generation-skipping transfer (GST) tax imposed on income distributions.

Do not deduct:

- Federal income taxes.
- Estate, inheritance, legacy, succession, and gift taxes.
- Federal duties and excise taxes.
- State and local sales taxes. Instead, treat these taxes as part of the cost of the property.

Line 12—Fiduciary Fees

Enter the deductible fees paid or incurred to the fiduciary for administering the estate or trust during the tax year.

Note: *Fiduciary fees deducted on Form 706 cannot be deducted on Form 1041.*

Line 15a—Other Deductions NOT Subject to the 2% Floor

Attach your own schedule, listing by type and amount, all allowable deductions that are not deductible elsewhere on Form 1041.

Do not include any losses on worthless bonds and similar obligations and nonbusiness bad debts. Report these losses on Schedule D (Form 1041).

Do not deduct medical or funeral expenses on Form 1041. Medical expenses of the decedent paid by the estate may be deductible on the decedent's income tax return for the year incurred. See section 213(c). Funeral expenses are deductible **ONLY** on Form 706.

The following are examples of deductions that are reported on line 15a. **Bond premium(s).** For taxable bonds acquired before October 23, 1986, if the fiduciary elected to amortize the premium, report the amortization on this line. You cannot deduct the amortization for tax-exempt bonds. In all cases where the fiduciary has made an election to amortize the premium, the basis must be reduced by the amount of amortization.

For more information, see section 171 and Pub. 550.

If you claim a bond premium deduction for the estate or trust, figure the deduction on a separate sheet and attach it to Form 1041.

Casualty and theft losses. Use **Form 4684**, Casualties and Thefts, to figure any deductible casualty and theft losses.

Deduction for clean-fuel vehicles. Section 179A allows a deduction for part of the cost of qualified clean-fuel vehicle property. See **Pub. 535**, Business Expenses, for more details.

Net operating loss deduction (NOLD). An estate or trust is allowed the net operating loss deduction (NOLD) under section 172.

If you claim an NOLD for the estate or trust, figure the deduction on a separate sheet and attach it to this return.

Estate's or trust's share of amortization, depreciation, and depletion not claimed elsewhere. If you cannot deduct the amortization, depreciation, and depletion as rent or royalty expenses on Schedule E (Form 1040), or as business or farm expenses on Schedule C, C-EZ, or F (Form 1040), itemize the fiduciary's share of the deductions on an attached sheet and include them on line 15a. Itemize each beneficiary's share of the deductions and report them on the appropriate line of Schedule K-1 (Form 1041).

Line 15b—Allowable Miscellaneous Itemized Deductions Subject to the 2% Floor

Miscellaneous itemized deductions are deductible only to the extent that the aggregate amount of such deductions exceeds 2% of adjusted gross income (AGI).

Among the miscellaneous itemized deductions that must be included on line 15b are expenses for the production or collection of income under section 212, such as investment advisory fees,

subscriptions to investment advisory publications, and the cost of safe deposit boxes.

Miscellaneous itemized deductions **do not** include deductions for:

- Interest under section 163.
- Taxes under section 164.
- The amortization of bond premium under section 171.
- Estate taxes attributable to income in respect of a decedent under section 691(c).
- Expenses paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were NOT held in the estate or trust.

For other exceptions, see section 67(b).

For estates and trusts, the AGI is figured by subtracting the following from total income on line 9 of page 1:

- **y1.** The administration costs of the estate or trust (the total of lines 12, 14, and 15a to the extent they are costs incurred in the administration of the estate or trust) that would not have been incurred if the property were NOT held by the estate or trust;
- **y2.** The income distribution deduction (line 18);
- **y3.** The amount of the exemption (line 21);
- **y4.** The deduction for clean-fuel vehicles claimed on line 15a; and
- **y5.** The net operating loss deduction claimed on line 15a.

For those estates and trusts whose income distribution deduction is limited to the actual distribution, and NOT the DNI (i.e., the income distribution is less than the DNI), when computing the AGI, use the amount of the actual distribution.

For those estates and trusts whose income distribution deduction is limited to the DNI (i.e., the actual distribution exceeds the DNI), the DNI must be figured taking into account the allowable miscellaneous itemized deductions (AMID) after application of the 2% floor. In this situation there are two unknown amounts: **(a)** the AMID; and **(b)** the DNI.

The following example illustrates how an algebraic equation can be used to solve for these unknown amounts:

The Malcolm Smith Trust, a complex trust, earned \$20,000 of dividend income, \$20,000 of capital gains, and a fully deductible \$5,000 loss from XYZ partnership (chargeable to corpus) in 1997. The trust instrument provides that capital gains are added to corpus. 50% of the fiduciary fees are allocated to income and 50% to corpus. The trust claimed a \$2,000 deduction on line 12 of Form 1041. The trust incurred \$1,500 of miscellaneous itemized deductions (chargeable to income), which are subject to the 2% floor. There are no other deductions. The trustee made a discretionary distribution of the accounting income of \$17,500 to the trust's sole beneficiary.

Because the actual distribution can reasonably be expected to exceed the DNI, the trust must figure the DNI, taking into account the allowable miscellaneous itemized deductions, to determine the amount to enter on line 15b.

The trust also claims an exemption of \$100 on line 21.

To compute line 15b, use the equation below:

AMID = total miscellaneous itemized deductions - (.02(AGI))

In the above example:

AMID = 1,500 - (.02(AGI))

In all situations, use the following equation to compute the AGI:

AGI = (line 9) - (the total of lines 12, 14, and 15a to the extent they are costs incurred in the administration of the estate or trust that would not have been incurred if the property were NOT held by the estate or trust) - (line 18) - (line 21).

Note: *There are no other deductions claimed by the trust on line 15a that are deductible in arriving at AGI.*

In the above example:

AGI = 35,000 - 2,000 - DNI - 100

Since the value of line 18 is not known because it is limited to the DNI, you are left with the following:

AGI = 32,900 - DNI

Substitute the value of AGI in the equation:

AMID = 1,500 - (.02(32,900 - DNI))

The equation cannot be solved until the value of DNI is known. The DNI can be expressed in terms of the AMID. To do this, compute the DNI using the known values. In this example, the DNI is equal to the total income of the trust (less any capital gains allocated to corpus; or plus any capital loss from line 4); less total deductions from line 16 (excluding any miscellaneous itemized deductions); less the AMID.

Thus, DNI = (line 9) - (line 16, column (2) of Schedule D (Form 1041)) - (line 16) - (AMID)

Substitute the known values:

DNI = 35,000 - 20,000 - 2,000 - AMID

DNI = 13,000 - AMID

Substitute the value of DNI in the equation to solve for AMID:

AMID = 1,500 - (.02(32,900 - (13,000 - AMID)))

AMID = 1,500 - (.02(32,900 - 13,000 + AMID))

AMID = 1,500 - (658 - 260 + .02 AMID)

AMID = 1,102 - .02AMID

1.02AMID = 1,102

AMID = 1,080

DNI = 11,920 (i.e., 13,000 - 1,080)

AGI = 20,980 (i.e., 32,900 - 11,920)

Note: *The income distribution deduction is equal to the smaller of the distribution (\$17,500) or the DNI (\$11,920).*

Enter the value of AMID on line 15b (the DNI should equal line 7 of Schedule B) and complete the rest of Form 1041 according to the instructions.

If the 2% floor is more than the deductions subject to the 2% floor, no deductions are allowed.

Line 18—Income Distribution Deduction

If the estate or trust was required to distribute income currently or if it paid, credited, or was required to distribute any other amounts to beneficiaries during the tax year, complete Schedule B to determine the estate's or trust's income distribution deduction. However, if you are filing for a pooled income fund, do not complete Schedule B. Instead, attach a statement to support the computation of the income distribution deduction. If the estate or trust claims an income distribution deduction, complete and attach:

- Part I (through line 9) and Part II of Schedule I to refigure the deduction on a minimum tax basis; AND

- Schedule K-1 (Form 1041) for each beneficiary to which a distribution was made or required to be made.

Cemetery perpetual care fund. On line 18, deduct the amount, not more than \$5 per gravesite, paid for maintenance of cemetery property. To the right of the entry space for line 18, enter the number of gravesites. Also write "Section 642(i) trust" in parentheses after the trust's name at the top of Form 1041. You do not have to complete Schedules B of Form 1041 and K-1 (Form 1041).

Line 19—Estate Tax Deduction (Including Certain Generation-Skipping Transfer Taxes)

If the estate or trust includes income in respect of a decedent (IRD) in its gross income, and such amount was included in the decedent's gross estate for estate tax purposes, the estate or trust is allowed to deduct in the same tax year the income is included, that portion of the estate tax imposed on the decedent's estate that is attributable to the inclusion of the IRD in the decedent's estate. For an example of the computation, see Regulations section 1.691(c)-1 and Pub. 559.

If any amount properly paid, credited, or required to be distributed by an estate or trust to a beneficiary consists of IRD received by the estate or trust, do not include such amounts in determining the estate tax deduction for the estate or trust. Figure the deduction on a separate sheet. Attach the sheet to your return.

Also, a deduction is allowed for the GST tax imposed as a result of a taxable termination or a direct skip occurring as a result of the death of the transferor. See section 691(c)(3). Enter the estate's or trust's share of these deductions on line 19.

Line 21—Exemption

Decedents' estates. A decedent's estate is allowed a \$600 exemption.

Trusts. A trust whose governing instrument requires that all income be distributed currently is allowed a \$300 exemption, even if it distributed amounts other than income during the tax year. All other trusts are allowed a \$100 exemption. See Regulations section 1.642(b)-1.

Tax and Payments

Line 23—Taxable Income

Net operating loss. If line 23 is a loss, the estate or trust may have a net operating loss (NOL). Do not include the deductions claimed on lines 13, 18, and 21 when figuring the amount of the NOL. For tax years beginning before August 6, 1997, an NOL generally may be carried back to the 3 prior tax years and forward to the following 15 tax years. For tax years beginning after August 5, 1997, an NOL generally may be carried back to the 2 prior tax years and forward to the following 20 years.)

Complete Schedule A of **Form 1045**, Application for Tentative Refund, to figure the amount of the NOL that is available for carryback or carryover. Use Form 1045 or file an amended return to apply for a refund based on an NOL carryback. For more information, see **Pub. 536**, Net Operating Losses.

On the termination of the estate or trust, any unused NOL carryover that would be allowable to the estate or trust in a later tax year, but for the termination, is allowed to the beneficiaries succeeding to the property of the estate or trust. See the instructions for Schedule K-1, lines 13d and 13e.

Excess deductions on termination. If the estate or trust has for its final year deductions (excluding the charitable deduction and exemption) in excess of its gross income, the excess is allowed as an itemized deduction to the beneficiaries succeeding to the property of the estate or trust.

In general, an unused NOL carryover that is allowed to beneficiaries (as explained above) cannot also be treated as an excess deduction. However, if the final year of the estate or trust is also the last year of the NOL carryover period, the NOL carryover not absorbed in that tax year by the estate or trust is included as an excess deduction. See the instructions for Schedule K-1, line 13a.

Line 25a—1997 Estimated Tax Payments and Amount Applied From 1996 Return

Enter the amount of any estimated tax payment you made with Form 1041-ES for 1997 plus the amount of any overpayment from the 1996 return that was applied to the 1997 estimated tax.

If the estate or trust is the beneficiary of another trust and received a payment of estimated tax that was credited to the trust (as reflected on the Schedule K-1 issued to the trust), then report this amount separately with the notation "section 643(g)" in the space next to line 25a.

Caution: Do not include on Form 1041 estimated tax paid by an individual before death. Instead, include the payments on the decedent's final income tax return.

Line 25b—Estimated Tax Payments Allocated to Beneficiaries

The trustee (or executor, for the final year of the estate) may elect under section 643(g) to have any portion of its estimated tax treated as a payment of estimated tax made by a beneficiary or beneficiaries. The election is made on Form 1041-T, Allocation of Estimated Tax Payments to Beneficiaries, which must be filed by the 65th day after the close of the trust's tax year. Form 1041-T shows the amounts to be allocated to each beneficiary. This amount is reported on the beneficiary's Schedule K-1, line 14a.

Failure to file Form 1041-T by the due date (March 6, 1998, for calendar year estates and trusts) will result in an invalid election. An invalid election will require the filing of amended Schedules K-1 for each beneficiary who was allocated a payment of estimated tax.

Attach Form 1041-T to your return ONLY if you have not yet filed it. If you have already filed Form 1041-T, do not attach a copy to your return.

Line 25d—Tax Paid With Extension of Time To File

If you filed either Form 2758 (for estates only), Form 8736, or Form 8800 to request an extension of time to file Form 1041, enter the amount that you paid with the extension request and check the appropriate box(es).

Line 25e—Federal Income Tax Withheld

Use line 25e to claim a credit for any Federal income tax withheld (and not repaid) by: (a) an employer on wages and salaries of a decedent received by the decedent's estate; (b) a payer of certain gambling winnings (e.g., state lottery winnings); or (c) a payer of distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, insurance contracts, etc., received by a decedent's estate or trust. Attach a copy of Form W-2, Form W-2G, or Form 1099-R.

Backup withholding. If the estate or trust received a 1997 Form 1099 showing Federal income tax withheld (i.e., backup withholding) on interest income, dividends, or other income, check the box and include the amount withheld on income retained by the estate or trust in the total for line 25e.

Report on Schedule K-1 (Form 1041), line 14, any credit for backup withholding on income distributed to the beneficiary.

Line 25f—Credit For Tax Paid on Undistributed Capital Gains

Attach copy B of Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains.

Line 25g—Credit for Federal Tax on Fuels

Enter any credit for Federal excise taxes paid on fuels that are ultimately used for nontaxable purposes (e.g., an off-highway business use). Attach Form 4136, Credit for Federal Tax Paid on Fuels. See Pub. 378, Fuel Tax Credits and Refunds, for more information.

Line 27—Underpayment of Estimated Tax

If line 28 is at least \$500 and more than 10% of the tax shown on Form 1041, or the estate or trust underpaid its 1997 estimated tax liability for any payment period, it may owe a penalty. See Form 2210 to determine whether the estate or trust owes a penalty and to figure the amount of the penalty.

Note: The penalty may be waived under certain conditions. See Pub. 505, Tax Withholding and Estimated Tax, for details.

Line 28—Tax Due

You must pay the tax in full when the return is filed. Make the check or money order payable to "Internal Revenue Service." Write the EIN and "1997 Form 1041" on the payment. Enclose, but do not attach, the payment with Form 1041.

Line 30a—Credit to 1998 Estimated Tax

Enter the amount from line 29 that you want applied to the estate's or trust's 1998 estimated tax.

Schedule A—Charitable Deduction

General Instructions

Generally, any part of the gross income of an estate or trust (other than a simple trust) that, under the terms of the will or governing instrument, is paid (or treated as paid) during the tax year for a charitable purpose specified in section 170(c) is allowed as a deduction to the estate or trust. It is not necessary that the charitable organization be created or organized in the United States.

Trusts that claim a charitable deduction must also file Form 1041-A. See Form 1041-A for exceptions.

A pooled income fund, nonexempt private foundation, or trust with unrelated business income should attach a separate sheet to Form 1041 instead of using

Schedule A of Form 1041 to figure the charitable deduction.

Election to treat contributions as paid in the prior tax year. The fiduciary of an estate or trust may elect to treat as paid during the tax year any amount of gross income received during that tax year or any prior tax year that was paid in the next tax year for a charitable purpose.

For example, if a calendar year estate or trust makes a qualified charitable contribution on February 10, 1998, from income earned in 1997 or prior, then the fiduciary can elect to treat the contribution as paid in 1997.

To make the election, the fiduciary must file a statement with Form 1041 for the tax year in which the contribution is treated as paid. This statement must include:

- ÿ1. The name and address of the fiduciary;
- ÿ2. The name of the estate or trust;
- ÿ3. An indication that the fiduciary is making an election under section 642(c)(1) for contributions treated as paid during such tax year;
- ÿ4. The name and address of each organization to which any such contribution is paid; and
- ÿ5. The amount of each contribution and date of actual payment or, if applicable, the total amount of contributions paid to each organization during the next tax year, to be treated as paid in the prior tax year.

The election must be filed by the due date (including extensions) for Form 1041 for the next tax year.

For more information about the charitable deduction, see section 642(c) and related regulations.

Specific Instructions

Line 1—Amounts Paid or Permanently Set Aside for Charitable Purposes From Gross Income

Enter amounts that were paid for a charitable purpose out of the estate's or trust's gross income, including any capital gains that are attributable to income under the governing instrument or local law. Include amounts paid during the tax year from gross income received in a prior tax year, but only if no deduction was allowed for any prior tax year for these amounts.

Estates, and certain trusts, may claim a deduction for amounts permanently set aside for a charitable purpose from gross income. Such amounts must be permanently set aside during the tax year to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit.

For a trust to qualify, the trust may not be a simple trust, and the set aside amounts must be required by the terms of a trust instrument that was created on or before October 9, 1969.

Further, the trust instrument must provide for an irrevocable remainder interest to be transferred to or for the use of an organization described in section 170(c); OR the trust must have been created by a grantor who was at all times after October 9, 1969, under a mental disability to change the terms of the trust.

Also, certain testamentary trusts that were established by a will that was executed on or before October 9, 1969, may qualify. See Regulations section 1.642(c)-2(b).

Do not include any capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes. Instead, enter these amounts on line 4.

Line 2—Tax-Exempt Income Allocable to Charitable Contributions

Any estate or trust that pays or sets aside any part of its income for a charitable purpose must reduce the deduction by the portion allocable to any tax-exempt income. If the governing instrument specifically provides as to the source from which amounts are paid, permanently set aside, or to be used for charitable purposes, the specific provisions control. In all other cases, determine the amount of tax-exempt income allocable to charitable contributions by multiplying line 1 by a fraction, the numerator of which is the total tax-exempt income of the estate or trust, and the denominator of which is the gross income of the estate or trust. Do not include in the denominator any losses allocated to corpus.

Line 4—Capital Gains for the Tax Year Allocated to Corpus and Paid or Permanently Set Aside for Charitable Purposes

Enter the total of all capital gains for the tax year that are:

- Allocated to corpus; and
- Paid or permanently set aside for charitable purposes.

Line 6—Section 1202 Exclusion Allocable to Capital Gains Paid or Permanently Set Aside for Charitable Purposes

If the exclusion of gain from the sale or exchange of qualified small business stock was claimed, enter the part of the gain included on Schedule A, lines 1 and 4, that was excluded under section 1202.

Schedule B—Income Distribution Deduction

General Instructions

If the estate or trust was required to distribute income currently or if it paid, credited, or was required to distribute any other amounts to beneficiaries during the tax year, complete Schedule B to determine the estate's or trust's income distribution deduction. However, if you are filing for a pooled income fund, do not

complete Schedule B. Instead, attach a statement to support the computation of the income distribution deduction.

Note: Use Schedule I to compute the DNI and income distribution deduction on a minimum tax basis.

Separate share rule. If a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the DNI allocable to the respective beneficiaries. For the estates of decedents dying after August 5, 1997, a similar rule applies to treat substantially separate and independent shares of different beneficiaries of an estate as separate estates.

If the separate share rule applies, figure the DNI allocable to each beneficiary on a separate sheet and attach the sheet to this return. Any deduction or loss that is applicable solely to one separate share of the trust or estate is not available to any other share of the same trust or estate.

For more information, see section 663(c) and related regulations.

Specific Instructions

Line 1—Adjusted Total Income

If the amount on line 17 of page 1 is a loss that is attributable wholly or in part to the capital loss limitation rules under section 1211(b) (line 4), then enter as a negative amount on line 1, Schedule B, the smaller of the loss from line 17 on page 1, or the loss from line 4 on page 1. If the line 17 loss is not attributable to the capital loss on line 4, enter zero.

If you are filing for a simple trust, subtract from adjusted total income any extraordinary dividends or taxable stock dividends included on page 1, line 2, and determined under the governing instrument and applicable local law to be allocable to corpus.

Line 2—Adjusted Tax-Exempt Interest

To figure the adjusted tax-exempt interest:

Step 1. Add tax-exempt interest income on line 2 of Schedule A, any expenses allowable under section 212 allocable to tax-exempt interest, and any interest expense allocable to tax-exempt interest.

Step 2. Subtract the Step 1 total from the amount of tax-exempt interest (including exempt-interest dividends) received.

Section 212 expenses that are directly allocable to tax-exempt interest are allocated only to tax-exempt interest. A reasonable proportion of section 212 expenses that are indirectly allocable to both tax-exempt interest and other income must be allocated to each class of income.

Figure the interest expense allocable to tax-exempt interest according to the guidelines in Rev. Proc. 72-18, 1972-1 C.B. 740.

See Regulations sections 1.643(a)-5 and 1.265-1 for more information.

Line 3

Include all capital gains, whether or not distributed, that are attributable to income under the governing instrument or local law. For example, if the trustee distributed 50% of the current year's capital gains to the income beneficiaries (and reflects this amount in column (1), line 16 of Schedule D (Form 1041)), but under the governing instrument all capital gains are attributable to income, then include 100% of the capital gains on line 3. If the amount on Schedule D (Form 1041), line 16, column (1) is a net loss, enter zero.

If the exclusion of gain from the sale or exchange of qualified small business stock was claimed, **do not** reduce the gain on line 3 by any amount excluded under section 1202.

Line 5

In figuring the amount of long-term and short-term capital gain for the tax year included on Schedule A, line 1, the specific provisions of the governing instrument control if the instrument specifically provides as to the source from which amounts are paid, permanently set aside, or to be used for charitable purposes.

In all other cases, determine the amount to enter by multiplying line 1 of Schedule A by a fraction, the numerator of which is the amount of net capital gains that are included in the accounting income of the estate or trust (i.e., not allocated to corpus) AND are distributed to charities, and the denominator of which is all items of income (including the amount of such net capital gains) included in the DNI.

Reduce the amount on line 5 by any allocable section 1202 exclusion.

Line 8—Accounting Income

If you are filing for a decedent's estate or a simple trust, skip this line. If you are filing for a complex trust, enter the income for the tax year determined under the terms of the governing instrument and applicable local law. Do not include extraordinary dividends or taxable stock dividends determined under the governing instrument and applicable local law to be allocable to corpus.

Lines 9 and 10

Do not include any:

- Amounts deducted on prior year's return that were required to be distributed in the prior year.
- Amount that is properly paid or credited as a gift or bequest of a specific amount of money or specific property. (To qualify as a gift or bequest, the amount must be paid in three or fewer installments.) An amount that can be paid or credited only from income is not considered a gift or bequest.
- Amount paid or permanently set aside for charitable purposes or otherwise qualifying for the charitable deduction.

Line 9—Income Required To Be Distributed Currently

Line 9 is to be completed by all simple trusts as well as complex trusts and decedent's estates, that are required to distribute income currently, whether it is distributed or not. The determination of whether trust income is required to be distributed currently depends on the terms of the governing instrument and the applicable local law.

The line 9 distributions are referred to as first tier distributions and are deductible by the estate or trust to the extent of the DNI. The beneficiary includes such amounts in his or her income to the extent of his or her proportionate share of the DNI.

Line 10—Other Amounts Paid, Credited, or Otherwise Required To Be Distributed

Line 10 is to be completed ONLY by a decedent's estate or complex trust. These distributions consist of any other amounts paid, credited, or required to be distributed and are referred to as second tier distributions. Such amounts include annuities to the extent not paid out of income, mandatory and discretionary distributions of corpus, and distributions of property in kind.

If Form 1041-T was filed to elect to treat estimated tax payments as made by a beneficiary, the payments are treated as paid or credited to the beneficiary on the last day of the tax year and must be included on line 10.

Unless a section 643(e)(3) election is made, the value of all noncash property actually paid, credited, or required to be distributed to any beneficiaries is the smaller of:

- ÿ1. The estate's or trust's adjusted basis in the property immediately before distribution, plus any gain or minus any loss recognized by the estate or trust on the distribution (basis of beneficiary), or
- ÿ2. The fair market value (FMV) of such property.

If a section 643(e)(3) election is made by the fiduciary, then the amount entered on line 10 will be the FMV of the property.

A fiduciary of a complex trust (and for tax years beginning after August 5, 1997, a decedent's estate) may elect to treat any amount paid or credited to a beneficiary within 65 days following the close of the tax year as being paid or credited on the last day of that tax year. To make this election, see the instructions for Question 6 on page 19.

The beneficiary includes the amounts on line 10 in his or her income only to the extent of his or her proportionate share of the DNI.

Complex trusts. If the second tier distributions exceed the DNI allocable to the second tier, the trust may have an accumulation distribution. See the line 11 instructions below.

Line 11—Total Distributions

If line 11 is more than line 8 and you are filing for a complex trust, complete **Schedule J (Form 1041)** and file it with Form 1041 unless the trust has no previously accumulated income.

Line 12—Adjustment for Tax-Exempt Income

In figuring the income distribution deduction, the estate or trust is not allowed a deduction for any item of the DNI that is not included in the gross income of the estate or trust. Thus, for purposes of figuring the allowable income distribution deduction, the DNI (line 7) is figured without regard to any tax-exempt interest.

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 11), and the DNI (line 7) is less than or equal to line 11, then enter on line 12 the amount from line 2.

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 11), and the DNI is more than line 11 (i.e., the estate or trust made a distribution that is less than the DNI), then figure the adjustment by multiplying line 2 by a fraction, the numerator of which is the total distributions (line 11), and the denominator of which is the DNI (line 7). Enter the result on line 12.

If line 11 includes tax-exempt income other than tax-exempt interest, figure line 12 by subtracting the total of the following from tax-exempt income included on line 11:

- ÿ1. The charitable contribution deduction allocable to such tax-exempt income, and
- ÿ2. Expenses allocable to tax-exempt income.

Expenses that are directly allocable to tax-exempt income are allocated only to tax-exempt income. A reasonable proportion of expenses indirectly allocable to both tax-exempt income and other income must be allocated to each class of income.

Schedule G—Tax Computation

Line 1a

Tax rate schedule. For tax years beginning in 1997, figure the tax using the Tax Rate Schedule below. Enter the tax on line 1a and check the "Tax rate schedule" box.

1997 Tax Rate Schedule

| If taxable income is: | | Its tax is: | | Of the amount over— |
|-----------------------|---------------|------------------|-----|---------------------|
| Over— | But not over— | | | |
| \$0 | \$1,650 | | 15% | \$0 |
| 1,650 | 3,900 | \$247.50 + 28% | | 1,650 |
| 3,900 | 5,950 | 877.50 + 31% | | 3,900 |
| 5,950 | 8,100 | 1,513.00 + 36% | | 5,950 |
| 8,100 | ----- | 2,287.00 + 39.6% | | 8,100 |

Schedule D. If the estate or trust had both net capital gain and any taxable income, complete Part V of Schedule D (Form 1041), enter the tax from line 54 of Schedule D, and check the "Schedule D" box.

Line 1b—Other Taxes

Include any additional tax from the following:

- **Form 4972**, Tax on Lump-Sum Distributions.

- Section 644 tax on trusts.

Note: *References to section 644 in these instructions refer to that section as in effect before its repeal by the Taxpayer Relief Act of 1997.*

Section 644 tax. If the trust sells or exchanges property at a gain before August 6, 1997, and within 2 years after receiving it from a transferor, a section 644 tax may be due. The tax may be due if both **1** and **2** below apply:

- ÿ1. There is an includible gain (defined below) recognized by the trust; and
- ÿ2. At the time the trust received the property, the property had an FMV higher than its adjusted basis.

The trustee is authorized by section 6103(e)(1)(A)(ii) to inspect the transferor's income tax return to the extent necessary to figure the section 644 tax if the transferor refuses to make a disclosure to the trustee.

Includible gain is the smaller of **1** or **2** below:

- ÿ1. The gain recognized by the trust on the sale or exchange of the property; or
- ÿ2. The amount by which the FMV of the property at the time of the initial transfer to the trust exceeds the adjusted basis of the property immediately after the transfer.

Figure the tax on the includible gain by subtracting the transferor's actual tax for the tax year of the sale or exchange from the transferor's tax for the year of the sale or exchange refigured to include the includible gain minus any deductions allocable to the gain.

See section 644 for additional information, including character rules, special rules, exceptions, installment sale rules, and the interest due on the tax if the transferor and the trust have different tax years.

If the section 644 tax is the only tax due on line 1b, enter the amount of the tax on line 1b and write "Section 644 tax" to the left of the amount column on line 1b. If

there is more than one tax, include the amount of the section 644 tax in the total tax entered on line 1b.

Attach the section 644 tax computation to the return. When figuring the trust's taxable income, exclude the amount of any includible gain minus any deductions allocable to the gain.

Line 2a—Foreign Tax Credit

Attach **Form 1116**, Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual), if you elect to claim credit for income or profits taxes paid or accrued to a foreign country or a U.S. possession. The estate or trust may claim credit for that part of the foreign taxes not allocable to the beneficiaries (including charitable beneficiaries). Enter the estate's or trust's share of the credit on line 2a. See **Pub. 514**, Foreign Tax Credit for Individuals, for details.

Line 2b

Nonconventional Source Fuel Credit

If the estate or trust can claim any section 29 credit for producing fuel from a nonconventional source, figure the credit on a separate sheet and attach it to the return. Include the credit on line 2b.

Qualified Electric Vehicle Credit

Use **Form 8834**, Qualified Electric Vehicle Credit, if the estate or trust can claim a credit for the purchase of a new qualified electric vehicle. Include the credit on line 2b.

Line 2c—General Business Credit

Complete this line if the estate or trust is claiming any of the credits listed below. Use the appropriate credit form to figure the credit. If the estate or trust is claiming only one credit, enter the form number and the amount of the credit in the space provided.

If the estate or trust is claiming more than one credit (not including the empowerment zone employment credit), a credit from a passive activity (other than the low-income housing credit or the empowerment zone employment credit), or a credit carryforward, also complete **Form 3800**, General Business Credit, to figure the total credit and enter the amount from Form 3800 on line 2c. Also, be sure to check the box for Form 3800.

Do not include any amounts that are allocated to a beneficiary. Credits that are allocated between the estate or trust and the beneficiaries are listed in the instructions for Schedule K-1, line 14, on page 30. Generally, these credits are apportioned on the basis of the income allocable to the estate or trust and the beneficiaries.

- Investment credit (Form 3468).
- Work opportunity credit (Form 5884).
- Welfare-to-work credit (Form 8861).
- Credit for alcohol used as fuel (Form 6478).
- Credit for increasing research activities (Form 6765).

- Low-income housing credit (Form 8586).
- Enhanced oil recovery credit (Form 8830).
- Disabled access credit (Form 8826).
- Renewable electricity production credit (Form 8835).
- Empowerment zone employment credit (Form 8844).
- Indian employment credit (Form 8845).
- Credit for employer social security and Medicare taxes paid on certain employee tips (Form 8846).
- Orphan drug credit (Form 8820).
- Credit for contributions to selected community development corporations (Form 8847).

Line 2d—Credit for Prior Year Minimum Tax

An estate or trust that paid alternative minimum tax in a previous year may be eligible for a minimum tax credit in 1997. See **Form 8801**, Credit for Prior Year Minimum Tax—Individuals, Estates, and Trusts.

Line 5—Recapture Taxes

Recapture of investment credit. If the estate or trust disposed of investment credit property or changed its use before the end of the recapture period, see **Form 4255**, Recapture of Investment Credit, to figure the recapture tax allocable to the estate or trust.

Recapture of low-income housing credit. If the estate or trust disposed of property (or there was a reduction in the qualified basis of the property) on which the low-income housing credit was claimed, get **Form 8611**, Recapture of Low-Income Housing Credit, to figure any recapture tax allocable to the estate or trust.

Recapture of qualified electric vehicle credit. If the estate or trust claimed the qualified electric vehicle credit in a prior tax year for a vehicle that ceased to qualify for the credit, part or all of the credit may have to be recaptured. See **Pub. 535** for details. If the estate or trust owes any recapture tax, include it on line 5 and write "QEV" on the dotted line to the left of the entry space.

Recapture of the Indian employment credit. Generally, if the estate or trust terminates a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year by reason of wages paid or incurred to that employee must be recaptured. See **Form 8845** for details. If the estate or trust owes any recapture tax, include it on line 5 and write "45A" on the dotted line to the left of the entry space.

Line 7—Household Employment Taxes

If **any** of the following apply, get **Schedule H (Form 1040)**, Household Employment Taxes, and its instructions, to see if the estate or trust owes these taxes.

ÿ1. The estate or trust paid **any one** household employee cash wages of \$1,000 or more in 1997. When figuring the amount of cash wages paid, combine cash wages paid by the estate or trust with cash wages paid to the household employee in the same calendar year by the household of the decedent or beneficiary for whom the administrator, executor, or trustee of the estate or trust is acting.

ÿ2. The estate or trust withheld Federal income tax during 1997 at the request of any household employee.

ÿ3. The estate or trust paid **total** cash wages of \$1,000 or more in **any** calendar quarter of 1996 or 1997 to household employees.

Line 8—Total Tax

Interest on tax deferred under the installment method for certain nondealer real property installment obligations. If an obligation arising from the disposition of real property to which section 453A applies is outstanding at the close of the year, the estate or trust must include the interest due under section 453A(c) in the amount to be entered on line 8 of Schedule G, Form 1041, with the notation "Section 453A(c) interest." Attach a schedule showing the computation.

Form 4970, Tax on Accumulation Distribution of Trusts. Include on this line any tax due on an accumulation distribution from a trust. To the left of the entry space, write "From Form 4970" and the amount of the tax.

Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. Include the interest due under the look-back method of section 460(b)(2). To the left of the entry space, write "From Form 8697" and the amount of interest due.

Form 5329, Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, Modified Endowment Contracts, and MSAs. If the estate or trust fails to receive the minimum distribution under section 4974, use Form 5329 to pay the excise tax. To the left of the entry space, write "From Form 5329" and the amount of the tax.

Tax on electing small business trusts (ESBTs). Special rules apply when figuring the tax on the portion of an ESBT consisting of stock in 1 or more S corporations. This tax must be figured separately from the tax on the remainder of the ESBT and is included in the total tax on Schedule G, line 8. The tax on the remainder of the ESBT is figured in the normal manner on Form 1041.

The tax on the S corporation items is figured as if that portion of the ESBT were a separate trust with the following modifications:

- Take into account only the income, losses, deductions, and credits allocated to the ESBT as an S corporation

shareholder and gain or loss from the disposition of S corporation stock.

- You may not claim a deduction for capital losses in excess of capital gains.
- You may not claim an income distribution deduction or an exemption amount.
- Except in figuring the maximum tax on capital gains, the tax is 39.6% of the separate trust's taxable income.
- You may not claim an exemption amount in figuring the alternative minimum tax.

When figuring the tax and DNI on the remaining portion of the trust, disregard the S corporation items.

Do not apportion to the beneficiaries any of the S corporation items.

Attach the tax computation to the return. To the left of the entry space, write "Sec. 641(d)" and the amount of tax on the S corporation items.

Other Information

Question 1

If the estate or trust received tax-exempt income, figure the allocation of expenses between tax-exempt and taxable income on a separate sheet and attach it to the return. Enter only the deductible amounts on the return. Do not figure the allocation on the return itself. For more information, see the instructions for **Allocation of Deductions for Tax-Exempt Income** on page 11.

Report the amount of tax-exempt interest income received or accrued in the space provided below Question 1.

Also, include any exempt-interest dividends the estate or trust received as a shareholder in a mutual fund or other regulated investment company.

Question 2

All salaries, wages, and other compensation for personal services must be included on the return of the person who earned the income, even if the income was irrevocably assigned to a trust by a contract assignment or similar arrangement.

The grantor or person creating the trust is considered the owner if he or she keeps "beneficial enjoyment" of or substantial control over the trust property. The trust's income, deductions, and credits are allocable to the owner.

If you checked "Yes" for Question 2, see the **Grantor Type Trust** instructions on page 8.

Question 3

Check the "Yes" box and enter the name of the foreign country if either **1** or **2** below applies.

ÿ1. At any time during the year the estate or trust had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country.

Exception. Check "No" if either of the following applies to the estate or trust:

- The combined value of the accounts was \$10,000 or less during the whole year; OR
- The accounts were with a U.S. military banking facility operated by a U.S. financial institution.

ÿ2. The estate or trust owns more than 50% of the stock in any corporation that owns one or more foreign bank accounts.

Get **Form TD F 90-22.1**, Report of Foreign Bank and Financial Accounts, to see if the estate or trust is considered to have an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country.

If you checked "Yes" for Question 3, file Form TD F 90-22.1 by June 30, 1998, with the Department of the Treasury at the address shown on the form. Form TD F 90-22.1 is not a tax return, so do not file it with Form 1041.

You may order Form TD F 90-22.1 by calling 1-800-829-3676 (1-800-TAX-FORM).

Question 4

The estate or trust may be required to file **Form 3520**, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, if:

- It directly or indirectly transferred property or money to a foreign trust. For this purpose, any U.S. person who created a foreign trust is considered a transferor.
- It is treated as the owner of any part of the assets of a foreign trust under the grantor trust rules.
- It received a distribution from a foreign trust.

Note: *An owner of a foreign trust must ensure that the trust files an annual information return on Form 3520-A, as well as U.S. owner and beneficiary statements. For details, see Notice 97-34, 1997-25 I.R.B. 22.*

The estate or trust may be required to file **Form 926**, Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership, to

- Pay any excise tax due under section 1491.
- Report information required under section 6038B.
- Report transfers of property to a foreign corporation, estate, trust, or partnership, and make elections under section 1492 with respect to those transfers.

For more information, see the Instructions for Form 926.

Question 5

An estate or trust claiming an interest deduction for qualified residence interest (as defined in section 163(h)(3)) on seller-provided financing, must include on an attachment to the 1997 Form 1041 the name, address, and taxpayer identifying number of the person to whom the

interest was paid or accrued (i.e., the seller).

If the estate or trust received or accrued such interest, it must provide identical information on the person liable for such interest (i.e., the buyer). This information does not need to be reported if it duplicates information already reported on Form 1098.

Question 6

To make the section 663(b) election to treat any amount paid or credited to a beneficiary within 65 days following the close of the tax year as being paid or credited on the last day of that tax year, check the box. This election can be made by the fiduciary of a complex trust or, for tax years beginning after August 5, 1997, the executor of a decedent's estate. For the election to be valid, you must file Form 1041 by the due date (including extensions). Once made, the election is irrevocable.

Question 7

To make the section 643(e)(3) election to recognize gain on property distributed in kind, check the box and see the instructions for Schedule D (Form 1041).

Question 8

If the decedent's estate has been open for more than 2 years, check the box and attach an explanation for the delay in closing the estate.

Question 9

A beneficiary is a skip person if the beneficiary is in a generation that is two or more generations below the generation of the transferor to the trust.

To determine if a beneficiary that is a trust is a skip person, and for exceptions to the general rules, see the definition of a skip person in the instructions for Schedule R of Form 706 .

Schedule I—Alternative Minimum Tax

Changes To Note

- The reduced tax rates that apply to net capital gain for sales, exchanges, or conversions of assets (including installment payments received) after May 6, 1997, also apply when figuring the alternative minimum tax (AMT). Use new Part IV of Schedule I if you completed Schedule D (Form 1041) and had an amount on line 24 or 27 of Schedule D (as refigured for the AMT, if necessary).
- For tax years beginning after 1986, the installment method is allowed for both the regular tax and the AMT for dispositions of property used or produced in a farming business and held primarily for sale to customers. No adjustment should be made on line 4j for these sales. File an amended Form 1041 to correct any prior year income tax return affected by this retroactive change. However, an

amended return generally must be filed within 3 years after the date the original return was filed or within 2 years after the date the tax was paid, whichever is later.

General Instructions

Use Schedule I to compute:

- ÿ1. The estate's or trust's alternative minimum taxable income;
- ÿ2. The income distribution deduction on a minimum tax basis; and
- ÿ3. The estate's or trust's alternative minimum tax (AMT).

Who Must Complete

- Complete Schedule I, Parts I and II, if the decedent's estate or trust is required to complete Schedule B.
- Complete Schedule I, Parts I and III (and IV, if applicable), if the decedent's estate's or trust's share of alternative minimum taxable income (Part I, line 13) exceeds \$22,500.

Recordkeeping

Schedule I contains adjustments and tax preference items that are treated differently for regular tax and AMT purposes. If you, as fiduciary for the estate or trust, completed a form to figure an item for regular tax purposes, you may have to complete it a second time for AMT purposes. Generally, the difference between the amounts on the two forms is the AMT adjustment or tax preference item to enter on Schedule I. Except for Form 1116, any additional form completed for AMT purposes does not have to be filed with Form 1041.

For regular tax purposes, some deductions and credits may result in carrybacks or carryforwards to other tax years. Examples are: investment interest expense; a net operating loss deduction; a capital loss; and the foreign tax credit. Because these items may be refigured for the AMT, the carryback or carryforward amount may be different for regular and AMT purposes. Therefore, you should keep records of these different carryforward and carryback amounts for the AMT and regular tax. The AMT carryforward will be important in completing Schedule I for 1998.

Credit for Prior Year Minimum Tax

Estates and trusts that paid alternative minimum tax in 1996, or had a minimum tax credit carryforward, may be eligible for a minimum tax credit in 1997. See Form 8801.

Partners, Shareholders, etc.

An estate or trust that is a partner in a partnership or a shareholder in an S corporation must take into account its share of items of income and deductions that enter into the computation of its adjustments and tax preference items.

Allocation of Deductions to Beneficiaries

The distributable net alternative minimum taxable income (DNAMTI) of the estate

or trust does not include amounts of depreciation, depletion, and amortization that are allocated to the beneficiaries, just as the distributable net income (DNI) of the estate or trust does not include these items for regular tax purposes.

Report separately on line 12 of Schedule K-1 (Form 1041) any adjustments or tax preference items attributable to depreciation, depletion, and amortization that were allocated to the beneficiaries.

Optional Write-Off Period Under Section 59(e)

The estate or trust may elect under section 59(e) to use an optional 10-year (60-month for intangible drilling and development expenditures and 3-year for circulation expenditures) write-off period for certain expenditures. If this election is made, the optional write-off period is used for regular tax purposes and there is no AMT adjustment. This election can be made for the following items:

- Circulation expenditures (section 173).
- Research and experimental expenditures (section 174).
- Intangible drilling and development expenditures (section 263(c)).
- Development expenditures for mines and natural deposits (section 616).
- Mining exploration expenditures (section 617(a)).

The election must be made in the year the expenditure was made and may be revoked only with IRS consent. See section 59(e) for more details.

Specific Instructions

Part I—Estate's or Trust's Share of Alternative Minimum Taxable Income

Line 1—Adjusted Total Income or (Loss)

Enter the amount from line 17 of page 1. If the adjusted total income includes the amount of the alcohol fuel credit as required under section 87, reduce the adjusted total income by the credit included in income.

Line 2—Net Operating Loss Deduction

Enter any net operating loss deduction (NOLD) from line 15a of page 1 as a positive amount.

Line 4a—Interest

In determining the alternative minimum taxable income, qualified residence interest (other than qualified housing interest defined in section 56(e)) is not allowed.

If you completed Form 4952 for regular tax purposes, you may have an adjustment on this line. Refigure your investment interest expense on another Form 4952 as follows:

Step 1. On line 1 of Form 4952, add any interest expense allocable to specified private activity bonds issued after August 7, 1986, to the other interest

expense. For a definition of "specified private activity bonds," see the instructions for line 4p.

Step 2. On line 2, enter the AMT disallowed investment interest expense from 1996.

Step 3. When completing Part II of Form 4952, refigure gross income from property held for investment, any net gain from the disposition of property held for investment, and any investment expenses, taking into account all AMT adjustments and tax preference items that apply. Include any interest income and investment expenses from private activity bonds issued after August 7, 1986.

To figure the adjustment for line 4a, subtract the total interest allowable for AMT purposes from the interest deduction claimed on line 10 of page 1. If the total interest expense allowed for AMT purposes is more than that allowed for regular tax purposes, enter the difference as a negative amount on line 4a.

Line 4b—Taxes

Enter any state, local, or foreign real property taxes; state or local personal property taxes; and state, local, or foreign income taxes that were included on line 11 of page 1.

Line 4d—Refund of Taxes

Enter any refunds received in 1997 of taxes described for line 4b above that were deducted in a tax year after 1986.

Line 4e—Depreciation of Property Placed in Service After 1986

Do not include on this line any depreciation adjustment from: (a) an activity for which you are not at risk; (b) a partnership or an S corporation if the basis limitations under section 704(d) or 1366(d) apply; (c) a tax shelter farm activity; or (d) a passive activity. Instead, take these depreciation adjustments into account when figuring the adjustments on line 4l, 4m, or 4n, whichever applies.

For AMT purposes, the depreciation deduction for tangible property placed in service after 1986 (or after July 31, 1986, if an election was made) must be refigured under the alternative depreciation system (ADS) described in section 168(g).

For property, other than residential rental and nonresidential real property, use the 150% declining balance method (switching to the straight line method in the first tax year when that method gives a better result). However, use the straight line method if that method was used for regular tax purposes. Generally, ADS depreciation is figured over the class life of the property. For tangible personal property not assigned a class life, use 12 years. See **Pub. 946**, How To Depreciate Property, for a discussion of class lives.

For residential rental and nonresidential real property, use the straight line method over 40 years.

Use the same convention that was used for regular tax purposes.

See Rev. Proc. 87-57, 1987-2 C.B. 687, or Pub. 946 for the optional tables for the alternative minimum tax using the 150% declining balance method.

Do not make an adjustment for motion picture films, videotapes, sound recordings, or property depreciated under the unit-of-production method or any other method not expressed in a term of years. (See section 168(f)(1), (2), (3), or (4).)

When refiguring the depreciation deduction, be sure to report any adjustment from depreciation that was allocated to the beneficiary for regular tax purposes separately on line 12 of Schedule K-1 (Form 1041).

To figure the adjustment, subtract the depreciation for AMT purposes from the depreciation for regular tax purposes.

If the depreciation figured for AMT purposes exceeds the depreciation allowed for regular tax purposes, enter the adjustment as a negative amount.

Line 4f—Circulation and Research and Experimental Expenditures

Caution: Do not make this adjustment for expenditures for which you elected the optional 3-year write-off period (10-year for research and experimental expenditures) under section 59(e) for regular tax purposes.

Circulation expenditures. Circulation expenditures deducted under section 173(a) for regular tax purposes must be amortized for AMT purposes over 3 years beginning with the year the expenditures were paid or incurred.

Research and experimental expenditures. Research and experimental expenditures deducted under section 174(a) for regular tax purposes generally must be amortized for AMT purposes over 10 years beginning with the year the expenditures were paid or incurred. However, do not make an adjustment for expenditures paid or incurred in connection with an activity in which the estate or trust materially participated under the passive activity rules.

Enter the difference between the amount allowed for AMT purposes and the amount allowed for regular tax purposes. If the amount for AMT purposes exceeds the amount allowed for regular tax purposes, enter the difference as a negative amount.

See section 56(b)(2)(B) for a discussion of the rules for losses on properties for which a deduction was allowed under section 173(a) or 174(a).

Line 4g—Mining Exploration and Development Costs

Caution: Do not make this adjustment for costs for which you elected the optional 10-year write-off period under section 59(e) for regular tax purposes.

Expenditures for the development or exploration of a mine or certain other mineral deposits (other than an oil, gas, or geothermal well) deducted under

sections 616(a) and 617(a) for regular tax purposes must be amortized for AMT purposes over 10 years beginning with the year the expenditures were paid or incurred.

Enter the difference between the amount allowed for AMT purposes and the amount allowed for regular tax purposes. If the amount allowed for AMT purposes exceeds the amount deducted for regular tax purposes, enter the difference as a negative amount.

See section 56(a)(2)(B) for a discussion of the rules for losses sustained on properties for which a deduction was allowed under section 616(a) or 617(a).

Line 4h—Long-Term Contracts Entered Into After February 28, 1986

For AMT purposes, the percentage of completion method of accounting described in section 460(b) generally must be used. However, this rule does not apply to any home construction contract (as defined in section 460(e)(6)).

Note: Contracts described in section 460(e)(1) are subject to the simplified method of cost allocation of section 460(b)(4).

Enter the difference between the amount reported for regular tax purposes and the AMT amount. If the AMT amount is less than the amount figured for regular tax purposes, enter the difference as a negative amount.

Line 4i—Amortization of Pollution Control Facilities

The amortization deduction under section 169 is not allowed for AMT purposes. Instead, the deduction is determined under the ADS described in section 168(g) using the class life for the facility under the straight line method.

To figure the adjustment, subtract the amortization deduction taken for regular tax purposes from the depreciation deduction determined under the ADS.

If the deduction allowed for AMT purposes is more than the amount allowed for regular tax purposes, enter the difference as a negative amount.

Line 4j—Installment Sales of Certain Property

The installment method does not apply for AMT purposes to any nondealer disposition of property that occurred after August 16, 1986, but before the first day of your tax year that began in 1987, if an installment obligation to which the proportionate disallowance rule applied arose from the disposition.

Enter as a negative adjustment on line 4j the amount of installment sale income that was reported for regular tax purposes.

Line 4k—Adjusted Gain or Loss (Including Incentive Stock Options)

Adjusted gain or loss. If the estate or trust sold or exchanged property during the year, or had a casualty gain or loss to business or income-producing property, it

may have an adjustment. The gain or loss on the disposition of certain assets is refigured for AMT purposes. Use this line if the estate or trust reported a gain or loss on Form 4797, Schedule D (Form 1041), or Form 4684 (Section B). When figuring the adjusted basis for those forms, take into account any AMT adjustments made this year, or in previous years, for items related to lines 4e, 4f, 4g, and 4i of Schedule I. For example, to figure the adjusted basis for AMT purposes, reduce the cost of an asset only by the depreciation allowed for AMT purposes.

Enter the difference between the gain or loss reported for regular tax purposes, and that figured for AMT purposes. If the AMT gain is less than the gain reported for regular tax purposes, enter the adjustment as a negative amount. If the AMT loss is more than the loss allowed for regular tax purposes, enter the adjustment as a negative amount.

Incentive stock options (ISOs). For regular tax purposes, no income is recognized when an incentive stock option (as defined in section 422(b)) is exercised. However, this rule does not apply for AMT purposes. Instead, the estate or trust must generally include on line 4k the excess, if any, of:

ÿ1. The fair market value of the stock acquired through exercise of the option (determined without regard to any lapse restriction) when its rights in the stock first become transferable or when these rights are no longer subject to a substantial risk of forfeiture, over

ÿ2. The amount paid for the stock, including any amount paid for the option used to acquire the stock.

Note: Even if the estate's or trust's rights in the stock are not transferable and are subject to a substantial risk of forfeiture, you may elect to include in AMT income the excess of the stock's fair market value (determined without regard to any lapse restriction) over the exercise price upon the transfer to the estate or trust of the stock acquired through exercise of the option. See section 83(b) for more details. The election must be made no later than 30 days after the date of transfer.

Increase the AMT basis of any stock acquired through the exercise of an incentive stock option by the amount of the adjustment. If the estate or trust acquired stock by exercising an incentive stock option and disposed of that stock in the same year, the treatment for regular tax and AMT purposes is the same (no adjustment is required).

Line 4l—Certain Loss Limitations

Caution: If the loss is from a passive activity, use line 4n instead. If the loss is from a tax shelter farm activity (that is not passive), use line 4m.

Refigure your allowable losses for AMT purposes from activities for which you are not at risk and basis limitations applicable to interests in partnerships and stock in S corporations, by taking into account

your AMT adjustments and tax preference items. See sections 59(h), 465, 704(d), and 1366(d).

Enter the difference between the loss reported for regular tax purposes and the AMT loss. If the AMT loss is more than the loss reported for regular tax purposes, enter the adjustment as a negative amount.

Line 4m—Tax Shelter Farm Activities

Note: Use this line only if the tax shelter farm activity is not a passive activity. Otherwise, use line 4n.

For AMT purposes, no loss is allowed from any tax shelter farm activity as defined in section 58(a)(2).

An excess farm loss from one farm activity cannot be netted against income from another farm activity. Any disallowed loss (for AMT purposes) is carried forward until offset by income from the same activity or when the entire activity is sold.

Include any other adjustment or tax preference item and your prior year AMT unallowed loss when refiguring the farm loss. For example, if depreciation must be refigured for AMT purposes, include the adjustment on this line. DO NOT include it again on line 4e, 4r, or 4s.

Determine your tax shelter farm activity gain or loss for AMT purposes using the same rules you used for regular tax purposes except that any AMT loss is allowed only to the extent that a taxpayer is insolvent (see section 58(c)(1)). An AMT loss may not be used in the current tax year to offset gains from other tax shelter farm activities. Instead, it must be suspended and carried forward indefinitely until either you have a gain in a subsequent tax year from that same tax shelter farm activity or the activity is disposed of.

Line 4n—Passive Activities

For AMT purposes, the rules described in section 469 apply, except that in applying the limitations, minimum tax rules apply.

Refigure passive activity gains and losses on an AMT basis. Refigure a passive activity gain or loss by taking into account all AMT adjustments or tax preference items that pertain to that activity.

You may complete a second Form 8582 to determine the passive activity losses allowed for AMT purposes, but do not send this AMT Form 8582 to the IRS.

Note: The amount of any passive activity loss that is not deductible (and is therefore carried forward) for AMT purposes is likely to differ from the amount (if any) that is carried forward for regular tax purposes. Therefore, it is essential that you retain adequate records for both AMT and regular tax purposes.

Enter the difference between the loss reported on page 1, and the AMT loss, if any.

Caution: Do not enter again elsewhere on this schedule any AMT adjustment or tax preference item included on this line.

Publicly traded partnerships (PTPs). If the estate or trust had a loss from a PTP, refigure the loss using any AMT adjustments and tax preference items.

Line 4o—Beneficiaries of Other Trusts or Decedent's Estates

If the estate or trust is the beneficiary of another estate or trust, enter the adjustment for minimum tax purposes from line 9, Schedule K-1 (Form 1041).

Line 4p—Tax-Exempt Interest From Specified Private Activity Bonds

Enter the interest earned from specified private activity bonds reduced (but not below zero) by any deduction that would have been allowable if the interest were includible in gross income for regular tax purposes. Specified private activity bonds are any qualified bonds (as defined in section 141) issued after August 7, 1986. See section 57(a)(5) for more information.

Exempt-interest dividends paid by a regulated investment company are treated as interest from specified private activity bonds to the extent the dividends are attributable to interest received by the company on the bonds, minus an allocable share of the expenses paid or incurred by the company in earning the interest.

Line 4q—Depletion

Refigure the depletion deduction for AMT purposes by using only the income and deductions allowed for the AMT when refiguring the limit based on taxable income from the property under section 613(a) and the limit based on taxable income, with certain adjustments, under section 613A(d)(1). Also, the depletion deduction for mines, wells, and other natural deposits under section 611 is limited to the property's adjusted basis at the end of the year, as refigured for the AMT, unless the estate or trust is an independent producer or royalty owner claiming percentage depletion for oil and gas wells. Figure this limit separately for each property. When refiguring the property's adjusted basis, take into account any AMT adjustments made this year or in previous years that affect basis (other than the current year's depletion).

Enter on line 4q the difference between the regular tax and AMT deduction. If the AMT deduction is more than the regular tax deduction, enter the difference as a negative amount.

Line 4r—Accelerated Depreciation of Real Property Placed in Service Before 1987

For AMT purposes, use the straight line method to figure depreciation. Use a recovery period of 19 years for 19-year real property and 15 years for low-income housing. Enter the excess of depreciation claimed for regular tax purposes over depreciation refigured using the straight line method. Figure this amount separately for each property and include on line 4r only positive amounts.

Line 4s—Accelerated Depreciation of Leased Personal Property Placed in Service Before 1987

For leased personal property other than recovery property, enter the amount by which the regular tax depreciation using the pre-1987 rules exceeds the depreciation allowable using the straight line method.

For leased 10-year recovery property and leased 15-year public utility property, enter the amount by which the depreciation deduction determined for regular tax purposes is more than the deduction allowable using the straight line method with a half-year convention, no salvage value, and the following recovery period:

10-year property 15 years
15-year public utility property 22 years

Figure this amount separately for each property and include on line 4s only positive amounts.

Line 4t—Intangible Drilling Costs

Caution: Do not make this adjustment for costs for which you elected the optional 60-month write-off under section 59(e) for regular tax purposes.

Except as provided below, intangible drilling costs (IDCs) from oil, gas, and geothermal wells are a tax preference item to the extent that the excess IDCs exceed 65% of the net income from the wells. Figure the tax preference item for all geothermal properties separately from the preference for all oil and gas properties.

Excess IDCs are figured by taking the amount of your IDCs allowed for regular tax purposes under section 263(c) (not including any section 263(c) deduction for nonproductive wells) minus the amount that would have been allowed if that amount had been amortized over a 120-month period starting with the month the well was placed in production.

Note: Cost depletion can be substituted for the amount allowed using amortization over 120 months.

Net income is determined by taking the gross income from all oil, gas, and geothermal wells reduced by the deductions allocable to those properties (determined without regard to excess IDCs). When figuring net income, use only income and deductions allowed for the AMT.

Exception. The preference for IDCs from oil and gas wells does not apply to taxpayers who are independent producers (i.e., not integrated oil companies as defined in section 291(b)(4)). However, this benefit may be limited. First, figure the IDC preference as if this exception did not apply. Then, for purposes of this exception, complete Schedule I through line 6, including the IDC preference. If the amount of the IDC preference exceeds 40% of the amount figured for line 6, enter the excess on line 4t (the benefit of this exception is limited). If the amount of the

IDC preference is equal to or less than 40% of the amount figured for line 6, do not enter an amount on line 4t (the benefit of this exception is not limited).

Line 4u—Other Adjustments

Include on this line:

- **Patron's adjustment.** Distributions the estate or trust received from a cooperative may be includible in income. Unless the distributions are nontaxable, include on line 4u the total AMT patronage dividend adjustment reported to the estate or trust from the cooperative.

- **Section 1202 exclusion.** If the estate or trust claimed the exclusion under section 1202 for gain on qualified small business stock, multiply the amount of the gain excluded from income (as shown on line 6 of Schedule D (Form 1041)) by 42% (.42). Enter the result as a positive number.

- **Related adjustments.** AMT adjustments and tax preference items may affect deductions that are based on an income limit other than AGI or modified AGI (e.g., farm conservation expenses). Refigure these deductions using the income limit as modified for the AMT. Include the difference between the regular tax and AMT deduction on line 4u. If the AMT deduction is more than the regular tax deduction, include the difference as a negative amount.

Note: Do not make an adjustment on line 4u for an item you refigured on another line of Schedule I (e.g., line 4q).

Line 7—Alternative Tax Net Operating Loss Deduction (ATNOLD)

For tax years beginning after 1986, the net operating loss (NOL) under section 172(c) is modified for alternative tax purposes by (a) adding the adjustments made under sections 56 and 58 (subtracting if the adjustments are negative); and (b) reducing the NOL by any item of tax preference under section 57 (except the appreciated charitable contribution preference item). For an estate or trust that held a residual interest in a real estate mortgage investment conduit (REMIC), figure the ATNOLD without regard to any excess inclusion.

When figuring an NOL from a loss year prior to 1987, the rules in effect before enactment of the Tax Reform Act (TRA) of 1986 apply. The NOL under section 172(c) is reduced by the amount of the tax preference items that were taken into account in figuring the NOL. In addition, the NOL is figured by taking into account only itemized deductions that were alternative tax itemized deductions for the tax year and that were a modification to the NOL under section 172(d). See sections 55(d) and 172 as in effect before the TRA of 1986.

If this estate or trust is the beneficiary of another estate or trust that terminated in 1997, include any AMT NOL carryover

that was reported on line 13e of Schedule K-1 (Form 1041).

The ATNOLD may be limited. To figure the ATNOLD limitation, first figure AMTI without regard to the ATNOLD. For this purpose, figure a tentative amount for line 4q of Schedule I by treating line 7 as if it were zero. Then, figure a tentative amount for line 6 of Schedule I. The ATNOLD limitation is 90% of the tentative line 6 amount. Enter on line 7 the smaller of the ATNOLD or the ATNOLD limitation. Any alternative tax NOL not used because of the ATNOLD limitation can be carried back or forward. See section 172(b) for details. The treatment of alternative tax NOLs does not affect your regular tax NOL.

Note: If you elected under section 172(b)(3) to forego the carryback period for regular tax purposes, the election will also apply for the AMT.

Line 13—Estate's or Trust's Share of Alternative Minimum Taxable Income

For an estate or trust that held a residual interest in a REMIC, line 13 may not be less than the estate's or trust's share of the amount on Schedule E (Form 1040), line 37, column (c). If that amount is larger than the amount you would otherwise enter on line 13, enter that amount instead and write "Sch. Q" on the dotted line next to line 13.

Part II—Income Distribution Deduction on a Minimum Tax Basis

Line 14—Adjusted Alternative Minimum Taxable Income

If the amount on line 8 of Schedule I is less than zero, and the negative number is attributable wholly or in part to the capital loss limitation rules under section 1211(b), then enter as a negative number the smaller of (a) the loss from line 8; or (b) the loss from line 4 on page 1.

Line 15—Adjusted Tax-Exempt Interest

To figure the adjusted tax-exempt interest (including exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company), subtract the total of (a) any tax-exempt interest from line 2 of Schedule A of Form 1041 figured for AMT purposes; and (b) any section 212 expenses allowable for AMT purposes allocable to tax-exempt interest, from the amount of tax-exempt interest received. DO NOT subtract any deductions reported on lines 4a through 4c. Section 212 expenses that are directly allocable to tax-exempt interest are allocated only to tax-exempt interest. A reasonable proportion of section 212 expenses that are indirectly allocable to both tax-exempt interest and other income must be allocated to each class of income.

Line 17

Reduce the amount on line 17 by any allocable section 1202 exclusion (as refigured for AMT purposes).

Line 18

Enter any capital gains that were paid or permanently set aside for charitable purposes from the current year's income included on line 1 of Schedule A. Reduce the amount on line 18 by any allocable section 1202 exclusion (as refigured for AMT purposes).

Lines 19 and 20

Capital gains and losses must take into account any basis adjustments from line 4k, Part I.

Line 25—Adjustment for Tax-Exempt Income

In figuring the income distribution deduction on a minimum tax basis, the estate or trust is not allowed a deduction for any item of DNAMTI (line 21) that is not included in the gross income of the estate or trust figured on an AMT basis. Thus, for purposes of figuring the allowable income distribution deduction on a minimum tax basis, the DNAMTI is figured without regard to any tax-exempt interest (except for amounts from line 4p).

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 24), and the DNAMTI (line 21) is less than or equal to line 24, then enter on line 25 the amount from line 15.

If tax-exempt interest is the only tax-exempt income included in the total distributions (line 24), and the DNAMTI is more than line 24 (i.e., the estate or trust made a distribution that is less than the DNAMTI), then figure the adjustment by multiplying line 15 by a fraction, the numerator of which is the total distributions (line 24), and the denominator of which is the DNAMTI (line 21). Enter the result on line 25.

If line 24 includes tax-exempt income other than tax-exempt interest (except for amounts from line 4p), figure line 25 by subtracting the total expenses allocable to tax-exempt income that are allowable for AMT purposes from tax-exempt income included on line 24.

Expenses that are directly allocable to tax-exempt income are allocated only to tax-exempt income. A reasonable proportion of expenses indirectly allocable to both tax-exempt income and other income must be allocated to each class of income.

Line 28—Income Distribution Deduction on a Minimum Tax Basis

Allocate the income distribution deduction figured on a minimum tax basis among the beneficiaries in the same manner as income was allocated for regular tax purposes. Report each beneficiary's share on line 7 of Schedule K-1 (Form 1041).

Part III—Alternative Minimum Tax Computation

Line 37—Alternative Minimum Foreign Tax Credit

To figure the AMT foreign tax credit:

ÿ1. Complete and attach Form 1116, with the notation at the top, "Alt Min Tax" for each type of income specified at the top of Form 1116.

ÿ2. Complete Part I, entering income, deductions, etc., attributable to sources outside the United States computed on a minimum tax basis.

ÿ3. Complete Part III. On line 9, do not enter any taxes taken into account in a tax year beginning after 1986 that are treated under section 904(c) as paid or accrued in a tax year beginning before 1987. On line 10 of Form 1116, enter the alternative minimum tax foreign tax credit carryover, and on line 17 of Form 1116, enter the alternative minimum taxable income from line 13 of Schedule I. On line 19 of Form 1116, enter the amount from line 36 of Schedule I.

Complete Part IV. The foreign tax credit from line 32 of the AMT Form 1116 is limited to the tax on line 36 of Schedule I, less 10% of what would have been the tax on line 36 of Schedule I, if line 7 of Schedule I had been zero and the exception for intangible drilling costs does not apply (see the instructions for line 4t on page 22). If Schedule I, line 7, is zero or blank, and the estate or trust has no intangible drilling costs (or the exception does not apply), enter on Schedule I, line 37, the smaller of Form 1116, line 32; or 90% of Schedule I, line 36. If line 7 has an entry (other than zero), or the exception for intangible drilling costs applies, for purposes of this line refigure what the tax would have been on Schedule I, line 36, if line 7 were zero and the exception did not apply. Multiply that amount by 10% and subtract the result from line 36. Enter on Schedule I, line 37, the smaller of that amount or the amount from Form 1116, line 32.

If the AMT foreign tax credit is limited, any unused amount can be carried back or forward in accordance with section 904(c).

Note: *The election to forego the carryback period for regular tax purposes also applies for the AMT.*

Line 39—Regular Tax Before Credits

Enter the tax from line 1a of Schedule G, reduced by the amount of any foreign tax credit entered on line 2a of Schedule G. DO NOT deduct any foreign tax credit that was allocated to the beneficiaries.

Part IV—Line 36 Computation Using Maximum Capital Gains Rates

Lines 44, 45, and 47. You generally may enter the amounts from Schedule D (Form 1041), lines 27, 24, and 21, on Schedule I, lines 44, 45, and 47, respectively. But if the gain or loss for any asset disposition

on Schedule D is different for the AMT than for the regular tax (e.g., because of a different basis for the AMT from depreciation adjustments or an incentive stock option adjustment), you must refigure the amounts from Schedule D, lines 27, 24, and 21 for the AMT. You should complete a second Schedule D using amounts for the AMT. Keep that Schedule D for your records, but **do not** attach it to Form 1041. Enter the amounts from lines 27, 24, and 21 of the AMT Schedule D on Schedule I, lines 44, 45, and 47 respectively.

Note: *Do not refigure the amount from Schedule D, line 36, when completing Schedule I, line 51.*

Schedule D (Form 1041)—Capital Gains and Losses

Changes To Note

Maximum capital gains tax rates. The Taxpayer Relief Act of 1997 generally reduced the tax rates that apply to net capital gain (the excess of net long-term capital gain over net short-term capital loss) for sales, exchanges, and conversions of assets (including installment payments received) after May 6, 1997. If the estate or trust has a net capital gain, use Part V of Schedule D to figure the tax on all of the estate's or trust's taxable income, including capital gains at the new rates. Although you will have to complete Schedule D to see how the new rates apply to the estate or trust, the following is a summary of the new rates:

- 20% for net gain from sales, exchanges, etc., **(a)** after May 6, 1997, and before July 29, 1997, for assets held more than 1 year, and **(b)** after July 28, 1997, for assets held more than 18 months. This rate is generally 10% for estates and trusts whose tax rate on ordinary income is 15%.
- 25% for unrecaptured section 1250 gain (generally, the part of real estate capital gains attributable to depreciation). The 25% rate applies only to gain from sales, exchanges, etc., **(a)** after May 6, 1997, and before July 29, 1997, for assets held more than 1 year, and **(b)** after July 28, 1997, for assets held more than 18 months.
- 28% for net gain from sales, exchanges, etc., **(a)** before May 7, 1997, and **(b)** after July 28, 1997, from property held more than 1 year but not more than 18 months. This rate also applies to collectibles gains and the taxable gain (but not more than the section 1202 exclusion) on the sale or exchange of qualified small business stock.

Constructive sales treatment for certain appreciated positions. The estate or trust may have to recognize gain if it entered into a constructive sale after June 8, 1997, of property in which it holds an appreciated position (such as a "short sale against the box"). See page 25.

Rollover of gain from qualified stock.

The estate or trust may be able to postpone gain from the sale of qualified small business stock if it reinvests in another qualified small business stock during the 60-day period that began on the date of the sale. See page 25.

Transfer of assets to a foreign trust.

Beginning on August 5, 1997, if a U.S. trust becomes a foreign trust, the transaction may be treated as a sale or exchange of trust assets and gain recognized. See new section 684 for details and exceptions.

Capital loss carryover worksheet. The capital loss carryover calculation has been moved from Schedule D to the instructions. See page 27.

General Instructions

Purpose of Form

Use Schedule D (Form 1041) to report gains and losses from the sale or exchange of capital assets by an estate or trust.

To report sales or exchanges of property other than capital assets, including the sale or exchange of property used in a trade or business and involuntary conversions (other than casualties and thefts), see Form 4797 and related instructions.

If property is involuntarily converted because of a casualty or theft, use Form 4684.

Section 1256 contracts and straddles are reported on **Form 6781**, Gains and Losses From Section 1256 Contracts and Straddles.

Capital Asset

Each item of property held by the estate or trust (whether or not connected with its trade or business) is a capital asset except:

- Inventoriable assets or property held primarily for sale to customers;
- Depreciable or real property used in a trade or business;
- Certain copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property;
- Accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of inventoriable assets or property held primarily for sale to customers; and
- Certain U.S. Government publications not purchased at the public sale price.

You may find additional helpful information in the following publications:

- **Pub. 544**, Sales and Other Dispositions of Assets; and
- **Pub. 551**, Basis of Assets.

Short-Term or Long-Term

Separate the capital gains and losses according to how long the estate or trust held or owned the property. The holding period for short-term capital gains and losses is 1 year or less. The holding period for long-term capital gains and

losses is more than 1 year. Property acquired by a decedent's estate from the decedent is considered as held for more than 18 months.

When you figure the length of the period the estate or trust held property, begin counting on the day after the estate or trust acquired the property and include the day the estate or trust disposed of it. Use the trade dates for the date of acquisition and sale of stocks and bonds traded on an exchange or over-the-counter market.

Section 643(e)(3) Election

For noncash property distributions, a fiduciary may elect to have the estate or trust recognize gain or loss in the same manner as if the distributed property had been sold to the beneficiary at its fair market value (FMV). The distribution deduction is the property's FMV. This election applies to all distributions made by the estate or trust during the tax year and, once made, may be revoked only with the consent of the IRS.

Note that section 267 does not allow a trust (or a decedent's estate for tax years beginning after August 5, 1997) to claim a deduction for any loss on property to which a section 643(e)(3) election applies. In addition, when a trust (or a decedent's estate for tax years beginning after August 5, 1997) distributes depreciable property, section 1239 applies to deny capital gains treatment for any gain on property to which a section 643(e)(3) election applies.

Section 644 Tax on Trusts

If a trust sells or exchanges property at a gain before August 6, 1997, and within 2 years after receiving it from a transferor, a special tax may be due. **Do not report includible gains under section 644 on Schedule D.** The tax on these gains is reported separately on Form 1041. For more information, see the instructions for Schedule G, line 1b, on page 17.

Related Persons

A trust cannot deduct a loss from the sale or exchange of property directly or indirectly between any of the following:

- A grantor and a fiduciary of a trust;
- A fiduciary and a fiduciary or beneficiary of another trust created by the same grantor;
- A fiduciary and a beneficiary of the same trust;
- A trust fiduciary and a corporation of which more than 50% in value of the outstanding stock is owned directly or indirectly by or for the trust or by or for the grantor of the trust; or
- For tax years beginning after August 5, 1997, an executor of an estate and a beneficiary of that estate, except when the sale or exchange is to satisfy a pecuniary bequest (i.e., a bequest of a sum of money).

Items for Special Treatment

The following items may require special treatment:

- Exchange of "like-kind" property.
- Wash sales of stock or securities (including contracts or options to acquire or sell stock or securities) (section 1091).
- Gain or loss on options to buy or sell (section 1234).
- Certain real estate subdivided for sale that may be considered a capital asset (section 1237).
- Gain on disposition of stock in an interest charge domestic international sales corporation (section 995(c)).
- Gain on the sale or exchange of stock in certain foreign corporations (section 1248).
- Sales of stock received under a qualified public utility dividend reinvestment plan. See Pub. 550 for details.
- Transfer of appreciated property to a political organization (section 84).
- Distributions received from an employee pension, profit sharing, or stock bonus plan. See Form 4972.
- Disposition of market discount bonds (section 1276).

Constructive Sales Treatment for Certain Appreciated Positions

Generally, the estate or trust must recognize gain (but not loss) on the date it enters into a constructive sale of any appreciated position in stock, a partnership interest, or certain debt instruments as if the position were disposed of at fair market value on that date. In most cases, this new rule applies to constructive sales after June 8, 1997.

The estate or trust is treated as making a constructive sale of an appreciated position when it (or a related person, in some cases) does one of the following:

- Enters into a short sale of the same or substantially identical property (i.e., a "short sale against the box").
- Enters into an offsetting notional principal contract relating to the same or substantially identical property.
- Enters into a futures or forward contract to deliver the same or substantially identical property.
- Acquires the same or substantially identical property (if the appreciated position is a short sale, offsetting notional principal contract, or a futures or forward contract).

Exception. Generally, constructive sale treatment **does not** apply if:

- The estate or trust closed the transaction before the end of the 30th day after the end of the year in which it was entered into,
- The estate or trust held the appreciated position to which the transaction relates throughout the 60-day period starting on the date the transaction was closed, **and**
- At no time during that 60-day period was the estate's or trust's risk of loss

reduced by holding certain other positions.

For details and other exceptions to these rules, see Pub. 550.

Exclusion of Gain on Qualified Small Business Stock

Section 1202 provides for an exclusion of 50% of the gain on the sale or exchange of qualified small business stock. The section 1202 exclusion applies **only** to qualified small business stock issued after August 10, 1993, and held for more than 5 years. To be **qualified small business stock**, the stock must meet **all** of the following tests:

- It must be stock in a C corporation (i.e., not S corporation stock).
- It must have been originally issued after August 10, 1993.
- As of the date the stock was issued, the corporation was a qualified small business. A qualified small business is a domestic C corporation with total gross assets of \$50 million or less **(a)** at all times after August 9, 1993, and before the stock was issued, and **(b)** immediately after the stock was issued. Gross assets include those of any predecessor of the corporation. All corporations that are members of the same parent-subsidiary controlled group are treated as one corporation.
- The estate or trust acquired the stock at its original issue (either directly or through an underwriter), either in exchange for money or other property or as pay for services (other than as an underwriter) to the corporation. In certain cases, the estate or trust may meet the test if it acquired the stock from another person who met this test (such as by gift or at death) or through a conversion or exchange of qualified small business stock you held.

• During substantially all the time the estate or trust held the stock:

1. The corporation was a C corporation,
2. At least 80% of the value of the corporation's assets were used in the active conduct of 1 or more qualified businesses (defined below), and
3. The corporation **was not** a foreign corporation, DISC, former DISC, corporation that has made (or that has a subsidiary that has made) a section 936 election, regulated investment company, real estate investment trust, REMIC, FASIT, or cooperative.

Note: A *specialized small business investment company (SSBIC)* is treated as having met tests 2 and 3 above.

A **qualified business** is any business **other than** the following:

- One involving services performed in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services.

- One whose principle asset is the reputation or skill of one or more employees.
- Any banking, insurance, financing, leasing, investing, or similar business.
- Any farming business (including the raising or harvesting of trees).
- Any business involving the production of products for which percentage depletion can be claimed.
- Any business of operating a hotel, motel, restaurant, or similar business.

For more details about limits and additional requirements that may apply, see section 1202.

Report in column (f) of line 6 the entire gain realized on the sale of qualified small business stock. In column (g) of line 6, report as 28% rate gain an amount equal to the section 1202 exclusion. Directly below the line on which you reported the gain, enter in column (a) "Section 1202 exclusion," and enter as a (loss) in column (f) the amount of the allowable exclusion. Also report 42% of the exclusion as a positive number on Schedule I, line 4u.

Rollover of Gain From Qualified Stock

If the estate or trust held qualified small business stock (as defined on page 25) for more than 6 months and sold it after August 5, 1997, it may postpone gain if it purchased other qualified small business stock during the 60-day period that began on the date of the sale. The estate or trust must recognize gain to the extent the sale proceeds exceed the cost of the replacement stock. Reduce the basis of the replacement stock by any postponed gain.

If the estate or trust chooses to postpone gain, report the entire gain realized on the sale on line 1 or 6. Directly below the line on which you reported the gain, enter in column (a) "Section 1045 Rollover" and enter as a (loss) in column (f) the amount of the postponed gain. If reported in Part II, enter the appropriate amount, if any, in column (g) of both lines.

Specific Instructions

Lines 1 and 6

Short-term and long-term capital gains and losses. Enter all sales of stocks, bonds, etc.

Redemption of stock to pay death taxes. If stock is redeemed under the provisions of section 303, list and identify it on line 6 and give the name of the decedent and the IRS office where the estate tax or generation-skipping transfer tax return was filed.

If you are reporting capital gain from a lump-sum distribution, see the instructions for Form 4972 for information about the Federal estate tax.

Column (d)—Sales Price

Enter either the gross sales price or the net sales price from the sale. On sales of stocks and bonds, report the gross amount as reported to the estate or trust on Form 1099-B or similar statement.

However, if the estate or trust was advised that gross proceeds less commissions and option premiums were reported to the IRS, enter that net amount in column (d).

Column (e)—Cost or Other Basis

Basis of trust property. Generally, the basis of property acquired by gift is the same as the basis in the hands of the donor. If the fair market value (FMV) of the property at the time it was transferred to the trust is less than the transferor's basis, then the FMV is used for determining any loss on disposition.

If the property was transferred to the trust after 1976, and a gift tax was paid under Chapter 12, then increase the donor's basis as follows:

Multiply the amount of the gift tax paid by a fraction, the numerator of which is the net appreciation in value of the gift (discussed below), and the denominator of which is the amount of the gift. For this purpose, the **net appreciation in value of the gift** is the amount by which the FMV of the gift exceeds the donor's adjusted basis.

Basis of decedent's estate property. Generally, the basis of property acquired by a decedent's estate is the FMV of the property at the date of the decedent's death, or the alternate valuation date if the executor elected to use an alternate valuation under section 2032.

See Pub. 551 for a discussion of the valuation of qualified real property under section 2032A.

Basis of property for bankruptcy estates. Generally, the basis of property held by the bankruptcy estate is the same as the basis in the hands of the individual debtor.

Adjustments to basis. Before figuring any gain or loss on the sale, exchange, or other disposition of property owned by the estate or trust, adjustments to the property's basis may be required.

Some items that may increase the basis include:

- ÿ1. Broker's fees and commissions.
- ÿ2. Reinvested dividends that were previously reported as income.
- ÿ3. Reinvested capital gains that were previously reported as income.
- ÿ4. Costs that were capitalized.
- ÿ5. Original issue discount that has been previously included in income.

Some items that may decrease the basis include:

- ÿ1. Nontaxable distributions that consist of return of capital.
- ÿ2. Deductions previously allowed or allowable for depreciation.
- ÿ3. Casualty or theft loss deductions.

See Pub. 551 for additional information.

See section 852(f) for treatment of load charges incurred in acquiring stock in a regulated investment company.

Carryover basis. Carryover basis determined under repealed section 1023 applies to property acquired from a

decedent who died after December 31, 1976, and before November 7, 1978, only if the executor elected it on a **Form 5970-A**, Election of Carryover Basis, that was filed on time.

Column (f)—Gain or (Loss) for Entire Year

Make a separate entry in this column for each transaction reported on lines 1 and 6 and any other lines that apply to the estate or trust. For lines 1 and 6, subtract the amount in column (e) from the amount in column (d). Enter negative amounts in parentheses.

Column (g)—28% Rate Gain or (Loss)

Enter the amount, if any, from Part II, column (f), that is from a sale, exchange, or conversion (or an installment payment received):

- Before May 7, 1997, OR
- After July 28, 1997, for assets that were held more than 1 year but not more than 18 months.

Also include collectibles gains and losses. A **collectibles gain or loss** is any gain or loss from the sale or exchange of a collectible that is a capital asset but **only** if that asset was held **either**:

- More than 18 months, OR
- More than 1 year but not more than 18 months if sold or exchanged after May 6, 1997, but before July 29, 1997.

Collectibles gain also includes gain from the sale of an interest in a partnership, S corporation, or trust attributable to unrealized appreciation of collectibles.

Collectibles includes works of art, rugs, antiques, metals (such as gold, silver, and platinum bullion), gems, stamps, coins, alcoholic beverages, and certain other tangible property.

Enter negative amounts in parentheses.

Lines 2 and 7

Installment sales. If the estate or trust sold property at a gain during the tax year, and will receive a payment in a later tax year, report the sale on the installment method and file **Form 6252**, Installment Sale Income, unless you elect not to do so.

Also, use Form 6252 to report any payment received in 1997 from a sale made in an earlier tax year that was reported on the installment method.

To elect out of the installment method, report the full amount of the gain on a timely filed return (including extensions).

Exchange of "like-kind" property. Generally, no gain or loss is recognized when property held for productive use in a trade or business or for investment is exchanged solely for property of a like-kind to be held either for productive use in a trade or business or for investment. However, if a trust exchanges like-kind property with a related person (see **Related Persons** on page 25), and before 2 years after the date of the last

transfer that was part of the exchange the related person disposes of the property, or the trust disposes of the property received in exchange from the related person, then the original exchange will not qualify for nonrecognition. See section 1031(f) for exceptions.

Complete and attach **Form 8824**, Like-Kind Exchanges, to Form 1041 for each exchange.

Line 9—Capital Gain Distributions

Enter as a long-term capital gain on line 9, column (f), the **total** capital gain distributions paid during the year, regardless of how long the estate or trust held its investment. Enter on line 9, column (g), the total of the amounts reported as the 28% rate gain portion of total capital gain distributions.

Line 14, Column (1)—Beneficiaries' Net Short-Term Capital Gain or Loss

Enter the amount of net short-term capital gain or loss allocable to the beneficiary or beneficiaries. Except in the final year, include only those short-term capital losses that are taken into account in determining the amount of gain from the sale or exchange of capital assets that is paid, credited, or required to be distributed to any beneficiary during the tax year. See Regulations section 1.643(a)-3 for more information about allocation of capital gains and losses.

Except in the final year, if the losses from the sale or exchange of capital assets are more than the gains, all of the losses must be allocated to the estate or trust and none are allocated to the beneficiaries.

Line 14, Column (2)—Estate's or Trust's Net Short-Term Capital Gain or Loss

Enter the amount of the net short-term capital gain or loss allocable to the estate or trust. Include any capital gain paid or permanently set aside for a charitable purpose specified in section 642(c).

Line 14, Column (3)—Total

Enter the total of the amounts entered in columns (1) and (2). The amount in column (3) should be the same as the amount on line 5.

Line 15—Net Long-Term Capital Gain or Loss

Allocate the net long-term capital gain or loss on line 15 in the same manner as the net short-term capital gain or loss on line 14. However, **do not** take the section 1202 exclusion on gain from the sale or exchange of qualified small business stock into account when figuring net-long term capital gain or loss allocable to the beneficiaries.

Line 15b. Unrecaptured section 1250 gain is figured as follows:

Step 1. For each section 1250 property in Part III of Form 4797 for which the estate or trust had an entry in column (g),

but not in column (h), of Part I of Form 4797, subtract line 26g of Form 4797 from the **smaller** of line 22 or line 24 of Form 4797.

Step 2. Add the amount(s) from Step 1 and any amounts reported to the estate or trust on Schedules K-1 from a partnership or an S corporation as "unrecaptured section 1250 gain."

Step 3. Figure the **smaller** of (a) the total from Step 2, or (b) the gain, if any, from Form 4797, line 7, column (g).

Step 4. If the estate or trust **did not** have an entry on Form 4797, line 8, the amount for Step 4 is the amount from Step 3. If it had an entry on Form 4797, line 8, column (g), reduce that amount by the amount, if any, from Form 4797, line 8, column (h). Then, subtract this result from the amount from Step 3.

Step 5. Add the result from Step 4 to the total amounts reported to you as "unrecaptured section 1250 gain" from an estate, a trust, a real estate investment trust, or a mutual fund.

Step 6. Combine the loss, if any, on Schedule D, line 5, with the gain or loss on Schedule D, line 12. If the result is zero or a gain, enter in the appropriate columns of line 15b the amount from Step 5. If the result is a loss, combine that loss with the amount from Step 5 and enter the result in the appropriate columns of line 15b, but not less than zero.

Part IV—Capital Loss Limitation

If the sum of all the capital losses is more than the sum of all the capital gains, then these capital losses are allowed as a deduction only to the extent of the smaller of the net loss or \$3,000.

For any year (including the final year) in which capital losses exceed capital gains, the estate or trust may have a capital loss carryover. Use the **Capital Loss Carryover Worksheet** below to figure any capital loss carryover. A capital loss carryover may be carried forward indefinitely. Capital losses keep their character as either short-term or long-term when carried over to the following year.

Part V—Tax Computation Using Maximum Capital Gains Rate

Line 21

If the estate or trust received capital gains that were derived from income in respect of a decedent, and a section 691(c)(4) deduction was claimed, then line 21 must be reduced by the portion of the section 691(c)(4) deduction claimed on Form 1041, page 1, line 19.

Line 54

If the tax using the maximum capital gains rate (line 52) is less than the regular tax (line 53), enter the amount from line 54

Capital Loss Carryover Worksheet
(keep for your records)



Use this worksheet to figure your capital loss carryovers from 1997 to 1998 if Schedule D, line 17, is a loss and (a) the loss on Schedule D, line 16, column (3), is more than \$3,000, OR (b) Form 1041, line 23 is a loss.

- | | |
|--|-----------|
| 1. Enter taxable income (or loss) from Form 1041, line 23 . . . | 1. _____ |
| 2. Enter loss from line 17 of Schedule D as a positive amount . . . | 2. _____ |
| 3. Enter amount from Form 1041, line 21 | 3. _____ |
| 4. Adjusted taxable income. Combine lines 1, 2, and 3, but do not enter less than zero | 4. _____ |
| 5. Enter the smaller of line 2 or line 4 | 5. _____ |
| Note: If line 5 of Schedule D is a loss, go to line 6; otherwise, enter -0- on line 6 and go to line 10. | |
| 6. Enter loss from Schedule D, line 5, as a positive amount . . . | 6. _____ |
| 7. Enter gain, if any, from Schedule D, line 13. If that line is blank or shows a loss, enter -0- | 7. _____ |
| 8. Add lines 5 and 7 | 8. _____ |
| 9. Short-term capital loss carryover to 1998. Subtract line 8 from line 6. If zero or less, enter -0-. If this is the final return of the estate or trust, also enter on Schedule K-1 (Form 1041), line 13b | 9. _____ |
| Note: If line 13 of Schedule D is a loss, go to line 10; otherwise, skip lines 10 through 14. | |
| 10. Enter loss from Schedule D, line 13, as a positive amount . . | 10. _____ |
| 11. Enter gain, if any, from Schedule D, line 5. If that line is blank or shows a loss, enter -0- | 11. _____ |
| 12. Subtract line 6 from line 5. If zero or less, enter -0- | 12. _____ |
| 13. Add lines 11 and 12 | 13. _____ |
| 14. Long-term capital loss carryover to 1998. Subtract line 13 from line 10. If zero or less, enter -0-. If this is the final return of the estate or trust, also enter on Schedule K-1 (Form 1041), line 13c | 14. _____ |

on line 1a of Schedule G, Form 1041, and check the "Schedule D" box.

Schedule J (Form 1041) — Accumulation Distribution for a Complex Trust

General Instructions

Use Schedule J (Form 1041) to report an accumulation distribution for a complex trust. An accumulation distribution is the excess of amounts properly paid, credited, or required to be distributed (other than income required to be distributed currently) over the DNI of the trust reduced by income required to be distributed currently. To have an accumulation distribution, the distribution must exceed the accounting income of the trust.

Specific Instructions

Part I—Accumulation Distribution in 1997

Line 1—Distribution Under Section 661(a)(2)

Enter the amount from Schedule B of Form 1041, line 10, for 1997. This is the amount properly paid, credited, or required to be distributed other than the amount of income for the current tax year required to be distributed currently.

Line 2—Distributable Net Income

Enter the amount from Schedule B of Form 1041, line 7, for 1997. This is the amount of distributable net income (DNI) for the current tax year determined under section 643(a).

Line 3—Distribution Under Section 661(a)(1)

Enter the amount from Schedule B of Form 1041, line 9, for 1997. This is the amount of income for the current tax year required to be distributed currently.

Line 5—Accumulation Distribution

If line 11, Schedule B of Form 1041 is more than line 8, Schedule B of Form 1041, complete the rest of Schedule J and file it with Form 1041, unless the trust has no previously accumulated income.

Generally, amounts accumulated before a beneficiary reaches age 21 may be excluded by the beneficiary. See sections 665 and 667(c) for exceptions relating to multiple trusts. The trustee reports to the IRS the total amount of the accumulation distribution before any reduction for income accumulated before the beneficiary reaches age 21. If the multiple trust rules do not apply, the beneficiary claims the exclusion when filing **Form 4970**, Tax on Accumulation Distribution of Trusts, as you may not be aware that the beneficiary may be a beneficiary of other trusts with other trustees.

For examples of accumulation distributions that include payments from one trust to another trust, and amounts distributed for a dependent's support, see Regulations section 1.665(b)-1A(b).

Part II—Ordinary Income Accumulation Distribution

Line 6—Distributable Net Income for Earlier Years

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|-------------------------------|
| 1969–1977 | Schedule C, Form 1041, line 5 |
| 1978–1979 | Form 1041, line 61 |
| 1980 | Form 1041, line 60 |
| 1981–1982 | Form 1041, line 58 |
| 1983–1996 | Schedule B, Form 1041, line 9 |

For information about throwback years, see the instructions for line 13. For purposes of line 6, in figuring the DNI of the trust for a throwback year, subtract any estate tax deduction for income in respect of a decedent if the income is includible in figuring the DNI of the trust for that year.

Line 7—Distributions Made During Earlier Years

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|--------------------------------|
| 1969–1977 | Schedule C, Form 1041, line 8 |
| 1978 | Form 1041, line 64 |
| 1979 | Form 1041, line 65 |
| 1980 | Form 1041, line 64 |
| 1981–1982 | Form 1041, line 62 |
| 1983–1996 | Schedule B, Form 1041, line 13 |

Line 11—Prior Accumulation Distribution Thrown Back to any Throwback Year

Enter the amount of prior accumulation distributions thrown back to the throwback years. Do not enter distributions excluded under section 663(a)(1) for gifts, bequests, etc.

Line 13—Throwback Years

Allocate the amount on line 5 that is an accumulation distribution to the earliest applicable year first, but do not allocate more than the amount on line 12 for any throwback year. An accumulation distribution is thrown back first to the earliest preceding tax year in which there is undistributed net income (UNI). Then, it is thrown back beginning with the next earliest year to any remaining preceding tax years of the trust. The portion of the accumulation distribution allocated to the earliest preceding tax year is the amount of the UNI for that year. The portion of the accumulation distribution allocated to any remaining preceding tax year is the amount by which the accumulation distribution is larger than the total of the UNI for all earlier preceding tax years.

A tax year of a trust during which the trust was a simple trust for the entire year is not a preceding tax year unless (a) during that year the trust received outside income or (b) the trustee did not distribute all of the trust's income that was required

to be distributed currently for that year. In this case, UNI for that year must not be more than the greater of the outside income or income not distributed during that year.

The term "outside income" means amounts that are included in the DNI of the trust for that year but that are not "income" of the trust as defined in Regulations section 1.643(b)-1. Some examples of outside income are: (a) income taxable to the trust under section 691; (b) unrealized accounts receivable that were assigned to the trust; and (c) distributions from another trust that include the DNI or UNI of the other trust. Enter the applicable year at the top of each column for each throwback year.

Line 16—Tax-Exempt Interest Included on Line 13

For each throwback year, divide line 15 by line 6 and multiply the result by the following:

| Throwback year(s) | Amount from line |
|-------------------|----------------------------------|
| 1969–1977 | Schedule C, Form 1041, line 2(a) |
| 1978–1979 | Form 1041, line 58(a) |
| 1980 | Form 1041, line 57(a) |
| 1981–1982 | Form 1041, line 55(a) |
| 1983–1996 | Schedule B, Form 1041, line 2 |

Part III—Taxes Imposed on Undistributed Net Income

For the regular tax computation, if there is a capital gain, complete lines 18 through 25 for each throwback year. If the trustee elected the alternative tax on capital gains, complete lines 26 through 31 instead of lines 18 through 25 for each applicable year. If there is no capital gain for any year, or there is a capital loss for every year, enter on line 9 the amount of the tax for each year identified in the instruction for line 18 and do not complete Part III. If the trust received an accumulation distribution from another trust, see Regulations section 1.665(b)-1A.

Note: *The alternative tax on capital gains was repealed for tax years beginning after December 31, 1978. The maximum rate on net capital gain for 1981, 1987, and 1991 through 1996 is not an alternative tax for this purpose.*

Line 18—Regular Tax

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|--------------------------------|
| 1969–1976 | Form 1041, page 1, line 24 |
| 1977 | Form 1041, page 1, line 26 |
| 1978–1979 | Form 1041, line 27 |
| 1980–1984 | Form 1041, line 26c |
| 1985–1986 | Form 1041, line 25c |
| 1987 | Form 1041, line 22c |
| 1988–1996 | Schedule G, Form 1041, line 1a |

Line 19—Trust's Share of Net Short-Term Gain

For each throwback year, enter the smaller of the capital gain from the two lines indicated. If there is a capital loss or a zero on either or both of the two lines indicated, enter zero on line 19.

| Throwback year(s) | Amount from line |
|-------------------|---|
| 1969–1970 | Schedule D, Line 10, column 2, or Schedule D, line 12, column 2 |
| 1971–1978 | Schedule D, line 14, column 2, or Schedule D, line 16, column 2 |
| 1979 | Schedule D, line 18, column (b), or Schedule D, line 20, column (b) |
| 1980–1981 | Schedule D, line 14, column (b), or Schedule D, line 16, column (b) |
| 1982 | Schedule D, line 16, column (b), or Schedule D, line 18, column (b) |
| 1983–1996 | Schedule D, line 15, column (b), or Schedule D, line 17, column (b) |

Line 20—Trust's Share of Net Long-Term Gain

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|--|
| 1969–1970 | 50% of Schedule D, line 13(e) |
| 1971–1977 | 50% of Schedule D, line 17(e) |
| 1978 | Schedule D, line 17(e), or line 31, whichever is applicable, less Form 1041, line 23 |
| 1979 | Schedule D, line 25 or line 27, whichever is applicable, less Form 1041, line 23 |
| 1980–1981 | Schedule D, line 21, less Schedule D, line 22 |
| 1982 | Schedule D, line 23, less Schedule D, line 24 |
| 1983–1986 | Schedule D, line 22, less Schedule D, line 23 |
| 1987–1996 | Schedule D, the smaller of any gain on line 16 or line 17, column (b) |

Line 22—Taxable Income

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|----------------------------|
| 1969–1976 | Form 1041, page 1, line 23 |
| 1977 | Form 1041, page 1, line 25 |
| 1978–1979 | Form 1041, line 26 |
| 1980–1984 | Form 1041, line 25 |
| 1985–1986 | Form 1041, line 24 |
| 1987 | Form 1041, line 21 |
| 1988–1996 | Form 1041, line 22 |

Line 26—Tax on Income Other Than Long-Term Capital Gain

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|---------------------|
| 1969 | Schedule D, line 20 |
| 1970 | Schedule D, line 19 |
| 1971 | Schedule D, line 50 |
| 1972–1975 | Schedule D, line 48 |
| 1976–1978 | Schedule D, line 27 |

Line 27—Trust's Share of Net Short-Term Gain

If there is a loss on any of the following lines, enter zero on line 27 for the applicable throwback year. Otherwise, enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|-------------------------------|
| 1969–1970 | Schedule D, line 10, column 2 |
| 1971–1978 | Schedule D, line 14, column 2 |

Line 28—Trust's Share of Taxable Income Less Section 1202 Deduction

Enter the applicable amounts as follows:

| Throwback year(s) | Amount from line |
|-------------------|---------------------|
| 1969 | Schedule D, line 19 |
| 1970 | Schedule D, line 18 |
| 1971 | Schedule D, line 38 |
| 1972–1975 | Schedule D, line 39 |
| 1976–1978 | Schedule D, line 21 |

Part IV—Allocation to Beneficiary

Complete Part IV for each beneficiary. If the accumulation distribution is allocated to more than one beneficiary, attach an additional copy of Schedule J with Part IV completed for each additional beneficiary. Give each beneficiary a copy of his or her respective Part IV information. If more than 5 throwback years are involved, use another Schedule J, completing Parts II and III for each additional throwback year.

If the beneficiary is a nonresident alien individual or a foreign corporation, see section 667(e) about retaining the character of the amounts distributed to determine the amount of the U.S. withholding tax.

The beneficiary uses Form 4970 to figure the tax on the distribution. The beneficiary also uses Form 4970 for the section 667(b)(6) tax adjustment if an accumulation distribution is subject to estate or generation-skipping transfer tax. This is because the trustee may not be the estate or generation-skipping transfer tax return filer.

Schedule K-1 (Form 1041)—Beneficiary's Share of Income, Deductions, Credits, etc.

General Instructions

Use Schedule K-1 (Form 1041) to report the beneficiary's share of income, deductions, and credits from a trust or a decedent's estate.

Who Must File

The fiduciary (or one of the joint fiduciaries) must file Schedule K-1. A copy of each beneficiary's Schedule K-1 is attached to the Form 1041 filed with the IRS and each beneficiary is given a copy of his or her respective Schedule K-1. One copy of each Schedule K-1 must be retained for the fiduciary's records.

Beneficiary's Identifying Number

As a payer of income, you are required under section 6109 to request and provide a proper identifying number for each recipient of income. Enter the beneficiary's number on the respective Schedule K-1 when you file Form 1041. Individuals and business recipients are responsible for giving you their taxpayer identification numbers upon request. You may use **Form W-9**, Request for Taxpayer Identification Number and

Certification, to request the beneficiary's identifying number.

Penalty. Under section 6723, the payer is charged a \$50 penalty for each failure to provide a required taxpayer identification number, unless reasonable cause is established for not providing it. Explain any reasonable cause in a signed affidavit and attach it to this return.

Tax Shelter's Identification Number

If the estate or trust is a tax shelter, is involved in a tax shelter, or is considered to be the organizer of a tax shelter, there are reporting requirements under section 6111 for both the fiduciaries and the beneficiaries.

See **Form 8264**, Application for Registration of a Tax Shelter, and **Form 8271**, Investor Reporting of Tax Shelter Registration Number, and their related instructions for information regarding the fiduciary's reporting requirements.

Substitute Forms

You do not need prior IRS approval for a substitute Schedule K-1 (Form 1041) that follows the specifications for filing substitute Schedules K-1 in **Pub. 1167**, Substitute Printed, Computer-Prepared, and Computer-Generated Tax Forms and Schedules, or is an exact copy of an IRS Schedule K-1. You must request IRS approval to use other substitute Schedules K-1. To request approval, write to: Internal Revenue Service, Attention: Substitute Forms Program Coordinator, T:FP:S, 1111 Constitution Avenue, NW, Washington, DC 20224.

Inclusion of Amounts in Beneficiaries' Income

Simple trust. The beneficiary of a simple trust must include in his or her gross income the amount of the income required to be distributed currently, whether or not distributed, or if the income required to be distributed currently to all beneficiaries exceeds the distributable net income (DNI), his or her proportionate share of the DNI. The determination of whether trust income is required to be distributed currently depends on the terms of the trust instrument and applicable local law. See Regulations section 1.652(c)-4 for a comprehensive example.

Estates and complex trusts. The beneficiary of a decedent's estate or complex trust must include in his or her gross income the sum of:

ÿ1. The amount of the income required to be distributed currently, or if the income required to be distributed currently to all beneficiaries exceeds the DNI (figured without taking into account the charitable deduction), his or her proportionate share of the DNI (as so figured); and

ÿ2. All other amounts properly paid, credited, or required to be distributed, or if the sum of the income required to be distributed currently and other amounts properly paid, credited, or required to be distributed to all beneficiaries exceeds the DNI, his or her proportionate share of the

excess of DNI over the income required to be distributed currently.

See Regulations section 1.662(c)-4 for a comprehensive example.

For complex trusts that have more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of DNI allocable to the respective beneficiaries. For the estates of decedents dying after August 5, 1997, a similar rule applies to treat substantially separate and independent shares of different beneficiaries of an estate as separate estates. For examples of the application of the separate share rule, see the regulations under section 663(c).

Character of income. The beneficiary's income is considered to have the same proportion of each class of items entering into the computation of DNI that the total of each class has to the DNI (e.g., half dividends and half interest if the income of the estate or trust is half dividends and half interest).

Allocation of deductions. Generally, items of deduction that enter into the computation of DNI are allocated among the items of income to the extent such allocation is not inconsistent with the rules set out in section 469 and its regulations, relating to passive activity loss limitations, in the following order.

First, all deductions directly attributable to a specific class of income are deducted from that income. For example, rental expenses, to the extent allowable, are deducted from rental income.

Second, deductions that are not directly attributable to a specific class of income generally may be allocated to any class of income, as long as a reasonable portion is allocated to any tax-exempt income. Deductions considered not directly attributable to a specific class of income under this rule include fiduciary fees, safe deposit box rental charges, and state income and personal property taxes. The charitable deduction, however, must be ratably apportioned among each class of income included in DNI.

Finally, any excess deductions that are directly attributable to a class of income may be allocated to another class of income. However, in no case can excess deductions from a passive activity be allocated to income from a nonpassive activity, or to portfolio income earned by the estate or trust. Excess deductions attributable to tax-exempt income cannot offset any other class of income.

In no case can deductions be allocated to an item of income that is not included in the computation of DNI, or attributable to corpus.

Except for the final year, and for depreciation or depletion allocations in excess of income (see Rev. Rul. 74-530, 1974-2 C.B. 188), you may not show any negative amounts for any class of income, because the beneficiary generally may

not claim losses or deductions from the estate or trust.

Gifts and bequests. Do not include in the beneficiary's income any gifts or bequests of a specific sum of money or of specific property under the terms of the governing instrument that are paid or credited in three installments or less.

Amounts that can be paid or credited only from income of the estate or trust do not qualify as a gift or bequest of a specific sum of money.

Past years. Do not include in the beneficiary's income any amounts deducted on Form 1041 for an earlier year that were credited or required to be distributed in that earlier year.

Beneficiary's Tax Year

The beneficiary's income from the estate or trust must be included in the beneficiary's tax year during which the tax year of the estate or trust ends. See Pub. 559 for more information, including the effect of the death of a beneficiary during the tax year of the estate or trust.

Specific Instructions

Line 1—Interest

Enter the beneficiary's share of the taxable interest income minus allocable deductions.

Line 2—Dividends

Enter the beneficiary's share of dividend income minus allocable deductions.

Line 3—Net Short-Term Capital Gain

Enter the beneficiary's share of the net short-term capital gain from line 14, column (1), Schedule D (Form 1041), minus allocable deductions. Do not enter a loss on line 3. If, for the final year of the estate or trust, there is a capital loss carryover, enter on line 13b the beneficiary's share of short-term capital loss carryover. However, if the beneficiary is a corporation, enter on line 13b the beneficiary's share of all short- and long-term capital loss carryovers as a single item. See section 642(h) and related regulations for more information.

Lines 4a through 4c—Net Long-Term Capital Gain

Enter the beneficiary's share of the net long-term capital gain from lines 15a through 15c, column (1), Schedule D (Form 1041), minus allocable deductions. Do not enter a loss on lines 4a through 4c. If, for the final year of the estate or trust, there is a capital loss carryover, enter on line 13c the beneficiary's share of the long-term capital loss carryover. (If the beneficiary is a corporation, see the instructions for line 3.) See section 642(h) and related regulations for more information.

Gains or losses from the complete or partial disposition of a rental, rental real estate, or trade or business activity that is a passive activity, must be shown on an attachment to Schedule K-1.

Line 5a—Annuities, Royalties, and Other Nonpassive Income

Enter the beneficiary's share of annuities, royalties, or any other income, minus allocable deductions (other than directly apportionable deductions), that is NOT subject to any passive activity loss limitation rules at the beneficiary level. Use line 6a to report income items subject to the passive activity rules at the beneficiary's level.

Lines 5b and 6b—Depreciation

Enter the beneficiary's share of the depreciation deductions attributable to each activity reported on lines 5a and 6a. See the instructions on page 11 for a discussion of how the depreciation deduction is apportioned between the beneficiaries and the estate or trust. Report any AMT adjustment or tax preference item attributable to depreciation separately on line 12a.

Note: *An estate or trust cannot make an election under section 179 to expense certain tangible property.*

Lines 5c and 6c—Depletion

Enter the beneficiary's share of the depletion deduction under section 611 attributable to each activity reported on lines 5a and 6a. See the instructions on page 11 for a discussion of how the depletion deduction is apportioned between the beneficiaries and the estate or trust. Report any tax preference item attributable to depletion separately on line 12b.

Lines 5d and 6d—Amortization

Itemize the beneficiary's share of the amortization deductions attributable to each activity reported on lines 5a and 6a. Apportion the amortization deductions between the estate or trust and the beneficiaries in the same way that the depreciation and depletion deductions are divided. Report any AMT adjustment attributable to amortization separately on line 12c.

Line 6a—Trade or Business, Rental Real Estate, and Other Rental Income

Enter the beneficiary's share of trade or business, rental real estate, and other rental income, minus allocable deductions (other than directly apportionable deductions). To assist the beneficiary in figuring any applicable passive activity loss limitations, also attach a separate schedule showing the beneficiary's share of income derived from each trade or business, rental real estate, and other rental activity.

Lines 6b Through 6d

Caution: *The limitations on passive activity losses and credits under section 469 apply to estates and trusts. Estates and trusts that distribute income to beneficiaries are allowed to apportion depreciation, depletion, and amortization deductions to the beneficiaries. These*

deductions are referred to as “directly apportionable deductions.”

Rules for treating a beneficiary's income and directly apportionable deductions from an estate or trust and other rules for applying the passive loss and credit limitations to beneficiaries of estates and trusts have not yet been issued.

Any directly apportionable deduction, such as depreciation, is treated by the beneficiary as having been incurred in the same activity as incurred by the estate or trust. However, the character of such deduction may be determined as if the beneficiary incurred the deduction directly.

To assist the beneficiary in figuring any applicable passive activity loss limitations, also attach a separate schedule showing the beneficiary's share of directly apportionable deductions derived from each trade or business, rental real estate, and other rental activity.

Line 7—Income for Minimum Tax Purposes

Enter the beneficiary's share of the income distribution deduction figured on a minimum tax basis from line 28 of Schedule I.

Line 8—Income for Regular Tax Purposes

Enter the beneficiary's share of the income distribution deduction figured on line 15 of Schedule B. This amount should equal the sum of lines 1 through 3, 4c, 5a, and 6a.

Line 10—Estate Tax Deduction (Including Certain Generation-Skipping Transfer Taxes)

If the distribution deduction consists of any income in respect of a decedent, and the estate or trust was allowed a deduction under section 691(c) for the estate tax paid attributable to such income (see the line 19 instructions on page 14), then the beneficiary is allowed an estate tax deduction in proportion to his or her share of the distribution that consists of such income. For an example of the computation, see Regulations section 1.691(c)-2. Figure the computation on a separate sheet and attach it to the return.

Line 11—Foreign Taxes

List on a separate sheet the beneficiary's share of the applicable foreign taxes paid or accrued and the various foreign source figures needed to figure the beneficiary's foreign tax credit. See Pub. 514 and section 901(b)(5) for special rules about foreign taxes.

Lines 12a through 12c

Enter any adjustments or tax preference items attributable to depreciation, depletion, or amortization that were allocated to the beneficiary. For property placed in service before 1987, report separately the accelerated depreciation of real and leased personal property.

Line 12d—Exclusion Items

Enter the beneficiary's share of the adjustment for minimum tax purposes from Schedule K-1, line 9, that is attributable to exclusion items (Schedule I, lines 4a through 4d, 4p, and 4q).

Line 13a—Excess Deductions on Termination

If this is the final return of the estate or trust, and there are excess deductions on termination (see the instructions for line 23 on page 14), enter the beneficiary's share of the excess deductions on line 13a. Figure the deductions on a separate sheet and attach it to the return.

Excess deductions on termination occur only during the last tax year of the trust or decedent's estate when the total deductions (excluding the charitable deduction and exemption) are greater than the gross income during that tax year.

Generally, a deduction based on an NOL carryover is not available to a beneficiary as an excess deduction. However, if the last tax year of the estate or trust is also the last year in which an NOL carryover may be taken (see section 172(b)), the NOL carryover is considered an excess deduction on the termination of the estate or trust to the extent it is not absorbed by the estate or trust during its final tax year. For more information, see Regulations section 1.642(h)-4 for a discussion of the allocation of the carryover among the beneficiaries.

Only the beneficiary of an estate or trust that succeeds to its property is allowed to deduct that entity's excess deductions on termination. A beneficiary who does not have enough income in that year to absorb the entire deduction may not carry the balance over to any succeeding year. An individual beneficiary must be able to itemize deductions in order to claim the excess deductions in determining taxable income.

Lines 13b and 13c—Unused Capital Loss Carryover

Upon termination of the trust or decedent's estate, the beneficiary succeeding to the property is allowed as a deduction any unused capital loss

carryover under section 1212. If the estate or trust incurs capital losses in the final year, use the **Capital Loss Carryover Worksheet** on page 27 to figure the amount of capital loss carryover to be allocated to the beneficiary.

Lines 13d and 13e—Net Operating Loss (NOL) Carryover

Upon termination of a trust or decedent's estate, a beneficiary succeeding to its property is allowed to deduct any unused NOL (and any AMT NOL) carryover for regular and AMT purposes if the carryover would be allowable to the estate or trust in a later tax year but for the termination. Enter on lines 13d and 13e the unused carryover amounts.

Line 14—Other

Itemize on line 14, or on a separate sheet if more space is needed, the beneficiary's tax information not entered elsewhere on Schedule K-1. This includes the allocable share, if any, of:

- Payment of estimated tax to be credited to the beneficiary (section 643(g));
- Tax-exempt interest income received or accrued by the trust (including exempt-interest dividends from a mutual fund or other regulated investment company);
- Investment income (section 163(d));
- Gross farming and fishing income;
- Credit for backup withholding (section 3406);
- The information a beneficiary will need to figure any investment credit;
- The work opportunity credit;
- The welfare-to-work credit;
- The alcohol fuel credit;
- The credit for increasing research activities;
- The low-income housing credit;
- The renewable electricity production credit;
- The empowerment zone employment credit;
- The Indian employment credit;
- The orphan drug credit; and
- The information a beneficiary will need to figure any recapture taxes.

Note: Upon termination of an estate or trust, any suspended passive activity losses (PALs) relating to an interest in a passive activity cannot be allocated to the beneficiary. Instead, the basis in such activity is increased by the amount of any PALs allocable to the interest, and no losses are allowed as a deduction on the estate's or trust's final Form 1041.